Report 2006

Part 1 **Economic and financial developments**

National Bank OF BELGIUM

Eurosystem

Foreword

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For several years now, the world economy has been growing at a very fast pace (by around 5 p.c. a year), driven mainly by China and other emerging economies. Among the more advanced nations, the expansion has generally been stronger in the United States than in Europe, which had for a long time been left lagging behind. In 2006, however, their economic growth rates balanced out with the US economy somewhat running out of steam during the course of the year while, in the euro area, after a series of abortive revivals, the recovery has at last materialised.

Economic growth in the euro area is estimated to have risen from an average of 1.5 p.c. in 2005 to 2.6 p.c. in 2006, the highest rate since the beginning of the century. The external environment has remained favourable and business investment has finally reacted to the strength of the export trade, to rising profits and to very attractive borrowing conditions. Companies have stepped up their recruitment rates, which in turn has shored up household consumption.

As usual, the average for the euro area tends to mask rather divergent performances from one country to another. It was favourably influenced by the pick-up in economic activity in the zone's biggest country, Germany, after several lethargic years.

Strong economic growth and the pressure it exerted on commodity prices – and especially oil prices – as well as on the degree of available production factor utilisation have strengthened inflation risks. As a result, most central banks have raised their interest rates.

In the euro area, the Governing Council of the European Central Bank, in line with its mandate, has striven to keep inflation expectations under control, without, however, undermining growth. It continued its policy of raising interest rates begun in December 2005, gradually raising the Eurosystem's benchmark rate from 2.25 to 3.5 p.c. At the end of 2006, all interest rates, whether short- or long-term, nominal or real, were nevertheless still at historically low levels and conducive to business and household investment. This also helped alleviate the public debt financing burden.

For its part, the European currency saw its exchange rate strengthen, without actually hitting new heights against the US dollar, mainly on the back of cyclical developments (with the above-mentioned slowdown in activity in the United States and a pick-up in the euro area) and the narrowing of short-term interest rate differentials that they brought with them.

In Belgium, the growth rate doubled between 2005 and 2006, rising from 1.5 to 3 p.c. In this case, too, it was the highest rate on record since the year 2000, and even higher than the euro area average. Not only did the expansion gain momentum, but it also turned out to be well-balanced, fuelled by consumer demand, investment and exports at the same time.

The other main provisional results for 2006 point to a 2.7 p.c. increase in real disposable income of households (i.e. average income after tax and adjusted for inflation) and an estimated rise in employment by 46,000 units (just over 1 p.c.), while inflation (as measured by the harmonised index of consumer prices) slowed down somewhat to 2.3 p.c.. Public finances closed the books with a small surplus of 0.1 p.c. of GDP, bringing a further reduction in the public debt ratio, which fell back below 90 p.c. of GDP, and the balance of payments on current account is estimated to have stabilised at 2.5 p.c. of GDP.

On the whole, these results are positive. This is good news, but we should not rest on our laurels.

Our exports are growing year by year, albeit at a much slower rate than the volume of international trade and our potential outlets. Our enterprises are therefore losing market share, a phenomenon that is affecting many other advanced nations but one that Germany in particular has managed to counteract by re-sharpening its competitive edge.

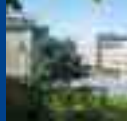
Net employment is gaining ground, despite the restructuring operations some companies carried out, and the jobless rate started to drop significantly in the second half of 2006. All the same, unemployment is still too high, especially in some areas of the country, while in certain segments of the labour market, increasing shortages of workers can be noted.

Belgium's public finances are in balance, something that is still not the case in many other countries. But this balance was once again facilitated by one-off operations and evidently benefited in 2006 from the sharp cyclical upswing, which took economic growth beyond its medium-term potential. Overall, some signs of a structural deficit have reappeared.

If economic prosperity is to be maintained and, if possible, further boosted, while at the same time guaranteeing sustainable social protection, against a backdrop of globalisation of trade and the population ageing, Belgium needs forward-looking policies based on a medium- and long-term perspective.

Fortunately, there is a fairly broad consensus on the main features of this programme : encouraging entrepreneurial spirit and innovation, keeping an eye on competitiveness through costs, raising the employment and labour market participation rates, speeding up the reduction of public debt.

The improvement in the economic situation cannot distract policy-makers from pursuing essential reforms. Quite the contrary, it should be seen as a golden opportunity to step them up.



International environment

World economy: strong growth, more evenly balanced, but risks persist

1. In 2006, despite a slight slackening of pace during the year, the world economy once again produced very robust growth, estimated at over 5 p.c. As in previous years, the Asian countries which are in the process of catching up, especially China, made the biggest contribution to this expansion. In the advanced economies, growth divergences lessened as activity gathered momentum in the EU and slowed down in the United States after the first quarter of 2006.

2. Notwithstanding this strong growth and the resulting sustained pressure on commodity prices for much of the year – oil prices, in particular, reached a peak in August – inflation was fairly subdued overall. The credibility of monetary policy, the abundant supply of labour-intensive goods and services offered by the emerging economies, and the keener international competition were contributory factors. However, the risk of inflation was heightened by the possible repercussions of the high cost of energy on prices in general, and the increased use of the production capacity. As a result, almost all central banks raised their interest rates.

3. In the United States, where interest rates had been rising since mid 2004, the Federal Reserve held its target rate for federal funds at 5.25 p.c. from June 2006, waiting to see whether the effect of the previous tightening of monetary policy would be sufficient to curb inflationary pressure. The deceleration in activity there was due mainly to lower investment in housing, and had hardly any impact on the rest of the world, where domestic demand proved robust. Thus, in Japan, domestic expenditure continued to grow fairly strongly and in July the central bank, considering that deflation had come to an end, terminated its zero interest rate policy. Moreover, Japanese firms continued to benefit from the expansion of their Asian markets, such as the strong growth of investment in China.

4. The current account imbalances worsened further in 2006. However, as the emerging economies of Asia and the oil-exporting countries maintained their strong propensity to save, and as the demographic outlook also bolstered demand for financial assets in Japan and Europe, the financing of American households and government continued unimpeded, at persistently low long-term interest rates. Yet the external debt of the United States cannot expand indefinitely. The slowing of domestic demand in that country and its acceleration in Europe, the slight appreciation of the renminbi plus China's plans for developing rural regions, and the easing of oil prices are all encouraging signs attenuating the threat of an abrupt correction. Concerted efforts are still required for the purpose of raising the level of savings in the United States, particularly by consolidating public finances, for conducting structural reforms in Europe and Japan to ensure that domestic demand is based on stronger potential growth prospects, for relaxing the foreign exchange regime in China and for stimulating domestic demand in the

emerging or oil-exporting economies. The IMF has embarked upon multilateral consultations to that end.

Euro area : the revival in domestic demand needs to be consolidated

5. In 2006, the euro area's GDP growth was estimated at 2.6 p.c., the highest level for six years, exceeding the forecasts on this occasion. Growth was particularly strong in the first half year, later subsiding to an annualised rate of about 2 p.c. While the external environment remained favourable, growth was also sustained by an acceleration in domestic demand. Fixed capital formation by businesses was particularly dynamic. It finally responded to the vigour of exports over the past three years, which has reduced the unused production capacity, and to the profits growth and highly favourable financing conditions. Investment in housing also picked up as a result of the low level of interest rates and the associated price increases on the secondary market ; after years in the doldrums, the German construction industry saw a revival in activity. Finally, firms stepped up their recruitment, and the fall in unemployment boosted consumer confidence and stimulated household spending. Growth differentials between euro area member countries declined as a result of a marked recovery in Germany and Italy. However, this last country is still suffering from a deterioration in its competitiveness.

6. In this favourable economic climate, the public deficit in the euro area dropped from 2.4 p.c. of GDP in 2005 to 2 p.c. in 2006. Of the five euro area members engaged in cutting their excessive deficit in accordance with the European rules, Germany, France and Greece are estimated to have reduced their deficit below the threshold of 3 p.c. of GDP in 2006, while Italy and Portugal still recorded a deficit of over 4.5 p.c. of GDP. Major corrective measures are planned for 2007 or are already in force in Germany, Italy and Portugal. Though they may temporarily dampen demand, they are nonetheless essential to reinforce confidence.

7. All deficit countries should make use of the cyclical upturn to speed up the consolidation of public finances, rather than be tempted to relax discipline, as has happened in similar circumstances in the past. They need to restore their structural budget balance, respecting the benchmark introduced at the time of the revision of the Stability and Growth Pact, which means improving that balance by 0.5 p.c. of GDP per annum. Moreover, greater attention must be paid to the sustainability of fiscal policy in view of population ageing, which requires the creation of surpluses in most countries.

8. The improvement in the economic climate should also encourage the pursuit of the structural reforms mapped out by the Lisbon strategy. The progress already made is most likely beginning to produce results, as is shown by the revival in employment. However, there is still much to be done to strengthen the resilience of the European economy in the face of a possible downturn in external demand, to secure a permanent increase in the employment rate and productivity, and to address the challenges presented by globalisation, technological development and the demographic outlook. Resolute implementation of national reform programmes is therefore vital, while the deepening of European integration should stimulate competition on the goods and services markets and encourage the mobility of the production factors.

Monetary policy and financial stability

Monetary policy: gradually less expansionary

9. The monetary policy of the Eurosystem is designed to safeguard price stability. The Maastricht Treaty accords primary importance to this objective because a policy which ensures an environment of stability and confidence in the soundness of the currency is the best way of contributing to growth and employment, particularly by reducing the risk premiums included in long-term interest rates. It does not preclude a counter-cyclical policy, in so far as the pressure on prices is largely linked to the business cycle, nor a gradual response to certain shocks affecting prices. The ECB Governing Council has defined price stability as an increase in the harmonised index of consumer prices (HICP) in the euro area of less than but close to 2 p.c. per annum in the medium term.

10. The HICP rose by 2.2 p.c. in 2006, as a result of a renewed rise in energy prices. Successive sharp increases in the most volatile consumer prices, namely energy and food, have caused the 2 p.c. threshold to be slightly exceeded in recent years. The medium-term perspective adopted by the ECB Governing Council allows major shocks affecting certain relative prices or indirect taxes, in either direction, to be absorbed by deviations from the target so long as they do not lead to persistent derailment.

11. To avoid such derailment, it is essential for price expectations to be firmly anchored. The Eurosystem's independence and its monetary policy strategy, especially the definition of price stability, make a substantial contribution here. However, it is also necessary to act in good time, before shocks spread to the whole of prices and incomes, or before prices are affected by other tensions.

12. In 2006, the Governing Council considered that maintaining the short-term interest rate at the extremely low level which had prevailed for the three preceding years would have entailed risks to price stability in the medium term. It therefore decided to continue the gradual increase in the minimum bid rate for the main refinancing operations, initiated in December 2005, and raised the rate in five stages from 2.25 p.c. to 3.50 p.c.

13. Admittedly, the secondary effects of the higher energy prices were remarkably limited, owing to the underutilisation of the economy's production capacity – evident in particular from the continuing high unemployment –, the competitive pressure generated by globalisation, and the credibility of the Eurosystem. Nevertheless, the consolidation of the cyclical upturn which continued during the year attenuated the first factor and required monetary policy to adopt a less expansionary stance.

14. The historically low interest rates also contributed towards the strong expansion of credit and the monetary aggregate M3, and a rise in property prices, which was particularly marked in some countries. The link seen in the past between the movements in M3 and prices seems to have weakened, owing to the increasing importance of portfolio considerations in the holding of monetary assets, or even perhaps a change in behaviour due to the new environment of price stability and low interest rates. Yet rapidly rising debt levels and liquidity combined with a strong rise in asset prices, such as the price of property, may also suggest the risk of 'financial bubbles', liable to cause damage when they later burst.

15. The ECB Governing Council modulated the pace of its interest rate increases in line with its assessment of the threats to price stability, as new data became available. It began to give signals about future interest rate movements, conditional upon a macroeconomic base scenario,

without giving any commitment on the frequency or size of future increases. It thus enhanced the transparency and predictability of its decisions while retaining the latitude essential for responding to new information.

16. Despite the gradual rate increases, monetary policy continued to underpin the cyclical expansion, witness for example the still low level of real short-term interest rates from a historical perspective. The effective euro exchange rate gained ground – though without attaining an exceptionally high level – primarily because of a time-lag in the economic cycle between the United States and the euro area, and the associated narrowing of the short-term interest rate differential. Long-term interest rates remained very low, and were therefore conducive to investment. On the one hand, the monetary policy reaction to the risks to price stability certainly contributed towards the reduction in the inflation risk premium, which those rates include, and which had been rising slowly up to May 2006. On the other hand, real long-term interest rates showed only a slight increase, as in the United States, since they were held down by the relative abundance of global savings and the perception of greater macroeconomic stability.

Financial supervision : crisis prevention and simulation

17. The international financial system remained very stable in 2006. That was due primarily to the persistence of a highly favourable macroeconomic environment, as the continuing growth and the financial health of businesses benefited the pursuit of banking activities. The progressive tightening of monetary policy, the recent price correction on certain property markets, and the rising debts of a number of companies involved in mergers and acquisitions could be the first signs of a change in market conditions. So far, however, financial intermediaries, given their intrinsically sound foundations, have coped comfortably with these developments. They have succeeded in maintaining their profitability and solvency at high levels, and continued to perfect and diversify their risk management techniques, particularly by using derivatives which afford protection against loan losses. These new products have already proved their worth in individual incidents, but the markets in these instruments have yet to demonstrate their liquidity and their capacity to provide effective protection against credit risks in the face of major shocks.

18. As well as the efforts made by financial institutions in terms of better risk control, the supervisory authorities have taken numerous measures to improve the operation of the financial system as a whole. That is reflected, in particular, in the virtually simultaneous introduction of various regulations which will have a significant influence on the conditions for pursuing financial activity in the EU. The recent introduction of the new IAS/IFRS harmonised accounting rules will be followed by new solvency rules applicable to both banks (Basel II) and insurance companies (Solvency II). In addition, the EU Directive on markets in financial instruments (MiFID) will profoundly alter the way of executing transactions in securities. These successive changes demand major efforts and may influence certain strategic choices by financial institutions.

19. The complexity of the rules partly reflects that of the financial institutions, which are tending to group together in large multinational entities and diversify their operations. These restructurings particularly concern Belgium, where the four leading financial groups serving the bulk of the domestic market in banking and insurance have all greatly expanded their activities, often organising themselves on functional lines which do not always coincide with their legal structures. Like their foreign competitors, these institutions saw their profits grow in 2006, benefiting both from the favourable economic climate and from the soundness of their financial structure. However, their risk profiles also continued to change as they diversified into new markets and new activities, such as dealing in risk transfer instruments. These large groups have perfected their risk management procedures, which should help to

prevent systemic problems. But their changing structure is tending to alter the channels for the transmission of potential financial shocks. The Belgian supervisory authorities need to anticipate this by strengthening their capacity to assess and manage accidents affecting large financial institutions, in full cooperation with the foreign authorities. In that connection, they participated in cross-border crisis simulation exercises, which gave the opportunity to test communication and decision-making processes within the euro area and the EU. At national level, these efforts must be reflected in a deepening of the cooperation between the Bank and the CBFA and an assessment of the effectiveness of the institutional arrangements set up by the law of 2 August 2002.

Belgian economy

A general expansion in activity, supported by all the main components of demand

20. After the hesitancy of activity from 2001 to 2005, the Belgian economy produced strong growth in 2006: following a vigorous recovery at the start of the year, growth reverted to a more moderate but still robust level. Average real GDP growth increased from 1.5 p.c. in 2005 to 3 p.c. in 2006, slightly outpacing that of the euro area and reaching its highest level for six years. All branches of activity, including industry, contributed to this growth, with construction producing a particularly marked rise of around 8 p.c. The Belgian economy benefited from the buoyancy of foreign demand, but also from the consolidation of domestic demand.

21. Despite further losses of market shares, exports of goods and services gathered momentum during the year, with volume growth averaging 3.4 p.c. Imports expanded slightly faster. As a result of an improvement in the terms of trade, however, net lending to the rest of the world remained steady at 2.3 p.c. of GDP.

22. Firms continued to step up their production capacity and increased their gross fixed capital formation by 4.4 p.c. While the investment revival of the preceding two years had concerned the service sector, especially maritime transport and logistical services, in 2006 it spread to manufacturing industry, which saw a significant increase in capacity utilisation rates. Apart from the outlook for demand, factors supporting investment were a further rise in corporate profitability, the fall in firms' debt ratios since the 2001 peak and the improvement in their liquidity. The persistently favourable financing conditions also played a role: despite edging upwards, interest rates remained historically low, stock market prices surged except for a brief blip in the middle of the year, and tax conditions were favourable to the recourse to own funds.

23. Firms maintained their net recruitment, and total employment grew by 1.1 p.c., or 46,000 units, slightly outstripping the previous year's expansion. However, since the labour force again increased quite significantly, the harmonised unemployment rate, taken as an annual average, recorded only a slight decline from 8.5 to 8.3 p.c., though it began to fall sharply in the second half of the year.

24. The real disposable income of households was about 2.7 p.c. up, mainly as a result of higher employment, the positive impact of the cyclical upturn on self-employed incomes, the growth of interest and dividend incomes and the final stage in the implementation of the tax reform.

This increase contrasts with the minimal changes seen in the four preceding years. Private consumption expanded by 2.4 p.c. The household savings ratio therefore showed only a small increase, boosted by the marked rise in incomes but also moderated by the improved confidence in the economic outlook and the labour market.

25. The bulk of these savings was once again allocated to housing construction and renovation : this type of investment increased by 4.8 p.c., responding more strongly to house price movements than in other euro area countries. However, the rise in mortgage interest rates, up from their low average level of 3.6 p.c. in September 2005 to 4.4 p.c. in November 2006, has already curbed demand for loans and tempered the rise in property market prices.

26. Consumer prices were relatively stable : having increased from 1.5 p.c. in 2003 to 2.5 p.c. in 2005, the rise in the harmonised index of consumer prices (HICP) reached 2.3 p.c. in 2006 ; it dropped from 2.6 p.c. in the first quarter to 1.9 p.c. in the fourth quarter. This chronological profile mainly reflects the direct effect of the oil price fluctuations on consumer prices of energy. The fact that the Belgian HICP is more sensitive to these variations, owing to the weight of oil products in consumption and the relatively low level of excise duties (a non-proportional tax) on these products, also explains why the index has risen slightly faster than the euro area index over the past two years. Excluding energy, unprocessed food and administrative price changes, "core" inflation accelerated slightly, rising from 1.3 p.c. in 2005 to 1.6 p.c., the most likely cause being the impact of the higher commodity costs on the prices of certain industrial products. Conversely, imports of manufactured goods from low-cost countries continued to curb prices, and internal inflationary pressure remained very subdued.

27. In particular, the rise in hourly labour costs in the private sector was modest at 2.4 p.c., comparable to the increase in the preceding two years, despite a substantial deceleration in the reductions in employers' social security contributions. The indexation effect was mitigated by the reform of the method of calculating the health index, which rose by just 1.8 p.c. in 2006, against 2.2 p.c. in 2005. Excluding indexation, negotiated increases were modest, in line with the provisions of the central agreement, and the growing international competition continued to inhibit pay rises. The cyclical increase in productivity kept the rise in unit labour costs down to 0.7 p.c. However, owing to the continued stricter wage moderation in Germany, the increase in hourly labour costs outpaced that recorded in the three main neighbouring countries for the third consecutive year, thus accentuating the deterioration in the competitiveness of Belgian firms in relation to those reference economies.

Structural changes and economic policy

28. The Belgian economy did rather well in 2006, and the Bank's forecasts, like those of the international institutions, assume growth of somewhat over 2 p.c. in 2007. However, the upturn in the cycle is no cause for complacency, neither in Belgium nor in the other euro area countries. On the contrary, it must be used to strengthen the economy's ability to adapt to the on-going structural changes, and to make progress towards sustainable development. The emergence of new global economic players such as China, India and the new EU Member States will contribute more towards Belgian prosperity if, as well as taking advantage of cheaper imports from those countries, Belgium can also respond better to their growing demand for goods and services, and, more generally, continue to remodel its production structure and specialise more in high value added products. Moreover, the only ways to ensure a rising standard of living and the maintenance of social protection, despite population ageing, are by boosting the employment rate, raising productivity and setting a budget path based on a sufficiently long-term view.

29. Progress has already been achieved. For instance, since the solidarity pact between the generations there has been greater awareness of the demographic issue; in the negotiations between the social partners, apart from labour cost restraint, special attention has been paid to promoting employment and training; the public employment services are arranging more effective guidance for the unemployed; the process of opening up various sectors to competition has continued; an innovation policy is gradually taking shape. But the scale of the challenges ahead demands unremitting efforts.

30. There is a need for a coherent strategy, geared to the medium- and long-term goals, in which the various levels of government, the social partners and all those involved in economic life have a role to play. The national reform programme, defined for the first time for the period 2005-2008 in the framework of the revised Lisbon strategy, therefore needs to be deepened and implemented. In the field of public finances, the labour market and structural policy, lasting measures need to be taken as soon as possible.

Fiscal policy: building up a structural surplus and enhancing the effectiveness of public spending

31. The Belgian general government accounts ended 2006 with a small surplus, slightly surpassing the stability programme target. Belgium's budget position contrasts favourably with the average deficit recorded in the euro area, where only Finland, Spain, Ireland and the Netherlands also achieved a balance or a surplus. This permitted a further reduction in the public debt ratio, which has dropped below 90 p.c. of GDP, or one-third lower than its 1993 peak, though it is still the third largest debt ratio in the euro area.

32. However, one-off measures representing 0.7 p.c. of GDP, some of which will entail a cost for future budgets, contributed to the good results in 2006, as did the growth revival and, albeit to a lesser extent than in the past, the further reduction in interest rates. The movement in the structural budget balance, which excludes non-recurring and cyclical factors, was therefore less favourable: having shown a surplus in 2005 (0.3 p.c. of GDP), this balance reverted to a deficit in 2006 (–0.4 p.c.). The structural primary surplus, which furthermore excludes interest payments, declined to 3.7 p.c. of GDP, compared to 4.6 p.c. in 2005 and a peak of around 7 p.c. in 1998. The erosion of that surplus in 2006 was due mainly to the movement in revenues, particularly following the implementation of the personal income tax reform, while the decline in the preceding years was caused mainly by the increase in expenditure. After a very strong rise in health care spending in 2003-2004, the growth of that expenditure has been better contained in the past two years.

33. Attainment of the goal of growing structural budget surpluses from 2007, as specified by Belgium's December 2006 stability programme and prescribed by law, will demand even more discipline than in recent years: in fact it entails increasing the primary surplus, since the implicit interest rate on the public debt might rise; in addition, one-off operations will have to be replaced by permanent measures.

34. The path laid down by the stability programme should in fact be regarded as a minimum. An immediate acceleration of the reduction of the public debt ratio should provide room for the expected increase in expenditure on pensions and health care, and will spread the budgetary effort more evenly over time, sharing it more fairly between the generations. The authorities will need to do still more to reinforce the economic foundations of social protection, by helping to raise the employment rate, to augment productivity and to establish a sustainable development model, particularly by the judicious management of revenue and expenditure.

35. On the revenue side, the burden of taxes and parafiscal charges on labour has been cut from over 44 p.c. of the wage bill in 1998 to less than 42 p.c. in 2006, but remains among the highest in Europe. In the case of further tax cuts, they ought to be specifically targeted and the effect on the government budget should be offset. It is possible to increase other levies, such as taxes on the consumption of products harmful to health or the environment, or to abolish certain tax exemptions, but that must be done with due regard for the openness of the Belgian economy. Efforts to ensure that taxes are properly collected must also continue.

36. Since there is little scope for raising new revenue, however, it is especially on the expenditure side that one should be selective. Assuming that future revenues are only affected by measures which have already been taken, attainment of the budget targets entails keeping the growth of primary expenditure more than half a percentage point below GDP growth during the period 2007-2010, whereas in the past decade that expenditure has grown faster than GDP. Government spending must be kept under strict control and every item must be checked in the light of the aims in view and the effect on economic growth in the medium and long term. Thus, it should be possible to enhance the effectiveness of the resources allocated to health and education, and particularly public administration, where the workforce has expanded rapidly in the past ten years. Expenditure which has an unwelcome redistributive effect must be reconsidered, and priority should be accorded to measures which encourage greater participation in the labour market, and to investment in physical and human capital, which should improve the economy's productivity and promote sustainable development.

37. All levels of government share responsibility for maintaining sound public finances. As pointed out in the recent IMF report on Belgium, whatever the degree of decentralisation in the Belgian federal system, there is a need to increase the accountability of its components and to improve coordination. In particular, it is essential to avoid inconsistency between the allocation of powers and resources, which places some levels of authority under much heavier pressure than others: under the current arrangements, that is true of the entity comprising the federal State and social security. Any redefinition of the powers and/or the methods of funding should tend to establish a better balance.

Employment policy: safeguarding competitiveness and increasing the labour supply

38. In the light of globalisation, rapid technological progress and the demographic prospects, it is essential both to support the demand for labour – particularly by a responsible movement in labour costs – and to raise the quantity and quality of the labour supply, in order to increase the employment rate, which in 2006 stood at 60.9 p.c. of the population aged between 15 and 64 years, a rate well below the European average.

39. Endeavouring to increase the labour supply while unemployment persists at a high level only sounds like a paradox. For one thing, shortages are already emerging in certain occupations, and they are not being entirely filled by the use of foreign workers, such as those from the new EU Member States. Unemployment – the reduction of which is obviously a priority – in many cases reveals a mismatch between demand and supply on the labour market. Also, although the population of working age is still expanding, it will soon decrease, and it is essential to allow for the time which measures take to implement: for instance, Belgium is currently benefiting from the raising of the standard retirement age for women, a measure introduced several years ago, which should enable Belgium to achieve the Lisbon target for the EU of a female employment rate of 60 p.c. by 2010, whereas the target of an overall employment rate of 70 p.c. will not be attainable by that date.

40. However, the employment rate is still particularly low, and unemployment high, for women, and especially for the young, persons between the ages of 55 and 64, the low skilled and persons of foreign origin. Particular attention needs to be paid to encouraging demand for labour in the case of these groups, notably by combating discrimination and by reductions in social security charges targeting low wage earners and certain age groups. There is also a need to develop work incentives and occupational skills, e.g. by guaranteeing an adequate differential between net earned incomes and unemployment benefits, by raising the actual age for retiring from the labour market – which will be a key factor in the sustainability of the public pension system –, by providing guidance for the unemployed, by establishing more care facilities, particularly for young children, by encouraging geographical mobility and by organising suitable training. Progress has already been made here in various ways, such as the solidarity pact between the generations, the reduction in the burden of taxes and parafiscal charges on low incomes, and the programme to encourage an active search for jobs. It is essential to maintain that course. In particular, the employment rate for persons aged between 55 and 64 years increased from 26 p.c. in 2000 to 32 p.c. in 2005, and the solidarity pact between the generations will boost it further, but the target of 50 p.c. which was set in Lisbon for the EU by 2010 remains a long way off.

41. The disparities in employment and unemployment rates are also geographical. It is good that the regional employment services are intensifying their cooperation, to match the labour supply more effectively with demand. In addition, the efforts to provide training and monitoring for job seekers must be pursued and reinforced.

42. The differential rates of social security contributions mentioned earlier can be regarded as a redistribution mechanism in favour of the most vulnerable groups on the labour market. Reductions in charges are also justified in the case of key occupations for the development of the knowledge-based economy; they already apply to the salaries of researchers in order to encourage R&D activities. But labour costs are determined mainly by negotiation between the social partners, and it is crucial that the movement in wages should safeguard the competitiveness of Belgian firms and encourage them to expand employment. Thus, the indicative wage norm for the years 2007 and 2008 – namely an increase of 5 p.c. over two years, the increase in costs being cut to 4.85 p.c. via a reduction in the withholding tax on earned incomes payable by the employer – comprises a partial correction for the increase in hourly labour costs, which have risen faster than in the three main neighbouring countries since 1996. The Central Economic Council had estimated this deviation at 1.5 p.c. The rise currently expected in those countries for the period 2007-2008 is 5.5 p.c. In addition, the central agreement recommends that the sectoral negotiators adopt adjustment mechanisms, adapting the real increases in line with the difference between the projected and actual indexations. Apart from the reference to the health index (which excludes the prices of road fuel, alcoholic beverages and tobacco), this type of agreement reduces the risk that automatic wage indexation, typical for Belgium, may unleash a wage dynamic damaging to competitiveness and employment. It is also important that the centrally agreed norm should permit sufficient differentiation in labour cost movements per sector and/or firm in order to improve the match between the labour supply and demand.

43. While safeguarding competitiveness via labour costs is vital in a small open economy like Belgium, it is a defensive measure which needs to be supplemented by seeking new products and striving for productivity gains. From that point of view, it is necessary to ensure constant upgrading of the skills of persons in work, and more generally all persons of working age, in order to augment their efficiency and increase their chances of employment, and to develop their versatility and creativity. That is why vocational training has become a key issue in the negotiations between the social partners. According to the social balance sheets, the resources which firms devoted to formal training declined from 1.4 p.c. of the wage bill in 2000 to around 1 p.c. in 2005, while the 2006 target endorsed by the solidarity pact between the generations was 1.9 p.c. The number of working hours spent on this training has also fallen. Conversely,

over the same period the proportion of workers taking part in such training increased slightly to 36 p.c., though that is still well below the target of 50 p.c. set for 2010. Although these data are imperfect and do not cover informal training, which is more common in small firms, they still highlight the need, acknowledged by the central agreement, to step up efforts in this regard.

Structural policy : encouraging entrepreneurship and innovation

44. Under the pressure of technological progress, globalisation and changes to the pattern of consumption resulting from growing prosperity, the production structure of the Belgian economy, like that of other advanced economies, is undergoing fundamental changes, the most striking being relative de-industrialisation. But let there be no mistake : far from disappearing, industrial production is actually expanding in volume by almost as much as services. Moreover, industrial products still dominate exports, where they account for three-quarters, and R&D, over 80 p.c. of which is concentrated in industry. Finally, industrial activity has significant knock-on effects on the rest of the economy. But the productivity gains in industry are causing a downward trend in employment in that sector, and in the relative prices of industrial products, so that industry's share of value added and employment has fallen from around 30 p.c. in 1970 to roughly 15 p.c. today. Within industry itself, there have been shifts such as the growing importance of chemicals, particularly the pharmaceutical industry, and the relative decline of metallurgy and textiles.

45. In the face of the growing pressure of competition generated by globalisation – the corollary to its contribution to prosperity in countries that, like Belgium, enjoy the benefits of cheap imports – it would be wrong to try to halt these changes. Instead, it is far more beneficial to anticipate them, to develop new products for which demand is growing and where price competition is less fierce, to make production processes more efficient and to take advantage of the opening up of new markets. While growth in the past resulted largely from the accumulation of capital and the use of well-established technologies, it must now, in the advanced economies, be based more than ever before on innovation. Moreover, that will not be confined to the industrial sphere, but will also trigger organisational changes in service companies and public administration. Furthermore, Belgium must make use of its strengths to attract exportable service activities, e.g. in the fields of finance, logistics and medicine. The successes achieved in specific cases, such as in certain pharmaceutical, aeronautical and electronic production processes, and more generally the steady rise in the average standard of living, show that Belgium is capable of adapting to a fast-changing environment. However, there is still a need to promote the development of new activities and reinforce productivity gains.

46. The efficient operation of competitive markets is vital to such progress. The spur of competition and, more particularly, the arrival of new, innovative firms on the market, are essential to boost overall productivity. Thus, the intensification of competition, e.g. by the strengthening of the Competition Council, and the reduction in the administrative burdens on businesses, especially in the initial stages, will contribute not only towards reducing monopoly gains but also towards enhancing the dynamic efficiency of the economy. In addition, various rules which still hamper the creation of new businesses or the expansion of certain activities, especially in the service sector, need to be relaxed.

47. Furthermore, governments have a more active role to play in developing innovation. They have at their disposal numerous means of stimulating progress towards a knowledge-based economy : education and lifelong training, investment in R&D, the tax environment for innovation, the organisation of partnerships and technology centres, policies on intellectual property and standardisation, the government's use of new technologies, etc. It is important to deploy all these levers effectively and to ensure closer cooperation between public authorities,

educational institutions, research institutes and the social partners, in order to promote innovation at all levels.

48. R&D activities are obviously essential : the public and private resources devoted to them have to be augmented, especially in the branches where they are under-represented, and research careers need to be made more attractive. However, these activities are only one part of the innovation process. Their spin-off effects need to be maximised by organising interactions between research centres and firms, by improving the spread of knowledge, by encouraging the spirit of enterprise and appetite for risk, in order to foster the development of practical applications which are also capable of meeting social and environmental needs.

49. In all sectors – including the traditional ones – a spirit of innovation must prevail. The environment will be more conducive to that if the policies on education, lifelong training and occupational mobility have prepared all the players in economic life accordingly. In that context, the social partners recently entered into a commitment to develop a culture of innovation in firms.

Conclusion

50. Fifty years after the signing of the Treaty of Rome and five years after the introduction of the euro notes and coins, the benefits of European integration for the population of all the participating countries cannot be overemphasised. Thus, the creation of a large area of monetary stability has contributed towards growth and employment by cutting transaction costs, reducing uncertainty, lowering interest rates, improving the allocation of resources and stimulating competition, even if these benefits have been partly masked by the incidence of oil shocks and structural rigidities. The European integration project now merits a new impetus.

51. In Belgium, in particular, to ensure rising prosperity and sustainable social protection in the face of globalisation and population ageing, the economy requires reforms and policies geared to a long-term view. Fortunately, there is a broad consensus on the key elements : stimulating innovation, maintaining vigilance over cost competitiveness, raising the employment rate and accelerating the reduction of the public debt. These good intentions need to be resolutely carried out. The favourable economic climate must not tempt policy makers to postpone the implementation of such a programme ; on the contrary, it provides the opportunity for taking action.

Brussels, 31 January 2007

1.

1.1 Summary

The global economy maintained its strong expansion in 2006, in a context of vigorous growth of international trade. Despite a further rise in commodity prices, the growth rate accelerated to 5.1 p.c., thus approaching the exceptionally high level recorded in 2004. Once again, world growth was driven largely by the emerging economies, especially those in Asia. While China, where investments and exports continued to soar, further reinforced its role as the engine of global economic activity, there was some adjustment to the balance of growth between the advanced countries, with a certain loss of momentum in the United States during the year and renewed vitality in Europe, especially in the euro area. The slowdown in the United States was due largely to the weakening of the housing market. In the euro area, after a series of aborted revivals, the recovery finally materialised, the main factor being the restored vigour of domestic demand, and particularly investment. The Japanese economic recovery was maintained, although household consumption showed occasional signs of vulnerability. Finally, in the oil-exporting countries, including Russia, activity was once again sustained.

TABLE 1 GDP GROWTH IN THE MAIN ECONOMIES

(percentage volume changes compared to the previous year)

	2004	2005	2006	*p.m. Share in the world economy*[1]
United States	3.9	3.2	3.3	*20.6*
Japan	2.3	2.7	2.8	*6.5*
Euro area	1.7	1.5	2.6	*15.1*
Other EU-15 countries	3.2	2.1	2.9	*4.4*
New EU-25 Member States[2]	5.1	4.7	5.6	*1.1*
China	10.1	10.2	10.6	*16.1*
India	8.5	8.5	8.0	*6.1*
Other emerging Asian countries[3]	6.1	4.7	4.9	*5.4*
Latin America[4]	5.0	4.1	4.7	*7.2*
OPEC	6.2	6.2	5.5	*4.5*
Other OECD countries[5]	4.5	3.8	3.4	*4.9*
Rest of the world	6.9	6.5	5.5	*8.1*
World	5.3	4.9	5.1	*100.0*
p.m. World trade[6]	*10.8*	*7.7*	*9.6*	

Sources: EC, IMF, OECD.

(1) Percentages of world GDP in 2005, based on purchasing power parities, i.e. taking account of the difference in absolute price levels between countries.
(2) Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia.
(3) Hong Kong, Malaysia, Philippines, Singapore, South Korea, Taiwan and Thailand.
(4) Excluding Venezuela.
(5) Australia, Canada, Iceland, New Zealand, Norway, Switzerland and Turkey.
(6) Average exports and imports of goods and services.

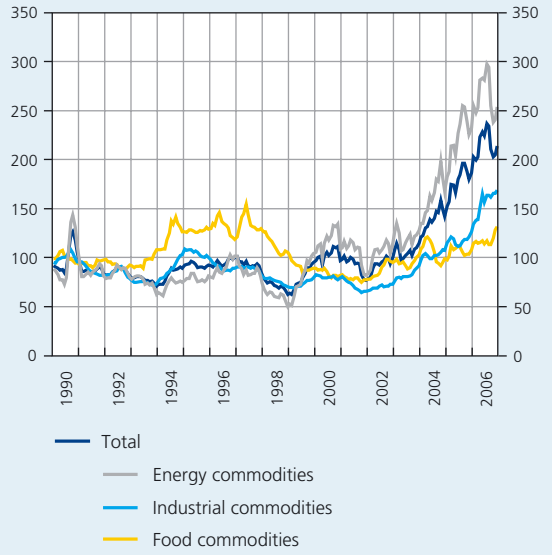
Taking the average for the year, prices of energy commodities expressed in US dollars rose by 19.1 p.c., mainly as a result of higher oil prices, while prices of industrial commodities, propelled by the increased cost of metals, principally aluminium and copper, rose by 32.6 p.c. These increases were due primarily to the strength of demand in the emerging economies, especially China. Prices of food commodities were 10.9 p.c. up, notably in response to reduced output. Overall, the global index of basic product prices rose by 21.1 p.c. in 2006.

Crude oil prices were again highly volatile during the year under review. After reaching a historic peak of over 78 dollars at the beginning of August, the price of Brent fell sharply in the ensuing months and for a short time dropped below the 60 dollar mark during November, before climbing back to an average of 63 dollars in December. As an annual average, the price of Brent denominated in US dollars increased by 20.3 p.c. against 2005. Unlike the oil price rise seen in 2004, which had been triggered mainly by unexpectedly strong demand for oil and the consequent erosion of unused capacity throughout the supply chain, the soaring prices in 2005 and the first eight months of 2006 were increasingly due to concerns about supply at a time when the oil market was already tight. Oil production was in fact disrupted in a number of regions, notably Nigeria, Iraq and Alaska, where one oil field was closed. The geopolitical context and resulting anxiety regarding the security of supplies was an additional factor aggravating the pressure on prices. The easing of oil prices from September onwards was influenced mainly by the relative waning of tensions in the Middle East, the comparatively moderate cyclone activity in the Gulf of Mexico, the absence of repercussions on Iran's production caused by the stand-off in the dispute over its nuclear policy, the fact that stocks were larger than expected in the advanced economies, and the regular downward adjustments to the IEA forecasts concerning demand for oil.

The rise in industrial commodity prices made a larger contribution than in 2005 to the increase in the index of basic product prices. In fact, it exceeded the increase in energy prices, a rather exceptional situation for the past ten years. In particular, metal prices jumped by 60 p.c., rising three times as fast as oil prices. However, in terms of value, industrial commodities still represent a much smaller share of the imports of advanced countries than energy commodities, at around 5 p.c. compared to 14 p.c. Episodes of surging industrial commodity prices are generally associated with vigorous global growth. In the case of metals, there are other factors, too, which explain the rising prices in 2006. To a substantial extent, the rise can be attributed to the low level of investment in the metallurgy sector in the late 1990s and in the early years of this century, following a period of falling prices. In addition, China's growing importance in the global economy, and particularly the rapid expansion of Chinese industrial production, constituted a major factor underpinning the price of metals.

CHART 1 PRICES OF BASIC PRODUCTS

(monthly data, US dollar, indices 1990 = 100)



Source: HWWA.

Despite the vigour of world growth and the renewed rise in commodity prices, on average, over the year, inflation generally remained moderate in the majority of the leading advanced economies. Thus, in the United States and the euro area, it held steady overall at the previous year's level. Nonetheless, inflationary pressures were more acute in the United States, where underlying inflation gathered pace significantly up to September, mainly as a result of the contagion effects generated by higher oil prices and the accelerating increase in rents. In Japan, the rise in consumer prices was very small, and was due mainly to an external factor, namely the higher cost of oil.

Labour market conditions generally improved once again in the advanced countries. Unemployment continued to decline overall. Employment expanded further at a sustained rate in the United States while continuing to recover in Japan; in the euro area, in particular, job creation accelerated markedly, thus contributing to the renewed buoyancy of household spending.

In general terms, the authorities of the leading economies adopted a more restrictive stance on macroeconomic policy. In the leading advanced countries, the tightening of monetary policy continued and became more widespread, but in varying degrees according to the relative positions of the economies in the business cycle. Thus, in the United States the target rate for federal funds was once again raised in the first half of 2006 from 4.25 to 5.25 p.c., but was held steady thereafter in the light of slower economic growth and the expected easing of inflationary pressures. In March, since the inflation figures had become positive and the risk of reverting to a deflationary situation was deemed minimal, the Bank of Japan officially terminated its policy of granting abundant liquidity at zero interest rates, and in July it raised its key interest rate to 0.25 p.c. In the euro area, detecting risks to price stability in the medium term, the ECB gradually raised its benchmark rate by 1.25 percentage points during 2006, setting it at 3.50 p.c. in December. The Bank of England, finding that inflation was liable to exceed the target for a considerable length of time, raised its key rate to 5 p.c., its highest level since September 2001. In China, too, fears of overheating prompted the central bank to tighten monetary conditions.

Although short-term interest rates were rising in the leading advanced countries in 2006, financial conditions remained favourable overall. During the first half of the year under review, long-term interest rates maintained the upward trend which had begun at the end of 2005. But that movement was subsequently reversed, so that long-term interest rates generally remained at a low level. Following an almost uninterrupted rise since the beginning of 2003, stock market prices showed a marked fall in May and June 2006, but they resumed their upward trend during the summer months and continued to rise thereafter.

In 2006, the leading economies recorded an improvement in public finances. While this was partly due to the effects of the automatic stabilisers, the improvement was to a large extent structural. However, in many economies, and especially in the United States and the euro area, the reduction in the structural deficit has benefited from favourable composition effects in the bases of taxation, and there is no guarantee that these will be permanent. The cyclically adjusted US public deficit declined from 3.6 to 2.4 p.c. of GDP. Japan's budget deficit also recorded a structural decline of around 1.5 percentage points of GDP, although it remained high by international standards at a cyclically adjusted figure of 4.6 p.c. In the euro area, almost all the Member States saw an improvement in their public finances, and the number of countries showing an excessive public deficit declined significantly. In the euro area as a whole, the structural public sector financing requirement thus fell from 2 to 1.7 p.c. of GDP.

The US current account deficit on the balance of payments showed a further sharp deterioration in 2006, reaching around 878 billion dollars, or 6.6 p.c. of GDP. The higher cost of oil combined with the adverse movement in the income item contributed to that deterioration. That deficit contrasts with substantial surpluses in other regions of the world, particularly in Asia and the

TABLE 2 CURRENT ACCOUNT BALANCES OF THE MAIN REGIONS OF THE WORLD [1]

(billions of US dollars, unless otherwise stated)

	2004	2005	2006	*p.m. 2006, percentages of GDP*
United States	–665.3	–791.5	–877.6	*–6.6*
Japan	171.6	168.3	164.9	*3.8*
Euro area	80.7	2.0	–31.3	*–0.3*
China	68.7	160.8	211.3	*8.3*
Other emerging Asian countries [2]	108.2	95.1	87.7	*2.7*
Oil-exporting countries [3]	217.6	371.5	540.5	*20.1*
Other countries	–55.6	–69.4	–131.3	*n.*

Sources: IMF, OECD.

(1) In principle, if the balance of payments figures for the various economies are added together, they should be in balance overall, but in practice there is a large net deficit. Owing to the scale of the gross flows of transactions recorded in the balance of payments, these figures are frequently tainted by errors.

(2) Hong Kong, India, Indonesia, Malaysia, Philippines, Singapore, South Korea, Taiwan and Thailand.

(3) This refers to the main oil-exporting countries, namely those recording a current account surplus in excess of ten billion US dollars on average over the period 2004-2006. Those countries are: Algeria, Islamic Republic of Iran, Kuwait, Libya, Nigeria, Norway, Qatar, Russia, Saudi Arabia, United Arab Emirates and Venezuela.

Box 1 – The role of the oil-exporting countries in the balance of payments current account imbalances

The rise in oil prices since 2002 has represented a massive transfer of income from the oil-importing countries to the main oil-exporting countries[1]. Oil revenues more than doubled in three years, reaching 625 billion dollars in 2005. The increased cost of oil thus exacerbated some existing imbalances, particularly the US current account deficit which consequently worsened by more than 1 p.c. of GDP. That development inevitably raises the question of the use of the oil revenues in a context in which the international community is calling on the surplus regions to contribute to the adjustment of global imbalances.

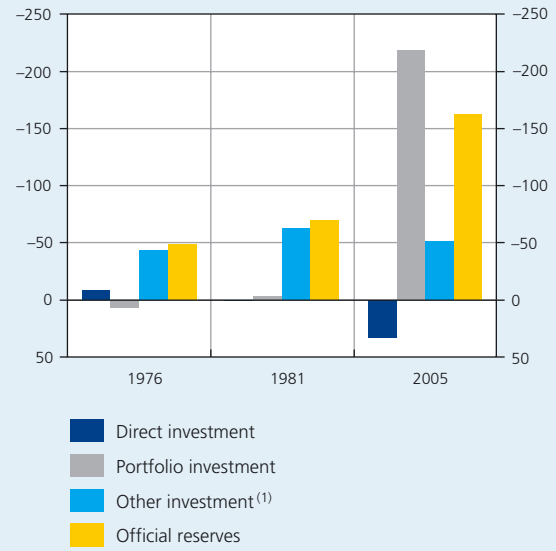
The oil bill can be recycled in the global economy via foreign investment (the capital market channel) or via imports (the trade channel). The substantial increase in the current account surplus of the oil-exporting countries indicates that their imports have risen more slowly than their exports. Decisions on the use of the oil revenues often rest with the government, in view of its large stake in the oil sector in most oil-producing countries. Thus, the soaring budget surplus in those countries is a sign that their authorities have adopted a more cautious stance than at the time of earlier oil shocks. That tendency is also reflected in the creation of oil revenue stabilisation funds in a number of countries, and in the use of oil revenues to repay the foreign debt, as was the case in Russia. The authorities of the oil-exporting countries seem to have learnt their lesson from the past, their attitude being determined by uncertainty over the duration of the higher oil prices and by each country's absorption capacity. Countries with a low absorption capacity, on account of the structural and institutional characteristics of their economy, may initially have found it more expedient to invest their "petrodollars" in the form of financial assets abroad.

The recycling of oil revenues on the financial markets has changed since the 1970s and early 1980s. In those days, the bulk of the excess savings of the oil-exporting countries was allocated to the official reserves and to international bank deposits. In recent years, these have given way to portfolio investments, and it is mainly Russia that has accumulated reserves of late. Owing to the limitations of the available data and the complexity of international financial transactions, it is not possible to identify clearly the destination and nature of the portfolio investments made. However, they probably originate mainly from the public sector, with a significant concentration in US securities, given that a number of oil-exporting countries have pegged their exchange rate to the US dollar, and oil prices are denominated in that currency. On the other hand, the oil-producing countries may have diversified their investments to a greater extent than previously, both geographically and between asset categories. Regional equity and bond markets, such as those in the Middle East, may have provided a greater outlet for the oil revenues. Despite this increased diversification, the growing volume of investments by the oil producers may have supported the dollar and played a role in the low level of US long-term interest rates. Another major difference in relation to earlier oil shocks, especially the first one, is that the oil-exporting countries received net foreign direct investment in 2005. The principal recipients were Russia, the United Arab Emirates, Saudi Arabia and Nigeria.

Imports of goods of the main oil-exporting countries have risen steeply in recent years, doubling in value between 2002 and 2005. The euro area is a major trading partner for this group of countries, and its share in their imports has remained relatively stable since 1995, at around 30 p.c. The proportion of imports from Japan and the United States is much smaller, at 5 and 9 p.c. respectively in 2005. In Japan's case, that share has hardly changed in ten years, while the United States has seen a drop of around 3 percentage points. It is imports from China that have expanded the most in recent years, with annual growth averaging 47 p.c. over the period 2003-2005. Thus, China's share in the imports of the oil countries tripled between 1995 and 2005, rising to over 7 p.c. Although the oil-exporting countries are spending their additional revenues more cautiously, studies conducted by the EC show that the recycling of oil revenues via the import channel has become more advantageous for the euro area than in the 1970s. Thus, from 2000 to 2005, for each dollar of additional income earned from exports to the euro area,

(1) Algeria, Islamic Republic of Iran, Kuwait, Libya, Nigeria, Norway, Qatar, Russia, Saudi Arabia, United Arab Emirates and Venezuela.

NET CAPITAL OUTFLOWS FROM OIL-EXPORTING COUNTRIES
(billions of 2005 US dollars)



Source : IMF.
(1) Including bank deposits.

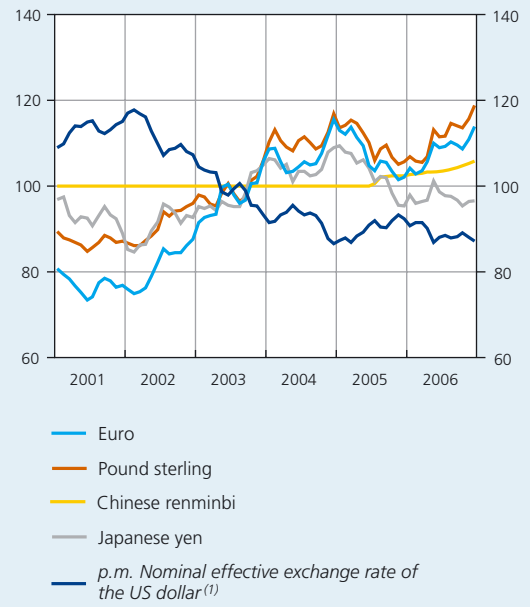
the oil exporters spent on average 74 cents on imports of goods from that area, compared to 59 cents over the period 1973-1981. In contrast, for the United States the direct effect on the current account deficit of an increase in expenditure by the oil countries seems to have been fairly limited, reflecting a mismatch between the supply of products for export and the demand originating from those countries, and also from other regions.

oil-exporting countries. The current account surplus of the main oil-exporting countries, swollen by the steep rise in oil prices since 2003, overtook the Asian surplus in 2006 to total around 540 billion dollars. As explained in box 1, this development also reflects the fact that those countries are less inclined than in the past to recycle their increased oil revenues by expanding their imports of goods and services. China's current account surplus, which was still bolstered by the dynamism of Chinese exports in the context of a virtually unchanged exchange rate policy, continued growing to over 200 billion dollars. Conversely, Japan's surplus hardly changed at all, while the euro area recorded a small deficit, after a current account close to balance in 2005.

The renewed attention which the financial markets paid to the persistently high deficit on the US current account, and the associated risks for the dollar exchange rate, were an important factor underlying the weakening of the US currency up to May in the year under review. In a context of temporary turbulence on the financial markets, the dollar recorded a marked, widespread fall in April and May. The euro was underpinned by better growth prospects for the euro area. From June to October, the dollar held more or less steady against the euro, despite the narrowing interest rate spread between the United States and the euro area, but in anticipation of a positive impact on the US economy of the decline in oil prices. The exchange rate of the pound sterling against the dollar was bolstered in the second half of the year by the improvement in the economic outlook in the United Kingdom. Despite the tightening of monetary policy by the Bank of Japan, the yen weakened fairly considerably against the dollar from June to October, perhaps because of the question mark over whether the deflation process had really come to an end, and the corresponding

CHART 2 BILATERAL EXCHANGE RATES OF THE LEADING CURRENCIES AGAINST THE US DOLLAR

(monthly averages, indices January 1999 = 100)



Sources: BIS, ECB.

(1) Average exchange rate of the dollar against the currencies of twenty-one advanced countries and four emerging Asian economies, weighted according to their share in US foreign trade.

prospect of interest rates in Japan being raised more slowly than expected. However, in November and December the dollar weakened further against the other currencies, owing to signs of a growth slowdown in the United States and because of the concern in the markets about the substantial proportion of dollars in the foreign exchange reserves of a number of countries, and signs that some of them wanted to increase the diversification of these official foreign exchange assets. The narrowing of the negative interest rate differential in relation to the United States and confirmation of the robustness of growth in the euro area also helped to strengthen the euro.

Since the dollar had followed the opposite trend in 2005 – appreciating for much of the year – there was hardly any change in 2006, on average, compared to the previous year, in its weighted average exchange rate, that showed an overall depreciation of just 1.2 p.c. Similarly, the euro remained practically steady against the dollar, appreciating by only 0.9 p.c. overall. Conversely, the yen depreciated against the dollar by an average of 5.5 p.c. Since the reform of the Chinese foreign exchange regime, announced in July 2005, and the associated modest revaluation of the renminbi against the dollar, the Chinese currency has appreciated only slightly owing to the maintenance of fairly strict fluctuation margins. Thus, the renminbi gained only 2.8 p.c. against the dollar, on average, during the year under review.

1.2 United States

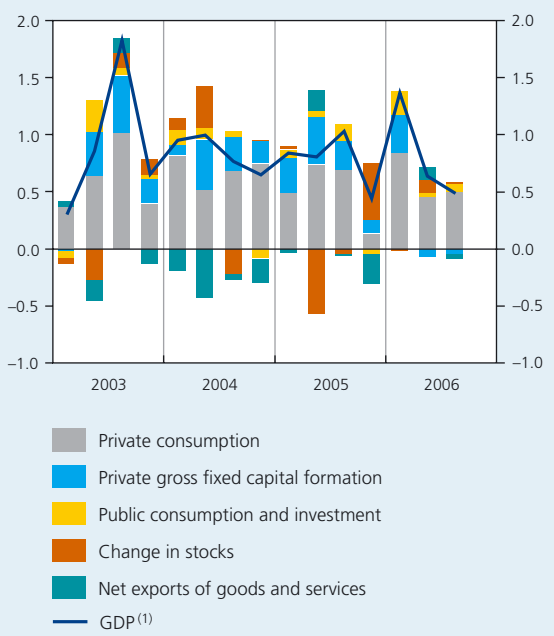
The US economy recorded growth averaging 3.3 p.c. in 2006. Continuation of the preceding years' vigorous expansion pushed GDP slightly above its potential level for the first time since 2001, by 0.4 p.c. according to the OECD. Almost all the domestic demand components supported the expansion of economic activity in 2006, except for investment in housing. The latter, which had still been rising strongly in 2004 and 2005, weakened and thus curbed GDP growth by 0.7 percentage point. Inflation eased slightly, while remaining relatively high, the main factors being oil prices and rents. The labour market retained its dynamism, and the scope for mobilising unused labour continued to diminish.

However, the relatively strong growth performance for 2006 as a whole masks a significant slowdown during the year. First, while GDP showed a further marked rise in the first quarter, up by 1.4 p.c. against the previous quarter, that was due in part to very mild weather conditions at the start of the year and to the public expenditure relating to the reconstruction which followed the disastrous hurricane season at the end of 2005. By the second quarter, economic growth recorded a sharp fall, the main reason being the persistent rise in energy prices and the increase in interest rates: in the second and third quarters, growth averaged only 0.6 p.c. It was in this period that house building activity recorded a particularly steep decline.

Spending by American households was less buoyant than in previous years, but was still the main engine of economic growth overall. Their investment in housing eroded after a lengthy and exceptional period of expansion, the main reasons being the marked rise in mortgage interest rates from mid 2005, the surge in building costs and the improvement in the conditions for acquiring apartments or houses on the secondary market. In December, the number of houses sold and the number of housing starts fell short of the highest level reached during the last housing market boom by 13.7 and 27.5 p.c. respectively. At the same time, the rise in house prices on the secondary market slowed down, dropping from around 14 p.c. year-on-year in the second quarter of 2005 to 7.7 p.c. in the third quarter of 2006. In certain regions, prices actually fell.

CHART 3 CYCLICAL PROFILE OF GDP AND THE MAIN CATEGORIES OF EXPENDITURE IN THE UNITED STATES

(seasonally adjusted data ; contribution to the volume change in GDP against the preceding quarter, percentage points, unless otherwise stated)



Source : BEA.
(1) Percentage changes against the preceding quarter.

The property market developments also had an impact on the growth of the other component of household expenditure, namely private consumption, which dipped from 3.5 to 3.2 p.c. In recent years, the strong rise in house prices had been a key factor sustaining household consumption as a result of the wealth effect, notably via "mortgage equity withdrawal", i.e. the scope for obtaining a bigger mortgage loan in accordance with the increased value of the underlying asset, in order to cover inter alia current purchases. The rise in energy prices also depressed household spending. At the same time, the faster growth of household disposable income, up from 1.2 to 3.4 p.c. in real terms, reinforced consumption. It was due to the stronger rise in earned incomes, attributable to the robust wage growth and the positive developments on the labour market. Employment in fact grew at close to its long-term rate, and the unemployment rate continued to fall, dropping to 4.6 p.c. of the labour force, the lowest level since 2001. In addition, rising stock market prices also boosted consumption.

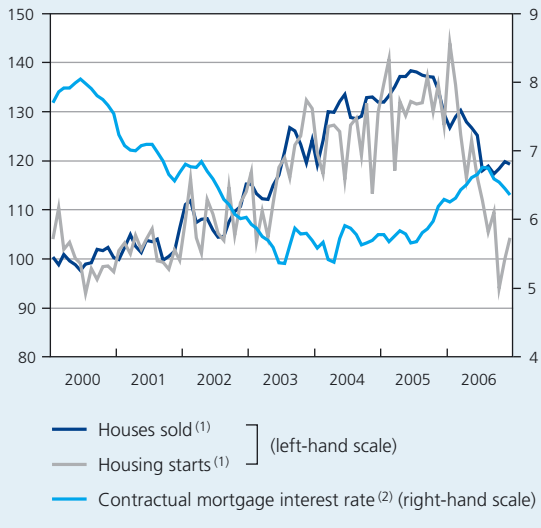
The household savings ratio remained negative, as in 2005 : that situation is totally exceptional, even though the downward trend was halted as dissaving declined from 0.4 to 0.2 p.c. of disposable income.

Investment by American businesses remained highly dynamic for the third consecutive year, and the rate of expansion actually increased, being supported by a further improvement in corporate profitability and by favourable financing conditions. It was primarily expenditure on non-residential construction that showed a marked rise. This growth was mainly apparent in expenditure on mining and drilling infrastructures and on office buildings and commercial property. Part of the means of production released by the residential construction sector was used for this purpose. Conversely, the growth of expenditure on equipment and software slowed down during the year under review, following a sharp rise in the previous year.

The growth rate of both exports and imports of goods and services speeded up during the year under review. Exports, particularly those of investment goods, were boosted by the vigour of global demand. The acceleration in their growth outpaced that of imports since domestic demand growth in the United States decelerated in comparison to that of its main trading partners. However, the contribution of net exports to economic growth remained negative, owing to the persistent difference of levels

CHART 4 HOUSING SECTOR IN THE UNITED STATES

(monthly data)



Source : Thomson Financial Datastream.
(1) Indices 2000 = 100.
(2) Average of fixed and variable rates.

TABLE 3 ECONOMIC DEVELOPMENTS IN THE UNITED STATES

(percentage changes compared to the previous year, unless otherwise stated)

	2004	2005	2006
Expenditure (volume)[1]			
Final domestic demand	4.0	3.6	3.0
Final consumption expenditure			
Households	3.9	3.5	3.2
General government	2.1	0.9	1.6
Gross fixed capital formation			
Housing	9.9	8.6	–4.1
Enterprises	5.9	6.8	7.6
General government	0.5	1.1	4.5
Changes in stocks[2]	0.4	–0.3	0.3
Net exports of goods and services[2]	–0.6	–0.2	–0.1
Exports	9.2	6.8	8.5
Imports	10.8	6.1	6.3
GDP	3.9	3.2	3.3
Labour market[3]			
Employment	1.1	1.8	1.9
Unemployment[4]	5.5	5.1	4.6
Prices and costs			
Consumer prices (CPI)	2.7	3.4	3.2
Unit labour costs	1.7	2.2	4.3
Prices of imported goods and services	5.0	6.3	4.3
Terms of trade	–1.3	–2.5	–0.7
Balance of payments and budget balance[5]			
Balance of current transactions	–5.7	–6.4	–6.6
Financing balance of general government	–4.6	–3.7	–2.3
p.m. Private savings ratio[6]	*2.0*	*–0.4*	*–0.2*
Gross debt ratio of general government[5]	*61.6*	*61.8*	*60.9*

Sources: OECD, BLS.
(1) Calendar adjusted data.
(2) Contribution to the change in GDP, percentage points.
(3) According to the household survey.
(4) Ratio between the number of unemployed and the labour force.
(5) Balance or outstanding total expressed as a percentage of GDP.
(6) Net savings expressed as a percentage of net disposable income.

between exports and imports: in 2006, the former were in fact about one-third lower than the latter.

During the year under review, the terms of trade remained subject to the adverse effects of the rise in oil prices, while the income item on the balance of payments went into deficit, notably because of the further increase in the foreign debt of the United States, which thus in turn contributed to the worsening of the debt via a snowball effect. Overall, the current account deficit therefore deteriorated further, reaching 6.6 p.c. of GDP, compared to 6.4 p.c. in 2005.

The growth of apparent labour productivity came to around 2 p.c., as in 2005. It can be classed as modest compared to the substantial productivity gains achieved from 2002 to mid 2004. Nonetheless, that is not abnormal for the current phase in the business cycle. Labour costs per person increased even faster in 2006 than in the previous year. As in 2005, that rise was to some extent distorted by the exceptional increases in income which some workers obtain by exercising options on shares in their company. On balance, unit labour costs recorded an increase which was more than 2 percentage points higher than in 2005.

Inflation, measured by the change in the CPI, averaged 3.2 p.c. or about the same as in 2005. Nonetheless, this relative stabilisation conceals a slight worsening of inflationary pressure, as underlying inflation increased from 2.2 to 2.5 p.c., while the most volatile components, particularly energy prices – which recorded slower growth, down from 16.9 to 11.2 p.c. – saw a decline in their contribution to the increase in consumer prices. Overall inflation gathered pace during the first half of the year, rising from 3.4 p.c. in December 2005 to 4.3 p.c. in June; it then eased, under the influence of a downward base effect caused by the rise in oil prices in 2005, and their decline following the peak reached at the beginning of August 2006. Underlying inflation also exhibited a marked acceleration during the year, increasing from 2.1 p.c. during the first three months to 2.9 p.c. in September, before dropping back to 2.6 p.c. in December. The increase in rents accelerated, thus making a substantial contribution towards the rise in underlying inflation. The main factor here is a shift in demand for housing from the purchase to the rental market, owing to the level to which prices have risen and the increase in mortgage interest rates.

In the first half of the year under review, the federal funds target rate was raised four times, by 25 basis points at a time, increasing it from 4.25 to 5.25 p.c. From July onwards, this interest rate was kept unchanged owing to the slackening of economic growth and an expected easing of inflationary pressure, in the light of the decline in energy prices and the moderating effect on total demand of the earlier interest rate hikes.

During the first half of the year, long-term – ten-year – interest rates continued the rise which had begun at the end of 2005. In the second half, they declined while still

remaining above the level of the beginning of the year. Nevertheless, long-term rates produced a less pronounced rise than short-term rates, so that the slope of the interest rate curve became negative. In the end, long-term rates were no higher at the end of the year under review than in June 2004, at the start of the latest cycle of rate increases by the Federal Reserve. This is a somewhat exceptional situation which, as last year, may be due to various factors, including the sustained interest among Asian non-resident investors in American public loans (for more details, see box 5 in the 2005 Report).

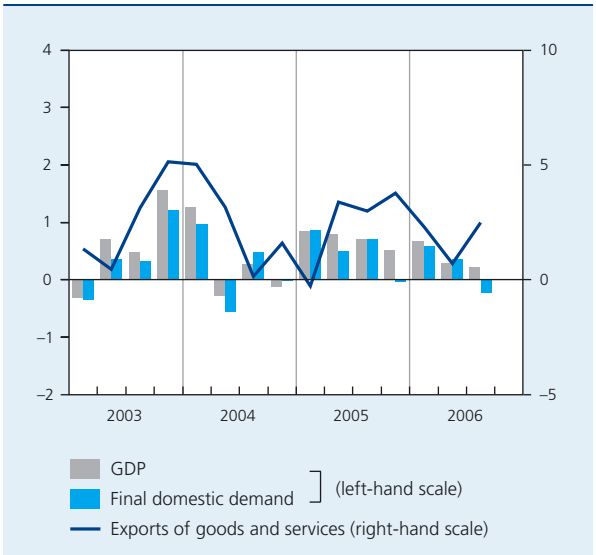
The general government budget deficit declined for the third successive year, falling from 3.7 p.c. of GDP in 2005 to 2.3 p.c. This notable improvement is due mainly to the expansion of tax revenues resulting from the cyclical upswing, the capital gains associated with the stock market buoyancy, and the increased income elasticity of tax revenues. This last development could be due, among other things, to greater income inequality.

1.3 Japan

Set in train in mid 2002 with strong export expansion, the economic recovery once again demonstrated its durability in 2006: GDP growth averaged 2.8 p.c. and, as in 2005, was based largely on domestic demand, especially business investment. Although domestic demand did falter slightly during the year, the reason lay in temporary factors: a substantial reduction in stocks in the second quarter and a contraction in private consumption in the third quarter following a wet summer. Deflation seems to have been halted, but the rise in consumer prices was again relatively insignificant, or even still negative according to some indicators.

CHART 5 CYCLICAL PROFILE OF GDP AND THE MAIN CATEGORIES OF EXPENDITURE IN JAPAN

(seasonally adjusted data, percentage changes in volume compared to the previous quarter)



Source: ESRI (Japan).

Persistently robust profits, the shedding of excess production capacity, the gradual expansion of bank lending and strong business confidence, which in 2006 reached its highest level for ten years, were all factors which encouraged businesses to proceed resolutely with their investment expansion. Conversely, the government once again cut back its gross fixed capital formation, while household investment in housing showed only a modest increase.

For the second consecutive year, the labour market recovery led to an expansion in both part-time and full-time jobs. The unemployment rate therefore continued to fall, dropping from 4.4 to 4.2 p.c. Although this development combined with the increased dividends associated with high corporate profits had a positive impact on the incomes of households, it was nonetheless partly counteracted by the effect of the higher prices of petroleum products, so that their real disposable incomes grew by only 1.3 p.c. overall, against 2.1 p.c. in 2005. The movement in household purchasing power remained a weak link, in that wage increases did not keep pace with the productivity gains achieved in a context of constant cost control by businesses and a preference for job security among workers. In general, consumer confidence remained anchored at a high level, and private consumption expanded by 1.3 p.c. in 2006.

During the year under review, exports benefited from the rapid expansion of world trade, as the negative effect of the gradual slowing of the American economy was in fact amply offset by the growth of the Asian markets. Conversely, the weakening of domestic demand was reflected in the slower growth of imports, so that the contribution of net exports to GDP growth increased significantly from 0.2 to 0.8 percentage point. The positive impact of this on the current trade balance was only partly offset by the deterioration in the terms of trade, caused mainly by the rising prices of crude oil and other commodities, and by the persistent weakness of the yen. The current account surplus expressed as a share of GDP therefore increased slightly to 3.8 p.c.

Although the growth of economic activity has been positive again since 2000, the deflation afflicting Japan since 1998 was not halted until the start of the year under review, at least according to the yardstick used by the

Bank of Japan to measure underlying inflation – i.e. the consumer price index excluding fresh food. The year-on-year change in that index recorded in January was positive for the third month in a row, and has been rising gradually since then. The five-yearly revision of the CPI which took place in July did not alter this trend, even though it did give rise to a downward adjustment – the level effect came to around 0.4 percentage point – following a change in the composition of the basket and an adjustment to the weightings, increasing the weight of goods and services which have gone down in price. Taking account of this revision, inflation was running at barely 0.3 p.c. during the year under review. However, on the basis of the more usual definition of underlying inflation, which also excludes the movement in energy prices, the Japanese economy was still facing slight deflation. The fall in unit labour costs resulting from substantial productivity gains in a climate of wage moderation continued to exert negative pressure on the movement in certain producer prices, particularly in the service sector.

In March 2006, in view of the return to positive inflation, and considering that there was little risk of reverting to a deflationary situation, the Bank of Japan officially terminated its policy of monetary easing. The excess liquidity accumulated by the banks in recent years was rapidly eliminated in the ensuing months. At the same time, a new framework was announced for the conduct of a transparent monetary policy. This stipulates that the Bank of Japan's mission is to support economic activity by pursuing the objective of medium-term price stability. The members of that central bank's Monetary Policy Committee defined price stability as a year-on-year increase in the CPI of between 0 and 2 p.c., but that definition is subject to annual review. Monetary policy decisions are based on a biannual analysis of the medium-term economic outlook and risks, conducted by the Bank of Japan. On the basis of its April economic projections, predicting a gradual acceleration in inflation, the Bank of Japan stated that it would proceed with a gradual increase in the base rate if the economy performed in line with expectations. In July, the base rate was thus raised by 25 basis points for the first time in five years.

In contrast, fiscal policy had already been tightened earlier. During the year under review, the Japanese public deficit was cut from 5.3 to 4.6 p.c., mainly as a result of the phasing out of a reduction in personal income tax, the impact on corporation tax of the marked revival in corporate profits, and the further contraction of public investment, as well as the continuing control over other public spending. However, no new consolidation measures were implemented as the Japanese government did not wish to risk jeopardising the economic recovery too soon, as it had done in 1997 with an increase in the tax on consumption. Nevertheless, restoring sound public finances is a priority for Japan. The budgetary cost of population ageing is becoming evident there sooner than in the majority of the other OECD countries. Moreover, Japan is burdened

TABLE 4 ECONOMIC DEVELOPMENTS IN JAPAN

(percentage changes compared to the previous year, unless otherwise stated)

	2004	2005	2006
Expenditure (volume)[1]			
Final domestic demand	1.8	2.4	1.8
Final consumption expenditure			
Households	1.9	2.3	1.3
General government	2.0	1.7	0.6
Gross fixed capital formation			
Housing	1.9	–0.7	1.0
Enterprises	4.9	7.5	9.2
General government	–8.6	–6.0	–9.8
Change in stocks[2]	–0.2	0.1	0.2
Net exports of goods and services[2]	0.8	0.2	0.8
Exports	13.9	7.0	10.4
Imports	8.5	6.2	5.3
GDP	2.3	2.7	2.8
Labour market			
Employment	0.2	0.4	0.3
Unemployment[3]	4.7	4.4	4.2
Prices and costs			
Consumer prices (CPI)	0.0	–0.6	0.3
Unit labour costs	–3.4	–1.3	–1.0
p.m. Household final consumption expenditure deflator	*–0.7*	*–1.0*	*–0.4*
Prices of imported goods and services	2.6	7.9	10.9
Terms of trade	–3.7	–6.1	–6.5
Balance of payments and budget balance[4]			
Balance of current transactions	3.7	3.7	3.8
Financing balance of general government	–6.3	–5.3	–4.6
p.m. Private savings ratio[5]	*3.1*	*2.9*	*2.9*
Gross debt ratio of general government[4]	*168.1*	*173.1*	*176.2*

Source: OECD.
(1) Calendar adjusted data.
(2) Contribution to the change in GDP, percentage points.
(3) Ratio between the number of unemployed and the labour force.
(4) Balance or outstanding total as a percentage of GDP.
(5) Net savings expressed as a percentage of net disposable income.

by a substantial gross public debt, in the order of 176 p.c. of GDP at the end of 2006; this makes public finances extremely vulnerable to the rise in long-term interest rates which will inevitably result from the gradual tightening of monetary policy.

1.4 China

China's economic growth, driven mainly by investment and exports, remained vigorous in 2006. Year-on-year GDP growth came to 10.6 p.c., slightly outpacing the rate recorded in 2005. Fears of an excessive expansion in investment prompted the Chinese authorities to tighten monetary and administrative policy and, following those measures, growth moderated somewhat during the year.

Despite the declared aim of the Chinese authorities to switch to growth based more on private consumption – one of the key objectives of the eleventh five-year plan for the period 2006-2010 –, the expansion of that expenditure component accelerated only slightly to 9.8 p.c., fuelled by the rising incomes of both urban and rural households. Investment continued to expand strongly, recording an 18 p.c. rise in 2006. Investment was encouraged not only by local government behaviour but also by the profitability of private businesses, which represent a growing share of the economy, and by strong demand for housing as a result of the rural exodus.

Export growth remained substantial, at 22 p.c., although it was down slightly against 2005. In contrast, imports expanded faster than in 2005, at 19 p.c., sustained by the vigour of domestic demand. The dynamism of exports is due to the robust demand from China's trading partners combined with a growing diversity in the range of Chinese exports. The measures taken by the EU-25 and the United States in 2005 to curb textile imports from China had only a limited effect on the growth of Chinese exports. The current account surplus continued to expand, reaching 8.3 p.c. of GDP in 2006. The development of economic activity swelled the general government budget surplus, despite some acceleration in social spending. That expenditure is particularly important in an institutional context in which uncertainty about the funding of pensions, health care and education, and the lack of access to credit, are helping to boost the household savings ratio, which stands at almost 30 p.c. of disposable income.

Inflationary pressures eased despite the rise in administered prices of petroleum products recorded during the year. That moderation was due essentially to the expansion of production capacity with, in some sectors, the presence of excess capacity leading to price falls, and productivity gains associated with the migration of workers from agriculture to industry.

TABLE 5 ECONOMIC DEVELOPMENTS IN CHINA

(percentage changes compared to the previous year, unless otherwise stated)

	2004	2005	2006
Expenditure (volume)			
Household final consumption expenditure	7.8	9.0	9.8
Gross fixed capital formation	15.1	18.2	18.0
Exports of goods and services	24.1	23.8	22.0
Imports of goods and services	21.2	13.6	19.0
GDP	10.1	10.2	10.6
Prices			
Consumer prices	3.9	1.8	1.4
Balance of payments and budget balance (1)			
Balance of current transactions	3.6	7.2	8.3
Financing balance of general government	0.0	0.2	1.5

Sources: IMF, OECD.
(1) Balance as a percentage of GDP.

After the reform of the Chinese foreign exchange regime, announced in July 2005, and the accompanying modest revaluation of the renminbi against the US dollar, the Chinese currency appreciated by only around 4 p.c. against the American currency up to the end of the year, owing to the maintenance of fairly strict fluctuation margins. The substantial accumulation of foreign exchange reserves continued during the year under review, stimulated by the growing size of the trade surpluses, to reach a record level of 1,012 billion dollars in October 2006, an increase of around 224 billion in a year. Despite stepping up its efforts, the People's Bank of China was unable to sterilise the entire expansion of the foreign exchange reserves, and the authorities took a series of additional measures to contain the liquidity in the banking system and the growth of credit. The one-year benchmark lending rate was raised twice by the People's Bank of China, by 27 basis points in April and in August, bringing it to 6.12 p.c. The latter also increased the one-year benchmark deposit rate from 2.25 to 2.52 p.c. Furthermore, the reserve requirement ratio applied to banks was gradually increased by 1.5 percentage point, to 9 p.c. These measures were supplemented by administrative rules applicable to the property sector and to new investment projects, and by rather more

informal pressure on the banks, encouraging them to restrict their supply of credit.

1.5 European Union

1.5.1 Euro area

ACTIVITY AND LABOUR MARKET

After four years of relatively sluggish activity, economic growth showed a marked acceleration in the euro area during the year under review, rising from 1.5 p.c. in 2005 to 2.6 p.c. This strengthening is largely attributable to the vigour of final domestic demand, up by 2.5 p.c., against 1.7 p.c. the previous year. Moreover, in contrast to 2005, net exports made a positive contribution to GDP growth, in the sum of 0.2 percentage point, owing to particularly dynamic foreign sales of goods and services. It was in the first half year that activity in the euro area recorded an especially strong revival, with growth rates of 0.8 and 1 p.c. respectively in the first two quarters. However, in the third quarter, growth reverted to a more sustainable rate, with a rise of 0.5 p.c. against the previous quarter, a pace which was broadly maintained thereafter. In that context, the labour market was more dynamic than it had ever been since the start of the decade.

The investment revival which, until the end of 2005, was relatively slow compared to that recorded at the time of previous economic recoveries, was one of the main factors propelling final domestic demand. Gross fixed capital formation by enterprises showed particularly strong growth of 5.5 p.c., against 3 p.c. in 2005. This upturn, which had been long awaited in view of the improvement in corporate profits and the favourable financing conditions, was accompanied by a marked rise in the capacity utilisation rate, to a level not achieved since the cyclical peak in 2000. The dynamism of investment, despite the slight tightening of financial conditions during the year under review, also reflects the notable improvement in the opinion of business leaders regarding the economic environment. At the end of 2006, business confidence in both industry and the service sector was above the average recorded in the past ten years. The robust investment was combined with the maintenance of the upward trend in lending to non-financial corporations by the financial sector.

Private investment in housing also expanded more strongly, rising by 3.7 p.c. against 2.8 p.c. in 2005. The secondary property market remained highly dynamic, although the house price data do point to some slackening of the pace of the increases in countries such as Spain and France, where prices rose by more than 10 p.c. in 2004 and 2005. The continuing very strong growth in lending to individuals for housing purchase bears witness to this dynamism, although the expansion of this lending also slowed down since May of the year under review. The falling investment in housing seen in Germany for many years also appears to have come to a halt. However, this recovery could be temporary to some extent, as German households may have brought forward to 2006 some of the house building planned for 2007, in order to avoid the rise in VAT in

TABLE 6 ECONOMIC DEVELOPMENTS IN THE EURO AREA

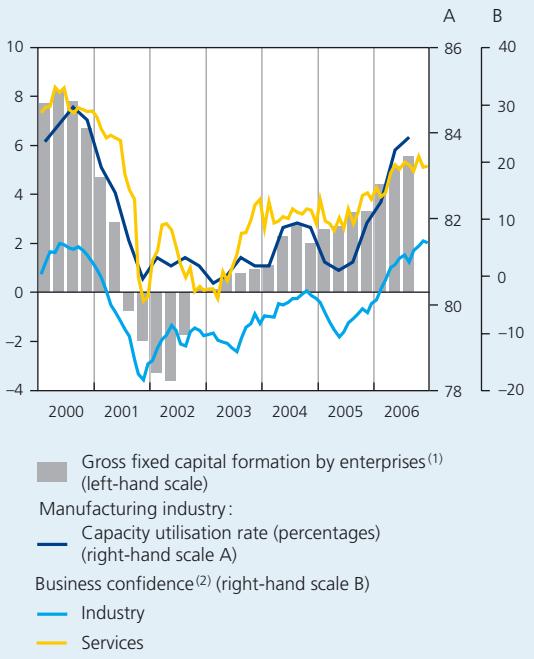
(percentage changes compared to the previous year, unless otherwise stated)

	2004	2005	2006
Expenditure (volume)[1]			
Final domestic demand	1.4	1.7	2.5
Final consumption expenditure			
Households	1.4	1.4	1.8
General government	1.2	1.3	2.2
Gross fixed capital formation			
Housing	2.8	2.8	3.7
Enterprises	2.1	3.0	5.5
General government	–1.3	1.2	1.9
Change in stocks[2]	0.2	0.1	0.0
Net exports of goods and services[2]	0.1	–0.3	0.2
Exports	6.8	4.3	7.9
Imports	6.7	5.3	7.5
GDP	1.7	1.5	2.6
Labour market			
Employment	0.7	0.7	1.4
Unemployment[3]	8.8	8.6	7.8
Prices and costs			
Consumer prices (HICP)	2.1	2.2	2.2
Unit labour costs	1.1	1.0	0.9
Prices of imported goods and services	1.5	3.6	4.5
Terms of trade	–0.4	–1.0	–1.4
Balance of payments			
Balance of current transactions[4]	0.8	0.0	–0.3
p.m. Private savings ratio[5]	*10.6*	*10.5*	*10.1*

Sources: EC, OECD.
(1) Calendar adjusted data, except for exports and imports.
(2) Contribution to the change in GDP, percentage points.
(3) Ratio between the number of unemployed and the labour force.
(4) Current balance as a percentage of GDP.
(5) Net savings as a percentage of net disposable income, except for Belgium, Spain and Portugal where the concept is on a gross basis.

CHART 6 BUSINESS INVESTMENT AND BUSINESS CONFIDENCE IN THE EURO AREA

(seasonally adjusted data)



Sources: EC, OECD.

(1) Calendar adjusted data, percentage changes in volume compared to the corresponding quarter of the previous year.

(2) Balance of replies to the monthly survey.

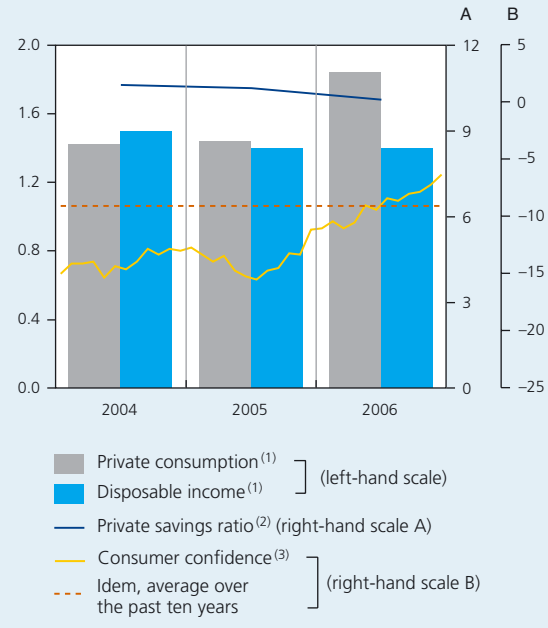
January 2007. Moreover, the abolition of house building subsidies in that country in respect of building permits issued after the end of 2005 probably stimulated demand for those permits in 2005, and that must have further reinforced construction activity in Germany during the year under review. The economic recovery in the euro area was also accompanied by a more sustained rise in public investment, of 1.9 p.c. compared to 1.2 p.c. in the previous year.

As in the previous two years, private consumption increased far more slowly than investment in 2006. While the real disposable income of households adhered to the same trend as in 2004 and 2005, the steady improvement in their confidence encouraged households to make a small reduction in their savings ratio and increase their consumption a little faster, by 1.8 p.c. against 1.4 p.c. in 2005. The rise in job creation and decline in unemployment apparently restored the confidence of households, whereas in the previous two years their morale had stagnated.

