

Report 2010

Economic and financial developments



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Foreword

by Guy Quaden, Governor



World economic growth, which had come to an abrupt halt at the end of 2008 and the beginning of 2009, regained momentum in 2010, to reach an estimated 5%. However, GDP expansion was much stronger in emerging economies than in industrialised countries.

In the euro area, it is expected to average around 1.7%, a figure which exceeds the initial forecasts but also masks a very patchy performance. The recovery was particularly vigorous in Germany which, after having suffered badly from the collapse of international trade in 2009, managed to take full advantage of the rebound in 2010. In contrast, in other countries (such as Spain, Portugal and especially Greece and Ireland) where growth had previously been based to an excessive extent on public or private debt, the slump persisted. Those countries were also hit by the crisis affecting their debt securities.

These events demonstrated once again that market responses may be too slow – as was the case before the crisis – or, conversely, too sudden and disruptive. Above all, they highlighted the shortcomings in the economic governance of the euro area. Sharing a common currency evidently necessitates serious institutional progress in the macroeconomic surveillance and the absorption of excessive internal and external imbalances, and in the mechanisms for resolving any future crises.

In this jittery context, the Eurosystem continued to provide stability. First, the monetary policy stance remained very accommodating, with the official interest rates held at a very low level. Also, regarding the provision of liquidity, the unconventional measures introduced at the start of the financial turbulence in 2008 have been supplemented since May 2010 by a programme for the purchase of government bonds on the secondary market.

However, these are not permanent choices, and they should be gradually modified, one according to the macroeconomic situation in order to keep inflation expectations firmly anchored, and the other as the operation of the financial markets returns to normal.

Indeed, the banking sector has not yet been stabilised, and the interactions between States' balance sheets and those of the banks have created new fragilities. However, considerable progress was achieved in 2010 in regard to the regulation and surveillance of the financial sector.

The Basel Committee in which the Bank participates has designed new rules. While it is acknowledged that they will require the banks to make a serious adjustment effort, a fairly long transitional period has been specified and the costs are by far outweighed by the benefits expected from a significant reduction in the risk of new financial crises. At the start of 2011, the European Systemic Risk Board and the European System of Financial Supervision began operating. They should contribute

towards more effective supervision at European level. In Belgium, the transfer to the Bank of the microprudential supervision of all banks and insurance companies, announced at the end of 2009, is to take effect from 1 April 2011.

In various respects, the Belgian economy's recent performance has been among the best in the euro area.

In 2009, the decline in activity in our country had been severe (−2.8 %), but less than the average for the euro area (−4.1 %), and our recovery in 2010 was a little stronger (2.0 % compared to 1.7 %). Employment began rising again (+28,000 net units), wiping out the previous year's losses (−15,000) sooner than expected; taking account of the expansion of the labour force, the harmonised unemployment rate stabilised at around 8.4 %. The labour market recovery restored the confidence of consumers and led to a fall in their savings ratio, which had risen steeply during the crisis. Businesses also benefited from the revival in foreign demand, especially in Germany.

The positive balance of Belgium's current transactions with the rest of the world expanded and, with the benefit of economic growth exceeding the assumption made in the budget, the public deficit declined from 6.0 % to 4.6 % of GDP (whereas it still averaged 6.3 % in the euro area).

Yet these relatively satisfactory results leave no room for complacency. In today's world, the reference to European averages is not ambitious enough, and in any case, Belgium needs resolute action to eliminate the inflation gap in relation to its neighbours, to continue and even speed up the consolidation of public finances, and to preserve and strengthen the economy's competitiveness in the long term.

With the economic recovery, prices of commodities, and especially oil, began rising again and inflation returned to moderately positive figures during the year. In this regard, however, Belgium performed noticeably less well. The rise in consumer prices averaged 2.3 % in Belgium in 2010, against 1.6 % in the euro area. In December, the gap actually widened to 1.2 percentage points (3.4 % compared to 2.2 % for the euro area, according to the harmonised index).

This divergence is due first to the relatively greater weight of energy in Belgian household consumption, which indicates a need to reinforce measures to encourage savings in that area. The methods of setting gas and electricity tariffs and the response of certain food prices are also part of the reason for the scale of the first-round effects in Belgium resulting from a rise in the prices of imported commodities.

Moreover, second-round effects are encouraged in Belgium by automatic indexation mechanisms which concern wages, but also other incomes (e.g. rents) and various prices and tariffs in sectors sheltered from international competition.

A review of all those pricing and income-setting mechanisms is desirable, together with reforms which, while maintaining social cohesion, would attenuate the vulnerability of the position of Belgian firms exposed to foreign competition.

The public debt-to-GDP ratio in Belgium (97.5 %) remains above the euro area average (84.2 %), although the gap is constantly narrowing. It is vital to resume the reduction in the debt ratio as soon as possible, not only to preserve investor confidence (considering that the yield differential between Belgian and German bonds widened in 2010) but also to cope with the budgetary costs of population ageing, which have unfortunately not been pre-financed.

It is therefore crucial to specify as speedily as possible the measures needed to stick to the stated budget path, namely to cut the deficit below 3 % by 2012 and restore a balanced budget in 2015. And, if growth is better than expected, the deficit reduction – to which all levels of authority have to make their contribution – should be speeded up.

The consolidation will have to be based first on selective spending cuts. In view of the scale of the adjustment required, it will most probably also be necessary to seek additional revenue, though without increasing the tax burden on labour, which is already particularly high.

The restoration of sound public finances must also be based on sufficiently vigorous economic growth, which is equally essential to reduce current unemployment. The severe recession affected the growth potential of the Belgian economy and heightened the urgency of reforms designed to boost it.

The prosperity of a small open economy such as Belgium is crucially dependent on its competitiveness in the broad sense, i.e. its production costs, particularly unit labour costs, but also on the nature of its output and the latter's adjustment to changing global demand.

Reasonable wage developments are desirable to encourage demand for labour. But it would be pointless without an accompanying policy to enhance both the quantity and quality of the labour supply. Finally, Belgium's place in the global economy also depends on its capacity for innovation, and hence on increased public and private investment in research and development.

To achieve the gradual but resolute consolidation of Belgium's public finances and to implement structural reforms on labour and product markets will admittedly entail substantial efforts. As concluded by the Report which I have the honour to present, the sooner that effort is made, the more bearable it will be. Conversely, the longer it is postponed, the more expensive and painful it will be, as is evident from the unfortunate example of other countries.