The euro area's labour market showed signs of a gradual recovery during the year under review. Employment growth accelerated from the end of 2005 to reach 1.4 p.c. in 2006, the highest rate since 2002. Jobs were created principally in the private sector, especially in the service branch. All euro area countries posted a rise in employment: the most pronounced job creation was once again recorded in Ireland, with a growth rate of over 4 p.c. The employment revival was underpinned by the strengthening economic growth in the euro area, and was amplified by the improved efficiency of the labour markets, as a result of the policies or reforms implemented by the authorities, and by the continued wage moderation.

After peaking at 8.8 p.c. in 2004, the unemployment rate of the euro area declined steadily, falling to an average of 7.8 p.c.: in December, it reached a historically low level of 7.5 p.c. This improvement was attributable mainly to the large Member States. However, the situation is still patchy within the euro area, with unemployment hovering around 4 p.c. in Ireland and the Netherlands, and running at 9 p.c. in Greece and France.

CHART 7 PRIVATE CONSUMPTION AND HOUSEHOLD CONFIDENCE IN THE EURO AREA



Sources: EC, OECD.

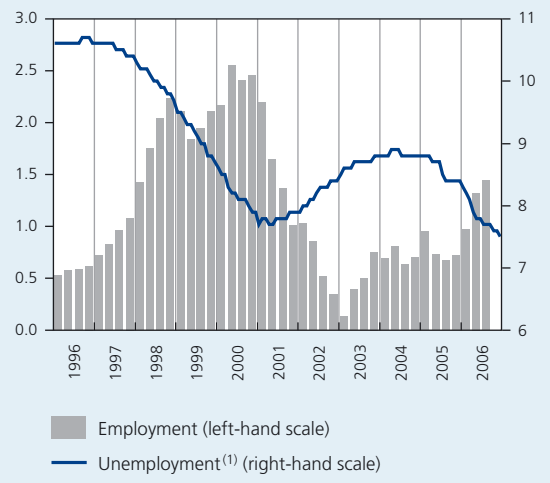
(1) Annual percentage changes in volume.

(2) Net savings as a percentage of net disposable income, except for Belgium, Spain and Portugal where the concept is on a gross basis.

(3) Balance of replies to the monthly survey, seasonally adjusted data.

CHART 8 LABOUR MARKET IN THE EURO AREA

(percentage changes compared to the corresponding quarter of the previous year, unless otherwise stated)



Source : EC.
(1) Percentages of the labour force.

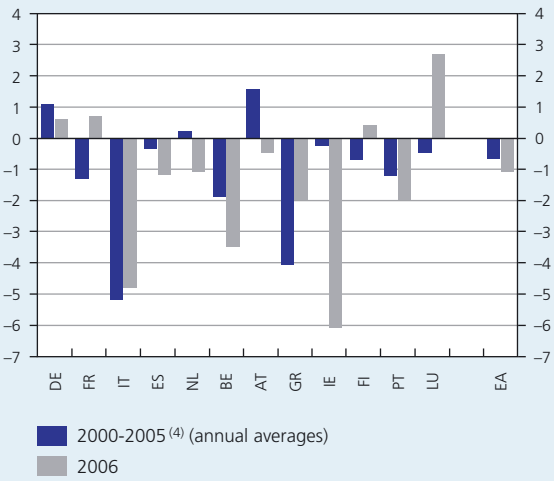
Apart from the improvement in the labour market situation, the structural reforms may also have contributed, in some countries, to the strengthening confidence and falling savings ratio of households. Thus, the pension reform in France may have strengthened consumer confidence in that country. Moreover, the surge in property and stock market prices may also have encouraged consumption expenditure by individuals.

Like public investment, public consumption expenditure expanded more strongly, by 2.2 p.c. against 1.3 p.c. in the previous year.

The growth of the euro area's exports of goods and services accelerated sharply in 2006, rising from 4.3 p.c. in 2005 to 7.9 p.c. This occurred in the context of rapid growth of the world economy and international trade, and of the euro area's export markets, especially those in Asia, the ten new Member States of the EU-25 and the oil-exporting countries. As in previous years, the expansion of exports of goods lagged behind that of the export markets. However, this erosion of the euro area's market shares masks divergent developments at the level of the Member States, owing to the uneven trends in their competitiveness and differences in the composition of exports by products and countries of destination. In particular, Germany and Italy are at the two extremes : the German economy gained market shares from 2000 to 2006, as a result of resolute wage moderation and a favourable foreign trade structure, whereas the Italian economy

CHART 9 EXPORT MARKET SHARES OF EURO AREA MEMBER COUNTRIES (1) (2) (3)

(annual percentage changes in volume)



Source : EC.
(1) Trade in goods.
(2) The euro area countries are ranked according to the size of their GDP in 2006.
(3) Ratio between exports in volume and export markets in volume, including trade within the euro area.
(4) For Belgium, BLEU up to 2003 ; for Luxembourg, 2004-2005 ; for Portugal, 2001-2005.

TABLE 7 GDP GROWTH IN THE EURO AREA COUNTRIES (1) (2)

(percentage changes in volume compared to the previous year)

	2004	2005	2006
Germany	0.8	1.1	2.6
France	2.0	1.2	2.1
Italy	0.9	0.1	1.8
Spain	3.2	3.5	3.7
Netherlands	2.0	1.5	3.0
Belgium	2.7	1.5	3.0 e
Austria	2.3	2.6	3.2
Greece	4.7	3.7	4.0
Ireland	4.3	5.5	5.1
Finland	3.3	3.0	5.0
Portugal	1.2	0.4	1.3
Luxembourg	3.6	4.0	5.2
Euro area	1.7	1.5	2.6

Sources : OECD, NBB.
(1) The euro area countries are ranked according to the size of their GDP in 2006.
(2) Calendar adjusted data.

suffered a serious decline in market shares, caused by its deteriorating competitiveness and inappropriate product specialisation. Owing to the strength of final demand, imports of goods and services into the euro area also increased at a much faster rate, with expansion up from 5.3 to 7.5 p.c.

Economic growth continued to vary between Member States of the euro area (for more details, see box 2). During the year under review, GDP growth was strongest in Luxembourg, at 5.2 p.c., while Portugal recorded the lowest figure at 1.3 p.c. Otherwise, Ireland, Finland, Greece and Spain remained among the leaders in terms of growth in the euro area. However, the divergences in GDP growth in the euro area diminished as a result of the marked economic revival in Germany and Italy, the more moderate acceleration in growth in Spain and Greece, and the slightly weaker expansion in Ireland.

Box 2 – Growth differentials in the euro area: analysis of demand

In recent years, growth differentials between Member States of the euro area have attracted much attention. The question was whether the participating countries did not feature institutional and economic differences which were too great for the Monetary Union to function properly. For each member country, the creation of the single currency meant that it no longer had a monetary policy of its own which it could use in response to shocks specifically affecting that country. Since the ECB's monetary policy is indivisible, it can only be geared to the economic developments of the euro area as a whole. In such an environment, country-specific shocks have to be absorbed by other mechanisms, such as the flexibility of the labour and product markets, or by the operation of the automatic stabilisers of fiscal policy. Differences in the movement in GDP in a monetary union are inevitable, and even desirable, if they are due to such adjustment mechanisms or if they reflect a process of catching up in terms of standard of living. On the other hand, persistent differences resulting from an inappropriate policy, structural imperfections or inefficient adjustment mechanisms, pose a threat to cohesion within a monetary union.

Measured by the unweighted standard deviation, growth differentials in the euro area have stood at around 2 percentage points since the mid 1990s, a level comparable to that in other monetary unions such as the United States. On a weighted basis, trend growth differentials have widened slightly, while cyclical differences have narrowed in recent years. The improvement in the synchronisation of the cycles may be attributed to the process of European integration, which has resulted in stronger trade links and closer coordination of policies.

Furthermore, the differences in the rate of economic expansion in the euro area are tending to persist for the majority of the euro area countries. In the past ten years, Spain has always produced stronger growth than the other large Member States while, at the other extreme, Germany and Italy have recorded expansion well below the average.

Private consumption is a key factor determining GDP growth differentials. Thus, in Germany, the weaker growth of private consumption was due primarily to a disappointing employment picture. This resulted partly from the rising labour costs in the first half of the 1990s, following German reunification. Conversely, in the Netherlands and Spain, wage moderation triggered vigorous expansion of employment. At the end of the last millennium, however, the Dutch economy suffered overheating, and that was reflected in particular in accelerating wage inflation and a loss of competitiveness.

Other factors determining consumer spending are confidence and wealth effects. Consumption expenditure is influenced by consumer confidence, or more precisely by consumers' concerns about their income prospects which, in turn, depend largely on their expectations regarding the labour market situation, the sustainability of the social security system, and the movement in the public debt. Thus, in Germany, the persistent weakness of employment growth, the wage moderation pursued for many years now, the uncertainty over the future of the

SUMMARY OF ECONOMIC GROWTH AND THE MAIN CATEGORIES OF EXPENDITURE [1] [2]

(annual averages for the period; contributions to the change in GDP in volume, percentage points, unless otherwise stated)

	GDP [3]	Total domestic demand	of which:			Net exports
			Private consumption	Public consumption	Gross fixed capital formation	
	1994-1998					
Germany	1.9	1.7	0.9	0.4	0.4	0.2
France	1.9	1.7	0.9	0.1	0.4	0.2
Italy	1.8	1.9	1.2	–0.2	0.6	–0.2
Spain	3.2	3.2	1.6	0.4	1.3	–0.1
Netherlands	3.4	3.3	1.6	0.4	0.9	0.2
Belgium	2.4	2.1	0.9	0.3	0.6	0.3
Euro area	2.3	2.2	1.1	0.2	0.6	0.1
p.m. Weighted standard deviation [4]	*1.1*	*1.2*				
	1999-2005					
Germany	1.2	0.5	0.5	0.1	–0.1	0.7
France	2.0	2.5	1.5	0.4	0.7	–0.4
Italy	1.3	1.6	0.6	0.4	0.5	–0.3
Spain	3.7	4.8	2.4	0.8	1.6	–1.2
Netherlands	1.8	1.4	0.8	0.5	0.2	0.5
Belgium	2.1	1.8	0.9	0.5	0.5	0.2
Euro area	1.9	1.9	1.1	0.4	0.5	0.0
p.m. Weighted standard deviation [4]	*1.1*	*1.5*				

Sources: EC, OECD.

(1) Calendar adjusted data.

(2) The countries are ranked according to the size of their GDP in 2006.

(3) Annual percentage changes.

(4) For the twelve member countries, percentage points.

social security system and the deterioration in public finances have possibly depressed consumer morale, and that may have further reinforced the vicious circle of weak economic growth and high unemployment. In Spain, the opposite seems to have happened, with the labour market performing well. A marked fall in the public debt may strengthen consumers' perception of their future purchasing power, and encourage them to reduce their savings ratio. Thus, the prolonged marked fall in that ratio in Belgium could be a sign of the emergence of considerations of that type, also known as "Ricardian effects", following the rigorous consolidation of public finances in the run-up to Stage Three of EMU and the ensuing relatively rapid reduction in the general government debt. Wealth effects resulting from stock market and property market developments may also have had an influence in some countries.

The divergent pattern of investment between Member States also plays a major role in the growth differentials. It seems that the uneven movements in real interest rates contributed to curbing investment in low growth/low inflation countries such as Germany, and at the same time stimulated investment, particularly in housing, in countries experiencing strong growth and rapidly rising prices, such as – among the six largest euro area countries – Spain. This pattern may be due to the convergence of nominal interest rates in the run-up to the third stage of EMU, while inflation differentials remained and, moreover, persisted thereafter. In addition, the downward trend in investment in building as a percentage of GDP is a characteristic of Germany where, for over ten years, this expenditure component has recorded almost constantly negative growth figures. This "recession" in the German construction sector is generally viewed as a lengthy process of adjustment following the emergence of excess capacity problems after German reunification.

Turning to the external sector, the contribution of net exports to GDP growth varied between the large countries of the euro area. It was mainly in Germany and to a lesser extent in the Netherlands and in Belgium, that net exports provided support for growth. The substantial contribution in Germany is due mainly to the expansion of the export volume as a result of the improvement in price competitiveness and a favourable export structure in terms of geographical markets and product specialisation. Conversely, in Italy, France and especially Spain, net exports made a negative contribution to GDP growth. In Spain, the negative contribution seems to have been caused mainly by the vigour of imports, since market shares increased substantially on the export side in the second half of the 1990s. The contribution of domestic demand to real GDP growth was also very considerable in the case of France, which thus exhibited a strong demand for imports. In Italy, the deterioration in price competitiveness and unfavourable specialisation of exports hampered the volume growth of foreign sales.

The fact that growth differentials are more apparent in domestic demand than in GDP implies that the other expenditure component, net exports, played a compensatory role. Italy is in a rather special position, since its net exports applied an additional brake to growth. The compensatory effect of net exports via changes in price competitiveness is a normal phenomenon, and is the principal mechanism correcting growth differentials in a monetary union. All other things being equal, strong expansion of domestic demand boosts imports, while pressure on prices and costs has an adverse effect on price competitiveness and export performance, and vice versa. After a time, the developments in the external sector gradually have an impact on domestic demand. However, in Germany, the restoration of price competitiveness via wage moderation from the second half of the 1990s has enhanced export performance, but until recently had no visible impact on the dynamics of domestic demand. Being so slow, this adjustment mechanism via external competitiveness does not function in an optimal way. The Member States therefore need to take structural measures to improve the efficiency of their markets and hence speed up their adjustment.

PRICES AND COSTS

Inflation in the euro area, measured by the harmonised index of consumer prices (HICP), came to 2.2 p.c., just as in 2005. During the first eight months of 2006, it fluctuated between 2.2 and 2.5 p.c., a level comparable to that observed in the final three months of 2005. From September, it dropped below 2 p.c. for the first time since February 2005, owing to a base effect caused by the rise in oil prices in September 2005 combined with the fall in those same prices following the peak at the beginning of August 2006. On average, energy prices increased by 7.7 p.c. in 2006, against 10.1 p.c. in 2005. In contrast, prices of unprocessed food recorded a sharper rise than in 2005, namely 2.8 p.c. against 0.8 p.c. That acceleration was due partly to the hot and dry weather prevailing over vast areas of Europe during the summer months.

The inflation differential between the euro area countries respectively displaying the highest and lowest rates of price increases diminished, narrowing to 2.3 percentage points. Finland recorded the lowest inflation rate, at 1.3 p.c., while the highest rate was seen in Spain, at 3.6 p.c.

Underlying inflation, i.e. inflation excluding unprocessed food and energy, increased from 1.3 p.c. at the start of the year to 1.6 p.c. in April, subsequently hovering around

TABLE 8 PRICE INDICATORS FOR THE EURO AREA

(percentage changes compared to the previous year)

	2004	2005	2006
HICP	2.1	2.2	2.2
p.m. Inflation differential in the euro area[1]	*3.1*	*3.0*	*2.3*
Underlying inflation rate[2]	2.1	1.5	1.5
GDP deflator	1.9	1.9	1.8
Compensation per employee[3]	1.8	1.3	2.0
Labour productivity	0.8	0.5	1.2
Unit labour costs[3]	1.1	1.0	0.9
Prices of imported goods and services	1.5	3.6	4.5

Sources: EC, OECD.

(1) Inflation differential between the countries with the highest and lowest rates respectively during the year in question.

(2) Measured by the HICP excluding unprocessed food and energy.

(3) Unlike the item relating to labour productivity, this item does not include information with respect to work performed by self-employed persons.

TABLE 9 UNIT LABOUR COSTS IN THE EURO AREA COUNTRIES[1]

(percentage changes compared to the previous year)

	2005	2006	Average 1999-2006
Germany	–1.7	–1.5	–0.1
France	1.8	1.7	1.9
Italy	4.1	3.7	3.0
Spain	2.5	2.5	3.0
Netherlands	–0.7	–1.0	2.2
Belgium	1.9	0.9	1.6
Austria	0.3	0.4	0.6
Greece	2.0	2.8	3.6
Ireland	4.5	5.0	3.6
Finland	1.6	–0.6	1.2
Portugal	4.2	3.2	4.0
Luxembourg	2.5	1.9	2.8
Euro area	1.0	0.9	1.6

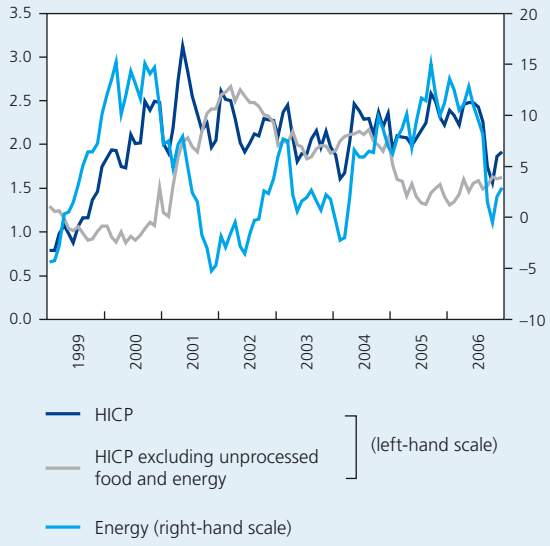
Source: OECD.

(1) The euro area countries are ranked in order of the size of their GDP in 2006.

1.5 p.c. It averaged 1.5 p.c. during the year under review, as in 2005. This relatively stable level indicates that the upward pressure on underlying inflation exerted by oil price rises remained modest overall in 2006. Moreover, several factors counterbalanced that effect: labour cost increases were relatively restrained; the strong competition, generated in particular by the emerging economies, continued to exert a moderating influence, mainly on prices of non energy industrial goods. The latter are in fact particularly affected by that competition. The increase in the prices of non energy industrial goods was therefore relatively small once again, despite a further acceleration, from 0.3 to 0.6 p.c. Moreover, in services inflation slowed down, falling to 2 p.c. Finally, the average rise in processed food prices remained unchanged overall in relation to 2005, at 2.1 p.c.

CHART 10 INFLATION, UNDERLYING INFLATION RATE AND ENERGY PRICES IN THE EURO AREA

(percentage changes compared to the corresponding month of the previous year)



Source: EC.

Overall, the difference between the headline inflation rate and underlying inflation maintained its 2005 level, namely 0.7 percentage point, but narrowed considerably from September. This is attributable mainly to the fluctuations in the prices of petroleum products and the euro.

Labour costs, measured by compensation per employee in the total economy, increased by an average of 2 p.c. in the euro area, against 1.3 p.c. in 2005. The disparities between Member States remained significant: the smallest rise (0.5 p.c.) was seen in Germany and the largest in Greece (5.2 p.c.). In Ireland, too, labour costs increased steeply, by almost 5 p.c.

Since labour productivity rose faster in 2006, by 1.2 p.c. against just 0.5 p.c. in 2005, the increase in unit labour costs was once again moderate in the euro area, at around 1 p.c. as in the previous year. The sharpest rise was recorded in Ireland, where unit labour costs were up by 5 p.c., while in Germany they declined by 1.5 p.c.

During the period 1999-2006, the euro area countries continued to display divergences in the movement in unit labour costs. Thus, the change in unit labour costs recorded in Germany and in Austria was below the euro area average in each year. Conversely, in the countries which are catching up in terms of their standard of living, and in Ireland and Italy, these costs showed a decidedly above-average increase. The divergences between movements in unit labour costs are very important, since they are one of the key determinants of a country's inflation dynamics and competitiveness.

BALANCE OF PAYMENTS

Between November 2005 and October 2006, the latest twelve months for which statistics are available, the current balance of the euro area – calculated here in such a way as to include only trade with countries outside the euro area, and excluding flows between member countries – showed a deficit of 21.9 billion euro, or around 0.3 p.c. of GDP, whereas it had recorded a surplus of 12.8 billion during the corresponding period of the previous year.

This deterioration was due essentially to the fall in the surplus on transactions in goods, down by 40.1 billion euro. Between October 2005 and September 2006, the volume of exports expanded by 7.1 p.c. against the corresponding period of the previous year, mainly as a result of vigorous global demand. During that period, the volume of imports increased by 5.9 p.c. However, this improvement in the coverage ratio was largely negated by the 5.7 p.c. deterioration in the terms of trade, caused chiefly by the rise in the prices of petroleum products and other commodities, even though that was tempered somewhat by the euro's appreciation against the dollar during the period. In consequence, the euro area's trade balance worsened, especially in relation to the OPEC countries, Russia and Africa. The deficit vis-à-vis the emerging Asian economies, and especially China, also continued to grow. In general, the penetration of imports from these countries and from the new Member States of the EU-25 has been increasing in recent years. Nevertheless, the euro area's trade surplus in relation to the new EU-25 Member States expanded, the main factor being growth differentials between these two regions.

The current account deficit was financed by an increased inflow of capital, as the financial account balance grew from 81.6 billion euro to 131.6 billion. This more substantial inflow seems to have occurred mainly in the "other investments" item, and was therefore channelled through the banking sector.

From November 2005 to October 2006, the net inflow of capital by way of direct and portfolio investment came to only 2.2 billion euro, whereas it had reached 34.2 billion during the corresponding period of the previous year; the portfolio investment surplus and the direct investment deficit contracted by around 101 and 69 billion euro respectively. Yet the scale of these fluctuations is relatively artificial since, in the previous year, a shift between these two items had amplified the balance considerably. That movement had been caused by the July 2005 restructuring of a large multinational enterprise which has its headquarters in the euro area, an operation which gave rise to an exchange of shares between the parent company

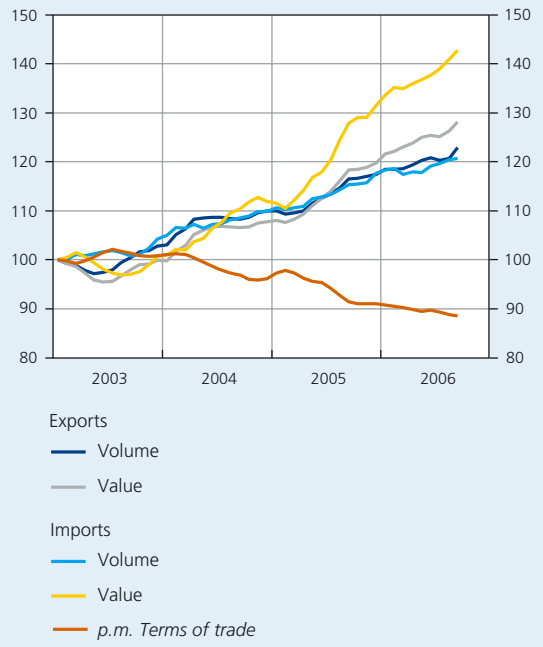
TABLE 10 BALANCE OF PAYMENTS OF THE EURO AREA
(billions of euro)

	From November 2004 to October 2005	From November 2005 to October 2006
Current account balance	12.8	–21.9
Goods	57.9	17.8
Services	32.1	36.2
Income	–11.7	–3.9
Current transfers	–65.3	–72.3
Capital account balance	13.2	9.3
Financial account balance	81.6	131.6
Direct investment	–186.9	–118.3
Equity capital and reinvested earnings	–160.1	–111.2
Other capital, mostly inter-company loans	–26.8	–7.1
Portfolio investment	221.1	120.5
Equities	179.7	151.3
Debt instruments	41.4	–30.8
p.m. Combined net direct and portfolio investment	*34.2*	*2.2*
Financial derivatives	–10.3	–0.5
Other investments (1)	46.8	119.2
Reserve assets	11.2	10.4
Errors and omissions	–107.6	–119.1

Source: ECB.
(1) Essentially, the balance resulting from the new financial liabilities of MFIs vis-à-vis non-residents of the euro area and from their formation of financial assets vis-à-vis these, excluding transactions relating to the reserve assets of the Eurosystem.

CHART 11 TRADE IN GOODS BETWEEN THE EURO AREA AND COUNTRIES OUTSIDE THE EURO AREA

(indices January 2003 = 100, three-month moving average of seasonally adjusted data)



Source: ECB.

and its foreign subsidiaries. While the inflow of capital in connection with the purchase of debt instruments totalled 41.4 billion in the twelve months up to November 2005, that was converted to a capital outflow totalling 30.8 billion in the following year, the main reason being a decline in net purchases by non-residents of securities denominated in euro. Meanwhile, net purchases of equities by foreign buyers remained at a high level of 151.3 billion, illustrating the relative improvement, during the first half of the year under review, in the profitability of firms in the euro area compared to those in the United States. Investments in marketable securities by euro area residents operated mainly in favour of the United Kingdom, the United States and offshore financial centres, while the principal beneficiaries of capital outflows in respect of direct investment were the British economy, followed by the United States and the ten new Member States of the EU-25.

FISCAL POLICY

According to the European Commission's autumn projections, the general government financing requirement declined, on average, in the euro area during the year under review, falling from 2.4 to 2 p.c. of GDP. The beneficial effects of the business cycle on social transfers were among the factors keeping public expenditure under control. The movement in revenue also benefited from the economic upturn, and from a range of other favourable factors. In all, public revenue increased from 45.1 p.c. of GDP in 2005 to 45.2 p.c., while spending declined from 47.6 to 47.2 p.c. These favourable developments amply compensated for the impact on the euro area's budget balance of the refund of part of the VAT revenue on company cars, that Italy had to pay out following the judgement handed down in September by the European Court of Justice.

Almost all the euro area countries posted an improvement in the general government budget balance, and the number of countries presenting a budget deficit in excess of 3 p.c. actually declined significantly: only Italy and Portugal still had an excessive deficit at the end of 2006. The situation in Italy is due partly to the ruling by the European Court of Justice mentioned earlier. The EC gave Portugal until 2007 to rectify its excessive deficit, and that country has already adopted a series of measures to boost tax revenues in 2006, including raising the VAT rate from 19 to 21 p.c., and restricting tax allowances. Conversely, Germany and Greece succeeded in cutting their deficits below the 3 p.c. mark in 2006, although in order to achieve that, Greece had to resort to one-off measures equalling 0.4 p.c. of GDP. As for France, the EC proposed abrogating the procedure for the correction of excessive deficits during the year under review, on being assured that the budget deficit, estimated at 2.7 p.c. of GDP, would remain below the 3 p.c. limit in 2006, with no risk of subsequent derailment. The Ecofin Council endorsed this proposal on 30 January 2007. Among the other countries, Spain, Finland and Ireland recorded budget surpluses, while the Netherlands and Belgium filed budgets which were in balance, or close to balance, although in the latter case that was due partly to the use of one-off measures once again.

With the exception of Italy, all countries achieved or even exceeded the targets set in their stability programmes, thanks to the unexpectedly vigorous growth. The difference between the targets and the projected actual figures is 1 percentage point or more in Germany, the Netherlands, Finland and Ireland. That is attributable to the particularly favourable movement in tax revenues.

In certain euro area countries, the 2006 tax revenues were boosted by above-average elasticity of revenues in relation to GDP. That high elasticity reflects a range of underlying factors: the strong rise in corporate profits, the impact on VAT revenues of the rise in petroleum product prices, the shift in private consumption expenditure in favour of

TABLE 11 FINANCING REQUIREMENT (–) OR CAPACITY OF GENERAL GOVERNMENT OF COUNTRIES IN THE EURO AREA[1][2]

(percentages of GDP)

	2003	2004	2005	2006		
				Actual figures	Stability programme target[3]	Difference
Germany	–4.0	–3.7	–3.2	–2.3	–3.3	1.0
France	–4.2	–3.7	–2.9	–2.7	–2.9	0.2
Italy	–3.5	–3.4	–4.1	–4.7	–3.5	–1.2
Spain	0.0	–0.2	1.1	1.5	0.9	0.6
Netherlands	–3.1	–1.8	–0.3	0.0	–1.5	1.5
Belgium[4]	0.0	0.0	–2.3	0.1 e	0.0	0.1
Austria	–1.6	–1.2	–1.5	–1.3	–1.7	0.4
Greece	–6.1	–7.8	–5.2	–2.6	–2.6	0.0
Ireland	0.3	1.5	1.1	1.2	–0.6	1.8
Finland	2.5	2.3	2.7	2.9	1.6	1.3
Portugal	–2.9	–3.2	–6.0	–4.6	–4.6	0.0
Luxembourg	0.3	–1.1	–1.0	–1.5	–1.8	0.3
Euro area	–3.1	–2.8	–2.4	–2.0	–2.3	0.3

Sources: EC, national stability programmes, NBB.

(1) The euro area countries are ranked according to the size of their GDP in 2006.

(2) Including, under the rules laid down for the excessive deficit procedure (EDP), net interest gains on certain financial transactions such as swaps or forward rate agreements (FRAs).

(3) On the basis of the stability programme updates at the end of 2005.

(4) The statistics shown in this table for Belgium for the period 2003-2005, like those for the other euro area countries, are the ones published by Eurostat on 23 October 2006. According to that source, the Railway Infrastructure Fund (RIF) is deemed to belong to the general government sector, and its assumption of BNRC debt in 2005 is treated as a capital transfer from the government to the non-financial corporations sector. This statistical treatment of the RIF has a negative influence on the financing balance of general government equal to 2.4 p.c. of GDP in 2005. The 2006 figure is also calculated in accordance with that methodology, but its impact – positive this time – is only about 0.05 p.c. of GDP, excluding the effect of a possible reclassification of the RIF in the corporations sector.

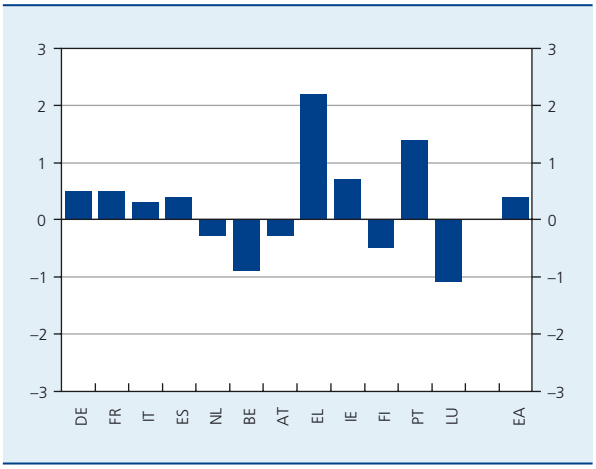
consumer durables which attract a higher average rate of VAT – that effect was particularly pronounced in the Netherlands, for example, where consumer confidence finally picked up, and in Germany, in anticipation of the VAT increase at the beginning of 2007 –, the stock market performance, and the surge in house prices in certain countries, such as Ireland. However, the experience of the 2001-2002 recession has shown that the strong growth of tax revenues generated by these factors, particularly the proceeds of corporation tax, wealth tax and, to a lesser extent, the tax on goods and services, cannot be regarded as permanent.

The uncertainty over the durability of these factors complicates the assessment of the efforts made by the Member States to achieve a structural improvement in their budget position, in accordance with their obligations under the reformed stability and growth pact. The preventive arm of the pact stipulates that Member States which have not yet attained their medium-term objective of a budget close to balance or in surplus must endeavour to improve their structural public deficit – i.e. their cyclically adjusted budget balance, net of one-off or temporary measures and factors – by an annual average of 0.5 percentage point of GDP. This benchmark of 0.5 percentage point of GDP refers to the medium term, and as a rule the effort to be made should be stepped up when the economy is doing well, in order to allow the automatic stabilisers to operate fully when economic growth falls below its potential. It is also the annual minimum adjustment required of countries with an excessive public deficit.

According to the EC's calculations, the structural budget deficit of the euro area was reduced by 0.4 percentage point of GDP during the year under review, bringing it to 1.7 p.c. That improvement is therefore slightly below the above-mentioned benchmark, a development which is all the more disappointing in that the Member States should have seized the opportunity presented by the favourable economic climate to speed up the rate of consolidation of their public finances. However, the progress made was decidedly variable between the countries of the euro area.

CHART 12 STRUCTURAL FINANCING BALANCE OF GENERAL GOVERNMENT IN THE EURO AREA [1] [2]

(change in 2006 compared to 2005, percentage points of GDP)



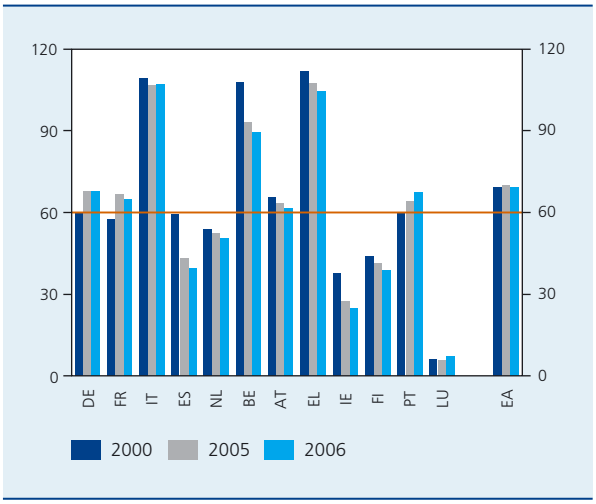
Source : EC.

(1) According to the EC, the structural financing balance of general government corresponds to the cyclically adjusted budget balance net of one-off or temporary measures and factors.

(2) The euro area countries are ranked according to the size of their GDP in 2006.

CHART 13 CONSOLIDATED GROSS PUBLIC DEBT IN THE EURO AREA [1]

(percentages of GDP)



Source : EC.

(1) The euro area countries are ranked according to the size of their GDP in 2006.

Of those recording an excessive public deficit in 2005, Greece and Portugal had agreed an adjustment procedure with the EC requiring them to aim at a structural improvement of around 1.5 percentage point of GDP in 2006, which they achieved, while Germany and Italy had been given two years to cut their structural deficits by 1 and 1.6 points respectively. Germany made the necessary effort in 2006, but Italy postponed it almost entirely to 2007. France, Ireland and Spain also made clear progress in consolidating their public finances. In contrast, the other countries made no improvement in their structural budget balance.

In contrast to previous years, the public debt ratio in the euro area declined, by around 1.2 percentage points of GDP, to 69.5 p.c. With the exception of Portugal and Italy, this improvement was evident in all countries. Nonetheless, seven of the twelve Member States recorded a debt ratio in excess of the reference value of 60 p.c. of GDP. In addition, the public debt of the member countries has remained unchanged overall in relation to the year 2000. The main reasons for this are the accommodating character of fiscal policy in France, Germany and Portugal, where the public debt has risen since then, and the slow progress with debt reduction in a number of other countries, such as Italy, Greece, the Netherlands and Austria.

In its 2006 study on the long-term sustainability of public finances in the euro area, based on new estimates of the budgetary effects of population ageing, the EC concluded that sustainability is not guaranteed at all. On the basis of the actual figures for structural primary budget balances and public debts in 2005, it shows that, even disregarding the costs of ageing, almost half of the euro area countries – Portugal, Greece, Germany, France and Italy – are liable to face an uncontrollable increase in their public debt unless they revise their fiscal policy. The long-term adverse impact of population ageing on public finances will be most marked in Luxembourg, Portugal, Ireland and Belgium. If other factors are taken into account, such as the current level of the public debt or the fiscal and parafiscal burden, the EC estimates that the risks to budgetary sustainability are high for Greece and Portugal, moderate for Belgium, Germany, France, Spain, Italy, Ireland and Luxembourg, and low for Finland, Austria and the Netherlands.

1.5.2 EU-25 Member States not belonging to the euro area and accession countries

RECENT ECONOMIC DEVELOPMENTS

With the exception of Malta, all the EU-25 Member States not belonging to the euro area recorded economic growth which was stronger than the average observed in the euro area. This applied in particular to the eight

Central and East European countries, which are in the process of catching up with the euro area, as per capita income there is significantly lower.

After exceptionally slow growth in 2005, the expansion of activity regained momentum in the United Kingdom in 2006. Private consumption was encouraged by the expansion of employment and a revival in the housing market. Business investment surged, stimulated by strong profitability and low financing costs, while public investment maintained its upward trend in accordance with the British government's policy aimed at improving or restoring the quality of public services. Apart from the rise in crude oil prices, the increase in public utility prices and the rising costs of higher education pushed up inflation to 2.3 p.c. during the year under review, i.e. above the 2 p.c. target set by the Bank of England. The opening of the borders to workers from the new EU-25 Member States prompted large-scale immigration of labour; combined with the increase in the participation rate of older workers, concerned about the amount of their retirement pension, this considerably expanded the labour supply. Although the British economy is still generating a large number of jobs, the unemployment rate increased to 5.4 p.c., though that level is still well below the figure for the euro area. Postponement of public investments previously approved helped to bring the public deficit just below 3 p.c. of GDP for the first time since 2003. On 24 January 2006, the Ecofin Council decided that the United Kingdom was in an excessive public deficit situation, and asked it to bring the deficit below 3 p.c. of GDP during the 2006/2007 fiscal year: it looks as if the country

TABLE 12 ECONOMIC SITUATION IN 2006 IN EU-25 MEMBER STATES NOT BELONGING TO THE EURO AREA[1]

	GDP in volume	HICP	Unemployment	Public finances[2]		Balance of payments current account	GDP per capital[3]
				Financing balance	Debt		
	(percentage changes compared to the previous year)		(percentages of the labour force)	(percentages of GDP)			(EU-15 = 100)
United Kingdom	2.7	2.3	5.4	–2.9	43.2	–2.5	108.1
Sweden	4.0	1.5	7.1	1.7	47.4	6.3	110.8
Denmark	3.0	1.9	3.8	3.0	29.8	1.9	114.5
Average	*2.9*	*2.2*	*5.4*	*–1.8*	*42.5*	*–1.0*	*109.0*
Poland	5.2	1.3	14.0	–4.2	49.3	–2.3	47.3
Czech Republic	6.0	2.1	7.2	–3.5	30.9	–3.1	70.5
Hungary	4.0	4.0	7.5	–10.1	67.6	–7.3	59.1
Slovakia	6.7	4.3	13.3	–3.4	33.0	–7.8	53.1
Average	*5.3*	*2.3*	*11.3*	*–5.0*	*47.0*	*–3.8*	*55.0*
Slovenia	4.8	2.5	6.0	–1.6	28.4	–1.9	76.8
Lithuania	7.8	3.8	5.9	–1.0	18.9	–8.9	50.0
Latvia	11.0	6.6	6.9	–1.0	11.1	–16.1	47.2
Estonia	10.9	4.4	5.6	2.5	4.0	–11.5	58.6
Average	*9.5*	*4.8*	*6.1*	*–0.1*	*12.9*	*–11.7*	*51.3*
Cyprus	3.8	2.2	4.9	–1.9	64.8	–6.0	76.0
Malta	2.3	2.6	7.4	–2.9	69.6	–10.9	64.4
p.m. Romania	*7.2*	*6.6*	*7.3*	*–1.4*	*13.7*	*–10.3*	*32.1*
Bulgaria	*6.0*	*7.3*	*8.9*	*3.3*	*25.8*	*–13.9*	*30.7*

Source: EC.

(1) The countries are grouped according to the size of their GDP in 2006.

(2) Excluding the revenues of defined contribution pension funds, which Eurostat authorised Denmark, Poland and Sweden to consider as public revenues up to 2007. The public debt of those countries therefore includes the financial liabilities of general government in regard to those funds.

(3) On the basis of purchasing power parities, i.e. taking account of the difference in the absolute price level between countries.

will achieve that aim, even without the constraint of possible financial sanctions.

In Sweden and Denmark, the robust economic growth was driven mainly by domestic demand, which was encouraged by the expansion of employment and the low level of interest rates, and by the continuing high level of consumer confidence, resulting from the stability of the macroeconomic environment, with low levels of inflation, large government surpluses, a modest and declining public debt and a substantial current account surplus.

Most of the Central and East European countries which joined the EU in 2004 recorded growth rates more than double the figures achieved, on average, by the euro area; in two Baltic states, GDP growth actually exceeded 10 p.c. Private consumption and investment were the factors driving this expansion. Although there were some variations in its dynamism between countries, private consumption generally grew strongly as a result of the increase in employment and household income, though credit expansion and the decline in interest rates were also contributory factors. Private investment made a substantial contribution towards growth, mainly as a result of the inflow of foreign direct investment and a surge in house building. In Poland, the growth of private consumption was curbed somewhat by the low level of consumer confidence, due to political instability, while in Hungary the fiscal consolidation tempered domestic demand.

In all these countries except Poland, inflation was generally well above the 2 p.c. mark, the reasons being dynamic domestic demand and relatively large wage increases. In Hungary, the fiscal consolidation which entailed an increase in indirect taxes and pruning of a number of subsidies, combined with the depreciation of the forint, also played a role.

As a result of strong economic growth and the emigration of workers, the unemployment rate fell significantly in the Central and East European countries, with the exception of Hungary, and this gave rise to labour shortages, especially in the Baltic States. Nonetheless, owing to drastic economic restructuring, long-term unemployment, which varied greatly from one region to another, continued to give cause for concern.

The most worrying problem is still the government financing requirement of the Visegrad countries, namely Poland, the Czech Republic, Hungary and Slovakia, which continued to exceed 3 p.c. of GDP. The EU Council had already noted an excessive public deficit in each of these four countries in 2004, but the situation has not improved in the meantime. In 2006, the position of public finances continued to show a worrying deterioration, especially in Hungary, where expenditure, particularly on health care and social benefits, seems difficult to control, and the budget targets are therefore systematically exceeded. The draconian economy measures announced by the government, such as the civil service cut-backs and the reduction in subsidies, together with the increases in indirect taxes, restrained the expansion of economic activity and stirred up some political unrest. In stark contrast to the Visegrad countries, the Baltic States recorded a small public deficit, or even in some cases a surplus.

To varying degrees, all the Central and East European countries record a substantial deficit on the current account of the balance of payments. This situation is normal, in view of their strong economic growth which not only encourages imports but also generates attractive investment returns, so that many of those countries can easily finance their current account deficit by means of foreign capital inflows. In some countries, the current account imbalances are nevertheless beginning to cause concern, because they are due more to a growing public deficit and are increasingly being financed by volatile capital flows.

Slovenia is the Member State recording the most balanced growth, with moderate inflation and sound public finances. That also explains why it was the first new Member State of the EU-25 to join the euro area on 1 January 2007.

Cyprus and Malta are more advanced new Member States and therefore benefit less from an economic catching up process. Malta had a bad tourist season in 2006, which accounts for its relatively modest economic growth rate and the large current account deficit. Moreover, Maltese public finances remained in an excessive deficit situation.

On the basis of an EC report, the Brussels European Council of 14 and 15 December 2006 decided that Bulgaria and Romania could join the EU from 1 January 2007, but subject to the application of a number of safeguard and adjustment measures. The reason for this requirement was that the improvement in the corruption situation fell short of expectations. These are two countries where per capita GDP measured in terms of purchasing power parity is one-third below the EU-15 average. Although they increase the EU's population by 6.3 p.c., with 7.7 and 21.6 million inhabitants respectively, their combined contribution to the EU's GDP is only around 1 p.c. Agriculture and industry are more important there than in the rest of the Union, while the private and public service sectors are still relatively small. These two economies have been

expanding strongly for several years, driven in particular by private consumption and even more so by private investment, but in the longer term their inadequate infrastructures, poor quality education and exodus of skilled labour could threaten continued growth.

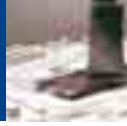
MONETARY POLICY DEVELOPMENTS

The countries which do not participate in ERM II aim solely at an inflation target, sometimes combined with an exchange rate target. The Bank of England base rate remained set at 4.50 p.c. until the beginning of August, but in view of the strength of economic growth and the rapid increase in the money supply and borrowing, which implied the risk of inflation remaining above the target for a longer period, it was raised to 4.75 p.c. from 4 August, and then increased by a further quarter of a percentage point on 9 November, bringing it to 5 p.c., its highest level since September 2001. For the same reasons, the *Sveriges Riksbank* increased its repo rate during the year in six stages, of 0.25 percentage point each, raising it from 1.50 to 3 p.c.

Poland has an inflation target of 2.5 p.c., with a 1 p.c. margin. At the beginning of 2006, in the context of favourable inflation expectations, the *Narodowy Bank Polski* was able to continue cutting interest rates, a policy which it had pursued throughout 2005. It lowered its key rate further by 0.25 percentage point on two occasions, reducing it to 4 p.c. from the beginning of March. The Czech central bank, *Česká národní banka*, succeeded in achieving its inflation target of 3 p.c., with a margin of 1 percentage point, by raising its key rate in two stages from 2 to 2.50 p.c. Finally, Hungary has an inflation target of 3.5 p.c., with a margin of 1 percentage point, and unilaterally pegged its currency to the euro, at the central rate of 282.36 forints to 1 euro. The forint depreciated by 4 p.c. against the euro between January and March, then fell again by more than 4 p.c. in June after remaining stable for a time. This sharp depreciation, and the increased volatility during the year under review, reflect the deterioration in public finances and the growing current account deficit. In this context, and in view of the worsening inflation outlook, the *Magyar Nemzeti Bank* was obliged to proceed with a substantial increase in its base rate from mid 2006, increasing it in several stages from 6.25 to 8 p.c. Since July the forint has recovered, regaining its January 2006 level by the end of the year under review.

The other countries participate in ERM II. Their currencies were stable against the euro, with the exception of the Slovakian koruna which appreciated by 9.1 p.c. The central banks of these countries adhered to the ECB's interest rate policy during the year under review.

On 11 July 2006, following favourable convergence reports drawn up on 16 May by the ECB and the EC, the EU Council decided that Slovenia would join the euro area on 1 January 2007, bringing the number of members to thirteen. The Slovenian tolar remained more or less stable against the euro, while the *Banka Slovenije* brought its key rate into line with that of the ECB in the second half of the year under review, thus reversing the cut which it had made in the first half of the year. Lithuania, which also wants to join the euro area, was faced with the problem that its inflation measured by the HICP had averaged 2.7 p.c. in the previous year, slightly exceeding the reference value, while the convergence reports pointed to a number of upside inflation risks in the years ahead.



2.

2.1 Strategic aspects

In accordance with the Treaty establishing the European Community, the principal objective of the Eurosystem's monetary policy is to maintain price stability, defined by the ECB Governing Council as an annual rise in the harmonised index of consumer prices (HICP) in the euro area of below but close to 2 p.c. in the medium term. Thus, monetary policy makes it possible to keep inflation anticipations firmly anchored, to reduce the risk premiums incorporated in long-term interest rates, and to preserve as far as possible the signalling function of relative price changes. Ultimately, all these factors contribute towards an economic environment conducive to sustainable growth and job creation.

The fact that inflation in the euro area slightly exceeded the objective in the year under review, at 2.2 p.c., is not at odds with that strategy, in view of its explicitly medium-term perspective. The Eurosystem therefore has the flexibility needed in the event of shocks to relative prices: taking account of the long and variable transmission lags, monetary policy cannot in fact prevent the direct impact of such shocks on inflation. With such a strategy, it is possible to prevent these shocks from triggering an undesirable level of volatility both for the monetary policy instrument itself, namely the key interest rates, and for economic activity. In 2006, inflation was in fact once again strongly influenced by the direct repercussions of the increase in crude oil prices, which resulted largely from the strong expansion of the emerging economies, even though that influence was partly cushioned by an opposing effect similarly originating from this process of increasing globalisation, namely the impact of imports of manufactured products from the emerging low-cost countries such as China, India and the new EU-25 Member States.

Having regard to the forward-looking nature of monetary policy, the Governing Council deemed it advisable to make gradual increases in its key rates, not so much in response to the fact that the threshold associated with price stability was once again exceeded during the period under review, but because it had become apparent that the low level of short-term interest rates implied growing risks to price stability in the medium term. The minimum bid rate for the main refinancing operations was therefore increased in five stages from 2.25 p.c. – the level which it had reached at the end of 2005 – to 3.50 p.c. in December 2006. In making these increases, the Governing Council took account of the upside risks to price stability in the medium term, revealed by the two pillars of the analytical framework of monetary policy, namely the economic analysis and the monetary analysis.

Economic analysis

Right from the start of the year under review, the Governing Council considered that the fragile recovery which had begun in mid 2005 would be maintained, and more particularly would strengthen to attain a level close to potential growth in 2006 and 2007. However, some uncertainty over the scale of this recovery still persisted at first, one reason being the discrepancy that had emerged between, on the one hand, the various confidence indicators – which predicted a vigorous revival in economic activity – and, on the other hand, the GDP figures for the final quarter of 2005, which pointed to a slight weakening of growth.

From the second quarter, this uncertainty gradually began to wane as indicators such as industrial output or retail trade confirmed the upturn in economic activity. Moreover, from the spring, the 2006 growth projections produced by the Eurosystem and by various institutions were gradually upgraded compared to those dating from the end of 2005, in stark contrast to what had happened in previous years, when the growth projections had been constantly revised downwards. Conversely, for 2007, economic activity was still predicted to expand at close to its potential level. During the first half of 2006, some forecasters did actually make small downward adjustments to their projections for 2007, mainly because of the potential impact of Germany's budgetary consolidation. In contrast, this factor had already been taken into account, in December 2005, in the projections produced by the Eurosystem.

TABLE 13 PROJECTIONS FOR GDP GROWTH AND INFLATION IN THE EURO AREA

(annual percentage changes)

	Projections for 2006				Projections for 2007		
	2nd quarter 2005	4th quarter 2005	2nd quarter 2006	4th quarter 2006	4th quarter 2005	2nd quarter 2006	4th quarter 2006
GDP (volume)							
EC	2.1	1.9	2.1	2.6	2.1	1.8	2.1
IMF[1]	2.3	1.8	2.0	2.4	2.2	1.9	2.0
OECD	2.0	2.1	2.2	2.6	2.2	2.1	2.2
Economic consensus[2]	1.9	1.7	2.1	2.6	–	1.8	1.9
SPF[3]	2.0	1.7	2.1	2.6	2.0	1.9	2.0
Eurosystem	[1.5 – 2.5]	[1.4 – 2.4]	[1.8 – 2.4]	[2.5 – 2.9]	[1.4 – 2.4]	[1.3 – 2.7]	[1.7 – 2.7]
Inflation							
EC	1.5	2.2	2.2	2.2	1.8	2.2	2.1
IMF[1]	1.7	1.8	2.1	2.3	1.9	2.2	2.4
OECD	1.3	2.1	2.1	2.2	1.6	2.0	1.9
Economic consensus[2]	1.7	1.9	2.2	2.3	–	2.1	2.2
SPF[3]	1.8	2.0	2.1	2.2	1.8	2.1	2.1
Eurosystem	[0.9 – 2.1]	[1.6 – 2.6]	[2.1 – 2.5]	[2.1 – 2.3]	[1.4 – 2.6]	[1.6 – 2.8]	[1.5 – 2.5]

Sources: EC, IMF, OECD, Economic consensus, ECB.
(1) For the 4th quarters of 2005 and 2006, the IMF projections are the ones published in September of the year in question.
(2) Averages of the forecasts produced by a panel of experts from the financial sector.
(3) Survey of professional forecasters, conducted by the ECB.

The Governing Council considered that the risks relating to this reference scenario, which predicted economic growth close to its potential level, were more or less balanced in the short term. Conversely, in the medium term this baseline scenario faced serious downside risks, connected essentially with the high oil prices, a potential resurgence of protectionist pressure and the possibility of an abrupt correction of the global imbalances, which could trigger a substantial rise in long-term interest rates and a sudden fall in the US dollar.

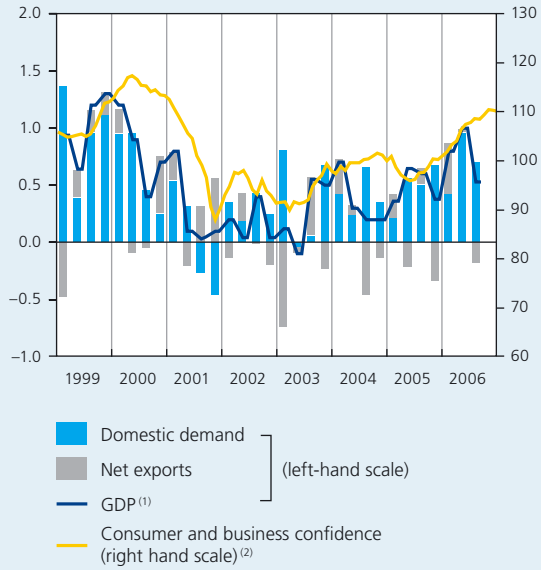
Subsequently, on the basis of the national accounts data, it became apparent that economic activity had indeed strengthened in the first half year: according to the initial estimates, which were later revised upwards, the volume of GDP had expanded by 0.6 and 0.9 p.c. respectively in the first and second quarters, clearly outpacing the rate anticipated by the various institutions in their projections. Moreover, the breakdown of GDP revealed that economic growth in the euro area during the first half of the year had been more broadly based than in the past, as domestic demand, and particularly investment, began to play an increasing role. On the other hand, in an environment in which wage increases remained moderate, the high oil prices continued to hold down the disposable income of households, and thus impeded the recovery of private consumption, which remained very modest despite a slight increase in momentum.

In this context, the Governing Council considered that the conditions remained fulfilled for a further expansion of GDP in the second half of the year, albeit at a rate closer to potential growth. Thus, the euro area's exports were set to benefit from the vigour of global demand, while investments should be able to continue taking advantage of favourable financing conditions and the improvement in corporate profitability. Private consumption was also expected to pick up, as a result of an increase in the real disposable income of households, generated mainly by higher employment.

On that basis, the projections for economic growth in 2006 were once again revised upwards in the second half of the year, mainly reflecting the better results recorded in the first two quarters. For the second half of 2006 and for 2007, however, the revisions were smaller, and growth was generally still predicted to come close to its potential level. The Governing Council confirmed that the risks surrounding the outlook for GDP growth in the short term were evenly balanced, whereas those relating to

CHART 14 ECONOMIC ACTIVITY AND CONFIDENCE INDICATORS IN THE EURO AREA

(data adjusted for seasonal and calendar effects, contribution to the volume change in GDP compared to the previous quarter, percentage points, unless otherwise stated)



Source : EC.
(1) Percentage changes compared to the previous quarter.
(2) Balance of replies to the monthly survey.

economic activity in the medium term were still oriented downwards, and were similar overall to those identified previously. In the third quarter, GDP growth came to 0.5 p.c., just short of expectations, probably as a result of a slight correction following the exceptional growth recorded in the second quarter. Nonetheless, that development did not cast doubt on the Governing Council's reference scenario which assumed that economic activity in the euro area would carry on expanding in the final quarter of 2006 and in 2007. The majority of the confidence indicators in fact continued to point steadfastly upwards in the final quarter of 2006.

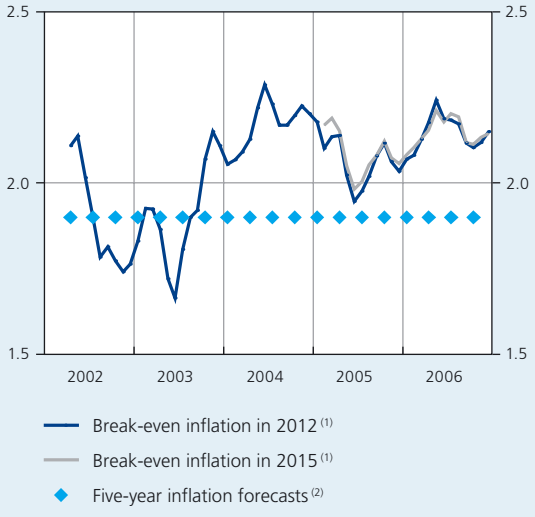
Regarding inflation, the possibility of the 2 p.c. mark being exceeded in 2006 soon became reality during the year under review. Thus, the year-on-year rise in the HICP remained well above 2 p.c. during the first eight months, peaking at 2.5 p.c. in the second quarter, the main reason being the surge in oil prices. Conversely, from September onwards inflation declined sharply, on account of the significant fall in crude oil prices on the international markets and a favourable base effect resulting from the soaring oil prices in 2005, caused by the bad weather which had hit the south-eastern United States. Having fallen to 1.6 p.c. in October, inflation gathered speed again at the end of the year, reaching 1.9 p.c. in December.

During the year under review, the Governing Council expressed its growing concern about the risks to price stability in the medium term. Since the spring, forecasters in general had also been predicting inflation of over 2 p.c. for 2007, one factor being the increase in indirect taxation in Germany. The Governing Council stated that the reference scenario for inflation, putting the figure at slightly higher than 2 p.c. in 2006 and 2007, was subject to significant upside risks, connected chiefly with a possible continuing rise in oil prices, possible additional increases in indirect taxes and administered prices, and the risk that the indirect and contagion effects, known as second-round effects, might be greater than initially predicted. A situation in which inflation exceeds the 2 p.c. mark for a lengthy period in fact implies a danger of second-round effects and the derailment of inflation expectations.

The Governing Council also considered that the said risks had become more apparent during the year under review, as the vigorous economic growth and the accompanying improvement in labour market conditions were eroding the excess production capacity and were therefore likely to encourage excessive wage increases. Thus, inflation expectations measured on the basis of indexed bonds

CHART 15 INFLATION EXPECTATIONS IN THE EURO AREA

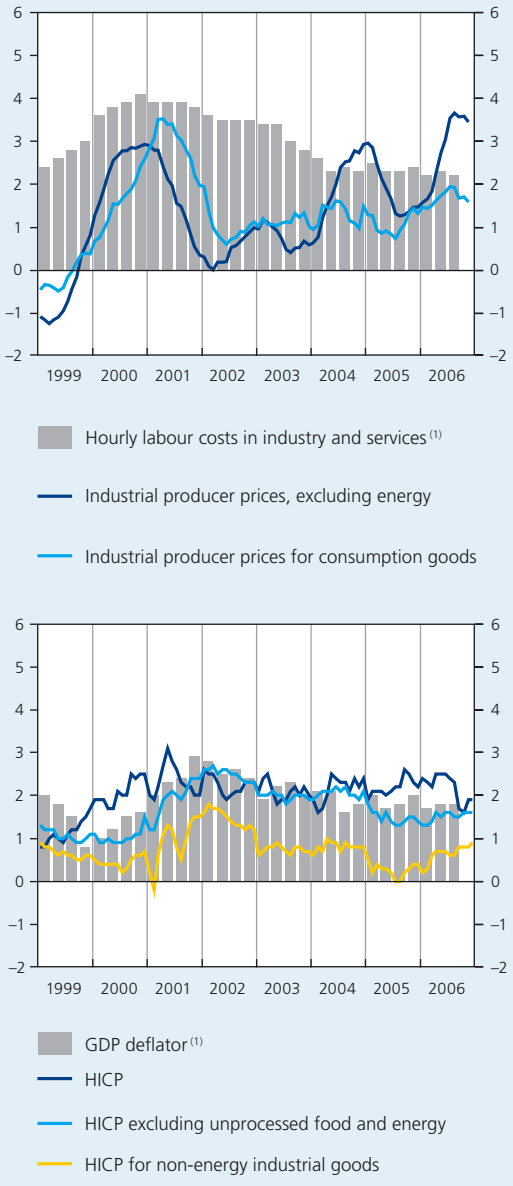
(annual percentage changes in the HICP)



Source : ECB.
(1) Break-even inflation corresponds to the difference between nominal government bond yields and yields on indexed government bonds maturing in the year mentioned.
(2) ECB survey of professional forecasters.

CHART 16 PRICES AND COSTS IN THE EURO AREA

(percentage changes compared to the corresponding month of the previous year, unless otherwise stated)



Sources : EC, ECB.
(1) Percentage changes compared to the corresponding quarter of the previous year.

showed a marked rise, peaking at 2.21 p.c. in May, then gradually easing thereafter, probably in the light of the continued tightening of monetary policy. Conversely, five-year inflation expectations measured on the basis of the ECB survey of professional forecasters remained steady at 1.9 p.c. ; however, the same survey also indicated that the probability of seeing inflation exceed 2 p.c. within five years had increased during the year. Having regard to the prospective nature of monetary policy, the Governing Council accorded more importance to the assessment of these risks to medium-term price stability than to the simple fact that, during the year under review, there had been very little actual sign of the indirect and second-round effects, as the underlying trend in inflation rate continued to hover around 1.5 p.c.

However, this relative stability in underlying inflation does not imply that the rise in the price of oil and other commodities had no impact on the prices of other goods. In that regard, the Governing Council stated that the dynamics of industrial producer prices excluding energy had greatly intensified in 2006, which suggested that the strong rise in the prices of oil and other commodities was beginning to affect later stages in the production chain, not only for intermediate products but also for consumption goods. The HICP component relating to non-energy industrial goods recorded a similar movement, even though the inflation rate for those goods remained below 1 p.c. at the end of the period, having been curbed by the impact of cheaper imports of manufactured goods as a result of globalisation.

However, inflation of domestic origin also remained modest. Measured by the GDP deflator, it averaged 1.8 p.c. over the first three quarters of the year under review. In particular, the rise in unit labour costs was moderate. This may in turn be affected by the strengthening global competition and by the impact of the structural reforms on the labour and product markets. It was also reflected in the reasonable increase in the price of services, which was close to 2 p.c.

Monetary analysis

During the year under review, the acceleration of monetary expansion, which had begun in mid 2004, continued. The growth rate of the broad monetary aggregate M3 increased from 7.7 p.c. in January to 9.7 p.c. in December. In the first half year, M3 continued to be driven mainly by the aggregate M1, which includes the most liquid components, namely notes and coins and overnight deposits. The Governing Council attributed this development essentially to the low opportunity cost of holding cash, combined with the continuing very low level of interest rates during the first half of the year.

Subsequently, despite gradually rising interest rates, the growth of M3 was unabated. A key underlying factor in this development was the low level of long-term interest rates, which encouraged the holding of shorter-term assets, some of which are included in M3, rather than financial instruments with longer maturities. However, the

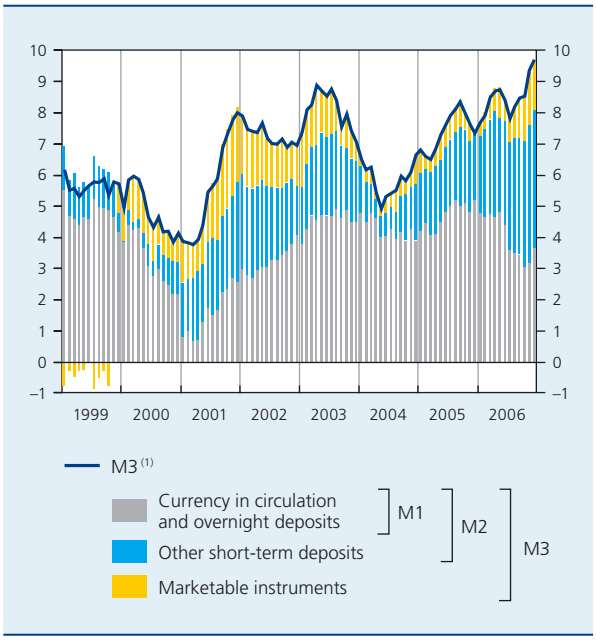
increase in the key interest rates began to influence the dynamism of the M3 components by creating a substitution effect between them. Thus, the gradual tightening of monetary policy did to some extent curb the growth of M1, which dropped from an average of 10.1 p.c. in the first half year to 7.2 p.c. in the second. Conversely, within the aggregate M2 minus M1, the expansion of term deposits with a maturity of less than two years accelerated significantly, whereas that of deposits repayable at less than three months' notice slowed down, since remuneration of those instruments was not adjusted in line with market rates, in contrast to that on term deposits (for more details, see box 3). Furthermore, the higher interest rates also increased the attraction of debt securities with a maturity of less than two years, which expanded by an average of 38.5 p.c. in 2006.

In the consolidated balance sheet of monetary financial institutions (MFIs), loans to the private sector, the main counterpart of M3, played a dominant role in the monetary dynamism in 2006. This lending recorded very vigorous expansion, increasing from 8.1 p.c. in 2005 to 10.9 p.c. in 2006, the highest rate since the start of Stage Three of EMU in 1999. However, this marked growth rate conceals divergent movements. Thus, household borrowing, while maintaining a high level, moderated somewhat in 2006. The gradual rise in mortgage interest rates and a deteriorating outlook on the housing market in certain countries were contributory factors. Conversely, the expansion of lending to non-financial corporations was particularly strong, rising from 8.6 p.c. in January to 13 p.c. in December, with a peak of 13.1 p.c. in November. Various factors contributed to this development, principally the strong economic growth and, more particularly, the strong expansion of investment, the dynamism of mergers and acquisitions and finally, the possibility that firms deemed it expedient to bring forward the financing of their investment projects, in order to take advantage of the still favourable lending conditions. The results of the Eurosystem's bank lending survey also indicate that the banks eased the criteria for granting loans. In fact, the more widespread practice of securitisation among credit institutions, the emergence of markets in credit derivatives and the revival of interest in syndicated loans made it easier for banks to manage their credit risk.

Thus, the sustained dynamism of the monetary aggregates and lending bears witness to a situation of ample liquidity, which presents risks to price stability in the longer term and amplifies the risks of imbalances on asset markets. As in 2005, the Governing Council expressed concern about this, especially in the light of the vigorous economic growth and the developments on housing markets in certain Member States of the Monetary Union.

CHART 17 M3 AND ITS COMPONENTS

(data adjusted for seasonal and calendar effects; contribution to the change in M3, compared to the corresponding month of the preceding year, in percentage points, unless otherwise stated)



Source : ECB.
(1) Percentage changes compared to the corresponding month of the previous year.

CHART 18 LOANS TO THE PRIVATE SECTOR

(percentage changes compared to the corresponding month of the previous year)

Source : ECB.

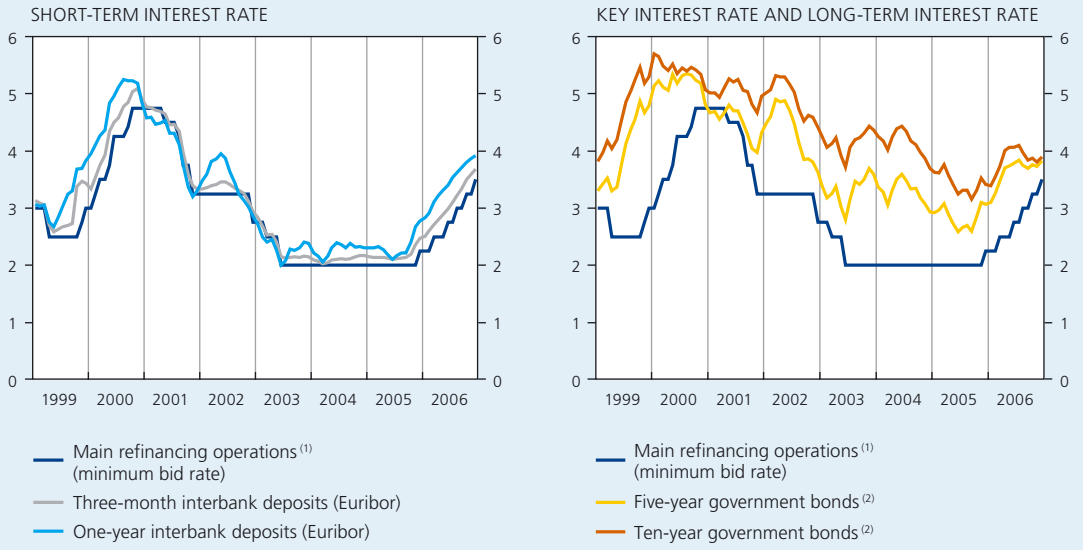
Box 3 – The transmission of the Eurosystem's monetary policy to market interest rates and bank rates in the euro area

Interest rates are one of the channels through which the central bank influences the real economic sphere. By adjusting its key interest rates – the reference rates for the interbank market – it steers money and bond market rates; however, its degree of control varies considerably according to the different maturities. A change in the rates on these markets also prompts credit institutions to make adjustments, in varying degrees, to their lending and deposit conditions, which then influence the behaviour of the economic agents as regards consumption, saving and investment. These institutions therefore generally play an important role in the efficiency of the transmission of monetary policy impulses, by determining the speed and scale with which they adjust debit and credit interest rates following a change in central bank interest rates. This box analyses two aspects: the transmission to the yield curve in the euro area of the cycle of increases in the Eurosystem's main key interest rate, which began in December 2005, and the subsequent transmission to the debit and credit interest rates applied by the banks.

On the money market, the raising of the Eurosystem's principal key interest rate, namely the minimum bid rate on the main refinancing operations, from 2 p.c. in November 2005 to 3.50 p.c. in December 2006, was accompanied by an almost identical increase in interest rates with a maturity of less than one year. The upward movement in money market rates actually anticipated the increase in the key rate, from September 2005 onward, when the ECB strengthened the tone of its communication. Transmission to longer-term rates was also evident. However, their rise, following a particularly steep fall in 2004 and 2005, was weaker in the case of the longest maturities, so that the risk-free yield curve became flatter. Thus, five-year interest rates increased by 123 basis points over the period from September 2005 to December 2006, against only 74 basis points for yields on ten-year government bonds.

TRANSMISSION OF THE KEY RATE TO MARKET INTEREST RATES FOR VARIOUS MATURITIES

(monthly averages, unless otherwise stated)



Sources: Thomson Financial Datastream, ECB.

(1) End-of-month data.

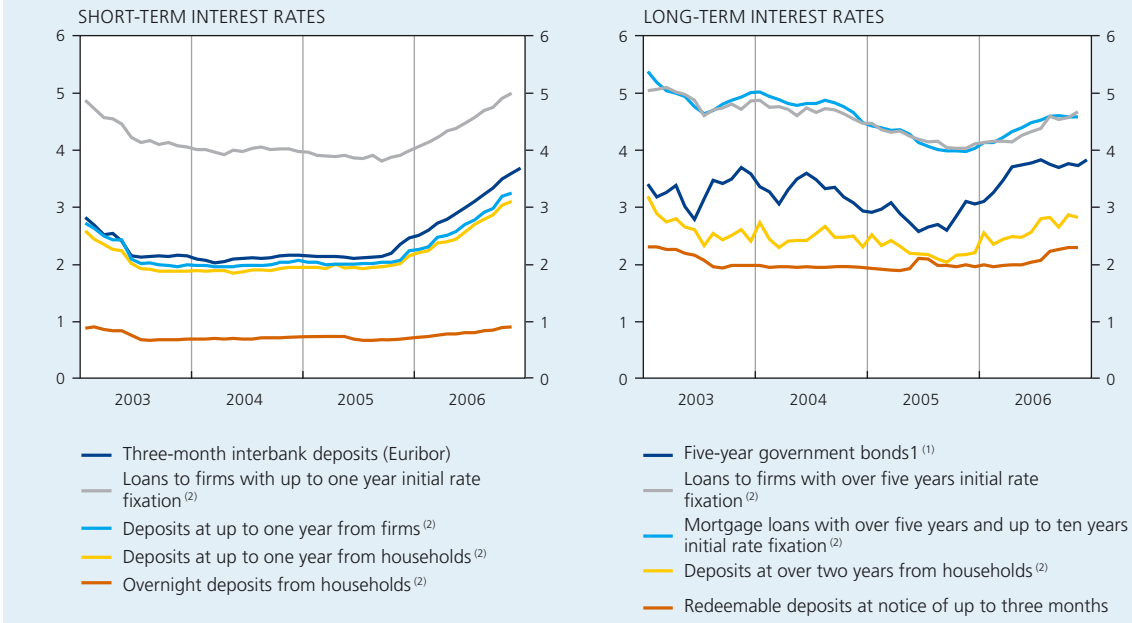
(2) Average yields on bonds issued by the Member States of the euro area, weighted by the respective outstanding amounts of public debt.

As is evident from the data on credit and debit interest rates which, when this Report went to press, were available only up to November 2006, the increase in the money market rates which began in September 2005 triggered a comparable but smaller rise in short-term rates on loans and term deposits. Moreover, the adjustment took place very quickly. Thus, when the three-month interest rate increased by 146 basis points between September 2005 and November 2006, the rates offered to business and households on deposits at up to one year were raised by 121 and 113 basis points respectively. Conversely, the interest rates on overnight deposits remained more or less unchanged, as is usually the case. The conditions for short-term loans to non-financial firms exhibited a profile broadly comparable to that of the money market rates.

In contrast, the transmission of bond market interest rates to longer-term debit and credit interest rates applied by MFIs was less complete. Over the period from September 2005 to November 2006, the rate on business loans with an initial fixed-interest period in excess of five years and the rate on mortgage loans with an initial fixed-interest period of more than five but less than ten years increased by 63 and 59 basis points respectively, while interest rates on five-year government bonds went up by 113 basis points. MFIs also made similar adjustments to the remuneration on term deposits at over two years in the case of households. Conversely, in accordance with traditional practice, the remuneration of household deposits repayable at less than three months' notice was not aligned with market conditions. The results of the ECB's Bank Lending Survey conducted among credit institutions in the euro area also reveal a reduction in their intermediation margins, on average, during 2006, except in the case of the riskiest loans, for which those margins increased.

TRANSMISSION OF MARKET RATES TO CREDIT AND DEBIT INTEREST RATES

(monthly averages)



Sources : Thomson Financial Datastream, ECB.

(1) Average of the yields on bonds issued by Member States of the euro area, weighted by the respective outstanding amounts of the public debt.

(2) MIR survey data.

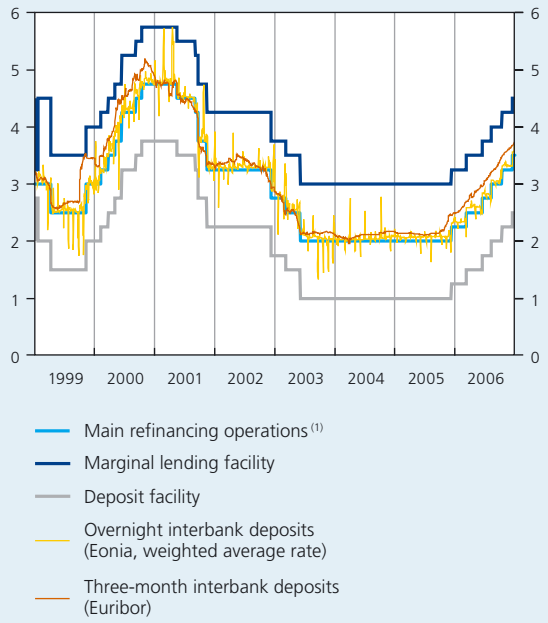
The analysis shows that, with the exception of relatively long-term bond yields, the upward movement in the Eurosystem's key interest rates which began in December 2005 was transmitted almost entirely to market rates. Conversely, MFIs did not adapt their credit and debit interest rates fully in line with market conditions during the period considered. However, the adjustment was significantly greater in the case of shorter-term banking products than for those with longer maturities.

Monetary policy decisions and monetary conditions

Following its December 2005 decision to raise the minimum bid rate on the main refinancing operations by 25 basis points, bringing it to 2.25 p.c., the ECB Governing Council continued to respond, during the year under review, to the increased risks to price stability indicated by economic and monetary analysis. Thus, in the first half of the year, it gradually adjusted the key rates of the Eurosystem, raising them by 25 basis points on two occasions, namely 2 March and 8 June. In the second half year, it saw a need to speed up slightly the adjustment to the accommodating stance of monetary policy by making three increases in interest rates, on 3 August, 5 October and 7 December. This brought the minimum bid rate on the main refinancing operations to 3.50 p.c. at the end of 2006.

CHART 19 EUROSYSTEM AND MONEY MARKET INTEREST RATES

(daily data)



Source : ECB.
(1) Fixed rate until 28 June 2000, minimum bid rate thereafter.

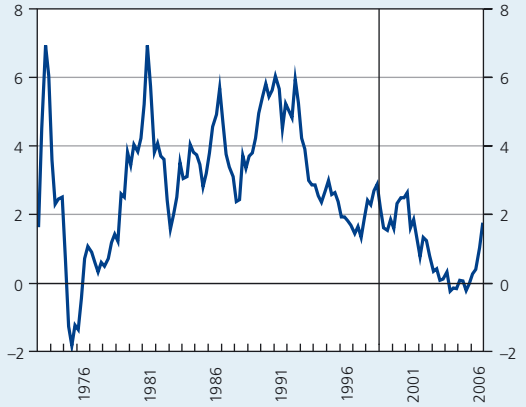
The financial markets clearly anticipated these interest rate increases, thanks to the communication by the Governing Council regarding its reference scenario for growth and inflation, the associated risks and their implications for maintaining price stability in the medium term. Between July and November, the Governing Council decided to strengthen its guidance given to market expectations by announcing a continuation of the gradual adjustments to the accommodating monetary policy stance, subject to the reference scenario materialising. However, the Governing Council did not commit itself to any particular interest rate path, in terms of either the frequency or the scale of the future increases. This communication strategy noticeably reduced the volatility on the financial markets, as is evident from the movement in three-month rates on the interbank market.

Despite the gradual tightening of monetary policy, the Governing Council considered that its stance remained accommodating throughout 2006, in view of the still historically low level of real interest rates, the vigorous growth of the money supply and credit, and ample liquidity in the euro area. In the first half of the year, real short-term interest rates, deflated by the consumer price index, increased only slightly, taking account of the surge in inflation. Conversely, in the second half of the year, owing to the easing of inflation and the continuing rise in nominal interest rates, real interest rates increased more steeply, rising from 0.3 p.c. in the first half year to 1.7 p.c. at the end of the period. Thus, real short-term interest rates in the euro area were once again positive throughout the year, after hovering around zero during the three preceding years. However, viewed from a historical perspective, real interest rates remained well below their long-term average. Moreover, taking an average for the year, they were still below any reasonable estimate of the neutral level of real interest rates.

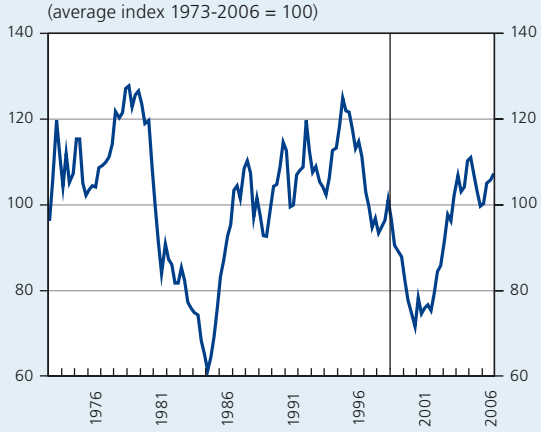
CHART 20 INDICATORS RELATING TO MONETARY CONDITIONS

(quarterly averages)

REAL SHORT-TERM INTEREST RATE IN GERMANY (1973-1998) AND IN THE EURO AREA (1999-2006) (1)



REAL EXCHANGE RATE OF THE GERMAN MARK (1973-1998) AND OF THE EURO (1999-2006) AGAINST THE US DOLLAR (2)
(average index 1973-2006 = 100)



Sources : BIS, EC, ECB.

(1) The real short-term interest rate is calculated as the difference between the three-month rate on the interbank market and the annual percentage change in the consumer price index.

(2) Nominal exchange rate of the German mark (1973-1998) and the euro (1999-2006) against the US dollar, deflated by the ratio between the consumer price indices in the United States and Germany (1973-1998) or the euro area (1999-2006).

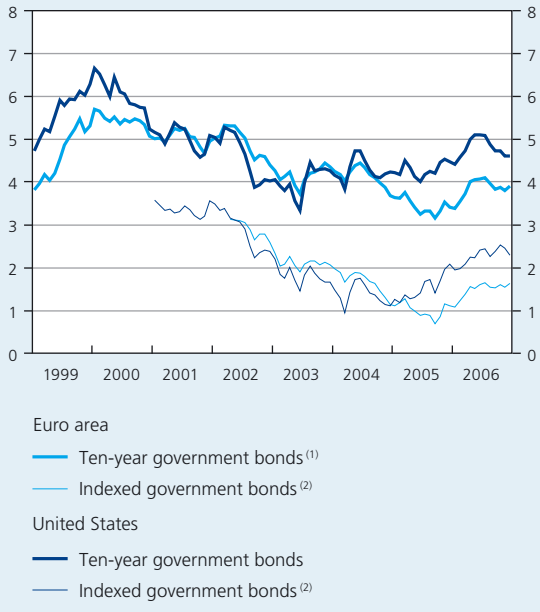
The downward movement in the euro, which had begun in the second half of 2005, was halted at the end of 2005 and gave way to a gradual appreciation of the euro's real exchange rate against the US dollar during the year under review. This mainly reflects the appreciation of the euro's nominal exchange rate against the dollar, which increased from 1.18 at the beginning of the year to 1.32 at the end of December, a rise of 11.4 p.c. As there was relatively little fear of a disorderly correction to the global imbalances, this rise was due mainly to the divergent trend in growth expectations between the euro area and the United States, and the associated monetary policy outlook. However, when these developments are viewed from a historical perspective, it is evident that the level of the euro's real exchange rate against the US dollar during the year was not exceptional. Moreover, the impact of the euro's appreciation against the dollar was attenuated by the movement in the exchange rate of the other currencies, since the nominal effective euro exchange rate rose by only 4.8 p.c. over the period.

The movements in real interest rates and in the effective exchange rate suggest that monetary policy contributed to the recovery of economic activity in the euro area during 2006. Box 4 shows that this also applied in Belgium, in that the prevailing economic conditions were comparable there.

Moreover, the low level of long-term interest rates also promoted the recovery of economic activity. Although the rise in short-term interest rates was transmitted to some extent to long-term rates, as described in more detail in box 3, the latter remained at a relatively low level throughout 2006, thus partially consolidating the steep fall seen in 2004 and 2005. As monetary policy has

CHART 21 LONG-TERM INTEREST RATES IN THE EURO AREA AND IN THE UNITED STATES

(monthly averages)



Source : ECB.

(1) Average of the yields on bonds issued by the Member States, weighted by the respective outstanding amounts of public debt.

(2) Indexed government bonds mature in 2011 and 2012 respectively for the United States and the euro area.

succeeded in firmly anchoring inflation expectations in recent years, the low level of nominal long-term interest rates essentially reflects the level of real interest rates. During the year under review, the yield on indexed bonds maturing in 2012 did increase to 1.6 p.c. in December, but was still very low in historical terms. In the United States, too, the level of real long-term interest rates remained relatively low, despite some transmission, during the year under review, of the tightening of the Federal Reserve's monetary policy. The increasing financial integration at international level in fact implies that bond market rates are determined increasingly by global factors.

The low level of real long-term interest rates seems to be attributable mainly to a reduction in the risk premiums which investors require in order to hold long-term instruments, rather than to a downward adjustment to the growth outlook. This decline in risk premiums may reflect the perception of greater macroeconomic stability, resulting partly from the credibility and increased transparency of monetary policy. Although this factor may have played a key role in explaining the downward trend in risk premiums, it still does not entirely explain the sudden acceleration in that reduction between 2004 and 2005. The low level of real long-term interest rates which persisted in 2006 therefore also reflects other factors, such as the strong demand for long-term bonds on the part of insurance companies and pensions funds, and more specifically, in the case of the United States, the recycling of the substantial surplus savings recorded by the emerging economies of Asia and the oil-producing countries in recent years.

Box 4 – The Belgian economy and the monetary policy of the Eurosystem

The primary objective of the Eurosystem's monetary policy is to maintain price stability in the euro area as a whole. Monetary policy decisions are therefore based on the economic and monetary situation in the whole of the euro area and are not geared to the situation in individual countries. The Eurosystem's monetary policy therefore cannot be used to rectify any national economic imbalances. If a Member State's performance in terms of economic growth or inflation is disappointing, that State has to take appropriate action, particularly in regard to fiscal policy, incomes policy or structural policies.

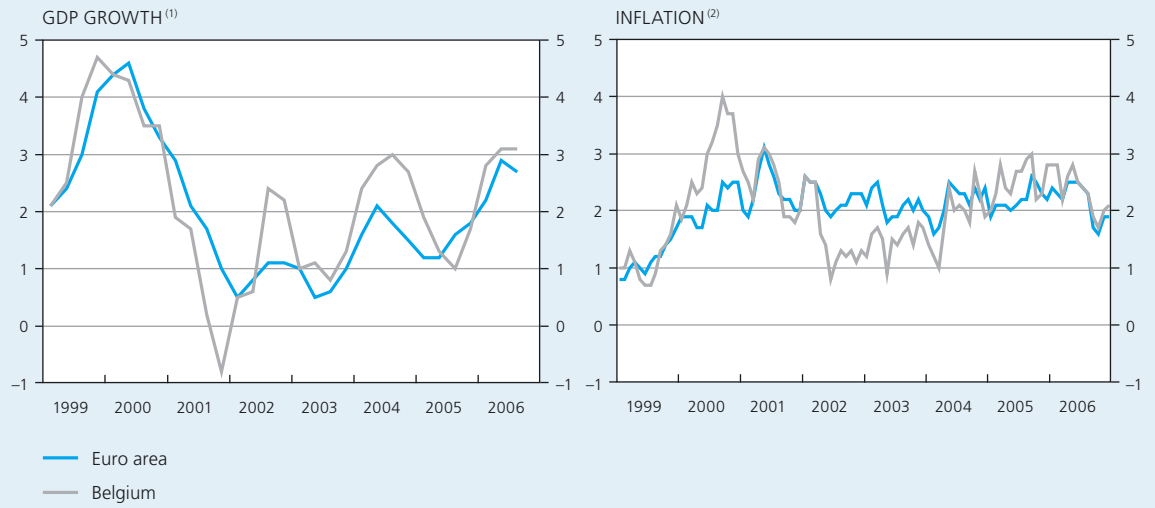
In a monetary union, the efficient operation of product, labour and capital markets plays a vital role in so far as it facilitates the adjustment to asymmetric shocks. Conversely, in the presence of wage or price rigidity, the adjustment mechanisms may prove particularly slow, thus prolonging the effects of the shocks. Furthermore, divergences in the functioning of national markets may mean that, for varying lengths of time, countries taken individually may react differently to common factors, such as monetary policy. In addition, dysfunctions in certain Member States may lie at the root of wage and price movements which are out of step with underlying economic fundamentals, and may thus lead to a loss of competitiveness and a decline in economic activity and employment. Fiscal policy may also be a source of asymmetry, particularly if it adopts a pro-cyclical stance giving rise to undesirable movements in growth or inflation. Conversely, in countries where the budget balance conforms to the medium-term objective adopted in their stability programme, the automatic stabilisers are an adequate instrument for counteracting the purely cyclical influence of idiosyncratic shocks.

This box aims to assess whether the common monetary policy has been appropriate from the point of view of the Belgian economy.

In a monetary union, it is considerably easier to conduct the common monetary policy when the business cycle among the various countries is synchronised. As a rule, the macroeconomic developments occurring in the Belgian economy are broadly similar to those in the euro area as a whole. Thus, the GDP growth rate is decidedly comparable, be it in terms of the trend or the synchronisation of the economic cycles. The year 2006 was no exception, since Belgium and the euro area both enjoyed a strong recovery in economic activity (see chapters 1 and 3).

ECONOMIC ACTIVITY AND INFLATION IN BELGIUM AND IN THE EURO AREA

(percentage changes compared to the corresponding period of the previous year)



Sources : EC, NAI, NBB.

(1) Data adjusted for seasonal and calendar effects, in volume.

(2) Excluding the estimated effect, in January and July 2000, of the fact that prices discounted in sales have been taken into account in the Belgian HICP since 2000; monthly data.

For inflation, the profiles are again very similar if one excludes temporary differences due to the greater short-term sensitivity of the Belgian HICP to fluctuations in oil prices, and those due to primarily administrative price changes. Taking account of cyclical movements, the risks to price stability were broadly similar in Belgium and in the euro area during the year under review (see chapter 5).

These macroeconomic findings were recently corroborated by more specific analyses produced by the Eurosystem Inflation Persistence Network (IPN). This temporary research network set up by the Eurosystem examined the degree and sources of inflation persistence, as well as price setting practices. The results showed that during the recent period the degree of inflation persistence in Belgium has been relatively modest, and comparable to the level seen for the euro area. Moreover, in regard to pricing, these analyses indicate that the frequency of price adjustments, which is a key determinant of the transmission of monetary policy, is not fundamentally different from that observed in the euro area as a whole. However, it is considerably lower than in the United States. In particular, the service sector seems to exhibit a lower level of price flexibility both in Belgium and in the euro area as a whole. The reason could be a degree of wage rigidity in so far as wages represent a significant proportion of that sector's production costs. The role of wages as a source of rigidity is examined by a new temporary research network created by the Eurosystem, the Wage Dynamics Network (WDN), which was set up during the year under review.

The evident similarities between Belgium and the euro area, in terms of both macroeconomic developments and price setting, show that the single monetary policy has been appropriate if it is examined from the point of view of the Belgian economy. That is due mainly to the close integration of the Belgian economy into the Monetary Union and the establishment of economic policies compatible with the operation of EMU, more particularly in regard to wage setting and public finances. However, these findings do not mean that there is no longer any challenge

ahead as regards public finances or the efficient functioning of product, labour and capital markets, be it with a view to making the Belgian economy more capable of absorbing shocks or to supporting its long-term growth potential. In fact, as demonstrated by the experience of the past eight years, the common monetary policy does not prevent certain countries from recording growth rates well in excess of those of the euro area as a whole, while still keeping control over price developments.

2.2 Operational aspects

In setting the key interest rates of the Eurosystem, and more particularly the minimum bid rate for the main refinancing operations, the ECB Governing Council decides the stance of monetary policy. In operational terms, monetary policy aims to steer the overnight market interest rate (Eonia) so as to keep it close to the minimum bid rate. The Eurosystem achieves that by determining the framework and conditions under which the banking system can refinance its structural liquidity requirement. That requirement is due to "autonomous factors", i.e. factors independent of monetary policy, such as movements in the banknotes in circulation, foreign exchange reserves or government deposits with the Eurosystem. This deficit is also enlarged by the obligation on credit institutions to maintain remunerated reserves in the form of deposits on accounts held with the national central banks.

In conducting the operational liquidity management in order to cover the needs of credit institutions, the Eurosystem assigns a key role to the main refinancing operations. In practice, these take the form of weekly allotments of one-week credit, whereby the Eurosystem temporarily makes funds available for the euro area banking system against collateral provided in the form of assets classed as eligible. These operations are crucial because, apart from the fact that the minimum bid rate signals the monetary policy stance, these allotments are also intended to cover the bulk of the refinancing needs of credit institutions in the euro area. The amounts allotted in these operations are based on the so-called reference amounts estimated in such a way as to ensure that the market is balanced in the subsequent week.

In the event of unforeseen fluctuations in liquidity, due for example to unexpected changes in autonomous factors, the reserve requirements play an important stabilising role. In fact, compliance with the obligation to maintain these reserves is only assessed on the basis of the average amount of the assets held on reserve during the reserve maintenance period which, on average, extends over four weeks. The daily balances can therefore fluctuate freely, giving credit institutions the chance to absorb temporary liquidity shocks. However, on the last day of the reserve maintenance period, the stabilising potential of the reserve requirements disappears.

In order to cope with contingencies arising on the last day of the reserve maintenance period and/or if recourse to the interbank market is no longer possible, the standing facilities system enables credit institutions to borrow or deposit funds overnight with the Eurosystem at pre-announced rates which create a symmetrical corridor of 100 basis points on either side of the minimum bid rate and represent the limits for the movement in overnight interest rates.

During the year under review, the liquidity required by credit institutions averaged 421.7 billion euro, a rise of around 12 p.c. against the previous year. After oscillating around 405 billion during the first half of the year, the liquidity requirement surged at the start of the summer, to reach an all-time high of 462 billion in July. Thereafter, while remaining fairly volatile, it declined slightly, then fluctuated around 430 billion euro in the fourth quarter of 2006.

While short-term variability is due mainly to government deposits, the upward trend in the liquidity requirement was still driven mainly by the growing demand for banknotes and the rising outstanding amount of the reserve requirements. The latter in fact increases in proportion to the expansion of the balance sheet of the banking institutions which are subject to the reserve requirement. Since the introduction of the euro notes and coins, the euro's increasing status as a reserve currency and the ever closer links with the neighbouring countries are both factors which may have contributed to the growing demand for banknotes on the part of non-residents. The existence of denominations with a much higher face value than that of the old banknotes in the national currency in the majority of the euro area countries also amplifies demand for cash. In addition, the opportunity cost of holding currency was still small in a context in which interest rates remained fairly low.

TABLE 14 CONSOLIDATED AND SIMPLIFIED FINANCIAL STATEMENT OF THE EUROSYSTEM[1]

(average of daily outstanding amounts, billions of euro)

	2004	2005	2006
Liquidity needs of credit institutions	–310.7	–376.6	–421.7
Operations unrelated to monetary policy[2]	–174.2	–230.1	–257.9
Notes in circulation[3]	–450.5	–519.6	–578.0
Gold and foreign exchange assets	302.8	296.6	329.1
p.m. Net change resulting from operations during the year[4]	*–15.1*	*–12.9*	*–9.6*
Government deposits	–53.4	–58.2	–55.6
Miscellaneous (net)	27.0	51.0	46.6
Average reserve requirement	–136.5	–146.5	–163.7
Open market operations	311.7	377.4	422.4
Main refinancing operations	241.6	289.8	307.0
Longer-term refinancing operations	70.2	87.6	115.5
Structural operations	0.0	0.0	0.0
Fine-tuning operations	–0.1	0.0	0.0
Total: residual money market surplus	**1.0**	**0.8**	**0.7**
Standing facilities	0.0	0.0	0.0
Marginal lending facility	–0.2	0.1	0.1
Deposit facility	–0.2	–0.1	–0.2
Difference between current account deposits and the average reserve requirement: surplus (–) or deficit	–1.1	–0.8	–0.7

Source: ECB.

(1) A plus sign indicates a Eurosystem asset, which is a factor expanding liquidity; a minus sign indicates a Eurosystem liability, a factor reducing liquidity.

(2) Including debt certificates issued and securities acquired before 1 January 1999.

(3) Excluding old national currency banknotes still in circulation, which come under "miscellaneous (net)".

(4) Difference at the end of the year compared to the situation as at 31 December in the previous year, in billions of euro. Excludes quarterly revaluations.

The increase in the average outstanding amount of net assets in gold and foreign exchange during the year under review essentially reflects the quarterly accounting revaluations resulting from movements in the price of gold and the euro exchange rate. These have no effect on liquidity needs since they are neutralised by the revaluation accounts, which are recorded under the "miscellaneous (net)" item in the simplified financial statement of the Eurosystem. Excluding revaluations, the average outstanding amount of the net assets in gold and foreign exchange declined, the main reason being the repayment of claims by the IMF and sales of gold conducted under the agreement on gold assets concluded on 8 March 2004 by fifteen European central banks.

In accordance with the principle of neutrality which the Eurosystem applies to its liquidity management policy, with the aim of avoiding any systematic bias in the use of the marginal lending facility or the deposit facility, the open market operations covered more or less the whole of the refinancing needs of the euro area's banking sector, essentially via the main refinancing operations and to a lesser extent via the longer-term refinancing operations. The purpose of the latter is to offer a stable source of finance, particularly for credit institutions of modest size. Twelve operations of this type, which take the form of monthly allotments of three-month credit, were conducted in 2006. The Governing Council also decided to increase the amount allocated under these operations from 30 to 40 billion euro with effect from 26 January 2006. This increase was designed to take account of the larger refinancing requirement of the euro area's banking system in 2006, but without calling into question the key role played by the main refinancing operations.

From the beginning of January to the end of December, The Eurosystem conducted fifty-two main refinancing operations for an average volume of just over 307 billion euro. With the aim of reducing the spread between the overnight rate and the minimum bid rate, while

CHART 22 OPERATIONAL CONDUCT OF THE EUROSYSTEM'S MONETARY POLICY IN 2006

(daily outstanding amounts, billions of euro, unless otherwise stated)

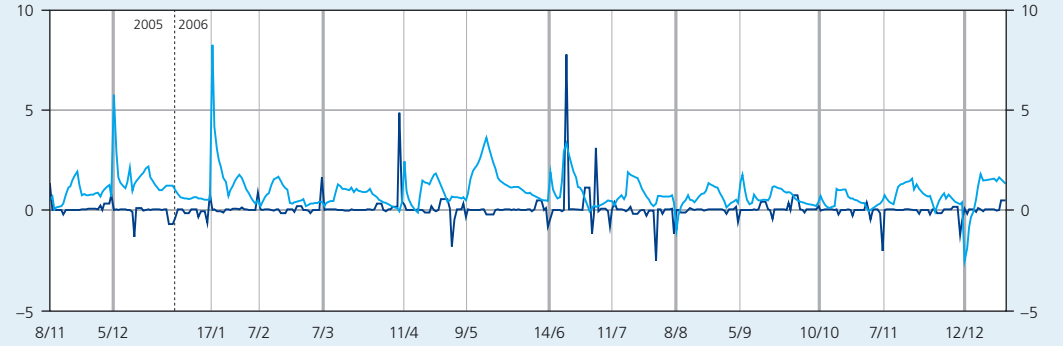
LIQUIDITY REQUIREMENT AND OPEN MARKET OPERATIONS

Eurosystem's open market operations (left-hand scale)

Liquidity needs increased by the reserve requirement (right-hand scale)

Last day of the reserve maintenance period; shown in bold if followed by an increase in the key interest rates

COVERAGE OF THE RESIDUAL MONEY MARKET BALANCE

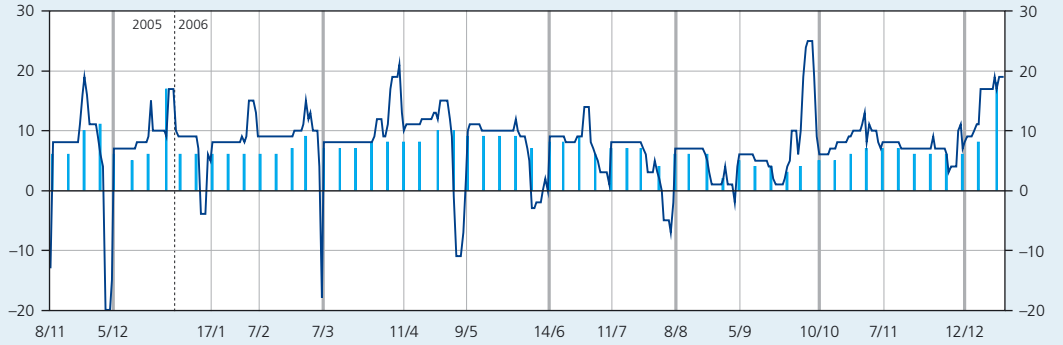


Net recourse to the standing deposit and marginal lending facilities (–)

Cumulative surplus or deficit (–) of current account deposits as a percentage of the reserve requirements

Last day of the reserve maintenance period; shown in bold if followed by an increase in the key interest rates

INTEREST RATE SPREADS IN RELATION TO THE MINIMUM BID RATE
(basis points)



Weighted average rate on overnight interbank deposits (Eonia) (1)

Weighted average rate of the main refinancing operations (1)

Last day of the reserve maintenance period; shown in bold if followed by an increase in the key interest rates

Source : ECB.
(1) Daily data.

maintaining the money market in balance, the Eurosystem continued its generous allotment policy between January and April, allocating a liquidity volume slightly greater than the reference amounts announced prior to each weekly tender. From 27 April until 30 August, this policy was accentuated and extended to all the main refinancing operations, including the last one in each reserve maintenance period, which had not previously been the case. Thereafter, this policy became gradually less generous once again, and was then suspended at the end of September before being re-applied from November, always in accordance with the ECB's assessment of the movement in the interest rate differential in question and the market liquidity situation.

Furthermore, in 2006 the Eurosystem had systematic recourse – except in November – to fine-tuning operations on the last day of each reserve maintenance period, in order to improve the stability of the overnight rate. The Eurosystem had made use of this tool on only nine occasions in 2005 and three in 2004. This development is due to changes made in March 2004, which extended the time between the settlement day of the last main refinancing operation in a reserve maintenance period and the end of that period. That extension implies a greater risk of an accumulation of unexpected imbalances in money market liquidity conditions, which, at the end of the reserve maintenance periods, may lead to a marked difference between the overnight rate and the minimum bid rate. To avoid that, the Eurosystem intervened on eleven occasions during the year: it injected 7 billion euro into the market on 17 January, 6.5 billion on 7 February, 26 billion on 11 April, 9.5 billion on 10 October and 2.5 billion on 12 December. On six occasions, it withdrew liquidity: 2.6 billion euro on 7 March, 11.5 billion on 9 May, 4.9 billion on 14 June, 8.5 billion on 11 July, 18 billion on 8 August and, finally, 11.5 billion on 5 September.

The implementation of the operational framework of monetary policy was successful in that the interest rate differential mentioned above only very rarely exceeded 20 basis points in absolute terms. Historically speaking, this is a very small spread, especially as there were a number of changes to the key rates in 2006; before the March 2004 reforms, such changes were often accompanied by periods of volatility in the interest rate spread well in excess of that value. Moreover, in 2006 the spread never exceeded 18 basis points, in absolute value, on the last day of the reserve maintenance periods, a time which is by definition far more sensitive to unforeseen fluctuations in liquidity conditions. In the past, and in the absence of systematic fine-tuning operations, that was precisely the day on which any imbalances had the greatest impact on the rate differential, since they could no longer be smoothed out by the stabilising function of the reserve requirements, so that operators had little choice: make use of the standing facilities at rather unfavourable interest rates, or go to the market where the rate was adjusted accordingly, thus diverging from the minimum bid rate. During the year under review, there was also a decline in the use of the net standing facilities on the last day of the reserve maintenance period, whereas on average, the use of the two facilities combined tended to increase slightly over that period as a whole.

3.

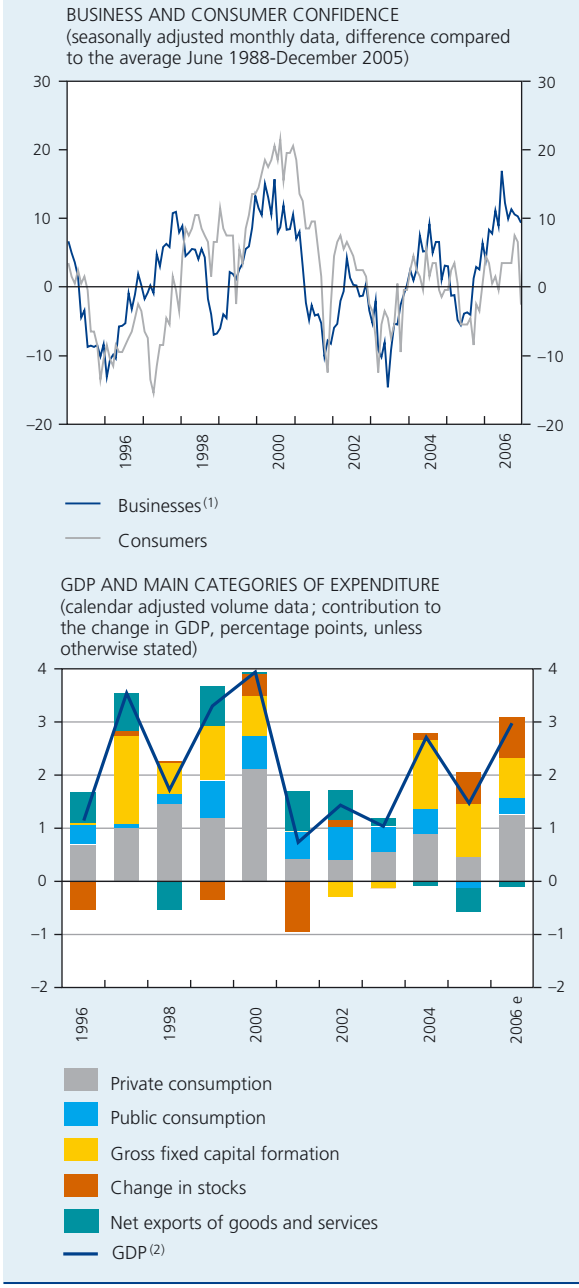
3.1 Summary

In Belgium, the notable strengthening of activity at the end of 2005 was consolidated during the year under review. Thus, GDP growth doubled in relation to the previous year, reaching 3 p.c. This was the highest growth since the start of the decade, and also outstripped the average for the euro area, as it had from 2002 to 2004.

This dynamism was fostered by a buoyant external environment. First, Belgium benefited from the vigorous growth of its main export markets, namely that of the euro area, a region which made a greater contribution than in 2005 to the expansion of the global economy, and of the other EU-25 countries. The Belgian economy, like that of the other European countries, was less affected than in previous years by adverse shocks. As an annual average, the euro exchange rate hardly changed during the year under review, while the rise in oil prices slowed down, amounting to around 20 p.c. in 2006, following the correction after the summer. Finally, on the financial markets, long-term interest rates remained at a low level, and stock market prices rose resolutely, with little volatility.

In this favourable context, activity growth was broadly based. For two years, in the aftermath of the cyclical downturn in 2001, businesses had been very reticent in their recruitment and investment decisions, in order to maintain their productivity and improve their profitability and their financial position, but were now the first to participate fully in the recovery. Following a temporary dip at the end of 2004 and the beginning of 2005, when industrial activity and exports had faltered for a short time in the euro area, business confidence as reflected in the overall synthetic business survey indicator staged a strong recovery in the second half of the year, in line with the general upward trend of the last four years. In 2006, consumer confidence strengthened in its wake, though it was dented temporarily in December by the announcement of a major company's restructuring.

CHART 23 THE BROADENING BASIS OF GROWTH



Sources: NAI, NBB.
(1) Overall synthetic business survey curve, gross series.
(2) Annual percentage changes.

Thus, the growth of value added was spread across the various branches of activity, with demand of all the Belgian economic agents providing balanced support. Business and household investment which, together with public investment, had already played a substantial part in economic growth in 2004 and 2005, once again made a significant contribution in 2006. Households and general government also stepped up their consumption expenditure. Finally, as in the previous year, the contribution of the change in stocks was considerable. Conversely, that of net exports of goods and services was negative, though much less so than in 2005.

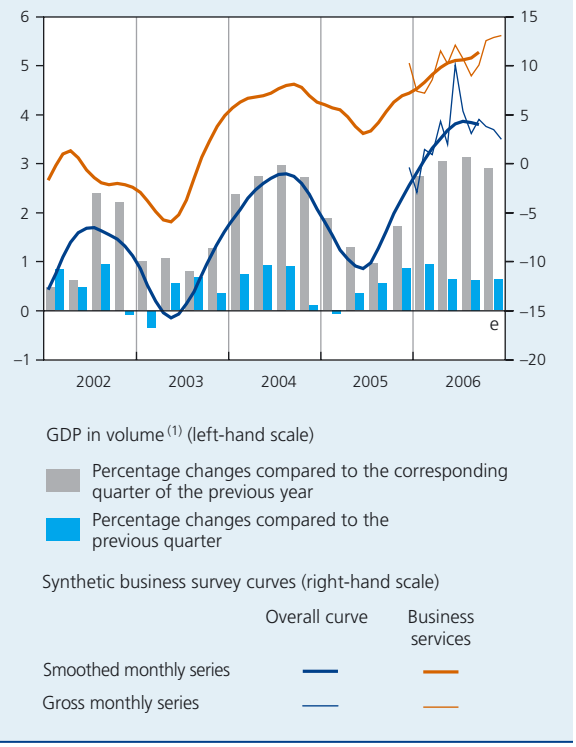
3.2 Activity

After four quarters of weak economic activity, a situation also seen in the euro area and connected both with the earlier currency appreciation and the soaring prices of energy and industrial commodities, GDP growth accelerated sharply at the end of 2005 and in the first quarter of the year under review. Year-on-year, the activity expansion then came to around 3 p.c. On a quarterly basis, the rate of expansion was sustained throughout the year, although it did ease slightly, reverting to a level close to the economy's potential, as the cyclical catching up effects waned.

The robustness of the growth was endorsed by the movement in business confidence, as measured by the Bank's overall synthetic indicator. After a low point in June 2005, that confidence increased steadily. Twelve months later, the gross indicator actually reached the highest value ever attained since the current method of calculation came into use, i.e. since 1980. In the ensuing months, it still remained at a high level, reflecting favourable conditions in the branches which it covers, namely

CHART 24 GDP AND BUSINESS SURVEY INDICATORS

(seasonally adjusted data)



Sources : NAI, NBB.
(1) Calendar adjusted data.

TABLE 15 VALUE ADDED IN THE BRANCHES OF ACTIVITY

(calendar adjusted volume data ; percentage changes compared to the previous year, unless otherwise stated)

	p.m. Weight (1)	2002	2003	2004	2005	2006 (2)
Agriculture	*1.2*	4.4	–7.5	7.2	7.7	–3.0
Industry	*19.4*	–0.9	–1.3	3.0	0.1	2.0
Construction	*4.9*	–1.5	1.2	4.6	1.8	8.2
Services	*74.6*	2.1	2.1	1.7	1.8	2.6
of which : market services (3)	*51.3*	2.5	2.4	1.7	2.3	3.3
Total	***100.0***	**1.3**	**1.2**	**2.1**	**1.5**	**2.7**
p.m. GDP		*1.4*	*1.0*	*2.7*	*1.5*	*3.0*

Source : NAI.
(1) Percentages of total value added in 2005.
(2) First nine months of 2006, compared to the corresponding period of the previous year.
(3) Trade, transport and communication, financial and insurance services, and real estate and business services.

industry, construction and trade. The business services confidence indicator, which is not included in the overall synthetic indicator, also shows a constant strengthening of activity in that branch from mid 2005. However, the cyclical downturn had been less pronounced there than in industry.

Excluding agriculture, all branches contributed to the recovery and the vigour of activity in 2006. In contrast to the previous year, industry made a significant positive contribution to economic growth, with value added up by 2 p.c. during the first nine months, whereas it had stagnated in 2005. The acceleration persisted during the year, so that the capacity utilisation rate rose sharply.

In 2006, construction was the most dynamic branch of activity since its value added increased by 8.2 p.c. over the first nine months of the year. Thus, having already made a modest contribution to the economy's expansion in 2005, with volume growth of 1.8 p.c., it was one of the drivers of the acceleration in 2006.

Services, which represent around three-quarters of value added in Belgium, also played a part in the upswing, recording growth of 2.6 p.c. for the first three quarters of 2006, against 1.8 p.c. for 2005 as a whole. Market services were particularly dynamic: trade, transport and communication activities, which had seen an overall decline in value added in 2005, were back in growth, while the rate of expansion in financial, real estate and business services, which had hardly been affected by the weakness of economic activity in 2005, was maintained throughout the year under review.

3.3 Real developments in the main sectors

Enterprises

Having made significant adjustments following the bursting of the stock market bubble and the widespread slowdown in economic activity in 2001, leading to an increase in the gross operating surplus of 3 percentage points of GDP over the period 2002-2006, enterprises gradually expanded their production capacity from 2004. That process was consolidated in 2006, with a further increase in their gross fixed capital formation of 4.4 p.c. in real terms. The gross investment ratio of enterprises thus improved by 1.1 percentage point of GDP from 2004 to 2006, following a 0.9 point decline overall in the previous two years, to reach 13.6 p.c., a high level close to that of the early 1990s.

While in 2004 and 2005, the investment recovery had been started by service enterprises, mainly large companies active, in particular, in the maritime transport

TABLE 16 GDP AND MAIN CATEGORIES OF EXPENDITURE

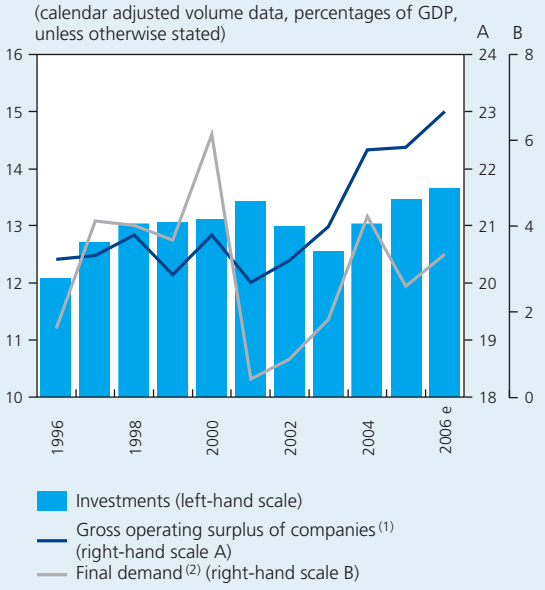
(calendar adjusted volume data; percentage changes compared to the previous year, unless otherwise stated)

	2002	2003	2004	2005	2006 e
Final consumption expenditure of individuals	0.7	1.0	1.6	0.8	2.4
Final consumption expenditure of general government	2.9	2.2	2.1	–0.6	1.3
Gross fixed capital formation	–1.5	–0.7	6.9	5.2	3.8
Housing	–0.8	3.6	9.0	3.5	4.8
Enterprises	–1.9	–2.3	6.7	4.8	4.4
General government	0.7	0.7	2.9	13.5	–3.0
p.m. Total final domestic expenditure	*0.8*	*0.9*	*2.8*	*1.4*	*2.4*
Change in stocks[1]	0.1	0.0	0.1	0.6	0.8
Exports of goods and services	0.8	2.9	5.7	3.3	3.4
Imports of goods and services	0.2	2.8	6.2	4.1	3.7
p.m. Net exports of goods and services[1]	*0.6*	*0.2*	*–0.1*	*–0.4*	*–0.1*
GDP	1.4	1.0	2.7	1.5	3.0

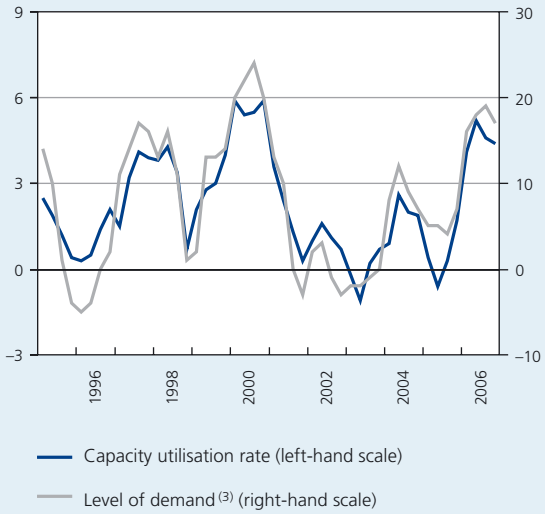
Sources: NAI, NBB.
(1) Contribution to the change in GDP.

CHART 25 INVESTMENTS BY ENTERPRISES

ENTERPRISES AS A WHOLE: MOVEMENT AND DETERMINANTS
(calendar adjusted volume data, percentages of GDP, unless otherwise stated)



MANUFACTURING INDUSTRY: CAPACITY UTILISATION RATE AND LEVEL OF DEMAND
(seasonally adjusted quarterly data, difference compared to the average 1980-2005, percentage points)



Sources: NAI, NBB.
(1) Value data, not calendar adjusted.
(2) Percentage changes compared to the previous year.
(3) Proportion of firms which did not mention a shortage of demand as a factor explaining the under-utilisation of production capacity in the Bank's quarterly survey of manufacturing industry.

branches, and more generally in logistical services, the majority of the branches of activity contributed to the vigour of investment in 2006. According to the information contained in VAT returns and the results of the Bank's half-yearly survey, manufacturing industry was no exception to this trend, whereas its gross fixed capital formation had contracted by over 15 p.c. between 2000 and 2005.

With the waning of the factors of uncertainty which had undermined the economic environment in preceding years, investment responded fully to the favourable demand conditions. In manufacturing industry, capital replacement and expansion were encouraged by the steep rise in capacity utilisation rates, which increased from 78.2 p.c. in the second quarter of 2005 to 84 p.c. a year later, the highest level since the end of 2000, before dropping back to around 83 p.c. in the last two quarters of 2006. The proportion of firms mentioning a shortage of demand as a factor explaining the under-utilisation of capacity fell sharply over the same period, reaching a low point in the third quarter.

Generally speaking, apart from demand, financing conditions also stimulated investment during the year under review. As regards external financing, stock market prices once again increased, as an annual average, with the Belgian All Shares index recording a rise of 24.1 p.c. in 2006. For their part, nominal interest rates remained at historically low levels, despite edging upwards slightly.

Turning to internal financing, the gross operating surplus of companies grew faster than GDP for the fifth year in a row. Its share of GDP, which had ranged between 20 and 21 p.c. from 1995 to 2002, thus increased steadily to reach 23 p.c. in 2006. According to the information available in the national accounts since 1995, and on the basis of comparable information extrapolated back to 1980, it thus surpassed, from 2004 onwards, the previous peak of 21.8 p.c. reached in 1989.

This movement parallels the general improvement in corporate profitability and solvency in recent years, evident from the accounting data. As described in more detail in box 5, the movement in the ratios for the situation of Belgian non-financial corporations shows that their balance sheets and profit and loss accounts have noticeably improved since 2002.

After a temporary loss of momentum in 2005, the growth rate of the gross operating surplus returned to a sustained level of 8.1 p.c. in 2006. The upturn in economic activity was reflected in an increase in the volume of sales and the restoration of labour productivity, which had deteriorated in 2005, so that the rise in unit labour costs was limited. In addition, the increase in import costs, propelled in particular by the rising commodity prices, was accompanied by a faster rise in export prices, leading to a slight improvement in the terms of trade

TABLE 17 COMPANIES ACCOUNT:
MAIN COMPONENTS AND DETERMINANTS OF THE GROSS OPERATING SURPLUS, AT CURRENT PRICES

	2002	2003	2004	2005	2006 e
Determinants of the gross operating surplus of companies (percentage changes compared to the previous year)					
Gross operating surplus	5.3	5.6	12.2	3.3	8.1
Gross operating margin per unit of sales[1]	4.5	3.5	7.0	0.9	4.1
Unit selling price[1]	0.2	–0.3	2.6	3.1	3.1
On the domestic market[1]	0.9	1.7	2.7	2.3	1.7
Exports	–0.5	–2.2	2.5	3.8	4.4
Costs per unit of sales[1]	–0.4	–0.9	2.0	3.4	2.9
Imported goods and services	–1.2	–2.0	2.8	4.6	4.0
Costs of domestic origin per unit of output[1][2]	0.8	0.2	0.3	1.4	1.0
of which: unit labour costs	1.3	–0.1	–0.8	1.9	0.5
Final sales in volume	0.8	2.0	4.9	2.4	3.8
On the domestic market[1]	0.4	1.1	3.8	1.9	3.9
Exports	1.2	2.9	5.9	2.8	3.7
Main components of the companies account (percentages of GDP)					
Gross disposable income					
Gross operating surplus	20.4	21.0	22.3	22.4	23.0
Other components of gross disposable income[3]	–8.2	–7.2	–7.7	–8.8	–9.2
Uses					
Gross capital formation	12.2	12.2	13.2	13.5	14.1
Capital transfers[4][5]	–0.4	0.7[6]	–0.2	–0.4[7]	–0.8
Financing balance	0.4	0.9[6]	1.6	0.5[7]	0.5

Sources: NAI, NBB.

(1) Including changes in stocks.

(2) Apart from compensation of employees, this item covers indirect taxes net of subsidies and gross mixed income of households.

(3) Net property incomes and net current transfers, including changes in the net claims of households on pension funds.

(4) These are net amounts, i.e. the difference between transfers paid to other sectors and those received from other sectors.

(5) Including net acquisitions of non-financial non-produced assets. These comprise, for example, land or patents and goodwill.

(6) Including the capital transfer of 1.8 p.c. of GDP effected by Belgacom in return for the government's assumption of its pension liabilities.

(7) In accordance with the data published by the NAI, excluding the capital transfer of 2.4 p.c. of GDP effected by the Railway Infrastructure Fund (RIF) in favour of the BNRC in respect of the assumption of its debt, as these two entities come under non-financial corporations. According to Eurostat, the RIF is part of the general government sector, and this debt assumption should be recorded as capital received by non-financial corporations from the government sector.

during the year under review, after a deterioration in the three preceding years.

While the expansion of their gross operating surplus enabled companies to increase their capacity to finance the other sectors of the economy from 2002 to 2004, that has not been the case in the past two years, as enterprises have devoted more of their additional resources to the payment of taxes and dividends and to expenditure on gross fixed capital formation. Their financing capacity thus declined from 1.6 p.c. of GDP in 2004 to 0.5 p.c. in 2006.

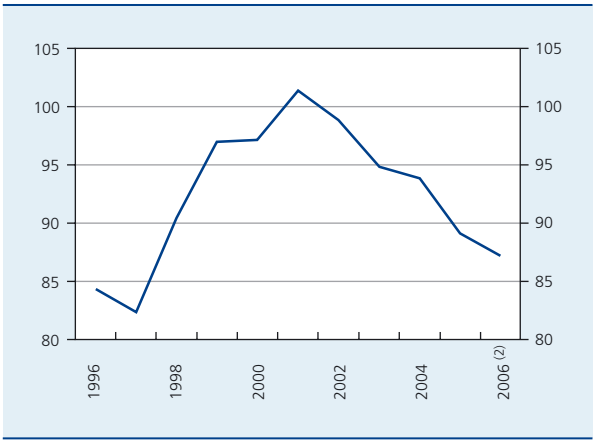
Box 5 – Improvement in the financial situation of enterprises

The strong economic growth in 2006 was founded partly on the rapid expansion of business investment, in line with the trend seen since 2004. The investment revival was encouraged, in particular, by the improvement in the financial situation of companies. Companies' debt levels and their results, which had worsened slightly from the late 1990s to 2001 and 2002 respectively, subsequently improved.

According to the financial accounts data, the debts of non-financial corporations increased from 1997 to 2001, in which year they slightly exceeded the total of their value added. Since then, non-financial corporations have cut their debt levels in relation to their value added.

INDEBTEDNESS OF NON-FINANCIAL CORPORATIONS (1)

(percentages of value added)



Sources: NAI, NBB.

(1) Total lending by financial institutions of the euro area and fixed-income securities issued; excluding loans between associated companies.

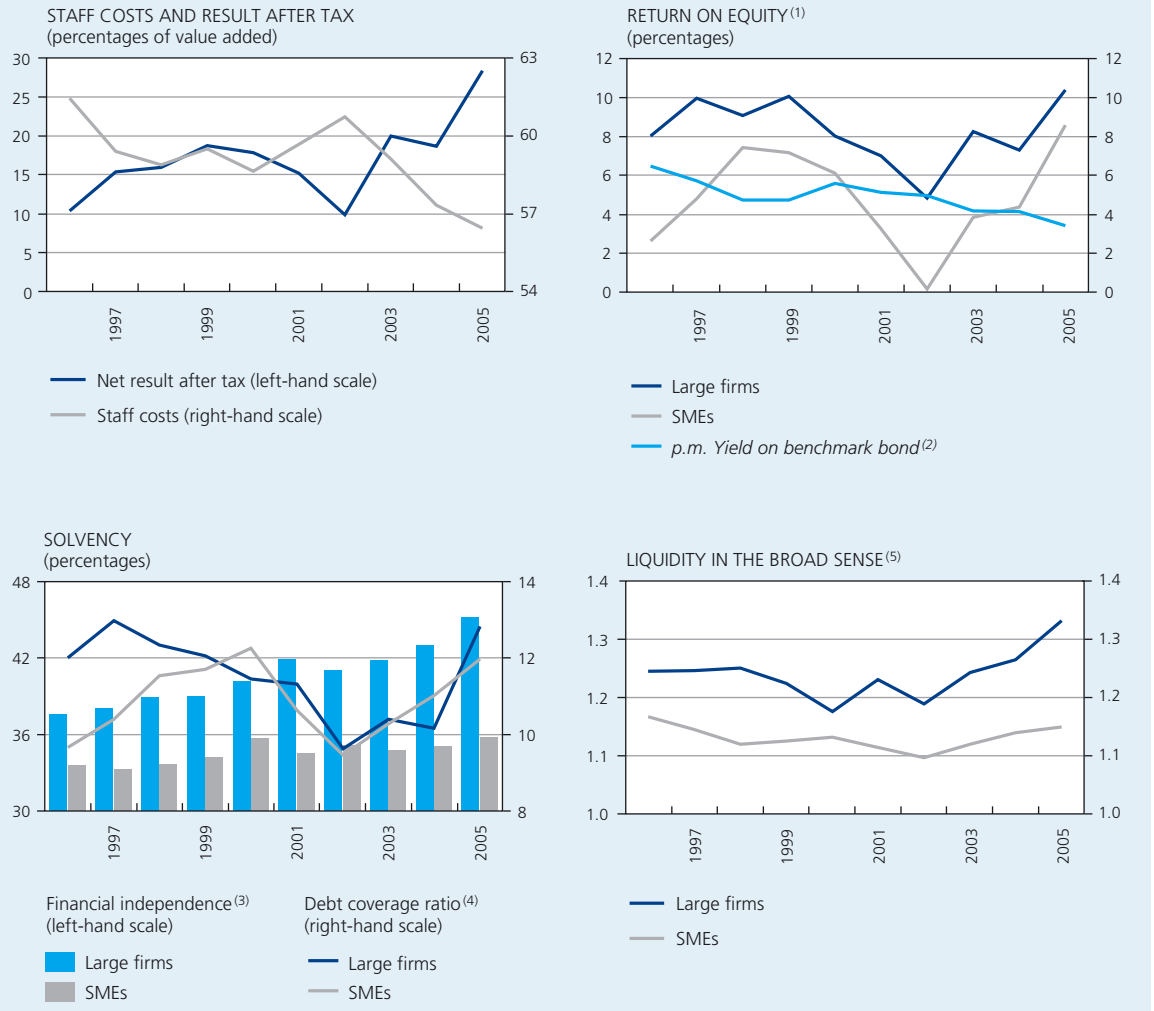
(2) Data for the first nine months, in percentages of value added in the last four quarters.

This reversal in corporate debt was accompanied by an improvement in firms' accounting ratios, as indicated by the figures published on the basis of the data from the Bank's Central Balance Sheet Office (1). That is true for both large firms and SMEs, although in the latter case the movements are less marked. Developments concerning results, profitability, solvency and liquidity will be discussed in turn below.

From 1999 to 2002, the share of value added represented by the net result after tax virtually halved, falling from 18.8 to 9.8 p.c. This deterioration, especially in 2001 and 2002, was caused partly by the growing proportion of staff costs, up from 59.5 to 60.7 p.c. of value added, and by large reductions in the value of the financial fixed assets owned by the firms. From 2003, the share of staff costs declined steadily, reaching a low point in 2005, at 56.4 p.c. This control of labour costs contributed to the strong rise in the net result after tax as a percentage of value added, which almost tripled in three years from 9.8 to 28.4 p.c. Moreover, the net result after tax grew faster than the gross operating surplus, owing to the substantial contribution made by other components of the profit and loss account to the improvement in the net profit, such as net financial income and net exceptional income, especially in 2005.

(1) Lagneaux F. and D. Vivet (2006), *Trend in the financial structure and results of firms in 2005*, Economic Review, NBB, December, pp. 31-53. The results were updated for the year 2005.

FINANCIAL SITUATION OF NON-FINANCIAL CORPORATIONS



Source: NBB (Central Balance Sheet Office).

(1) Ratio between the net result after tax and the equity.

(2) Yield on ten-year Belgian government bonds (OLOs) on the secondary market (annual average).

(3) Ratio between equity and total liabilities.

(4) Percentage of its debts that a firm could repay by using the whole of the year's cash flow for that purpose.

(5) Ratio between total assets realisable and available (stocks, claims at up to one year, cash investments, liquid resources and accruals and deferrals) and the short-term liabilities (debts at up to one year and accruals and deferrals).

Financial profitability, measured as the net result after tax as a percentage of the equity, had also reached a low point in 2002, for both large firms and SMEs. It subsequently bounced back, regaining in 2005 the level of the late 1990s in the case of large firms, and actually exceeding it in the case of SMEs. For the latter, which are traditionally less profitable than large firms, the return on equity thus exceeded the gross yield on a ten-year government bond.

Solvency indicates the ability of companies to honour their short- and long-term financial commitments. A first measure of solvency relates the equity to the total liabilities; a high ratio therefore indicates that the firm is independent of borrowings. In general, large firms and SMEs increased their financial independence over the

ten-year period considered. Moreover, that trend should have accelerated in 2006, as a result of the capital contributed that year in order to take advantage of the new tax rules on notional interest. Another measure of solvency is the degree to which borrowings are covered by the cash flow: it indicates the firm's ability to repay its debts. That ratio, which had reached a low point in 2002, improved steadily and in 2005 came near to the high level reached in 1997, in the case of large firms, and in 2000 in the case of SMEs. Overall, corporate solvency has therefore improved significantly in recent years.

Finally, liquidity offers an indication of the ability of firms to mobilise assets which are realisable and available (cash, etc.) in order to meet their short-term commitments, namely debts maturing during the year. For both SMEs and other firms, the liquidity ratio in the broad sense was higher than one throughout the period; that corresponds to positive net working capital. While the ratio had fallen slightly from 1997 to 2002 for both categories of firms, it has since recovered strongly, particularly in the case of large firms, whose liquidity reached a record level in 2005.

The consolidation of the financial situation of non-financial corporations is not specific to Belgium, since it was also seen throughout the euro area, where it was a prerequisite for the revival in business investment.

Individuals

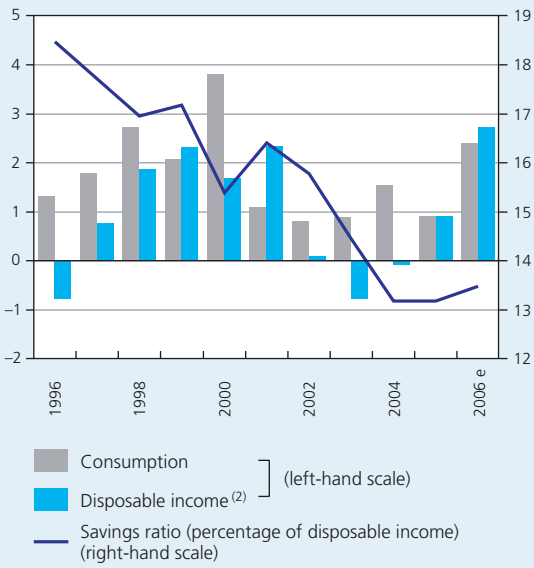
In 2006, continuing a movement which had begun in 2003, a year before the business investment revival, households once again increased their expenditure on housing construction and renovation, by 4.8 p.c. in volume, outpacing GDP growth. As in previous years, this was encouraged by the still low level of interest rates and by the steep rise in property prices on the secondary market (for more details, see box 6).

In addition, during the year under review, household purchasing power increased significantly, whereas in cumulative terms it had hardly risen at all between 2001 and 2005. This led to an almost equivalent expansion in household expenditure on consumption, with volume growth up from 0.8 to 2.4 p.c. This was therefore the main factor driving the acceleration in GDP growth in 2006.

Overall, the household savings ratio increased slightly, from 13.2 p.c. of disposable income in the two preceding years to 13.5 p.c. Two factors exerted an opposing influence on the saving behaviour of households in 2006. On the one hand, households gained confidence the more they believed that the improvement in the general economic situation, particularly employment, would be maintained, and that led them to reduce their precautionary saving. On the other hand, significant changes in their real disposable income, such as those observed during the year under review, tend to be reflected only gradually in their consumption expenditure.

CHART 26 CONSUMPTION, DISPOSABLE INCOME AND SAVINGS RATIO OF INDIVIDUALS

(percentage changes in volume compared to the previous year [1], unless otherwise stated)



Sources: NAI, NBB.
(1) Non calendar adjusted data.
(2) Data deflated by the private final consumption expenditure deflator.

Real disposable income increased sharply, by 2.7 p.c., as a result of the implementation of the final stage in the reform aimed at reducing the burden of personal

TABLE 18 GROSS DISPOSABLE INCOME OF INDIVIDUALS, AT CURRENT PRICES

(percentage changes compared to the previous year, unless otherwise stated)

	2002	2003	2004	2005	2006 e	*p.m. 2006 e, billions of euro*
Gross primary income	1.4	0.4	2.3	3.6	3.8	*230.2*
p.m. In real terms[1]	*0.1*	*–1.2*	*–0.1*	*0.7*	*1.6*	
Compensation of employees	3.9	1.9	2.8	3.4	3.8	*161.2*
Paid employment	–0.1	0.0	0.6	1.0	1.1	
Compensation per person	4.0	1.8	2.1	2.4	2.7	
Gross operating surplus and gross mixed income	–1.4	2.1	2.1	3.2	4.3	*41.4*
of which: income from self-employed activity	–1.7	3.8	2.7	1.4	5.0	*22.2*
Income from movable property[2]	–6.5	–9.2	0.0	5.5	3.7	*27.6*
Current transfers[2]	1.6	–1.4	2.2	2.8	–1.4	*–40.5*
Current transfers received	5.0	3.5	4.2	3.6	3.4	*67.7*
Current transfers paid	3.6	1.5	3.4	3.3	1.6	*108.1*
Gross disposable income	1.4	0.9	2.4	3.8	5.0	*189.7*
p.m. In real terms[1]	*0.1*	*–0.8*	*–0.1*	*0.9*	*2.7*	
Final consumption expenditure	2.1	2.6	4.0	3.8	4.7	*166.1*
Savings ratio[3]	15.8	14.4	13.2	13.2	13.5	

Sources: NAI, NBB.
(1) Figures deflated by the private final consumption expenditure deflator.
(2) These are net amounts, i.e. the difference between incomes or transfers received from other sectors and those paid to other sectors, excluding transfers in kind.
(3) Gross savings, as a percentage of gross disposable income, these two aggregates being taken inclusive of the change in the net claims of households to pension funds.

taxation. The increase was all the stronger in that inflation measured by the deflator of private consumption slowed down in 2006. Gross primary income in nominal terms also contributed, but to a more modest degree: after a sharp acceleration in 2005, to 3.6 p.c., it increased slightly faster, by 3.8 p.c.

Overall, compensation of employees – which represents around 70 p.c. of the primary income of individuals – increased by 3.8 p.c. in nominal terms, against 3.4 p.c. in 2005, owing to a stronger rise in compensation per person, but also to a slightly higher rate of paid employment growth. Stimulated by a favourable economic climate, the income item comprising the gross operating surplus and gross mixed income expanded further, growing by 4.3 p.c. in 2006, against 3.2 p.c. in the previous year. That improvement was concentrated on self-employed incomes, which were 5 p.c. up, while rents imputed to owner occupiers – recorded under the gross operating surplus – increased more slowly than in the previous year.

The rise in net incomes from movable property slowed from 5.5 p.c. in 2005 to 3.7 p.c. This was due to weaker expansion of property incomes allocated under insurance contracts and dividends received by households. The rise in those dividends was nonetheless sustained, since the increase recorded in the previous year could be regarded as exceptional, comparable to a catching up movement after the continuous falls from 2002 to 2004. In contrast, the net interest income of households increased slightly against the previous year, for the first time since 2001.

Net current transfers paid by households declined by 1.4 p.c., mainly as a result of the moderate increase in current transfers paid. That increase was only 1.6 p.c., compared to 3.3 p.c. in 2005, owing to the movement in taxes on earned and property incomes. The growth rate of transfers received, which essentially correspond to social security benefits excluding health care, decelerated slightly, from 3.6 to 3.4 p.c.

Box 6 – Property prices and investment in housing

Since mid 2002, the economic situation has improved steadily in the construction sector, whereas in the other sectors the business climate was subject to greater uncertainty. The expansion of the construction sector continued in 2006 and was a significant factor underpinning the acceleration of economic activity in general. In the third quarter of 2006, the growth of this sector's value added peaked at around 9 p.c. against the corresponding quarter in the previous year.

The favourable conditions in the construction sector are attributable to various factors. A breakdown of construction-related investment shows that residential investment, which represents around 55 p.c. of the total, formed the main basis. In addition, in 2005 and 2006, the expansion of local authority investment also provided substantial support for the building industry, owing to the electoral cycle. However, that is a temporary factor.

After a long period of weak growth in the 1990s and the early years of this century, investment in housing expanded by 18.2 p.c. in total over the period 2004-2006. Other indicators, such as the number of housing starts or the number of building permits issued, which may be regarded as advance indicators, confirm the revival in house building activity.

These noteworthy results for expenditure on residential construction and renovation coincided with a period in which real house prices recorded a relatively sharp increase on the secondary market. The two movements are not unconnected, and may be attributed both to structural factors, such as socio-demographic trends, and to macroeconomic variables, such as the disposable income of households and interest rates. Tax considerations, changes in the conditions applied to mortgage loans, or restrictions imposed by new environmental or planning regulations, may also have affected these movements.

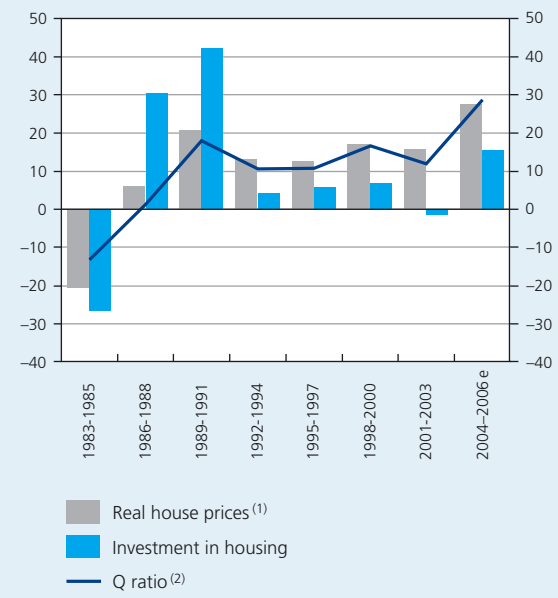
Furthermore, the price rises recorded on the secondary market may themselves have an impact on residential investment, and hence on real economic activity. This box aims to explain the importance of this connection in the case of Belgium.

In the main, the literature describes two channels through which property prices may exert an effect on economic activity. The first channel, which generally receives the most attention, operates via private consumption : the wealth effects – due mainly to the realisation of capital gains on property and the use of property as collateral for obtaining credit – imply a positive link between house prices and private consumption. The other channel, important for building activity, operates via investment in houses or apartments. It is based on the comparison between the market value and the replacement cost, also known as Tobin's Q effect, which applies to all types of investments. All other things being equal, a rise in the price of existing buildings makes new housing relatively cheaper, which means in other words that price rises on the secondary market may stimulate new property construction. The strength of this response is, of course, also determined by other factors, such as supply rigidities resulting from the availability of building land, so that the reaction of investment to house prices tends to be limited and delayed.

Empirical research shows that the wealth effect on consumption is relatively weak in Belgium. That is evident from the very low correlation observed in Belgium between the increase in real house prices and the growth of private consumption : on the basis of annual data relating to the period 1980-2006, it was only 0.2. One explanation for this relatively low figure is the absence of flexible formulas on the Belgian financial markets enabling households to increase their mortgage loan in accordance with the rising value of their property, in contrast to what is available, for example, in the Anglo-Saxon countries or the Netherlands. Conversely, the correlation between real house prices and investment in housing over the same period comes to 0.6, which suggests that the influence of the Tobin's Q effect is greater.

HOUSE PRICES ON THE SECONDARY MARKET AND VOLUME OF INVESTMENT IN HOUSING

(percentage changes compared to the preceding period)



Sources : FPS Economy, SMEs, Self-employed and Energy ; NAI ; STADIM ; NBB.

(1) Nominal house prices deflated by the private final consumption expenditure deflator.

(2) The Q ratio is defined here as the ratio between the index of nominal house prices and the housing investment deflator.

Overall, the positive link between housing prices and investment is considerably more significant in Belgium than in the other euro area countries (1). Since 1980, price falls on the secondary market have been accompanied by lower investment, while price rises have generally triggered an increase. However, the response of investment to prices is not stable over time. Thus, in the 1980s, the apparent elasticity was relatively high, while in the 1990s and in the initial years of this century, investment hardly reacted at all to the rise in prices on the secondary market.

Tobin's Q, which indicates the degree to which investment responds to price movements on the secondary market, can be calculated as the ratio between nominal house prices and the housing investment deflator. Following the sharp fall in property prices in the early 1980s, that ratio declined so that new building became less attractive in comparison with a purchase on the secondary market. As a result of price increases on that market in the second half of the 1980s, the attractiveness of new property increased, causing a surge in investment. Conversely, although Tobin's Q increased almost constantly during the 1990s, owing to the continuous price rises on the secondary market, investment in housing hardly expanded at all during that period. More recently, the acceleration in the rise in property prices has once again made it more attractive to build new property, which could explain the revival in residential investment.

However, the situation in the 1990s shows that Tobin's Q is not the only determinant of investment's reaction to house prices, since that reaction is influenced by a multiplicity of other factors such as the movement in the price of building land, which itself depends in particular on the availability of such land. However, instead of depressing

(1) See European Commission (2006), *Economic situation in the euro area*, Quarterly Report on the Euro area, Vol. 5 N° 1, pp. 5-25. For Belgium, this estimates elasticity at 1.4, which is well above the average for the euro area (0.4). The elasticities of the other euro area countries range between 0.0 (Spain) and 0.8 (Germany).

the total volume of property investment, that factor may prompt a reallocation in favour of the construction of apartment blocks, as has been seen in recent years. Finally, exogenous factors, such as the construction of social housing, tax incentives or tax amnesty measures (e.g. the one-off declaration of financial assets) also play a role.

The way in which property investment responds to prices on the secondary market is not only important for assessing its effect on economic activity, but also because it may in turn dampen the rise in property prices by expanding the supply. Thus, the fact that, as mentioned earlier, investment is more responsive in Belgium than in the other euro area countries, may be part of the reason for the generally more moderate rise in house prices in Belgium compared to those in other countries.

General government

The final consumption expenditure of general government increased by 1.3 p.c. in real terms, following the exceptional 0.6 p.c. decline in the previous year. All categories of public expenditure grew faster than in 2005, including civil service pay and health care. In 2005, health care spending had practically stagnated in volume, after two years of exceeding the norm of 4.5 p.c. set by the government. In 2006, it began rising again, but growth was limited to 1.3 p.c.

In contrast to consumption expenditure, public investment, which had grown by 13.5 p.c. in 2005, fell by 3 p.c. However, these movements are greatly influenced by sales of government buildings, which – according to the accounting conventions - are regarded as disinvestment by the general government sector. In fact, as in 2004, these transactions represented around 0.2 p.c. of GDP during the year under review, six times more than in 2005, when admittedly they had been negligible. Leaving these aside, the volume of public investment actually increased in 2006 by 5.9 p.c., a rate almost 2 percentage points higher than the previous year's figure. This acceleration was due to the expenditure of the federal government and of the communities and regions, the level of which had fallen in the previous year. However, the biggest contribution to the growth of public investment came from the local authorities, on account of the municipal and provincial elections, even though the rate of expansion was lower than in the year preceding the elections, as is usually the case.

Rest of the world

In the year under review as a whole, the volume of exports of goods and services grew by 3.4 p.c., practically equalling the 2005 growth rate. However, this relatively similar movement masks the significant recovery of exports during 2006, supported by the revival in activity in the euro area, following their sluggishness for much of the previous year.

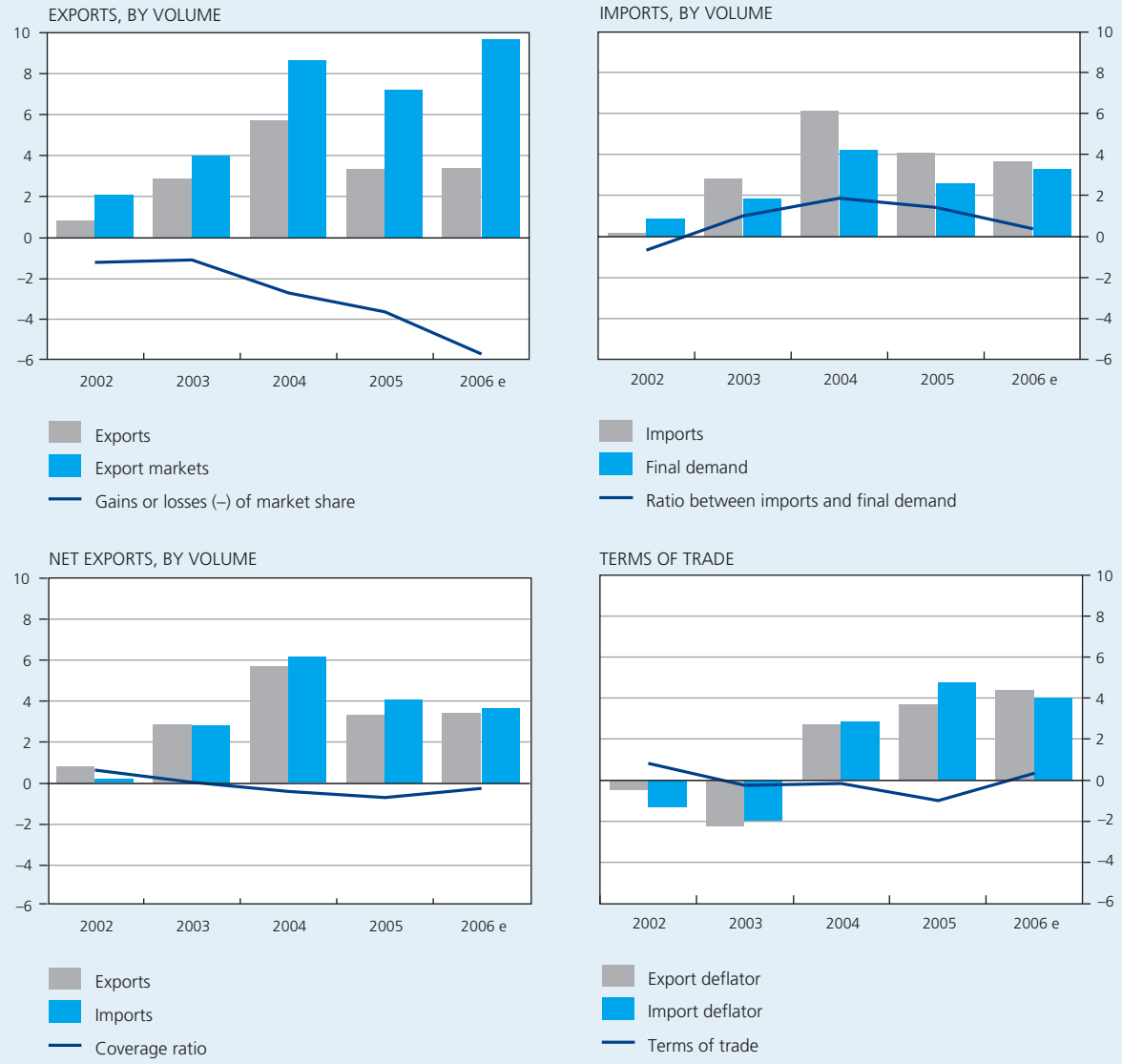
Nonetheless, the export growth appears limited in comparison with the expansion of the markets relevant to Belgium which, according to the OECD's calculations grew by 9.7 p.c. overall, compared to 7.2 p.c. in 2005. However, these figures are affected by the presence of VAT carrousels in the United Kingdom, which have the effect of inflating that country's export and import statistics. As these fraudulent transactions probably expanded in scale during the first half of the year, British imports are likely to have risen by around 12 p.c. in 2006, or almost twice as fast as in the previous year. Since the United Kingdom accounted for 8.1 p.c. of Belgian exports of goods in 2005, the contribution of this factor to total market growth is not inconsiderable.

The potential external demand addressed to Belgium was nonetheless vigorous, especially that from neighbouring countries. In consequence, the losses of market share seem to have been substantial once again, in the order of 5.7 p.c. compared to 3.6 p.c. in 2005. The losses appear to have accelerated for the third consecutive year, even disregarding the overvaluation of imports by the United Kingdom. Since 1995, the volume of market share lost is estimated at a total of around 24 p.c., a weaker performance than that of most other advanced countries.

However, the greatest caution must be exercised in examining Belgium's market shares. In value terms, Belgian exports are in fact as dynamic as the European average; combined with the relatively low volume growth, this indicates a systematically stronger rise in export prices. A purely statistical explanation of these divergences between the movements in volume and value cannot be ruled out, as they are difficult to reconcile in the light of

CHART 27 EXPORTS AND IMPORTS OF GOODS AND SERVICES

(calendar adjusted data, percentage changes compared to the previous year)



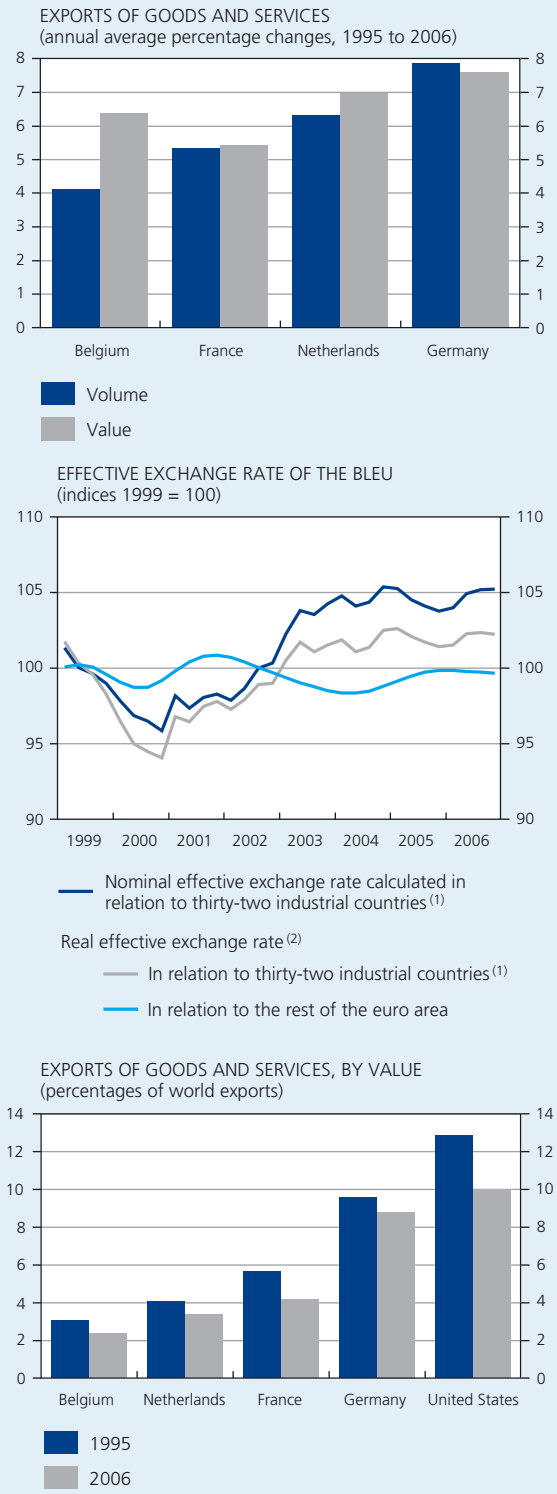
Sources : OECD, NAI, NBB.

the information available for other indicators relating to domestic prices and costs.

In particular, the cumulative scale of the losses of market share in terms of volume cannot be attributed entirely to changing cost competitiveness. Measured by the real effective exchange rate of the BLEU, this appeared to be relatively stable over the past three years, a period in which losses of market share have been accentuated. Moreover, the recent movements in competitiveness were largely dictated by the nominal effective exchange rate of the euro, following a perceptible improvement in the relative costs in local currency in 2003. Also, in relation to its main competitors, namely the countries of the euro area, the competitiveness of the BLEU remained stable in 2006, following a slight deterioration in 2004 and in the first half of 2005.

In an international context featuring the rapid emergence of new centres of activity and intensification of the globalised character of trade, the relative loss of market shares is to be expected in the case of economies in an advanced state of development. In fact, by participating to a greater extent in world trade, the emerging

CHART 28 EXPORTS OF GOODS AND SERVICES AND EFFECTIVE EXCHANGE RATE



Sources: EC, OECD, NAI, NBB.

(1) Weighted average exchange rate against the currencies of the rest of the EU-25 and the following countries: Australia, Canada, Japan, Mexico, New Zealand, Norway, Switzerland, Turkey and the United States.

(2) Nominal effective exchange rate deflated by unit labour costs for the economy as a whole.

economies are contributing to the expansion of the global volume of trade, including via the mutual links which they are developing. It is therefore logical that the old industrialised countries should hold a less prominent position in a rapidly expanding world trade. Although Belgium has not been spared, in value terms the share of its exports in world trade has not contracted excessively in relation to neighbouring countries or the United States over the past eleven years.

Belgium's import growth rate slowed slightly, declining from 4.1 p.c. in 2005 to 3.7 p.c. in 2006. The apparent contrast with the accompanying acceleration in final demand is due to the fact that, in 2006, economic growth was supported to a lesser extent than in 2005 by business investment (excluding purchases of public buildings), which has a high import content.

Altogether, net exports of goods and services made a slightly negative contribution to GDP growth of around 0.1 percentage point.

For the second year running, the rise in the prices of exports and imports of goods and services outpaced the volume growth. Under the combined impetus of the higher commodity prices and the still vigorous expansion of the world economy, import prices rose at a sustained rate of 4 p.c. in 2006. Export prices were up by 4.4 p.c., climbing even faster than in the previous year when the rise came to 3.8 p.c. This acceleration was probably due to the fact that the earlier increase in the cost of imported components was incorporated in producer prices of manufactured goods. In these two years, there have been significant movements in exchange rates, but their overall influence on these developments has been minimal since, as an annual average, the euro has remained relatively stable. In view of the relative movements in the prices of foreign transactions, the terms of trade improved by 0.3 p.c., following a cumulative deterioration of 1.2 p.c. during the three preceding years.

The improvement in the terms of trade in 2006 almost entirely offset the deterioration in the export/import volume coverage ratio. Expressed at current prices, Belgium's trade balance was practically stable at 8.3 billion, whereas it had shown a marked fall from 2003 to 2005. This stabilisation appeared to apply to both the balance of transactions in goods and that of trade in services.

In regard to the balance of transactions relating to services, the increase in the surplus seen in the first nine months of 2006, totalling 0.2 billion, resulted from contrasting developments among the various transaction categories. The increase in revenues from land freight transport and

TABLE 19 NET LENDING TO THE REST OF THE WORLD

(balances; billions of euro, unless otherwise stated)

	2002	2003	2004	2005	2006 e	First nine months 2005	First nine months 2006
1. Current account	12.4	11.4	10.2	7.5	7.7	6.4	4.4
Goods and services	12.3	11.3	10.7	8.4	8.3	6.3	4.1
Goods	10.2	9.7	7.8	4.7	n.	4.5	2.1
Services	2.1	1.6	2.9	3.7	n.	1.8	2.0
Transport	1.0	0.8	1.6	1.3	n.	0.9	1.0
Travel	–3.4	–3.6	–3.9	–4.0	n.	–3.4	–3.7
Other services	4.6	4.4	5.2	6.5	n.	4.3	4.7
Factor incomes	4.7	5.7	4.6	4.2	4.8	4.2	4.7
Earned incomes	3.3	3.5	3.7	3.8	n.	2.8	2.8
Incomes from direct and portfolio investment	1.4	2.2	1.0	0.4	n.	1.4	1.8
Current transfers	–4.6	–5.7	–5.2	–5.1	–5.4	–4.0	–4.4
Transfers of general government	–3.7	–4.1	–3.8	–3.8	n.	–3.0	–3.6
Transfers of other sectors	–0.9	–1.6	–1.4	–1.4	n.	–1.1	–0.8
2. Capital account	–0.6	–0.9	–0.4	–0.7	–0.4	–0.5	–0.6
3. Net lending to the rest of the world (1 + 2)	11.8	10.4	9.8	6.8	7.2	5.9	3.8
p.m. Idem, percentages of GDP	*4.4*	*3.8*	*3.4*	*2.3*	*2.3*	*2.7*	*1.6*
Financing capacity of the domestic sectors as a percentage of GDP	*4.8*	*4.4*	*3.6*	*2.5*	*2.4*	*n.*	*n.*

Sources: NAI, NBB.

business consultancy services contributed to this growth, as did the increase in royalties and licence fees received by residents and the reduction in expenditure on financial services. However, that growth was limited by renewed expansion of expenditure on travel and air transport, and by a decline in revenue generated by services to related companies located abroad.

The increase in the surplus payments of factor incomes, up from 4.2 billion euro in 2005 to 4.8 billion in 2006, contributed to the expansion of the balance of current transactions. This growth was due, in particular, to an increase in interest income on loans granted by resident enterprises to associated companies. It was also reinforced by a rise in dividends generated by portfolio investments, following acquisitions by residents of numerous shares in foreign mutual funds. The improvement in the balance of factor incomes was nevertheless attenuated somewhat by, among other things, a rise in interest rates on money market instruments, whereas net liabilities to the rest of the world in this form increased, and by a decline in net incomes obtained from other investment categories. The surplus generated by earned incomes, which is determined mainly by salaries paid by the European institutions to resident officials, remained stable.

While the deficit on current transfers by households and enterprises dropped below its 2005 level, that generated by general government increased significantly, one factor being a large reduction in transfers received from the EU, due to expiry of the 2000-2006 planning period for the Structural Funds, from which the federated entities received funding. This brought the deficit on current transfers to 5.4 billion.

Following the sale of the Belgian embassy site in Tokyo at the end of the year under review, the deficit on the capital account was cut from 0.7 to 0.4 billion euro. During the first nine months of 2006, that balance had deteriorated slightly owing to the effects of the system of trading greenhouse gas emission quotas, set up by the EU under the Kyoto agreement. Implemented by the

member countries from 1 January 2005, this system is intended to encourage industrial firms to limit their emissions of carbon dioxide – or of any other gas having an equivalent effect – by allocating them a limited number of emission rights. Depending on the quantities of gas which they generate, they can resell their surplus quotas or buy quotas from other firms via trading platforms, so as to be able, in the first four months of each year, to make up a number of quotas corresponding to their emissions in the previous year. In net terms, Belgian companies bought more quotas than they sold to the rest of the world.

Overall, in contrast to the three preceding years, Belgium's net lending to the rest of the world, which – according to the balance of payments concepts – corresponds to the sum of the current and capital account balances, increased, rising from 6.8 billion in 2005 to 7.2 billion in 2006, which meant that it remained steady as a percentage of GDP, at 2.3 p.c.

3.4 Structural developments

Belgium's vigorous GDP growth in 2006 was founded primarily on the excellent performance at the start of the year. The subsequent loss of momentum brought the expansion of activity back to a rate more compatible with the economy's potential, i.e. the output growth which can be sustained, taking account of the availability of the production factors – labour and capital – and productivity gains, without generating imbalances on the product and labour markets, particularly in the form of inflationary pressure.

A country's potential growth determines its level of economic development and the average prosperity of the population. According to the OECD's calculations, per capita GDP in Belgium is higher than in the largest EU-25 countries. However, the figures for the Nordic countries, the other Benelux countries, Austria and Ireland are higher.

Belgium is particularly noted for its high hourly productivity, well above that of the other countries considered, except for Luxembourg; it even exceeds that of the United States, though per capita GDP there is significantly higher. This performance is partly attributable to the fact that the production process is more capital intensive. Conversely, the mobilisation of the labour force, measured by the number of hours worked per capita, is lower in Belgium. That position is due both to a number of hours worked per employee which is below the European average, and to the low employment rate of the population, especially in the case of persons aged over fifty-five and the low skilled. As a corollary, this last characteristic tends to boost the average apparent productivity of labour in the economy.

An economy's potential growth cannot be directly measured, it has to be estimated. The method preferred by the Bank, following the example of the EC, is based on the use of a production function which can measure the contribution of the various determinants, namely the production factors and total factor productivity (TFP). With due regard for the uncertainty inherent in this type of estimate, the potential growth of the Belgian economy is assessed at an average of 2.1 p.c. over the past ten years. However, it has not remained constant during that period: in fact, after hovering around 2.3 p.c. from 1999 to 2002, it declined temporarily to 1.8 p.c. in 2004, before reverting to an estimated level of 2.3 p.c. in 2006.

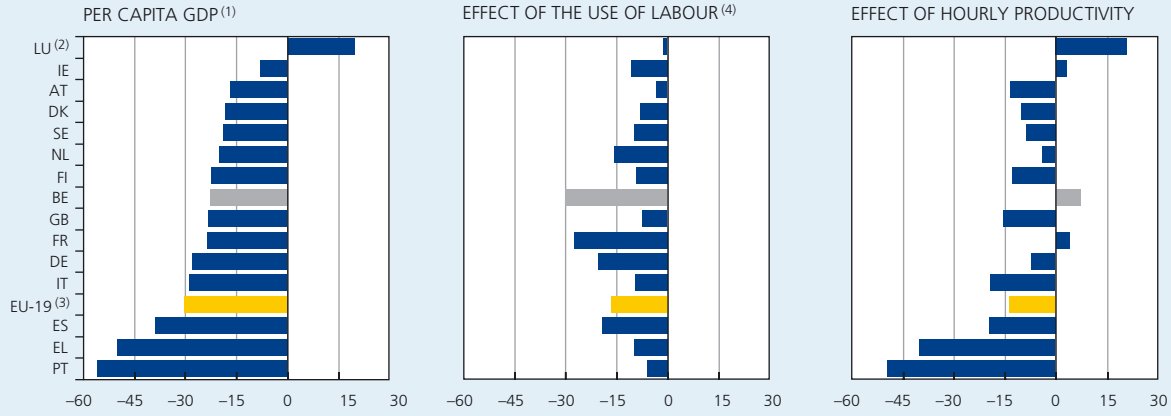
These fluctuations in the rate of expansion of potential GDP were determined mainly by changes in the contribution of the capital stock. In particular, in 2002 and 2003, firms cut back their investment and, given the rising trend in depreciation, the expansion of the net capital stock slowed sharply. The contribution of the capital stock of firms to potential growth was thus reduced by 0.6 percentage point between 2001 and 2003. Since then, it has recovered by 0.3 percentage point, as a result of the investment revival.

For its part, the contribution of the factor labour has tended to edge slowly but almost constantly upwards over the years. Taking the period 1996-2006 as a whole, it tripled from 0.2 to 0.6 percentage point. The principal factor contributing to this acceleration is the faster growth of the population of working age, notably because of an increase in net immigration, especially after the year 2000. The contribution of the factor labour has also increased in the other European countries, so that the employment rate in Belgium has remained below the European average.

The contribution of TFP remained stable. TFP is an indicator of the efficiency with which the production factors are combined. It reflects a range of elements such as the efficiency of the organisation of the production processes or the quality of the production factors used. Thus, TFP is influenced by many variables which can be linked to a number of dimensions, such as macroeconomic stability, the operation of the markets, education and training, basic infrastructures, research, innovation and technology.

CHART 29 INTERNATIONAL COMPARISON OF PER CAPITA GDP

(difference in relation to the United States in 2004, percentage points)



Source : OECD.

(1) Based on purchasing power parities in 2000.

(2) In the case of Luxembourg, the population includes frontier workers in order to take account of their contribution to GDP.

(3) The EU-15 countries and the four new Member States which are also members of the OECD, namely – in descending order of per capita GDP – the Czech Republic, Hungary, Slovakia and Poland.

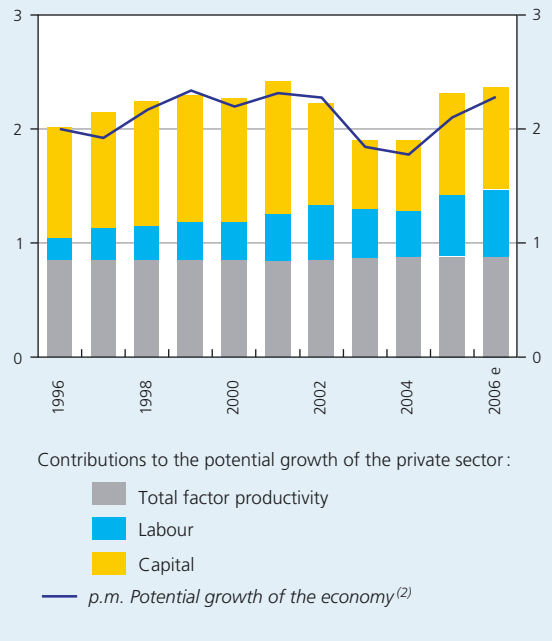
(4) Ratio between the number of hours worked and the population.

Assessment of the movement in TFP and its potential growth in the medium term therefore entails a detailed analysis of these various dimensions, which is often difficult to achieve with traditional statistics. To overcome this problem, it is possible to use various sources of information. Thus, one can refer to the indicators and recommendations published by the EC and the OECD respectively in connection with the revised Lisbon Strategy and the "Going for Growth" process. Another source of information consists in the composite indicators of competitiveness, developed by bodies such as the Institute for Management Development (IMD) and the World Economic Forum (WEF). These receive fairly widespread media coverage, their attraction lying in their relative simplicity and the fact that the countries are ranked according to their apparent performance. The use of such composite indicators can indeed supply useful information, provided that they are interpreted with a degree of caution, as explained in box 7.