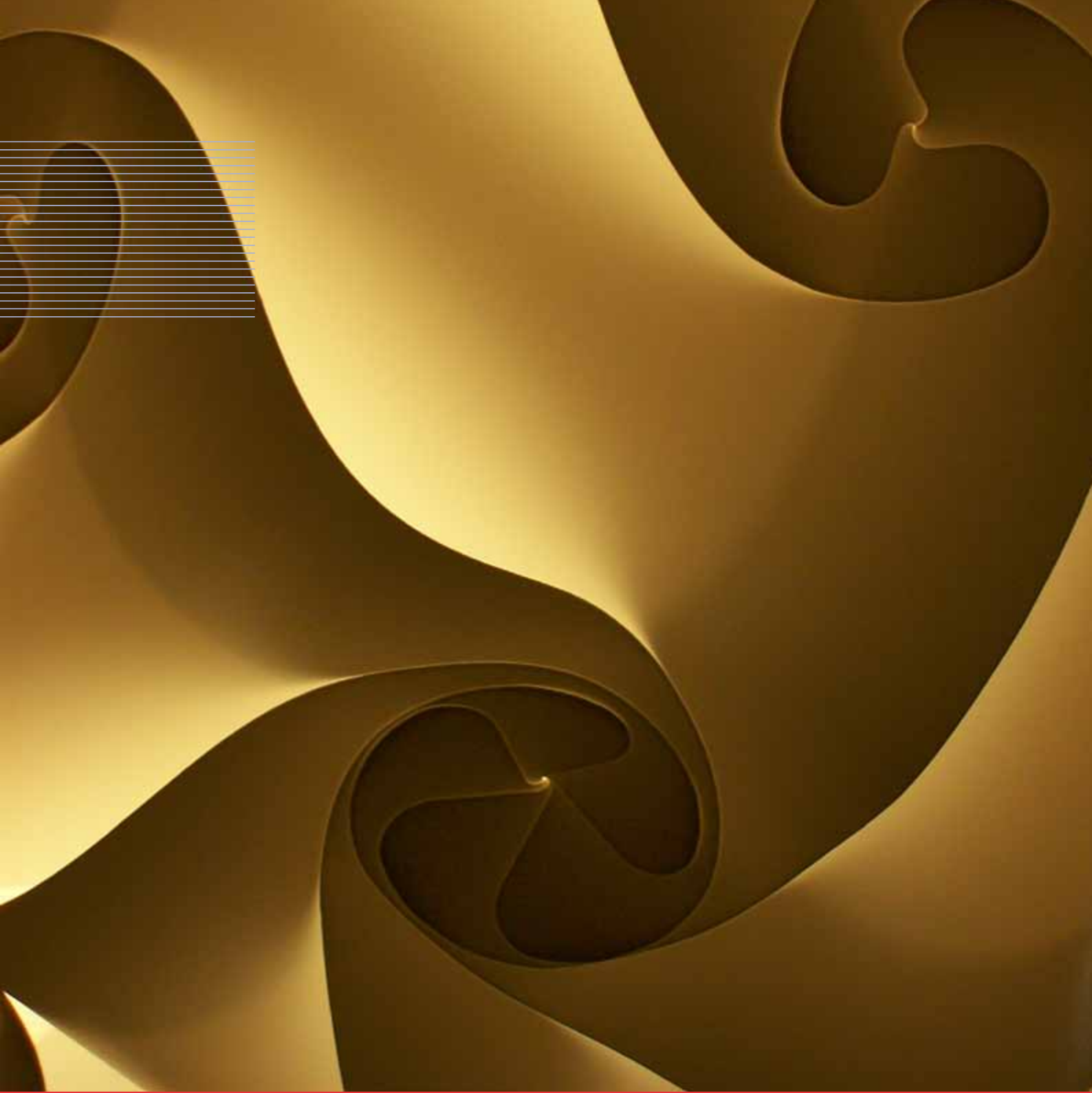


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Report presented by
the Governor on behalf
of the Council of Regency

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Global and European economy: patchy recovery and a need for closer cooperation

1. The global economic recovery which had begun in the spring of the previous year continued in 2010, so that world GDP – after having declined by 0.6% in 2009 – expanded by an estimated 5%. Some of the factors facilitating the recovery – the easing of monetary conditions, measures to support the financial sector, fiscal stimuli, and the rebuilding of inventories – reached their limit. That is particularly true of fiscal policy in many countries. The mounting public debt even ushered in a new phase in the financial crisis, with tensions on the markets for sovereign debt instruments of some European countries. After the initial rebound, the transition to more self-sustaining growth was marked by a slowdown, particularly in the United States. As is clear from the experience of previous banking crises, the consolidation of private and public balance sheets is liable to inhibit the expansion of demand for a time.
2. The recovery was not geographically uniform either: in the old industrialised countries, it was much slower than in the emerging economies. In 2010, GDP was still below its 2007 level in the former whereas it exceeded that figure in the latter, sometimes to a considerable extent – by almost a third in China and a quarter in India. In the emerging countries, growth generated inflationary pressures and drove up commodity prices, while the scale of unused production capacity and unemployment continued to keep prices in check in the advanced economies. In Japan, prices actually fell.
3. Such heterogeneity obviously called for differentiation in monetary policies. For instance, in the United States, the Federal Reserve responded to the slowdown in activity and the underlying trend in domestic prices with a new securities purchase programme, while the central banks of many emerging countries tightened their policy. However, the exchange rate movements which should have resulted from the differences in the macroeconomic situation and monetary policy were sometimes thwarted by large-scale intervention. An abundant supply of liquidity in the United States combined with stable exchange rates between certain currencies and the dollar aggravated the pressures which capital inflows exerted on other currencies.

* Two regents did not give their approval to this report, as they disagree with certain remarks and recommendations in it.