More detailed analysis of the IMD and WEF indicators reveals that Belgium is in an intermediate position in the EU-15 in the general rankings drawn up on that basis, and that its position declined from 2001 to 2006. This relative decline concerns a large number of underlying determinants and variables, in particular those relating to the efficiency of the government (quality of public institutions, etc.), of firms (their productivity, etc.), innovation performance, and the macroeconomic

CHART 30 POTENTIAL GROWTH AND DETERMINANTS (1)

(percentage points, unless otherwise stated)



Sources : NAI, NBB.

(1) For more details, see Rigo C. (2005), *Potential growth of the Belgian economy and its determinants*, Economic Review, NBB, n° 3, pp. 45-64.

(2) Percentage changes compared to the previous year.

environment. Conversely, Belgium added further to two of its strengths, namely the basic infrastructures and higher education.

A number of these findings can be corroborated by referring to specific indicators. For example, according to the composite innovation indicator developed by the EC's Community R&D Information Service (CORDIS), Belgium is in an intermediate position in the EU-15 in terms of its overall ranking. That position is the outcome of an above-average effort in the field of research and innovation, but shortcomings in the application of the research results in new products and processes.

In the future, action to remedy the weaknesses highlighted by these composite indicators could boost TFP and, taking account of the high level of investment in 2006, combat the expected erosion of potential growth resulting from demographic changes, and particularly population ageing. Another way to speed up the increase in potential growth is to raise the employment rate. The EC's structural indicators regularly point to Belgium's employment rate, which is still much lower than that of other countries, particularly for persons aged over fifty-five.

Box 7 – Composite indicators of competitiveness

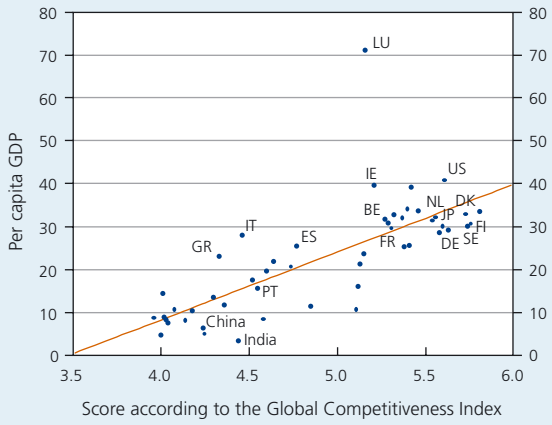
The use of composite indicators can help to identify the elements requiring action in order to safeguard the future growth of an economy and preserve its competitive advantages, particularly by influencing total factor productivity or the availability of the production factors labour and capital.

These indicators aim to incorporate the information obtained from a generally large number of variables considered relevant, and summarise it by means of statistical aggregation processes. Since they are, in principle, calculated in similar ways for a large number of countries, by a system of benchmarking, they thus make it possible to rank an economy's performance in various spheres related to its competitiveness by means of an international comparison. In addition, the component variables offer detailed information on the various factors promoting the economy's efficient operation, and on the way in which they change over time.

Composed of quantitative variables, collected from a range of statistical sources, and qualitative information, generally obtained via questionnaires sent to business managers, the indicators published by various institutions differ in the aspects which they aim to cover. In the case of the global competitiveness indicators, the best known are the ones calculated by the Institute for Management Development (IMD) and the World Economic Forum (WEF). The aspects taken into account by these indicators are both numerous and varied; the indicators are also very complicated to produce, since performance in some of the spheres relating to productivity potential is sometimes difficult to measure accurately. Thus, the limitations in terms of the availability of standardised statistics often mean that certain variables have to be omitted, even though they are relevant for assessing an economy's dynamism. Other limitations common to the various indices include the small number of persons polled, the choice of the weightings accorded to the different variables, which may have a significant influence on the resulting rankings, and the frequent changes of method which, though helping to improve the indicators' quality, may also distort the comparison of the rankings from one year to the next.

In view of these limitations, these indices and the resulting rankings should be interpreted with a degree of caution. Thus, rather than attach too much importance to the exact results, it is preferable to cross-check the information offered by the rankings produced by various institutions, and consider them as a set of indicators which may provide a picture of a relevant economic reality. In this regard, it is worth noting that the information incorporated in these indices helps to explain the differences in the level of prosperity observed between various nations. In particular, the countries which head the ranking produced by the WEF on the basis of its global competitiveness index are generally also the countries with the highest levels of per capita GDP.

LINK BETWEEN THE WEF GLOBAL COMPETITIVENESS INDEX AND PER CAPITA GDP (1)



Sources : WEF, World Bank.

(1) GDP in 2005, in thousands of US dollars, adjusted for purchasing power parities.

Regarding the position held by Belgium, a number of findings relating to the factors underlying the IMD and WEF scores merit attention. Ranked 26th in 2006 according to the Global Competitiveness Indicator calculated by the IMD, and 20th according to the WEF reference index (the Global Competitiveness Index), Belgium is in both cases in an intermediate position among the EU-15 countries.

A detailed examination of the variables included in the composition of these two indices shows that Belgium has a number of strengths. These concern in particular the quality of the basic infrastructure, higher education and further training, the high level of business productivity, and the country's international openness.

Conversely, Belgium is placed at a disadvantage by weaker scores in regard to the high fiscal and parafiscal charges, its results in terms of innovation, and the employment rate. Despite the efforts made to consolidate public finances, the still high public debt ratio and the quality of the institutions, which seem to suffer from a negative image with business leaders, also depress the scores achieved by Belgium.

Both the global indicator of the IMD and the various indices calculated by the WEF indicate a gradual decline in Belgium's position since 2001. However, this deterioration is only relative ; although progress has been achieved in a number of spheres, it is still less than in some countries which Belgium still outperformed five years ago. In the case of the Growth Competitiveness Index calculated by the WEF, the lower score accorded to Belgium can also be attributed in part to the inclusion in 2005 of the level of public debt among the variables used in its composition.

Apart from purely methodological aspects, a more detailed analysis of the variables determining the level of the indices calculated by the IMD and the WEF reveals a decline in the efficiency of government institutions and businesses. The former appear to be considered more bureaucratic, and attract greater criticism regarding the quality of the policies implemented, e.g. in terms of clarity, transparency and ability to adapt to economic changes. The loss of business competitiveness appears to relate mainly to productivity, and to certain factors concerning

labour market developments, such as labour costs, labour relations and standards of training. Furthermore, while Belgium's position in terms of basic infrastructures and education improved from 2001 to 2006, the aspects connected with innovation performance and potential seem to have taken an adverse turn.

4.

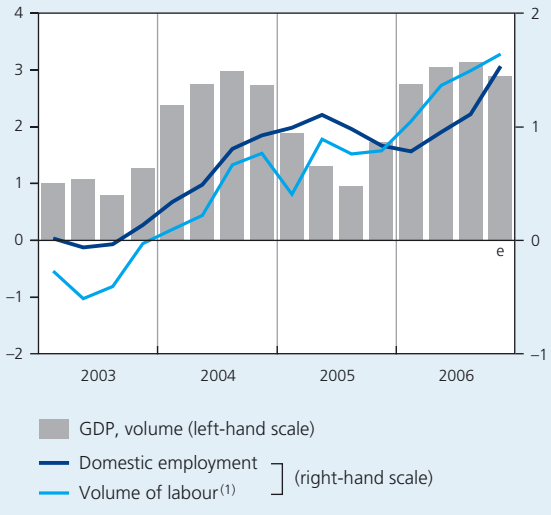
4.1 Labour market

The strengthening of economic activity observed during 2005 was reflected, after the usual time lag of two to three quarters, in an acceleration in employment growth. While that growth had slowed from the third quarter of 2005 until the beginning of the year under review, dropping to 0.8 p.c. year on year, the increase in the number of jobs subsequently systematically gathered pace, reaching 1.5 p.c. at the end of 2006. As an annual average, the expansion of domestic employment in 2006 was therefore slightly greater than the previous year's figure, at 1.1 compared to 1 p.c.

The volume of labour – i.e. the total number of hours worked in the Belgian economy – expanded more strongly, by 1.4 p.c. on average in 2006, than the number of persons in work, in contrast to the situation in 2005. It is in fact normal for working time per person to diminish in a period of weakening economic activity, as was the case that year. When the economy picks up, the labour available is again used more intensively, before the workforce employed can be adjusted to the new activity conditions. However, the cyclical character of the volume of labour is not fully reflected in the data published by the NAI, since they do not contain any information on the amount of overtime worked by full-time employees.

CHART 31 ACTIVITY AND THE LABOUR MARKET

(data adjusted for seasonal and calendar effects, percentage changes compared to the corresponding quarter of the previous year)



Sources: NAI, NBB.
(1) Total number of hours worked by employees and self-employed persons.

The ratio between movements in economic activity and movements concerning the production factor labour, expressed in terms of persons employed or hours worked, measures the change in apparent labour productivity, which is subject to relatively large fluctuations caused by cyclical movements in activity, since it takes time for the number of jobs to be adjusted. Conversely, the number of hours worked is adjusted more promptly, in particular by recourse to more flexible ways of managing human resources, such as changes to working time regimes or temporary lay-offs, in sectors where that is possible. In principle, therefore, the changes in productivity per hour worked are smaller.

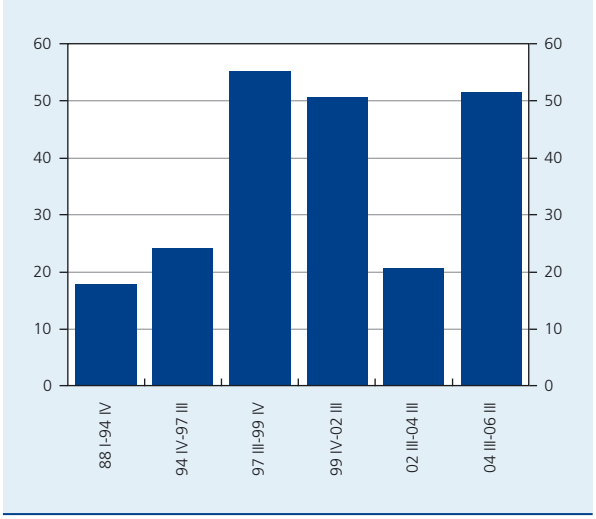
The integration of new technologies into the capital stock and improvements to the qualifications and skills of the labour force cause an upward trend in labour productivity. All other things being equal, the quantity of labour necessary to produce one unit of goods or services is thus tending to decline steadily. The job intensity of growth, which can be defined as the ratio between the expansion of employment and activity growth, is therefore changing in inverse proportion to apparent labour productivity.

The job intensity of growth varies according to the nature of the activity: it is relatively high in the service branches, and especially in personal services; conversely, in the primary and secondary branches it is lower, and shows a clear downward trend. Where industry is concerned, the subcontracting of supporting activities, in which productivity gains are harder to achieve, is reinforcing the productivity growth brought about by the integration of technological progress and leading to a shift in employment towards the service branches. At the level of the economy as a

whole, job intensity depends on the structure of the activity and is boosted by the gradual shift towards a service economy. Government measures aimed at increasing the employment of persons with low skills, who are therefore less productive, e.g. by reducing contributions in the case of the lowest wages or by subsidising the service voucher system, in practice bring about an increase in job intensity. That intensity is also likely to rise as a result of the wage moderation efforts, as a more favourable relative movement in labour costs contributes towards curbing the substitution of capital for labour. Finally, the movement in the job content of growth also depends on the economy's rate of expansion : in view of the rising trend in productivity, a minimum of economic growth is needed to create jobs. That does not depend exclusively on the scale of the growth but also on the economy's current phase of the business cycle. When activity regains momentum, job intensity tends to decline, as the expansion of production is first absorbed by increasing the working time and/or productivity of existing staff. Conversely, the additional labour which may be required at a later stage may prove less productive at first, thus bolstering the job content of growth.

CHART 32 JOB INTENSITY OF GROWTH (1)

(data adjusted for seasonal and calendar effects ; ratio, in percentages, between the average quarter-on-quarter change in domestic employment and the corresponding average change in the volume of GDP)



Sources : NAI, NBB.
(1) The various periods considered in the chart correspond to complete economic cycles, extending from one peak to the next.

The interaction of these various factors has been reflected in relatively large fluctuations in the job intensity of growth over the past twenty years. Examination of those developments over the periods between two successive peaks in the cycle since the second quarter of 1988 reveals that job intensity ranged between about 15 and 55 p.c. whereas, leaving aside the period 1997-1999 when GDP growth had averaged 0.7 p.c. per quarter, the various economic cycles thus defined featured a relatively similar average rate of expansion in activity, of 0.5 to 0.6 p.c. per quarter. During the two cycles observed from 1988 to 1997, the number of jobs had risen, on average, by 0.1 p.c. per quarter, so that the employment content of growth was in the order of 20 p.c. During the next cycle, which

TABLE 20 LABOUR SUPPLY AND DEMAND

(annual averages, thousands of persons ; year-on-year change, unless otherwise stated)

	2002	2003	2004	2005	2006 e	2005, level
Population of working age (1)	31	30	30	44	49	6,879
Labour force	16	48	66	61	38	4,860
National employment	–6	1	27	41	46	4,264
Frontier workers	0	1	1	0	0	51
Domestic employment	–5	1	27	41	46	4,212
Self-employed	–7	–5	–1	7	8	685
Employees	1	5	27	34	38	3,527
Public sector	17	10	12	–2	6	786
Private sector	–15	–5	15	36	32	2,742
Unemployed job seekers	22	47	38	20	–8	596

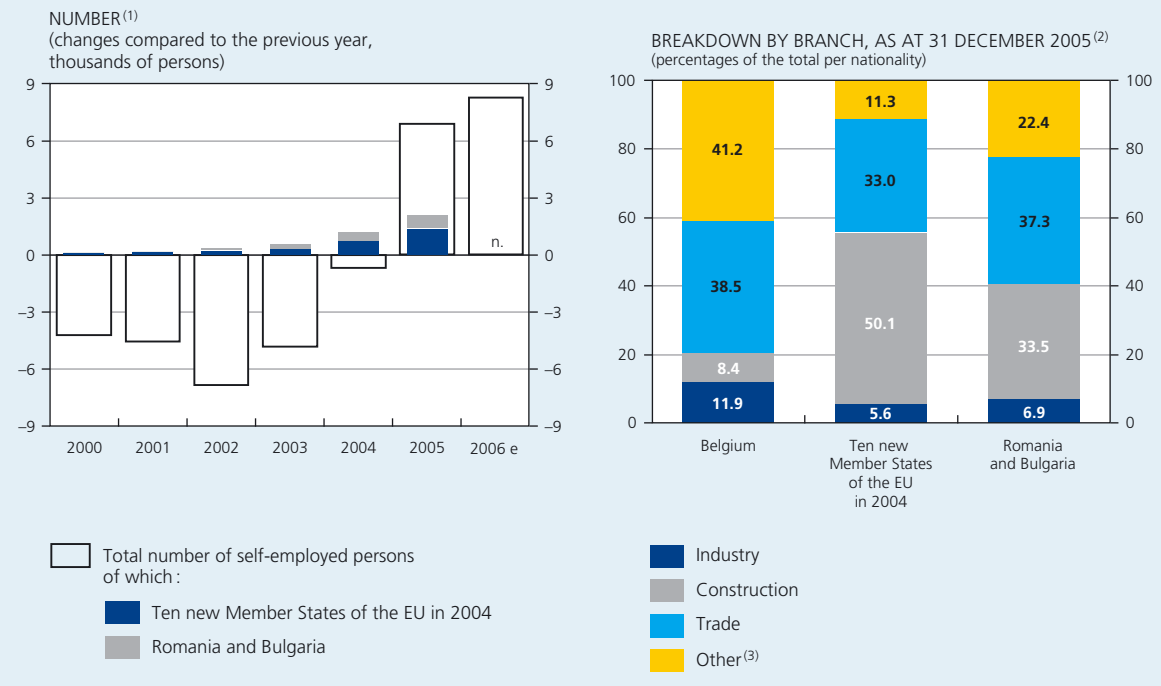
Sources : BREO, FOREM, NAI, NEMO, VDAB, NBB.
(1) Persons aged from 15 to 64 years.

lasted until the end of 1999 and saw stronger expansion of activity, a much steeper rise in employment pushed job intensity up to 55 p.c. Job intensity remained at a high level during the period 2000-2002, although the growth rate of activity was lower. At that time, firms which had struggled to recruit sufficient numbers of skilled workers to meet their needs during the preceding cycle probably preferred to retain their workforce, pending the restoration of more sustained growth, in order to avoid the subsequent adjustment costs. However, this had the effect that, during the period 2002-2004, firms did not need to recruit on a large scale, and the employment content of growth more than halved to around 20 p.c. In the most recent cycle, which began in 2004, employment growth has averaged 0.3 p.c. per quarter, boosting the job intensity of growth to 51 p.c., a rate comparable to the high levels recorded in the late 1990s and at the beginning of the present decade.

In this context, around 46,000 additional jobs were created in Belgium in 2006, outstripping the 2005 figure and representing the strongest expansion since 2001, when employment grew by 58,000 persons. As in 2005, this expansion was due to the rise in the number of both self-employed persons and employees.

From 1996 to 2004, the number of self-employed workers declined continuously, dropping from 711,000 to a low of 678,000, according to the NAI census. This series of falls was interrupted by an upward movement in 2005, which continued in 2006: the number of self-employed persons increased by 7,000 and 8,000 respectively during those two years. That revival is due in part to the government measures taken to encourage entrepreneurship and to make self-employed activity more attractive, particularly for young people. Examples include the loans granted on favourable terms by the federal government's Participation Fund to young people and job seekers, among others. But the number of self-employed workers recorded was also augmented as a result of the interest shown in that status by the nationals of countries joining the EU since 2004. From 2004 to 2005, the number of such persons registered with the Belgian National Institute for the Social Security of the Self-employed (NISSE), mainly of Polish nationality, increased by 1,400 units, or one-fifth of the total rise recorded by the NAI;

CHART 33 SELF-EMPLOYED ACTIVITY



Sources: NAI, NISSE, NBB.

(1) A breakdown by nationality is not available for 2006.

(2) Since the directors of industrial companies also include those active in construction, their number has been allocated between these two branches of activity on the basis of the ratio observed for other self-employed persons.

(3) Agriculture and fisheries, liberal professions, services and miscellaneous occupations.

it had already risen in 2004, while the overall number of self-employed persons was still falling. In 2004 and 2005 respectively, around 500 and 700 new self-employed workers of Romanian or Bulgarian nationality were also registered. Although those two countries did not join the EU until 1 January 2007, under the European Association Agreements with the Central and East European countries their citizens had already been exempt, since 1995, from the obligation to hold a work permit in order to pursue a self-employed activity. In total, 3,480 Polish self-employed workers were recorded, on average, in Belgium in 2005, with figures of 1,166 and 657 respectively for the other two nationalities mentioned. Foreign self-employed workers are mainly active in the construction industry. At the end of 2005, half of the self-employed workers originating from Member States which joined the EU in 2004 and one-third of the Romanian and Bulgarian nationals registered as self-employed in Belgium were in fact working in that branch, compared to barely 8.4 p.c. of Belgian self-employed persons.

The fact that the increased supply of labour from those countries mainly concerned self-employed activities is due largely to the restrictions imposed on the principle of free access to the labour market applicable within the EU. In fact, at the time of the accession of the ten new Member States in May 2004, in order to avoid a distortion of the labour market caused by an influx of cheap labour, the Belgian authorities – like those of the majority of other countries in the EU-15 – decided, in the case of nationals of these new Member States, to make use of the option offered by European law of maintaining the measures restricting direct access to paid employment for a two-year transitional period, which could be extended until 2011 at the latest. However, these exceptional rules did not apply to workers from Cyprus or Malta. There were no such restrictions applicable to self-employed workers, so that recourse to that status enabled nationals of the eight Central and East European countries to start working, perfectly legally, in Belgium. At the beginning of 2006, the government decided to extend the transitional period; however, the restrictions were relaxed, both in favour of those eight countries and for Bulgaria and Romania, in the case of a number of occupations considered critical, i.e. jobs for which few suitable candidates are available on the local labour market. Lists of these critical occupations were drawn up per region, in consultation with the social partners. These rules will continue to apply until the establishment of a system of registration which will record all foreign workers active in Belgium. That register will also record workers on secondment from foreign firms who, in principle, are only working in Belgium for a limited period, under freedom to provide services within the EU, and must therefore not be included in the Belgian employment statistics.

The relaxation of the rules on access for employees originating from the new Member States, whereby a number of construction industry occupations were classed as critical, could tend to make self-employed status less attractive, and thus weaken the dynamism seen in the past two years in the expansion of self-employed activity, in favour of employee status.

During the year under review, the number of employees increased by 38,000 units, against 34,000 in 2005. In that year, owing to a decrease in civil service staff, the growth of paid employment was due exclusively to the private sector. In 2006, the number of public sector employees increased again, by around 6,000 persons. However, these are not necessarily regular staff. In fact, a gradual shift is taking place in the composition of the public sector workforce: in 1999, the ratio between regular staff and contract workers was 60 p.c. compared to 40 p.c.; five years later, this latter group represented 43 p.c. of public sector employees.

Despite the marked rise in the number of jobs, the harmonised employment rate, which indicates the proportion of persons in work among the population of working age, namely persons aged between 15 and 64 years, declined slightly, to 60.9 p.c. The calculation of the harmonised activity, employment and unemployment rates is not based on administrative data but on the results of the labour force surveys, harmonised at European level. Consequently the level of these rates and their movement may differ from those calculated on the basis of administrative data. The labour force survey offers the great advantage of supplying internationally comparable data, as well as numerous details on the socio-economic characteristics of the persons polled. However, as with any survey, the results are subject to a confidence interval. Minor fluctuations from one year to the next, like those recorded in 2006, should therefore be treated with caution.

The socio-economic status of the survey participants, i.e. their exact situation in relation to the labour market (in work, seeking work or inactive), is determined on the basis of a series of criteria drawn up by the International Labour Office (ILO). Thus, persons are considered to be in work if they have performed at least one hour's remunerated work in the week preceding the survey. To be recorded as job seekers, the respondents must satisfy three criteria simultaneously: not in work, actively seeking employment and available for the labour market. Persons who are neither in work nor unemployed according to the ILO definition are recorded as inactive.

The results of the labour force survey illustrate the wide variations between the regional labour market situations. Thus, during the first three quarters of 2006, 64.4 p.c. of the population of Flanders aged between 15 and 64 years had a job, compared to 53.4 and 55.9 p.c. respectively in Brussels and Wallonia. These differentials are relatively stable, reflecting the absence of any convergence between the three regions.

Furthermore, in comparison with other countries, Belgium has a relatively low employment rate for women, the young, older people, the low skilled and persons of foreign origin. Mirroring the respective situation on the labour market in the three regions of the country, the proportion of persons in these risk groups who are in work is almost always lower in Brussels and Wallonia than in Flanders: in the case of women, the young and persons who are not EU-15 nationals, the differential between those two regions and Flanders numbered or exceeded on average 10 percentage points during the first three quarters of 2006. It should also be noted that the employment rate of young people, except in Brussels, and that of the low skilled has fallen since 2000, despite the measures taken in their favour in the recent past. That is due partly to the fact that the year 2000 was in a more advanced phase of the economic upswing than the year under review. Although still low, the employment rate of non EU-15 nationals has increased overall since the start of the decade, showing a much stronger improvement than for the population as a whole.

The situation of persons in the 55-64 age group on the labour market has also improved: since 2000, their employment rate has risen in all regions, by 2 to 6 percentage points. In contrast to the other risk groups, their relative position is considerably more favourable in Brussels, where 37 p.c. of these persons were working in 2006, than in Wallonia or Flanders, where around 31 p.c. had a job. Despite that improvement, on average less than one in three persons in Belgium between the ages of 55 and 64 had a job. This is far from the target of 50 p.c. by 2010 set at the Stockholm European Summit in 2001 for the EU-25 as a whole, where the employment rate of older workers came to 44 p.c. in 2006.

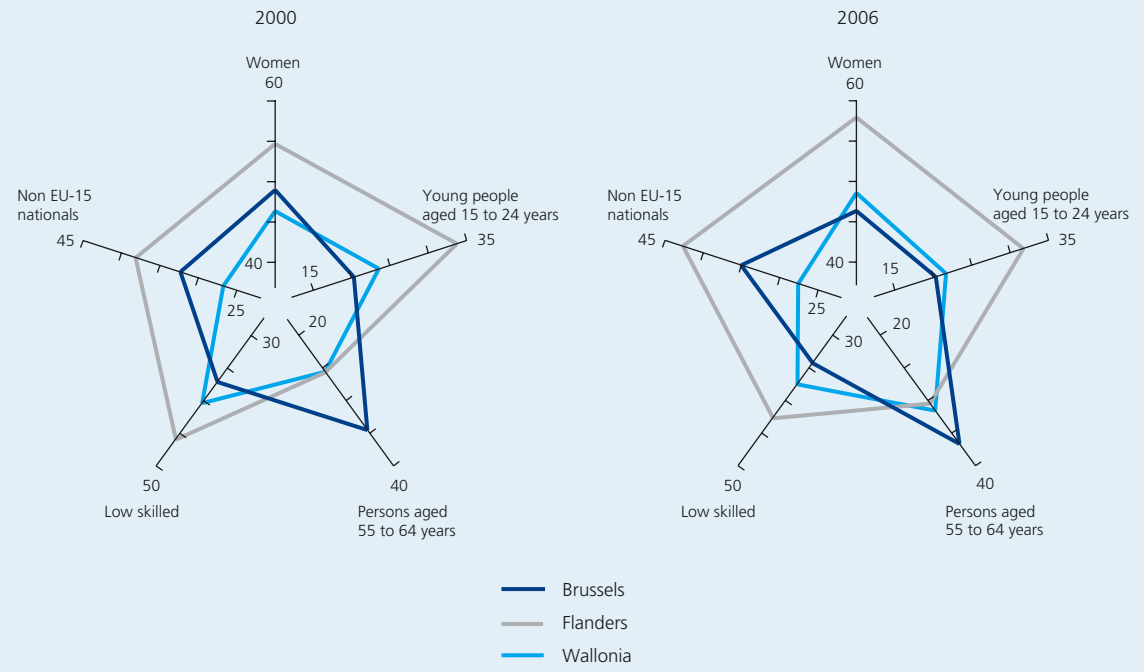
TABLE 21 HARMONISED LABOUR MARKET INDICATORS[1] FOR THE 15 TO 64 AGE GROUP
(annual averages)

	2002	2003	2004	2005	2006 e[2]
Harmonised activity rate[3]	64.8	64.9	65.9	66.7	66.4
Brussels	63.9	63.1	64.3	65.7	64.8
Flanders	66.8	66.8	68.0	68.6	68.0
Wallonia	61.4	62.2	62.6	63.7	63.4
Harmonised employment rate[4]	59.9	59.6	60.4	61.1	60.9
Brussels	54.5	53.2	54.1	54.8	53.4
Flanders	63.5	62.9	64.3	64.9	64.4
Wallonia	54.9	55.4	55.1	56.1	55.9
Harmonised unemployment rate[5]	7.6	8.2	8.4	8.5	8.3
Brussels	14.7	15.8	15.9	16.5	17.7
Flanders	4.9	5.7	5.4	5.5	5.2
Wallonia	10.6	10.9	12.1	11.9	11.8

Sources: EC; FPS Economy, SMEs, Self-employed and Energy; NBB.
(1) Based on the labour force survey data.
(2) Annual estimate for Belgium, and average of the first three quarters for the regions.
(3) Labour force (i.e. persons in work and job seekers) as a percentage of the total population of working age.
(4) Persons in work as a percentage of the total population of working age.
(5) Job seekers as a percentage of the labour force of working age.

CHART 34 HARMONISED EMPLOYMENT RATES (1) OF THE RISK GROUPS

(annual average for 2000, average of the first three quarters of 2006 ; percentages of the corresponding population of working age)



Sources : EC ; FPS Economy, SMEs, Self-employed and Energy.
(1) Based on the labour force survey data.

Box 8 – The labour supply : recent developments and medium-term outlook

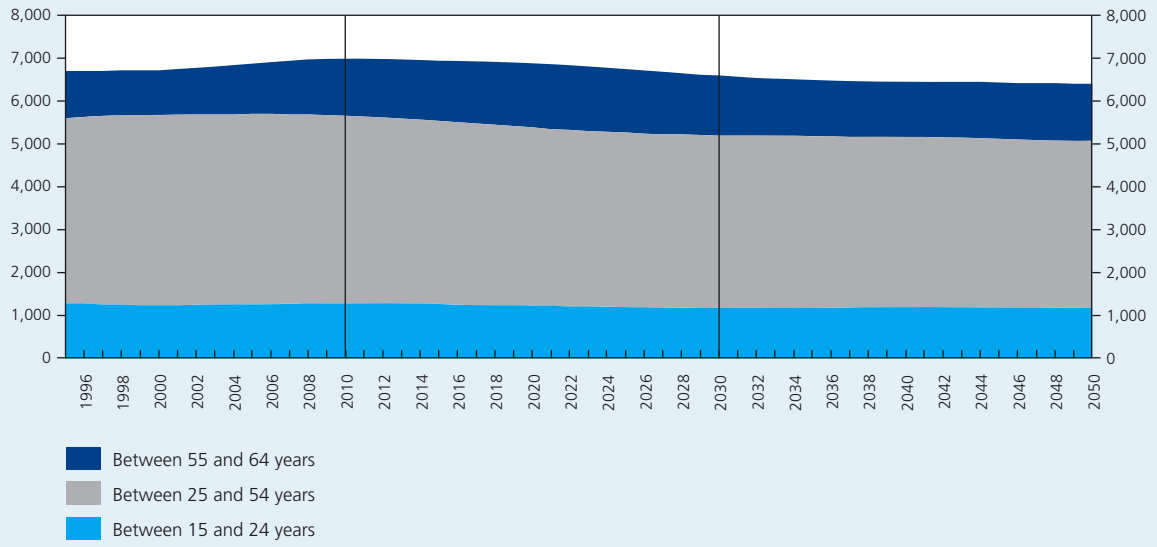
In Belgium, as in most of the EU countries, the decline in the birth rate after World War II will ultimately be reflected in a smaller population of working age, namely persons between the ages of 15 and 64 years. According to the population forecasts for 2000-2050 produced by the NSI and the Federal Planning Bureau, it will continue to expand until 2010, before declining in absolute terms by a total of almost 600,000 units up to the projection horizon in 2050.

Population ageing is already evident in a rise in the proportion of the oldest age group. In 2006, persons aged between 55 and 64 years represented 17 p.c. of the population of working age ; that figure is predicted to rise to around 22 p.c. from 2020, then drop to 21 p.c. in 2050.

The consequences of population ageing are particularly significant in Belgium because the employment rate for the over fifties is still low from a European perspective, the main reason being the greater use of schemes permitting a final exit from the labour market before the statutory retirement age. Ultimately, all other things being equal, the rise in the proportion of persons aged between 55 and 64 years in the population of working age, who have the lowest employment rate, will lead to a reduction in the labour supply and in the economy's growth potential.

TREND AND MEDIUM-TERM PROJECTION OF THE WORKING AGE POPULATION IN BELGIUM

(thousands of persons)



Sources : FPB, NSI.

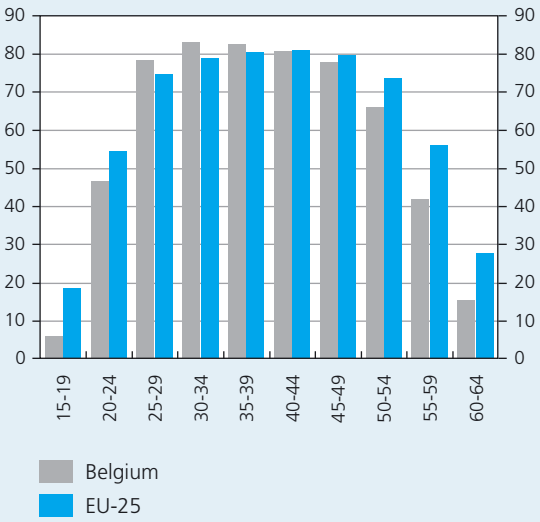
Population ageing therefore presents some major challenges for Belgium's economy, in common with the economies of most other advanced countries. A sharp increase in participation in the labour market will be essential, simply to maintain the growth rate of activity in the future. One can hardly expect a large contribution from the 25-49 age group, whose employment rate is already high : at 80.5 p.c. in 2006, it was 1.5 percentage points above the EU-25 average. As regards the youngest age group, most of whom are still pursuing their education, which will have a positive influence on their subsequent participation in the labour market and increase their chances of finding work, one might consider doing more to combine work and study, in line with the practice in various EU Member States. This often involves part-time jobs. The main source of significant support for the increase in the employment rate must therefore be the over fifty age group.

In its Annual Report in May 2006, the Study Committee on Ageing (SCA) shows that, assuming annual growth of labour productivity averaging 1.75 p.c. up to 2050, the overall employment rate needs to increase by around 8 percentage points between now and 2030, just to maintain the annual average growth of economic activity at 2 p.c., i.e. the figure recorded since 2000.

This SCA simulation takes account of the measures which the government decided to implement in order to curb early retirement from the labour market under the solidarity pact between the generations, excluding those aimed at reducing the attraction of the so-called *Canada Dry* arrangements for which the SCA did not have sufficient information. The effects of the pact appear to be relatively modest since, by 2030, employment will have expanded by only 45,000 units, with the overall employment rate up by 0.7 percentage point and the employment rate for persons in the 55-64 age group up by 2.6 percentage points.

EMPLOYMENT RATE PER AGE GROUP IN BELGIUM AND IN THE EU-25, IN 2006 (1)

(percentages of the corresponding population of working age)



Source : EC.

(1) Based on the second quarter data of the labour force survey.

Apart from a cohort effect, due to the increased participation of women in the labour market with each succeeding generation, the observed growth of the number of older workers is due partly to the tightening up of the conditions for access to a number of early retirement schemes. Overall, the impact of these measures should not be underestimated, as is evident from the trend in the number of beneficiaries between 2000 and 2006.

From 2002 to 2004, the age for qualifying for the status of an older unemployed person not seeking work was gradually raised from fifty to fifty-eight years, so that new unemployed persons in this age group must remain available for the labour market. As a result, the numbers claiming the status of an older unemployed person have fallen sharply : during the year under review, 116,000 persons were granted exemption from seeking work under these rules, whereas the 2000 figure was 141,000. One p.c. of persons aged 50-54, all of whom were existing claimants, were still granted that status, compared to around 8 p.c. in 2000. A fall was also recorded among the 55-59 age group, but it was less marked since new unemployed persons aged 58 or 59 years can still claim the status. Moreover, those who, prior to 2002, were eligible for exemption from age fifty and retained that status after the qualifying age was raised, have meanwhile almost all joined the 55-59 age group. Conversely, among the over sixties, who were unaffected by the reform, the proportion of older unemployed persons increased further by around 3 percentage points from 2000 to 2006.

There was also a slight fall in the number of full-time early retirements. In 2000, 6.6 p.c. of persons aged 50 to 64 years received a full-time early retirement pension ; during the year under review, that applied to 5.8 p.c. This decline concerns all age groups over 50 years, even though, since 2003, there has again been a small increase in the numbers taking full-time early retirement.

In Belgium, as in many other countries, it appears that when measures are taken to discourage the use of certain schemes permitting an early exit from the labour market, there is a shift towards other systems. That probably explains why persons over the age of 50 have opted more frequently for a total career break or a full-time time credit

in recent years. However, in 2006 this concerned only 7,000 persons, compared to 3,000 six years earlier.

Since 1997, there has been a gradual increase in the statutory retirement age for women in the private sector. It will go up from 60 to 65 in 2009, the same age as for men; in general, that is also the retirement age in the public sector. However, it is possible for both women and men to opt for early retirement after working for a certain number of years. Between 1997 and 2005, that period of activity has been gradually increased from 20 to 35 years. These reforms have led to a very sharp fall in the numbers under the age of 65 taking retirement. Thus, at 1 January 2006, 144,000 persons aged between 50 and 64, or 7.6 p.c. of the population in that age group, were receiving a private sector pension, whereas six years earlier that figure was 12 p.c. or 206,000 persons. In both cases, the over sixties represent the vast majority of these pensioners under the age of 65. These statistics include persons who, having worked in both sectors, combine a private sector pension, as a former employee and/or self-employed person, with a public sector pension. As at 1 January 2006, this applied to 27,000 people.

In the public sector, the normal retirement age is 65 years, but civil servants may be eligible for an early retirement pension from the age of 60, provided they have held their post for a minimum of 5 years. Nonetheless, as in the private sector, there are schemes specific to certain groups, permitting earlier retirement. Overall, the number of persons aged between 50 and 64 years receiving a public sector pension has increased since the beginning of the decade: in 2000 this applied to 78,000 people, or 4.5 p.c. of the population group concerned; in 2005, this figure had risen to 89,000 pensioners, or 4.8 p.c. of the total number in the 50-64 age group. This increase occurred solely in the 60-64 age group, where the proportion was up from 10.4 to 12.3 p.c.

Although the invalidity scheme is not commonly used in Belgium as a means of early departure from the labour market, the number of invalidity benefit claimants has also risen in recent years. At the end of 2000, claimants

TABLE 22 DEPARTURE FROM THE LABOUR MARKET BY PERSONS AGED FROM 50 TO 64 YEARS

(thousands of persons, annual averages, unless otherwise stated; in brackets, percentages of the population of the corresponding age group)

	2000				2006 (1)			
	50-54 years	55-59 years	60-64 years	Total 50-64 years	50-54 years	55-59 years	60-64 years	Total 50-64 years
Older unemployed, not seeking work	55 *(8.1)*	58 *(11.1)*	28 *(5.3)*	141 *(8.2)*	7 *(1.0)*	64 *(9.5)*	45 *(8.4)*	116 *(6.0)*
Full-time early retirement	9 *(1.3)*	38 *(7.2)*	68 *(13.0)*	114 *(6.6)*	5 *(0.7)*	42 *(6.3)*	64 *(12.0)*	111 *(5.8)*
Total career breaks / full-time time credit	2 *(0.3)*	1 *(0.3)*	0 *(0.0)*	3 *(0.2)*	2 *(0.3)*	5 *(0.7)*	0 *(0.1)*	7 *(0.4)*
Pensions								
Private sector (2)	1 *(0.2)*	4 *(0.7)*	201 *(38.2)*	206 *(12.0)*	3 *(0.4)*	3 *(0.4)*	138 *(27.2)*	144 *(7.6)*
of which: without mixed public/private sector career (3)	n. *(n.)*	n. *(n.)*	n. *(n.)*	n. *(n.)*	3 *(0.4)*	3 *(0.4)*	111 *(21.9)*	117 *(6.1)*
Public sector (4)	7 *(1.1)*	16 *(3.1)*	54 *(10.4)*	78 *(4.5)*	8 *(1.1)*	20 *(3.0)*	62 *(12.3)*	89 *(4.8)*
Invalidity (5)	40 *(5.8)*	40 *(7.6)*	35 *(6.7)*	115 *(6.6)*	44 *(6.2)*	53 *(7.8)*	37 *(7.2)*	134 *(7.0)*

Sources: BREO; FOREM; FPS Economy, SMEs, Self-employed and Energy; NEMO; NPO; NSDII; PSPS; VDAB; NBB.

(1) In the case of public sector pensions and invalidity, the data relate to 2005.

(2) Total for persons receiving a private sector retirement pension (scheme for employees and/or self-employed persons), including persons combining that pension with a public sector pension. Situation as at 1 January.

(3) Total for persons receiving a private sector retirement pension (scheme for employees and/or self-employed persons), excluding persons combining that pension with a public sector pension. Situation as at 1 January.

(4) Total for persons receiving a public sector retirement pension, including persons combining that pension with a private sector pension. The latter cannot be isolated from the available figures. Situation as at 1 July.

(5) Situation as at 31 December.

numbered 115,000 persons, whereas in 2005, 134,000 persons were receiving an invalidity pension, i.e. 7 p.c. of residents aged between 50 and 64 years.

In 2006, taking all these schemes together, almost one person in three aged between 50 and 64 years and resident in Belgium had left the labour market. Although the majority were over sixty, one person in four between the ages of 55 and 59 years was concerned, and one in ten between the ages of 50 and 54 years.

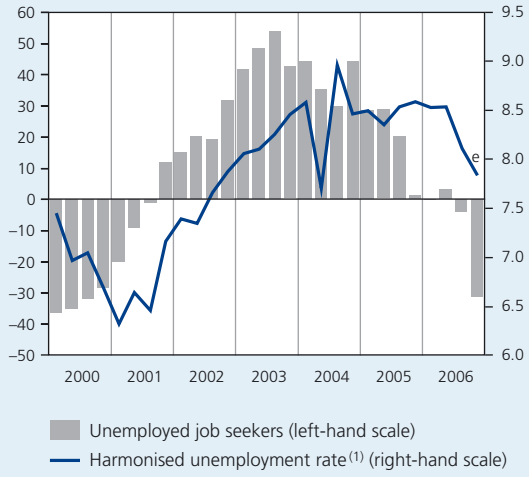
In December 2005, in order to prepare the country more effectively for the shock of population ageing (for more details, see box 8), following consultation with the social partners, the federal government adopted the solidarity pact between the generations. This restricted access to the ordinary early retirement scheme. The conventional early retirement age, previously set at 58 years for workers with a career spanning 25 years, will be raised to 60 years in 2008, subject to 30 years' seniority for men. From 2012 onwards, the required seniority will be gradually increased to 35 years for both men and women. There are still some exemptions available for certain arduous occupations, yet to be defined, and in the construction industry, for night work and for long careers. The definition of an enterprise undergoing restructuring was also changed to limit the use of early retirement schemes in the event of mass redundancies. The firms concerned must set up an employment unit for six months, to assist redundant workers in their search for a new job.

More generally, the pact established a framework which encourages persons reaching the end of their career to keep their job or return to work. Financial incentives have been introduced, such as new cuts in employers' contributions for firms employing or recruiting older workers, a new bonus system granting a pension supplement for persons continuing to work after the age of 62 years, greater scope for combining a pension with an earned income, and more generous tax treatment of second pillar incomes under pension systems in the case of persons resuming work or remaining in employment up to the statutory retirement age.

The number of job seekers recorded in the administrative statistics declined during the year under review. This was the first decrease since 2001. It is due not only to the expansion of employment, but also to the slower growth of the labour force than in previous years. However, the fall in unemployment, which showed a marked acceleration in the final quarter of 2006, was limited, averaging only 8,000 units over the year.

CHART 35 UNEMPLOYMENT

(changes compared to the corresponding quarter of the previous year, thousands of persons, unless otherwise stated)



Sources: EC, NEMO, NBB.

(1) According to the labour force survey concept. Percentages of the total labour force of working age, i.e. between 15 and 64 years. Seasonally adjusted data.

The harmonised unemployment rate also showed a marked fall in the second half of 2006, and its annual average is estimated to have dropped from 8.5 to 8.3 p.c. of the labour force. That contrasts with the movement for the EU-25 as a whole, where the harmonised unemployment rate for persons aged 15 to 64 fell more sharply in 2006, from 9.1 to 8.3 p.c. According to the labour force survey findings, the reason for that difference was that employment expanded less rapidly in Belgium, while the population of working age increased more strongly. Moreover, the activity rate in the EU-25 rose slightly from 70 to 70.4 p.c., unlike in Belgium, where it dropped, from 66.7 to 66.4 p.c.

In the regions, the more favourable labour market situation in Flanders is also reflected in the unemployment figures. On average, during the first three quarters of 2006, the harmonised unemployment rate in that region was 5.2 p.c., whereas it stood at 11.8 p.c. in Wallonia and 17.7 p.c. in Brussels. In 2006, the residents of Flanders, who make up 58 p.c. of the Belgian population of working age, represented around 37 p.c. of the 588,000 unemployed persons included in NEMO's administrative statistics, while 46.6 p.c. lived in Wallonia and 16.5 p.c. in Brussels, where the population of working age accounts for 32 and 10 p.c. respectively of the total. The structure of the unemployed population also exhibited marked

TABLE 23 UNEMPLOYED JOB SEEKERS IN 2006

(annual averages, percentages of the total per geographical area)

	Belgium	Brussels	Flanders	Wallonia
Breakdown by sex				
Men	47.4	50.8	46.5	46.9
Women	52.6	49.2	53.5	53.1
Breakdown by age				
Under 25 years	21.5	16.7	21.8	22.9
25 to 54 years	73.2	79.1	71.2	72.8
55 years and over	5.3	4.2	7.0	4.4
Breakdown by educational level				
Primary and 1st level secondary	26.5	23.8	28.6	25.9
Higher secondary levels (1)	58.5	51.2	56.5	62.6
Higher education	13.4	16.0	14.9	11.3
Other (2)	1.6	9.0	0.0	0.2
Breakdown by duration of unemployment				
Under six months	28.5	23.5	35.8	24.6
Six months to two years	33.1	33.0	35.5	31.2
Over two years	38.4	43.6	28.7	44.2
p.m. Total number unemployed (3)	*588*	*97*	*217*	*274*
Percentages of the total number of unemployed	*100.0*	*16.5*	*36.8*	*46.6*

Sources: BREO, FOREM, NEMO, VDAB.
(1) Including apprenticeship contracts.
(2) Qualifications not recognised in Belgium, or educational level not known.
(3) Thousands of persons.

differences between regions. In regard to the duration of unemployment, some 36 p.c. of Flemish unemployed persons were seeking work for less than six months, and fewer than 30 p.c. for more than two years. In contrast, in Brussels and Wallonia, over 40 p.c. had been unemployed for a long time, and only a quarter for less than six months. As regards the breakdown by age, sex and educational level, Brussels is different from the other regions. While the structure of unemployment in Flanders and Wallonia is fairly comparable to that for Belgium as a whole, in relative terms the capital had more male unemployed persons, fewer young job seekers and fewer unemployed persons with a medium level of education. Brussels also had more unemployed persons who, according to the NEMO statistics, hold qualifications not recognised in Belgium, the reason being the high proportion of persons of foreign origin in that region.

To respond more effectively to the regional disparities on the labour market, the regional employment services reinforced their cooperation: the agreement of 24 February 2005 between the regions and communities concerning the interregional mobility of job seekers was incorporated in the respective regulatory frameworks. Under that agreement, information on vacancies notified to one of those services is automatically passed on to the others if the job offers concern another region or if they are on the list of critical occupations. The cooperation also extends to other areas such as vocational training.

Since July 2006, the programme to encourage active job seeking, implemented in July 2004, whereby assistance with the job search is combined with monitoring of fulfilment of the criteria for claiming unemployment benefit, has applied to all persons under the age of fifty who are wholly unemployed and claiming benefits, except for persons who are unfit for work. It aims to monitor job seekers individually, to help them in their efforts to find work or to initiate a vocational training project offering the prospect of satisfactory reintegration into the labour market. Nevertheless, specific characteristics are taken into account, i.e. age, educational level, aptitudes, social and family background, ability to travel and any form of discrimination which might work against the job seekers.

The labour market situation in the sub-region where the unemployed person is resident is also taken into consideration. To supplement the information obtained from the regional employment services on participation in the action organised in the course of their work, NEMO invites job seekers to one or more personal interviews in order to assess their efforts to find work. If those efforts are deemed inadequate, an action plan is imposed which, if not respected, leads to sanctions. These may consist in the temporary, or even permanent, suspension or reduction of benefits.

This scheme is still expanding, since job seekers aged from 40 to 49 years were not included until July 2006. The number of persons given an initial interview is therefore continuing to rise. According to the statistics available as at 31 December 2006, of the 96,634 persons questioned in an initial interview, 53 p.c. were making an adequate effort to find a job. The efforts made by the others were deemed inadequate and a personal action plan was arranged. The percentage of persons fulfilling the NEMO criteria has declined since the results published previously. At the end of June 2005 it was 69 p.c. This decline is due in part to the greater heterogeneity, particularly in terms of age, of the job seekers questioned as the programme is phased in.

In all, since the system was introduced, from July 2004 to December 2006, 4,774 persons have been penalised by loss of part of their entitlement to benefits, namely 1,507 in Flanders, 2,766 in Wallonia and 501 in Brussels. Around 4,600 other job seekers – 1,550, 2,143 and 884 respectively according to the region – also had their benefits suspended, in most cases for unjustified failure to attend the interviews. This type of sanction can be lifted as soon as the unemployed person attends the appointment with NEMO. Conversely, 1,055 persons (or 1.1 p.c. of those attending an initial interview), namely 318 in Flanders, 595 in Wallonia and 142 in Brussels, had their benefits totally suspended, or in other words, they were disqualified from claiming unemployment benefits.

4.2 Labour costs in the private sector

The movement in labour costs in the private sector is largely determined by the central agreements concluded every two years at national level between representatives of employers and workers. For the period 2005-2006, however, the draft central agreement providing for an indicative norm for the increase in nominal labour costs per hour worked of 4.5 p.c. failed to secure unanimous approval. In the absence of a consensus between the social partners, the government – pursuant to the law of 1996 on the promotion of employment and the safeguarding of competitiveness – passed a royal decree at the beginning of 2005 making the norm binding. In practice, the norm was probably slightly exceeded, as hourly labour costs in the private sector increased by a total of 4.6 p.c., rising by 2.2 and 2.4 p.c. respectively in 2005 and 2006.

After two years of moderate indexation, labour costs came under stronger pressure in 2005 and 2006 owing to the movement in the health index of consumer prices. Taking account of the higher than expected inflation, the impact of wage indexation, which represented a total of 3.9 p.c., exceeded the 3.3 p.c. anticipated by the Secretariat of the Central Economic Council (CEC) in its November 2004 technical report and assumed for the purpose of calculating the maximum scope available for real labour cost increases, used as a basis for the central negotiations. It was this steeper increase in indexation that caused the wage norm to be slightly exceeded.

The marked rise in oil prices in fact drove inflation higher, and that was passed on in wages via the automatic indexation mechanism. However, it was not passed on in full, as petrol and diesel are not included in the health index basket. Moreover, there was a time lag which varied according to the indexation mechanism used by each joint committee. The method of applying automatic wage indexation is specified in the sectoral agreements, and may therefore differ significantly from one committee to another. The broad range of indexation methods can be divided into two main categories of linking mechanisms. In the first, e.g. in the joint sub-committee for private hospitals (JC 305.01), indexation applies when the moving average of the health index exceeds a central index. In the second – steadily growing – category, indexation takes place at fixed intervals, namely monthly (e.g. in the joint committee for the gas and electricity industry, JC 326), every two months (e.g. in the joint committee for banks, JC 310), every three months (e.g. in the joint committee for construction, JC 124), every four months (e.g. in the joint committee for persons employed by notaries, JC 216), every six months (e.g. in the joint committee for cleaning and disinfection firms, JC 121) or annually (e.g. in the joint committee for the food industry, JC 118). Generally speaking, the movement in the four-month moving average of the health index, after a two-month time lag, is a good approximation of the rate of pay indexation applied in practice in the private sector as a whole.

On the other hand, during the year under review, two factors attenuated the impact of the wage indexation. First, as described in detail in box 12, the introduction of the new national consumer price index in January 2006

TABLE 24 LABOUR COSTS IN THE PRIVATE SECTOR

(data adjusted for seasonal and calendar effects; percentage changes compared to the previous year, unless otherwise stated)

	2001	2002	2003	2004	2005	2006 e
Gross wages per hour worked	4.0	3.1	1.4	2.8	2.5	2.4
Collectively agreed wages[1]	3.5	3.7	1.8	2.3	2.5	2.3
Real agreed adjustments	0.9	1.4	0.4	0.9	0.4	0.5
Indexations	2.5	2.3	1.4	1.4	2.1	1.8
Wage drift[2]	0.5	–0.6	–0.4	0.5	0.0	0.0
Employers' social security contributions[3]	0.4	1.2	0.2	–0.5	–0.3	0.0
Social security	0.0	0.6	0.0	–0.2	–0.2	0.0
of which: impact of reductions in contributions	0.0	–0.1	–0.2	–0.5	–0.3	0.0
Other contributions[4]	0.4	0.5	0.2	–0.2	–0.1	0.0
Labour costs per hour worked	4.4	4.1	1.5	2.4	2.2	2.4

Sources: NAI; NSSO; FPS Employment, Labour and Social Dialogue; NBB.

(1) Wage increases fixed by joint committees.

(2) Increases and bonuses granted by enterprises over and above those under central and sectoral collective agreements, wage drift resulting from changes in the structure of employment and errors and omissions, contribution to the change in labour costs, percentage points.

(3) Contribution to the change in labour costs resulting from changes in the implicit contribution rates, percentage points.

(4) Actual contributions which are not paid to the government and imputed contributions.

exerted a moderating effect on the health index – which can be estimated at 0.5 percentage point in 2006 – and, consequently, on the automatic wage indexation. Next, in recent years many joint committees have inserted a so-called all-in clause in their biennial agreements. This makes the scale of the real increases dependent on the actual wage indexations: if the latter exceed the figures based on the inflation forecasts produced at the time of the preparation of the central agreement, the difference is deducted in whole or in part, depending on the case, from the real wage increases granted in the second year – i.e. 2006 in the case of the agreements concluded in 2005 – or during the ensuing agreement period. According to the FPS Employment, Labour and Social Dialogue data relating to the sectoral agreements concluded in 2005, one-fifth of private sector workers are covered by a collective labour agreement which contains an all-in clause.

Combined with the wage moderation efforts agreed between the social partners, the all-in clauses partly explain the small real increases in 2006, which came to only 0.5 p.c. after an already meagre 0.4 p.c. in 2005. Such small increases had never been recorded since the beginning of the decade, except in 2003. Another point worth remembering is that, in the biennial wage agreement cycle, the second year increases are systematically higher, in view of the time taken to conclude and implement the agreements by the joint committees.

In contrast to 2005, the impact of employers' social security contributions on the movement in labour costs was neutral during the year under review. That situation is due to administrative factors and developments concerning reductions in the social security contributions paid to the government by employers; the share of those reductions in the total wage bill remained unchanged at 3.9 p.c. The main reason for this stabilisation is that the reductions granted to employers are fixed amounts, not indexed to prices, and this counteracted the positive effect of the introduction, on 1 July, of a new measure to reduce the employers' contributions, namely the "young person's bonus", intended to encourage the hiring of low-paid workers under the age of thirty years. This was in addition to the existing reductions in favour of target groups on the labour market, namely older workers, long-term job seekers, the first employees recruited by a firm, young workers, workers affected by a collective reduction in working time and the four-day week, and finally, workers affected by restructuring. The budget set aside for these groups increased by almost 200 million euro in 2006, to 498 million, or one-eighth of the funding for the general reductions in social security contributions, known as the structural reductions.

Other measures intended to cut labour costs also gained in importance during the year under review. This concerns the support in the form of reductions in the payroll tax, to encourage specific forms of working such as shift work and overtime, and also research. Under this scheme,

TABLE 25 REDUCTIONS IN EMPLOYERS' SOCIAL SECURITY CONTRIBUTIONS

(totals, millions of euro)

	2003	2004	2005	2006 e
Total	**3,451**	**4,073**	**4,547**	**4,697**
p.m. Percentages of the private sector wage bill	*3.2*	*3.6*	*3.9*	*3.9*
of which:				
Structural reductions (1)	2,944	3,423	3,822	3,872
Target groups	–	201	309	498
of which:				
Young workers	–	–	–	65
Older workers	–	98	103	111
p.m. Reductions in payroll tax (2)				
Millions of euro	*8*	*25*	*121*	*335*
Percentages of the private sector wage bill	*0.0*	*0.0*	*0.1*	*0.3*

Sources: General notes on the budget, NSSO.
(1) Including those targeting either low wages or high wages.
(2) Except the reductions granted to universities and colleges.

in order to prevent the reductions granted from being reflected in higher net wages, the employer is required to deduct the whole of the payroll tax due on taxable pay, except in the case of overtime, when half of the rebate is handed over to the workers. In the end, after deduction of the said reductions, the balance of the payroll tax is paid over to the Treasury. In view of these specific characteristics, the part which the companies retain is recorded as a subsidy in the national accounts, rather than as a direct reduction in charges. This system of wage subsidies has expanded greatly in recent years: having totalled barely 25 million euro in 2004, these subsidies amounted to 121 million in 2005 and 335 million in 2006, or 0.1 and 0.3 p.c. respectively of the total wage bill.

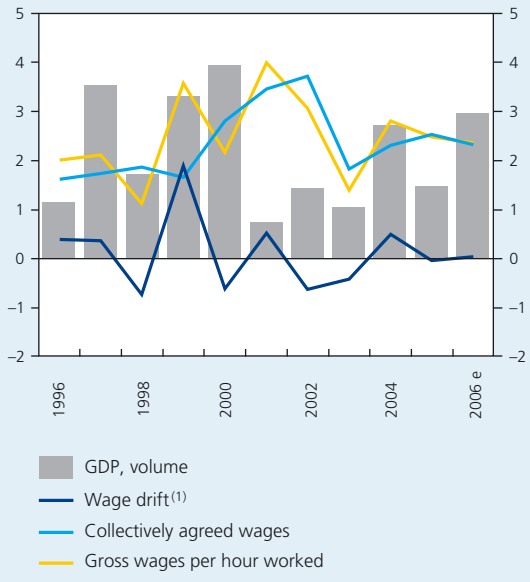
In 2006 the employers' other social contributions also exerted a neutral effect on the movement in labour costs. These consist of the imputed social contributions, such as redundancy pay, and the payments made by employers under a supplementary pension plan. In view of the economic upswing in 2006, redundancy pay did not generate any additional pressure.

Nor did the wage drift contribute to the increase in labour costs during the year under review. Traditionally highly volatile, the contribution of this factor has been slightly negative, on average, since the start of the decade. Its tendency to exert ever less pressure is also observed in the euro area.

The wage drift comprises the part of the movement in hourly labour costs which is not explained by the movement in collectively agreed wages or employers' social

CHART 36 WAGE DRIFT IN THE PRIVATE SECTOR

(data adjusted for seasonal and calendar effects; percentage changes compared to the previous year, unless otherwise stated)



Sources: NAI; FPS Employment, Labour and Social Dialogue; NBB.
(1) Contribution to the change in labour costs, percentage points.

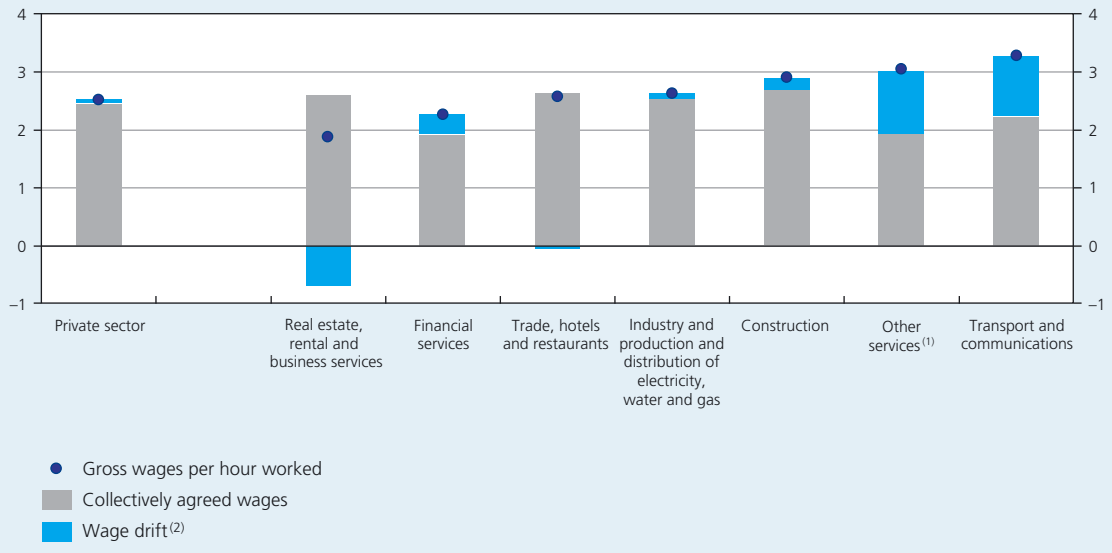
contributions. In particular, it includes increases and bonuses granted on top of the agreed increases, extra pay for working overtime, the impact of changes in the wages of the small group of workers not covered by any sectoral agreement, or the impact of wage agreements concluded at firm level and diverging from the sectoral agreements. More and more joint committees include in their agreements explicit provisions allowing firms to conclude specific agreements, since that is the level at which it is possible to adopt wage policies which most faithfully reflect the conditions of activity and competition confronting employers in practice. However, there are no sources permitting systematic monitoring of company agreements. In general, it is evident that variations in the wage drift are linked to some extent with the economic situation.

Beyond these developments, there are various factors which might explain the tendency of the wage drift to decline in relative importance. First, the competitive pressure resulting from the increasing globalisation has prompted firms to continue their policy of wage moderation, despite the more favourable economic climate. In addition, certain measures relating to employment which allow companies to hire staff at lower gross wages, such as the service voucher system, have exerted a downward influence on the wage drift. Other changes to the structure of employment have had a similar effect, such as the increased participation of women in the labour market, since they are less well paid, on average, than men, and the expansion of part-time working and temporary employment contracts, arrangements which may curb wage dynamics in the course of working life.

Although the wage negotiation mechanism is based on a single norm, defined under the central agreements concluded at national level, it nonetheless permits some differentiation, both in the level of agreed wages and in the components of wages reflected in the wage drift. In this regard, there is little point in comparing annual wage adjustments between branches of activity, since wages do not necessarily respond simultaneously to the economic cycle or to price fluctuations; it is therefore more appropriate to compare the annual average rise over a specific period. This shows that, during the period 1996-2005, the movement in gross hourly wages was certainly not similar in all branches of activity. While the average increase in gross hourly wages in the private sector came to 2.5 p.c. per annum, it varied between 1.9 p.c. in the real estate, rental and business services sector, and 3.3 p.c. in transport and communications. This differentiation between branches of activity is due to divergences in both collectively agreed wages and the wage drift.

CHART 37 GROSS WAGES PER HOUR WORKED IN THE PRIVATE SECTOR, BY BRANCH OF ACTIVITY: 1996-2005

(average annual percentage changes from 1996 to 2005, unless otherwise stated)



Sources: NAI; FPS Employment, Labour and Social Dialogue; NBB.

(1) I.e. the "health and social work", "community, social and personal services" and "domestic services" branches.

(2) Average annual contribution to the change in labour costs, percentage points.

Thus, while the indicative wage norm agreed at national level is taken into account by the joint committees at sectoral level, the specific characteristics of the branch of activity, such as competition conditions, market prospects, operating results or the power ratio between employers and workers, obviously play an important role in the negotiations. In fact, while collectively agreed wages increased by an annual average of 2.4 p.c. during the

Box 9 – Empirical studies on labour cost differentiation

A number of empirical studies, presented at a symposium held by the Bank in October 2006 on the subject of wage and price rigidities, conclude that the Belgian economy's wage diversity is comparable to that of other advanced countries. A wide dispersion of wage changes and wage levels is also evident.

One of these studies, conducted as part of an international project on wage flexibility (*International Wage Flexibility Project* – IWFP)[1], analyses annual wage changes in sixteen advanced countries, including Belgium, over various periods. It finds that, almost everywhere and for all the periods considered, wage changes are heavily concentrated around an annual average. It therefore appears that, each year, a substantial proportion of workers receive a wage increase which is close to the average. On the other hand, there is considerable dispersion around that annual average, with a significant number of large, small and even negative wage changes. That is true in Belgium, as it is in the fifteen other advanced countries studied. These findings emerge from the administrative data studied by the IWFP for the period 1978-1985, but also from the data obtained by the *Panel Study of Belgian Households* (PSBH) for the period 1994-2001. Preliminary research conducted on administrative statistics analysed by the Bank for the period 1990-2002 confirms these findings.

Another study, conducted by a group of ULB researchers[2], examined the level of wages in Belgium over a number of years, the persistent differences observed and their causes. It reveals that the wages of Belgian workers are determined largely by the workers' individual characteristics – such as their educational level, age, seniority, occupational category, sex and contract of employment –, and by the characteristics of their employers, such as the size of the firm and the region. Thus, there are still significant differences between workers who have the same characteristics but are employed in different branches of activity. Wage differentials at sectoral level are therefore due only partly to differences in the structure of employment. More profitable firms are shown to pay higher wages, on average, and that practice explains a substantial part of the wage differentials at sectoral level. When the wage-setting process is decentralised, one would expect workers in more productive, more profitable firms to receive higher pay for the same work. Sectoral wage differentials in Belgium seem to be around the average for the advanced countries, the dispersion being greater in the Anglo-Saxon countries and smaller in the Scandinavian countries. A coordinated wage-setting mechanism like Belgium's therefore does not appear to prevent wages from being adjusted in line with the microeconomic reality.

The sectoral wage differentials in Belgium are confirmed by a study conducted by KUL researchers[3]. This shows that workers are in a stronger bargaining position, and can therefore obtain relatively higher wages, in the branches of activity exposed to less competition. In those branches of activity, firms are not necessarily more productive, but they have greater market power so that it is easier for them to set their selling prices higher than their unit costs. Such an adjustment of wages to competitive pressure is also evident from the finding that the bargaining position of workers and the market power of the firms are less in the branches of activity with a higher import penetration rate. Wages in Belgium therefore seem to adapt to some extent to the international competition confronting many firms.

(1) Dickens W.T., L. Goette, E.L. Groshen, S. Holden, J. Messina, M.E. Schweitzer, J. Turunen and M.E. Ward (2006), *How wages change: micro evidence from the International Wage Flexibility Project*, National Bank of Belgium, Working Paper no.96.

(2) Plasman R., F. Rycx and I. Tojerow (2006), *Industry wage differentials, unobserved ability, and rent-sharing: evidence from matched worker-firm data, 1995-2002*, National Bank of Belgium, Working Paper no.90.

(3) Abraham F., J. Konings and S. Vanormelingen (2006), *Price and wage setting in an integrating Europe: firm level evidence*, National Bank of Belgium, Working Paper no.93.

period 1996-2005 for the private sector as a whole, the increase came to 2.7 p.c. in construction and 1.9 p.c. in financial services and the other services branch, a 0.8 percentage point difference.

Much larger differences are evident between branches in regard to the wage drift, which reflects in particular the wage adjustments made at the level of the firms, though this says nothing about any changes made to the pay structure within firms. While the wage drift contributed an average of 0.1 percentage point per annum to the rise in labour costs in the private sector from 1996 to 2005, its contribution came to 1.1 point in other services and –0.7 point in real estate, rental and business services, a difference averaging 1.8 percentage points per annum.

Finally, labour cost differentiation does not occur only between sectors and firms, but also at the level of individual pay. An examination of the empirical literature on this subject, summarised in box 9, reveals that wage changes in Belgium and in other countries display significant dispersion, and that Belgium's wage diversity is comparable to that of other advanced countries.

If productivity variations between branches are taken into account, even greater differentiation is apparent at the level of unit labour costs. Overall, their rise for the private sector as a whole has slowed, dropping to 0.7 p.c. in the year under review, as the movement in hourly labour costs corresponded more closely to the movement in productivity. The slackening pace of economic activity combined with a more favourable movement in employment had in fact significantly reduced the productivity gains in 2005, whereas the rise in hourly labour costs hardly slowed at all.

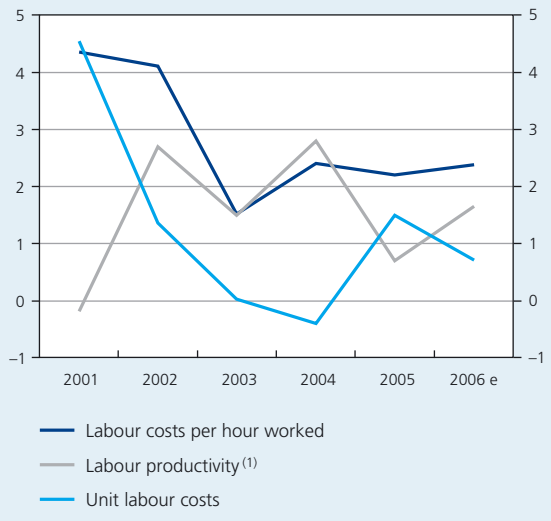
During the period 1996-2005, certain branches, such as industry, construction, and transport and communications, though recording an above-average increase in gross hourly wages, achieved labour productivity gains in line with the rise in hourly labour costs, so that the increase in unit labour costs was below the already moderate average for the private sector. Conversely, that increase was relatively higher in other services where hourly labour costs were rising faster than in the rest of the private sector but there was no accompanying stronger productivity growth. In real estate, rental and business services, the wage moderation efforts were insufficient during the period mentioned to compensate for the movement in productivity, implying a steep rise in unit labour costs. Conversely, in financial services, the moderate wage increases were accompanied by substantial productivity gains, so that unit labour costs showed a marked fall from 1996 to 2005.

Analysis of the relative dynamism of exports by Belgian industry compared to world trade developments reveals the role played by market conditions in wage setting. If the industrial branches are divided into two categories, progressive or regressive, according to whether their export markets measured by volume are more or less dynamic than the average, it is evident that, during the period 1996-2005, unit labour costs declined, on average, by 0.2 p.c. per annum in the progressive branches, while the rate of decline came to 0.6 p.c. in the regressive branches. The activities which are, a priori, the most vulnerable on the international markets therefore seem to have made greater efforts to adapt their unit labour costs to the pressure of international competition.

Maintenance of Belgium's competitive position is an essential concern in the determination of the indicative wage norm, which is in fact based on the maximum margin calculated by the CEC Secretariat for the rise in hourly labour costs in the private sector, according to the expected movement in those costs in the three main neighbouring countries for the ensuing two years. As explained in box 10, this mechanism has steered the movement in wages in Belgium for the past ten years.

CHART 38 LABOUR COSTS AND LABOUR PRODUCTIVITY IN THE PRIVATE SECTOR

(data adjusted for seasonal and calendar effects, percentage changes compared to the previous year)

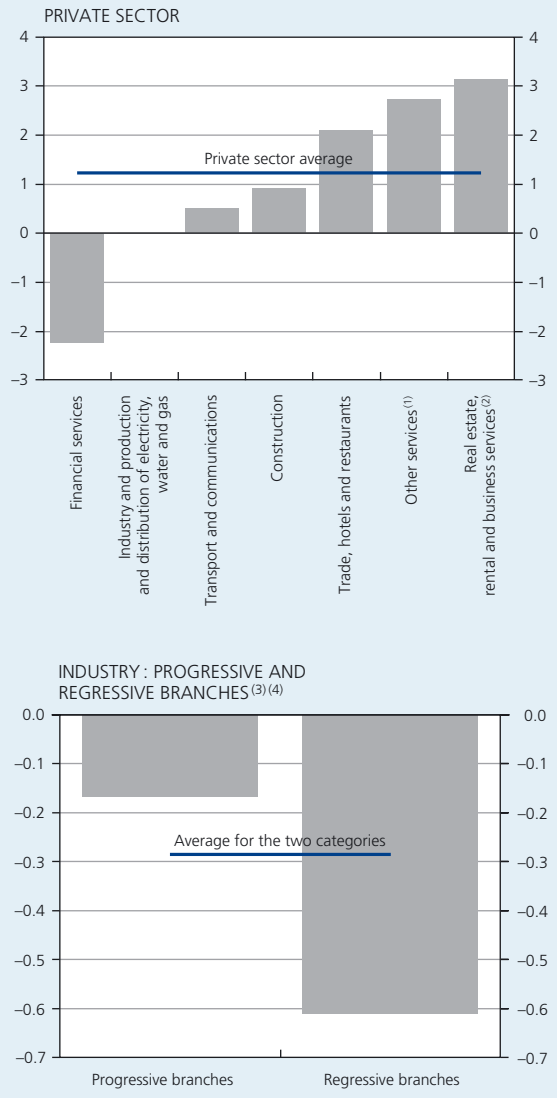


Sources : NAI, NBB.

(1) Value added, by volume, per hour worked for employees and self-employed persons.

CHART 39 UNIT LABOUR COSTS IN THE PRIVATE SECTOR : 1996-2005

(average annual percentage changes, 1996 to 2005)



Sources : NAI, NBB.

(1) I.e. the "health and social work", "community, social and personal services" and "domestic services" branches.

(2) Excluding housing services.

(3) The breakdown into progressive and regressive branches is only possible for twenty branches of activity covering more than 80 p.c. of industry's value added. It is based on the progressivity coefficients calculated for all products recorded in the foreign trade statistics for the period 1995-2005. Those coefficients are defined as the ratio between the volume growth of trade in the product and the average volume growth of trade for all products in the reference region, namely the EU-15.

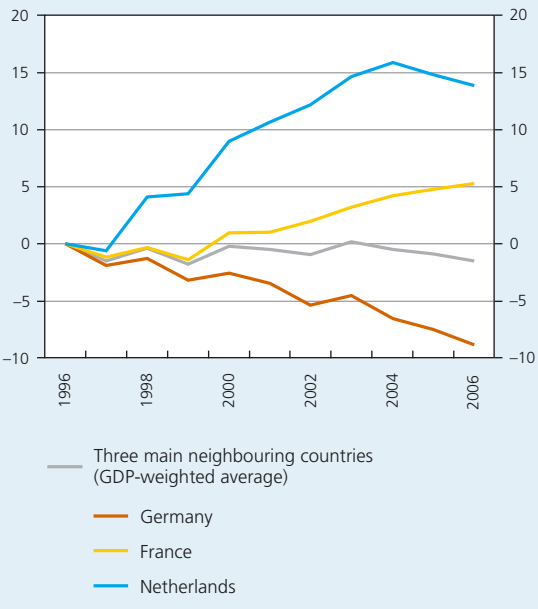
(4) For a more detailed explanation of the progressivity and regressivity concepts, see Melyn W. (2004), *Characteristics and development of Belgium's foreign trade*, Economic Review, NBB, no.3, pp. 7-28.

According to the CEC Secretariat, the wage handicap in relation to the three main neighbouring countries, calculated using 1996 as the base year in accordance with the law on the promotion of employment and the safeguarding of competitiveness, had been eliminated in 2003 but subsequently built up again. The increase recorded in the years 2005-2006 is due to the fact that wage indexation outstripped the figure expected at the time of the negotiations, and the rise in other countries' labour costs fell short of the forecasts made at the time. For that period, according to the CEC Secretariat, hourly labour costs increased overall by 4.7 p.c. in Belgium, compared to 3.6 p.c. in the three main neighbouring countries. Since 1996, the cumulative handicap in terms of labour costs – excluding wage subsidies in Belgium or in the three main neighbouring countries – came to 1.5 percentage points.

In view of the commitments given under the central agreement for 2007-2008, all other things being equal, that handicap should be reduced by 0.5 percentage point by 2008. The social partners have in fact agreed a 5 p.c. norm, whereas, according to the estimates of the CEC Secretariat, hourly labour costs are set to rise, on average, by 5.5 p.c. in the three main neighbouring countries over the period 2007-2008, with an increase of 4.3 p.c. in Germany, 6 p.c. in the Netherlands and 7.1 p.c. in France.

CHART 40 LABOUR COSTS PER HOUR WORKED IN THE PRIVATE SECTOR : DIFFERENCE IN RELATION TO BELGIUM, ACCORDING TO THE CEC (1)

(percentage points, difference compared to the index for Belgium, 1996 = 100)



Source : CEC.

(1) CEC data for labour costs per worker and working time.

The average divergence in labour costs compared to the three main trading partners masks significant bilateral differences. Thus, up to and including 2001, labour cost increases in Belgium roughly paralleled those in France; subsequently, Belgium actually enjoyed a more favourable trend. In comparison with the Netherlands, there was a considerable divergence in Belgium's favour, especially since 1999. Belgium's wage handicap is therefore attributable solely to the very moderate movements in hourly wages in Germany. In that country, in response to a protracted period of weak economic growth and high unemployment, and growing fears of a relocation of production to other countries, the maintenance of employment gradually became an increasing focus of attention during the collective bargaining. Wage moderation was also encouraged by the relocation or development of activities in the former East Germany. In addition, it was accompanied by a clear tendency towards decentralisation of the wage negotiations, particularly by the use of the so-called opt-out safeguard clauses. More and more firms also took measures to cut costs, such as increasing working time without financial compensation, reducing bonuses, or linking additional pay to performance. Finally, as part of the employment promotion measures, the rapid expansion of the number of low-paid jobs in Germany also exerted downward pressure on hourly labour costs.

Box 10 – Ten years of central agreements on the definition of the wage norm

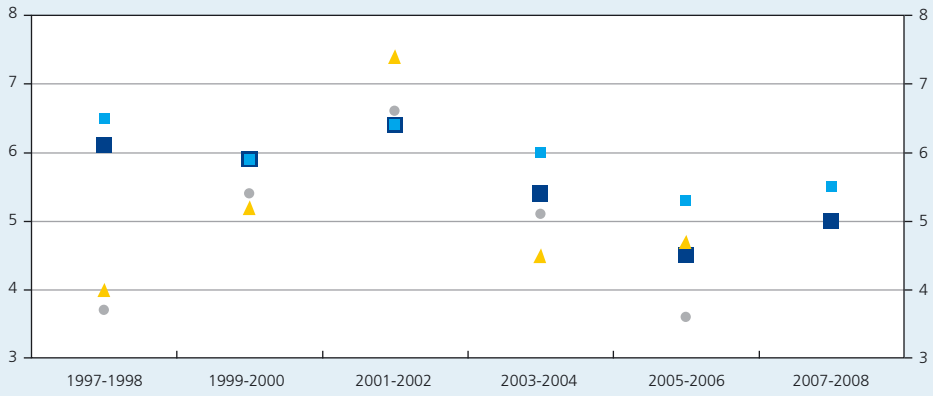
Until 1996, labour cost developments in Belgian firms were monitored under the law safeguarding the country's competitiveness, adopted on 6 January 1989. That law gave the government the right to intervene if competitiveness was threatened and if the social partners failed to agree on the action to be taken. Various criteria were used to assess Belgium's competitive position in relation to that of the seven main trading partners. Since the introduction of the law of 26 July 1996 on the promotion of employment and the safeguarding of competitiveness, the role of the social partners has been reinforced, in that they determine a margin for wage increases at the time of the biennial negotiation of a central agreement; this has introduced a prospective dimension into the wage-setting process.

That margin, which concerns nominal labour costs per hour worked, is agreed with due regard for the movement in labour costs in the three main training partners – Germany, France and the Netherlands – and with adjustment for any slippages occurring in the preceding two years. It is used as a norm for the wage increases negotiated at branch and firm level. The wage norm always includes at least the predicted indexations, which are based on the expected movement in the health index of consumer prices, and the estimated scale increases. The social partners set this norm on the basis of the anticipated movements in labour costs for the three main trading partners, as calculated by the CEC Secretariat in accordance with the OECD's forecasts of labour costs per worker and its own forecasts of changes in working time. Any derailment in previous years is also calculated by the CEC Secretariat which, for that purpose, takes as a basis the data relating to the movement in labour costs per worker according to national sources and the movement in working time according to the Eurostat labour force surveys. Since the entry into force of the law of 26 July 1996, six wage norms have been adopted, including the one agreed on 21 December 2006 for the period 2007-2008. The concept of a norm evolved from a maximum margin specified by the first agreements, and became an indicative norm from the period 2001-2002 onwards. Apart from the definition of the wage norm, the agreements comprise employment promotion measures. More specifically, commitments are given concerning training, the employment of risk groups, the elimination of unemployment traps, the retirement issue, the balance between working and private life, equality of opportunity for men and women, mobility, etc. In addition, these agreements contain provisions on organisation and working time, health and safety at work, the alignment of the status of manual and non-manual workers, sustainable development and measures to stimulate innovation and R&D. In concluding the 2007-2008 agreement, the social partners added to these topics four new anchorage points relating to the abolition of the clauses linking pay scales to age, the granting of staff incentives linked to the firm's results, the issue of diversity and non-discrimination at work, and the policy of preventing the use of alcohol and drugs in the workplace. New measures on all these subjects will be negotiated between the social partners during 2007.

Following the conclusion of the central agreement, real agreed adjustments are adopted at sectoral level, more precisely at the level of the joint committees, and supplemented, if appropriate, by agreements at the level of the firms, a practice which has been gaining ground in recent years. Even though the maximum/indicative wage norm is always taken into account, there is nevertheless evidence of the norm being exceeded *ex post*.

HOURLY WAGE INCREASES UNDER THE CENTRAL AGREEMENTS

(cumulative percentage changes compared to the previous year)



	1997-1998	1999-2000	2001-2002	2003-2004	2005-2006	2007-2008
Expected indexation	4.2	3.1	3.1	3.0	3.3	3.9
Actual indexation (1)	2.7	2.7	4.8	2.8	3.9	–

- Wage norm *ex ante*
- Wage increase expected in the three main trading partners
- Actual increase *ex post* in the three main trading partners
- Actual increase *ex post* in Belgium

Source: CEC.

(1) Calculations based on data from FPS Employment, Labour and Social Dialogue.

Although respect for the norm was good during the periods 1997-1998, 1999-2000 and 2003-2004, labour cost increases in 2001-2002 and in 2005-2006 exceeded those set by the wage agreements for the corresponding years. In both cases, the reason was that the indexations were higher than anticipated at the time of the wage negotiations. Thus, the central agreement for the period 2001-2002 assumed that the indexation would come to 3.1 p.c., whereas in reality it amounted to 4.8 p.c. For the period 2005-2006, allowance had been made for indexation of 3.3 p.c. whereas in practice the indexation came to 3.9 p.c. In regard to the agreement for the period 2001-2002, mention should be made of a special provision relating to the branches which had performed particularly well: while the indicative wage norm was set at 6.4 p.c., the overall rise in labour costs in these branches could be up to 7 p.c. Finally, turning to the central agreement for 2007-2008, a 5 p.c. norm was agreed for the increase in the average hourly labour costs in the private sector; from October 2007, firms will also benefit from a structural reduction in charges equivalent to 0.15 p.c. of labour costs, in the form of a subsidy corresponding to non-payment to the Treasury of payroll tax representing 0.25 p.c. of gross wages. Under the new agreement, the social partners also call on the sectors which do not yet have an adjustment mechanism for avoiding any wage derailment to introduce such mechanisms.

While *ex ante* respect for the wage norm is important, actual *ex post* compliance is crucial for the competitiveness of Belgian firms. That was achieved in 1999-2000 and in 2003-2004. Conversely, in the other three periods, labour costs in Belgium rose faster than those in the three neighbouring countries, placing Belgian firms at a disadvantage in relation to their foreign counterparts. That was due not only to the effect already mentioned of the higher than expected indexations, but also to the fact that the hourly wage increases expected in the three neighbouring countries were almost systematically overestimated at the time of the negotiations. That was the case in all periods, except for 2001-2002. This shows that it is difficult to set the wage norm on the basis of forecasts, and that in order to maintain competitiveness it is desirable to be able to make prompt adjustments, a facility offered by the all-in agreements in the event of unexpected developments in the price indexation of wages.

5.

5.1 Summary

In 2006, inflation measured by the harmonised index of consumer prices (HICP) came to 2.3 p.c., against 2.5 p.c. in 2005. For the second consecutive year, it thus slightly outpaced the rate for the euro area, which was 2.2 p.c. in both 2005 and 2006. Primarily administrative price changes curbed inflation by around 0.1 percentage point in 2006, as a result of reductions in the excise duty on diesel and the abolition, in mid 2005, of a tax which had been introduced earlier in the year on non-recyclable packaging.

TABLE 26 HARMONISED INDEX OF CONSUMER PRICES FOR BELGIUM

(percentage changes compared to the previous year)

	Total	Energy	Unprocessed food[1]	Underlying trend in inflation[2]	Processed food	Non-energy industrial goods	Services	*p.m. Health index*[3]
2000	2.7	16.3	0.2	1.1	1.3	0.0	2.3	*1.9*
2001	2.4	1.4	6.9	2.1	2.2	2.0	2.0	*2.7*
2002	1.6	–3.6	3.2	2.1	1.5	1.7	2.6	*1.8*
2003	1.5	0.2	1.7	1.7	2.8	1.0	1.9	*1.5*
2004	1.9	6.6	0.9	1.4	2.2	0.3	2.1	*1.6*
2005	2.5	12.7	1.7	1.4	2.0	0.3	2.1	*2.2*
2006	2.3	7.3	3.3	1.6	2.1	0.9	2.1	*1.8*
	Excluding primarily administrative price changes[4]							
2000[5]	3.0	16.8	0.2	1.5	1.2	0.7	2.4	
2001	2.6	1.9	6.9	2.2	2.1	1.9	2.5	
2002	1.9	–2.7	3.2	2.4	1.5	1.6	3.3	
2003	1.8	1.0	1.7	2.0	2.1	1.0	2.7	
2004	1.7	4.8	0.9	1.5	2.2	0.3	2.3	
2005	2.6	13.4	1.7	1.3	1.6	0.3	2.1	
2006	2.5	8.3	3.3	1.6	2.2	0.9	2.1	

Sources: EC; FPS Economy, SMEs, Self-employed and Energy; NBB.

(1) Fruit, vegetables, meat and fish.

(2) Measured by the HICP excluding unprocessed food and energy.

(3) National CPI, excluding products considered harmful to health, namely tobacco, alcoholic beverages, petrol and diesel.

(4) That is, measures relating to the radio and television licence fee, tariff changes in the network industries in which liberalisation is farthest advanced, namely telecommunications, electricity and gas, and changes to indirect taxes.

(5) Excluding the estimated effect, in January and July 2000, of the fact that prices discounted in sales have been taken into account in the HICP since 2000.

Once again, inflation was substantially affected by the globalisation of the world economy, as that process is bringing significant changes in relative prices. Thus, the relative prices of commodities continued to climb during the year under review. The oil price hit a record level of almost 80 dollars per barrel of Brent at the beginning of August. However, it later subsided, fluctuating around 60 dollars per barrel from October onwards. Whereas the energy component had exerted constant pressure on inflation in 2005 and during the first eight months of 2006, it thus ceased to make any significant contribution by the end of the year under review. That is evident from the fact that inflation dropped to 1.9 p.c. during the fourth quarter, after having reached 2.6 p.c. in the first quarter. Nonetheless, taking the year under review as a whole, energy prices still made a significant contribution to the rise in the HICP, averaging 0.7 percentage points against 1.3 points in 2005. That contribution exceeded the figure recorded for the euro area over the past two years. The small but positive inflation differential in relation to the euro area is therefore due to the greater short-term sensitivity of Belgium's HICP to fluctuations in crude oil prices. The rise in the cost of crude oil recorded during the year under review also had an indirect effect on consumer prices, particularly the prices of non-energy industrial goods.

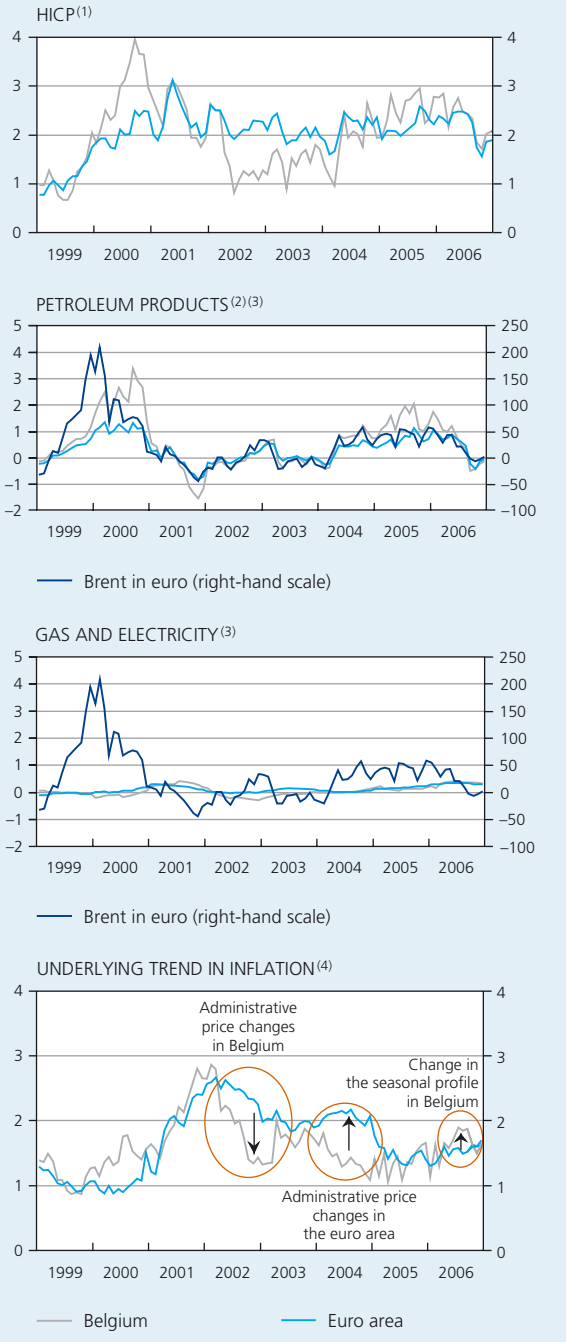
The process of globalisation is on the other hand also exerting a moderating effect on the movement in the relative prices of labour-intensive goods and services, particularly via imports from low-cost countries. According to a recent OECD study, the effect of the latter during the period from the beginning of 2000 to the end of 2005 was 0.2 to 0.4 percentage point per annum for Belgium, thus exceeding the upward influence – estimated at between 0.1 and 0.2 percentage point per annum – exerted by the rise in commodity prices attributable to globalisation, namely 20 to 40 p.c. of the recorded increase in crude oil prices and 10 p.c. of the increase in metal prices. Apart from this direct channel, stronger international competition is also having a moderating influence on the movement in costs of domestic origin, particularly unit labour costs. In 2006, wage moderation limited the transmission of the increase in commodity prices to underlying inflation. Excluding administrative price changes, the latter nevertheless gathered pace, rising from 1.3 p.c. in 2005 to 1.6 p.c.

5.2 Volatile components of the HICP

Once again, the movement in inflation recorded during the year under review was greatly influenced by the movement in crude oil prices. The latter have an almost immediate impact on consumer prices of petroleum products,

CHART 41 INFLATION IN BELGIUM AND IN THE EURO AREA

(percentage changes compared to the corresponding month of the previous year, unless otherwise stated)



Sources : EC, NBB.

(1) Excluding the estimated effect, in January and July 2000, of the fact that prices discounted in sales have been taken into account in the HICP since 2000.

(2) Petrol, diesel and heating oil.

(3) Contribution to overall inflation, percentage points.

(4) Measured by the HICP, excluding unprocessed food and energy.

such as petrol, diesel and heating oil. The contribution of these three products to overall inflation, which was still 1.7 percentage points in January, first declined gradually before becoming slightly negative from September, largely because of the movement in crude oil prices. To a lesser extent, the movement in the prices of these products was determined by two factors which to some degree offset the upward effect of the increased price of crude oil, namely the reduction in excise duty on diesel, resulting from the reverse ratchet system introduced in May 2005, and the fact that consumers obtained larger reductions on the maximum prices set under the "programme contract" (for more details, see box 11).

Changes in the prices of these three petroleum products have a similar immediate, if less pronounced, effect on inflation in the euro area, both during periods when crude oil prices are rising, as was the case in 1999-2000 and in 2004-2006, and during periods of falling prices, as in 2001. The greater sensitivity of the Belgian HICP to crude oil price fluctuations is due to two factors. First, petroleum products represent a larger share of the consumption basket used to calculate the HICP for Belgium, mainly because of the larger weight of heating oil. Second, the excise duties levied on these products – which, because of their flat-rate character – tend to cushion the effect of crude oil price movements – are lower, on average, in Belgium than in the euro area. While excise duties on petrol are slightly higher in Belgium than in the euro area, those on diesel and heating oil are significantly lower. As a result, crude oil prices have a greater impact on the consumer prices of these three petroleum products in Belgium than in the euro area.

Although consumer prices of gas and electricity depend to some extent on crude oil prices, they are less sensitive to fluctuations in those prices and take more time to react. Thus, long-term gas supply contracts are indexed to the movement in crude oil prices after a time lag of around six months. The influence of this factor is also weakened by the significant share of transport and distribution costs in the final selling price of gas. The pass-through to electricity prices is even more limited, since only a relatively small proportion of electricity production is based on oil and gas. Moreover, domestic production and distribution costs have a greater weight in the cost structure of this form of energy. In addition, movements in gas and electricity prices take longer to be reflected in the HICP since, in the case of the market segments which had not been liberalised by the end of the year under review – namely Wallonia and Brussels – the index is calculated on the basis of the annual invoices sent out to households by the distributors. The rate of increase in the prices of these products therefore only began accelerating gradually from mid 2004, and had not yet started to slow down significantly during the year under review. The contribution of gas and electricity to inflation came to 0.3 percentage point in 2006, against 0.1 point in 2005. In the euro area, the movement in gas and electricity prices also tracks the crude oil price with a certain time lag, and is also less pronounced there. The transmission of fluctuations in crude oil prices to these products therefore does not appear to be a source of asymmetry in the movement in inflation in Belgium and the euro area.

Overall, energy prices increased by 7.3 p.c. on average in 2006, against 12.7 p.c. in 2005.

Apart from energy prices, the prices of unprocessed food are another traditional source of short-term variations in inflation, as those prices are largely determined by sometimes highly unstable supply conditions. Those conditions proved to be negative overall during the year under review, mainly because of the weather, whereas they had tended to be neutral in 2005. The rise in the prices of unprocessed food therefore speeded up, from 1.7 p.c. in 2005 to 3.3 p.c. in 2006.

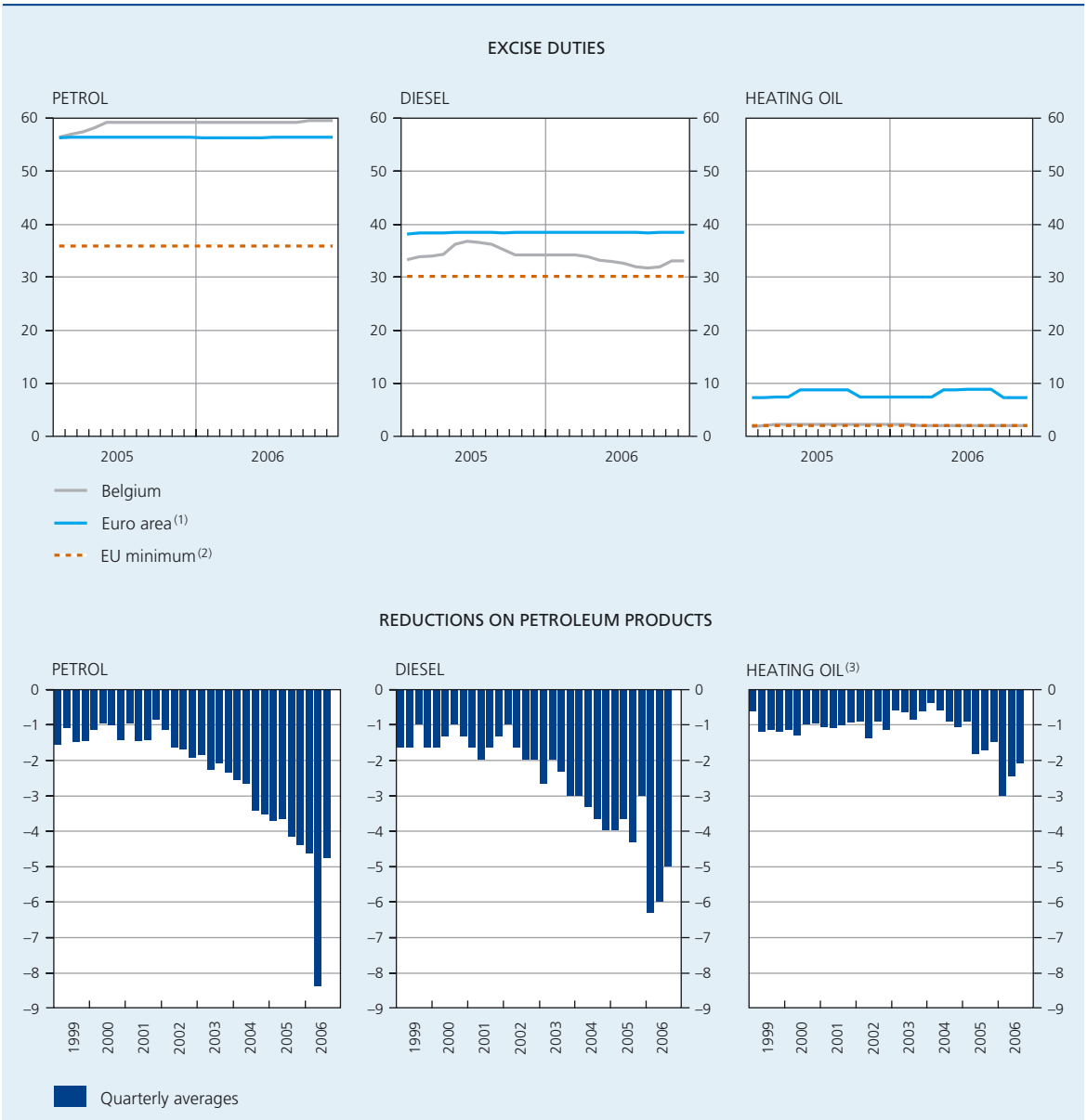
Box 11 – Factors which have tempered the direct impact of crude oil price increases

In recent years, the soaring price of crude oil has led to a marked rise in inflation. In May 2005, in order to curb the increase in petrol and diesel prices, the federal government froze the original ratchet system which it had introduced in August 2003 with the aim of raising the excise duties on petrol and diesel, and introduced a reverse ratchet system designed to reduce those duties.

Under the original ratchet system, half of each price reduction resulting from the application of the "programme contract" was to be offset by a permanent increase in excise duties up to an annual maximum cumulative amount specified by law. In 2004, the ceiling for petrol and diesel was set at the same level, namely 2.8 euro cents per litre. While this threshold was retained for petrol in 2005, it was increased to a maximum of 3.5 euro cents per litre for diesel. Initially, this system was to remain in force until 2007.

EXCISE DUTIES AND REDUCTIONS GRANTED IN PETROLEUM PRODUCT DISTRIBUTION

(euro cents per litre)



Sources : EC, NBB.

(1) Average level of excise duties in the euro area weighted by quantities consumed in each country.

(2) Minimum rate of excise duty applicable from 1 January 2004.

(3) Deliveries over 2,000 litres.

Under the new reverse ratchet system, each increase in VAT revenues generated by a price increase under the "programme contract" is totally offset by a cut in excise duties, so long as the prices set by the "programme contract" exceed the thresholds of 1.10 euro per litre for diesel and 1.50 euro for petrol. As a result, the excise duties on diesel dropped by around 5 euro cents per litre between July 2005 and the end of August 2006. In other words, without this measure, and taking account of the fact that 21 p.c. VAT would also have been payable on those reduced excise duties, the price of diesel would have been around 6 euro cents per litre higher at the end of the year under review. No decline was recorded for petrol, since the maximum price did not exceed the threshold for activating the measure.

In practice, the introduction of the reverse ratchet system therefore led to a further increase in the difference between diesel and petrol prices from mid 2005 onwards. The reductions in excise duties thus granted are permanent, even if oil prices start falling again as they did from September 2006. The excise duties on diesel are therefore again well below the European average, and at the end of August actually came close to the European minimum rate. In November, the excise duties on unmixed diesel increased by 1 euro cent per litre, however, in order to bring about a differential rate of excise duties on unmixed diesel and biodiesel respectively.

Another factor which has limited the direct impact of the rise in crude oil prices is that, over the years, the distribution sector has granted consumers increasing discounts on the maximum prices for petroleum products set by the "programme contract". The average reduction can be estimated by comparing the average consumer price recorded for the HICP with the maximum price charged at the same time. This shows that the difference between those two prices has increased systematically in recent years. During the first nine months of 2006, the average reduction on petrol and diesel was 6 euro cents per litre, whereas from 1999 to 2002 it had always fluctuated between 1 and 2 euro cents. The average discount granted on heating oil also increased, rising from around 1 euro cent per litre between 1999 and 2002 to 2.5 euro cents during the first three quarters of 2006. This increase in the discounts could be due to the high oil prices themselves, which make it more difficult to pass on cost increases because demand has become more elastic. However, it could also indicate that there is now increased competition among petroleum product distributors, although the fact that some service stations grant much larger reductions than others seems to prove that this market is still highly segmented and that imperfect competition still prevails.

Taking account of the weight of the various products in the HICP, the impact of the increased reductions granted in petroleum product distribution from 2002 to 2006 can be estimated at 0.15 percentage point. In the case of the reverse ratchet system, the cumulative effect comes to 0.06 point. These two factors together therefore contributed towards reducing the aggregate level of prices by 0.21 percentage point. The rebate which the federal government had granted at the end of 2005 on heating oil bills had no impact on price levels in 2006, since that measure was no longer in force. Having regard to the statistical conventions in use for the compilation of the price index, the similar rebate granted provisionally during the year under review to households using gas for heating had no influence on the movement in energy prices recorded in the HICP.

5.3 Underlying trend in inflation

Exclusion of the volatile components from the HICP provides an indicator of the underlying trend in inflation, even though the use of that concept has probably become less relevant in the current context, since the method used to calculate it implies asymmetric treatment of the effects of globalisation. This indicator of underlying inflation in fact excludes the direct impact of the increase in energy prices, which is due in part to the strong expansion of demand in the emerging countries, whereas the downward pressure which globalisation of the world economy exerts on prices of manufactured products is not neutralised.

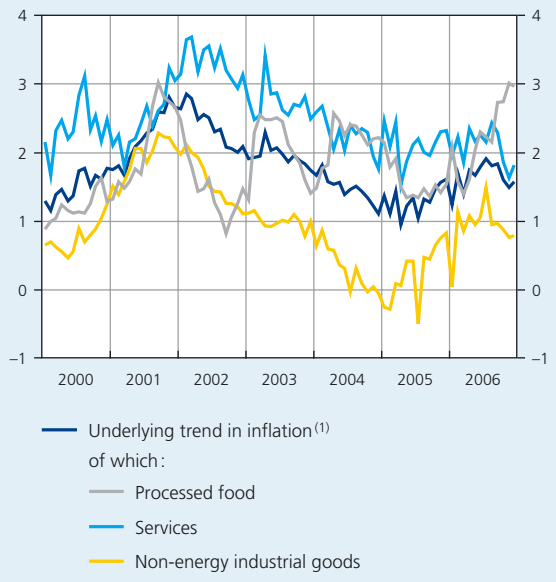
In Belgium, this indicator presents a profile which corresponds overall to that for the euro area as a whole. Since the start of monetary union, it is only certain temporary factors, such as administrative price changes, that have given rise to occasional asymmetry. Thus, underlying inflation in Belgium fell sharply in 2002 and 2003, following the abolition of the radio and television licence fee in Flanders and in Brussels, and its reduction in Wallonia, while administrative price changes exerted strong upward pressure in the euro area in 2004. Since 2005, the underlying trend in inflation in Belgium has once again moved in parallel with that in the euro area. That situation remained unchanged during the year under review, allowing for the fact that the temporary rise recorded in Belgium during the summer was due essentially to a change in the seasonal profile of the HICP, which is in turn due to the updating of the basket of package holidays in the calculation of the index.

To determine the degree to which market forces have influenced the underlying trend in inflation, it is preferable to disregard administrative price changes. In Belgium, the latter mainly influenced the movement in prices of processed food. They were connected with the increases in tobacco prices, but also with the introduction, at the beginning of 2005, of a tax on non-recyclable packaging, a tax which was abolished later in the same year. This last measure therefore exerted an upward influence on the annual change in this component in the first half of 2005 and a downward influence in the first half of 2006. Leaving aside these administrative price changes, the underlying trend in inflation gathered pace, rising from 1.3 p.c. in 2005 to 1.6 p.c. in 2006. By the end of the year under review, however, that acceleration seemed to have ceased. This rise primarily reflects the transmission of the increase in the price of crude oil and other commodities. However, its upward influence was partly offset by the moderating effect exerted by globalisation via imports of manufactured products, and the relatively moderate movement in wages.

At the level of producer prices, i.e. the stage preceding consumption, the transmission of the increased cost of crude oil and other commodities is particularly apparent for intermediate products. These are in fact products comprising relatively little value added, which are therefore more vulnerable to changes in commodity prices. Producer prices of consumption goods seem to have been relatively unaffected, at least until the end of 2005. Afterwards a rise set in which continued throughout 2006. The fact that the share of domestic value added is decidedly greater at this later stage in production than for intermediate products explains not only the limited degree of transmission, but also the fact that the impact made itself felt later, given that in this case there is greater latitude for refraining from passing on cost increases immediately in selling prices. This argument also explains why consumer prices of non-energy industrial goods recorded in the HICP are even less sensitive than producer prices of consumption goods. The share represented by domestic costs is in fact greater still at the level of consumer prices, particularly because the latter include transport and distribution costs.

CHART 42 UNDERLYING TREND IN INFLATION

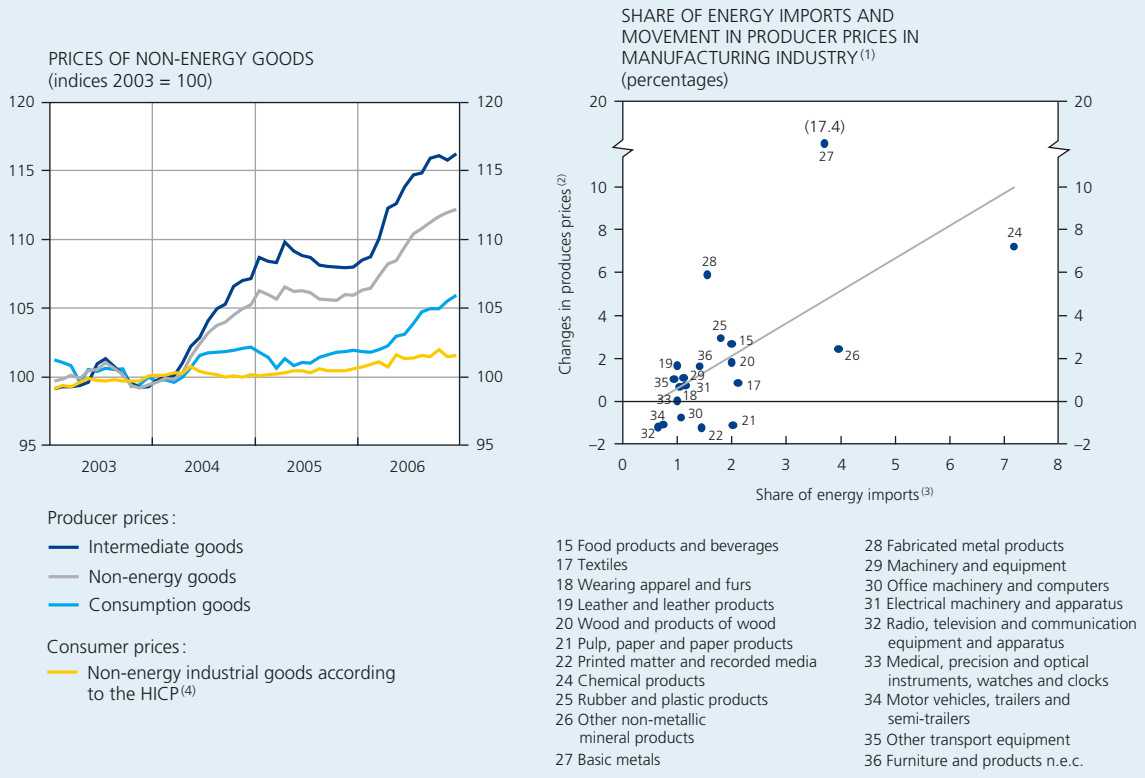
(percentage changes compared to the corresponding month of the previous year)



Sources : EC, NBB.

(1) Measured by the HICP, excluding unprocessed food and energy, primarily administrative price changes, and the estimated effect, in January and July 2000, of the fact that prices discounted in sales have been taken into account in the HICP since 2000.

CHART 43 TRANSMISSION OF THE INCREASE IN THE PRICE OF CRUDE OIL AND OTHER COMMODITIES

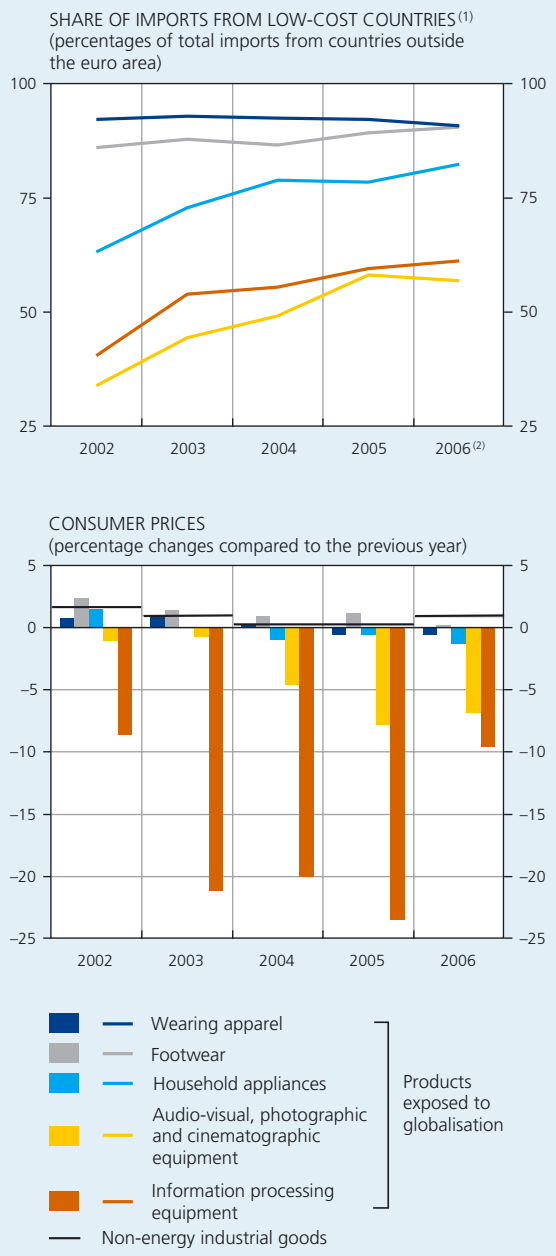


Sources : FPS Economy, SMEs, Self-employed and Energy ; NAI ; NBB.
(1) Excluding energy.
(2) Changes from January 2003 to September 2006, expressed as annual growth rates.
(3) Share of energy imports in the cumulative costs, calculated by means of the latest input-output table (2000).
(4) Excluding the estimated effect of prices discounted in the sales in January and July each year.

More detailed analysis of the link between prices and costs for twenty non-energy subsectors of manufacturing industry also reveals that the cost structure is a key determinant of the transmission observed. Thus, the movement in prices since 2003 shows a positive correlation with the percentage of production costs represented by energy, ascertained by analysing the cumulative costs on the basis of the input-output table for the year 2000. However, that correlation is relatively low, and there are various factors which may account for it. First, the cumulative cost approach underestimates the real importance of energy in pricing, since non-energy imports also usually comprise an energy component which could not be identified and which may vary from one sector to another. Next, this bivariate analysis takes no account of the potential role of factors other than energy price movements. Thus, it is noticeable that the products which display the largest fluctuations in producer prices – basic metals and manufactured metal products – are precisely the ones whose prices are also influenced by the marked rise in the prices of metal commodities. Moreover, the sectors exhibiting relatively moderate price movements include some which are generally considered to be most affected by globalisation. That applies to wearing apparel, office machinery and computers, and radio, television and communication equipment and apparatus.

This compensatory effect of globalisation is also evident in the movement in the prices of certain non-energy products in the HICP, particularly on account of the relatively moderate movement in the producer prices of the products mentioned, but also because direct imports from low-cost countries account for a growing percentage of the consumption of these products. Despite the widespread acceleration in the increase in non-energy industrial product prices recorded in 2006, the opposite trend was apparent in the case of wearing apparel, footwear and household appliances, while the prices of

CHART 44 GLOBALISATION AND CONSUMER PRICES



Sources : EC ; FPS Economy, SMEs, Self-employed and Energy ; NAI.

(1) The low-cost countries are all countries outside the euro area except Australia, Canada, Denmark, Japan, New Zealand, Norway, Sweden, Switzerland, the United Kingdom and the United States.

(2) Data for the first nine months.

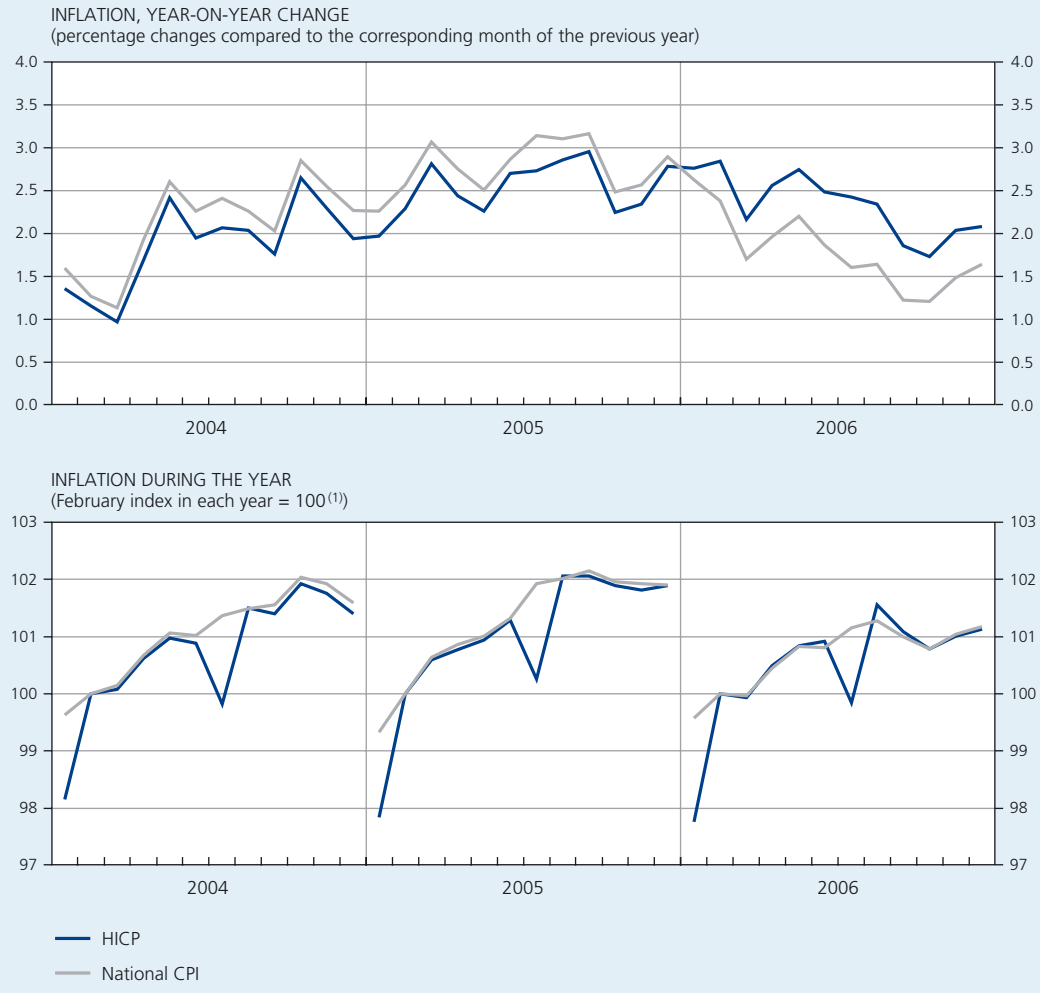
audio-visual, photographic and cinematographic equipment and prices of information processing equipment continued to decrease, albeit more slowly than in 2005. It is generally acknowledged that globalisation is exerting a significant influence on the prices of these products. However, fluctuations in the prices of audio-visual, photographic and cinematographic equipment and information processing equipment are also due to the major technological progress achieved. Moreover, the movement in the prices of information processing equipment recorded in the Belgian HICP was depressed to some extent by the switch to a new method of adjustment for quality changes in 2003.

The underlying trend in inflation was also modest overall, since inflationary pressure of domestic origin remained limited. Consequently, service inflation remained steady at around 2 p.c. for the second successive year, despite a temporary rise recorded during the summer, following the change in the seasonal profile of the basket. That outcome was due mainly to the wage moderation which, as in other euro area countries, is attributable in part to globalisation. In Belgium, wage moderation in 2006 is also explained partly by the introduction of a new national consumer price index in January (for more details, see box 12). More fundamentally, that result shows that the impact of the higher oil prices was confined to the direct and indirect first-round effects, and that there was very little sign of any second-round contagion effects in 2006.

Box 12 – Reform of the national consumer price index

Since the introduction of the harmonised index of consumer prices (HICP) in 1997, two measures of inflation have existed side by side in Belgium for goods and services consumed by households. The HICP is an essential indicator for monetary policy, as the Governing Council of the Eurosystem has defined price stability on that basis. In Belgium, the indexation of incomes is based on the national consumer price index (national CPI) and, since 1994, the health index which is derived from it. For that reason, the social partners consult on the design and calculation of that index in the Index Committee and the National Labour Council. This involvement of the social partners is specific to Belgium, and does not apply to the Belgian HICP.

IMPACT OF THE REFORM OF THE NATIONAL CONSUMER PRICE INDEX



Sources : EC, NBB.

(1) Since the HICP has been influenced by prices discounted in the sales since they were first recorded in 2000, the month of February was preferred to January as the basis for the indices calculated by this method.

In January 2006, a new national CPI was introduced owing to the obsolescence of the index in use up to the end of 2005. The basket of goods and the weightings used for that index were in fact still based on the household consumption structure of the years 1995-1996, and had never been updated since the index was introduced in January 1998. Moreover, it proved necessary to adjust the recorded prices of certain goods in order to take account of the changes in their quality, by analogy with the HICP. The social partners reached agreement on this subject in the Index Committee in December 2005. The obsolescence of the national index had become evident in 2004-2005 and had affected the inflation figures. During that period, the differences between inflation measured by the national index and that measured by the HICP came to around 0.25 percentage point per annum. Obviously, a difference of that size exerted a significant influence on the rise in the health index of consumer prices, and consequently on the rise in labour costs over the period 2004-2005.

Now that it has been revised, the national CPI is once again very similar to the HICP. Thus, the two indices recorded very similar movements in 2006, except that, since prices discounted in the sales are taken into account in the HICP and not in the national CPI, the former is systematically dragged downwards in January and July every year. This parallelism seen in 2006 contrasts with the years 2004 and 2005, when the two indices gradually diverged during the year.

However, inflation measured by the annual change in the national CPI was significantly moderated in 2006 by the way in which the new index was introduced. The conversion ratio for making the transition from the old national index to the new one is in fact based on the average levels attained by these two indices respectively in 2004. Thus, the excess inflation recorded since 2004 by the old index was in practice fully offset in 2006. Consequently, the annual change in the national CPI came to 1.8 p.c. during the year under review, while inflation measured by the HICP came to 2.3 p.c. In general, the social partners followed the same method in the National Labour Council to set the conversion ratio applicable to the health index. The conversion therefore had a marked downward influence on the annual change in the health index in 2006, which stood at 1.8 p.c. The part of the indexations granted in 2004 and 2005 on account of the obsolescence of the index was therefore counterbalanced during 2006. Since the transition from the old to the new index only influences the annual changes in 2006, the figures for inflation measured by the two indices should be more comparable from 2007.

It was also decided that, henceforth, the national CPI would be partially updated every two years, a major step forward with a view to maintaining its representativeness. However, the HICP remains a more accurate index because of its greater flexibility from the point of view of updating, and its greater efficiency in adjustments for quality changes.

Despite the progress made, there are still a number of challenges ahead. The main improvements to be made at European level lie in the treatment of housing costs in the case of owner-occupied housing, costs which are not yet taken into account in the HICP, and in the harmonisation and generalised introduction of adjustments for changes in quality. These challenges also concern a fortiori the Belgian HICP and, more particularly, the national CPI, which still comprises fewer adjustments for changes in quality despite the 2006 reform. For Belgium, more specifically, other major challenges are the updating of the data on the structure of retail trade and the extension to a larger number of products of the elementary aggregation based on the geometric mean. In both cases, the HICP and the national CPI should better reflect the substitution effects between outlets and between products. The introduction of the new national index once again illustrated the importance of monitoring the quality and representativeness of the inflation measure.

6.

6.1 Revenue, expenditure and overall balance

In the year under review, the general government accounts closed with a small surplus. The target of a balanced budget, set by the December 2005 stability programme, was therefore met. The government was aided in achieving that by economic growth which was almost 1 percentage point higher than the figure projected when the programme was drawn up, and by one-off measures which were once again substantial.

For the year 2005, there is a divergence between the statistics issued by the NAI and Eurostat. According to the general government accounts published by the NAI in September 2006, a surplus of 0.1 p.c. of GDP was achieved in 2005, and that is the figure notified to the EC in the framework of the excessive deficit procedure (EDP). In October 2006, however, Eurostat adjusted that figure.

Unlike the NAI, that office took the view that the Railway Infrastructure Fund (RIF), established in 2005, formed part of the general government sector, and the transfer to that Fund of the major part of the debt of the Belgian National Railway Company (BNRC) at the time of its restructuring on 1 January 2005 should be regarded as a debt assumption by the government, and therefore as expenditure of the general government sector. According to this argument, the assumption of this 7.4 billion euro debt should therefore have been recorded under public expenditure as a capital transfer, causing the budget to show a deficit of 2.3 p.c. of GDP in 2005.

While that debt assumption has no direct impact on the budget outcome for 2006, in view of its non-recurrent nature, the same is not true of the sectoral classification selected for the RIF, since that entity's interest charges are slightly less than its receipts. The latter comprise compensation for making the railway infrastructure owned by the

TABLE 27 TARGETS FOR THE FINANCING REQUIREMENT (–) OR CAPACITY OF BELGIAN GENERAL GOVERNMENT[1]

(percentages of GDP)

	2002	2003	2004	2005	2006	2007	2008	2009	2010
Stability programme and successive updates									
November 2002	0.0	**0.0**	0.3	0.5					
November 2003		0.2	**0.0**	0.0	0.0	0.3			
December 2004			0.0	**0.0**	0.0	0.3	0.6		
December 2005				0.0	**0.0**	0.3	0.5	0.7	
December 2006					0.0	**0.3**	0.5	0.7	0.9
p.m. Actual figures									
According to the view taken by Eurostat[2]	*0.0*	*0.0*	*0.0*	*–2.3*	*0.1 e*				
According to the view taken by the NAI[2]	*0.0*	*0.0*	*0.0*	*0.1*	*0.1 e*				

Sources: EC, FPS Finance, NAI, NBB.

(1) According to the methodology used in the framework of the excessive deficit procedure (EDP). That methodology differs from that of the ESA 95 which was adapted in 2001 to exclude from the calculation of the overall balance the net interest gains on certain financial transactions, such as swaps and forward rate agreements (FRAs).

(2) According to the view taken by the NAI, the Railway Infrastructure Fund (RIF), set up in the context of the BNRC restructuring on 1 January 2005, comes under the non-financial corporations sector. According to Eurostat, that Fund forms part of the general government sector and the assumption of BNRC debt should be recorded as a capital transfer from that sector to the non-financial corporations sector.

Fund available to Infrabel, and a capital transfer which the government pays to the Fund to enable it to progressively repay its debt. The budget outcome for the year under review is therefore marginally worse according to the NAI's view than according to that taken by Eurostat, but – after rounding – the difference is imperceptible when expressed as a percentage of GDP, since in both cases the result is a surplus of 0.1 p.c.

The new 2006 stability programme confirmed the commitments made in 2005, i.e. a surplus of 0.3 p.c. of GDP in 2007, increasing thereafter by an annual 0.2 percentage point up to 2013 to reach 1.5 p.c. of GDP, and maintained at that level until 2018. Since 2005, these objectives are included in the law of 5 September 2001 guaranteeing a continuous reduction in the public debt and creating an Ageing Fund, which refers to the budget path set by the stability programme up to the year 2012.

Box 13 – Influence of non-recurrent factors on the overall balance of general government

Non-recurrent factors can be described as elements which have a significant impact on government revenue or expenditure, but whose influence is felt only in one year, or over a few years at the very most. Since the reform of the stability and growth pact in 2005, the public finance situation of the Member States has been assessed on the basis of the budget balances after adjustment for cyclical and non-recurrent factors. From now on, attention therefore focuses more on the underlying trend in fiscal policy, and the emphasis is on structurally sound public finances.

When budgets are drawn up in Belgium, it is common to see substantial use of one-off measures to flatter the overall balance. This was done in the 1980s, for example, with the elimination from the budget of aid to the national sectors, and in the 1990s with the privatisation of certain public enterprises and the anticipation of dividends or shares in the profits which they were due to pay out. Many of these operations were later disregarded in the calculation of the general government financing balance, following the revision of the accounting rules used for compiling the national accounts. The tendency to resort to measures of this type was also evident in recent years. That had been particularly true in 2003, when they improved the budget position by 1.2 p.c. of GDP. In 2006, too, they enhanced the financing balance significantly, by 0.7 p.c. of GDP, a level comparable to the 2004 figure. Conversely, in 2005 they had caused it to deteriorate by 2 p.c. of GDP, owing to the transfer on 1 January 2005 of the major part of BNRC debt to the RIF. Leaving aside that operation, non-recurrent factors had exerted a favourable influence in that year on the general government budget balance, totalling 0.4 p.c. of GDP.

In terms of their influence on public finances, non-recurrent factors can be divided into one-off factors or measures, and measures whose effect is neutralised over a number of years.

The one-off factors only have a direct influence on the government budget in the year in which they are implemented. In Belgium, that applies in particular to the regularisation of taxes, assumption of debts, temporary allowances towards the cost of energy consumption and, in 2006, the effect of the structural acceleration of the collection of corporation tax.

The other measures, whose impact is offset in the years following their implementation, can in turn be divided into two categories, according to whether their subsequent effects are felt in the short or long term. The first category concerns shifts relating to the collection of taxes, notably between the withholding tax on earned incomes and the assessments, shifts in BNRC Group funding, and the securitisation of tax arrears. The second category comprises real estate sales – in the case of government buildings which are sold and subsequently leased by public authorities – and capital transfers intended to compensate for the assumption of pension liabilities. These factors trigger a "boomerang" effect since they are later reflected in higher primary expenditure or lower revenues.

NON-RECURRENT FACTORS (1)

(millions of euro, unless otherwise stated)

	2003	2004	2005	2006
One-off factors				
Regularisation of taxes	0	498	0	75
RIF's assumption of BNRC debt	0	0	–7,400	0
Heating cost subsidies	0	0	–145	–97
Accelerated collection of corporation tax	0	0	0	700
Other (2)	–546	–259	225	0
Measures with a reversible effect				
With short-term influence				
Shifts in the collection of taxes	–227	184	205	0
Shift in BNRC Group funding	–1,051	1,051	0	0
Securitisation of tax arrears	0	0	439	486
With long-term influence (3)				
Property sales	195	689	171	953
Capital transfers in return for the assumption of pension liabilities	5,000	151	481	0
Impact on the overall balance				
According to the view taken by Eurostat				
Millions of euro	3,371	2,314	–6,024	2,117
Percentages of GDP	1.2	0.8	–2.0	0.7
According to the view taken by the NAI (4)				
Percentages of GDP	1.2	0.8	0.4	0.7

Sources: budget documents, NBB.

(1) A positive (negative) figure indicates an improvement (deterioration) in the general government financing balance resulting from non-recurrent factors.

(2) For 2005, the other one-off factors concern a capital transfer to general government by Aquafin, following a dispute regarding the VAT rate applicable (225 million euro). In 2006, a shift in the BNRC Group funding led to a one-off reduction in subsidies (100 million euro), but that effect was offset by an exceptional payment by the Flemish Community to the water supply companies and Aquafin (around 100 million euro).

(3) Since the non-recurrent factors are defined as elements which exert a significant influence on public finances for one year or a few years at the very most, in the case of measures with a long-term influence the later effects are disregarded; in any case, they are sometimes difficult to assess reliably. This convention avoids the appearance of persistent discrepancies between nominal and structural budget balances over a long period in the absence of new non-recurrent factors.

(4) According to the view taken by the NAI, the Railway Infrastructure Fund (RIF), set up in the context of the BNRC restructuring on 1 January 2005, comes under the non-financial corporations sector. According to Eurostat, that Fund forms part of the general government sector, and the assumption of BNRC debt should be recorded as a capital transfer from that sector to the non-financial corporations sector.

Revenue

In 2006, the fiscal and parafiscal revenues of general government declined by 0.7 percentage point to 44.2 p.c. of GDP. This contraction was due to the overall impact of the fiscal and parafiscal measures, the reduction in the share of GDP represented by earned incomes, which are taxed relatively heavily, and the adverse movement in certain categories of taxes, such as excise duties and the advance payments made by self-employed persons. The reduction in the fiscal and parafiscal burden applies almost exclusively at the level of Entity I, which comprises the federal government and social security, since the revenues of the communities, regions and local authorities forming Entity II remained practically unchanged.

The reduction in fiscal and parafiscal revenues is attributable mainly to the levies on earned incomes. During the year under review, these dropped by no less than 1 percentage point of GDP. Of the measures designed to reduce the fiscal and parafiscal burden, it is mainly the application of the personal income tax reform, approved in 2001, and the reduction in personal contributions on low incomes that had the greatest influence. Their effect

TABLE 28 REVENUE OF GENERAL GOVERNMENT[1]

(percentages of GDP, according to the view taken by Eurostat)

	2002	2003	2004[2]	2005	2006 e
Fiscal and parafiscal revenue	44.7	44.2	44.4	44.8	44.2
Levies weighing chiefly on earned income	27.2	26.9	26.3	26.2	25.3
Personal income tax[3]	12.5	12.3	12.1	12.1	11.4
Social contributions[4]	14.7	14.6	14.3	14.2	13.9
Taxes on company profits[5]	3.0	2.9	3.2	3.4	3.7
Levies on other incomes and on assets[6]	3.4	3.5	3.6	3.7	3.7
Taxes on goods and services	11.1	11.0	11.3	11.5	11.5
of which :					
VAT	6.7	6.6	6.8	7.0	7.1
Excise duties	2.2	2.3	2.4	2.4	2.3
Non-fiscal and non-parafiscal revenue[7]	5.1	6.9	4.8	5.1	4.8
Total revenue	49.8	51.1	49.2	50.0	49.0
p.m. Entity I[8]	*42.1*	*43.2*	*41.4*	*42.1*	*41.2*
Federal government[8]	*27.5*	*28.8*	*27.3*	*28.1*	*27.4*
of which : transfers to the communities and regions[9]	*9.6*	*9.9*	*9.7*	*9.9*	*9.7*
Social security[8]	*14.8*	*14.5*	*14.3*	*14.1*	*13.9*
Entity II[8]	*7.7*	*7.9*	*7.8*	*7.9*	*7.8*
Communities and regions[8]	*4.1*	*4.3*	*4.3*	*4.4*	*4.5*
Local authorities[8]	*3.6*	*3.7*	*3.5*	*3.4*	*3.4*

Sources : NAI, NBB.

(1) In accordance with the ESA 95, total revenue of general government does not include the proceeds of fiscal revenue which the government transfers to the EU.

(2) In 2004, fiscal and parafiscal revenue was augmented by around 0.1 p.c. of GDP as a result of the shift between VAT and GNI resources following the EU financing reform. That factor increased both revenue and expenditure without any significant effect on the overall balance.

(3) Mainly withholding tax on earned income, advance payments, assessments and the proceeds of additional percentages on personal income tax.

(4) Total social contributions, including the special social security contribution and the contributions of persons not in work.

(5) Mainly advance payments, assessments and withholding tax on corporate income from movable property. Mainly withholding tax on income from movable property of individuals, withholding tax on income from immovable property (including the proceeds of additional percentages), inheritance taxes and registration fees.

(6) Income from property, imputed social contributions, current transfers and capital transfers from other sectors, plus sales of goods and services produced.

(7) The revenue of the general government sub-sectors does not include the transfers which they receive from other sub-sectors.

(8) This consists essentially of personal income tax and VAT revenues which are transferred under the Special Finance Act.

was reinforced by the decline in the share of GDP represented by earned incomes – compensation of employees and gross mixed income, excluding imputed contributions – down from 56.3 to 55.7 p.c. Advance payments by self-employed persons were also 3.7 p.c. down, despite the increase in their incomes.

Revenues generated by personal income tax fell by 0.7 percentage point of GDP during the year under review. Although the said tax reform had no new impact on 2006 incomes, it nevertheless continued to have a significant effect since, as planned, the provisions concerning incomes from previous years had not been fully integrated into the scale of the withholding tax on earned incomes. Consequently, the reform made a further contribution towards reducing the assessments in 2006, totalling 1,245 million euro, or 0.4 p.c. of GDP. It was mainly the measures aimed at equalising the treatment of the various forms of cohabitation, such as the alignment of the tax-free allowance for married individuals with that for single people, and individualisation of the tax allowances for replacement incomes, which had the greatest influence on revenues in 2006. The latter were also affected by a new measure, namely the raising of the percentages and ceilings applied in calculating the standard allowance for professional expenses, which cut revenues by 77 million euro.

TABLE 29 MAIN FISCAL AND PARAFISCAL MEASURES

(millions of euro, changes compared to the previous year)

	2004	2005	2006
Structural fiscal measures	489	245	–764
Federal government and social security	491	260	–643
Personal income tax	–534	–486	–1,336
Personal income tax reform	–500	–464	–1,245
Other	–34	–22	–91
Corporation tax	0	89	–149
Taxes on goods and services	692	442	–155
Levies on other incomes and on assets	24	–56	516
Evasion control and better collection	310	270	480
Communities and regions[2]	–68	–50	–50
Local authorities	65	35	–71
Additional percentages on personal income tax	–4	–65	–122
Endogenous effect of the federal reform	–31	–73	–111
Rate increase	28	8	–11
Additional percentages on the withholding tax on immovable property	32	0	0
Other	37	100	51
Structural parafiscal measures	–506	–413	–433
Employers' contributions	–622	–364	–75
Employees' contributions	116	–50	–359
Non-recurrent measures	812	–38	617
Total	**795**	**–207**	**–580**
p.m. Percentages of GDP	*0.3*	*–0.1*	*–0.2*

Sources: budget documents, NBB.

(1) This table does not show the corporation tax reform implemented in 2006 – including the tax allowance for venture capital – since its effect is neutral, according to official sources.

(2) In 2004, this mainly concerned the abolition of the regional element of the withholding tax on immovable property for firms in the Flemish Region and for households with dependants in the Walloon Region. In 2005 and 2006, water charges were abolished in the Flemish Region following the change in Aquafin's funding.

The burden of parafiscal charges on labour dropped by 0.2 p.c. of GDP during the year under review. The entry into force on 1 July of a new reduction in employers' contributions for low wage earners under the age of thirty years, introduced when the budget was drawn up in the context of the generation pact, curbed the increase in revenues by 65 million euro. Employees' contributions were cut by 359 million as a result of the extension of the work bonus, which comprises a reduction in employees' social security contributions granted to low wage earners and to certain employees affected by corporate restructuring.

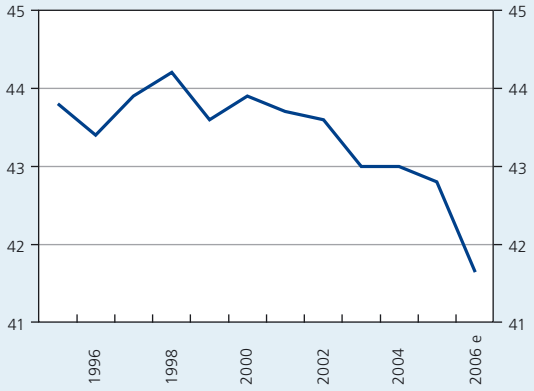
Taking account of all these measures, the implicit tax rate on labour – i.e. the fiscal and parafiscal levies as a percentage of the wages, calculated on the basis of the national accounts data – showed a marked fall during the year under review, dropping by 1.1 percentage point to 41.6 p.c. The latest statistics available from the EC show that the implicit tax rate on labour in Belgium was still 6.5 percentage points above the EU-15 average in 2004. Despite the large reduction in that rate in Belgium in 2006, there is therefore still a substantial difference in relation to the average implicit tax rate in the EU-15, especially as other countries have also taken similar measures in the meantime.

Taxes on company profits recorded a steep rise for the third year running, up from 3.4 p.c. of GDP in 2005 to 3.7 p.c. This increase is due mainly to the decision to speed up the assessment of corporation tax so that, from

CHART 45 IMPLICIT TAX RATE ON LABOUR [1] [2]

(percentages of labour costs, unless otherwise stated)

TREND IN BELGIUM [3]



TREND IN THE EU-15

	Change from 1995 to 2000 [4]	Change from 2000 to 2004 [4]	*p.m. Level in 2004*
SE	1.2	–2.0	*45.9*
BE	**0.1**	**–0.8**	***43.0***
FR	0.8	0.8	*42.4*
IT	3.9	0.2	*42.0*
FI	0.7	–2.2	*41.9*
AT	1.5	0.5	*40.7*
DE	1.3	–1.5	*39.2*
EL	4.1	–0.3	*37.9*
DK	0.8	–3.5	*37.4*
NL	0.5	–4.6	*31.0*
PT [5]	–0.5	2.8	*29.8*
ES	–0.8	1.3	*29.4*
LU	0.6	–1.0	*29.0*
IE	–1.5	–1.9	*26.3*
GB	–0.3	–0.6	*24.8*
Average EU-15 [6]	0.2	–0.6	*36.5*

Sources : EC, NBB.

(1) Calculated on the basis of the national accounts.

(2) Defined as total earned income levies paid to general government divided by the total amount of wages.

(3) The reductions in the withholding tax on earned income for scientific research, shift work and overtime – which, in accordance with the ESA 95 methodology, are regarded as subsidies granted to corporations – are not included.

(4) Percentage points.

(5) Year 2003.

(6) Weighted according to the tax base.

now on, the tax is always collected during the tax year. For the year under review, the effect on the assessments is estimated at around 700 million euro. A total of 0.1 percentage point of the increased revenue is also due to the rapid growth of advance payments by companies, up by 7.4 p.c. in a context of rising gross operating profits, and despite the introduction of the venture capital allowance and the deductibility of regional subsidies.

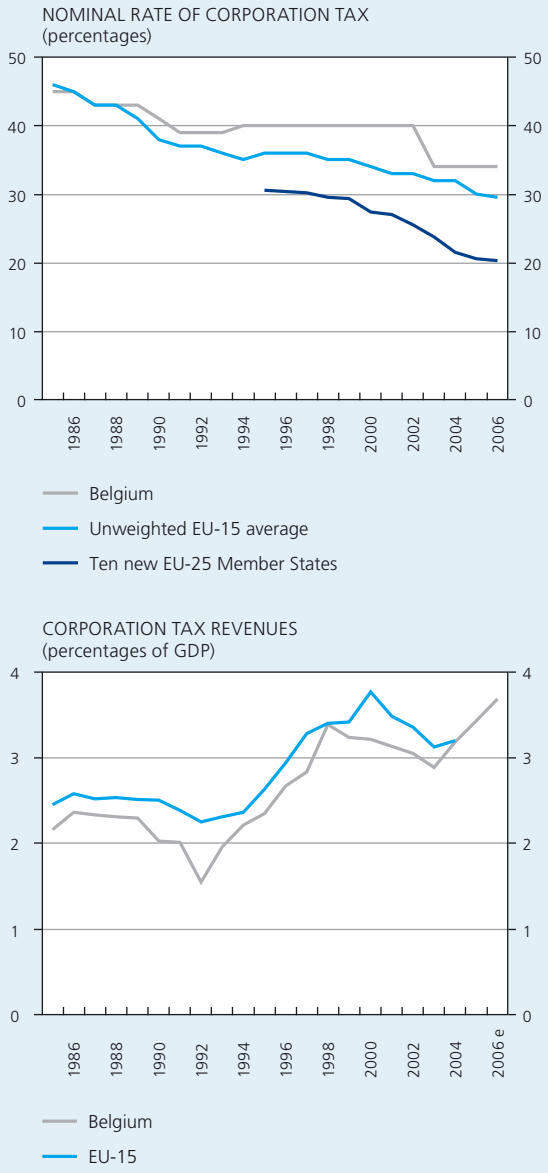
On the international scene, there is a clear tendency towards reducing nominal rates of tax on company profits, one reason being that countries are trying to attract investment. Thus, the average standard nominal rate in the EU-15 has fallen from 46 p.c. in 1985 to just under 30 p.c. in 2006. In the ten Member States which joined the EU on 1 May 2004, it is even around 10 percentage points lower than in the EU-15.

In Belgium, the federal authorities have tried in recent years to respond to these changes in the international context. Thus, the lowering of the standard nominal rate to 33.99 p.c. in 2003 did much to absorb the discrepancy which had developed between the Belgian rate and that of the EU-15 in the 1990s. Since then, however, that discrepancy has widened to over 4 percentage points as a result of the rate reductions recently recorded in a number of EU-15 Member States. To ensure that Belgium remains attractive to investors, the government decided to introduce a venture capital allowance – also known as a notional interest allowance – from the 2007 tax year onwards, which applies to 2006 incomes for the majority of companies. This measure alleviates the discrimination between the tax treatment of capital and borrowings. In addition, it provides an alternative which is acceptable from a European perspective to replace the preferential tax regime enjoyed by the coordination centres. In order to offset the resulting loss of revenues, provision has been made for a series of compensatory measures, the principal one comprising an adjustment to the tax exemption for capital gains.

In both Belgium and the EU-15, the downward trend in nominal rates currently seems to be accompanied by a substantial widening of the tax base, due partly to the limitation of preferential tax arrangements. The public revenues generated by the corporation tax have in fact increased over the past two decades. In Belgium, leaving aside the temporary increase in revenues originating from the assessments, they reached their highest level for twenty years.

Levies on other incomes and on assets remained steady despite the disappearance of the proceeds of the securitisation of arrears of personal income tax and corporation tax, which had been carried out in 2005, and the fact that the amounts recovered during the year under review in respect of the arrears in question were assigned to the company which had become the owner of those claims. The effect of these transactions was offset by various factors. First, as in previous years, there was a particularly favourable movement in certain regional taxes such as registration fees and gift taxes : this was due partly to reforms in these tax systems in the three regions,

CHART 46 CORPORATION TAX IN THE EU-15 AND IN BELGIUM



Sources : EC, OECD, IFS, NAI, NBB.

although the actual arrangements varied. Furthermore, this category of levy includes revenues in the order of 50 million euro derived from the temporary opportunity available to the diamond sector to update the value of its stocks. Finally, the introduction during the year under review of a 1.1 p.c. levy on premiums paid in respect of insurance products in classes 21 and 23, and a withholding tax of 15 p.c. on the interest on capitalisation funds investing principally in fixed-income securities, generated additional revenues totalling 455 million euro.

Taxes on goods and services increased slightly, by 0.1 percentage point of GDP, the main factor being the securitisation of arrears relating principally to indirect taxes. That operation generated gross revenue of 713 million euro. Structural measures exerted a small negative influence on revenues. The impact of the levies on electricity production was more than offset by the disappearance of the influence of the temporary increase in the tax on beverages in non-reusable packaging in 2005, the operation of the reverse ratchet system on diesel, and the phasing out of the compensatory excise duty and vehicle registration tax. However, the main factor causing erosion was the movement in excise revenues, which actually fell short of the 2005 figure in nominal terms, notably because of the decline in consumption of mineral oils prompted by their increased cost.

Non-fiscal and non-parafiscal revenues dropped from 5.1 p.c. of GDP in 2005 to 4.8 p.c. This decline was due partly to the fact that, in 2005, these revenues had been increased by the payment to the government of 225 million euro by Aquafin, the company responsible for wastewater treatment in the Flemish Region; the capital transfers totalling 481 million from the *Autonoom Gemeentelijk Havenbedrijf Antwerpen* (Port of Antwerp Authority) and the BNRC holding company in exchange for the assumption of certain pension liabilities were another factor.

Primary expenditure

In 2006, primary expenditure expressed as a percentage of GDP reverted to a level close to its 2004 figure, namely 44.8 p.c., after peaking at 48 p.c. in 2005. However, these fluctuations do not represent the structural movement in expenditure, since they are greatly distorted by the influence of time lags between the indexation of certain expenditure and the movement in the HICP, the business cycle and temporary factors. The latter were in fact particularly significant in 2005, as the assumption of BNRC debt – in consequence of the company's restructuring on 1 January 2005, in order to conform to the European regulations – boosted the level of expenditure by 2.4 percentage points of GDP. The movement in primary expenditure in real terms was affected accordingly, being decidedly positive in 2005 and hence strongly negative in 2006.

In order to obtain a better indicator, reflecting the government's structural policy in regard to primary expenditure, that expenditure has to be adjusted for the influence of non-recurrent factors, the business cycle and differences between inflation and the price indexation of wages and social benefits.

TABLE 30 PRIMARY EXPENDITURE OF GENERAL GOVERNMENT

(deflated by the HICP, percentage changes compared to the previous year, unless otherwise stated)

	Average 1995-2001	2002	2003	2004	2005	2006 e	Average 1995-2006 e
Level recorded[1]	43.0	44.1	45.8	44.5	48.0	44.8	44.0
p.m. Entity I[2]	*26.5*	*26.3*	*27.6*	*26.7*	*29.8*	*26.8*	*26.9*
Entity II[2]	*16.6*	*17.8*	*18.2*	*17.8*	*18.1*	*18.0*	*17.1*
Real growth recorded	1.8	5.3	5.0	0.5	8.5	–4.2	2.3
Influence of non-recurrent factors[3][4]	–0.1	1.1	1.7	–2.2	7.0	–5.9	0.1
Influence of cyclical factors[3]	–0.1	0.1	0.3	0.2	0.0	–0.1	0.0
Effect of indexation[3][5]	–0.1	0.8	–0.1	–0.4	–0.1	–0.5	–0.1
Real growth adjusted for non-recurrent and cyclical factors and for the effects of indexation	2.1	3.3	3.2	2.9	1.6	2.3	2.3

Sources: EC, NAI, NBB.

(1) Percentages of GDP, according to the view taken by Eurostat.

(2) The entities' expenditure does not include mutual transfers.

(3) Contribution to the recorded real growth of primary expenditure.

(4) In 2004, the movement in primary expenditure was inflated by around 0.1 p.c. of GDP by the shift between VAT and GNI resources following the EU financing reform. That factor boosted both revenue and expenditure without having any significant impact on the overall balance.

(5) Effect caused by the difference between the actual indexation of public sector wages and social security benefits and the rise in the HICP.

In 2006, the effect of the non-recurrent factors largely mirrored the same type of factors which had influenced expenditure growth in 2005. Their contribution to the contraction in the volume of primary expenditure thus totalled almost 6 percentage points, while in the previous year they had inflated the rate of expansion by 7 points.

At federal government level, the specific non-recurrent factors associated with the year under review consisted principally of sales of buildings and land worth 953 million euro – of which 575 million came from the sale of buildings located in Belgium as a single lot, and 378 million from the sale of the Belgian embassy site in Tokyo –, an allowance granted to households using natural gas for heating, at a cost of 97 million, and the impact of the operations concerning the BNRC. Thus, the subsidies paid to Infrabel, the company managing the rail infrastructure, were reduced by 100 million in 2006, a corresponding sum being carried forward to 2007. Conversely, the Flemish Community decided to allocate part of its available resources to an advance payment of subsidies to the water supply companies and to Aquafin, in the sum of around 100 million.

The growth rate of primary expenditure is also subject to cyclical fluctuations as a result of the movement in unemployment benefits, which follow the business cycle with a certain time lag. Thus, the high rate of activity growth in 2004 and 2006 curtailed the upward effect that these benefits had exerted on expenditure from 2002 to 2004. Consequently, unemployment expenditure, which had already fallen by 0.9 p.c. in real terms in 2005, was cut by a further 3.2 p.c. in 2006. The resulting brake on the growth of general government expenditure, an effect which had been insignificant in 2005, represented 0.1 percentage point.

The indexation mechanism for social benefits and civil service pay is a third external factor which influences the real movement in primary expenditure. On the one hand, social benefits and wages, which account for almost 60 p.c. of the government's primary expenditure, are linked to the movement in the health index of consumer prices. Since 2003, that index has risen more slowly than the HICP because – unlike the latter – it was not directly affected by the steep rise in road fuel prices or by a series of measures to increase indirect taxes. As explained in chapter 5 on prices, the smaller rise in the health index in 2006 was also due to the effects of the reform of the national CPI. This caused the fall in inflation as measured by that index, and hence according to the health index, to exceed by 0.5 percentage point the fall indicated by the HICP. The impact of these various factors was only marginally tempered during the year under review by the smoothing of the health index effected for the purpose of calculating the reference index used to determine the timing of the indexations. In fact, when the rate of increase in the health index slows down, as in 2006, the

smoothing delays the transmission of that reduction to wages. Overall, the indexation mechanism contributed 0.5 percentage point towards the moderation of the real expansion of expenditure.

After adjustment for the effects of these various factors, primary expenditure increased by 2.3 p.c. in 2006, a rate comparable to the average growth of the past decade, but slightly higher than the trend growth of GDP.

The movement in the adjusted primary expenditure of the various government sub-sectors was more homogeneous than in previous years, with growth ranging between 2.1 and 2.7 p.c. depending on the level of government. Entity I expenditure increased at a rate close to the trend growth of GDP. That was not the case for the sub-sectors making up Entity II, where expenditure growth has averaged 2.5 p.c. over the past twelve years, mainly as a result of the strong expansion of local authority spending.

In 2006, the adjusted primary expenditure of the federal government grew by 2.2 p.c. in real terms. This rise was due partly to the increase in subsidies granted to enterprises, particularly the reductions in the withholding tax on earned incomes in favour of certain categories of workers. These reductions, designed to encourage the employment of researchers, shift working and flexibility of labour via the more favourable tax treatment of overtime pay, contributed more than 200 million euro - or 0.8 percentage point – to the growth of federal expenditure. An additional 0.5 percentage point was also due to investment grants paid to the BNRC Group and organic fund expenditure in favour of the development of the Regional Express Network (REN). Expenditure on civil service staff pensions also increased significantly, as a result of the marked rise in the number of pensioners. Conversely, the other major expenditure categories increased at a more moderate pace than in the recent past.

The volume growth of the adjusted expenditure of social security accelerated sharply in 2006, reaching 2.1 p.c. Owing to its significant size – it now represents over one-third of total social spending – and volatility, health care expenditure generally has a decisive influence on the movement in social security spending. Its volume increase remained modest in 2006, following stagnation in 2005, thus remaining for the second consecutive year below the growth target of 4.5 p.c., decided at the time of the formation of the federal government in 2003 for the term of this legislature. The calculation of a moving average, which attenuates the impact of fluctuations caused by shifts, accounting delays or short-term measures, indicates that the real growth of health care expenditure is currently tending to fall short of the average for the past twelve years.

The cyclically adjusted growth of the other social expenditure categories as a whole increased in 2006. In part, this acceleration was due to social measures which were more substantial in 2006 than in the previous two years. Of these, the increase in family allowances for children between the ages of six and seventeen years – commonly known as the schooling allowance – came to over 70 million euro during the year under review. In addition, some major social initiatives were also taken in favour of pensions, totalling an extra 51 million. This mainly concerns the adjustment of the oldest pensions in line with prosperity, the aim being to counteract the spontaneous decline in the relative affluence of the oldest pensioners, and increases in the pensions of self-employed persons,

TABLE 31 ADJUSTED PRIMARY EXPENDITURE BY GENERAL GOVERNMENT SUB-SECTOR [1] [2]

(deflated by the HICP, percentage changes compared to the previous year)

	Average 1995-2001	2002	2003	2004	2005	2006 e	Average 1995-2006 e
Federal government	1.8	1.1	1.9	2.8	2.4	2.2	1.9
Social security	2.3	2.2	4.1	3.4	1.0	2.1	2.4
p.m. Entity I	*2.1*	*1.9*	*3.4*	*3.2*	*1.5*	*2.1*	*2.2*
Communities and regions	1.9	4.7	2.3	4.0	0.4	2.7	2.3
Local authorities	2.0	7.5	3.5	0.1	4.4	2.6	2.7
p.m. Entity II	*2.0*	*5.8*	*2.8*	*2.4*	*2.0*	*2.6*	*2.5*

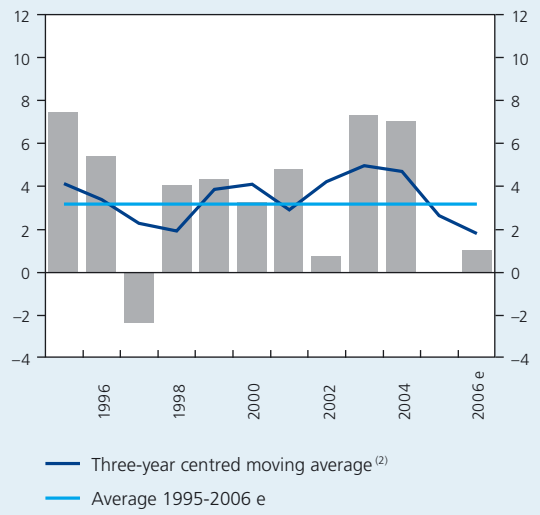
Sources: EC, NAI, NBB.

(1) The expenditure of the general government sub-sectors does not include mutual transfers.

(2) Real growth adjusted for the influence of non-recurrent and cyclical factors, and for indexation effects.

CHART 47 HEALTH CARE EXPENDITURE [1]

(deflated by the HICP, percentage changes compared to the previous year)



Sources : NAI, NBB.

(1) Public spending on health care, excluding sickness and invalidity benefits, benefits for the disabled, transfers to institutions caring for the disabled, and spending on long-term care insurance.

(2) A real growth figure of 4.5 p.c. in 2007 was assumed for the purpose of calculating the 2006 moving average.

particularly their minimum guaranteed pensions. Other categories of replacement incomes, such as disability benefits, were also adjusted once again in line with prosperity.

Finally, the subsidies paid to businesses by social security increased sharply, principally as a result of intervention under the service voucher scheme, which was stepped up by around 200 million euro. Expenditure relating to the Social Maribel measures in favour of the non-market sector and unemployment benefit activation – measures recorded as subsidies under the ESA 95 – also continued to rise in 2006.

Following relatively weak growth in 2005, the volume of the adjusted primary expenditure of the communities and regions increased by 2.7 p.c. in 2006, slightly outpacing the recent average, as their expenditure on the consumption of goods and services, investment and investment aid in fact returned to positive growth following a decline in 2005. These movements – reduction in a post-election year such as 2005, following a peak in the election year, and a subsequent revival – seem to confirm the impact of the electoral cycle of this level of government on the most discretionary expenditure categories and hence on the total expenditure of the communities and regions.

The movement in the real primary expenditure of local authorities is also greatly influenced by the impact of the electoral cycle on their investment. Thus, the latter generally expands most strongly in the years preceding the local and provincial elections and, to a lesser extent, in election years such as 2006. Growth of investment spending was once again seen to slow down during the last year of the electoral cycle which has just ended. That is reflected in the total local primary expenditure which increased by 2.6 p.c., a rate close to the average for the period 1995-2006 and significantly lower than the 2005 figure.

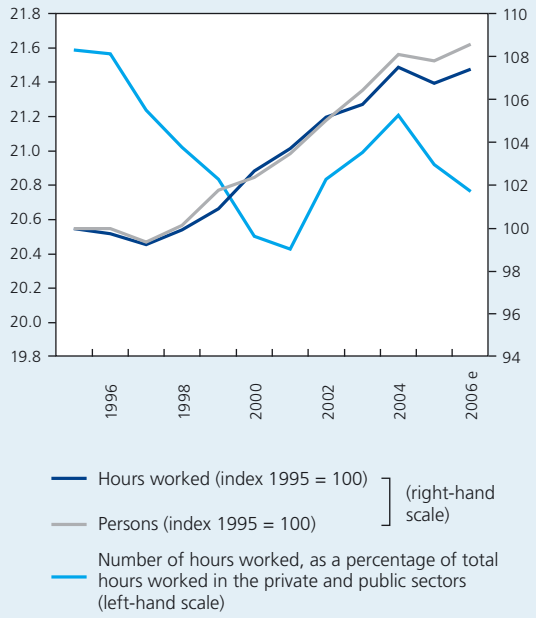
Box 14 – Public sector employment

Public consumption expenditure makes up almost half of total public spending. Since the total amount of wages represented 53 p.c. of public consumption expenditure in 2006, employment in this sector is a decisive factor for expenditure. That employment does not include the jobs subsidised directly or indirectly by the government, such as persons employed by the LEAs or under the service voucher scheme, and jobs in the non-market sector.

In 2006, around 785,000 people worked in the general government sector, excluding the public broadcasting companies. That represents an increase of 8.6 p.c. compared to 1995. Owing to the success of the part-time working arrangements, the number of hours worked – which is more significant in determining the total amount of wages – increased by a slightly lower figure of 7.4 p.c., the rise being almost continuous between 1995 and 2006. That growth is due mainly to public administration in the strict sense – i.e. excluding education, defence, transport and related services – and, to a lesser extent, to education, while jobs in national defence declined. However, since the volume of private sector employment increased faster, there was a decline in the public sector's

share of total employment, down from 21.6 p.c. in 1995 to 20.8 p.c. in 2006, a level which was below the average for the past ten years.

PUBLIC SECTOR EMPLOYMENT [1]



Sources : NAI, NBB.

(1) The national accounts figures have been adjusted to avoid breaks in the series. Thus, an adjustment was made to neutralise the effect of the reclassification, in 2002, of the public radio and television companies from the non-financial corporations sector to the general government sector.

The bulk of the employment growth occurred in the local authorities. The police service reform, which led, in particular, to a transfer of around 8,500 persons from the federal government to the local authorities in 2002, is only a minor component of that, since the main increase took place in the rest of local government in the strict sense, but also, to a lesser extent, in education. The local authorities thus increased their share of total public sector employment to over 35 p.c. in 2005.

Employment growth was less marked in the communities and regions, which are nonetheless still the largest public sector employers, accounting for almost 43 p.c. of public jobs. Education, which represents over three-quarters of the staff employed by these entities, practically regained its 1995 level, while administration in the strict sense and the regional transport companies contributed to the growth of employment in this sub-sector.

Finally, employment by the federal government and social security represented only just over 22 p.c. of public sector jobs in 2005, which was less than in 1995. Administration increased its proportion of employment in this entity, while the national defence workforce declined in absolute terms.

EMPLOYMENT BY GOVERNMENT SUB-SECTOR[1]

(thousands of persons, unless otherwise stated)

	1995	2000	2005	*p.m. Percentage changes 1995-2005*
Entity I	173.5	178.6	173.2	*–0.2*
Federal government[2]	147.6	150.6	143.8	*–2.6*
Social security	25.9	28.1	29.4	*13.5*
Entity II	549.9	562.0	606.7	*10.3*
Communities and regions	320.8	316.9	332.3	*3.6*
Local authorities[2]	229.1	245.1	274.4	*19.8*
Total	**723.4**	**740.7**	**779.8**	***7.8***

Sources: NAI, NBB for the breakdown by sub-sectors

(1) The national accounts figures have been adjusted to avoid breaks in the series. Thus, an adjustment was made to neutralise the effect of the reclassification, in 2002, of the public radio and television companies from the non-financial corporations sector to the general government sector.

(2) In 2002, the police service reform led to the transfer of part of the former gendarmery from the federal government to the local authorities. That transfer concerned around 8,500 persons. Excluding that transfer, employment in the federal government and local authorities would have expanded by 3.2 and 16.1 p.c. respectively.

Interest charges of general government

Since reaching a peak in 1990, the interest charges of general government have declined at an annual average rate of 0.5 percentage point of GDP. That is due to the combined effect of the systematic reduction in the debt ratio from the record high attained in 1993, and the more or less continuous fall in the implicit interest rate on the public debt.

Owing to the rise in short-term interest rates, the rate of the reduction in interest charges slowed sharply in 2006, with a decrease of just 0.2 percentage point of GDP for the year. That decrease was in fact due exclusively to the reduction in the public debt by 4.1 points, since the implicit interest rate edged upwards for the first time since 2002. The impact of the increase in short-term interest rates more than negated the effect of the fall in the implicit rate on the long-term debt; that rate continued to decline as a result of keeping a differential favourable to new issues. In contrast, the market rate on twelve-month Treasury certificates, the Treasury's principal short-term financing instrument, rose from an average of 2.3 p.c. in 2005 to 3.3 p.c. in 2006.

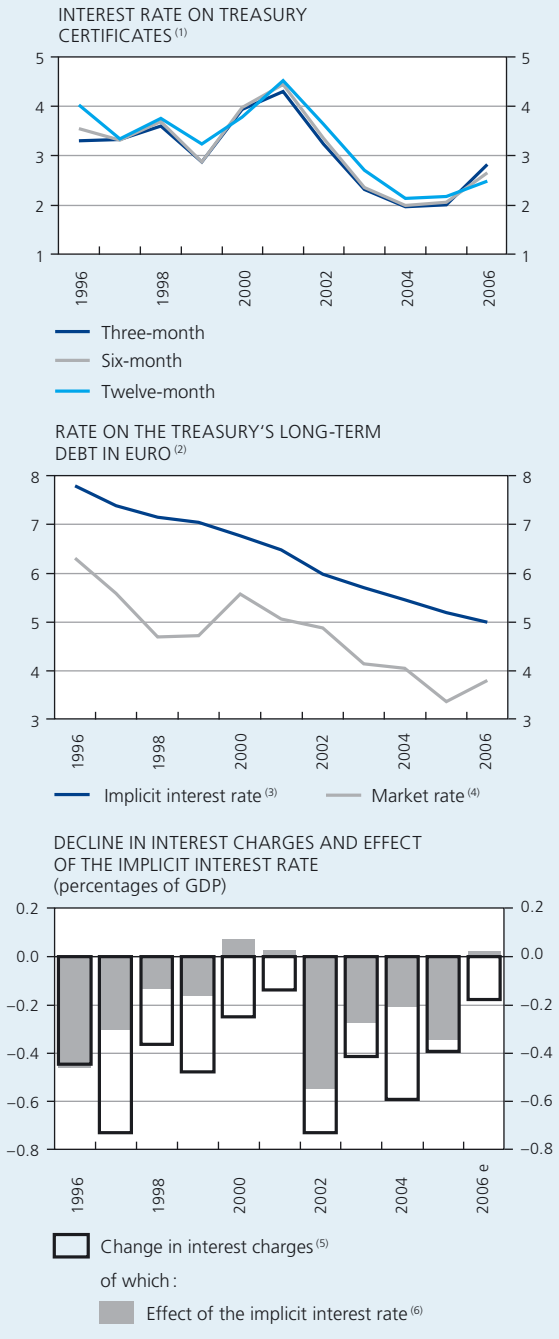
Owing to the gradual exhaustion of the old bond lines issued at higher interest rates, the downward trend in the long-term implicit rate is set to decelerate sharply in the coming years, even if interest rates remain steady. A fortiori, if market rates increase, that will trigger a rise in the implicit rate on the public debt.

Overall balance of general government sub-sectors

The movement in the budget balance of general government is the outcome of developments which vary between sub-sectors. The modest budget surplus achieved during the year under review resulted from a small surplus in Entity I, which comprises the federal government and social security, and a balanced budget in Entity II, which comprises the communities and regions plus the local authorities.

The federal government accounts ended with a deficit of 0.1 p.c. of GDP. Excluding the influence of the restructuring of the BNRC in 2005, the federal budget balance deteriorated by 0.1 percentage point of GDP, despite a further 0.1 point decline in interest charges. The deterioration was due to the decline in revenue, which was only partly offset by lower expenditure. The fall in revenue is due mainly to structural measures reducing the burden of

CHART 48 BREAKDOWN OF THE CHANGE IN INTEREST CHARGES



Sources : EC, FPS Finance, NAI, NBB.

(1) Implicit average rate on Treasury certificates.

(2) Excluding the loans issued before 1 January 1999 in currencies other than the Belgian franc and excluding variable-rate linear bonds on which the rate fluctuates in the same way as short-term rates.

(3) Ratio between interest charges (including issue premiums) and the average monthly outstanding amount of the debt.

(4) Average interest rate on public loans with a maturity of six years or more.

(5) According to the methodology used for the excessive deficit procedure (EDP).