4. International coordination is more essential than ever to discourage policies focused on short-sighted national interests, that would lead to escalating tensions and a contraction of trade, as happened in the 1930s. Free international trade and exchange rates which reflect the fundamental position of the economies are ultimately in everyone's interests. The same is true of the orderly correction of the current account imbalances via macroeconomic policies and structural reforms designed to ensure that, in the countries in surplus, growth is based more on domestic demand, while in the deficit countries it is driven more by foreign demand. The G20 and the IMF have a crucial role to play in coordinating the efforts. It is also important that the Doha Round of trade talks should succeed. Moreover, closer international cooperation is necessary to promote the development of the weakest economies, which are particularly affected by the rising food prices, and to tackle the environmental problems facing our planet.
5. In Europe too, the crisis has tested the ability of governments to offer a coherent response to its repercussions. It is true that, in contrast to the United States, the euro area's economic growth exceeded the initial forecasts in 2010, but at 1.7 % growth was still modest compared to the 4.1 % decline in activity recorded in 2009, and it was very uneven. The recovery was led by Germany, which succeeded in taking full advantage of the revival in international trade thanks to competitive labour costs and a supply of quality products sold on the emerging markets. In contrast, the slump persisted in some countries such as Greece, Ireland, Portugal and Spain where, prior to the crisis, growth had outpaced that of the rest of the euro area, but had been based too heavily on public or private debt. In those countries, the crisis caused greater problems for the public finances than elsewhere, either because their initial situation was already particularly fragile, as in Greece, or because of the impact which the correction of imbalances in the private sector had on economic activity and financial stability, as in Ireland, where the deterioration in the banks' situation drove up the cost of financing for the State which had guaranteed their liabilities.
6. On the financial markets, Greek public debt securities faced a growing loss of confidence at the start of the year, and especially in April. Moreover, the contagion spread to other sovereign debt markets and affected the financing costs of banks throughout the euro area and the euro exchange rate. At the beginning of May, to stem the crisis and safeguard financial stability in the euro area, the European authorities and the IMF set up a conditional financial assistance package for Greece. Next, a mechanism enabling the financing of euro area countries up to € 750 billion was set up for three years. In November, renewed tensions led Ireland to resort to that mechanism.
7. These events demonstrated once again that the constraints imposed by market forces may be too slow and too weak – which was the case before the crisis – or conversely too sudden and disruptive. Above all, they highlighted the shortcomings in the economic governance of EMU and the problems which a monetary union may encounter in the absence of political union. The single currency and the closely intertwined nature of the economies imply a need for more active solidarity, though without any dilution of responsibilities, and improved compatibility between national policies. Institutional progress is absolutely vital. The stability and growth pact, which – unfortunately – was relaxed in 2004-2005 when some large countries had failed to abide by the rules, needs to perform better in its role of safeguarding fiscal discipline. A speedier correction of excessive deficits, greater attention to debt dynamics and, above all, virtually automatic application of the sanctions would make the pact more effective. In addition, there is a need to establish macroeconomic surveillance to warn Member States of divergences in competitiveness and imbalances such as ballooning private debt, and to promote corrective policies in the event of excessive imbalances. In this area, too, there must be transparent procedures accompanied by sanctions.
8. Finally, in 2013 a mechanism for resolving sovereign debt crises in the euro area should supersede the provisional arrangements introduced in May 2010. If preventive measures fail and market funding dries up, financial assistance must give the country in question time to restore

its credibility in order to control the contagion and guarantee financial stability in the monetary union. At the same time, the mechanism must be so designed as to limit moral hazard, i.e. the risk that its very existence may make lenders less cautious and make governments less inclined to respect the fiscal rules. The imposition of strict conditions ensuring a return to sustainable public finances and the introduction of collective action clauses in line with international practices in the terms and conditions of bond issues of all States would achieve that aim.

Monetary and prudential policy: sources of stability

9. In these troubled times, the Eurosystem continued to ensure stability by its monetary policy stance and the measures taken to overcome disruption on the financial markets. Throughout the year under review, the ECB Governing Council considered that the highly accommodating monetary policy implemented from October 2008 remained the most appropriate for ensuring medium-term price stability. The interest rate on most of the refinancing operations was therefore held at 1 %. In addition, the Council continued to use non-standard measures to ensure that this policy improved the conditions offered to borrowers by the banks – which are the main sources of finance in the euro area – despite the seizing up of some markets. As in the previous year, the Eurosystem offered unlimited refinancing at a fixed rate, and the abundant liquidity thus injected into the money market drove down overnight rates to an extent dependent on the scale of the banks' demand for funds. However, some exceptional measures were withdrawn: for example, twelve-month loans granted in the previous year were not renewed in 2010. Conversely, on 10 May, the serious tensions which reappeared on the financial markets prompted the Governing Council to launch a "securities markets programme": primarily in May and June, the Eurosystem bought debt instruments of certain States on the secondary markets whose malfunctioning was disrupting the transmission of monetary policy.
10. Both the exceptionally accommodating monetary policy stance and the non-standard measures are temporary, and will be gradually phased out, the former according to the macroeconomic situation and the latter as the operation of the financial markets returns to normal. Particularly low interest rates are indicated so long as the low utilisation of production factors exerts downward pressure on prices, and lending remains sluggish. The non-standard measures whereby the Eurosystem partly acts as a substitute for the failing interbank market are appropriate so long as that market remains fragmented, but their gradual withdrawal will encourage the institutions most dependent on central bank credit – and the governments concerned – to proceed with the necessary restructuring.
11. The importance of a monetary policy geared to medium-term price stability is hardly in doubt. Thus, the firm anchoring of inflation expectations certainly helped to avert the risk of deflation. But the crisis also showed that stable prices are not enough to ensure financial stability. Even though low interest rates are still the order of the day, the question will soon arise as to the role which monetary policy must play in preventing future crises. In connection with the aim of price stability, it is necessary to take account of the risks of deflation associated with the bursting of a financial bubble which may develop without any immediate impact on consumer prices. The medium-term stance of the Eurosystem's policy enables these risks to be taken into consideration. The monetary analysis – which is one of the pillars of that policy – needs to be further improved so that the emergence of dangerous imbalances is promptly identified: it is already clear that an asset price boom is generally more damaging where it concerns the property market and is fuelled by credit. A more symmetrical monetary policy response to financial developments may therefore have a stabilising effect, whereas intervention which is confined to crisis episodes may encourage operators to take more risks. Nonetheless, the monetary authorities essentially have only one instrument at their disposal, namely the short-term interest rate. It influences all economic developments, and cannot combat a bubble on one particular market or just in certain parts of the euro area. That is why prudential policies

are crucial. They must take full account of the lessons of the crisis: that crisis did not only originate from a macroeconomic environment of low interest rates, it was also due to serious shortcomings in the management and supervision of the financial sector.

12. In order to enhance the resilience of the financial system, the Basel Committee, in which the Bank participates, has devised new banking sector regulations. To prevent the risk of certain sources of finance drying up in a crisis, liquidity is now subject to quantitative constraints, while the requirements concerning the level and quality of capital and reserves have been raised. The Basel Committee also wants to combine these new microprudential rules with measures to take better account of the systemic dimension of risks. A counter-cyclical mechanism could ensure the accumulation of additional capital resources in a boom period, resources that could be mobilised during a recession, while specific standards would be imposed on banks which, owing to their size or market share in certain segments of activity, present risks for the system as a whole.
13. These measures will require considerable adjustment efforts, but their cost should be seen in the light of the major benefits expected in the form of a significantly reduced likelihood of a crisis. The Basel Committee is aware that an accelerated reduction in balance sheets to comply with these new criteria as quickly as possible could cause a sudden contraction in bank intermediation, and has therefore specified a fairly long transitional period. Certain ratios have yet to be calibrated, but the solvency and liquidity requirements will have been increased considerably by 2018. At the same time, the insurance sector will be subject to specific rules from 2012, under the Solvency II Directive, which is modelled on the risk-based approach applied to banks. To ensure that other financial activities do not escape the prudential obligations and that the inadequately controlled development of certain products does not weaken the system as a whole, the European Union has introduced additional regulations covering alternative investment funds, credit rating agencies and the derivatives market.
14. However strict they are, prudential rules can never totally eliminate the risk of bank failures. It is therefore essential to supplement the regulations with a robust crisis management system. It must be acknowledged that progress has been slower on this second issue, which involves such questions as the sharing of the costs between the private sector and the government. Shareholders, but also certain creditors, should be available as the first line of defence in the event of problems, via specific financial instruments such as subordinated bonds or bail-in mechanisms, converting certain debts into capital where there is an imminent risk of default. Preparations for possible government intervention should be made by the leading financial institutions setting up organisational arrangements which, in an emergency, facilitate their dismantling or division into more homogenous entities, and by legislation which, in extreme circumstances, allows the transfer of elements of the assets of credit institutions or securities issued by them. However effective these arrangements may be, loss socialisation probably cannot be ruled out altogether. To limit the scale of that and make banks take responsibility for their share of the costs, the European authorities advocate greater harmonisation of deposit guarantee funds. They also want the Member States to create resolution funds financed by bank levies.
15. Greater progress has been made in establishing an integrated system of supervision, with the launch of the European System of Financial Supervision at the beginning of 2011. The three European Supervisory Authorities are to harmonise the application of the regulatory measures and the operational conduct of microprudential surveillance in the Member States, while the European Systemic Risk Board has the task of developing a global view of the pattern of systemic risks, incorporating in particular the interactions between components of the financial system and the correlations between risk categories. This new structure must be deployed without delay to ensure financial supervision at European level that is capable of fully restoring market confidence. In particular, it is important that the microprudential and macroprudential work streams are closely interlinked from the start. That will entail efficient exchange of the

information necessary for understanding and analysing risks, effective combination of the skills developed in central banks and supervisory bodies, and a focus on targeted recommendations and measures, both individual and systemic.

16. Fulfilment of these conditions presupposes that similar arrangements are in place in each Member State. It is therefore particularly opportune that the final stage in Belgium's switch to the "twin peaks" supervision model goes with the establishment of the new European prudential architecture. Since October 2010, the new Committee for Systemic Risks and System-relevant Financial Institutions, comprising the members of the Boards of Directors of the Bank and the CBFA and a member of the Federal Public Service Finances as an observer, has had the power to supervise systemic financial institutions, including monitoring and assessing their strategic developments and risk profile. From April 2011, this transitional structure is to give way to the integration, within the Bank, of the supervision of individual institutions, while the CBFA will become the Financial Services and Markets Authority, responsible for supervising the smooth operation of the markets and the protection of consumers of financial services. The Bank, hitherto involved in the overall analysis of structural trends and cyclical developments in the financial system, will therefore take on a new role, consisting in checking on compliance with the rules and the adequacy of risk management procedures. It intends to make full use of this multi-faceted assignment in order to join in the effort being made at international level to set up a more efficient framework of prudential regulation and supervision.

The Belgian economy: taking advantage of the recovery to consolidate public finances, control costs and speed up the reforms necessary to secure sustainable growth

17. The Belgian economy stood up relatively well to the crisis, which nevertheless left its mark on the banking sector, public finances and potential output. In 2010, it is estimated that Belgium's GDP grew by 2 %, regaining its 2007 level, while the euro area's GDP remained 2 % below that year's figure. Following a recession which was less severe than for the euro area, thanks in particular to the moderate private sector debt and the operation of the automatic stabilisers, Belgium enjoyed a slightly stronger recovery. The rebound in foreign demand, which Belgian exporters were able to exploit, provided the initial impetus. Private consumption then took over, despite the virtual stagnation of the real disposable income of households. Following a strong rise in the previous year, due to individuals' fears concerning their assets and employment, the savings ratio declined in 2010. Confidence may well have been bolstered by the labour market recovery: employment began expanding again, wiping out the losses of the previous year, and the harmonised unemployment rate stabilised at around 8.4 %. Household investment in housing continued to fall, as did the gross fixed capital formation of firms. Yet signs of recovery did emerge during the year, as a result of cyclical developments and particularly favourable financing conditions, bank interest rates having dropped to very low levels in historical terms, while corporate profits picked up.
18. After two years of heavy losses, the banks succeeded in restoring their profitability and increasing their solvency, but they nevertheless remain vulnerable. The restructuring plans implemented by a number of institutions to consolidate their balance sheet also have the effect of scaling down their activities, and hence the basis of their income and profits. Reserving profits is one of the main ways of accumulating the capital which will be needed both to satisfy the new regulatory requirements and to reimburse the government. Moreover, the establishment of a more stable funding base, less dependent on interbank and wholesale markets, remains a key aim for some banks.
19. The crisis caused a deterioration in public finances. The general government accounts, which had been kept close to balance since 2000, recorded a deficit of 6 % of GDP in 2009 and 4.6 % in 2010, the improvement having been due largely to the disappearance of non-recurring

factors which had degraded the balance in 2009. The deficits of the past three years and the measures taken in 2008 to support the financial sector caused the public debt to grow from 84.2 % of GDP at the end of 2007 to 97.5 % at the end of 2010. It is high time to implement a consolidation strategy to ensure the sustainability of public finances and cope with the imminent surge in the budgetary costs of ageing. There is no need to fear too great an adverse impact on growth in the short term: while the fiscal stimuli managed to prevent a negative spiral, the restrictive effect of consolidation in a recovery phase could be offset by additional private spending thanks to the improvement in confidence. In any case, foreign demand plays a major role in Belgium's economic cycle.

20. To achieve the aims of Belgium's stability programme, namely to cut the deficit below 3 % of GDP in 2012 and restore a balanced budget in 2015, courageous decisions are needed, because it would be futile to hope for a spontaneous recovery or to count on a reduction in interest charges comparable to that enjoyed by governments in the past twenty years. Any prevarication would inevitably entail higher adjustment costs, precisely because of the interest to be paid, especially if there were an increase in risk aversion on the financial markets. It is true that the 2010 public deficit was smaller than the figure of 6.3 % of GDP recorded by the euro area as a whole, and the gap between the Belgian public debt ratio and that of the euro area continued to diminish, dropping to around 13 percentage points. Also, the growth outlook for the Belgian economy is not marred by a serious loss of competitiveness or excessive private debt levels. On the contrary, persistent current account surpluses have created an external credit position: at the end of September 2010, the net financial assets of the private sector exceeded the net public debt by around 13 % of GDP. However, owing to tensions on the sovereign debt markets in certain euro area countries, and in the absence of a new federal government in Belgium, the long-term interest rate differential vis-à-vis Germany tended to widen in 2010. To secure the confidence of investors, consumers and businesses alike, the measures needed to stick to the stated budgetary path, and even to achieve faster progress, must be implemented without delay. It is in fact crucial to halt the self-fuelling effect of interest charges on the public debt and then to cut the level of that debt before the costs of population ageing become too onerous.
21. A large-scale programme needs to be devised on the basis of an open-minded examination of all possible measures, and followed by resolute implementation. Consolidation must be based principally on selective spending cuts, targeting expenditure which contributes the least to the sustainable development of the economy and employment and to attenuating social inequality. Structural measures are needed to break the trend towards expenditure rising faster than GDP, and to temper the budgetary costs of ageing in the future. To that end, it is necessary in particular to take measures aimed at a further significant reduction in early departures from the labour market, in order to achieve an increase in the effective retirement age. Such measures would supplement others which should be implemented in order to increase the employment rate. Taking account of the scale of the budgetary adjustment required, it will probably also be necessary to seek additional revenue, though taking care not to add to the already particularly heavy burden of taxes on labour incomes. On the contrary, it would be desirable to alleviate that burden, even if it means raising certain taxes on consumption or capital income. The battle against tax and benefit fraud must continue, particularly by means of appropriate, effective checks. Finally, all corporate and personal income tax exemptions should be reviewed.
22. The proper management of public finances requires a sound institutional structure based on the principles of good governance. It is essential that the bodies which supply statistics, macroeconomic forecasts and budgetary recommendations are independent. That is true of the National Accounts Institute and the High Council of Finance. There is also a need for a framework which guarantees policy continuity and consistency. Continuity could be promoted by systematic multi-annual planning and by the application of stringent rules. Thus, a new federal government ought to act swiftly to establish a budgetary plan which at least covers