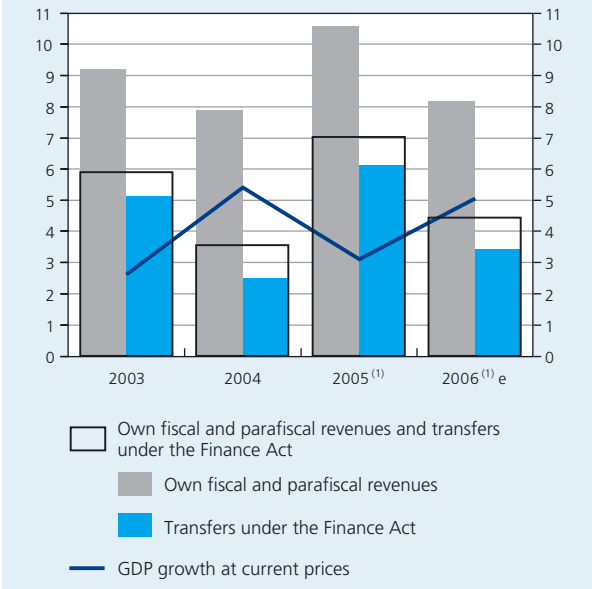
(6) Ratio between interest charges in the current year and debt at the end of the previous year, according to the Eurostat view of the RIF. An adjustment was made in assessing the implicit rate in 2005, to take account of the impact of the inclusion of the RIF in the general government sector from 1 January 2005.

fiscal and parafiscal charges, and the fall in the share of value added represented by wages. On the expenditure side, the contraction is attributable mainly to the increase in the sale of government buildings, which is considered as negative expenditure under the ESA 95.

Social security recorded a small surplus for the second consecutive year. Its revenues were down by 0.1 point. The rise in social contributions lagged behind GDP growth, partly because of the decline in wages as a percentage of GDP and partly because of the measures designed to cut the contributions. This effect was partially offset by an increase in transfers from the federal government by way of "alternative funding", which is based on sharing of the tax revenues collected by the Treasury. Apart from an increase in VAT revenues transferred on that basis, 15 p.c. of the revenue generated by the withholding tax on incomes from movable property was also transferred to social security during the year under review. Social security expenditure fell by 0.3 percentage point GDP, mainly because of the favourable movement in unemployment expenditure, which is closely linked to the business cycle, and to the modest rise in health care spending.

CHART 49 REVENUES OF THE COMMUNITIES AND REGIONS

(percentage changes compared to the previous year)



Sources : NAI, NBB.

(1) The data have been adjusted to take account of the change in Aquafin's funding, which is no longer based on water charges but on the fees paid by the Flemish Region water supply companies.

TABLE 32 OVERALL BALANCE OF GENERAL GOVERNMENT AND BY SUB-SECTOR [1] [2]

(percentages of GDP)

	2002	2003	2004	2005	2006 e
Primary balance	5.7	5.4	4.7	2.0	4.2
Entity I	5.6	4.9	4.2	1.5	3.9
Federal government	5.2	5.3	4.3	1.6	3.8
Social security	0.5	–0.3	0.0	0.1	0.2
Entity II	0.1	0.4	0.5	0.5	0.3
Communities and regions	0.1	0.3	0.4	0.4	0.3
Local authorities	0.0	0.2	0.1	0.1	0.0
Interest charges	5.7	5.3	4.7	4.3	4.1
Overall balance	0.0	0.0	0.0	–2.3	0.1
Entity I	0.3	0.1	–0.1	–2.4	0.1
Federal government	–0.2	0.3	–0.1	–2.5	–0.1
Social security	0.5	–0.3	0.0	0.1	0.2
Entity II	–0.3	0.0	0.1	0.1	0.0
Communities and regions	–0.1	0.0	0.2	0.3	0.2
Local authorities	–0.2	–0.1	–0.1	–0.2	–0.2

Sources : EC, NAI, NBB.

(1) According to the methodology used for the excessive deficit procedure (EDP).

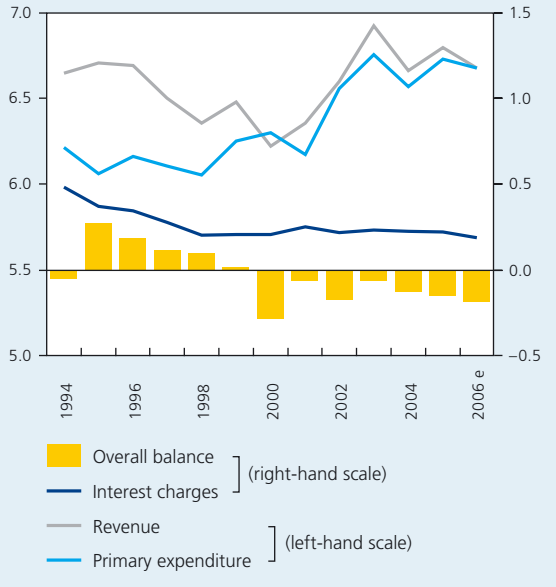
(2) The table presents the figures according to the view taken by Eurostat regarding the BNRC restructuring in 2005. According to the view taken by the NAI, as a result of the different treatment of that operation, the balances of general government, Entity I and the federal government would be 2.4 p.c. of GDP more favourable in 2005 than according to Eurostat, and 0.05 p.c. of GDP less favourable in 2006.

The communities and regions recorded a surplus of 0.2 p.c. of GDP. Their revenue declined by 0.2 percentage point of GDP. The share of the proceeds of personal income tax and VAT, transferred to these entities under the Finance Act, increased more slowly than in 2005. As in previous years, the movement in a number of regional taxes, such as the registration fees and gift taxes, was particularly favourable. On the property market, substantial price rises and the increased number of transactions gave a marked boost to registration fees. In the case of gift taxes, the reductions in rates in the three regions prompted a very considerable increase in the number of gifts recorded. Expenditure growth speeded up compared to the previous year, in line with the electoral cycle typical of these entities, but remained below GDP growth.

As in 2005, local authorities recorded a deficit of 0.2 p.c. of GDP. That stabilisation is due to the contraction of their revenues following the federal reform of personal income tax, and to a slight reduction in their expenditure as a percentage of GDP. In relation to 1994 – a year comparable to 2006 in terms of the electoral cycle –, the overall balance of local authorities was down by 0.1 percentage point of GDP. Over that period, expenditure growth, which largely

CHART 50 REVENUE, EXPENDITURE AND OVERALL BALANCE OF LOCAL AUTHORITIES

(percentages of GDP)



Sources : NAI, NBB.

negated the fall in interest charges, was the reason for the deterioration in local finances, since revenues returned to their original level in 2006.

6.2 Structural balances and debt

Cyclically adjusted and structural budget balances

Indicators constructed on the basis of the cyclical adjustment method used by the ESCB show that the economic cycle had a favourable impact on the change in the budget balances in 2006. Activity growth was well above its trend level, and that situation was only partly offset by composition effects very slightly unfavourable to public finances. Overall, the growth of the income and expenditure components which have a major impact on the general government account, such as earned incomes and private consumption, exceeded its trend rate to a lesser extent than GDP. In all, taking account of the movements recorded in previous years, the impact of the business cycle on the budget balances seems to have remained slightly negative, but diminished by around 0.5 percent of GDP. The cyclically adjusted primary surplus therefore improved by 1.8 percent of GDP.

However, the strong increase in that surplus is due solely to the substantial change in the effect of non-recurrent factors. In 2005, those factors had caused a further deterioration in the budget balances of 2 p.c. of GDP, essentially because of the transfer of the bulk of BNRC debt to the RIF. In contrast, they exerted a favourable effect on those balances amounting to 0.7 p.c. of GDP during the year under review.

Whereas in 2005 the structural primary surplus had shown a marked increase for the first time since 1999, it deteriorated again by 0.9 point during the year under review. This notable easing of the structural budgetary policy is mainly attributable to cyclically adjusted public revenues net of non-recurrent factors, whose expansion fell significantly short of the trend activity growth and, to a lesser extent, the structural growth of primary expendi-

TABLE 33 CYCLICALLY ADJUSTED[1] AND STRUCTURAL BUDGET BALANCES[2]

(percentages of GDP, according to the view taken by Eurostat)

	2004		2005		2006 e
Primary balance					
Level observed	4.7		2.0		4.2
Change observed		–2.7		2.2	
Cyclical change		–0.6		0.5	
GDP growth		–0.5		0.6	
Composition effects		–0.1		–0.1	
Cyclically adjusted level	4.7		2.6		4.4
Cyclically adjusted change		–2.1		1.8	
Impact of non-recurrent factors	0.8		–2.0		0.7
Structural level	3.9		4.6		3.7
Structural change		0.7		–0.9	
Overall balance					
Level observed	0.0		–2.3		0.1
Structural level	–0.8		0.3		–0.4
Structural change		1.1		–0.8	
p.m. Structural level estimated by the EC[3]	*–0.9*		*0.2*		*–0.7*

Sources: EC, NAI, NBB.

(1) According to the methodology described in Bouthevillain C., Ph. Cour-Thimann, G. van den Dool, P. Hernández de Cos, G. Langenus, M. Mohr, S. Momigliano and M. Tujula (2001), *Cyclically adjusted budget balances: an alternative approach*, ECB Working Paper Series n° 77 (September). A simpler explanation of this methodology is supplied in box 6 *Cyclically adjusted budget balances: calculation method used by the ESCB* in the NBB Report 2003 (Part 1), pp. 83-84.

(2) According to the methodology used for the excessive deficit procedure (EDP), and according to the view taken by Eurostat regarding the RIF. The structural balance levels and movements are virtually identical regardless of whether the viewpoint adopted is that of the NAI or Eurostat.

(3) Assuming volume GDP growth of 2.7 p.c., the EC estimated in its *Autumn 2006 Economic Forecasts* the observed level of the overall balance for 2006 as a deficit of 0.2 p.c. of GDP.

ture, which slightly outpaced that trend. Box 15 describes in more detail the changes in the structural stance of budgetary policy in recent years.

Thanks to a further fall in interest charges, the structural financing balance deteriorated by less than the structural primary balance. The structural surplus of 0.3 p.c. of GDP recorded in 2005 was converted to a structural deficit of 0.4 p.c. of GDP.

Structural budget balances have become more important for the assessment of budgetary policy since the reform of the stability and growth pact in 2005. The reformed pact in fact stipulates that, for the purposes of the European surveillance procedures, budget outcomes must be adjusted for the influence of cyclical and temporary factors when being checked against the medium-term objective for public finances, and against the budget path set in order to attain it. However, in the framework of the European budget rules a different cyclical adjustment method is used instead of that of the ESCB, namely the EC method, while the one-off measures taken into account are not necessarily the same as those used in this analysis. Despite these methodological differences, the EC's assessment of the structural budget balance is only slightly different from the Bank's estimate: for the year under review, the EC puts that balance at a slightly larger deficit equal to 0.7 p.c. of GDP.

Box 15 – Analysis of structural budget developments

The assessment of public finances accords ever greater importance to structural budget balances, adjusted for the impact of the business cycle and non-recurrent factors. The movement in the structural primary balance is regarded as an indicator of the structural stance of budgetary policy. However, it is influenced by various factors on both the revenue and the expenditure side. A recent ECB Working Paper presented a detailed method of analysing these structural budget movements[1]. This box offers a brief explanation of that method and then applies it to Belgium.

The said method calculates structural primary revenue and expenditure by adjusting the main individual categories of revenue and expenditure for non-recurrent factors and cyclical variations. The adjustment for the effect of the automatic stabilisers is based on the method used by the ESCB and in this Report, as described in box 6 in the 2003 Report. For the main categories of fiscal and parafiscal revenue, the movement in structural revenues as a ratio of trend GDP is explained on the basis of various factors. These include structural measures taken by the government, such as tax increases or cuts, the automatic change in the fiscal and parafiscal burden in cases where the elasticity of the revenue in question is different from 1 – which is true of personal income tax, for example, owing to the progressive nature of the tax scales – and the impact of differences in trend growth between the various bases of taxation and GDP. However, these three factors are generally not sufficient to account for the whole of the movement in structural fiscal and parafiscal revenues. Residual factors, such as inaccuracies in the assessment of the impact of the measures or of the business cycle, and inconsistencies between the time series used to approximate the tax base and the various public revenue categories, may in fact play a role. In the case of primary expenditure, only the contribution of the main expenditure categories to the changes in the ratio between structural primary expenditure and trend GDP is shown.

In Belgium, the structural primary balance has fallen by 3.4 percentage points of GDP since the start of monetary union. This easing of budgetary policy is attributable to a sharp increase in the government's structural primary expenditure and, to a lesser extent, to a decline in structural public revenues.

Between 1998 and 2006, structural revenues fell by 0.9 percentage point in relation to trend GDP. That is due mainly to the movement in fiscal and parafiscal revenues, as other structural revenues increased only slightly in relation to trend GDP.

(1) Kremer J., C. Rodrigues Braz, T. Brosens, G. Langenus, S. Momigliano and M. Spolander (2006), *A disaggregated framework for the analysis of structural developments in public finances*, ECB Working Paper Series n° 579 (January).

MOVEMENT IN THE STRUCTURAL BUDGETARY POLICY[1]

(change compared to the previous year, percentages of trend GDP, unless otherwise stated)

	1999	2000	2001	2002	2003	2004	2005	2006 e	Change from 1998 to 2006 e
Structural primary balance[2]	–1.0	0.0	0.0	–0.7	–1.2	–0.3	0.7	–0.9	–3.4
Structural revenues	–0.2	0.1	0.0	0.2	–0.8	–0.1	0.8	–0.8	–0.9
Fiscal and parafiscal revenues	–0.1	–0.1	–0.3	0.3	–0.7	0.0	0.6	–0.8	–1.1
Automatic change in the fiscal burden	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.2
Trend growth of tax bases	0.1	0.2	0.0	–0.1	–0.2	–0.3	0.1	–0.2	–0.3
Structural measures	0.0	–0.5	–0.1	–0.4	–0.2	0.1	–0.1	–0.4	–1.6
Residual factors	–0.2	0.2	–0.3	0.7	–0.3	0.2	0.5	–0.3	0.6
Non-fiscal and non-parafiscal revenues	–0.1	0.1	0.3	–0.1	–0.1	–0.1	0.1	0.0	0.2
Structural primary expenditure	0.7	0.0	0.1	0.9	0.4	0.1	0.1	0.1	2.4
Wages	0.2	–0.1	0.0	0.4	0.0	–0.2	0.0	–0.1	0.3
Current purchases of goods and services	0.0	0.0	0.1	0.4	–0.1	0.0	–0.1	0.0	0.4
Social benefits	0.1	0.0	0.2	0.3	0.4	0.2	–0.2	–0.1	0.9
of which:									
Pensions	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0
Unemployment benefits	0.0	–0.1	0.0	0.1	0.0	0.0	–0.1	0.0	–0.1
Health care	0.2	0.1	0.2	–0.1	0.3	0.3	–0.1	0.0	0.8
Subsidies	0.1	–0.1	0.0	–0.1	0.1	0.0	0.3	0.1	0.5
Gross fixed capital formation	0.3	0.0	–0.2	–0.1	0.0	0.1	0.0	0.1	0.1
Other	–0.1	0.1	–0.1	0.0	0.0	0.0	0.0	0.1	0.1

Sources: EC, NAI, NBB.

(1) Adjusted for cyclical and non-recurrent factors, as defined in box 13.

(2) Percentages of GDP. Since, according to the ESCB's method of calculation, the structural primary balance is expressed in relation to observed GDP, the movement in the latter does not entirely correspond to the difference between the movement in structural revenues and the movement in structural primary expenditure, which are in fact compared to trend GDP.

The easing of the structural fiscal and parafiscal burden is chiefly due to the policy of reducing charges. Structural measures exerted a negative impact in almost every year, and reduced public revenues by 1.6 percentage point in relation to trend GDP over the period as a whole. The structural fiscal and parafiscal burden also fell as a result of adverse macroeconomic trends. The components of revenue and expenditure which are the most heavily taxed in relative terms recorded a nominal trend growth rate below that of GDP, causing a structural reduction in public revenues of 0.3 percentage point during the period considered. The impact of these two factors was only partly offset by the automatic increase in the fiscal burden which results from the progressive nature of personal income tax. The influence of the latter is modest, principally because of the automatic indexation of the tax scales, and can be estimated at only 0.2 percentage point for the period under review. Finally, residual factors increased the structural revenues by 0.6 point over the same period. During the year under review, however, these last factors exerted a negative effect which amounted to 0.3 point, essentially owing to the adverse movement in excise revenues (reflecting, inter alia, certain changes in the composition of private consumption) and the contraction of advance payments made by self-employed persons.

The sharp structural rise in primary expenditure over the period considered, totalling around 2.4 percentage points in relation to trend GDP, can be attributed to several categories of expenditure. Health care spending, which on average rises faster than trend GDP, thus contributed 0.8 percentage point to the structural increase in primary expenditure, while other social expenditure, taken together, showed a much smaller rise. Subsidies were also stepped up considerably during the period. In recent years, that development has been due, inter alia, to the increased expenditure for the service voucher system and certain reductions in charges in favour of businesses, such as those for shift working, research and overtime. In accordance with the ESA 95 methodology, these items are recorded as subsidies in the government accounts. Finally, compensation of public sector employees, current purchases of goods and services, and public investment increased faster than trend GDP during the period considered.

Debt of general government

In 2006, the general government debt amounted to 89.1 p.c. of GDP, according to the view taken by Eurostat regarding the RIF (87.5 p.c. of GDP according to the view taken by the NAI). It was thus 4.1 percentage points of GDP lower than in the previous year, a result slightly above the average for the reductions recorded since 1993, when the debt had peaked at 133.5 p.c. of GDP.

TABLE 34 CONSOLIDATED GROSS DEBT OF GENERAL GOVERNMENT

(percentages of GDP, unless otherwise stated)

	1993	Average 1994-2002	2003	2004	2005	2006 e	Change from 1993 to 2006 e
Debt level (end of period) according to the view taken by Eurostat[1]	133.5		98.6	94.3	93.2	89.1	
p.m. Idem, according to the view taken by the NAI[1]					91.5	87.5	
Change in the debt		–3.4	–4.7	–4.3	–1.1	–4.1	–44.4
Endogenous change[2]		–2.8	–2.7	–5.0	–0.6	–4.6	–37.8
Primary balance required to stabilise the debt[2]		2.9	2.7	–0.3	1.5	–0.4	
Implicit interest rate on the debt[3]		6.4	5.3	5.0	4.6	4.6	
Growth of nominal GDP[3]		3.9	2.6	5.4	3.1	5.1	
Actual primary balance		5.7	5.4	4.7	2.0	4.2	
Change resulting from other factors		–0.6	–2.0	0.7	–0.5	0.5	–6.6
Transactions with the NBB (including capital gains on gold)		–0.4	–0.1	0.0	0.0	0.0	
Privatisation operations and other financial transactions		–0.3	–2.3	–0.4	–0.1	0.0	
Net formation of financial assets outside the public sector		–0.3	0.2	0.0	–0.2	0.0	
Sectoral classification changes		0.1	0.0	0.0	–0.4	0.0	
Other[4]		0.4	0.2	1.1	0.2	0.5	

Sources: EC, NAI, NBB.

(1) According to the view taken by the NAI, the Railway Infrastructure Fund (RIF), set up in the context of the BNRC restructuring on 1 January 2005, comes under the non-financial corporations sector. According to Eurostat, that Fund belongs to the general government sector.

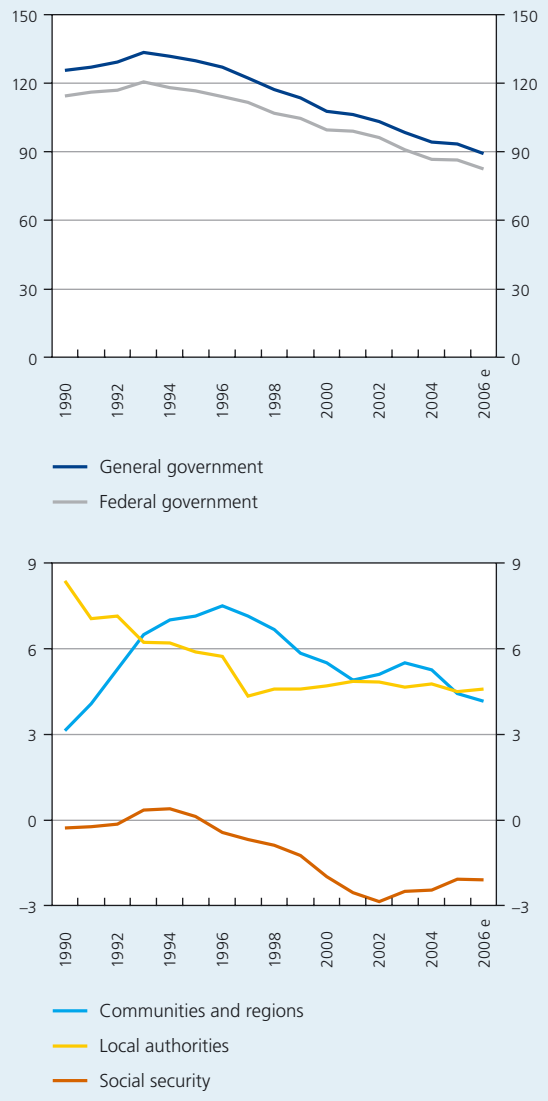
(2) The endogenous change in the public debt is determined by the difference between the primary balance required to stabilise the debt – i.e. the balance equal to the difference between the implicit interest rate on the debt and the rate of growth of nominal GDP, multiplied by the ratio between the debt at the end of the previous year and the GDP of the period in question – and the actual primary balance.

(3) Percentages.

(4) Mainly lending, equity investment, the impact of exchange differences and of issue and repurchase premiums, and statistical discrepancies.

CHART 51 CONTRIBUTION OF THE GENERAL GOVERNMENT SUB-SECTORS TO THE CONSOLIDATED GROSS PUBLIC DEBT [1] [2]

(percentages of GDP)



Sources : EC, NBB.

(1) According to the Eurostat view of the RIF.

(2) Consolidated gross debt of the sub-sector, less the part of the debt of the other government sub-sectors which it holds.

This renewed fall is very largely due to the endogenous change in the public debt, which contributed 4.6 percentage points to the debt reduction, compared to an average of 2.8 points from 1994 to 2002. Although, in relation to that period, the actual primary balance has contracted from 5.7 to 4.2 p.c. of GDP, the essential conditions for avoiding a snowball effect have eased considerably as a result of the downward trend in the implicit interest rate and because, during the year under review, nominal GDP growth exceeded the level of that interest rate. In fact, in this case there is no need to create a primary surplus in order to stabilise the debt.

Compared to its 1993 peak, the general government debt has fallen by around 44 percentage points of GDP. The federal government's share of the debt, amounting to approximately 90 p.c. of the total, has declined more or less proportionately, to represent 82.5 p.c. of GDP in 2006. The debt of the communities and regions had risen to 7.5 p.c. in 1996, but has since declined, falling to 4.1 p.c. of GDP in 2006. That movement is due to generally positive budget balances accumulated during that period. The local authorities saw their debt fall from 8.4 p.c. of GDP in 1990 to 4.3 p.c. in 1997. Since that sharp reduction, their debt has remained steady, oscillating around that level and reaching 4.6 p.c. of GDP in 2006. Finally, the gross debt of social security has fallen steadily since the mid 1990s. However, in 2001 it was taken over by the federal government. Taking into account the assets which it holds on other public authorities, this sub-sector has recorded a credit position since 1996, which expanded continuously until 2002, when it reached around 3 p.c. of GDP. That position has since been eroded somewhat, falling to 2.1 p.c. of GDP at the end of the year under review.

7.

7.1 Structure of finance and investments in the Belgian economy

Households, which held net financial assets estimated at around 626 billion euro at the end of 2005, constitute the Belgian economy's only net creditor sector. They therefore finance, directly or indirectly, the other resident sectors and the rest of the world. As at 31 December 2005, companies formed the largest debtor sector: although they held more financial assets than households, their financial liabilities were even larger and exceed the assets by about 276 billion. The net debt of general government came to just over 241 billion at the end of 2005, and that of the rest of the world totalled around 103 billion. The financial corporations sector presented a financial position which was more or less in balance, since many of its constituent institutions are treated, by convention, as pure financial intermediaries.

Once again, the formation of financial assets by Belgian households exceeded the new liabilities which they incurred during the first nine months of the year under review. Consequently, the net financial assets of households increased by 5.7 billion euro, disregarding fluctuations in prices and exchange rates. At the same time, non-financial corporations, for convenience simply referred to from now on as corporations or companies, recorded a net financing capacity of 6.8 billion, enabling them to reduce their net debt level to some extent. In contrast, the financial transactions of general government ended with a deficit of 4.3 billion during the period considered.

TABLE 35 FINANCIAL ASSETS AND LIABILITIES BY SECTOR

(outstanding amount at the end of 2005, billions of euro)

	Financial assets					Total financial liabilities
	Households	Non-financial corporations	General government	Financial corporations[1]	Rest of the world	
Financial liabilities						
Households	–	–	6.5	129.9	–	136.4
Non-financial corporations	94.8	443.3	16.7	118.4	430.7	1,104.0
General government	13.8	8.8	34.0	126.4	135.4	318.3
Financial corporations[1]	504.9	69.1	18.8	328.0	654.4	1,575.1
Rest of the world	148.9	307.2	1.2	865.7	–	1,323.1
Total financial assets	762.4	828.5	77.2	1,568.3	1,220.5	4,456.9
Net financial assets	626.0	–275.5	–241.1	–6.8	–102.6	

Source: NBB.

(1) Financial corporations mainly comprise the NBB, credit institutions and institutional investors. In the financial accounts, the NBB and credit institutions are treated as pure financial intermediaries, whose financial assets equal their financial liabilities.

TABLE 36 STRUCTURE OF THE FINANCIAL ASSETS AND LIABILITIES OF THE RESIDENT NON-FINANCIAL SECTORS

(billions of euro)

	Households		Non-financial corporations		General government	
	Outstanding amount at the end of 2005	Flows of the first nine months of 2006	Outstanding amount at the end of 2005	Flows of the first nine months of 2006	Outstanding amount at the end of 2005	Flows of the first nine months of 2006
Financial assets[1]	762.4	14.0	828.5	40.3	77.2	–2.2
of which:						
Notes, coins and deposits	223.2	8.8	78.2	21.7	5.0	1.1
Fixed-income securities	84.6	–6.2	16.3	0.0	15.9	–2.7
Units of UCIs	130.2	5.5	0.1	0.0	1.0	1.4
Shares and other equity	145.0	0.2	397.4	8.7	20.1	0.3
Insurance technical reserves	175.9	10.4	6.5	–0.2	–	–
Loans	–	–	344.7	24.1	20.2	–1.0
Financial liabilities	136.4	8.4	1,104.0	33.6	318.3	2.2
of which:						
Notes, coins and deposits	–	–	–	–	0.9	0.1
Fixed-income securities	–	–	33.3	1.2	258.9	3.1
Shares and other equity	–	–	655.4	32.1	–	–
Loans	128.4	9.2	405.6	–0.6	46.3	2.9
Financial balance	626.0	5.7	–275.5	6.8	–241.1	–4.3

Source: NBB.

(1) Apart from the main categories of financial instruments presented in the table and various minor assets not specifically named, this item also covers errors and omissions in Belgium's financial account with the rest of the world, traditionally treated as unrecorded capital movements. When the cumulative flows of these errors and omissions are negative, the sum of the outstanding amounts of the main categories of instruments included in the table may exceed the total amount of the financial assets.

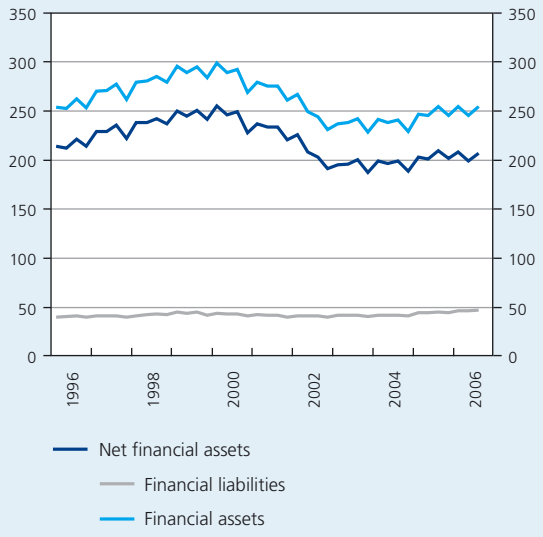
7.2 Households

As at 30 September 2006 – taking account of valuation effects – Belgian households owned financial assets totalling 781 billion euro, an increase of 4 p.c. in one year. However, their debts increased faster, by 9.5 p.c., mainly because of the continuing strong demand for mortgage loans. At the end of the first nine months of the year under review, the financial liabilities of households represented a total of 145 billion euro.

Consequently, as at 30 September 2006, households owned net financial assets estimated at 637 billion euro. Expressed in nominal terms, that was an all-time record figure for their financial worth. However, in relation to GDP at current prices, the total net assets of households remained below the level reached in the year 2000 before the bursting of the speculative stock market bubble. As at 31 December 2005, the net financial assets of households represented three and a half times their disposable income, or about twice the level of GDP.

CHART 52 FINANCIAL ASSETS OF HOUSEHOLDS

(quarterly data, percentages of GDP annualised at current prices)



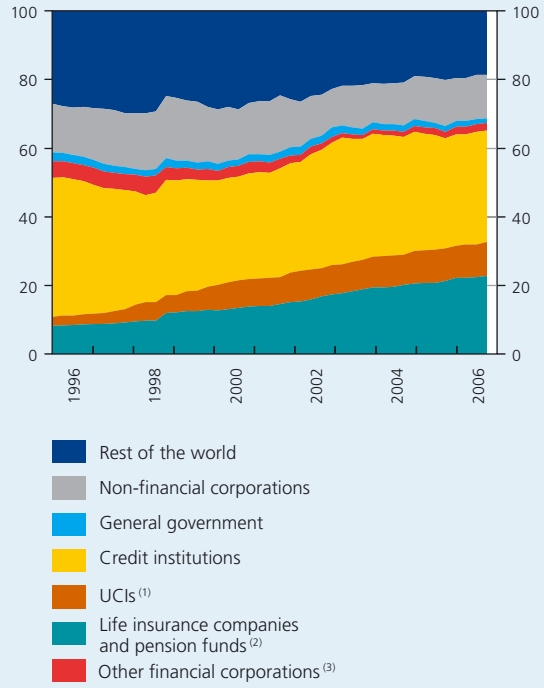
Sources: NAI, NBB.

Formation of financial assets

At the end of the first nine months of 2006, credit institutions held one-third of the assets of households, a proportion which has fluctuated considerably over the past ten years. Assets placed with life insurance companies and pension funds, which are expanding constantly, represented 23 p.c. of the households' portfolio. They now account for a larger share than claims on the rest of the world (19 p.c.), which have tended to decline in the past few years, notably because of the entry into force of the EU Directive on the taxation of savings income in the form of interest payments. Disintermediated investments in equities and bonds issued by Belgian companies amounted to 13 p.c. as at 30 September 2006, and units in UCIs represented 10 p.c.: these two asset categories have accounted for a relatively stable proportion of the households' portfolio for several years. Finally, the liabilities of general government and of the entities included in the category "other financial corporations" represented only a minor direct counterpart to the financial assets of households as at 30 September 2006.

CHART 53 FINANCIAL ASSETS OF HOUSEHOLDS: BREAKDOWN BY COUNTERPARTY SECTOR

(end-of-quarter data, percentages of the total outstanding)



Source : NBB.

(1) Except pension savings funds.

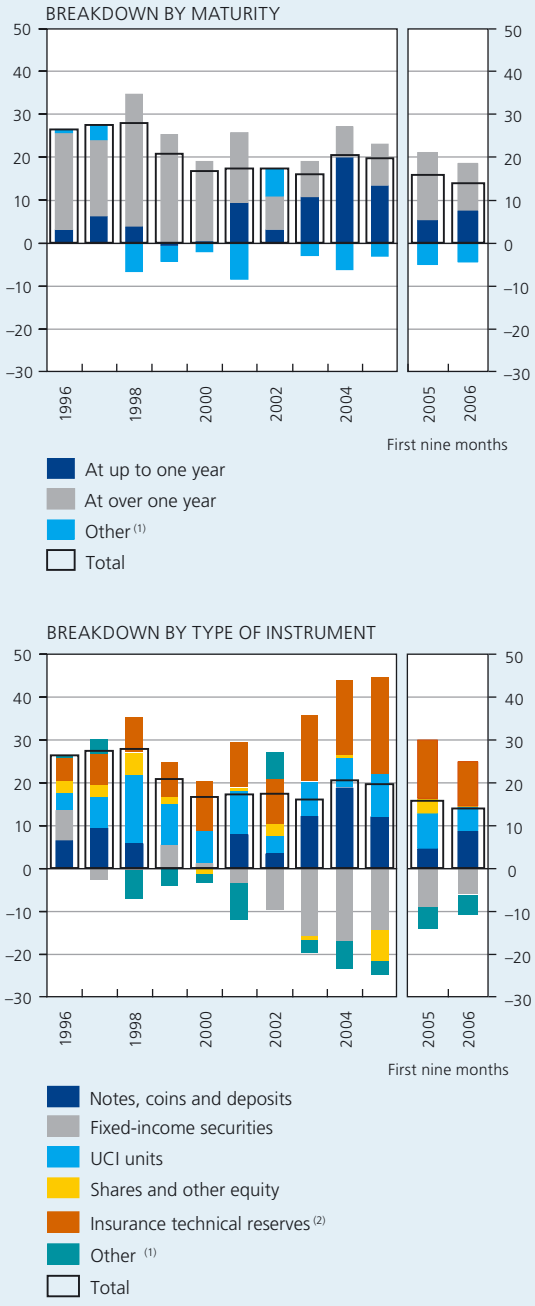
(2) Including pension savings funds.

(3) This category comprises the NBB, financial auxiliaries, the "non-life" sectors of insurance companies, and financial intermediaries not included under other headings.

Households formed new financial assets totalling 14 billion euro during the first nine months of the year under review, against 15.8 billion during the corresponding period of the previous year. The majority of these funds were invested in assets at over one year, although to a

CHART 54 FORMATION OF FINANCIAL ASSETS BY HOUSEHOLDS

(billions of euro)



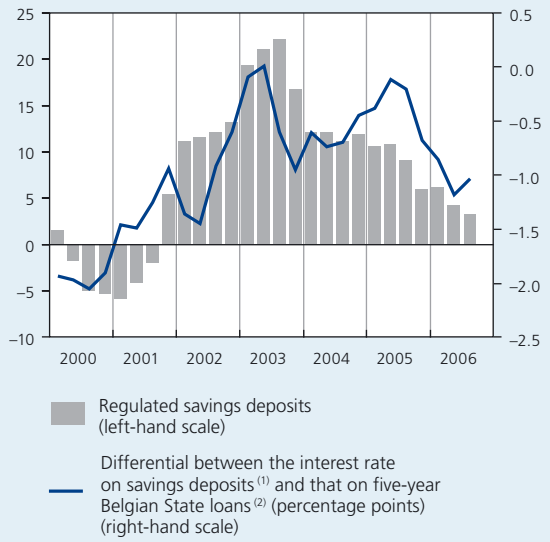
Source : NBB.

(1) Includes transitional items and statistical adjustments.

(2) This item essentially comprises the net claims of households on life insurance reserves and pension funds.

CHART 55 SAVINGS DEPOSITS OF HOUSEHOLDS AND INTEREST RATE DIFFERENTIAL

(percentage changes compared to the corresponding quarter of the previous year, except for the interest rate differential)



Source : NBB.

(1) Implicit interest rate on regulated savings deposits as indicated by the profit and loss accounts of credit institutions; quarterly averages.

(2) Net yield on the secondary market in linear bonds with a residual term of five years, the movement in which is taken as an indicator of the movement in the interest rate on investments competing with savings deposits; quarterly averages.

lesser extent than in 2005, mainly because of the flattening of the yield curve.

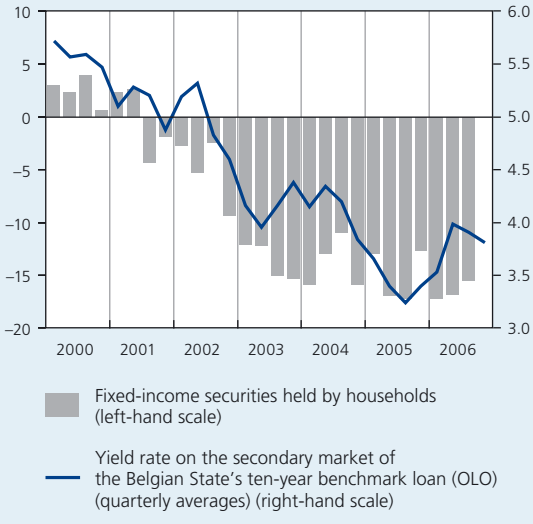
Notes, coins and bank deposits accounted for a large proportion of household savings flows. The formation of time deposits, still negative in the previous year, was a major factor in the growth of this asset category during the year under review. The renewed interest of households in time deposits is attributable to the gradual rise in credit interest rates on these products; this was particularly apparent for short-term deposits, which quite clearly reflected the tightening of the Eurosystem's key interest rates (on this subject, see box 3). Conversely, interest rates paid on savings deposits remained relatively low in 2006. Thus, the difference between the net five-year yield on linear bonds (OLOs) and the interest rate on savings accounts increased in favour of government loans, despite rate hikes in the middle of the year by a number of banks whose market shares are still modest. Consequently, savings deposits – on which the interest up to 1,630 euro per taxpayer (2007 income) is exempt from the withholding tax on income from movable property – recorded weaker growth than in previous years. As at 30 September 2006, the outstanding amount of savings deposits was a little over 3 p.c. higher than the previous year's level.

The systematic decline in investments in fixed-income securities in recent years was evident once again in the first nine months of the year under review. The marked rise in long-term interest rates, which had begun at the end of the previous year but was interrupted in the third quarter of 2006, did not appear to encourage bond investments on the part of households. The latter effected net disposals of fixed-income securities totalling 6.2 billion euro during the first nine months of 2006.

Net flows of investments in shares and other equity were very modest during the first nine months of 2006. The year before, households had continued to favour equity investments in the first six months, before a very marked decline at the end of the year, due to the Suez take-over bid for Electrabel: many small Electrabel shareholders responded to the Suez bid for their shares but did not keep the proceeds of the exchange in the form of equities. The fall observed in the first nine months of the year under review occurred despite the impetus which share issues received from the introduction of the notional interest deduction (on this subject, see box 17), which does not appear to have boosted subscriptions by households. One reason might be the decline in stock market prices recorded in the second quarter since, as demonstrated in the previous year's Report, households evidently rely largely on a share's stock market performance in order to assess expected future returns and to decide whether to

CHART 56 FIXED-INCOME SECURITIES HELD BY HOUSEHOLDS AND LONG-TERM YIELD RATES

(percentage changes compared to the corresponding quarter of the previous year, except for the yield rate)



Source : NBB.

buy or sell. In that context, the rally which occurred in the second half of the year may have revived the interest of households in investing in equities in the fourth quarter of 2006.

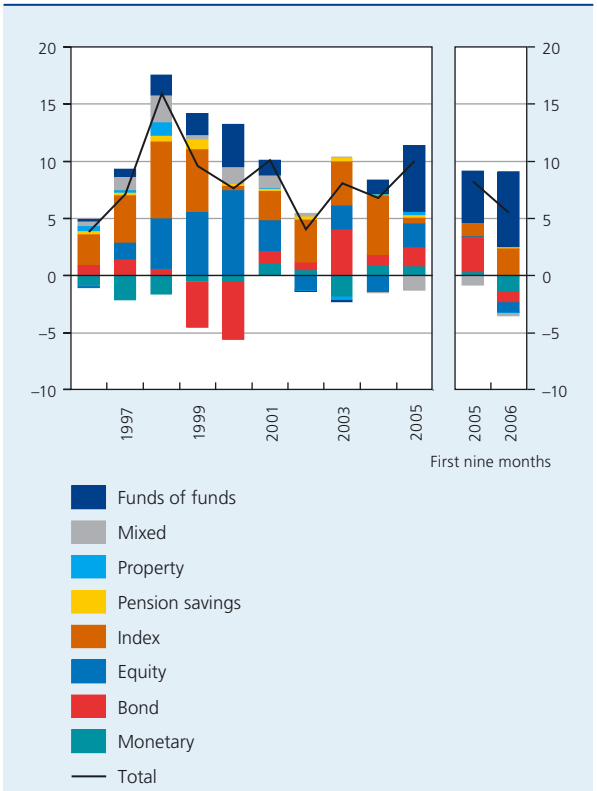
In the UCI sector, new contributions – subscriptions minus repayments – represented 5.5 billion euro during the first nine months of 2006, well below the figure recorded for the same period of the previous year. Households made net withdrawals of capital from bond funds, which had recorded a net contribution in recent years despite the low level of interest rates. This trend reversal can be attributed to a new tax rule, applicable since 1 January 2006, whereby the interest income on capitalisation units in funds with a European passport, directly or indirectly holding at least 40 p.c. of their investments in claims of any kind except bonds issued before 1 March 2001, attracts the 15 p.c. withholding tax on income from moveable property. This measure was intended to bring the list of financial assets generating income subject to the Belgian tax on income from movable property into line with the list of products covered by the EU Directive on the taxation of savings income in the form of interest payments. It could therefore also explain the net withdrawal of capital invested in monetary UCIs, observed in 2006.

Unit redemptions also exceeded subscriptions in the equity UCI sector. That sector therefore did not profit from the households' lack of enthusiasm for UCIs investing in interest-bearing assets, which admittedly do not represent the same degree of risk. In the first instance, net withdrawals of positions in monetary, bond and equity UCIs benefited funds of funds, UCIs which invest essentially in other UCIs and are actively promoted by various financial intermediaries. Investments in units of index UCIs, which generally offer a capital protection clause, also recorded positive flows during the first nine months of 2006. This category is in fact exempt from the withholding tax on income from movable property if the annual return is capitalised and paid out at maturity in the form of a capital gain.

The influence of taxation on the allocation of household savings was also manifest in another category of financial instruments. Since the start of the year under review, premiums paid on individual life insurance policies have been subject to a 1.1 p.c. tax. In reality, though the amounts which households are investing in insurance technical reserves are still substantial, the inflow has slowed significantly compared to the first nine months of 2005 : investments in this asset category, which mainly covers reserves formed in connection with a life insurance policy or a pension fund, totalled around 10 billion euro. True, it seems that some households had anticipated this

CHART 57 NET ACQUISITION OF UCI UNITS BY HOUSEHOLDS

(billions of euro)



Source : NBB.

measure, by effecting at the end of the previous year payments originally planned for 2006. But other savers clearly preferred to put their savings into alternative financial products. That was evident during the year under review from the strong growth of class 26 contracts, a term denoting pure capitalisation products which guarantee a minimum return but do not offer any life insurance cover. In contrast to class 21 contracts, products in class 26 are exempt from the new tax on contributions, but the interest is still subject to the withholding tax on income from movable property if the investment has a term of over eight years. However, the development of this type of tax-efficient contracts as short- or medium-term investment instruments has not been sufficient to offset the decline in premiums collected by insurance companies in classes 21 and 23, as the outstanding amount of class 26 products is relatively small at present.

New financial liabilities

During the first nine months of the year under review, the new financial liabilities of households reached a record high of 8.4 billion euro, against 7.7 billion during the corresponding period of 2005. Once again, home loans accounted for the major part of the debts contracted by households, although consumer credit also recorded a sharp rise.

It is evident from the results of the bank lending survey that the supply conditions for home loans have moved in the borrowers' favour, as banks once again eased their lending criteria slightly. On the other hand, credit institutions reported a weakening of demand for mortgage loans for the major part of the year under review, in contrast to the very marked expansion reported in the first half of 2005.

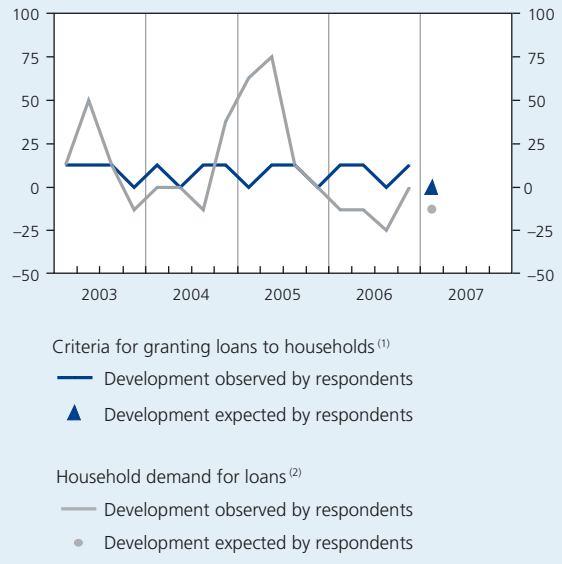
The decline in demand for credit began to be reflected in the movement in lending. In the first quarter, lending was still well above the figure for the same period of 2005, but from the second quarter the rate of expansion slowed significantly, and new lending reverted to the – still very high – level of a year earlier. The rise in interest rates applicable to mortgage loans is probably the reason for this slowdown.

The refinancing of existing mortgage loans appears to be particularly sensitive to the movement in interest rates. That is hardly surprising, since the attraction of refinancing a loan lies in the more advantageous borrowing conditions which can thereby be obtained. Logically, the slowdown and subsequent decline in refinancing activity since the end of 2005 can be linked to the rise in interest rates over that same period. From the point of view of households, it is no longer such a good time to redeem a loan: refinancing accounted for only 7 p.c. of total loans granted in September 2006, compared to 18 p.c. a year earlier.

The revival of interest in fixed-rate mortgage loans apparent in 2005 continued in 2006: this formula accounted for 78 p.c. of the contracts signed in September. By comparison, in September 2004, around 73 p.c. of borrowers had opted for one of the variable interest rate formulas. This trend reversal, occurring in the space of two years, is due to two factors. First, the relatively low but rising level of interest rates may have prompted expectations of higher rates in the future. Second, the flattening of the yield curve reduced the differential between fixed and

CHART 58 RESULT OF THE EUROSYSTEM'S BANK LENDING SURVEY: MORTGAGE LOAN SUPPLY AND DEMAND IN BELGIUM

(quarterly data)



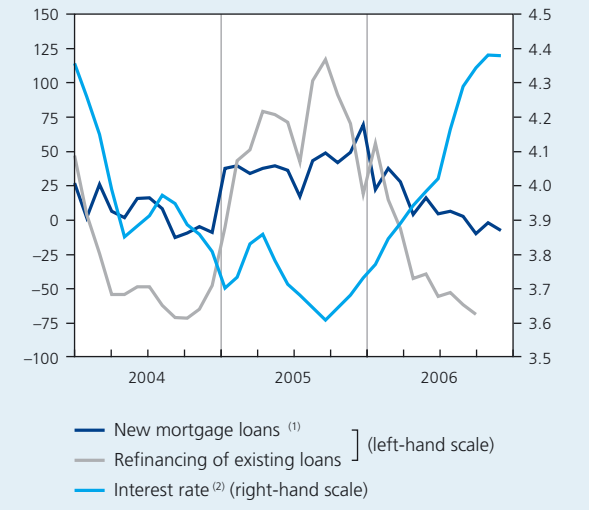
Source: NBB.

(1) Balance in percentages of weighted replies by credit institutions to the Eurosystem's bank lending survey indicating the degree to which lending criteria were eased or tightened (–).

(2) Balance in percentages of weighted replies by credit institutions to the Eurosystem's bank lending survey indicating the degree of increase or decrease (–) in demand for credit.

CHART 59 NEW MORTGAGE LOANS TO HOUSEHOLDS, REFINANCING AND INTEREST RATES

(percentage changes compared to the corresponding month of the previous year, except for interest rates)



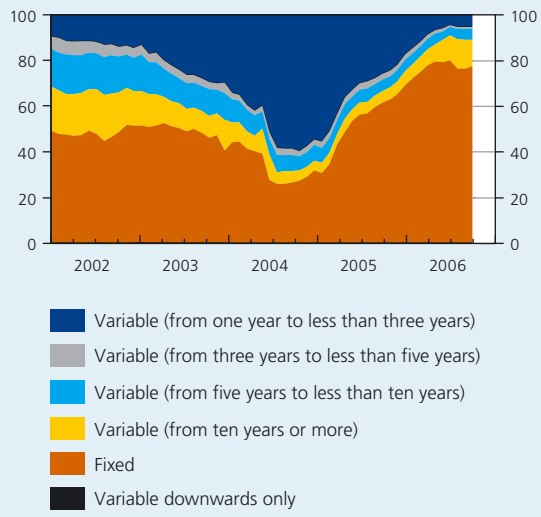
Sources: PLU, NBB.

(1) Excluding the refinancing of existing loans.

(2) Average of the rates charged on the main categories of mortgage loans, weighted by the amounts of new loans contracted in each of those categories.

CHART 60 BREAKDOWN OF NEW MORTGAGE CONTRACTS BY TYPE OF INTEREST RATE [1]

(monthly data, percentages of the total)



Source : PLU.
(1) The wording in brackets refers to the period for which the rate is initially fixed.

variable rates. These factors made the fixed-rate option much more attractive to borrowers.

During the first half of the year under review, the outstanding amount of consumer credit increased by 1.1 billion euro, twice the growth recorded for the corresponding period of 2005. In contrast, the number of defaulting contracts – which mainly concern consumer credit – declined slightly to 492,177 as at 31 December 2006, compared to 501,102 at the end of 2005. That improvement is also evident in the smaller number of defaulting debtors and in the lower outstanding amounts of unsettled arrears. These developments confirm the benefits of the existing legislation on the prevention of excessive debt levels, particularly the wider duties allocated to the Central Individual Credit Register in mid 2003, and especially its conversion to a positive credit register. A recent significant amendment to that legislation is discussed in box 16.

Nonetheless, this overall improvement conceals recurrent problems on certain segments of the consumer credit market. This applies to the opening of credit lines, the only category to see an increase in contracts in difficulty in 2006. As at 31 December, they represented around 42 p.c. of all defaulting contracts. Non-bank lenders, who account for two-thirds of the credit lines opened, continue to dominate in this segment. It is becoming increasingly common to open a credit line with these institutions. This facility, which is very often linked to a card, authorises the holder to draw on credit at will up to a certain amount, but the timing and size of the capital repayments are not predetermined. These characteristics mean that the credit facility harbours potential dangers for the consumer. Aware of the risks, the legislation introduced with effect from 1 February 2007 a maximum period for "resetting the counter at zero" : in future, borrowers have a maximum of five years in which to repay the whole of the amount borrowed via a credit line. Although the specified period is long, this system should prevent some borrowers from becoming permanently trapped in a situation where the debit interest is building up to the point where they can no longer repay the capital.

Box 16 – The new legislation on maximum annual percentage rates

In the early 1990s, in order to increase market transparency, the legislation had defined a single method of calculating the rate applicable to all consumer credit : the annual percentage rate (APR). This concept takes account of all aspects of a loan : the rate of capital repayment, the payment of interest and any charges associated with the granting and administration of the loan. All financial institutions asked to grant consumer credit must disclose the APR to the potential borrower, who can therefore readily compare the terms offered by various institutions.

The law also stipulates, for each type of consumer credit, the maximum APRs which lenders must not exceed. A new royal decree[1] updating these maximum rates came into force on 1 February 2007. It covers two aspects : the setting of new ceilings and the introduction of an automatic mechanism for adjusting the maximum rates.

(1) Royal Decree of 19 October 2006, amending the Royal Decree of 4 August 1992 on consumer credit costs, rates, duration and repayment terms, with a view to setting maximum annual percentage rates.

From now on, the maximum APR applied to consumer credit will depend on the type of credit (loan/hire purchase, credit line with or without a card, or financial leasing) and the amount borrowed. The smaller that amount, the higher the maximum APR, since that rate is defined inclusive of a number of fixed charges which are independent of the contract amount. The initial values of these maximum rates stipulated in the said regulations are shown in the schedule below.

NEW SCHEDULE OF MAXIMUM ANNUAL PERCENTAGE RATES

(percentages)

Credit amount	Loans and hire purchase	Credit line with card	Credit line without card	Financial leasing
Up to 1,250 euro	21	17	13	15
From 1,250 to 5,000 euro	16	15	12	12
Over 5,000 euro	13	14	12	11

Source: FPS Economy, SMEs, Self-employed and Energy.

The intention is to adjust each of these maximum rates in line with the movement in the reference indices (short- and medium-term OLOs and three-month Euribor) reflecting the cost of the credit. Twice a year, at the end of March and the end of September, each reference index is checked to see whether it has changed by 0.75 percentage point or more since the last time the corresponding maximum APR was adjusted. If it has, an underlying reference rate, initially corresponding to the starting value of the maximum APR concerned, is increased (reduced) by the amount of the rise (fall) recorded in the reference index. A new maximum APR is determined by rounding off this adjusted reference rate to the nearest unit or half unit. The new maximum APRs and the new indices and corresponding reference rates, are published in the Belgian Official Gazette and enter into force on the first day of the second month following publication.

The new system offers many advantages over the previous legislation. First, the maximum rates are now linked to the movement in the reference indices via an objective, transparent and systematic procedure, in contrast to the old system. Also, the schedule of maximum rates has been considerably simplified: it now contains only twelve maximum rates instead of the previous twenty-eight, thus making it easier for lenders and consumers to understand. Finally, the new schedule offers maximum rates which are lower, overall, than under the old system. The new legislation may be seen as more restrictive, since it may lead to the refusal of certain credit which would have been granted at a higher rate: that could potentially impair the well-being of households (perhaps faced with the impossibility of financing their requirements) and the profitability of banks (deprived of the income which that credit would have generated). On the other hand, the existence of maximum rates is very effective in performing the required role of combating excessive debt. These ceilings protect consumers from exorbitant interest rates and from excessive debt levels liable to jeopardise their ability to repay. In so doing, the maximum rates also reduce the risk of default on the part of the borrower, and that benefits the lender. Finally, it should be stressed that, at aggregate level, the new maximum interest rates on consumer credit do not appear to be very restrictive: they are still well above the average APR of 7.9 p.c. charged by banks on loans contracted during the first nine months of 2006. However, although there are not as yet any official statistics on the average APR charged by non-bank lenders, it would seem that the rates which they have been charging up to now on credit lines were generally in the region of the maximum rates permitted under the old system.

7.3 Non-financial corporations

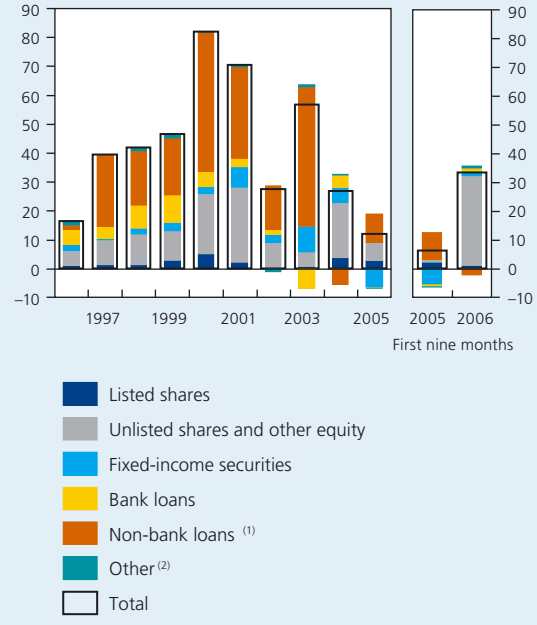
During the first nine months of 2006, firms contracted new liabilities totalling 33.6 billion euro, compared to 6.5 billion during the corresponding period of 2005. The scale of the new financial liabilities incurred by Belgian companies in 2006 is due in part to the continuing sustained expansion of their tangible investments, as their gross capital formation totalled 41.8 billion euro in 2006 against 38.1 billion in 2005, an annualised rise of 9.6 p.c. at current prices. In addition, Belgian companies effected substantial financial investments in 2006. Thus, taking account of revaluation effects, the total financial assets held by Belgian non-financial corporations at the end of September 2006 increased by 6.5 p.c. year on year to around 887 billion, a sizeable amount which exceeds the financial assets owned by households.

New financial liabilities

The expansion of the new liabilities was driven by the strong growth of issues of unlisted shares and other equity which, at 30.8 billion euro, became the main source of corporate finance during the first nine months of 2006. The fact that the rest of the world – which can be assumed to comprise mainly associated non-financial corporations established abroad – was the main counterpart in these issues indicates a resurgence of intra-group financing during the year under review. Conversely, there was a sharp fall in flows between firms in the form of non-bank loans. Recourse to risk capital via the issue of listed shares, traditionally modest in Belgium, recorded lower growth than over the corresponding period of the previous year, representing around 1.3 billion during the first nine months, against 2.2 billion. A positive flow of 1.7 billion was recorded in respect of bank loans to firms: that is the opposite of what happened in the first three quarters of 2005 and appears to herald a gradual revival in this method of financing. Finally, net issues of fixed-income securities made a small contribution towards corporate financing at a total of 1.2 billion, in contrast to 2005 when redemption of these instruments came to 5.1 billion over the corresponding period. In November, there was still one large transaction, namely the raising of 1.7 billion euro by Belgacom.

CHART 61 NEW FINANCIAL LIABILITIES OF NON-FINANCIAL CORPORATIONS: BREAKDOWN BY INSTRUMENT

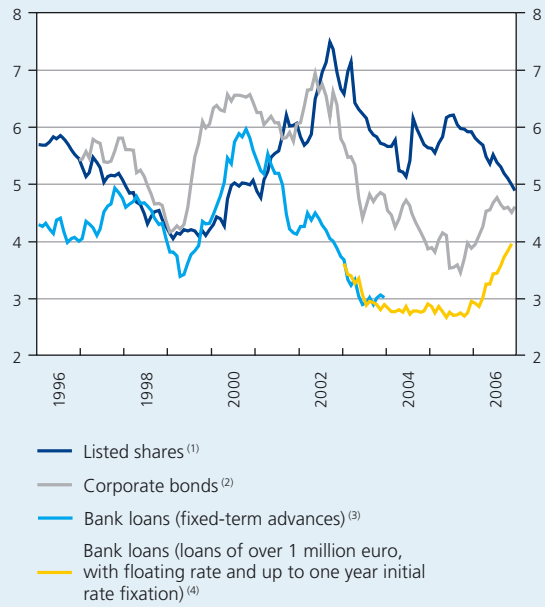
(billions of euro)



Source: NBB.
(1) Mainly loans granted by Belgian and foreign non-financial corporations.
(2) Includes technical reserves of non-autonomous pension funds and transitory items.

CHART 62 FINANCING COSTS OF NON-FINANCIAL CORPORATIONS IN BELGIUM

(percentages)



Sources: Thomson Financial Datastream, NBB.
(1) Estimated on the basis of a dividend discount model, monthly averages. Long-term dividend growth is deemed to converge with the economy's potential growth.
(2) Yield on a bond with a BBB rating denominated in euro with a maturity of five to seven years, monthly averages.
(3) Data from the monthly RIR survey.
(4) Data from the monthly MIR survey, for new loans contracted.

One of the major factors determining a firm's chosen method of financing is the relative cost of each of the available instruments. In this connection, chart 62 illustrates the movement in the cost of bank loans, corporate bond issues and share issues. This last indicator was estimated on the basis of a dividend discount model for which the methodology was explained in box 19 in the 2005 Report. Briefly, one can state that the cost of equity financing is augmented by an increase in dividends (actually paid and/or expected in the future) and is reduced by a rise in stock market prices. The assumption made regarding long-term dividend growth has a major influence on the level of the indicator, so that attention should focus on the respective movements in costs rather than on the cost levels. It should also be noted that, although the cost of equity financing described here takes account of stock market prices, and is therefore more useful for explaining listed share issues, it is also applicable to unlisted share issues, as issues of these two categories of instruments show a relatively close correlation.

In recent times, the movement in the costs of the various sources of finance for Belgian companies has been particularly favourable to equity financing. From July 2005 until the end of 2006, the cost of equity financing declined by more than 20 p.c., while the cost of bank loans and corporate bonds increased by around 45 and 30 p.c. respectively. These higher borrowing costs were due to the cycle of increases in the ECB's key interest rates, which began in December 2005, while the cost of equity financing benefited from the buoyancy of the stock markets (see below), where the favourable outlook for future profits drove up prices. The optimism displayed by Belgian entrepreneurs and investors throughout the year, which may be reflected in below-normal risk aversion, also helped to bring down the cost of equity financing.

The enthusiasm of Belgian companies for equity financing rather than borrowings in 2006 is nevertheless also due to the introduction of a new provision, namely the risk capital allowance, more commonly known as the notional interest deduction. By allowing the deduction of the theoretical interest charges on capital, the new measure makes equity financing significantly more attractive (for more details, see box 17).

Box 17 – Notional interest and financial choices for firms

Introduced by the law of 22 June 2005 and entering into force on 1 January 2006, the tax allowance for risk capital, more commonly known as the notional interest deduction (NID), will probably have a structural influence on the financial behaviour of economic agents in Belgium. Intended to reduce the present discrimination between debt financing and equity financing, by reducing the tax burden for all firms established in Belgium, it should also enhance the country's fiscal attractions for both Belgian and foreign investors. Moreover, since it is by definition more attractive for the most heavily capitalised companies, it offers a viable alternative to the planned dismantling of the coordination centre regime. The advantageous tax rules applicable to coordination centres had been introduced in 1982. During the discussions launched in the late 1990s concerning tax regimes which distort competition, the Ecofin Council had eventually concluded that this regime was a harmful fiscal measure, implying a form of unfair competition, and should therefore be abolished. The EC Decision in 2003 stating that the regime could no longer be considered compatible with the rules on State aid was another reason for abandoning it.

The aim of this box is to explain the mechanisms whereby the NID may influence the financing choices of companies – other than coordination centres – already established in Belgium. That influence may vary according to the type of investor : individual or corporate (and assumed to belong to the same group), resident or non-resident.

Before any discussion of the choice between debt and equity[1], it is worth pointing out that the tax aspects, or more generally the cost-related aspects, are not the only factors determining the choice of the optimal capital structure. In the first instance, the decision on opening up the capital (and hence the control) depends

(1) Equity financing means both the reinvestment of profits and the issue of new shares.

on considerations specific to the company, such as its internal organisation, method of governance, size, maturity, profitability, growth prospects, etc. Furthermore, these factors operate in a given institutional (degree of competition, market functioning, existence of specialised equity markets, etc.), and legal context (protection for creditors versus protection for shareholders, maintenance of existing shareholders' control mechanisms via the issue of shares without voting rights, etc.) which may be conducive in varying degrees to one or other type of financing.

To gain an understanding of the impact of the NID on corporate financing choices, two "fictitious" companies[1] with different financing methods are considered: the first (company A) is financed exclusively by debt, while the second (company B) is financed exclusively via its own resources. Their profits before taxes and financial expenses are the same, at 100. If company A allocates the whole of its profits before taxes and financial expenses to interest payments, the deduction allowed for interest charges cancels out the whole of the tax. The private Belgian investor will receive final interest income of 85, i.e. 100 minus the 15 p.c. withholding tax. In the case of company B, financed entirely out of its own resources, there is no question of any deduction, and the profits attract the normal rate of tax (33.99 p.c., rounded off to 34 p.c. for the purposes of the example), leaving profits after tax of 66. The private investor will in this case receive a sum of 49.5, in view of the 25 p.c. withholding tax on dividends received. Conversely, if no dividend is paid, so that the profits are reflected in a capital gain on resale of the share (incorporation of the retained earnings in the share price), the individual will receive the whole of the profit after tax, or 66, since capital gains are not taxed in Belgium.

The discrimination between debt and equity thus operates at two levels: from the point of view of the firm, via the full deductibility of interest charges, and for the investor (in this case an individual), via the tax differential in favour of interest income. Debt financing is thus the first preference, followed by equity financing without payment of dividends, and finally equity financing with payment of dividends.[2]

The situation is different if the borrower firm is financed by another company[3], e.g. one belonging to the same group. Company A (subsidiary), which receives funds from its parent company, will have to make recompense by paying interest of 100; the whole of that interest will be classed as taxable income, generating a net profit of 66 for the parent company. For its part, company B will pay its parent company dividends of 66, of which 95 p.c. are tax free subject to certain conditions[4], leaving a net profit of 64.9 for the parent company. If, instead of paying dividends, the subsidiary reinvests the profits, the group will receive income of 66, as capital gains are also tax free within a group. From the group's point of view, debt financing gives the same outcome as a shareholding with retained earnings, while a shareholding with regular dividend payments attracts very slightly less favourable tax treatment.[5]

The second part of the table shows the extent to which the NID changes the preferences. Here, too, for the purposes of the exercise, a rather extreme case is considered, namely that the self-financed firm B has sufficient own resources to deduct notional interest for the whole of its profits. It should be remembered that the NID permits deduction from the tax base of a part of the equity capital, calculated by multiplying the equity – after "adjustment" for certain factors – by a notional rate of remuneration on the capital. The adjustment of the capital is justified because it cannot be assumed that the whole capital is allocated to the productive activity of the business; the legislator also wanted to avoid assets being invested artificially in a company in order to increase the basis for the deduction, and thus take advantage of any cascade effects between companies in the same group.

(1) A business financed exclusively by debt and having no own funds is a totally theoretical example.

(2) The risk associated with the various operations, and the investor's preference for or against regular payments (dividends), should be taken into account in the calculations since they vary.

(3) In principle, it is assumed here that the parent company is also a Belgian firm, but the tax rules applicable to a foreign parent company are in some cases very similar to those for Belgian firms.

(4) Under the Participation Exemption Regime (PER), designed to prevent multiple companies from being taxed on the same income. Under this system, if certain conditions are respected, the company receiving the dividends is granted a tax exemption of 95 p.c. on dividends on which the paying company has already been taxed. Moreover, such provisions are central to the EU Directive on parents and subsidiaries, in force throughout the EU Member States.

(5) No account is taken here of differences in the taxation of the incomes of the investor financing the parent company.

CHOICE OF FINANCING BEFORE AND AFTER INTRODUCTION OF THE NOTIONAL INTEREST DEDUCTION (NID)

	Before the NID			After the NID		
	Company A:	Company B:		Company A:	Company B:	
	Financed entirely by debt	Financed entirely via own resources		Financed entirely by debt	Financed entirely via own resources	
	Loan with interest	*Shareholding with dividends*	*Shareholding with capital gains*	*Loan with interest*	*Shareholding with dividends*	*Shareholding with capital gains*
Profit before taxes and financial expenses	100	100	100	100	100	100
Interest charges	100	–	–	100	–	–
Notional interest	–	–	–	–	100	100
Profit after taxes[1] and interest charges	0	66	66	0	100	100
Investor's income	Creditor	Shareholder		Creditor	Shareholder	
1. Belgian individual	**85.0** (withholding tax of 15 p.c. on interest received)	49.5 (withholding tax of 25 p.c. on dividends received)[2]	66.0 (no tax on capital gains)[3]	85.0 (withholding tax of 15 p.c. on interest received)	75.0 (withholding tax of 25 p.c. on dividends received)[2]	**100.0** (no tax on capital gains)[3]
2. Belgian parent company	**66.0** (all interest received taxed at corporate tax rate)	64.9 (5 p.c. of dividends received taxed at corporate tax rate) (PER)	**66.0** (no tax on capital gains)[3]	66.0 (all interest received taxed at corporate tax rate)	98.3 (5 p.c. of dividends received taxed at corporate tax rate) (PER)	**100.0** (no tax on capital gains)[3]

Source: NBB.
(1) I.e. the normal rate of corporate tax of 33.99 p.c. (including the complementary crisis contribution), rounded off to 34 p.c. for simplicity.
(2) This is the commonest case; the withholding tax may be 15 p.c. in certain cases, e.g. for "new shares", or 10 p.c. in the case of liquidation.
(3) No account is taken here of any costs entailed in selling shares (such as stock market fees), which may also have tax implications (e.g. share buybacks).

The deduction rate is the average annual yield on ten-year linear bonds (with a ceiling of 6.5 p.c., which may be amended by royal decree). That is therefore a risk-free rate, which is normally less than the effective cost of capital, especially if the business has a risky profile: SMEs, in particular, could be placed at more of a disadvantage than large companies, which generally enjoy better conditions for access to the financial markets. That is why the legislation provides for a 0.5 percentage point increase in the deduction rate for SMEs. It is also worth mentioning that the introduction of the NID was accompanied by the abolition of the 0.5 p.c. registration fee for capital contributions.

In the first example, namely financing by an individual, the introduction of the NID, which is assumed to neutralise the whole of the tax base, alters the order of preferences by increasing the profit associated with equity financing (with or without payment of dividends), while the profit associated with debt financing remains unchanged. The net position of the private investor is now better in the case of an investment in equities with capital gains on resale than in the case of a bond investment. However, bond investments are still more attractive than equity investments with dividend payments, although the yield differential between these two alternatives is considerably reduced in favour of equity investments.

In the second example, which assumed financing between entities within the same group, the introduction of the NID also causes major changes. The group's net position will now be decidedly better in the case of equity financing, be it with or without payment of dividends, and debt financing will be relegated to last position. However, the Belgian parent company may in some cases also be able to use the NID, in theory even for the whole of its profits. In that case, the corporate tax, even that applied to the interest income received by the parent company, can be recovered in full. The parent company can therefore distribute to its own individual shareholders a sum of 100, whatever the chosen method of intra-group financing; depending on the chosen method of remuneration, the shareholders will receive 75 or 100 p.c. of that sum.

A similar exercise conducted for the intermediate, and probably more realistic, case of a firm financed half by debt and half by equity, does not fundamentally alter, from the investor's point of view, the nature of the results obtained in the two extreme cases.

To conclude, before the introduction of the NID, there was tax discrimination between debt and equity, primarily at the level of the taxation of the individual investor's income, but there was virtually no discrimination if the finance was arranged within the group. The introduction of the NID effectively enhances the attractions of equity and, by reducing the tax burden, enables companies to pay their shareholders a better return. However, even if the NID is taken into account, the cost of debt will still be lower for firms, in practice, than the cost of equity. The reason is that the deductibility of interest charges relates to the total debt, whereas the NID is calculated on only part of the equity. In addition, the NID is based on a notional, risk-free rate which is lower than the interest rate actually paid on a loan, and, a fortiori, lower than the real cost of risk capital.

Shares

During the first nine months of 2006, share issues totalled 32.1 billion euro, a huge increase on the previous year (3.2 billion). This record figure actually exceeded that recorded at the turn of the millennium when share issue volumes had reached a peak. A more detailed examination of the available data on changes which firms made to their capital, particularly those relating to the number and size of the operations carried out, indicates that the growth essentially concerned large-scale operations amounting to 10 million euro or more, while there was no particular increase in the volume of smaller-scale operations. It therefore seems that a good many medium-sized and large firms changed their capital structure as a result of the new tax environment created by the NID.

Of the 32.1 billion euro raised by Belgian firms, 30.8 billion came from issues of unlisted shares and other equity, and 1.3 billion via listed share issues. It is therefore mainly for unlisted shares that 2006 can be called an exceptional year.

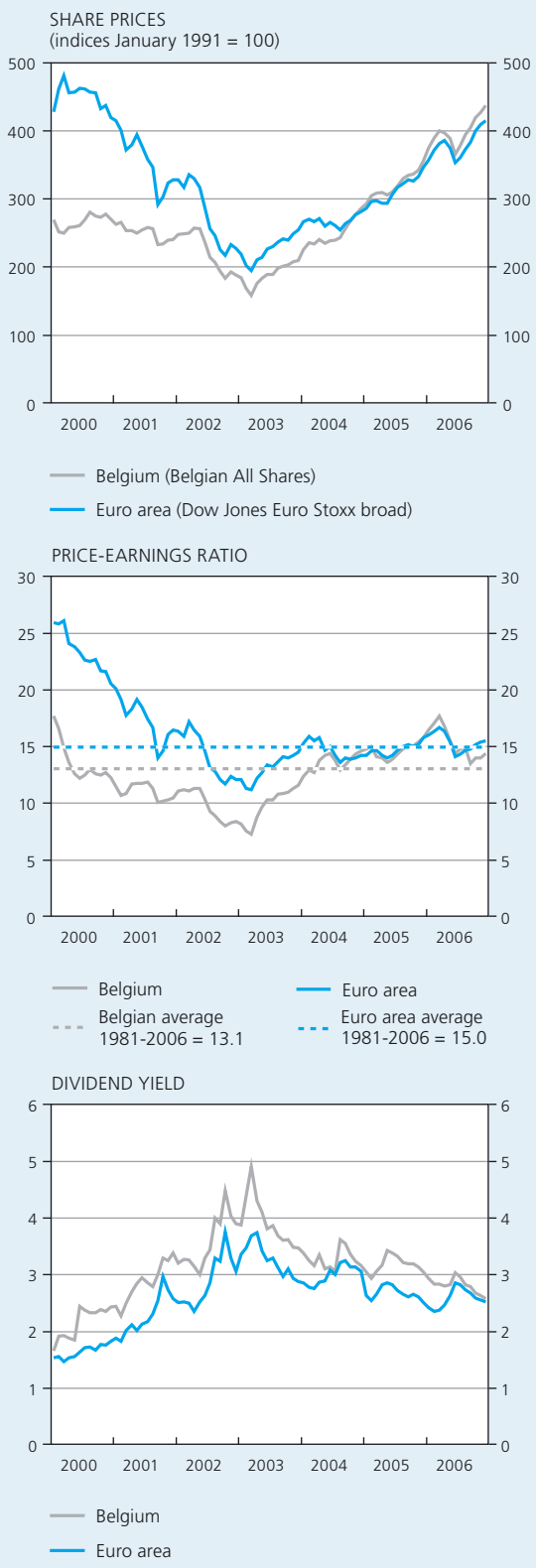
There are sometimes wide variations in the motivations and circumstances behind the use of unlisted shares. Thus, it seems that flows from other countries, whether associated with direct investment or other types of participation, were behind a large proportion of the unlisted share issues during the first nine months of 2006. These were probably issues initiated by fairly large firms established in Belgium, perhaps associated or linked with foreign companies which supply funds to them by acquiring shares or other equity. Moreover, the coordination centres established in Belgium and used to relay finance to both Belgian and foreign companies, are financed mainly by the issue of unlisted shares.

Purely intra-sectoral flows (i.e. unlisted share issues subscribed by the resident company sector itself) are also recorded in the financial accounts, and totalled 0.4 billion euro during the first three quarters. This may concern professional investors, such as non-financial holding companies which acquire shares in traditional companies or operate in illiquid markets, in order to take advantage of the large growth potential offered by certain companies via private equity/venture capital transactions.

Finally, unlisted shares are also issued by small enterprises which are less well-known and which therefore have greater difficulty in entering the stock markets. Similarly, this instrument is commonly used by family firms whose shareholders are often reluctant to open up the capital, for fear of losing control. However, it seems that unlisted share issues subscribed directly by individuals explain only

CHART 63 STOCK MARKET PRICES, PRICE-EARNINGS RATIO AND DIVIDEND YIELD IN BELGIUM AND IN THE EURO AREA

(monthly averages)



Sources : Thomson Financial Datastream, Euronext Brussels.

a small part of the aggregate flows, by comparison with the large volumes subscribed by other companies, both Belgian and foreign. As was the case in 2005, households actually sold unlisted shares for a total of 2.2 billion euro during the first nine months.

As already mentioned, stock market financing conditions proved favourable in 2006, encouraging listed share issues. The rise in stock market prices continued in Belgium and in the euro area, despite a dip between May and July 2006 : the Belgian All Shares index and its euro area equivalent, the Dow Jones Euro Stoxx broad index, rose by 22.8 and 19.6 p.c. respectively between December 2005 and December 2006. Although the gains in 2006 were even higher than those recorded for the euro area, Belgian shares ended the year under review with a price-earnings ratio of 14.4 against 15.5 for their European counterparts. The valuation of Belgian shares was 1.3 percentage points higher than their average valuation over the past twenty-six years. On the basis of the dividend yield, Belgian shares remained more attractive than European shares ; however, that relative advantage largely ebbed away during the year under review, since the dividend yield differential in favour of Belgian shares shrank from over 50 basis points at the end of 2005 to less than 10 points a year later.

Belgian companies were launched onto the stock market in rapid succession throughout the year under review. In total, taking all the Euronext Brussels markets together, nineteen introductions were recorded in 2006 ; taking account of the delisted companies, and including financial corporations, that brought the number of Belgian companies issuing listed shares to 156 as at 31 December 2006.

Launched in November 2004 and having already been highly successful in 2005, the Free Market segment continued in 2006 to attract SMEs in a growth phase, wishing to take advantage of simplified access to the capital market. In 2006, no fewer than nine Belgian SMEs made their debut here, excluding the transfer to the Free Market of one company originally quoted on Eurolist : these companies, with an average market capitalisation of around 7.7 million euro, raised an average of 1 million euro by their initial public offering. It should be remembered that this market keeps the requirements imposed on new entrants to an absolute minimum : no minimum capitalisation, no obligation to publish interim figures, no need to conform to IAS/IFRS standards, the only obligation etc. ; which still applies concerns a prospectus approved by the CBFA and compliance with the usual rules on investor protection. Nonetheless, the bankruptcy, at the beginning of December, of one of the companies listed on this

market highlights the relative riskiness of investing in this unregulated segment.

June 2006 saw the launch of Alternext, which is positioned between Eurolist and the Free Market in terms of admission criteria and listing requirements, with the aim of attracting mainly large SMEs, as admission to this market is reserved for companies proving that they have been in existence for at least two years and wishing to raise a minimum of 2.5 million euro; the listing requirements are less stringent than on Eurolist, the major difference being the absence of any obligation to conform to the IAS/IFRS standards. So far, four Belgian companies have been introduced on this segment: these firms, with an average market capitalisation of around 21.3 million, thus more imposing than the companies listed on the Free Market, raised an average of 6.5 million during their initial public offering.

Non-bank loans

Flows of non-bank lending declined during the first nine months of 2006, whereas they had expanded during the corresponding period of 2005. That development confirms that companies chose a different method of financing during the year under review and contrasts with the substantial activity recorded on this segment in preceding years.

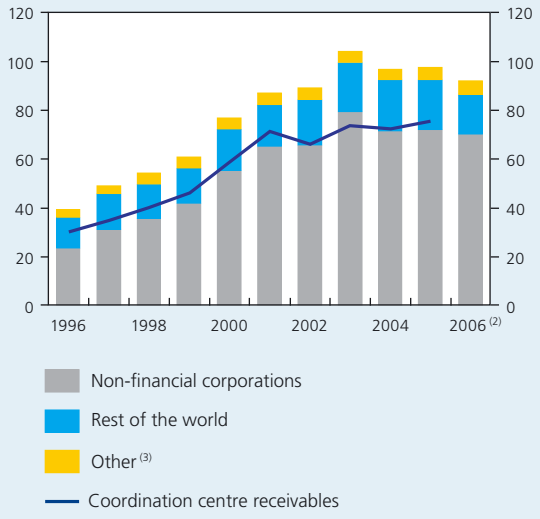
Non-bank loans essentially consist of loans between Belgian companies, whether or not belonging to the same group, and loans received by Belgian firms from non-bank companies located abroad. The scale of these flows between companies is considerable. Between 1996 and 2005, they averaged around 21 billion euro a year, or half the average new liabilities of enterprises. The presence of the coordination centres in Belgium is a major contributory factor, and so is the presence of non-financial holding companies, albeit to a lesser extent.

Between 1996 and 2003, the outstanding amount of loans between companies expanded considerably as a proportion of GDP, before contracting slowly in the next three years. At the end of the third quarter of 2006, it represented the equivalent of 92 p.c. of GDP, against 40 p.c. at the end of 1996.

Loans granted between resident companies make up the bulk of the amount outstanding; at the end of the third quarter of 2006, they came to 219 billion euro, or 76 p.c. of the total. The rapid growth of financial flows between resident enterprises, seen in Belgium between 1996 and 2003, was driven by various factors, such as the

CHART 64 SECTORAL BREAKDOWN OF NON-BANK LOANS [1] CONTRACTED BY NON-FINANCIAL CORPORATIONS

(end of period, percentages of GDP)



Source: NBB.
(1) Loans between enterprises in question here do not include trade credit.
(2) Figures as at 30 September 2006.
(3) The "other" item covers general government and financial corporations other than credit institutions, granting non-bank loans.

advantageous tax status of coordination centres, whose responsibilities include the financing operations and cash management of multinational groups. Their activities in fact developed over the same period, then slackened pace owing to the uncertainty over their status and their future. The contraction in the flows of non-bank loans from 2004 could be linked to the reduced activity of the coordination centres, as shown by the change in the receivables recorded under their assets.

Non-bank loans granted by the rest of the world to enterprises also increased significantly, although less dramatically, during the past ten years, rising from 13 p.c. of GDP at the end of 1996 to 16 p.c. at the end of the third quarter of 2006. This increase is partly a reflection of the internationalisation of corporate financing.

Bank loans

During the first nine months of 2006, bank lending to companies expanded slightly, by 1.7 billion euro, whereas a fall of 0.9 billion had been recorded during the corresponding period of the previous year. Various factors influenced the pattern of lending, particularly increased

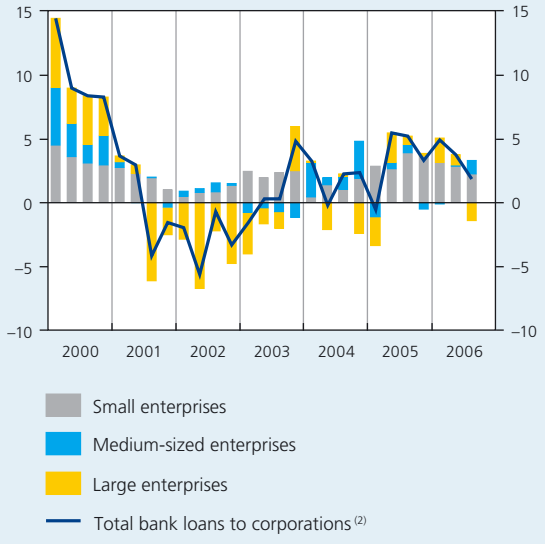
demand fuelled by the strong economic growth, a factor whose influence was probably partly offset by the increase in the cost of financing by bank loans, recorded from mid 2005.

The Central Credit Register operated by the Bank is an alternative source of data on bank lending. The picture which it provides varies according to the firms' size. However, its data differ from those of the financial accounts since they cover only lending by Belgian banks, and include loans to non-monetary financial intermediaries except for insurance companies and pension funds.

The Central Credit Register data indicate a modest revival in lending over the past few quarters. It is being driven by small enterprises, although the expansion of the loans extended to them did slow down at the end of the period. Whereas from mid 2005 the volume of loans to large enterprises had recorded positive growth, that trend was reversed in the third quarter of 2006. The contribution of medium-sized companies to the credit expansion, which had been modest in the first half of the year, later showed a stronger rise.