the legislature. As to consistency, that requires the various levels of government to take on more responsibility so that they bear the full consequences of their decisions on both revenue and expenditure, an economically rational allocation of powers, improved policy coordination, the maintenance of provisions ensuring the country's social cohesion, and finally, especially in the current circumstances, the participation of everyone – from local authorities to the federal State – in the consolidation effort, particularly via adherence to specific targets in relation to the budget balance.

23. The restoration of sound public finances must also be based on a sufficiently vigorous economy. More than ever before, technological changes, the emergence of new players on the global economic scene, demographic trends and environmental threats constitute structural challenges. Potential output could remain below the previously expected level for a long time: in the advanced countries in general, as well as giving rise to greater risk aversion, the crisis has shown that, in the past, growth was inflated by excessive debt. The recession has therefore accentuated the urgency of reforms to boost that potential and consolidate the basis of social protection. The prosperity of a small, open economy is fundamentally dependent on its competitiveness in the broad sense, i.e. costs – unit labour costs in particular –, but also the quality of its institutions, production factors and product range. In that regard, even though the maintenance of a larger current account surplus and higher growth than that of the euro area may be reassuring, there are some points which indicate a need for vigilance, such as the tendency for exports to expand at a slower pace than those of other European countries, the persistence of unemployment and the economy's great sensitivity to commodity price shocks. Cost control and structural reforms on the labour market and product markets are necessary to consolidate growth.
24. In the euro area, the new macroeconomic supervision structure will pay particular attention to the divergence of prices and costs. While Belgium is generally close to the average in this respect, prices react more strongly to commodity cost increases: that was the case in 2008 and again in 2010. Thus, in December 2010, the rise in the harmonised index of consumer prices, namely 3.4%, was 1.2 percentage points higher than that for the euro area. Leaving aside energy and food, the difference was 0.1 point. The scale of the first-round effects of an increase in commodity prices is due not only to the relatively high weight of energy in the index, and to the lower rate of excise duty on energy products, but also to the method of setting gas and electricity tariffs and the reaction by food prices. There is a need for greater transparency and a revision of certain pricing mechanisms. The Price Observatory, the CREG and the Competition Council have a role to play here. Also, the automatic wage indexation specific to Belgium and the indexation of other incomes and various prices and tariffs in sectors sheltered from international competition heighten the risk of second-round effects. The use of the health index achieves only a partial correction, since only road fuel, alcohol and tobacco are excluded. It is therefore important that the wage negotiations should duly take account of the need to correct divergences from developments in partner countries, in accordance with the Law on the promotion of employment and the safeguarding of competitiveness. It is from that perspective that the draft central agreement for 2011-2012 stipulates that any labour cost increases apart from indexation will not take effect until 2012 and will not exceed 0.3%. The Bank welcomes the social partners' commitment to examining ways of reducing the volatility of the effects of the indexation system, particularly where energy prices are concerned. It hopes that this will lead to reforms in pricing and income-setting mechanisms which ensure the structural attenuation of the vulnerability of Belgian firms exposed to international competition.
25. Labour cost moderation is conducive to job creation, but it would be pointless without an accompanying policy to enhance the quality and quantity of the labour supply. Thus, it is essential to step up the efforts to assist the jobless in order to prevent the rise in long-term unemployment from being reflected in a reduced chance of finding work. The variations in unemployment between regions and social groups also call for specific training and mobility

policies. Special attention must focus on getting young people into work, especially the low-skilled; they are among the main victims of the crisis, because those already in employment have been relatively protected by labour hoarding in firms. More generally, progress is vital in regard to basic and in-service training, and encouraging greater participation in working life, since the labour shortages in certain occupations became more acute as soon as activity picked up. In order to boost growth potential and reinforce the social security base, the employment rate of the population aged from 20 to 64 years must continue to rise. In 2009, it was 67.1 %, i.e. lower than the 69.1 % recorded in the EU and the 75 % or more seen in Germany, the Netherlands, Austria, Denmark and Sweden. The EU has set a target of a 6 percentage point increase over ten years, under the Europe 2020 strategy.

26. Belgium's prosperity and its successful involvement in the global economy also depend crucially on its capacity for innovation. Competitiveness is not in fact determined solely by the cost of labour or energy, but also by the nature of the output and the quality of the goods and services offered. It is up to businesses to be dynamic in designing new products for which demand is likely to be less price sensitive, on account of their intrinsic qualities, in exploring new markets and improving the efficiency of production processes. Belgium still specialises too little in research-intensive products which are hard to copy. A climate which fosters the creation, spread and implementation of innovations needs to be established, notably by encouraging R&D, networks of producers and research centres, entrepreneurial spirit, life-long learning and professional mobility. The innovation policy will pay special attention to the development and application of technologies which will enable the economy to adapt to the new international standards regarding energy use and respect for the environment. Firms must develop a range of goods and services that meets the criteria of economic and ecological sustainability and seize the resulting export opportunities.
27. In regard to the growth of activity and employment, the external balance or budget outcomes, the Belgian economy has recently outperformed the average for the euro area. Belgium still has the assets which made it prosperous and enabled it to construct a social protection system that helps to reduce inequality and stabilise the economy. However, in the current circumstances, in order to maintain and further improve that performance, the political authorities and the social partners must take vigorous steps without delay. The consolidation of public finances and the strengthening of our economy's competitiveness are two priorities for the short term. The measures taken to achieve them should be structural, and should form part of a longer-term strategy which needs to be implemented no less urgently, with the aim of boosting the economic growth potential while encouraging social cohesion and respect for the environment. It is a question of building a balanced, stable and effective institutional framework, and implementing structural reforms in order to boost the employment rate, promote the entrepreneurial spirit and innovation, and achieve savings on energy and commodities. The sooner the effort is made, the easier it will be to bear. Conversely, the longer it is postponed, the more expensive and painful it will be, as is evident from the unfortunate example of other countries.

Brussels, 2 February 2011

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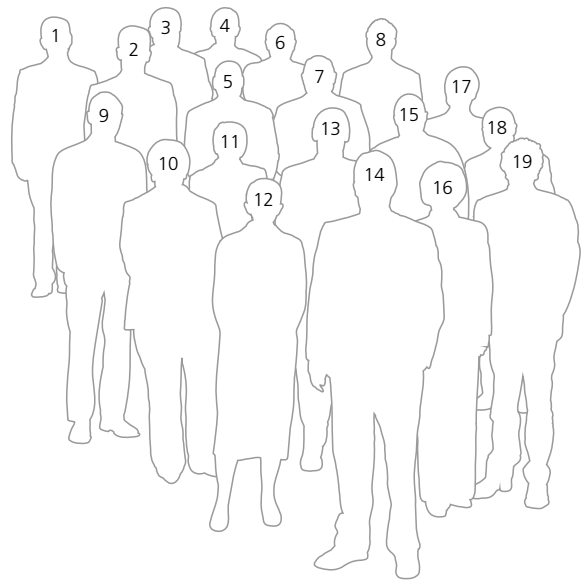
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1.

International
environment

1.1 Global economy

1.1.1 Summary

Activity and economic policies

The revival of the global economy, which had begun in mid-2009 thanks to fiscal recovery measures and a particularly accommodating monetary policy, continued in 2010. Boosted essentially by the strong expansion in the emerging countries, global GDP grew by 5% in 2010, thereby restoring the vigorous growth achieved before the outbreak of the financial crisis. Thus, while the emerging countries represent around one-third of that GDP, they contributed almost two-thirds of its growth, with China accounting for roughly half of that contribution. Conversely, in the advanced economies the recovery was very gradual and patchy, and economic activity did not regain its previous momentum. The pace of the global recovery slackened during the year, especially in the United States.

This slowdown occurred in the advanced economies once the temporary stimulus resulting from the turnaround in the inventory cycle and the expansionary fiscal policy gradually ebbed away, while the revival in activity was not yet sufficiently underpinned by a self-sustaining dynamism. The past excesses and the severe consequences of the crisis continued to depress domestic demand, and in some economies such as Japan and the euro area the recovery was largely export-based. Though business investment did expand, particularly thanks to the restoration of profitability, it was still curbed by the substantial under-utilisation of production capacity and the still highly uncertain economic outlook. Countries where the construction industry had come to represent an exceptionally large proportion of activity before the property bubble burst were hard hit by the restructuring of their economy. Moreover, the property markets still remained fragile in most cases. In addition, the labour market situation only improved slightly, so

that private consumption recorded meagre growth overall. Another factor depressing household demand in the advanced countries is the effort which households have made to rebuild their assets, which had suffered greatly from the crisis on the financial and property markets, and to reduce their debt levels which had soared in some countries as a result of excessively easy credit. Finally, the acceleration of the consolidation of public finances pursued by some countries under pressure from the financial markets also curbed the growth of domestic demand.

In the emerging economies, led by Asia, the recovery was much stronger overall, and domestic demand made a substantial contribution. The pre-crisis excesses were more limited there, and the consequences of the crisis were less severe. Moreover, those countries were often able to give a strong fiscal stimulus because, with sound public finances, they had sufficient scope to do so. Nonetheless, in the second half of the year they, too, faced a slowdown in GDP growth, though that was due partly to economic policy measures designed to prevent overheating of the economy, particularly in China.

Overall, financing conditions continued to improve during the year, underpinning the economic recovery. However, vigorous government intervention was necessary in the spring and in November, to remedy a European sovereign debt crisis and to preserve financial market stability. This debt crisis clearly demonstrated the need to strengthen economic governance in the EU, and especially in the euro area.

Inflation increased in 2010 as a result of higher commodity prices, but its underlying trend remained very weak, reflecting the under-utilisation of the economy's production capacity. Thus, the central banks of the main advanced countries were able to hold their key interest rates at a very low level. In the first half of the year, it seemed that they

TABLE 1 GDP GROWTH IN THE MAIN ECONOMIES

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

	2008	2009	2010	<i>p.m.</i> 2009, share of world GDP ⁽¹⁾	<i>p.m.</i> 2010, contribution to world GDP growth ⁽¹⁾
United States	0.0	-2.6	2.8	20.7	0.58
Japan	-1.2	-6.3	4.3	6.0	0.26
Euro area ⁽²⁾	0.3	-4.1	1.7	15.2	0.26
Denmark, United Kingdom and Sweden	-0.3	-5.0	2.2	3.7	0.08
Other EU Member States ⁽³⁾	3.8	-3.7	1.7	1.5	0.03
Other advanced OECD countries ⁽⁴⁾	1.1	-0.7	2.9	3.8	0.11
China	9.6	9.2	10.3	12.7	1.31
India	6.3	5.7	9.7	5.1	0.49
Other emerging Asian countries ⁽⁵⁾	3.1	0.2	7.3	7.0	0.51
Latin America ⁽⁶⁾	4.2	-1.8	5.9	8.1	0.48
Main oil-exporting countries ⁽⁷⁾	4.7	-2.6	3.4	7.9	0.27
World ⁽¹⁾	2.6	-0.6	5.0	100.0	5.0
<i>p.m. World trade</i> ⁽⁸⁾	3.1	-10.7	12.0		

Sources: EC, IMF, OECD.

(1) The percentage point contribution to global GDP growth of the country or group of countries considered and their percentage share of global GDP are calculated in the same way as global growth, on the basis of purchasing power parities.

(2) Excluding Cyprus and Malta.

(3) Bulgaria, Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland and Romania.

(4) Australia, Canada, Iceland, New Zealand and Switzerland.

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

(6) Excluding Venezuela.

(7) Oil-exporting countries recording a current account surplus in excess of \$ 40 billion over the period 2007-2009 (Algeria, Angola, Iran, Iraq, Kuwait, Libya, Nigeria, Norway, Qatar, Russian Federation, Saudi Arabia, United Arab Emirates and Venezuela).

(8) Average exports and imports of goods and services.

might withdraw all the unconventional measures put in place since the outbreak of the crisis in order to sustain bank lending and the operation of the financial markets, and a number of them did in fact abolish some of those crisis measures. In view of the publication of disappointing growth figures, the uncertain outlook and the low underlying inflation, they decided to make their monetary policy more accommodating again from the summer, e.g. by arranging additional purchases of securities. Conversely, in certain emerging economies, the rapid expansion of lending combined with overheating on the property markets made it necessary to tighten policy.

Regarding fiscal policy, the budget deficits stabilised or even declined slightly overall, while the debt ratios increased again. The sovereign debt crisis forced a number of European countries to act more swiftly to put their public finances in order, and only a few countries initiated new expansionary fiscal measures.