CHART 65 LOANS GRANTED BY BELGIAN CREDIT INSTITUTIONS TO CORPORATIONS, BY SIZE OF ENTERPRISE (1), ACCORDING TO THE CENTRAL CREDIT REGISTER

(contribution to the change in bank lending to corporations, percentage points unless otherwise stated)



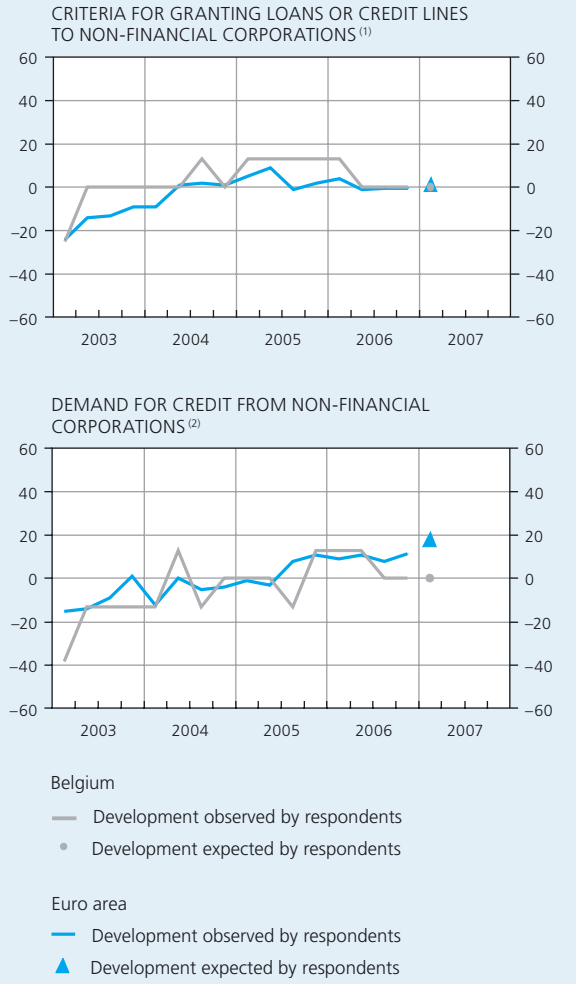
Source : NBB.

(1) Companies which filed their annual accounts in the abbreviated format are deemed to be small enterprises. Those which filed full-format accounts are regarded as large or medium-sized depending on whether or not their turnover exceeded 37.2 million euro for two consecutive years.

(2) End-of-quarter data adjusted for exchange rate fluctuations and sectoral reclassifications ; percentage changes compared to the corresponding quarter of the previous year.

CHART 66 RESULTS OF THE EUROSYSTEM'S SURVEY ON BANK LENDING TO NON-FINANCIAL CORPORATIONS

(quarterly data)



Sources : ECB, NBB.

(1) Balance in percentages of weighted replies by credit institutions to the Eurosystem's bank lending survey indicating the degree to which access criteria to loans and credit lines were eased or tightened (–).

(2) Balance in percentages of weighted replies by credit institutions to the Eurosystem's bank lending survey indicating the degree of increase or decrease (–) in demand for credit.

Demand factors seem to have played a dominant role during the recent period in the pattern of bank lending, according to the findings of the Eurosystem's bank lending survey which is one source of information on credit supply and demand conditions.

In the first quarter of 2006, credit institutions in the euro area once again eased their loan criteria, on average, in the case of corporate borrowers ; in Belgium, that easing was more pronounced. Subsequently, both Belgian banks and their colleagues in the euro area stated that they had

kept their credit standards unchanged. At the same time, the Belgian banks said that, in the first half of the year under review, firms' demand for loans had increased, but later stabilised. In the euro area, demand for loans was rising throughout the year under review.

The Bank's business investment survey, conducted in November, points to a deterioration in the opinion of the firms polled on credit conditions; in 2005, 52 p.c. of the firms questioned took a favourable view of the current conditions for access to new loans or new credit lines, but in 2006 that proportion dropped to 35 p.c., because of the rise in interest rates.

Formation of financial assets

During the first nine months of 2006, corporations formed new financial assets totalling 40.3 billion euro, against 12.6 billion during the corresponding period of 2005.

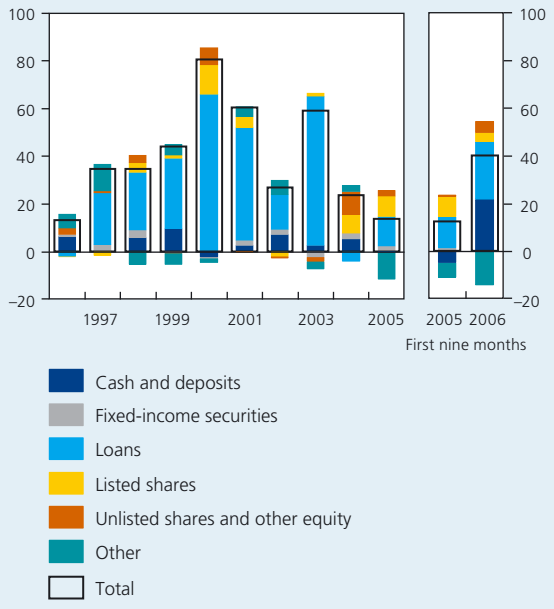
As in the two previous years, equities represented a relatively large proportion of these new assets. During the first nine months of 2006, the formation of financial assets in the form of listed or unlisted shares, essentially of foreign corporations, represented 8.7 billion euro, a figure close to the 9 billion attained during the corresponding period of 2005.

Over the same period, firms granted loans to other Belgian and foreign companies for a total of 24.1 billion euro, compared to 13.3 billion during the corresponding period of 2005. This strong expansion of non-bank lending indicates some recovery following the sluggishness on this segment in 2004 and 2005, attributable to the slackening pace of activity on the part of the coordination centres which at that time were uncertain about their future status.

The formation of financial deposits surged by 21.7 billion euro during the first nine months of 2006, whereas a fall of 4.8 billion had been recorded in the corresponding period of 2005. The substantial increase in interest rates on these deposits is probably among the contributory factors.

CHART 67 NEW FINANCIAL ASSETS OF NON-FINANCIAL CORPORATIONS: BREAKDOWN BY INSTRUMENT

(billions of euro)



Source : NBB.

7.4 General government

During the first nine months of the year under review, the financial accounts of general government deteriorated, as the deficit increased from 3.2 billion euro during the corresponding period of 2005 to 4.3 billion. This deterioration was reflected in the movement in the financial assets, which declined by 2.2 billion, compared to 1.1 billion in 2005. The liabilities expanded by 2.2 billion, the same amount as in 2005.

New issues

As in previous years, most of the new financial liabilities took the form of net issues of euro-denominated securities by the Treasury, for a cumulative total of 1.5 billion euro at the end of September, against 3.9 billion a year earlier.

Since the introduction of the euro, the Treasury has based its issuing strategy on a number of key principles in order to minimise the State's financing costs while taking account of the risks. Regularity, transparency and predictability are among those principles, and adherence to them is ensured by publication of an issue schedule for both OLOs and Treasury certificates, and by the announcement of issue volumes.

In the medium- and long-term segment, this strategy resulted in the issue of two new benchmark loans, via a consortium. At the beginning of the year under review,

TABLE 37 FINANCIAL ASSETS AND LIABILITIES OF GENERAL GOVERNMENT

(billions of euro)

	2001	2002	2003	2004	2005 [1]	2006	First nine months 2005	First nine months 2006
Formation of financial assets [2]	5.1	4.6	–4.3	3.6	2.9	n.	–1.1	–2.2
New financial liabilities	4.9	5.7	–4.5	4.1	2.6	n.	2.2	2.2
Securities denominated in euro	5.6	5.8	–2.1	–1.6	2.4	n.	3.7	2.1
of which:								
Treasury	8.5	5.4	–0.9	–1.6	3.1	–0.8	3.9	1.5
At up to one year	1.7	–0.5	–0.3	–0.2	0.8	0.1	2.5	3.4
At over one year	6.7	5.9	–0.6	–1.4	2.3	–1.0	1.4	–1.9
Other liabilities denominated in euro [2]	0.7	1.1	–1.2	7.1	0.8	n.	–2.7	–0.9
Treasury liabilities denominated in foreign currencies	–1.4	–1.2	–1.3	–1.4	–0.7	–0.2	1.2	1.0
Financial balance	0.2	–1.2	0.2	–0.6	0.3	n.	–3.2	–4.3

Source: NBB.

(1) Data compiled in accordance with the NAI's point of view whereby the RIF is treated as a non-financial corporation, rather than as a public authority in accordance with the Eurostat view. In 2005, both the formation of financial assets and the new financial liabilities of general government were influenced by operations connected with the assumption of BNRC debt by the RIF. Those operations consist in the refinancing by the State of part of the debt totalling 1.9 billion euro, and the registration of a claim of an equivalent amount on the RIF. Consequently, the financial balance was unaffected.

(2) Including "Ageing Fund Treasury Bonds".

the Treasury as usual placed a new ten-year benchmark loan. In May, a fifteen-year benchmark loan was issued by the Treasury in response to investor demand for longer maturity instruments.

The OLO lines were topped up during the year by four tenders. The thirty-year benchmark loan, issued in 2004, was once again offered on two occasions. It continued to attract interest from institutional investors (life insurance companies, pension funds, etc.), who subscribed 2.4 billion euro. Investor demand motivated the choice of lines used. Investors are increasingly seeking long-term investments, as the counterpart to household savings in the second and third pension pillars, in order to match the maturities of their assets as far as possible with those of their liabilities.

Altogether, the Treasury issued linear bonds for a total of 20.8 billion euro in 2006, against 23.3 billion in 2005.

Issues of State notes, a public debt instrument reserved for private investors, are normally smaller in scale. In 2006, the Treasury borrowed 0.7 billion euro via State notes, compared to 0.6 billion in the previous year. These were mainly five-year State notes, with a small proportion of eight-year notes. State notes are listed on Euronext Brussels, on the fixing segment. They therefore offer constant liquidity and represent a financial instrument designed more specifically for households seeking security for their investments.

Management of the public debt

In 2006, the Treasury's budget operations ended with a deficit, thus increasing the gross balance to be financed. Medium- and long-term issues were insufficient to cover it, so that the financial assets declined. Short-term debt in foreign currencies continued to diminish.

The Treasury devoted a smaller volume than in 2005 to the redemption or repayment of loans maturing during the year under review. Conversely, there was an increase in the volume of redemptions on securities maturing in 2007 or later.

For the purposes of efficient management of the public debt, the Treasury must be able to guarantee the liquidity of the securities issued and control the risks associated with its borrowing operations. Those risks include currency, refinancing, interest rate and credit risks. Risk control, like the liquidity of the securities, helps to reduce the cost of financing the public debt.

TABLE 38 FINANCING REQUIREMENTS AND RESOURCES OF THE FEDERAL STATE

(billions of euro)

	2005	2006
Gross balance to be financed	23.5	25.7
Gross financing requirements	21.9	23.2
Budget deficit or surplus (–)[1]	1.8	3.5
Medium- and long-term debt maturing during the year	20.0	19.7
In euro	19.7	19.6
In foreign currencies	0.4	0.1
Redemptions and exchanges (securities maturing the next year or later)	1.6	2.5
Other financing requirements	0.0	0.1
Funding resources	23.8	21.5
Medium- and long-term issues in euro[2]	23.8	21.5
Linear bonds (OLOs)	23.3	20.8
State notes	0.6	0.7
Medium- and long-term issues in foreign currencies	0.0	0.0
Net change in the short-term debt in foreign currencies	–0.3	–0.1
Net change in the short-term debt in euro and in financial assets	0.0	4.3

Source: SPF Finance.

(1) Excluding transfers to the Ageing Fund. 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) Excluding issues of "Ageing Fund Treasury Bonds".

In regard to the risks, the proportion of the debt in foreign currencies has fallen sharply in recent years, so that the currency risk on the debt has become negligible. That decline continued in 2006, as the debt in foreign currencies represented only 0.52 p.c. of the total debt at the end of 2006, against 0.63 p.c. at the end of 2005. The fluctuations in the foreign currency debt over the years are due to the issue of Treasury bills (BTBs or Belgian Treasury Bills), short-term securities with a legal and tax status comparable to that of Treasury certificates but capable of being issued in foreign currencies.

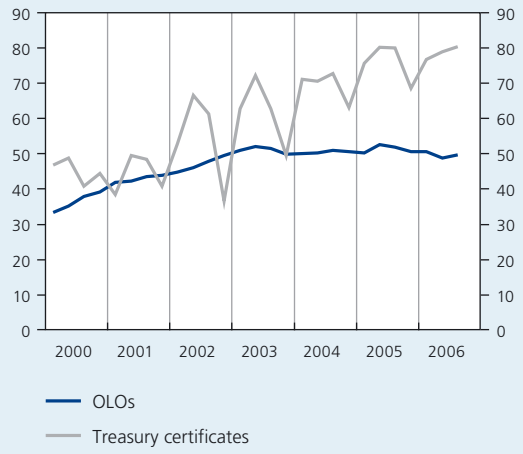
The refinancing risk and the interest rate risk are monitored by four indicators. Since 2005, those have been calculated on the basis of a six-month average, in order to smooth out sudden movements in the indicators which are not triggered by an increase in the risk. For the refinancing risk, the first indicator limits the amount which can be refinanced within twelve months to 22.5 p.c. of the total debt in euro, and the second limits the amount to be refinanced within five years to 60 p.c. of the total debt in euro. For 2006, these proportions came to 19.4 and 53.7 p.c. respectively. The interest rate risk, which expresses the variability of the interest rate on the debt, is influenced by the refinancing operations and the use of derivatives such as swaps. The limit for the interest rate risk at twelve months is set at 25 p.c. of the debt in euro, whereas it is 65 p.c. for the risk at sixty months. At the end of the year under review, the interest rate risk at twelve months was 21.6 p.c. and that at five years was 57.7 p.c.

The credit risk is determined by the loss which the Treasury would incur if one or more of its counterparties defaulted on its contractual payment obligations. To limit the risk, the Treasury deals only with counterparties with a minimum credit rating of "A". For the purpose of managing this risk, the Treasury concluded credit support agreements with six primary dealers in 2006, whereby the Treasury's counterparties guarantee a favourable outcome for the swaps, by paying the amounts concerned into an account with the Bank.

Diversification of holders of benchmark OLOs is one of the ways of ensuring liquidity. It has a positive impact on the pricing of the financial instruments, and hence on the cost of the debt.

CHART 68 SHARE OF OLOS AND TREASURY CERTIFICATES ISSUED BY THE BELGIAN STATE AND HELD BY THE REST OF THE WORLD

(end-of-quarter data, percentages of the total)



Source: NBB.

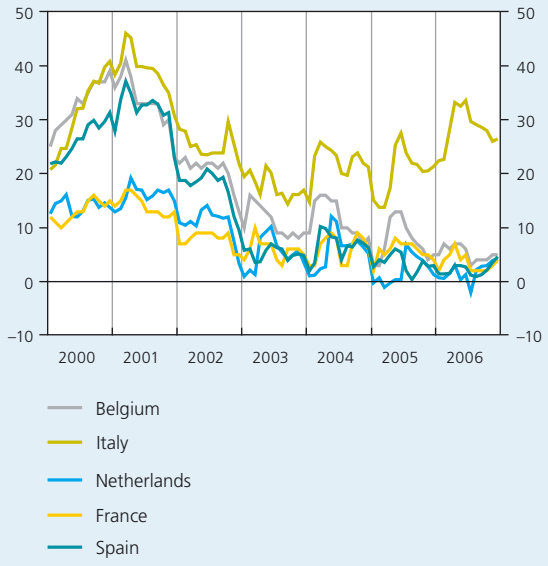
The holdership of Belgian public debt securities is very diverse, as interest in the Belgian public debt among foreign investors remained strong in 2006, partly because of the pursuit of a relatively sound policy on public finances. While the proportion of OLOs held by foreigners has stabilised in recent years, standing at 49.6 p.c. in September 2006, foreign holdings of Treasury certificates have maintained an upward trend for five years, reaching 80.3 p.c. at the end of that month. This rise reflects the strong foreign demand prompted by the relative scarcity of short-term euro-denominated government paper.

During recent years, the Treasury's efforts to augment the liquidity of Belgian public debt securities have had a positive effect on financing conditions and costs, thus contributing to a partial reduction in the yield spreads between the Belgian State ten-year benchmark loan and the German *Bund* of a similar maturity. However, the improvement in Belgium's public finances relative to those of Germany is still the main reason for the contraction of the yield differentials. That situation led two of the three main rating agencies to upgrade their assessment of the Belgian State's long-term debt in 2006. In March, Moody's Investors Service changed the outlook for the Aa1 rating from stable to positive, and in May, Fitch Ratings increased the long-term debt rating from AA to AA+, with a stable outlook, while in the previous month Standard & Poor's confirmed their AA+ rating with a stable outlook.

However, the differentials have not disappeared altogether, owing to differences in liquidity and credit risk. The spread between the yield on the Belgian ten-year benchmark loan and that of the German benchmark bond averaged 5 basis points during the year under review, compared to 7 points in 2005. The yield differentials also remained low overall for Dutch (2 basis points), Spanish (2 basis points) and French (4 basis points) benchmark loans. In contrast, in the case of Italian loans, financing conditions worsened further during the year under review, with an average spread of 28 basis points vis-à-vis the German *Bund*. This situation bears witness to the problems facing Italian public finances during that period, which prompted two agencies to downgrade their rating for the Italian public debt.

CHART 69 YIELD DIFFERENTIALS ON TEN-YEAR GOVERNMENT BONDS [1] IN RELATION TO THE GERMAN *BUND*

(monthly averages, basis points)



Source : BIS.
(1) For Belgium, secondary market yield on government benchmark loans (OLOs).

8.

8.1 International financial markets

The global financial markets remained decidedly tranquil during 2006, with only very brief turbulence caused by price corrections on commodity and equity markets in May and June. The decline in investors' appetite for risky financial assets did not last, as perceived potential upside risks to US inflation did not materialise to the extent initially feared, allowing the US Federal Reserve to leave its federal funds target rate unchanged at 5.25 p.c. in the second half of the year, after having raised it in seventeen consecutive steps of 25 basis points. The continuation of strong, and increasingly broadly-based, global economic growth and the persistence of accommodative financing conditions – notwithstanding the further withdrawal of monetary stimulus in Europe, and the Bank of Japan's decision to end its zero interest rate policy – provided the backdrop for a strong rebound of global equity markets from the temporary correction. At the end of the year, the US and euro area stock market return indices (which take into account dividend payments) were up respectively by 15.8 and 25.2 p.c. relative to their level at the end of 2005, rising above the levels reached on the eve of the bursting of the stock market bubble in 2000.

The extent and vigour of the rise in US and euro area equity prices since the end of March 2003 – when return indices had dropped by around 50 p.c. relative to their value in the first quarter of 2000 – brings to mind the buoyant stock market conditions in the second half of the 1990s. Yet, an important difference between the two periods is that price-earnings ratios have remained close to their historical averages, in contrast to the earlier period when price-earnings ratios were almost double that level. Thanks to the very strong growth of corporate profits in recent years on both sides of the Atlantic, price-earnings multiples in the US and the euro area have remained close to their long-term averages (17.8 and 15). This may also help to explain why investors' expectations of future stock market volatility – as measured by the implied volatility in options on stock market indices – dropped again in the second half of 2006 to the low levels registered before the temporary turbulence in May and June.

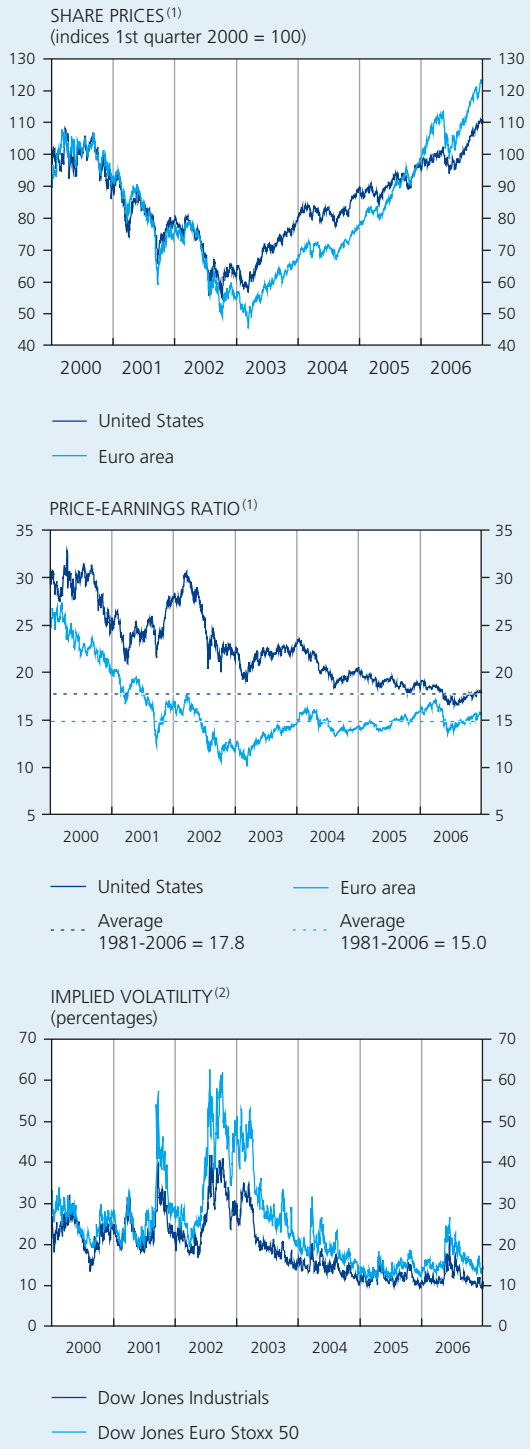
The renewed vigour of investors' search for yield fed an appetite for high-yield assets, whether or not supported by borrowing to leverage the expected returns on investments, also helping exchange rates and stock markets of emerging market economies to gradually recoup the losses sustained in May and June, which mainly affected countries with still high external financing needs, such as Hungary and Turkey. Following significant improvements in emerging markets' macroeconomic fundamentals and economic policies, and given the generally benign global financial and economic conditions coupled with the low yields available in developed countries' fixed income markets, the investor base for emerging market assets has structurally increased in recent years. This has led to growing interest in emerging markets' local currency financial assets and contributed to a narrowing of spreads relative to interest rates on US Treasuries on emerging markets' sovereign dollar-denominated bonds. These spreads reached historically low levels in 2006, and since 2005 have decoupled from spreads on high-yield corporate bonds, with which there was a strong coincidence in the years before.

On this last market segment, spreads relative to US Treasuries remained close to the low levels that have prevailed since 2004, underpinned by the persistence of very low default rates on speculative-grade corporate bonds. While the average annual global speculative-grade default rate had peaked at above 10 p.c. in 2002, it amounted to only 1.69 p.c. in 2006, well below the 25-year average of 4.6 p.c. The default rate on US speculative-grade bonds remained higher than on non-US speculative-grade bonds, as has been the case since 2004, but the two converged in the last quarter of 2006.

However, default rates are a "lagging" indicator of corporate credit quality. More forward-looking indicators, such as the balance between up- and downgrades of corporate bonds, show that – starting from an exceptionally strong position – there was a gradual shift away from factors improving corporate creditworthiness towards those causing it to deteriorate. After years of balance sheet restructuring, debt reduction and increasing profitability, US and European corporations appear to be gradually

CHART 70 STOCK MARKET DEVELOPMENTS

(daily data)



Source : Thomson Financial Datastream.

(1) Stock market indices defined by Thomson Financial Datastream, expressed in local currency (return indices).

(2) Measures of expected volatility, based on the prices of a basket of options on the Dow Jones Industrials and Dow Jones Euro Stoxx 50 stock market indices.

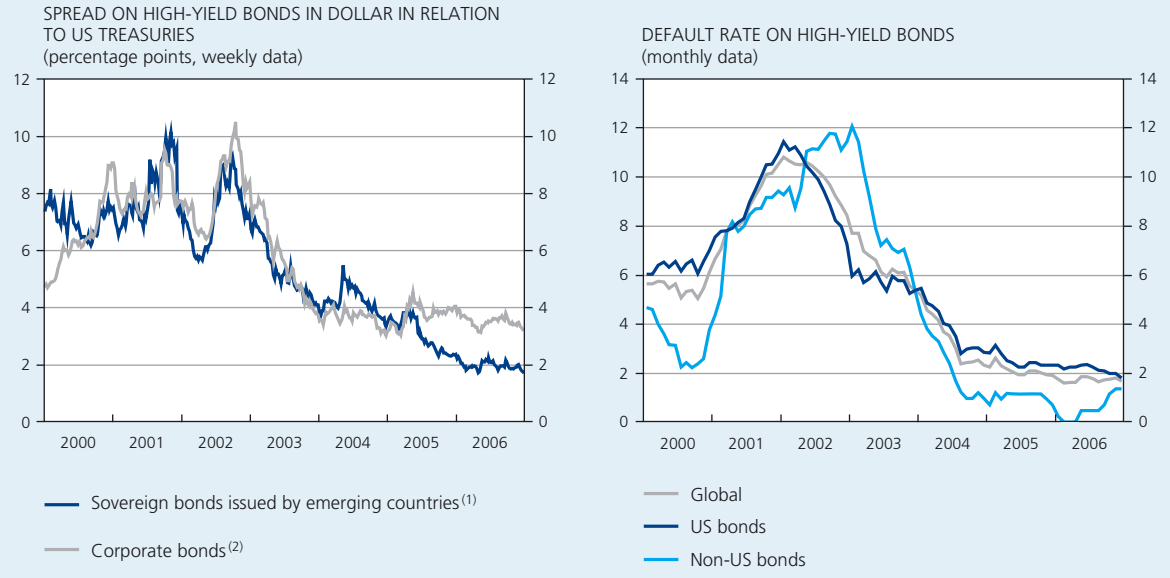
re-leveraging their balance sheet to fund increases in capital expenditures, higher dividends, record levels of equity buybacks, and a global surge in the number and value of mergers and acquisitions. These developments took place at a time when the momentum of corporate profits – which had continued to grow at rates in excess of 10 p.c. for several quarters – was generally expected to be reaching its zenith, before slowing down in the course of 2007.

The increase in debt financing by the US and euro area non-financial corporate sector undoubtedly benefited from the presence of historically low interest rates and the strong appetite of investors for corporate credit. The market segment of high-yield bonds and loans, which both concern credit extended to firms with a weaker credit rating, showed high issuance volumes and very strong demand on the primary market. While offering ample (re)financing opportunities to high-risk borrowers (potentially contributing in this way to the low default rates), it also stimulated a high number of leveraged buy-outs, which have been a distinct feature of the corporate M&A market in recent quarters.

These leveraged buy-outs are corporate take-overs originated by private equity funds or firms, but backed with debt financing. While, in Europe, banks or bank syndicates were traditionally the main providers of the debt financing backing these buy-outs, there has recently been a rise in the prominence of non-bank providers of credit, such as hedge funds and managers of collateralised loan obligations (CLOs). The latter instruments pool several leveraged loans together and use them as collateral for issuing new debt instruments, with different risk profiles (tranches), whereby the most risky tranche fully absorbs the first losses on the underlying leveraged loans before the next tranche is affected. This tranching of risk by restructuring the cash flows of the underlying financial assets has facilitated the entry of insurance companies and pension funds (interested mainly in the low-risk debt instruments) in a market previously dominated by banks. At the same time, with these "structured" products it is now possible to create high-risk/high-return "mezzanine" and "equity" tranches, which appeal to less risk-averse institutional investors, such as hedge funds.

These changes in the method of financing leveraged buy-outs in Europe are but one manifestation of the important structural changes taking place in the global credit markets. In recent years, those markets have become deeper and more sophisticated, thanks to the introduction of new financial instruments, advances in risk management techniques and the increased involvement of non-bank financial institutions, such as hedge funds. Notable

CHART 71 INTEREST RATE SPREAD AND DEFAULT RATE ON HIGH-YIELD BONDS



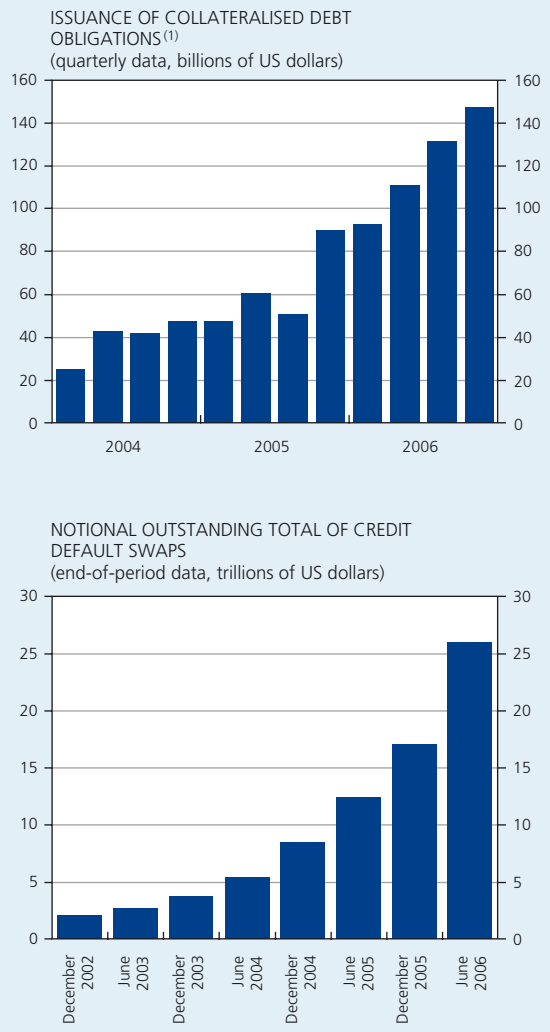
Sources: JP Morgan, Merill Lynch, Moody's, Thomson Financial Datastream.
(1) EMBIG index; spread relative to interest rate on US Treasuries with a corresponding maturity.
(2) Corporate bonds denominated in US dollar with a rating lower than BBB/Baa3; spread relative to the interest rate on ten-year US Treasuries.

developments include the explosive growth in the outstanding amounts of credit risk transfer instruments, such as credit default swaps (CDSs), and the numerous issues of structured finance instruments such as collateralised debt obligations (CDOs).

These structural changes have stimulated increasing interlinkages between previously segmented credit markets, potentially leading to a more consistent pricing of credit risk across various products. By increasing the risk transfer, hedging and diversification opportunities for individual financial institutions, they also allow a wider dispersion of risk throughout the financial system. Yet, the increasing complexity of the financial instruments employed to shift risk, and the dearth of data about some markets or major market participants' exposures, has tended to increase the opaqueness as to where the ultimate risk exposures are currently located in the financial system. In this connection, it remains somewhat uncertain how these markets will perform in the face of systemic macroeconomic or financial stress, to which many of the recent market segments have not yet been exposed. An important issue in such circumstances will be the behaviour of leveraged operators, such as hedge funds, and its consequences for market liquidity and asset prices. Two major hedge funds (Amaranth Advisors and Vega Asset Management) suffered sizeable losses in September, related respectively to long trading positions in the natural gas market and short positions in the US, European and Japanese fixed income markets. In comparison with the experience with Long-Term Capital Management (LTCM) in 1998, these substantial losses had little impact on the financial markets. This low spill-over in comparison with the LTCM debacle was related inter alia to the orderly way in which their positions could be unwound and their assets could be liquidated by selling them to other market participants.

The role of the banks is also changing, as in certain market segments it is increasingly limited to credit origination, with exposures subsequently being offloaded to third parties. This increased tradability of loans will allow banks to optimise their risk exposures in accordance with their available capital – a process which will undoubtedly be fostered by the implementation of Basel II in the EU in 2007 – but will also lead to a potential exposure to shocks affecting the liquidity of these new markets. Moreover, as originators and servicers of the assets included in structured finance products, the banks will often be required to retain some residual risk exposure to the assets involved, so as to minimise agency problems. While these new market segments may generate additional sources of income, expansion into these "untraditional" activities may expose some of the banks concerned to unexpected losses in the event of a systemic market shock, especially

CHART 72 CREDIT RISK TRANSFER INSTRUMENTS



Sources: Bond Market Association, ISDA.
(1) Only securities guaranteed by claims purchased (funded CDOs).

if strong competition on these new markets was associated with an erosion of risk management standards and an underpricing of risks. This may, for example, be the case in the provision of finance and prime brokerage services to hedge funds, where increased competition has allegedly contributed to a weakening of risk management standards.

However, the ability of the banking system to deal with unexpected losses – stemming, for example, from a sudden economic downturn, leading to substantial credit quality erosion, or from a disorderly resolution of global current account imbalances – has presumably strengthened, judging by the high levels of profitability registered by US and European banks in 2006. In the euro area, more particularly, banks' profitability was supported by continued cost control, continuously low loan loss provisions and high fee income, related for example to asset management and investment banking activities. Households' strong demand for mortgage loans and a pick-up in corporate borrowing also appear to have largely offset the impact on net interest income of a decline in banks' intermediation margins, which resulted from the low interest rate environment, the flattening (even inversion) of yield curves and heightened competition.

8.2 Belgian credit institutions

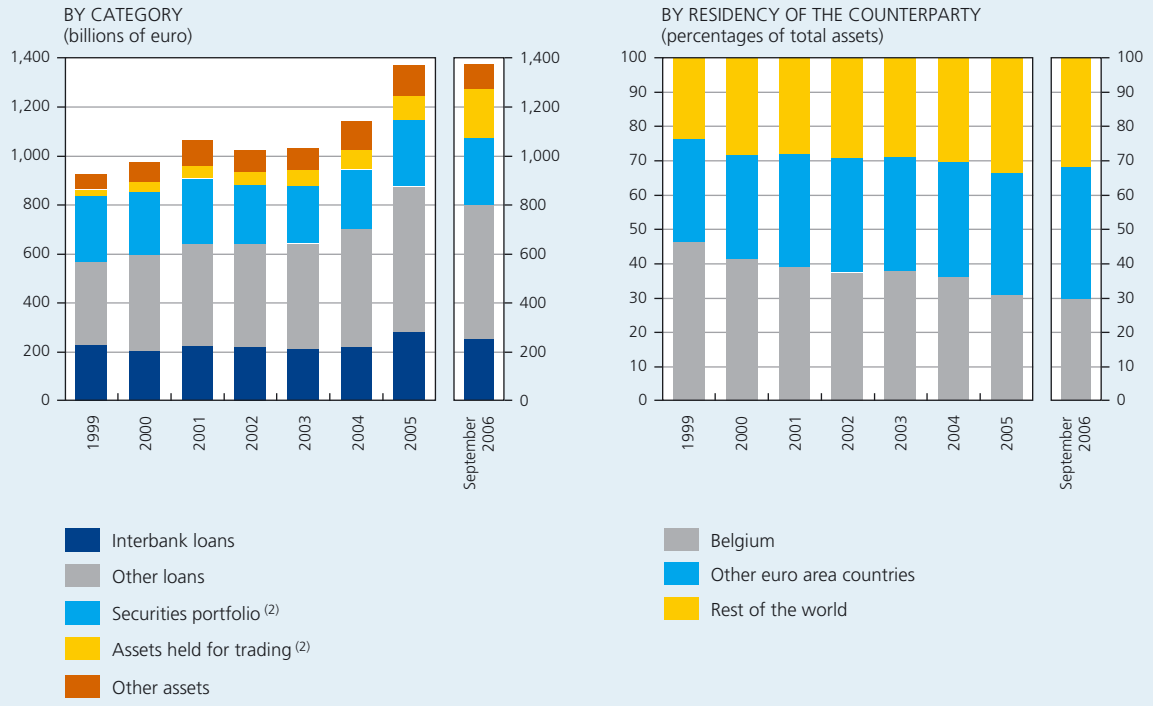
8.2.1 Composition of the assets of Belgian credit institutions

In recent years, Belgian banks have gradually acquired a more international profile. The limited scope for growth on the domestic market encouraged credit institutions to extend their activities abroad, first in neighbouring countries, by creating bi-national groups, and more recently via acquisitions in Central and Eastern Europe and in Turkey. Thus, the KBC group has expanded very strongly in Slovakia, the Czech Republic, Hungary and Poland. In 2005, the Dexia group decided to acquire a Turkish bank, Denizbank, the deal being finalised in the last quarter of 2006. The Fortis group is also active on the Turkish and Central and East European markets, inter alia as a result of the purchase of Disbank in July 2005.

As at 30 September 2006, the balance sheet total of credit institutions stood at 1,348.7 billion euro. As a result of the above-mentioned developments, the share of the Belgian banking sector's assets located in Belgium has fallen steadily, from 46.5 p.c. in 1999 to 29.6 p.c. in September 2006. However, the figures as at that last date are not entirely comparable with those for the end of 2005 because, since 1 January 2006, both listed and unlisted Belgian banks have been required to adopt the IAS/IFRS (International Accounting Standards/International Financial Reporting Standards) when compiling their consolidated accounts. These new standards change the way in which financial assets and liabilities are recorded (for a detailed description, see box 18). The changes in the various balance sheet items between December 2005 and September 2006 are therefore not due solely to changes in the economic environment and the behaviour of banks, but also to the application of these new accounting rules.

CHART 73 BREAKDOWN OF THE ASSETS OF BELGIAN CREDIT INSTITUTIONS

(consolidated end-of-period data [1])



Sources: CBFA, NBB.

(1) The data as at the end of September 2006, compiled in accordance with the IAS/IFRS, concern six large Belgian banks which accounted for 92.5 p.c. of the total consolidated assets of the Belgian banking sector at the end of 2005.

(2) For the data at the end of September 2006, owing to the application of the IAS/IFRS, the "securities portfolio" item corresponds to the securities contained in the categories "assets designated at fair value", "assets available for sale" and "held-to-maturity investments", while from now on the item "assets held for trading", includes derivatives.

TABLE 39 BREAKDOWN OF THE FINANCIAL ASSETS [1] OF BELGIAN CREDIT INSTITUTIONS BY SECTOR AND BY RESIDENCY OF THE COUNTERPARTY

(consolidated data at the end of September 2006 [2]; percentages of the total, unless otherwise stated)

	Billions of euro	Percentages of the total	Breakdown by residency of the counterparty		
			Belgium	Rest of the world	
				Total	of which: Other euro area countries
Credit institutions	306.5	27.0	1.5	25.6	14.0
Non-financial corporations	309.4	27.3	7.0	20.3	7.7
Households	237.8	21.0	11.4	9.6	8.4
Central governments	197.5	17.4	6.3	11.2	9.3
Non-bank financial institutions	82.2	7.2	2.6	4.6	0.9
Total	**1,133.4**	**100.0**	**28.7**	**71.3**	**40.3**

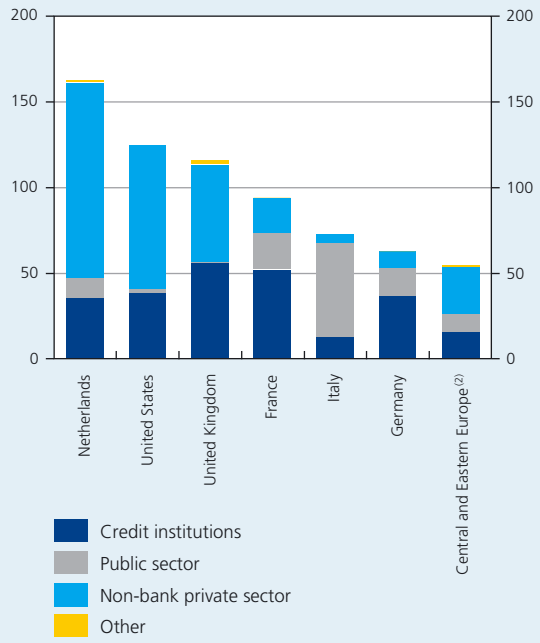
Sources: CBFA, NBB.

(1) Except equities and derivatives.

(2) These data, compiled in accordance with the IAS/IFRS, concern six large Belgian banks which together accounted for 92.5 p.c. of the total consolidated assets of the Belgian banking sector at the end of 2005.

CHART 74 ASSETS [1] OF BELGIAN CREDIT INSTITUTIONS VIS-À-VIS THE REST OF THE WORLD

(consolidated data at the end of September 2006, billions of euro)



Sources : CBFA, NBB.

(1) The assets in this chart are broken down on the basis of final risk, i.e. after risk transfer. These data are still based on the Belgian accounting rules.

(2) Including Turkey.

The new accounting system for the consolidated accounts provides a more detailed breakdown of the financial assets by counterparty sectors and by residency of the counterparty. That undoubtedly represents progress in terms of prudential information, as those data used to be available only on a territorial basis, and consequently did not include activities conducted abroad.

The Belgian banking sector's financial assets display a high degree of both sectoral and geographical diversification. Credit institutions, non-financial corporations, households and general government account for fairly similar proportions, namely 27, 27.3, 21 and 17.4 p.c. Almost the whole of the interbank loans, and the bulk of the loans granted to non-financial corporations and general government in the form of loans or debt securities, are located outside Belgium. Thus, lending to enterprises abroad is about three times as high as to corporations in Belgium, at 20.3 and 7 p.c. respectively, the main concentration being in countries outside the euro area, at 12.6 p.c. That is not due solely to Belgian banks' expansion abroad, but also to the low recourse to bank loans on the part of Belgian firms in recent years. In contrast to non-financial corporations and general government, Belgian households still account for a higher volume of outstanding loans than non-resident households, at 11.4 p.c. compared to 9.6 p.c. In the case of households, mortgage loans continue to dominate, representing over three-quarters of the total outstanding claims on households in September 2006.

Although the Belgian banks' international expansion recently included the acquisition of banks in Central Europe and Turkey, the major part of the assets of Belgian credit institutions abroad (69.9 p.c.) is still located in six advanced countries, namely Germany, France, the Netherlands, Italy, the United Kingdom and the United States.

Regarding the share of these foreign assets formed vis-à-vis the non-bank private sector, the concentration is even greater, since at the end of September 2006, the Netherlands, the United States and the United Kingdom accounted for roughly 62.1 p.c. of these assets. While the major part of this business with the United States and the United Kingdom takes place via cross-border transactions, most of the assets in the Netherlands were acquired through local agencies, highly active in granting mortgage loans to Dutch households. The Belgian banks' transactions with foreign credit institutions are largely effected with Dutch, US, British, French and German counterparties. Belgian banks also hold a sizeable portfolio of Italian government securities.

Claims on Central and Eastern Europe are mainly composed of loans to the non-bank private sector (48.9 p.c.). Claims on the banking sector and the public sector account for 28.2 and 19.7 p.c. respectively.

8.2.2 Credit risk

Lending is still the main source of risk for Belgian banks. The stock of unrecoverable loans and those with an uncertain future has declined steadily since 2001, falling by the end of September 2006 to 2 p.c. of the total outstanding loans on an unconsolidated basis. On that date, the coverage ratio of these loans came to 51.7 p.c., the lowest level since 2000.

In recent years, credit institutions have benefited from a favourable economic climate and the general improvement in borrower solvency. Moreover, among Belgian customers, there has been a shift in recent years away from corporate lending and towards loans to households which, on average, present a lower risk profile. While the total amount of outstanding loans to non-financial

Box 18 – Introduction of IAS/IFRS

In accordance with a European Regulation, the IAS/IFRS (International Accounting Standards/International Financial Reporting Standards) have been applied since 1 January 2005 to the consolidated annual accounts of all listed Belgian companies, and particularly the large *bancassurance groups*. From 1 January 2006, the Belgian legislature extended that obligation regarding the prudential consolidated accounts to all banks, including those which are not listed, for the data they have to submit to the prudential authorities.

Although the application of these standards entails major changes to the recording of all balance sheet items, those changes are especially important on the assets side. First, they introduce the concept of fair value, defined as the amount for which a financial instrument could be traded between well-informed, willing parties in a transaction effected under normal competition conditions. That is broader than the concept of market value. Under IAS/IFRS, the quoted price on an active market is regarded as the best indication of fair value, and should be accorded priority if it exists, but it is not the only indicator. In the absence of an active market, the concept of fair value may include other valuation techniques, e.g. by referring to the valuation of similar financial instruments.

In addition, the IAS/IFRS introduce a new classification of financial assets, dividing them into separate accounting portfolios which are subject to specific accounting methods.

METHOD OF RECORDING FINANCIAL ASSETS IN ACCORDANCE WITH THE IAS/IFRS

Classification of financial assets	Valuation method	Recording of changes in fair value
Assets held for trading	Fair value	Through profit or loss
Assets designated at fair value	Fair value	Through profit or loss
Loans and receivables	Amortised cost (1)	–
Held-to-maturity investments	Amortised cost (1)	–
Available-for-sale assets	Fair value	Through equity

(1) The amortised cost is the amount at which a financial instrument was acquired, minus principal repayments, net impairments and amortisation of the difference between the acquisition price and the maturity value.

The first portfolio contains assets held for trading, namely assets acquired for the purpose of resale in the near future, and derivatives other than those recognised explicitly as hedging derivatives. They are recorded at fair value, and value changes are recorded in the profit and loss account.

The second portfolio contains financial assets (other than derivatives) which the banks have irrevocably chosen to record at fair value ("fair value option"). Value changes in this portfolio are also recorded in the profit and loss account. Credit institutions may use this fair value option, for instance, as a means of offsetting the volatility of results caused by the revaluation of derivatives used for hedging purposes in the course of asset and liability management (ALM), but not eligible for recognition as hedging derivatives.

The loans and receivables category includes financial assets (other than derivatives) with fixed or determinable payments, which are, except in some special cases, not quoted on an active market. They are valued at amortised cost.

Held-to-maturity investments include the securities and financial instruments which banks intend and are able to hold until their maturity. Derivatives and equities are excluded. This category can be used provided that, during the current year and the two preceding years, the volume of securities sold before maturity is negligible. Assets in this portfolio are valued at amortised cost.

The portfolio of available-for-sale financial assets contains assets not classified in the other portfolios, and constitutes a residual category. These assets are recorded at fair value, and in this case value changes are recognised directly in the equity.

To provide a clearer idea of the economic reality behind the new method of classifying financial assets, it is useful to relate the various portfolios defined according to the IAS/IFRS to the breakdown by type of financial instruments.

FINANCIAL ASSETS OF BELGIAN CREDIT INSTITUTIONS ACCORDING TO THE NEW PRUDENTIAL ACCOUNTING SYSTEM

(consolidated data at the end of September 2006 (1), billions of euro, unless otherwise stated)

	Loans and advances	Debt instruments	Equities	Derivatives (2)	Total	*p.m. Percentages*
Assets held for trading	40.6	53.8	40.7	63.5	198.6	*16.0*
Assets designated at fair value through profit or loss	18.3	17.7	0.9		37.0	*3.0*
Loans and receivables	752.9				752.9	*60.5*
Held-to-maturity investments		14.9			14.9	*1.0*
Available-for-sale assets	0.3	234.9	5.2		240.4	*19.3*
Total	**812.1**	**321.3**	**46.9**	**63.5**	**1,243.8**	***100.0***
p.m. Percentages	*65.3*	*25.8*	*3.8*	*5.1*	*100.0*	

Sources: CBFA, NBB.

(1) These data, compiled in accordance with the IAS/IFRS, concern six large Belgian banks which together accounted for 92.5 p.c. of the total consolidated assets of the Belgian banking sector at the end of 2005.

(2) Including hedging derivatives subject to specific rules, particularly on the recording of changes in fair value in the profit and loss account.

One third of the trading assets held by Belgian credit institutions are derivatives. Previously, these assets were recorded off balance sheet at their notional amount. From now on, under the IAS/IFRS, derivatives are assumed to be held for trading purposes and are recorded at their fair value on bank balance sheets, gains and losses now being reported in the profit and loss account. However, they may also be designated explicitly as hedging derivatives, provided the transaction documentation requirements are satisfied and the effectiveness of the hedging is proved. Belgian banks have made little use of this option, as the outstanding amount of hedging derivatives, recorded at fair value, is only 1.6 billion euro.

Loans and advances to credit institutions and customers, which represent the biggest item in the banks' total assets (65.3 p.c.), are to a very large extent included in the portfolio of loans and receivables valued at amortised cost. If all the held-to-maturity investments are added, it emerges that nearly 62 p.c. of the financial assets held by Belgian banks are still recorded at amortised cost.

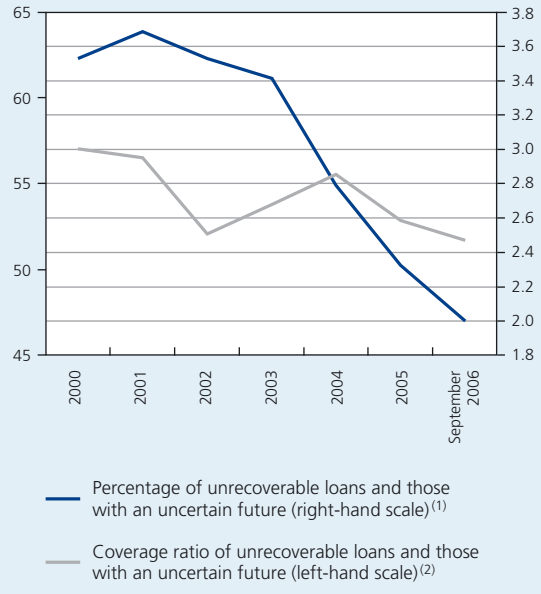
Belgian banks also hold a sizeable portfolio of debt securities. The majority are classified as available-for-sale assets, and changes in their fair value have no influence on the profit and loss account, since they are recorded directly in the equity. The rest of the securities are held mainly for trading purposes. Most equities are recorded under assets held for trading, and represent only 3.8 p.c. of the total financial assets.

Application of the IAS/IFRS also modifies the accounting treatment of the liabilities, but to a lesser extent, as 77.5 p.c. of banks' liabilities are still valued at amortised cost. These liabilities consist mainly of deposits by customers and credit institutions. In addition, financial liabilities contracted for trading purposes, and therefore recorded at fair value, represent 9.4 p.c. of the balance sheet total. They consist largely of derivatives and short positions in equities and fixed-income securities. The other liabilities include the own funds and subordinated debts.

corporations has remained relatively stable since 2001, at around 80 billion euro, the amount of loans to households has risen from 81.6 billion in 2001 to 122.6 billion at the end of the first nine months of 2006, as – during that period – Belgian households expressed a strong demand for mortgage loans, encouraged by easier financing conditions.

CHART 75 UNRECOVERABLE AND UNCERTAIN LOANS OF CREDIT INSTITUTIONS GOVERNED BY BELGIAN LAW AND COVERAGE RATIO

(end-of-period data on an unconsolidated basis, percentages)



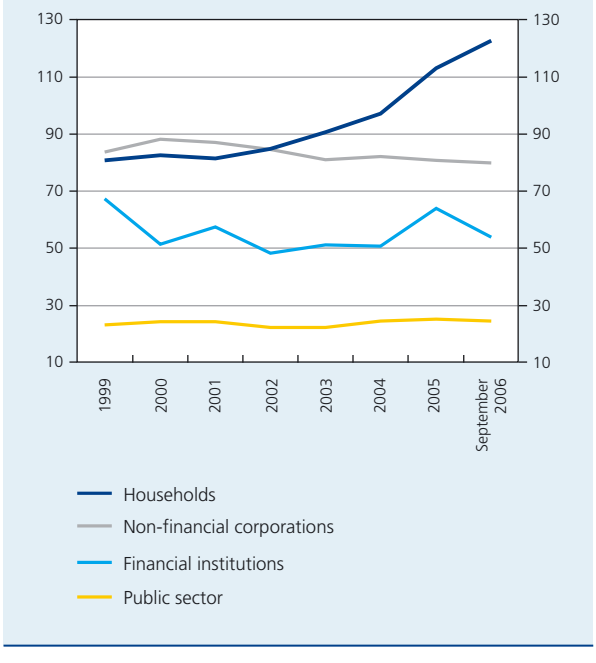
Sources: CBFA, NBB.

(1) Stock of unrecoverable and uncertain loans as a percentage of total customer loans.

(2) Stock of value reductions on loans as a percentage of unrecoverable and uncertain loans.

CHART 76 LOANS BY BELGIAN CREDIT INSTITUTIONS TO RESIDENTS

(end-of-period data on a territorial basis, billions of euro)



Sources: CBFA, NBB.

However, as already mentioned, Belgian banks conduct a growing proportion of their business with foreign countries, usually via their subsidiaries. This internationalisation is increasing their exposure to credit cycles outside Belgium. Under the new accounting system, this dimension can be taken into account in pricing the credit risk, since the stock of unrecoverable loans and those with an uncertain future, now known as impaired loans, is also reported on a consolidated basis and therefore includes loans granted abroad by subsidiaries. That stock is further broken down by type of counterparty.

TABLE 40 IMPAIRED LOANS OF BELGIAN CREDIT INSTITUTIONS[1]

(consolidated data as at the end of September 2006[2])

	Percentages of impaired loans[3]	Coverage ratio[4]	*p.m. Total outstanding loans, billions of euro*
Non-financial corporations	2.6	53.3	*252.9*
Households	1.9	26.1	*239.5*
Central governments and non-bank financial institutions	0.2	83.6	*52.1*
Total	**2.0**	**42.6**	***544.5***
p.m. Idem, on an unconsolidated basis	*2.0*	*51.7*	*395.5*

Sources: CBFA, NBB.

(1) Excluding loans to credit institutions and the securities portfolio.

(2) These data, compiled in accordance with the IAS/IFRS, concern six large Belgian banks which together accounted for 92.5 p.c. of the total consolidated assets of the Belgian banking sector at the end of 2005.

(3) Gross outstanding amount of impaired loans as a percentage of total gross outstanding loans.

(4) Amounts of individual impairments as a percentage of the gross outstanding impaired loans.

On a consolidated basis, the proportion of impaired loans came to 2 p.c. at the end of September 2006, the same as the level recorded on an unconsolidated basis. Most of these loans concern non-financial corporations and households, as the proportion of impaired loans is very much lower in the case of general government and financial institutions, at 0.2 p.c. Moreover, that percentage relates to a far smaller amount of outstanding credit than for the other two sectors. Conversely, the coverage ratio of 83.6 p.c. is substantially higher, owing to the usual absence of collateral for this type of very low risk loans.

The corporate sector has a higher risk profile than the household sector, both because the proportion of impaired loans is higher, at 2.6 p.c. compared to 1.9 p.c., and because the coverage ratio is about double that for loans to households, at 26.1 p.c. The latter consist mainly of mortgage loans, so that the banks have significant collateral to cover potential losses on this type of lending, and that reduces the need for provisions.

8.2.3 Composition of the liabilities of Belgian credit institutions and interest rate risk

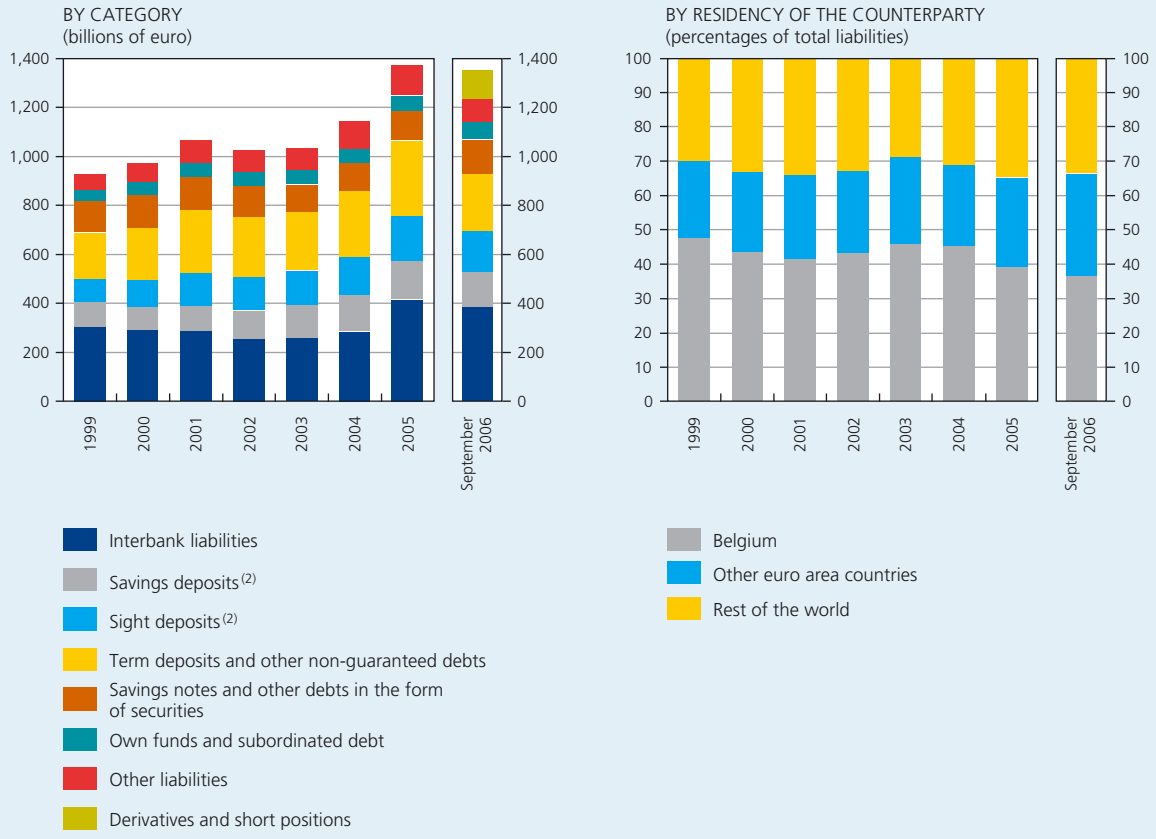
The internationalisation of the Belgian banks has not only affected the composition of their financial assets. These institutions have borrowed more from abroad. Whereas in 1999, some 50 p.c. of their funding came from domestic sources, that figure had fallen to around 36.5 p.c. by September 2006.

The large proportion of liabilities originated abroad is due to extensive recourse to the international interbank markets as a source of funding; 89.2 p.c. of interbank liabilities, accounting for 28.5 p.c. of the balance sheet total, were contracted with foreign counterparties. Conversely, in deposit taking, the Belgian market continued to dominate, with 51.8 p.c. of the total deposits. This contrasts with the breakdown in the case of lending, where Belgium accounted for only 42.5 p.c. The still high percentage of deposits collected in Belgium is attributable mainly to savings deposits, of which 97.4 p.c. are held by residents. For other deposits, the distribution between Belgium and the rest of the world was in fact more comparable with that for loans.

Savings deposits and sight deposits both play a key role in the financing of Belgian banks, which make extensive use of these short-term positions to finance long-term assets. This structure exposes them to interest rate risks. Since the rates on a large proportion of the assets are fixed for a fairly long period, a general rise in interest rates affects the remuneration of the liabilities sooner than that of the assets, causing the intermediation margin to contract. That contraction will be especially marked if the rise is accompanied by a flattening of the yield curve, i.e. a narrowing of the spread between short- and long-term interest rates. This combination of developments occurred during the period under review, which explains why the intermediation margin calculated on an annual basis declined from 0.94 p.c. in 2005 to 0.90 p.c. in September 2006.

CHART 77 BREAKDOWN OF THE LIABILITIES OF BELGIAN CREDIT INSTITUTIONS

(consolidated end-of-period data [1])



Sources: CBFA, NBB.

(1) The data as at the end of September 2006, compiled in accordance with the IAS/IFRS, concern six large Belgian banks which together accounted for 92.5 p.c. of the total consolidated assets of the Belgian banking sector at the end of 2005.

(2) The sight deposit and savings deposit categories include only deposits recorded at amortised cost.

TABLE 41 INTERMEDIATION ACTIVITIES OF BELGIAN CREDIT INSTITUTIONS

(consolidated data as at the end of September 2006 [1], percentages of the total)

	Interbank market		Customers			
	Assets	Liabilities	Loans	Deposits	of which:	
					Savings deposits [2]	Other deposits
Belgium	6.4	10.8	42.5	51.8	97.4	35.7
Other euro area countries	52.0	40.1	28.9	18.9	2.0	24.8
Rest of the world	41.7	49.1	28.7	29.4	0.6	39.5
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Sources: CBFA, NBB.

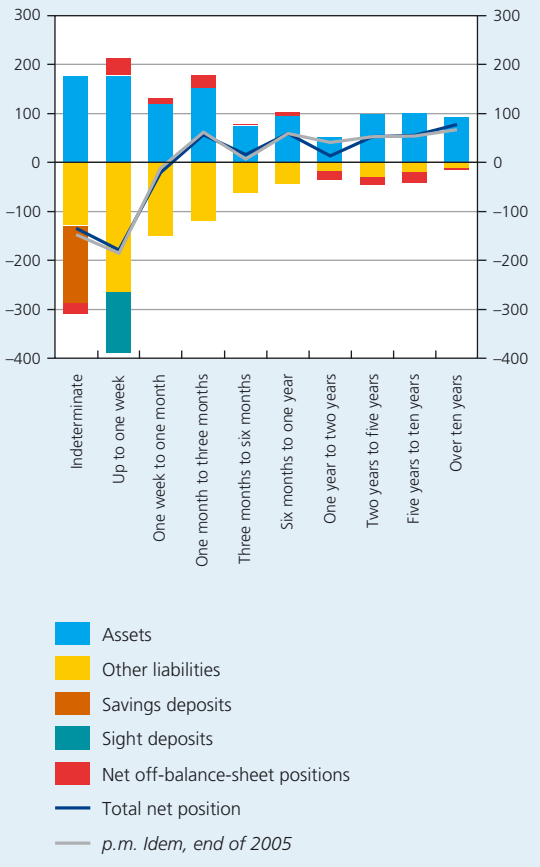
(1) These data, compiled in accordance with the IAS/IFRS, concern six large Belgian banks which together accounted for 92.5 p.c. of the total consolidated assets of the Belgian banking sector at the end of 2005.

(2) The savings deposit category includes only deposits recorded at amortised cost.

The stress tests conducted by the four big Belgian banks in consultation with the Bank and the CBFA, in order to estimate the impact on net interest income of a general rise in interest rates or a flattening of the yield curve, confirm the negative effect of such developments on the intermediation margin. Nonetheless, they also indicate that, in the longer term, a general interest rate rise usually bolsters interest income. On the one hand, once the remuneration of the assets has been adjusted, the higher level of interest rates in general helps to swell the banks' interest income. Also, the "endowment effect", i.e. the difference between the cost of financing on the interbank market and the interest rate on sight deposits, which traditionally provide a low rate of remuneration, tends to become larger, also helping to boost interest income. Conversely, a persistent flattening of the yield curve would maintain pressure on margins.

CHART 78 MATURITY TRANSFORMATION ACTIVITIES OF BELGIAN CREDIT INSTITUTIONS (1)

(data on an unconsolidated basis at the end of September 2006, billions of euro, unless otherwise stated)

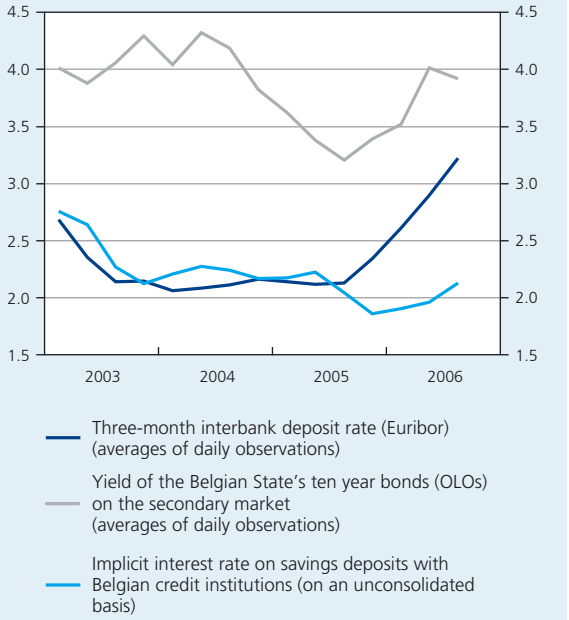


Sources: CBFA, NBB.

(1) This chart shows the assets, liabilities and off-balance-sheet positions by various maturity classes, measured by residual term up to the date of the next interest rate adjustment.

CHART 79 MARKET INTEREST RATES AND IMPLICIT RATE ON SAVINGS DEPOSITS

(quarterly data)



Sources: CBFA, NBB.

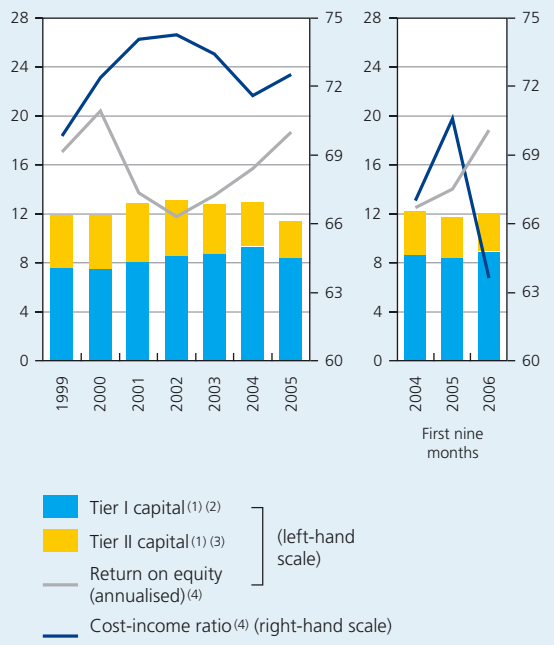
8.2.4 Profitability and solvency

Despite the shrinking intermediation margin, which had a negative impact on the net interest income of Belgian banks in 2006, the banking sector's overall profitability improved, as indicated by the higher return on equity. That increase is largely due to the strong growth of non-interest income, partly as a result of fee income in respect of asset management, securities transactions and the sale of insurance products. Moreover, operating expenses were down as a percentage of banking income. Finally, net value adjustments on loans on an unconsolidated basis came to only 0.05 p.c. of the outstanding total for the twelve month period ending on 30 September 2006.

The solvency ratio of Belgian credit institutions, calculated in accordance with Basel I, increased from 11.5 p.c. in 2005 to 12 p.c. at the end of the first nine months of 2006. The composition of the regulatory own funds also changed slightly, as a large Belgian credit institution increased its capital. Thus, the Tier I capital stood at 8.9 p.c. at the end of September 2006, compared to 8.4 p.c. nine months earlier. The method of calculating the solvency ratios will change on entry into force of the new Basel II rules. This new

CHART 80 PROFITABILITY AND SOLVENCY INDICATORS OF CREDIT INSTITUTIONS GOVERNED BY BELGIAN LAW

(consolidated data for solvency and annual profitability indicators, on an unconsolidated basis in the case of the profitability indicators for the first nine months, percentages)



Sources: CBFA, NBB.

(1) End-of-period data as a percentage of the risk-weighted assets.

(2) Own funds in the strict sense, consisting essentially of paid-up capital, reserves, minority interests and, as the main deduction item, positive consolidation differences.

(3) Mainly subordinated loans.

(4) Owing to the entry into force of the new accounting system, the consolidated profit and loss account as drawn up in 2006 according to the IAS/IFRS cannot be compared with that for 2005, which was still based on the Belgian accounting standards. The return on equity and operating expenses for the first three quarters of the year are therefore compared on an unconsolidated basis. The data have also been adjusted to neutralise the effect of a change in the consolidation scope of a large credit institution during the first nine months of 2006.

regulatory framework is intended, inter alia, to refine the calculation of the regulatory own funds for credit risk by making use of the best practices developed by banks. From 1 January 2007, banks are permitted to use two systems: the standardised approach based on external credit risk measures, such as ratings provided by rating agencies, and the "foundation" approach based on internal models (IRB foundation). The latter permits the use of such models to determine the probability of default for various bank loans, while the other parameters, namely exposure at default, and the loss given default, are still determined on an overall basis by the supervisory authorities. From 2008, banks will be able to use their models as part of a more advanced process (IRB advanced) in which all the parameters influencing loan losses can be calculated via their internal models. Implementation of the Basel II regulatory standards is likely to confirm the strong solvency of the Belgian banking sector. Impact studies indicate that, on average, these standards should lead to a reduction in the capital requirements for credit risk of the Belgian banks.

8.3 Belgian insurance companies

The large Belgian financial institutions pursue highly diverse activities in both the banking and the insurance sector, as is clear from the breakdown of their net results per sphere of activity for the first nine months of 2006. During that period, insurance activities contributed 47.5, 29.1, 15.3 and 6.9 p.c. respectively to the consolidated profits of the ING, Fortis, KBC and Dexia groups. As a general rule, those percentages were lower than for the first nine months of 2005, since the growth of profitability in the banking segment outpaced that in the insurance segment in 2006.

TABLE 42 RETURN ON EQUITY OF *BANCASSURANCE* GROUPS ACTIVE ON THE BELGIAN MARKET (1)

(annualised figures for the first nine months on a consolidated basis, percentages)

	Fortis	Dexia	KBC	ING
2004	21.5 (2)	17.5	14	25.4
2005	23.3 (3)	19.3	19	26.7
2006	21.1 (3)	23.0	26	23.1

Sources: figures published by the groups.

(1) According to IAS/IFRS. For 2004, *pro forma* figures, compiled according to IAS/IFRS as presented by the groups in their financial reports, are provided.

(2) On the basis of the year 2004 as a whole.

(3) On the basis of the last twelve months.

At the end of 2005, the four large financial groups had a market share of 82 p.c. of deposits collected from Belgian residents, and 51.3 p.c. of insurance premium income. In recent years, these institutions have performed well in both the banking sector, as discussed earlier, and in the insurance sector, for reasons which will be examined in more detail in this section. During the first nine months of 2006, the weighted average return on equity of these four groups, for their banking and insurance activities taken together, stood at 23.1 p.c., compared to 23.3 p.c. a year earlier.

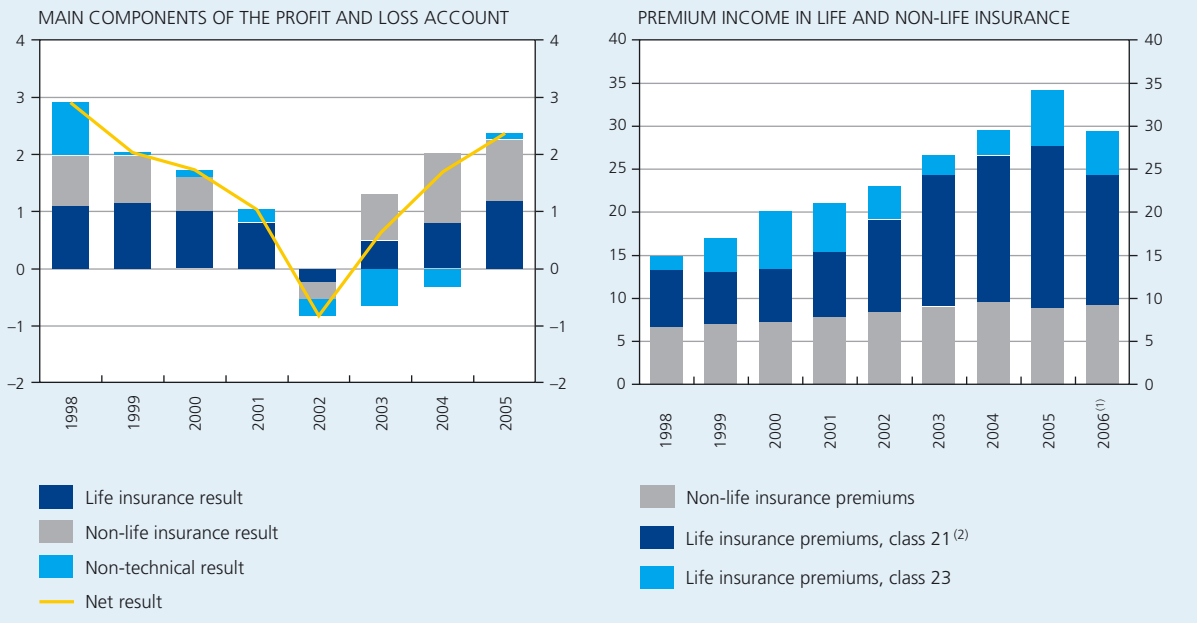
8.3.1 Profitability of insurance activities

The insurance sector, which had been loss-making in 2002, has since seen a gradual improvement in its results, especially in 2005, when profits jumped by 39.6 p.c. to 2.4 billion euro. This strong recovery is due essentially to a 49.3 p.c. increase in the results on life insurance. The non-technical result, which includes among other things investment income not attributed to the life and non-life branches and exceptional income, also recovered sharply, becoming positive for the first time since 2002. Conversely, in the non-life business, results were 12.2 p.c. down, though that decline is due largely to a significant change in the composition of the Belgian insurance sector: at the end of 2004, a major foreign insurer relocated its European headquarters, previously based in Belgium. The impact of this change is neutralised in the remainder of this chapter.

Extrapolation of the provisional figures for the first nine months indicates that non-life insurance premiums grew by only 4.2 p.c. in 2006. As in the previous year, that percentage is below the average of 5.8 p.c. recorded from 2000 to 2004. The keener competition in recent months in some product categories, such as insurance against motor vehicle damage and fire insurance, has driven down the prices of these policies, which have, admittedly, been relatively profitable in past years.

Despite this smaller premium growth in 2006, the provisional data for the first nine months suggest that the combined ratio – expressing insurance and operating costs as a percentage of premium income – has fallen, in contrast to 2005 when it increased slightly from 103.3 to 104.3 p.c. Cost control in 2006 thus seems to have consolidated the structural improvement seen since 2001, when that ratio had reached a record high of 117.5 p.c.

CHART 81 RESULTS OF BELGIAN INSURANCE COMPANIES
(billions of euro)



Sources: Assuralia, CBFA, NBB.
(1) Estimated premium income in 2006, based on the first nine months of the year.
(2) Includes collected premiums on other types of contracts with a guaranteed yield.

In life insurance, premium income declined in 2006. Estimated on the basis of the first nine months of the year, the decrease was about 20 p.c. for both guaranteed return products (class 21) and unit-linked insurance (class 23). This reduction was probably to a large extent linked to the imposition, from 1 January 2006, of a new tax of 1.1 p.c. on premium payments in respect of class 21 and class 23 insurance contracts. While the fact that households anticipated that tax caused premium payments to increase sharply in 2005, the tax exerted a negative effect in 2006. The profitability of these activities was not only affected by the decline in premiums, but also by the lower entry charges which some insurance companies introduced to offset the effect of the new tax. However, the impact of this change varies greatly from one company to another, and was probably less pronounced over the year as a whole, since the shift in payments to the previous year mainly affected premiums which would have been collected at the beginning of 2006.

8.3.2 Sensitivity to interest rate movements

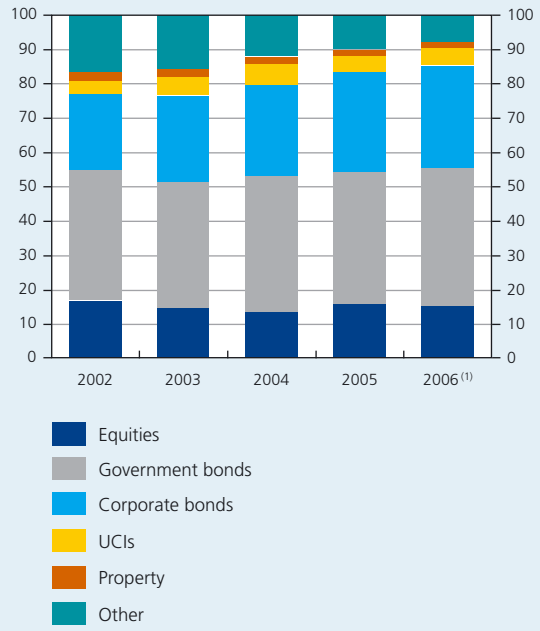
Insurance companies' incomes are determined not only by the premiums collected and the insurance costs, but also by the return on their investments. In non-life insurance, this investment income is less important, on the whole, than in life insurance because the technical provisions in the former case are proportionately smaller. The time lapse between collection of the premiums and the payment of the compensation is relatively short, whereas in life insurance, the premiums are intended to build up the necessary reserves so that the contractual obligations can subsequently be met. These differences are reflected in the size of the investment portfolios, and hence in the financial income. In 2005, that income represented 32.2 p.c. of collected life insurance premiums, against 16.4 p.c. in the case of non-life insurance.

In the latter branch, the favourable movement in investment income in 2005, following the realisation of capital gains on equity and bond portfolios, boosted the technical result despite the slight fall in the insurance result. In 2006, the provisional data for the first nine months point to a modest decline in investment performance.

In life insurance, there is an essential distinction between class 21 and class 23 investment income. In the latter case, the entire return on the portfolio goes to the policyholders, and the insurance company does not incur any investment risk, obtaining its income exclusively from entry, management and exit charges. In contrast, in the case of class 21 contracts, the company guarantees a fixed minimum return each year. That is why bonds make up the bulk of the assets covering these contracts. At the end of September 2006, bonds represented 70 p.c. of class 21 investments while equities accounted for 15.4 p.c.

CHART 82 LIFE INSURANCE INVESTMENT PORTFOLIO EXCLUDING CLASS 23

(end-of-period data, percentages of the total)

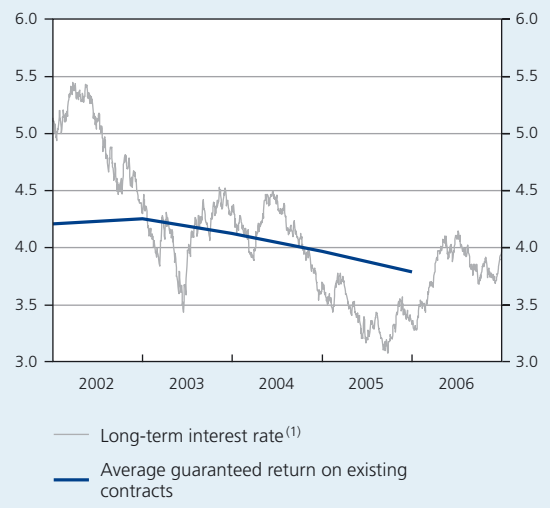


Sources: CBFA, NBB.
(1) Data at the end of September.

To the extent that the average maturity of these bond portfolios is less than the duration of the associated life insurance contracts, a decline in interest rates is detrimental to the profitability of the activities. However, this impact is not necessarily immediate. As a result, from 2002 to 2005, the investment results recorded on these bond portfolios increased, despite the falling interest rates, thanks to the realisation of capital gains on some of the bonds. Obviously, such transactions involve the replacement of old high-coupon bonds with new instruments at lower interest rates, thus reducing future interest income.

The opposite happens if interest rates start rising, as they did during the initial months of 2006. Although such a trend is favourable in the long run, as it widens the margin between market rates and guaranteed returns, it initially weighs on the profit and loss account in class 21 since it hampers the realisation of capital gains and

CHART 83 LONG-TERM INTEREST RATES AND AVERAGE GUARANTEED RETURN ON CLASS 21 CONTRACTS



Sources : CBFA, NBB.

(1) Interest rate on the secondary market for ten-year Belgian government bonds (OLOs) (daily data).

may even give rise to losses on more recently acquired bonds.

In order to cope better with the low level of long-term interest rates, insurance companies cut the guaranteed rate on their new contracts. That move reduced the average guaranteed rate on the entire portfolio from 4.3 p.c. at the end of 2002 to 3.8 p.c. at the end of 2005. In addition, more flexible contracts were launched, with shorter maturities and guaranteed rates which can be adjusted at the time of each premium payment. Yet, that greater flexibility of new contracts could, in the short run, limit the positive effects of a rise in interest rates. While the traditional class 21 policies consisted mainly of long-term contracts with severe penalties for early redemption, many of the contracts concluded nowadays have a shorter term and offer the policyholder the option of early redemption at modest cost. Premium payments on capitalisation accounts (class 26) also expanded strongly in 2006, albeit from a low initial level. These insurance products, which do not attract the 1.1 p.c. tax, are similar to traditional savings deposits and expose insurers to similar liquidity and interest rate risks. A steep rise in interest rates could push insurance companies into jacking up the guaranteed returns or bonuses in order to avoid large-scale redemption of class 21 and class 26 contracts, even if their investment portfolio contains a large number of low-coupon bonds.

8.3.3 Solvency of insurance companies

The solvency of insurance companies declined during the first nine months of 2006. On the basis of provisional quarterly figures, which, inter alia, take no account of any redistribution of profits to shareholders and policyholders, the available regulatory solvency margin came to 254.3 p.c. of the minimum requirement at the end of September 2006, compared to 274.6 p.c. at the end of 2005.

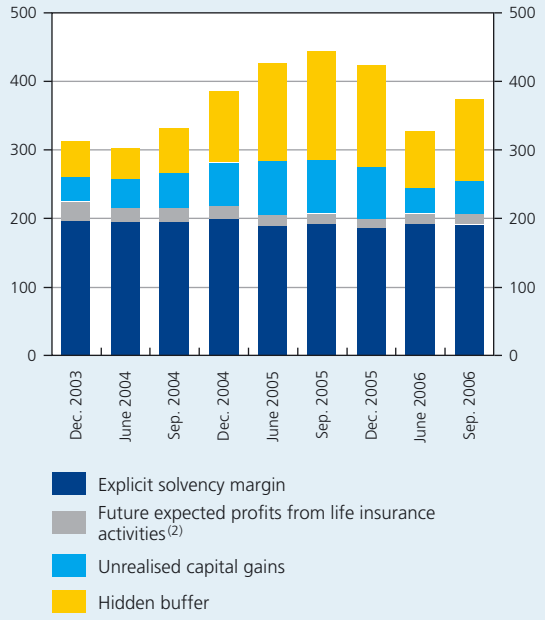
The available margin consists of a number of components. The main one, namely the explicit solvency margin, which essentially comprises the insurance companies' own funds and certain other balance sheet items, rose from 185.2 to 190.8 p.c. of the minimum requirement, as a result of the profits recorded by insurers in the first nine months of 2006. Under the current solvency rules, insurance companies may also – with the consent of the CBFA – include two other elements in their regulatory margin : part of the expected future profits on life insurance activities, and unrealised gains on their investment portfolio.