World trade

Following an unprecedented contraction in the volume of world trade in late 2008 and early 2009, the growth of international trade in goods began a vigorous recovery towards the middle of 2009, in parallel with the revival in economic activity. That recovery continued in 2010, but began to run out of steam from the second quarter.

From the start of the recovery up to the initial months of 2010, the trade of the advanced economies expanded at well above the average pace of recent decades. Growth was even stronger in the emerging economies, mainly as a result of fiscal stimuli such as major infrastructure projects in China, requiring huge amounts of commodities and investment goods. During this phase, another factor stimulating the rapid expansion of world trade was the waning of the extreme uncertainty which, at the time of the financial crisis, had caused the postponement of

Box 1 – Specific features of the 2009-2010 economic recovery

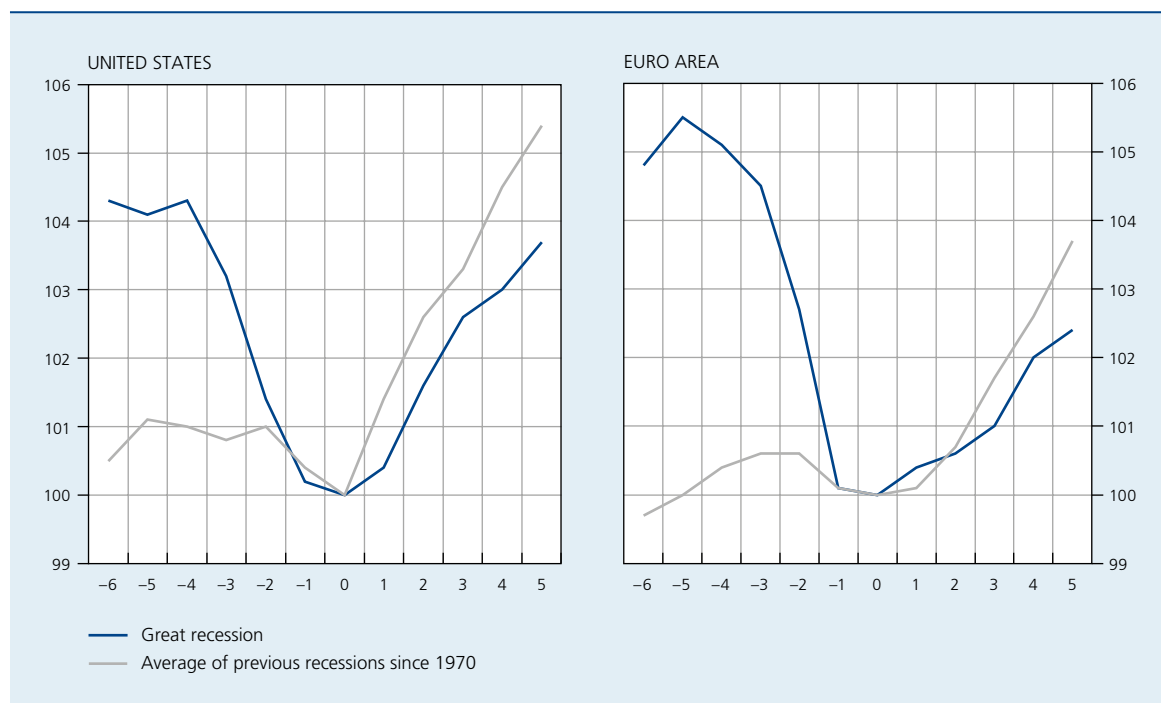
From the second half of 2009, the global economy began to climb out of the worst recession experienced since the Second World War. In 2010, that recovery continued, but in a number of countries growth slackened speed, raising doubts about the recovery's strength and sustainability.

The IMF considered that the slower pace of the ongoing economic recovery in most of the advanced economies was due mainly to the fact that the recession was triggered by a financial crisis. In such cases, past experience had shown that it takes almost twice as long for GDP to regain its pre-recession level, because the expansion phase which precedes such recessions is often based on excesses such as an unsustainable increase in lending, heavy debts, and a bubble affecting certain asset prices. Once that bubble has burst, households and companies have to repay their debts and rebuild their assets in order to consolidate their balance sheet. That is generally a protracted process which inhibits the dynamism of domestic demand. The modest recovery in 2010 could also be due to the fact that the recession was global, so that external demand contributes less to the economic revival than in the case of a more limited, regional shock.

In the United States, the great recession came to an end in the second quarter of 2009. In the five ensuing quarters, cumulative volume GDP growth came to only 3.7% so that, in the third quarter of 2010, GDP was still below its pre-crisis level. That expansion was moderate compared to other expansion phases in the past, with activity up by an average of 5.4% five quarters after a recession. The movement in the main expenditure components in the United States corroborates the IMF's findings. The weakness of the recovery was particularly evident in household

VOLUME GDP GROWTH DURING AND AFTER A RECESSION ⁽¹⁾

(indices, level at the end of the recession (period 0) = 100 ⁽²⁾)



Sources: EC, BEA, CEPR, NBER.

(1) Seasonally adjusted quarterly volume data, also adjusted for calendar effects in the case of the euro area.

(2) The dating of the business cycles is based on the data from the Business Cycle Dating Committee of the NBER for the United States and the CEPR for the euro area. Since the beginning of the 1970s, seven recessions have been identified in the United States and four in the euro area.

consumer spending and investment in housing: households saved more in order to rebuild their assets, which had been hard hit by the fall in property prices and share prices from mid-2007 to the beginning of 2009; moreover, less easy access to credit granted by financial institutions and the bad labour market situation – whose impact is greater in the United States because social protection is relatively less developed there – prompted them to curb the growth of their expenditure.

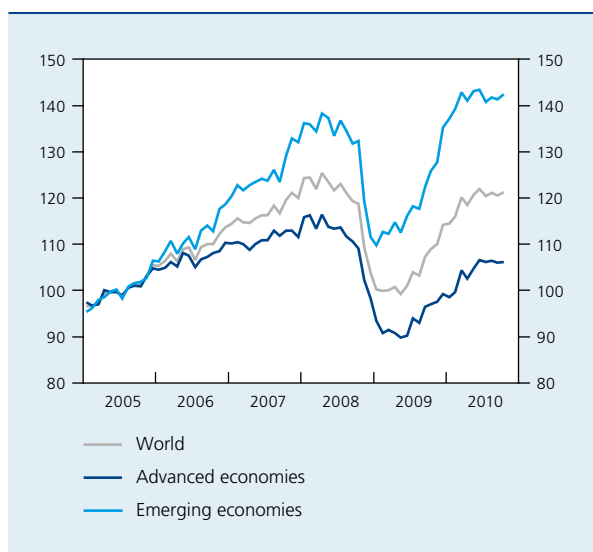
In the euro area, too, the 2009-2010 recovery proved less robust than at the time of previous upswings: five quarters after the end of the great recession, cumulative GDP growth was 1.4 percentage points below the average recorded in the past, and the level of activity was still around 3 percentage points below the pre-crisis level. As typically happens after a financial crisis, final domestic demand was considerably more depressed than usual, which was reflected in a weaker revival in private consumption expenditure and investment by households and firms, a pattern due, as in the United States, to the rebuilding of the net worth of the private sector and the deterioration of the labour market, though to a degree which varied from one country to another. A factor specific to the euro area concerned the developments resulting from the exceptional situation of certain peripheral countries, where serious imbalances had accumulated before the crisis. Those countries faced new tensions on their financial markets, undermining the confidence of households and companies and contributing to a sharper deterioration in bank credit access conditions.