It is this last element which caused the contraction of the available margin in the first nine months of 2006. While the decline in interest rates between 2003 and 2005 had generated a surge in the capital gains on bonds included in the regulatory margin, the recent rate rise depressed those gains during the part of 2006 under consideration. It should be noted that only part of the unrealised gains is included in the regulatory margin, the other part constituting a hidden buffer. If the latter is taken into account, the overall solvency margin available to the insurance companies declined in the first three quarters of 2006 from 423.7 to 374.3 p.c. of the minimum requirement.

In reality, the rise in long-term interest rates is less detrimental than it appears for the solvency of insurance companies, as it also reduces the present value of the liabilities, i.e. essentially the life insurance technical reserves. That reduction exceeds the fall in the value of the bond portfolio since, as already mentioned in the preceding section, the average maturity of the liabilities in life insurance is traditionally longer than that of the assets. However, these changes in the value of the liabilities are not recorded under the current rules, which do not provide for an adjustment to the discount rate applied to the technical provisions in the event of fluctuations in market interest rates. Stress tests conducted by the largest insurance companies on the basis of economic valuations of the assets and liabilities confirm that a rise in long-term interest rates in fact has a positive effect on solvency.

CHART 84 AVAILABLE SOLVENCY MARGIN OF BELGIAN INSURANCE COMPANIES (1)

(percentages of the minimum required margin)



Sources : CBFA, NBB.

(1) Provisional quarterly figures.

(2) This component of the solvency margin is to be gradually reduced and eliminated altogether by 2010.

The distortions created by the current method of valuing the technical provisions should disappear with the introduction of fair value recording of these provisions in accordance with IAS/IFRS. Since 2005, Belgian insurance companies forming part of a listed group have been required to compile their consolidated accounts in accordance with these international standards, but the current version of IFRS 4, which deals with the recording of insurance contracts, still permits companies to value those contracts largely in accordance with the Belgian accounting rules.

Ultimately, however, the new fair value accounting principle will extend to insurance contracts and will have to be applied not only to the consolidated accounts but also to the prudential data which all insurance companies supply on a company basis. In fact, in order to match the capital requirements more closely with each company's individual risk profile, a new system, known as *Solvency II*, is to be adopted at European level, by analogy with the capital requirements imposed on banks under the Basel II agreement. It is similarly based on three pillars. The first pillar, concerning the quantitative requirements, allows companies to use their own internal risk management models to calculate their required capital. This pillar also requires the valuation of the technical provisions at their fair value. The second pillar, relating to qualitative requirements, provides that the supervisory authorities responsible for reviewing the companies' internal calculations may, if appropriate, impose supplementary capital requirements. The third pillar is intended to strengthen market discipline by imposing obligations regarding the disclosure of information.

Statistical annex

TABLE I GDP AND MAIN CATEGORIES OF EXPENDITURE, BY VOLUME

(percentage changes compared to the previous year, calendar adjusted data)

	1999	2000	2001	2002	2003	2004	2005	2006 e
Household final consumption expenditure	2.2	4.0	0.8	0.7	1.0	1.6	0.8	2.4
Housing	4.9	1.2	–4.4	–0.8	3.6	9.0	3.5	4.8
Gross fixed capital formation by enterprises	3.4	4.5	3.1	–1.9	–2.3	6.7	4.8	4.4
Expenditure of general government	4.5	2.9	1.2	2.7	2.1	2.1	0.4	1.0
Final consumption	3.3	2.9	2.4	2.9	2.2	2.1	–0.6	1.3
Gross fixed capital formation	19.5	2.7	–11.6	0.7	0.7	2.9	13.5	–3.0
p.m. Total gross fixed capital formation (1)	*5.0*	*3.6*	*0.0*	*–1.5*	*–0.7*	*6.9*	*5.2*	*3.8*
Change in stocks (2)	–0.4	0.4	–1.0	0.1	0.0	0.1	0.6	0.8
Total domestic expenditure	2.7	4.1	0.0	0.9	0.9	2.9	2.0	3.2
Exports of goods and services	5.1	8.7	0.8	0.8	2.9	5.7	3.3	3.4
Total final expenditure	3.7	6.1	0.4	0.9	1.8	4.2	2.6	3.3
Imports of goods and services	4.4	9.2	–0.1	0.2	2.8	6.2	4.1	3.7
p.m. Net exports of goods and services (2)	*0.8*	*0.0*	*0.8*	*0.6*	*0.2*	*–0.1*	*–0.4*	*–0.1*
GDP	3.3	3.9	0.7	1.4	1.0	2.7	1.5	3.0

Sources: NAI, NBB.

(1) Housing, gross fixed capital formation by enterprises and gross fixed capital formation by general government.

(2) Contribution to the change in GDP.

TABLE II GNI AND MAIN CATEGORIES OF EXPENDITURE, BY VOLUME

(percentage changes compared to the previous year, data not adjusted for calendar effects)

	1999	2000	2001	2002	2003	2004	2005	2006 e
Household final consumption expenditure	2.1	3.8	1.1	0.8	0.9	1.5	0.9	2.4
Housing	5.0	1.0	–4.3	–0.7	3.7	9.0	3.2	5.1
Gross fixed capital formation by enterprises	2.1	6.0	3.3	–3.0	–2.4	8.1	3.2	4.9
Expenditure of general government	4.5	2.9	1.2	2.7	2.1	2.2	0.3	1.0
Final consumption	3.3	2.9	2.4	2.9	2.2	2.1	–0.6	1.3
Gross fixed capital formation	19.4	2.4	–11.4	0.5	1.0	3.2	12.8	–2.5
p.m. Total gross fixed capital formation (1)	*4.2*	*4.5*	*0.2*	*–2.2*	*–0.7*	*7.9*	*4.0*	*4.2*
Change in stocks (2)	0.1	0.1	–0.9	0.1	0.1	0.2	0.4	1.0
Total domestic expenditure	2.9	3.8	0.3	0.7	1.0	3.1	1.6	3.6
Exports of goods and services	5.0	8.4	0.9	1.2	2.9	5.9	2.8	3.7
Total final expenditure	3.8	5.8	0.5	0.9	1.9	4.4	2.1	3.6
Imports of goods and services	4.4	8.8	0.2	0.2	3.0	6.3	3.5	4.3
p.m. Net exports of goods and services (2)	*0.6*	*0.1*	*0.5*	*0.8*	*0.1*	*0.0*	*–0.5*	*–0.4*
GDP	3.4	3.7	0.8	1.5	1.0	3.0	1.1	3.1
Trade surplus or deficit (–) resulting from the change in the terms of trade (3)	–0.5	–1.4	0.1	0.5	–0.4	–0.2	–0.6	0.2
Net primary incomes received from the rest of the world (3)	0.2	0.4	–0.7	–0.2	0.1	–0.4	–0.1	–0.1
GNI	3.0	2.6	0.2	1.7	0.7	2.3	0.4	3.1

Sources: NAI, NBB.

(1) Housing, gross fixed capital formation by enterprises and gross fixed capital formation by general government.

(2) Contribution to the change in GDP.

(3) Contribution to the change in GNI.

TABLE III GNI AND MAIN CATEGORIES OF EXPENDITURE DEFLATORS

(percentage changes compared to the previous year, data not adjusted for calendar effects)

	1999	2000	2001	2002	2003	2004	2005	2006 e
Household final consumption expenditure	0.1	3.5	2.3	1.3	1.7	2.4	2.9	2.2
Housing	0.9	2.7	4.2	4.5	1.3	0.8	1.6	4.7
Gross fixed capital formation by enterprises	2.1	1.8	–0.5	–2.3	1.3	1.1	0.8	2.1
Expenditure of general government	1.4	1.9	2.5	3.7	2.4	2.4	3.8	2.0
Final consumption	1.4	1.7	2.6	3.9	2.5	2.6	4.1	2.1
Gross fixed capital formation	1.6	3.4	0.6	0.5	1.2	–0.5	0.7	0.4
p.m. Total gross fixed capital formation (1)	*1.8*	*2.2*	*0.6*	*–0.6*	*1.3*	*0.9*	*1.0*	*2.6*
Total domestic expenditure (2)	0.8	2.8	2.0	1.5	1.8	2.2	2.8	2.3
Exports of goods and services	–0.3	9.5	2.1	–0.5	–2.2	2.5	3.8	4.4
Total final expenditure (2)	0.3	5.8	2.1	0.6	–0.1	2.3	3.3	3.3
Imports of goods and services	0.3	11.8	2.0	–1.2	–2.0	2.8	4.6	4.0
p.m. Terms of trade	*–0.6*	*–2.0*	*0.1*	*0.7*	*–0.2*	*–0.3*	*–0.7*	*0.3*
GDP	0.4	1.8	2.0	1.9	1.6	2.4	2.0	1.9
GNI	0.9	3.3	1.9	1.4	2.0	2.6	2.6	1.7

Sources: NAI, NBB.

(1) Housing, gross fixed capital formation by enterprises and gross fixed capital formation by general government.

(2) Excluding changes in stocks.

TABLE IV GNI AND MAIN CATEGORIES OF EXPENDITURE AT CURRENT PRICES

(millions of euro, data not adjusted for calendar effects)

	1999	2000	2001	2002	2003	2004	2005	2006 e
Household final consumption expenditure	126,369	135,726	140,300	143,227	146,889	152,804	158,673	166,091
Housing	11,025	11,433	11,392	11,818	12,409	13,630	14,297	15,723
Gross fixed capital formation by enterprises	33,431	36,080	37,076	35,126	34,700	37,907	39,435	42,226
Expenditure of general government	55,910	58,613	60,777	64,749	67,710	70,845	73,800	76,046
Final consumption	51,252	53,678	56,378	60,303	63,163	66,177	68,496	70,856
Gross fixed capital formation	4,658	4,934	4,399	4,446	4,547	4,667	5,304	5,191
p.m. Total gross fixed capital formation (1)	*49,114*	*52,447*	*52,867*	*51,389*	*51,656*	*56,204*	*59,036*	*63,139*
Change in stocks	1,161	2,508	180	62	810	2,593	3,390	4,613
Total domestic expenditure	227,896	244,359	249,724	254,981	262,518	277,778	289,595	304,698
Exports of goods and services	179,471	213,080	219,555	220,969	222,475	241,581	257,697	278,873
Total final expenditure	407,367	457,439	469,279	475,950	484,993	519,359	547,292	583,572
Imports of goods and services	169,119	205,698	210,396	208,298	210,335	229,850	248,751	269,905
p.m. Net exports of goods and services	*10,353*	*7,382*	*9,159*	*12,672*	*12,140*	*11,731*	*8,946*	*8,968*
GDP	238,248	251,741	258,883	267,652	274,658	289,509	298,541	313,666
Net primary incomes received from the rest of the world	4,664	5,694	3,922	3,384	3,788	2,705	2,548	2,212
GNI	242,912	257,435	262,806	271,036	278,446	292,213	301,089	315,879

Sources : NAI, NBB.

(1) Housing, gross fixed capital formation by enterprises and gross fixed capital formation by general government.

TABLE V VALUE ADDED OF THE VARIOUS BRANCHES OF ACTIVITY, BY VOLUME

(percentage changes compared to the previous year, data not adjusted for calendar effects)

	1999	2000	2001	2002	2003	2004	2005	*p.m. Percentages of the 2005 GDP*
Agriculture, hunting, forestry and fisheries	2.9	4.2	–5.5	4.3	–7.6	7.3	7.8	*1.1*
Industry	0.9	4.8	0.0	–0.8	–1.2	3.2	–0.2	*17.2*
Mineral-extracting industry	1.2	1.1	–11.4	–5.1	0.1	3.6	3.3	*0.1*
Electricity, gas, water	2.5	7.0	–1.7	–1.9	–0.8	–1.3	2.2	*1.9*
Manufacturing industry	0.7	4.6	0.3	–0.7	–1.3	3.8	–0.5	*15.2*
of which:								
Non-metallic minerals	–0.7	–0.5	3.6	–1.3	–3.4	1.6	1.0	*0.8*
Iron, steel and non-ferrous metals	3.5	3.8	1.8	0.4	–2.4	5.2	–6.2	*2.2*
Metal-working industry	1.5	11.8	–1.4	–4.4	–2.7	3.3	3.6	*3.5*
Paper, printing, publishing	3.8	2.3	1.8	–1.7	1.7	–1.4	0.6	*1.1*
Chemicals and rubber	1.9	6.3	0.4	2.2	–0.4	6.5	–3.1	*3.4*
Textiles, clothing and footwear	–3.2	–8.2	–0.3	–1.5	–8.9	–2.1	–2.7	*0.7*
Food, beverages, tobacco	–1.0	–5.2	2.2	1.9	2.2	2.9	–6.4	*2.0*
Building industry	3.9	5.8	1.0	–1.5	0.9	5.1	1.1	*4.3*
Market services	4.3	3.2	2.2	2.3	2.2	2.1	1.6	*54.2*
Trade and repairs	3.3	–1.5	3.7	4.3	4.9	3.7	–3.3	*11.1*
Financial services	10.0	3.3	–0.7	10.2	–5.7	1.9	2.9	*5.5*
Real estate, renting and business services	4.0	4.8	2.5	0.9	3.1	1.5	4.4	*20.2*
Transport and communications	3.3	4.3	3.2	0.5	2.1	0.6	4.2	*7.5*
Health care and social services	5.6	4.8	3.0	1.2	1.9	3.1	1.5	*6.2*
Hotels and restaurants and miscellaneous services to households	0.7	4.1	–2.0	–1.2	1.4	1.9	–4.2	*3.6*
Non-market services	1.7	2.4	0.5	1.6	1.3	0.8	0.2	*12.2*
Value added of branches, at basic prices	3.1	3.6	1.3	1.4	1.2	2.3	1.1	*89.0*
Taxes net of subsidies on products (1)	0.6	0.5	–0.4	0.3	–0.1	0.9	0.1	*11.0*
GDP	3.4	3.7	0.8	1.5	1.0	3.0	1.1	*100.0*

Source: NAI.

(1) Contribution to the change in GDP.

TABLE VI LABOUR MARKET

(annual averages, thousands of units)

	1999	2000	2001	2002	2003	2004	2005	2006 e
Population of working age[1]	6,715	6,724	6,743	6,774	6,805	6,835	6,879	6,928
Labour force	4,569	4,616	4,670	4,685	4,734	4,799	4,860	4,898
National employment	4,061	4,142	4,200	4,194	4,195	4,223	4,264	4,310
Frontier workers (balance)	49	50	50	50	50	51	51	51
Domestic employment	4,012	4,091	4,150	4,144	4,145	4,172	4,212	4,258
Self-employed	699	695	690	684	679	678	685	693
Employees	3,313	3,396	3,460	3,461	3,466	3,494	3,527	3,565
Private sector	2,577	2,656	2,711	2,696	2,691	2,706	2,742	2,774
Public sector	736	741	749	765	776	788	786	791
Unemployment[2]	508	474	470	491	538	577	596	588

Sources : FPS Economy, SMEs, Self-employed and Energy ; NAI ; NEMO ; NBB.

(1) Persons aged 15 to 64.

(2) Unemployed job-seekers, consisting of wholly unemployed persons receiving benefits, excluding older unemployed persons not seeking work, and other compulsorily or voluntarily registered job-seekers.

TABLE VII UNEMPLOYMENT RATE

(percentages of the corresponding labour force aged 15 to 64[1], annual averages)

	1999	2000	2001	2002	2003	2004	2005	Average of the first three quarters 2005	Average of the first three quarters 2006
Total	8.6	7.1	6.6	7.6	8.2	8.4	8.5	8.5	8.4
According to sex									
Women	10.5	8.7	7.5	8.7	8.9	9.6	9.6	9.6	9.4
Men	7.2	5.8	6.0	6.7	7.7	7.5	7.7	7.6	7.6
According to age									
15 to 24	21.0	17.4	16.9	17.7	21.7	21.1	21.5	21.3	20.6
25 to 54	7.4	6.1	5.6	6.6	7.1	7.4	7.4	7.4	7.4
55 to 64	5.1	3.0	3.1	3.9	2.8	3.8	4.5	4.3	4.9
According to region									
Brussels	15.9	14.0	13.0	14.7	15.8	15.9	16.5	16.5	17.7
Flanders	5.4	4.3	4.0	4.9	5.7	5.4	5.5	5.4	5.2
Wallonia	12.7	10.3	9.9	10.6	10.9	12.1	11.9	12.1	11.8
According to educational level									
Lower secondary education or less	13.6	11.1	10.0	11.7	12.4	13.3	14.1	13.9	13.8
Upper secondary education	8.0	6.8	6.7	7.3	8.4	8.5	8.5	8.6	8.3
Higher education	3.8	3.3	3.5	4.1	4.4	4.7	4.4	4.3	4.8

Sources : EC ; FPS Economy, SMEs, Self-employed and Energy.

(1) These unemployment rates are calculated on the basis of the harmonised data from the labour force survey.

TABLE VIII HARMONISED INDEX OF CONSUMER PRICES

(percentage changes compared to the corresponding period of the previous year)

	Total	Energy	Unprocessed food[1]	Underlying trend in inflation[2]	Processed food	Non-energy industrial goods	Services	*p.m. National consumer price index*	*p.m. Health index*[3]
1999	1.1	2.0	0.0	1.1	0.6	0.8	1.8	*1.1*	*0.9*
2000	2.7	16.3	0.2	1.1	1.3	0.0	2.3	*2.5*	*1.9*
2001	2.4	1.4	6.9	2.1	2.2	2.0	2.0	*2.5*	*2.7*
2002	1.6	–3.6	3.2	2.1	1.5	1.7	2.6	*1.6*	*1.8*
2003	1.5	0.2	1.7	1.7	2.8	1.0	1.9	*1.6*	*1.5*
2004	1.9	6.6	0.9	1.4	2.2	0.3	2.1	*2.1*	*1.6*
2005	2.5	12.7	1.7	1.4	2.0	0.3	2.1	*2.8*	*2.2*
2006	2.3	7.3	3.3	1.6	2.1	0.9	2.1	*1.8*	*1.8*
2006 January	2.8	15.9	2.7	1.1	1.5	0.0	2.0	*2.6*	*2.0*
February	2.8	12.9	3.0	1.6	1.0	1.1	2.2	*2.4*	*2.0*
March	2.2	10.9	–0.3	1.3	0.8	0.9	1.9	*1.7*	*1.3*
April	2.6	10.6	1.1	1.7	1.1	1.1	2.3	*2.0*	*1.7*
May	2.8	13.2	1.7	1.6	1.5	1.0	2.2	*2.2*	*1.9*
June	2.5	9.6	1.6	1.7	1.7	1.1	2.3	*1.9*	*1.7*
July	2.4	6.4	3.0	1.9	2.3	1.5	2.1	*1.6*	*1.6*
August	2.3	5.8	3.3	1.8	2.4	1.0	2.4	*1.6*	*1.7*
September	1.9	–1.0	6.7	1.9	3.0	1.0	2.3	*1.2*	*1.8*
October	1.7	–0.2	5.6	1.6	3.0	0.9	1.9	*1.2*	*1.9*
November	2.0	2.7	6.0	1.5	3.2	0.8	1.6	*1.5*	*1.8*
December	2.1	3.6	4.8	1.6	3.2	0.8	1.8	*1.6*	*1.9*

Sources: EC; FPS Economy, SMEs, Self-Employed and Energy.

(1) Fruit, vegetables, meat and fish.

(2) Measured by the HICP excluding unprocessed food and energy.

(3) National CPI excluding the products considered harmful to health, namely tobacco, alcoholic beverages, petrol and diesel.

TABLE IX INCOMES OF THE VARIOUS SECTORS AT CURRENT PRICES[1]

(millions of euro)

	1999	2000	2001	2002	2003	2004	2005	2006 e
Households								
Gross primary income	185,558	195,945	205,226	208,090	209,011	213,876	221,667	230,169
Wages and salaries[2]	125,137	130,814	138,074	143,390	146,106	150,181	155,342	161,178
Incomes from movable property[3]	25,784	28,648	29,721	27,795	25,237	25,229	26,617	27,591
Gross mixed income	23,176	24,165	24,613	24,116	24,760	25,276	25,740	26,957
Gross operating surplus	11,461	12,318	12,818	12,789	12,908	13,189	13,969	14,443
Current transfers[3]	–34,547	–37,084	–38,981	–39,588	–39,048	–39,909	–41,025	–40,452
Transfers received	51,305	52,828	55,739	58,540	60,570	63,134	65,436	67,674
Transfers paid (–)	–85,852	–89,912	–94,720	–98,128	–99,618	–103,043	–106,461	–108,127
Gross disposable income	151,011	158,860	166,245	168,502	169,963	173,966	180,642	189,717
p.m. In real terms[4]	*168,486*	*171,307*	*175,310*	*175,476*	*174,119*	*173,966*	*175,533*	*180,341*
(percentage changes compared to the previous year)	*(2.3)*	*(1.7)*	*(2.3)*	*(0.1)*	*(–0.8)*	*(–0.1)*	*(0.9)*	*(2.7)*
Companies								
Gross primary income	39,373	42,233	38,051	40,832	46,049	51,755	51,086	55,327
Gross operating surplus	48,014	52,466	51,816	54,564	57,624	64,667	66,791	72,185
Incomes from movable property[3]	–8,641	–10,233	–13,765	–13,732	–11,576	–12,912	–15,705	–16,859
Current transfers[3]	–6,280	–6,507	–6,480	–6,548	–6,370	–7,389	–8,490	–9,707
Gross disposable income	33,093	35,726	31,571	34,284	39,678	44,366	42,596	45,619
General government								
Gross primary income	17,982	19,258	19,529	22,114	23,386	26,582	28,336	30,383
Current transfers[3]	38,173	41,051	42,972	43,348	41,730	43,376	45,531	46,172
Gross disposable income	56,155	60,309	62,500	65,462	65,117	69,958	73,868	76,556
Rest of the world								
Gross disposable income	2,654	2,541	2,490	2,789	3,688	3,923	3,984	3,987
GNI	242,912	257,435	262,806	271,036	278,446	292,213	301,089	315,879

Sources : NAI, NBB.

(1) The data in this table are calculated in gross terms, i.e. before deduction of consumption of fixed capital.

(2) Remuneration (excluding that of owner entrepreneurs), including social security contributions and civil service pensions.

(3) These are net amounts, i.e. the difference between incomes or transfers received from other sectors and those paid to other sectors, excluding transfers in kind.

(4) Data deflated by means of the household final consumption expenditure deflator.

TABLE X SUMMARY OF THE TRANSACTIONS OF THE MAIN SECTORS OF THE ECONOMY AT CURRENT PRICES[1]

(millions of euro)

	1999	2000	2001	2002	2003	2004	2005	2006 e
1. Households								
1.1 Gross disposable income	151,011	158,860	166,245	168,502	169,963	173,966	180,642	189,717
p.m. Gross adjusted disposable income	*181,995*	*191,130*	*200,453*	*204,508*	*208,123*	*214,424*	*222,773*	*233,270*
1.2 Change in net equity of households in pension funds reserves	1,569	1,549	1,607	1,541	1,716	2,048	2,110	2,245
1.3 Final consumption expenditure	126,369	135,726	140,300	143,227	146,889	152,804	158,673	166,091
p.m. Actual final consumption	*157,354*	*167,995*	*174,507*	*179,233*	*185,049*	*193,262*	*200,804*	*209,644*
1.4 Gross savings (1.1 + 1.2 – 1.3)	26,210	24,683	27,553	26,816	24,790	23,210	24,079	25,871
p.m. Percentages of gross disposable income[2]	*17.2*	*15.4*	*16.4*	*15.8*	*14.4*	*13.2*	*13.2*	*13.5*
p.m. Percentages of gross adjusted disposable income[2]	*14.3*	*12.8*	*13.6*	*13.0*	*11.8*	*10.7*	*10.7*	*11.0*
1.5 Capital transfers[3]	25	–361	–569	–543	–819	–1,272	–1,269	–1,473
1.6 Gross capital formation	13,316	13,987	13,543	14,228	14,478	15,964	16,761	18,332
1.7 Financing balance (1.4 + 1.5 – 1.6)	12,919	10,336	13,440	12,045	9,493	5,974	6,049	6,066
2. Companies								
2.1 Gross disposable income	33,093	35,726	31,571	34,284	39,678	44,366	42,596	45,619
2.2 Change in net equity of households in pension funds reserves	–1,565	–1,547	–1,606	–1,540	–1,721	–2,045	–2,109	–2,250
2.3 Gross savings (2.1 + 2.2)	31,527	34,179	29,965	32,744	37,958	42,321	40,486	43,369
2.4 Capital transfers[3]	1,376	1,461	645	984	–1,940	654	1,207	2,376
2.5 Gross fixed capital formation	31,102	33,478	34,839	32,613	32,531	35,472	36,871	39,481
2.6 Change in stocks	1,186	2,554	281	134	890	2,740	3,445	4,704
2.7 Financing balance (2.3 + 2.4 – 2.5 – 2.6), NAI's point of view[4]	616	–393	–4,509	980	2,597	4,764	1,377	1,561
3. General government								
3.1 Gross disposable income	56,155	60,309	62,500	65,462	65,117	69,958	73,868	76,556
p.m. Gross adjusted disposable income	*25,171*	*28,039*	*28,292*	*29,456*	*26,956*	*29,501*	*31,737*	*33,002*
3.2 Change in net equity of households in pension funds reserves	–3	–2	–1	–1	5	–3	–1	5
3.3 Final consumption expenditure	51,252	53,678	56,378	60,303	63,163	66,177	68,496	70,856
p.m. Actual final consumption	*20,267*	*21,409*	*22,170*	*24,297*	*25,003*	*25,720*	*26,365*	*27,302*
3.4 Gross savings (3.1 + 3.2 – 3.3)	4,900	6,628	6,121	5,158	1,958	3,778	5,371	5,706
3.5 Capital transfers[3]	–1,427	–1,586	–418	–808	2,604	562	–94	–488
3.6 Gross fixed capital formation	4,658	4,934	4,399	4,446	4,547	4,667	5,304	5,191
3.7 Change in stocks	14	2	–15	29	20	–46	45	45
3.8 Financing balance according to the ESA 95 (3.4 + 3.5 – 3.6 – 3.7), NAI's point of view[4]	–1,198	106	1,319	–126	–5	–281	–72	–18
p.m. Financing balance according to the EDP[5], NAI's point of view[4]	*–1,180*	*211*	*1,458*	*7*	*123*	*–28*	*308*	*176*
p.m. Financing balance according to the EDP[5], Eurostat's point of view[4]	*–1,180*	*211*	*1,458*	*7*	*123*	*–28*	*–6,858*	*316*
4. Total of domestic sectors								
4.1 Financing balance (1.7 + 2.7 + 3.8)	12,337	10,050	10,250	12,899	12,085	10,457	7,354	7,610

Sources : NAI, NBB.

(1) The data in this table are calculated in gross terms, i.e. before deduction of consumption of fixed capital.

(2) Disposable income, including changes in the net equity of households in pension funds reserves.

(3) These are net amounts, i.e. the difference between transfers received from other sectors and those paid to other sectors, including net acquisitions of non-financial non-produced assets and net acquisitions of valuables.

(4) According to the NAI's point of view, the Railway Infrastructure Fund (RIF), set up in the context of the BNRC restructuring on 1 January 2005, comes under the non-financial corporations sector. According to Eurostat's point of view, the Fund is classified under the general government sector and the assumption of BNRC debt should be recorded as a capital transfer from the general government sector to the non-financial corporations sector.

(5) The ESA 95 methodology was adapted in 2001 to exclude from the calculation of the overall balance the net interest gains on certain financial transactions, such as swaps and forward rate agreements (FRAs). However, this adjustment is not taken into account for the purpose of the excessive deficit procedure (EDP) or for the EC's assessment of the stability programmes.

TABLE XI REVENUE, EXPENDITURE AND FINANCING BALANCE OF GENERAL GOVERNMENT

(millions of euro; according to the NAI's point of view, unless otherwise stated[1])

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006 e
Revenue[2]	108,267	113,531	118,126	123,657	128,460	133,256	140,434	142,336	148,986	153,470
Fiscal and parafiscal revenue	97,320	102,445	106,585	111,764	115,064	119,519	121,433	128,526	133,893	138,571
Levies weighing chiefly on earned income	58,981	61,651	63,598	66,837	70,102	72,689	73,763	76,206	78,335	79,277
Personal income tax[3]	27,040	28,379	29,032	31,131	32,712	33,440	33,677	34,900	36,069	35,611
Social security contributions[4]	31,941	33,271	34,566	35,706	37,390	39,249	40,085	41,306	42,266	43,666
Taxes on profits of companies[5]	6,259	7,760	7,702	8,089	8,091	8,142	7,912	9,210	10,222	11,547
Levies on other income and in respect of property[6]	7,613	7,981	7,982	8,526	8,700	9,052	9,518	10,416	11,143	11,565
Taxes on goods and services	24,468	25,053	27,304	28,312	28,171	29,637	30,241	32,693	34,192	36,182
Non-fiscal and non-parafiscal revenue[7]	10,947	11,086	11,541	11,893	13,396	13,737	19,001	13,810	15,094	14,899
Expenditure excluding interest charges	95,782	98,473	102,991	106,842	110,294	117,928	125,738	128,721	136,021	140,556
Social insurance benefits	48,681	50,127	51,680	53,737	56,506	59,654	63,129	66,670	68,873	71,083
Replacement incomes	28,685	29,403	30,023	30,748	32,120	34,291	35,809	37,383	38,726	39,900
Pensions	19,087	19,710	20,250	20,968	21,866	22,942	23,810	24,806	25,793	26,707
Private sector pensions	13,458	13,810	14,149	14,549	15,110	15,722	16,253	16,690	17,336	17,971
General government pensions	5,629	5,900	6,101	6,418	6,757	7,220	7,558	8,116	8,457	8,736
Old persons' guaranteed income	233	231	227	249	258	258	264	283	276	284
Early retirement pensions	1,308	1,254	1,215	1,163	1,153	1,144	1,184	1,239	1,255	1,298
Unemployment benefits	4,475	4,520	4,504	4,381	4,637	5,356	5,745	6,069	6,169	6,109
Career breaks and time credit	138	160	197	236	274	352	432	488	552	606
Sickness and disability insurance benefits	2,547	2,635	2,722	2,840	3,023	3,208	3,366	3,486	3,649	3,826
Industrial accidents and occupational diseases	489	494	485	486	489	495	494	495	500	511
Integration allowance	409	399	424	426	420	536	514	517	532	559
Other social insurance benefits[8]	19,996	20,724	21,657	22,989	24,386	25,364	27,320	29,288	30,147	31,183
of which:										
Health care	11,925	12,521	13,208	13,999	15,027	15,372	16,743	18,253	18,707	19,343
Family allowances	4,179	4,241	4,261	4,324	4,433	4,564	4,664	4,755	4,873	5,054
Other primary expenditure	47,101	48,346	51,312	53,105	53,788	58,274	62,609	62,051	67,148	69,473
Compensation of employees	26,082	26,836	28,032	29,039	30,326	32,532	33,765	34,691	36,198	37,412
Current purchases of goods and services	7,167	7,472	7,779	8,196	8,690	10,100	10,295	10,617	10,764	11,248
Subsidies to enterprises	2,583	2,845	3,046	3,199	3,335	3,345	3,823	3,539	4,982	5,626
Current transfers to the rest of the world	1,637	1,791	2,018	2,006	2,167	2,427	2,758	3,085	3,201	3,266
Other current transfers	2,834	2,853	2,879	2,871	3,044	3,177	3,386	3,577	3,894	3,977
Gross fixed capital formation	3,819	3,838	4,658	4,934	4,399	4,446	4,547	4,667	5,304	5,191
Other capital expenditure	2,980	2,711	2,900	2,860	1,828	2,247	4,034	1,875	2,804	2,753
Net amount excluding interest charges	12,485	15,058	15,134	16,815	18,166	15,328	14,696	13,615	12,966	12,914
Interest charges	17,034	16,906	16,332	16,709	16,847	15,454	14,701	13,896	13,038	12,932
Financing balance according to the ESA 95, NAI's point of view[1]	–4,549	–1,848	–1,198	106	1,319	–126	–5	–281	–72	–18
p.m. Financing balance according to the EDP[9], NAI's point of view[1]	*–4,531*	*–1,762*	*–1,180*	*211*	*1,458*	*7*	*123*	*–28*	*308*	*176*
p.m. Financing balance according to the EDP[9], Eurostat's point of view[1]	*–4,531*	*–1,762*	*–1,180*	*211*	*1,458*	*7*	*123*	*–28*	*–6,858*	*316*

Sources: EC, NAI, NBB.

(1) According to the NAI's point of view, the Railway Infrastructure Fund (RIF), set up in the context of the BNRC restructuring on 1 January 2005, comes under the non-financial corporations sector. According to Eurostat's point of view, the Fund is classified under the general government sector and the assumption of BNRC debt should be recorded as a capital transfer from the general government sector to the non-financial corporations sector.

(2) In accordance with the ESA 95, general government revenues do not include the tax revenues transferred to the EU.

(3) Mainly withholding tax on earned income, advance payments, assessments and proceeds of additional percentages on personal income tax.

(4) Total social contributions, including the special social security contribution and the contributions of non-active persons.

(5) Mainly advance payments, assessments and the withholding tax on income from movable property payable by companies.

(6) Mainly the withholding tax on income from movable property payable by households, the withholding tax on income from immovable property (including proceeds of additional percentages), inheritance taxes and registration fees.

(7) Property incomes, imputed social security contributions, current and capital transfers from other sectors and sales of produced goods and services.

(8) Apart from the two main sub-categories mentioned in the table, this item also includes mainly allowances to handicapped persons and transfers to the institutions accommodating them, payments by subsistence funds and pensions to war victims.

(9) The ESA 95 methodology was adapted in 2001 to exclude from the calculation of the overall balance the net interest gains on certain financial transactions, such as swaps and forward rate agreements (FRAs). However, this adjustment is not taken into account for the purpose of the excessive deficit procedure (EDP) or for the EC's assessment of the stability programmes.

TABLE XII FINANCING BALANCE OF GENERAL GOVERNMENT, BY SUB-SECTORS

(millions of euro; according to the NAI's point of view, unless otherwise stated[1])

	Entity I			Entity II			General government		
	Federal government	Social security	Total	Communities and regions	Local authorities	Total	According to the ESA 95, NAI's point of view[1]	*p.m. According to the EDP[2], NAI's point of view*[1]	*p.m. According to the EDP[2], Eurostat's point of view*[1]
1997	–5,293	754	–4,540	–271	261	–10	–4,549	*–4,531*	*–4,531*
1998	–3,638	872	–2,765	696	222	918	–1,848	*–1,762*	*–1,762*
1999	–3,718	1,554	–2,164	921	45	966	–1,198	*–1,180*	*–1,180*
2000	–1,123	1,345	223	610	–727	–117	106	*211*	*211*
2001	–2,257	1,795	–462	1,953	–172	1,781	1,319	*1,458*	*1,458*
2002	–628	1,360	732	–382	–476	–858	–126	*7*	*7*
2003	795	–704	91	90	–186	–96	–5	*123*	*123*
2004	–450	–109	–559	667	–389	278	–281	*–28*	*–28*
2005	–577	159	–418	809	–463	346	–72	*308*	*–6,858*
2006 e	–641	625	–16	594	–596	–2	–18	*176*	*316*

Sources: EC, NAI, NBB.

(1) According to the NAI's point of view, the Railway Infrastructure Fund (RIF), set up in the context of the BNRC restructuring on 1 January 2005, comes under the non-financial corporations sector. According to Eurostat's point of view, the Fund is classified under the general government sector and the assumption of BNRC debt should be recorded as a capital transfer from the general government sector to the non-financial corporations sector.

(2) The ESA 95 methodology was adapted in 2001 to exclude from the calculation of the overall balance the net interest gains on certain financial transactions, such as swaps and forward rate agreements (FRAs). However, this adjustment is not taken into account for the purpose of the excessive deficit procedure (EDP) or for the EC's assessment of the stability programmes.

TABLE XIII CONSOLIDATED GROSS DEBT OF GENERAL GOVERNMENT[1]

(end-of-period outstanding amounts, millions of euro; according to the NAI's point of view, unless otherwise stated[2])

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
1. Official debt of the Treasury	243,082	241,903	246,755	251,061	257,163	262,752	263,018	265,518	269,160	270,601
In national currency[3]	223,637	224,523	236,314	242,455	250,085	257,288	259,295	263,074	267,420	269,145
At up to one year	47,894	41,888	36,553	33,310	34,851	31,115	30,222	30,355	31,036	32,243
At over one year	175,743	182,635	199,762	209,144	215,234	226,173	229,073	232,719	236,384	236,902
In foreign currencies	19,444	17,380	10,441	8,606	7,079	5,464	3,724	2,444	1,740	1,456
2. Components of the official debt of the Treasury not included in the consolidated gross debt[4]	3,274	3,321	4,595	5,429	4,572	3,996	3,459	0	0	0
3. Other federal government liabilities[5]	12,729	12,640	12,982	11,533	14,034	13,843	8,453	7,685	7,212	n.
4. Consolidation between federal government units[6]	2,978	3,116	3,792	4,189	7,745	12,974	17,358	21,246	22,649	n.
of which: Ageing Fund assets[7]	–	–	–	–	374	1,087	4,266	12,492	13,504	14,661
5. Consolidated gross debt of federal government (1 – 2 + 3 – 4)	249,558	248,105	251,351	252,975	258,881	259,624	250,654	251,957	253,724	n.
6. Consolidated gross debt of communities and regions	19,993	19,416	18,376	17,165	16,800	16,878	15,694	15,358	13,586	n.
7. Consolidated gross debt of local authorities	11,769	12,121	12,163	13,213	13,686	14,011	14,481	15,354	15,480	n.
8. Consolidated gross debt of social security	2,117	1,774	1,429	1,237	0	103	90	52	428	n.
9. Consolidation between the general government sub-sectors[8]	12,945	12,590	12,640	13,300	14,032	14,263	10,128	9,752	10,169	n.
10. Consolidated gross debt of general government[1] (5 + 6 + 7 + 8 – 9)	270,493	268,827	270,679	271,291	275,334	276,352	270,791	272,969	273,048	274,431 e
p.m. Consolidated gross debt of general government according to Eurostat's point of view[2]	*270,493*	*268,827*	*270,679*	*271,291*	*275,334*	*276,352*	*270,791*	*272,969*	*278,294*	*279,536 e*

Sources: EC, FPS Finance, NBB.

(1) Concept of debt as defined in Council Regulation (EC) No 3605/93 of 22 November 1993 on the application of the Protocol on the excessive deficit procedure annexed to the Treaty establishing the European Community.

(2) According to the NAI's point of view, the RIF, set up in the context of the BNRC restructuring on 1 January 2005, comes under the non-financial corporations sector. According to Eurostat's point of view, that Fund is classified in the general government sector.

(3) In Belgian franc up to the end of 1998 and in euro thereafter.

(4) Mainly Treasury certificates presented to the IMF.

(5) Mainly the debudgeted Treasury debt, the debts of SHLAF, the Deposit and Consignment Office, and – until 2002 – CREDIBE, and coins in circulation.

(6) Federal government debt, the counterpart of which is an asset of a federal government unit.

(7) Including the capitalised interest on "Ageing Fund Treasury Bonds".

(8) Debt of a general government sub-sector, the counterpart of which is an asset of another general government sub-sector.

TABLE XIV CURRENT AND CAPITAL TRANSACTIONS ON A TRANSACTION BASIS

(millions of euro)

	2004			2005			First nine months 2006		
	Credits	Debits	Balances	Credits	Debits	Balances	Credits	Debits	Balances
1. Total current transactions on a transaction basis	285,603	275,449	10,154	310,123	302,621	7,502	248,706	244,284	4,422
Goods and services	239,785	229,040	10,745	256,172	247,795	8,377	204,071	199,961	4,110
Goods	197,389	189,561	7,828	211,311	206,625	4,686	168,753	166,640	2,113
General merchandise	183,744	177,868	5,876	197,881	195,338	2,543	158,091	157,659	432
Goods for processing	12,023	10,910	1,113	11,531	10,317	1,214	8,828	7,933	895
Repairs to goods	225	170	55	310	208	102	243	171	72
Purchases of goods in ports	1,325	428	897	1,427	505	922	1,246	488	758
Non-monetary gold	72	185	–113	162	257	–95	345	389	–44
Services	42,396	39,479	2,917	44,861	41,170	3,691	35,318	33,321	1,997
Transport	10,489	8,900	1,589	11,160	9,904	1,256	8,667	7,673	994
Travel	7,423	11,275	–3,852	7,926	11,943	–4,017	6,987	10,684	–3,697
Communications services	1,790	1,282	508	1,774	1,069	705	1,312	982	330
Construction services	1,520	906	614	1,532	698	834	1,162	543	619
Insurance services	689	498	191	671	409	262	569	342	227
Financial services	2,394	2,584	–190	2,729	2,816	–87	2,125	2,035	90
Data-processing and information services	1,963	1,612	351	2,128	1,504	624	1,712	1,177	535
Royalties and licence fees	821	836	–15	892	890	2	853	596	257
Other services to enterprises	13,269	10,577	2,692	13,867	10,948	2,919	10,272	8,492	1,780
of which: merchanting (net)	1,234	–	1,234	1,468	–	1,468	958	–	958
Personal, cultural and recreational services	364	397	–33	419	366	53	318	252	66
Services provided or received by general government, not included elsewhere	1,674	612	1,062	1,763	623	1,140	1,341	545	796
Income	39,441	34,802	4,639	46,501	42,252	4,249	39,739	35,050	4,689
Earned income	5,258	1,606	3,652	5,446	1,619	3,827	3,990	1,149	2,841
Income from direct and portfolio investment	34,183	33,196	987	41,055	40,633	422	35,749	33,901	1,848
Current transfers	6,377	11,607	–5,230	7,450	12,574	–5,124	4,896	9,273	–4,377
General government	2,010	5,859	–3,849	2,660	6,429	–3,769	1,420	5,009	–3,589
Other sectors	4,367	5,748	–1,381	4,790	6,145	–1,355	3,476	4,264	–788
2. Total capital transactions	318	712	–394	319	993	–674	271	905	–634
Capital transfers	273	517	–244	314	822	–508	133	515	–382
Acquisitions and sales of non-produced non-financial assets	45	195	–150	5	171	–166	138	390	–252
3. Net lending to the rest of the world (1 + 2)	285,921	276,161	9,760	310,442	303,614	6,828	248,977	245,189	3,788

Source: NBB.

TABLE XV FORMATION OF FINANCIAL ASSETS AND NEW FINANCIAL LIABILITIES OF HOUSEHOLDS

(millions of euro)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	First nine months 2005	First nine months 2006	*p.m. Outstanding amount at the end of September 2006*
Formation of financial assets	27,468	27,933	20,878	16,808	17,329	17,444	16,084	20,583	19,784	15,841	14,011	*781,416*
At up to one year	6,234	3,914	–600	382	9,295	3,129	10,704	19,900	13,385	5,407	7,568	*232,583*
Notes, coins and sight deposits	1,289	1,236	3,775	2,117	–3,606	4,383	3,537	6,752	6,058	2,534	1,288	*53,313*
Savings deposits	7,881	4,520	3,422	–5,129	5,554	11,543	17,934	14,180	8,335	4,814	1,245	*149,805*
Time deposits	61	300	–7,138	3,621	5,726	–11,989	–8,577	–1,724	–1,719	–2,180	6,247	*25,090*
Fixed-income securities	–853	–484	–135	252	575	–1,258	–357	–244	–113	–76	186	*581*
Units of monetary UCIs	–2,145	–1,660	–524	–479	1,046	450	–1,832	937	824	315	–1,399	*3,795*
At over one year	17,691	30,798	25,307	18,632	16,573	7,789	8,403	7,106	9,647	15,631	11,089	*552,095*
Time deposits	271	–279	–279	–467	223	–503	–627	–371	–637	–558	6	*3,024*
Fixed-income securities	–1,847	–15	5,644	818	–4,092	–8,536	–15,437	–16,720	–14,387	–8,781	–6,404	*75,573*
Shares and other equity	2,807	5,363	1,568	–1,360	776	2,861	–916	727	–7,087	3,321	231	*155,293*
Units of non-monetary UCIs	9,282	17,558	10,143	8,079	9,036	3,589	9,879	5,847	9,239	7,955	6,900	*131,452*
Insurance technical reserves[1]	7,178	8,172	8,232	11,562	10,630	10,379	15,504	17,623	22,519	13,694	10,356	*186,752*
Other assets and statistical adjustments[2]	3,544	–6,778	–3,830	–2,207	–8,539	6,526	–3,023	–6,423	–3,248	–5,197	–4,646	*–3,262*
New financial liabilities	5,801	6,299	5,355	2,121	–2,167	4,137	5,540	6,277	11,918	7,748	8,358	*144,760*
Loans at up to one year	–29	581	1,601	–659	–1,203	280	–998	–167	830	523	61	*5,950*
Loans at over one year	5,519	5,141	3,040	3,191	557	4,331	6,505	5,864	11,415	8,078	9,147	*131,685*
Mortgage loans	3,456	2,568	5,473	2,360	394	4,947	6,165	6,333	10,037	6,834	8,236	*106,629*
Instalment loans	692	1,399	326	588	354	325	–208	–481	648	567	524	*11,458*
Other	1,372	1,174	–2,759	243	–191	–941	548	12	731	678	387	*13,598*
Other liabilities[3]	311	577	714	–410	–1,521	–474	34	580	–328	–853	–849	*7,125*
Financial balance[4]	21,667	21,634	15,523	14,687	19,496	13,307	10,544	14,307	7,867	8,093	5,653	*636,656*

Source : NBB.

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

(2) This item covers, in so far as they can be recorded, financial derivatives and miscellaneous assets on financial institutions, including interest accrued and not due. It also covers errors and omissions on Belgium's financial account with the rest of the world. To maintain consistency between the accounts, these are regarded as unrecorded capital movements.

(3) This item comprises other accounts payable within the meaning of the ESA 95, such as taxes or contributions due but not yet paid, or interest accrued and not due.

(4) The balances of the financial accounts of the domestic sectors do not correspond to the net financing capacities or requirements as recorded in the real accounts, owing to the differences between the dates of recording of the transactions in these two accounts, statistical adjustments or errors and omissions. Thus, for example, the financial accounts cannot, for lack of data, record most of the trade credits and advances.

TABLE XVI FORMATION OF FINANCIAL ASSETS AND NEW FINANCIAL LIABILITIES OF NON-FINANCIAL CORPORATIONS

(millions of euro)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	First nine months 2005	First nine months 2006	*p.m. Outstanding amount at the end of September 2006*
Formation of financial assets	34,890	34,751	44,264	80,600	60,500	27,003	59,011	23,653	13,981	12,604	40,327	*886,666*
At up to one year	12,180	31,271	30,675	49,384	44,481	2,185	39,789	–8,314	28,135	18,602	19,782	*318,052*
Notes, coins and sight deposits	1,617	3,431	865	156	502	805	1,916	1,473	2,148	985	–1,206	*30,957*
Other deposits	–1,273	2,096	8,180	–2,749	1,806	6,135	–146	3,606	–1,579	–5,913	21,287	*63,877*
Other (1)	11,836	25,743	21,629	51,977	42,173	–4,756	38,019	–13,394	27,567	23,530	–298	*223,218*
At over one year	11,723	9,382	8,952	33,807	11,642	18,734	22,218	29,613	–477	2,207	34,533	*605,831*
Shares and other equity (2)	–772	7,263	1,094	19,437	4,306	–2,825	–703	17,364	11,073	9,012	8,705	*443,151*
Fixed-income securities	1,807	1,011	–329	–922	–156	2,038	–1,546	–1,236	2,361	504	–1,328	*7,180*
Other (1)	10,688	1,108	8,187	15,292	7,492	19,521	24,467	13,486	–13,912	–7,309	27,157	*155,500*
Other assets and statistical adjustments (3)	10,987	–5,902	4,638	–2,591	4,378	6,085	–2,996	2,354	–13,677	–8,204	–13,988	*–37,217*
New financial liabilities	39,567	41,881	46,678	82,039	70,431	27,559	56,700	26,919	11,995	6,545	33,555	*1,177,141*
At up to one year	16,174	24,342	19,354	39,417	25,663	–4,429	23,127	–11,670	15,578	12,812	–1,717	*223,311*
Loans granted by credit institutions	1,804	5,720	5,441	590	–1,276	–551	–2,392	2,428	–6,345	–4,089	4,411	*54,304*
Other loans (1)	14,078	17,916	12,480	35,682	25,433	–5,021	23,509	–13,442	24,241	18,741	–4,914	*163,367*
Fixed-income securities	292	706	1,433	3,146	1,506	1,143	2,009	–657	–2,319	–1,840	–1,214	*5,640*
At over one year	23,131	16,383	25,786	42,272	44,161	33,231	32,810	38,416	–3,211	–5,961	34,432	*943,316*
Loans granted by credit institutions	2,444	2,283	4,229	4,549	3,979	2,239	–4,558	1,839	6,042	3,231	–2,743	*60,992*
Other loans (1)	10,581	1,012	7,154	12,442	6,536	20,354	24,847	7,793	–14,209	–9,131	2,655	*125,158*
Shares and other equity (2)	9,884	11,818	12,968	25,876	27,955	9,010	5,716	22,680	8,982	3,201	32,109	*728,428*
Fixed-income securities	222	1,271	1,436	–595	5,691	1,628	6,805	6,104	–4,026	–3,262	2,412	*28,738*
Other liabilities (4)	261	1,155	1,538	350	606	–1,243	764	173	–372	–306	840	*10,515*
Financial balance (5)	–4,677	–7,130	–2,413	–1,439	–9,931	–556	2,311	–3,266	1,986	6,059	6,772	*–290,475*

Source: NBB.

(1) Including intrasectoral loans of non-financial corporations.

(2) Including profits made on foreign direct investments.

(3) See note 2 to table XV.

(4) This item comprises the technical reserves of non-autonomous pension funds and other accounts payable within the meaning of the ESA 95, such as taxes or contributions due but not yet paid, or interest accrued and not due.

(5) See note 4 to table XV.

TABLE XVII FORMATION OF FINANCIAL ASSETS AND NEW FINANCIAL LIABILITIES OF GENERAL GOVERNMENT

(millions of euro)

	1997	1998	1999	2000	2001	2002	2003	2004	2005 [1]	First nine months 2005	First nine months 2006	*p.m. Outstanding amount at the end of September 2006*
Formation of financial assets	–1,077	–878	1,810	1,223	5,130	4,553	–4,319	3,583	2,893	–1,087	–2,158	*76,584*
Deposits, loans and securities other than shares	415	55	1,575	1,496	3,289	5,176	–3,932	3,744	3,221	–926	–2,645	*38,511*
With general government	2,161	38	516	1,154	4,400	5,556	1,678	3,621	1,746	–2,559	–3,726	*29,262*
With other sectors	–1,746	17	1,059	342	–1,112	–380	–5,610	123	1,474	1,633	1,081	*9,249*
Other assets [2]	–1,492	–933	235	–273	1,841	–624	–387	–161	–327	–161	487	*38,073*
New financial liabilities	3,891	1,466	2,777	2,076	4,900	5,733	–4,546	4,145	2,560	2,155	2,189	*320,587*
In national currency [3]	3,919	3,535	2,881	3,926	6,276	6,947	–3,264	5,505	3,259	964	1,173	*317,925*
At up to one year	820	–4,942	–5,317	–4,630	–520	206	–229	–1,632	906	–351	3,082	*50,634*
of which :												
Treasury certificates	550	–5,832	–6,807	–3,483	1,383	57	–840	–143	853	2,770	3,807	*30,680*
Other securities	723	1,147	–221	–795	–1,959	–82	594	–504	–160	–126	359	*2,396*
At over one year	3,100	8,477	8,198	8,555	6,796	6,741	–3,035	7,138	2,353	1,315	–1,910	*267,291*
of which :												
Linear bonds	4,329	8,552	14,455	15,073	12,570	11,628	7,790	4,968	4,125	3,015	–1,114	*213,124*
Other securities	347	318	–5,415	–6,427	–6,442	–5,778	–9,654	–5,929	–2,370	–2,000	–942	*13,265*
In foreign currencies	–29	–2,069	–105	–1,849	–1,377	–1,214	–1,282	–1,361	–699	1,191	1,017	*2,662*
At up to one year	–604	–887	1,517	–397	372	–164	–762	–50	–329	1,561	1,017	*1,584*
At over one year	575	–1,183	–1,622	–1,452	–1,748	–1,050	–520	–1,310	–370	–370	0	*1,078*
Financial balance [4]	–4,967	–2,345	–966	–853	230	–1,180	227	–562	333	–3,241	–4,347	*–244,003*

Source : NBB.

(1) Data compiled according to the NAI's point of view, whereby the RIF is treated as a non-financial corporation rather than as a government authority in accordance with Eurostat's point of view. In 2005, both the formation of financial assets and the new financial liabilities of general government were influenced by operations concerning the assumption of BNRC debt by the RIF. They consisted in the State's refinancing of part of the debt in the sum of 1.9 billion euro, and the registration of a claim on the RIF for a corresponding amount. There was therefore no effect on the financial balance.

(2) Shares and other equity, units of UCIs, financial derivatives and other accounts receivable.

(3) In Belgian franc up to the end of 1998 and in euro thereafter.

(4) See note 4 to table XV.

TABLE XVIII FORMATION OF FINANCIAL ASSETS AND NEW FINANCIAL LIABILITIES OF MONETARY FINANCIAL INSTITUTIONS [1]

(data on a territorial basis, millions of euro)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	First nine months 2005	First nine months 2006	*p.m. Outstanding amount at the end of September 2006*
Formation of financial assets												
Interbank claims	–2,886	–536	5,672	–47,874	317	15,680	59,190	47,997	58,477	50,997	–781	*355,081*
Belgian MFIs	–6,134	2,055	4,118	–26,509	–5,436	–6,903	8,112	7,087	16,026	10,557	–6,476	*57,781*
Foreign MFIs	3,248	–2,591	1,554	–21,366	5,753	22,583	51,078	40,910	42,451	40,440	5,696	*297,300*
Loans [2]	3,583	6,519	15,448	12,484	14,280	21,091	14,943	19,465	51,718	26,897	1,030	*360,338*
of which:												
Households	5,146	4,913	4,999	2,051	76	3,284	5,625	6,734	13,367	9,796	9,498	*123,590*
Non-financial corporations	1,440	3,151	5,510	2,271	1,700	–1,421	–7,660	–1,533	1,201	–831	862	*80,381*
Fixed-income securities	8,196	1,591	14,142	–12,309	28,201	–11,605	1,888	8,650	11,292	3,497	–1,326	*239,194*
of which:												
General government	514	1,245	–12,560	–18,540	–9,405	–8,062	–8,226	–5,683	–545	–3,524	–1,564	*65,417*
Rest of the world	8,551	3,428	25,291	5,917	38,209	–2,421	9,753	14,083	12,601	8,220	894	*169,382*
Other assets	6,388	5,534	9,513	9,238	4,381	–1,538	8,382	29,282	9,640	12,224	17,344	*155,286*
Total	15,281	13,108	44,774	–38,462	47,180	23,628	84,403	105,394	131,128	93,615	16,267	*1,109,899*
Households	5,153	4,940	5,265	1,803	–1,777	3,082	5,665	6,718	13,345	9,870	9,581	*125,114*
Non-financial corporations	2,780	3,862	5,590	3,424	1,540	–4,263	–6,388	–2,266	1,107	–1,050	1,676	*85,811*
General government	–2,405	973	–12,759	–19,214	–11,307	–9,397	–7,858	–6,155	–917	–3,524	–1,252	*92,494*
Financial institutions	–5,143	174	10,500	–22,902	–4,507	–5,477	22,944	27,971	13,800	4,719	16,146	*166,038*
Rest of the world	14,896	3,160	36,177	–1,572	63,230	39,683	70,040	79,125	103,793	83,600	–9,884	*640,442*
New financial liabilities												
Interbank liabilities	–5,875	3,202	17,513	–57,890	17,583	786	57,646	48,154	89,387	61,199	8,936	*436,333*
Belgian MFIs	–6,134	2,055	4,118	–26,509	–5,436	–6,903	8,112	7,087	16,026	10,557	–6,476	*57,781*
Foreign MFIs	259	1,147	13,394	–31,381	23,019	7,689	49,534	41,067	73,361	50,642	15,413	*378,552*
Cash and deposits [2]	17,614	18,884	16,814	4,808	27,834	22,917	21,277	40,011	47,649	33,767	3,638	*450,604*
of which:												
Households	8,464	7,595	3,927	303	5,820	7,219	10,622	15,513	13,739	5,525	5,389	*204,807*
Non-financial corporations	1,751	2,751	2,141	–395	2,151	5,069	1,375	–239	1,028	–1,152	6,419	*62,448*
Fixed-income securities	–7,517	–12,447	–602	4,792	–5,777	–4,119	–8,900	–5,499	–9,558	–10,002	423	*52,120*
Savings notes	–8,532	–7,332	–5,905	–3,051	–4,790	–4,033	–6,976	–7,357	–7,280	–5,911	–2,126	*28,915*
Other fixed-income securities	1,014	–5,115	5,303	7,843	–987	–86	–1,924	1,858	–2,278	–4,091	2,549	*23,205*
Other liabilities and statistical adjustments [3]	11,060	3,469	11,050	9,828	7,539	4,043	14,379	22,728	3,650	8,650	3,269	*170,841*
Total	15,281	13,108	44,774	–38,462	47,180	23,628	84,403	105,394	131,128	93,615	16,267	*1,109,898*
Households	–1,859	494	2,101	–543	–1,842	5,122	3,771	6,713	6,187	–6	8,544	*254,787*
Non-financial corporations	7,109	–14,401	10,439	–3,938	5,921	7,049	449	–3,295	–182	–6,884	7,709	*38,018*
General government	–2,027	–1,975	–991	296	9	–1,218	–91	–309	–34	165	939	*12,348*
Financial institutions	–1,934	23,493	13,922	–19,056	–1,697	–7,469	22,648	37,038	20,476	10,365	–504	*231,531*
Rest of the world	13,993	5,496	19,304	–15,220	44,789	20,145	57,627	65,247	104,681	89,975	–421	*573,215*

Source: NBB.

(1) Credit institutions, monetary UCIs and monetary authorities.

(2) Other than those included in interbank transactions.

(3) Statistical adjustments are due to the equalisation of the total of financial assets and liabilities, Belgian MFIs being treated as pure financial intermediaries.

TABLE XIX FORMATION OF ASSETS AND NEW LIABILITIES OF NON-MONETARY FINANCIAL INSTITUTIONS

(millions of euro)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	First nine months 2005	First nine months 2006	*p.m. Outstanding amount at the end of September 2006*
Non-monetary UCIs												
Formation of financial assets	6,106	13,709	14,850	18,524	12,110	3,886	4,029	6,240	6,492	5,466	7,443	*118,125*
Deposits	2,649	5,091	5,291	1,264	2,041	2,957	2,390	1,994	1,860	2,562	778	*30,549*
Fixed-income securities	1,604	2,278	2,023	4,281	1,529	203	–487	4,728	–1,123	–717	1,538	*23,138*
Shares and other equity (1)	962	3,749	5,768	9,630	5,444	1,753	338	–2,465	414	–908	–389	*38,154*
UCI units	662	1,770	2,255	3,334	1,962	–2,653	204	–5	5,856	4,579	4,781	*19,375*
Other assets	229	821	–487	15	1,134	1,627	1,583	1,988	–515	–50	736	*6,909*
New financial liabilities	6,106	13,709	14,850	18,524	12,110	3,886	4,029	6,240	6,492	5,466	7,443	*118,125*
UCI units held by Belgian households	5,472	12,503	11,944	11,046	8,820	5,237	5,905	4,265	1,209	1,414	3,569	*86,561*
UCI units held by other investors	633	1,206	2,906	7,478	3,290	–1,350	–1,876	1,975	5,283	4,053	3,874	*31,564*
Insurance companies and pension funds												
Formation of financial assets	6,176	6,872	9,222	8,994	9,971	10,508	16,405	20,418	22,480	14,437	11,422	*217,187*
Deposits	317	–561	599	296	420	1,748	3,311	2,589	63	–3	–2,557	*10,169*
Fixed-income securities	2,785	3,483	4,170	363	3,115	1,733	11,729	14,867	16,002	14,247	8,952	*109,923*
Loans	–427	–604	87	157	551	376	–87	–104	–645	–470	891	*10,979*
Shares and other equity	3,263	4,093	–36	514	518	3,470	–1,250	76	2,124	–1,675	1,123	*36,824*
UCI units	369	729	4,048	7,168	4,431	2,978	2,206	2,538	4,250	1,825	3,289	*40,771*
Other assets	–131	–268	354	497	935	203	495	452	688	513	–275	*8,521*
New financial liabilities	6,175	6,872	9,179	11,067	10,676	10,774	16,382	20,396	23,965	15,370	12,545	*220,521*
Net claims of households on life insurance reserves and pension funds reserves	5,336	6,242	7,422	9,387	9,315	8,585	13,027	15,121	20,210	12,146	9,075	*151,703*
Other insurance technical reserves	721	666	527	557	637	1,069	1,580	2,197	1,838	1,728	664	*27,810*
Other liabilities	118	–36	1,230	1,123	725	1,119	1,775	3,078	1,917	1,497	2,807	*41,008*
Other (2)												
Formation of financial assets	2,892	27,217	16,649	6,211	5,026	7,612	5,778	–4,036	4,773	2,903	26,547	*196,528*
Deposits	–1,145	221	848	150	711	–299	3,587	95	1,768	1,230	3,786	*9,020*
Loans	1,621	–431	103	2,156	1,250	3,200	1,595	267	839	–467	13,396	*38,736*
Shares and other equity	2,699	27,153	16,102	3,131	2,099	3,671	–1,619	–2,461	1,907	1,532	709	*135,631*
Other assets	–282	274	–405	775	965	1,040	2,215	–1,936	259	608	8,656	*13,141*
New financial liabilities	2,486	27,825	16,498	6,483	3,866	6,020	6,798	–3,993	6,119	4,943	26,988	*201,310*
Loans	328	–461	1,337	2,253	3,450	799	8,313	–3,880	1,497	282	8,421	*28,387*
Shares and other equity	872	27,945	12,938	4,624	1,177	2,901	–68	–63	4,165	4,070	17,835	*161,063*
Other liabilities	1,287	341	2,223	–394	–761	2,319	–1,447	–51	458	591	732	*11,860*

Sources : Belgian Asset Managers Association, Belgian Association of Pension Institutions, CBFA, NBB.

(1) Including real estate certificates.

(2) Financial holding companies, real estate investment funds with fixed capital (Sicafi), private closed-end equity funds (Pricaf), undertakings for investment in claims, mortgage companies, regional social housing companies, finance companies, investment firms and UCI management companies.

TABLE XX NET ISSUES OF SECURITIES[1] BY FINANCIAL[2] AND NON-FINANCIAL CORPORATIONS AND GENERAL GOVERNMENT

(millions of euro)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	First nine months 2005	First nine months 2006	*p.m. Outstanding amount at the end of September 2006*
Fixed-income securities	816	–474	4,163	9,386	6,274	5,315	–4,541	–2,453	–13,352	–10,223	5,503	*357,866*
Financial and non-financial corporations	–5,661	–2,565	2,938	6,844	1,393	704	–1,146	511	–15,101	–15,072	2,378	*95,738*
Securities at up to one year	115	1,093	5,851	7,759	–1,212	1,386	631	888	–3,525	–5,585	–1,703	*15,491*
Securities at over one year	–5,776	–3,658	–2,913	–916	2,605	–682	–1,777	–377	–11,575	–9,487	4,081	*80,247*
General government	6,477	2,091	1,225	2,542	4,881	4,611	–3,395	–2,964	1,749	4,849	3,125	*262,128*
Securities at up to one year	1,226	–5,597	–6,194	–4,652	501	–189	–1,011	–693	364	4,204	5,182	*34,661*
Securities at over one year	5,251	7,688	7,419	7,194	4,380	4,800	–2,384	–2,271	1,385	644	–2,057	*227,467*
Shares	11,760	41,075	26,579	30,952	29,415	12,485	4,415	22,894	13,149	7,436	52,996	*995,150*
Listed shares	2,662	12,503	9,367	7,939	5,711	1,048	818	4,182	5,407	4,846	2,994	*216,068*
Unlisted shares and other equity[3]	9,098	28,571	17,212	23,014	23,704	11,437	3,598	18,712	7,742	2,590	50,002	*779,083*
p.m. Recourse by financial and non-financial corporations to the securities market	*6,099*	*38,510*	*29,517*	*37,796*	*30,808*	*13,189*	*3,269*	*23,404*	*–1,951*	*–7,636*	*55,374*	*1,090,888*

Sources : CBFA, Euronext Brussels, NBB.

(1) Excluding derivatives and units of UCIs.

(2) Excluding the Eurosystem.

(3) Including reinvested earnings on direct investments effected in Belgium by foreign companies.

TABLE XXI INTEREST RATES

(end of quarter, annual percentages)

		Yield on the interbank market		Yield on the Belgian secondary market in securities issued by Belgian general government				
		Overnight [1]	Three-month [2]	Three-month Treasury certificates	Linear bonds			Rates of the ten-year reference linear bond
					At one year	At two years	At five years	
2002	I	3.39	3.45	3.33	3.80	4.29	4.99	5.41
	II	3.49	3.44	3.36	3.62	3.97	4.64	5.16
	III	3.42	3.30	3.14	2.96	3.18	3.82	4.51
	IV	3.44	2.87	2.73	2.61	2.78	3.56	4.32
2003	I	2.66	2.52	2.42	2.27	2.53	3.31	4.18
	II	2.38	2.15	2.02	1.94	2.21	3.02	3.94
	III	2.10	2.13	2.02	2.03	2.36	3.25	4.09
	IV	2.32	2.12	2.00	2.18	2.62	3.60	4.34
2004	I	2.06	1.96	1.87	1.89	2.23	3.16	4.10
	II	2.13	2.12	2.03	2.28	2.72	3.68	4.44
	III	2.09	2.15	2.02	2.28	2.59	3.36	4.06
	IV	2.21	2.16	2.00	2.23	2.47	3.07	3.68
2005	I	2.12	2.15	2.03	2.24	2.48	3.09	3.73
	II	2.17	2.11	2.00	1.98	2.08	2.53	3.22
	III	2.15	2.18	2.03	2.20	2.35	2.72	3.19
	IV	2.42	2.49	2.27	2.68	2.80	3.04	3.32
2006	I	2.62	2.82	2.62	3.04	3.25	3.59	3.82
	II	2.89	3.06	2.82	3.33	3.55	3.87	4.09
	III	3.10	3.42	3.17	3.55	3.56	3.59	3.69
	IV	3.69	3.73	3.49	3.82	3.87	3.92	3.99

Sources : ECB, NBB.

(1) The weighted average interest rate on the interbank market of the euro area for unsecured overnight loans in euro (EONIA).

(2) Average interest rate offered on the interbank market of the euro area for unsecured three-month loans in euro (Euribor).

TABLE XXII MAIN INTEREST RATES OF THE EUROSYSTEM

(annual percentages)

Dates of announcement of changes	Rate on the main refinancing operations[1]	Rate on the marginal lending facility	Rate on the deposit facility
1998 22 December	3.00	4.50[2]	2.00[2]
1999 8 April	2.50	3.50	1.50
4 November	3.00	4.00	2.00
2000 3 February	3.25	4.25	2.25
16 March	3.50	4.50	2.50
27 April	3.75	4.75	2.75
8 June	4.25	5.25	3.25
31 August	4.50	5.50	3.50
5 October	4.75	5.75	3.75
2001 10 May	4.50	5.50	3.50
30 August	4.25	5.25	3.25
17 September	3.75	4.75	2.75
8 November	3.25	4.25	2.25
2002 5 December	2.75	3.75	1.75
2003 6 March	2.50	3.50	1.50
5 June	2.00	3.00	1.00
2004 –			
2005 1 December	2.25	3.25	1.25
2006 2 March	2.50	3.50	1.50
8 June	2.75	3.75	1.75
3 August	3.00	4.00	2.00
5 October	3.25	4.25	2.25
7 December	3.50	4.50	2.50

Source: ECB.

(1) Until the operation settled on 21 June 2000, fixed rate of the weekly allotments of two-week credits. From the transaction settled on 28 June 2000, minimum bid rate at the tenders for the credit allotments.

(2) Except for the period from 4 to 21 January 1999, during which the rate for the marginal lending facility was 3.25 p.c. and that for the deposit facility 2.75 p.c. The purpose of this narrower "corridor" (50 basis points) was to facilitate the transition of market operators to the new system.

TABLE XXIII EXCHANGE RATES[1]

(national monetary units per ecu or euro, annual averages)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
US dollar	1.134	1.121	1.066	0.924	0.896	0.946	1.131	1.244	1.244	1.256
Japanese yen	137.1	146.4	121.3	99.5	108.7	118.1	131.0	134.4	136.9	146.0
Swiss franc	1.644	1.622	1.600	1.558	1.511	1.467	1.521	1.544	1.548	1.573
Korean won[2]	1,069.8	1,568.9	1,267.3	1,043.5	1,154.8	1,175.5	1,346.9	1,422.6	1,273.6	1,198.6
Hong Kong dollar[2]	8.750	8.695	8.269	7.198	6.986	7.375	8.808	9.688	9.677	9.755
Singapore dollar[2]	1.678	1.876	1.806	1.592	1.604	1.691	1.970	2.102	2.070	1.994
Canadian dollar	1.569	1.665	1.584	1.371	1.386	1.484	1.582	1.617	1.509	1.424
Norwegian krone	8.019	8.466	8.310	8.113	8.048	7.509	8.003	8.370	8.009	8.047
Australian dollar	1.528	1.787	1.652	1.589	1.732	1.738	1.738	1.691	1.632	1.667
Pound sterling	0.692	0.676	0.659	0.610	0.622	0.629	0.692	0.679	0.684	0.682
Swedish krona	8.651	8.916	8.807	8.445	9.255	9.161	9.124	9.124	9.282	9.254
Danish krone	7.484	7.499	7.435	7.454	7.452	7.431	7.431	7.440	7.452	7.459
Cyprus pound	0.583	0.577	0.579	0.574	0.576	0.575	0.584	0.582	0.577	0.576
Czech koruna	35.93	36.32	36.88	35.60	34.07	30.80	31.85	31.89	29.78	28.34
Estonian kroon	15.72	15.75	15.65	15.65	15.65	15.65	15.65	15.65	15.65	15.65
Hungarian forint	211.7	240.6	252.8	260.0	256.6	243.0	253.6	251.7	248.1	264.3
Lithuanian litas[2]	4.536	4.484	4.264	3.695	3.582	3.459	3.453	3.453	3.453	3.453
Latvian lats[2]	0.659	0.660	0.626	0.559	0.560	0.581	0.641	0.665	0.696	0.696
Maltese lira[2]	0.437	0.435	0.426	0.404	0.403	0.409	0.426	0.428	0.430	0.429
Polish zloty	3.715	3.918	4.227	4.008	3.672	3.857	4.400	4.527	4.023	3.896
Slovenian tolar	181.0	186.0	194.5	206.6	218.0	226.0	233.8	239.1	239.6	239.6
Slovak koruna[2]	38.11	39.54	44.12	42.60	43.30	42.69	41.49	40.02	38.60	37.23
p.m. Effective euro exchange rate[3] *(index 1st quarter 1999 = 100)*	*98.6*	*100.7*	*95.9*	*86.1*	*86.7*	*89.2*	*99.9*	*103.8*	*103.0*	*103.4*

Source: ECB.

(1) Ecu exchange rate until 1998, euro exchange rate thereafter.

(2) As the ECB has only provided official reference rates since 2001, the rates shown in the table for the period prior to that date are indicative.

(3) Data compiled on the basis of the weighted averages of the bilateral euro exchange rates. The weightings are calculated from the trade in manufactured products during 1995-1997 and 1999-2001 with the trading partners (including China) whose currencies appear in the table, and take account of the effects of third markets.

Methodological note

Unless otherwise indicated, when data are compared from year to year, they all relate to the same period of the years in question. In the tables, the totals shown may differ from the sum of the items owing to rounding.

In order to describe the development of various important economic data relating to Belgium in the year 2006 as a whole, it was necessary to make estimates, as the statistical material for that year is inevitably sometimes still very fragmentary. In the tables and charts these estimates, which were finalised in early February 2007, are marked "e". They represent mere orders of magnitude intended to demonstrate the trends which already seem to be emerging. For the years prior to 2006, the data in the Report are those of the official national accounts. On the other hand, the comments on the international environment and the international comparisons are based on data from international institutions, which for the year under review were generally closed a few months earlier.

The monetary unit used in the Report for the data concerning Belgium or the other countries of the euro area is the euro, since, on 1 January 1999, it became the currency of all these countries except Greece and Slovenia, for which it replaced the national currency on 1 January 2001 and 2007 respectively. The amounts relating to the periods prior to its introduction are converted at the irrevocable euro conversion rates. Except in the chapters on monetary policy and prices, where the definition coincides with the historical reality, the euro area is defined in this Report as consisting of the twelve EU countries which adopted the single currency, excluding Slovenia. Apart from Belgium, the area therefore consists of Austria, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal and Spain. For convenience, the term "euro area" is also used to designate this group of countries for periods prior to the start of Stage 3 of EMU.

Since 1999, the NAI, in accordance with the obligation imposed by Eurostat, has applied the ESA 95 methodology for compiling the national accounts, instead of the ESA 79 methodology. The ESA 95 gives a more accurate and complete picture of economic developments[1]. It also provides a better guarantee of the international comparability of the macroeconomic data. As far as possible, the Report incorporates the definitions and methods resulting from ESA 95. However, it still expresses the data in gross terms, as under the ESA 79, although this new system presents the main aggregates derived from the national accounts in the form of net results for consumption of fixed capital. Gross data have the advantage of reducing the problem connected with the valuation of depreciation, which is based on the assumption of perfect knowledge of the stock of fixed capital. Furthermore, gross data make it easier to interpret certain movements such as those of

(1) For fuller information concerning the ESA 95, see the NAI publication entitled *Comptes nationaux 1998 – Partie 1 : Estimation des agrégats annuels*. The changes caused by the switch to the ESA 95 for the account of general government are specified in more detail in another publication from the same source, entitled *Comptes nationaux 1998 – Partie 3 : Comptes des administrations publiques*.

the gross operating surplus. For similar reasons, the sectoral breakdown groups together, under the heading "individuals", households and non-profit institutions serving households, which constitute separate sectors according to the ESA 95 methodology. Nevertheless, the terms "individuals" and "households" are used as synonyms.

The Belgian national accounts, like those of other European countries, underwent a series of important methodological revisions in 2005 and 2006, affecting the basic data and/or the methods of calculation for the majority of the aggregates (value added, consumption, investment, compensation, etc.), and the breakdown of price and volume effects.

One of the main methodological adjustments in 2005 was the change in the treatment of financial intermediation services indirectly measured (FISIM). Before this revision, the FISIM output was recorded, by convention, as intermediate consumption of a notional branch, and was therefore not taken into account for the calculation of GDP. Following the entry into force of a new European Regulation, in January 2005, the FISIMs are now divided among the user sectors, reclassifying part of the interest payments as service payments. This reclassification had a considerable impact on the value of certain aggregate flows of goods and services: the output of financial corporations, intermediate and final consumption, imports and exports. This has affected the value added of the various branches of activity and sectors, as well as GDP.

The 2006 revisions concern the volume estimates and cover three aspects: adjustments to the deflators underlying the series relating to output, intermediate consumption and value added, in order to improve the quality of the national accounts; modification of the methodology used for the volume estimates of the output of non-market educational establishments, those estimates now being based on a direct volume indicator (number of pupil hours per type of education and per region) rather than on deflators specific to each component of production costs (intermediate consumption, salaries, fixed capital consumption); and the conversion of the series at prices of a fixed base year (2000, in the 2005 version of the national accounts) into series at prices of the year preceding the one for which they were first published.

The latter conversion makes it possible to "chain" the volume change in the aggregates or sub-aggregates. According to this method, their volume growth between two consecutive periods is calculated systematically by reference to the previous year's prices and weights. The changes between consecutive periods are linked together (cumulated) to give a chained index. When the chained index of an aggregate or sub-aggregate is applied to the amount (level) of a *reference year*, such as 2004, as in the official national accounts published in the year under review, that provides a measure of the volume change in "*chained euros (reference year 2004)*". The choice of the reference year has no effect on the growth profile of the series. The introduction of chained indices improves the accuracy of the measure of economic growth and increases the international comparability of the data. However, in using chained level series it is necessary to allow for the fact that this chaining leads to a loss of additivity in regard to the volume levels (except for the figures relating to the reference year and the year immediately following it). Non-additivity implies, for example, that in the case of chained level series, GDP is not equal to the sum of its components (final consumption, investment, change in stocks and net exports).

A more detailed explanation of the changes made to the national accounts methodology was supplied by the NAI in the publications entitled *Comptes nationaux – Partie 2 : Comptes détaillés et tableaux 1995-2004* and *Comptes nationaux – Partie 2 Comptes détaillés et tableaux 1995-2005*, issued in December 2005 and November 2006 respectively.

When this Report went to press, the revised official national accounts were available only for the period 1995-2005, so that, to gain a longer historical perspective, it was necessary to make estimates by retropolation, e.g. for the calculation of the ratio of the consolidated public debt to GDP.

In the chapter devoted to the international environment, the presentation is also consistent with the ESA 95 or its equivalent, the System of National Accounts published jointly by the United Nations, the World Bank, the EC, the IMF and the OECD (SNA 1993). Nevertheless, the statistics from the sources to which reference is made in the Report, principally the EC and the OECD, have still not been made completely uniform, because the period for which the methodological revision or the conversions from one ESA system to the other have been carried out still varies greatly from one country to another.

The breakdown of the financial accounts between individuals and companies is largely based on data from Belgian credit institutions. The information making it possible to break down the other financial transactions of the private sector, especially transactions with foreign countries or purchases of securities, is much more fragmentary. The main statistics which can be used for this purpose, namely the globalisation of the annual accounts of enterprises compiled by the Bank's Central Balance Sheet Office, are in fact partial, are produced only annually and are available only after a time-lag of several months. It has therefore been necessary to introduce some assumptions and make various estimates.

Conventional signs

–	the datum does not exist or is meaningless
e	estimate by the Bank
n.	not available
p.c.	per cent
p.m.	pro memoria

List of abbreviations

Countries

BE	Belgium
DE	Germany
EL	Greece
ES	Spain
FR	France
IE	Ireland
IT	Italy
LU	Luxembourg
NL	Netherlands
AT	Austria
PT	Portugal
FI	Finland
EA	euro area
DK	Denmark
SE	Sweden
GB	United Kingdom
EU-15	European Union excluding the ten countries which joined in 2004
EU-25	European Union excluding Bulgaria and Romania
JP	Japan
US	United States

Other

ALM	Asset & Liability Management
APR	Annual Percentage Rate
BEA	Bureau of Economic Analysis
BIS	Bank for International Settlements
BLEU	Belgian-Luxembourg Economic Union
BLS	Bureau of Labor Statistics
BNRC	Belgian National Railway Company
BREO	Brussels Regional Employment Office
BTB	Belgian Treasury Bills
CBFA	Commissie voor het Bank- Financie- en Assurantiewezen, Commission bancaire, financière et des assurances (Banking, Finance and Insurance Commission)
CDO	Collateralised debt obligation
CDS	Credit default swap
CEC	Central Economic Council
CLO	Collateralised liability obligation
CPI	Consumer price index
CREDIBE	former Central Office for Mortgage Loans
EC	European Commission
ECB	European Central Bank
Ecofin	EU Council of Ministers of Economic Affairs and Finance
EDP	Excessive Deficit Procedure
EMBIG	Emerging Market Bond Index Global
EMU	Economic and Monetary Union
ERM	European Exchange Rate Mechanism
ESA	European System of Accounts
ESCB	European System of Central Banks
ESRI	Economic and Social Research Institute, Cabinet Office for the Government of Japan
EU	European Union
FISIM	Financial Intermediation Services Indirectly Measured
FOREM	Office communautaire et régional de la formation professionnelle et de l'emploi (Community and regional vocational training and employment office)
FPB	Federal Planning Bureau
FPS	Federal Public Service
FRA	Forward rate agreement
GDP	Gross Domestic Product
GNI	Gross National Income
HICP	Harmonised Index of Consumer Prices
HWWA	Hamburgisches Welt-Wirtschafts-Archiv

IAS	International Accounting Standards
IEA	International Energy Agency
IFRS	International Financial Reporting Standards
IFS	Institute for Fiscal Studies
ILO	International Labour Office
IMD	Institute for Management Development
IMF	International Monetary Fund
IPN	Inflation Persistence Network
IRB	Internal Rating Based
ISDA	International Swaps and Derivatives Association
IWFP	International Wage Flexibility Project
JC	Joint committee
KUL	Katholieke Universiteit Leuven
LEA	Local Employment Agency
LTCM	Long-Term Capital Management
MFI	Monetary Financial Institution
MIR	Monetary Financial Institutions Interest Rates
NAI	National Accounts Institute
NBB	National Bank of Belgium
NCB	National central bank
NEMO	National Employment Office
NID	Notional interest deduction
NISSE	National Institute for the Social Security of the Self-employed
NPO	National Pensions Office
NSA	National System of Accounts
NSDII	National Sickness and Disability Insurance Institute
NSI	National Statistical Institute
NSSO	National Social Security Office
OECD	Organisation for Economic Cooperation and Development
OLO	Linear bond
OPEC	Organisation of Petroleum Exporting Countries
PER	Participation Exemption Regime
PLU	Professional Lenders' Union
Pricaf	Private Equity Sicaf (Private closed-end equity fund)
PSBH	Panel Study of Belgian Households
PSPS	Pension Service of the Public Sector
R&D	Research and Development
REN	Regional Express Network
RIF	Railway Infrastructure Fund
RIR	Retail Interest Rates

SCA	Study Committee on Ageing
SHLAF	Social Housing Loan Amortisation Fund
SICAFI	Société d'investissement à capital fixe immobilier (real estate investment fund with fixed capital)
SME	Small and Medium-sized Enterprises
SPF	ECB Survey of Professional Forecasters
STADIM	Belgian real estate research and advice bureau
TFP	Total Factor Productivity
UCI	Undertaking for Collective Investment
ULB	Université libre de Bruxelles
VAT	Value Added Tax
VDAB	Vlaamse dienst voor arbeidsbemiddeling en beroepsopleiding (Flemish employment exchange and vocational training service)
WDN	Wage Dynamics Network
WEF	World Economic Forum

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