Since domestic demand in the private sector failed to pick up sufficiently autonomously in the United States, the euro area and many other countries too, the recovery faltered during 2010, owing to a smaller contribution from the change in inventories and the withdrawal of certain fiscal measures which had been introduced in the wake of the crisis to revitalise activity and even, in some economies, the first steps towards fiscal consolidation.

purchases of consumer durables and investment goods, products which account for a large share of international trade. Finally, a further contribution resulted from the

rebuilding of inventories: commodities in Asia, and particularly electronic consumer goods in the western countries.

CHART 1 INTERNATIONAL TRADE IN GOODS
(seasonally adjusted monthly data, average volume of exports and imports, indices 2005 = 100)



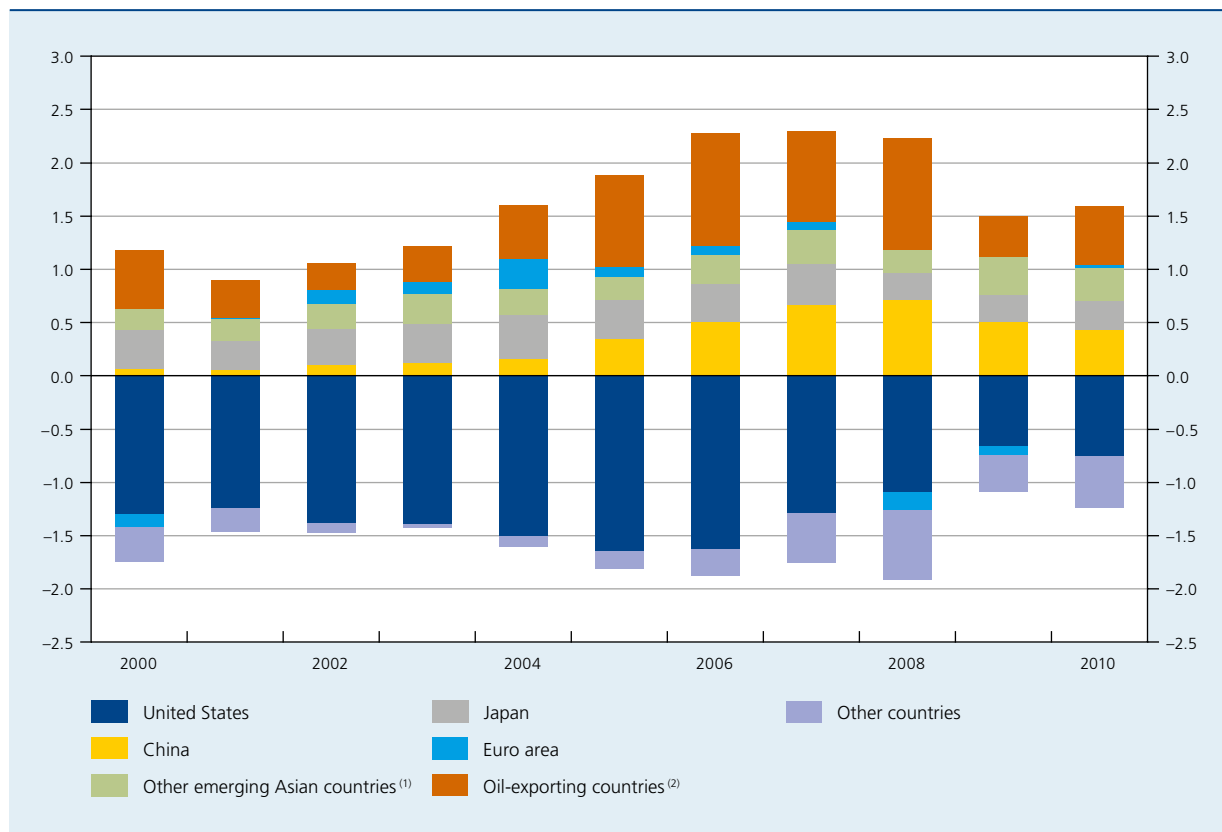
Source : CPB.

The slowdown in activity during the year was reflected in the pattern of international trade, particularly owing to the moderation of inventory building. It was primarily in Asia that the quarter-on-quarter growth of trade declined sharply, dropping from 7.8% in the first quarter to -0.9% in the third quarter.

Global imbalances

The global imbalances on the balance of payments current account were amplified again in 2010, following a marked reduction in 2009. This increase was due mainly to the world trade revival and the rising commodity prices. On a regional basis, the main factor was an increase in the surplus of the oil-exporting countries and a worsening of the deficit in the United States. Correcting the imbalances remains a major challenge. That question has been on the agenda of every G20 meeting since the launch, at the Pittsburgh summit in September 2009, of a medium-term strategy aimed at strong, sustainable and balanced growth and the avoidance of future crises, outlined in the Framework for Strong, Sustainable and Balanced Growth. A key aspect of the Framework is the

CHART 2 CURRENT ACCOUNT BALANCES IN THE MAIN ECONOMIES
(in % of global GDP)



Source: IMF.

(1) Hong Kong, Indonesia, Malaysia, Philippines, Singapore, South Korea, Taiwan, Thailand.

(2) Algeria, Angola, Azerbaijan, Bahrain, Congo, Ecuador, Equatorial Guinea, Gabon, Iran, Kuwait, Libya, Nigeria, Norway, Oman, Qatar, Russian Federation, Saudi Arabia, Syria, Turkmenistan, United Arab Emirates, Venezuela and Yemen.

Mutual Assessment Process, for which the IMF provides technical assistance. For the G20 members, this involves discussing their economic policy plans and their growth prospects. At the meeting of G20 leaders held in Seoul in November 2010, it was agreed that multilateral collaboration would be further stepped up by adopting guidelines, under the Mutual Assessment Process, with the aim of identifying and promptly correcting serious external imbalances arising in the future.

1.1.2 Commodity prices and exchange rates

Commodity markets

In 2010, commodity prices maintained the upward trend which had begun in the spring of 2009, driven mainly by the global economic recovery. Their year-on-year rise thus averaged 29%, according to the HWWI index expressed

in US dollars. However, they did fluctuate throughout the year, rising until the beginning of May then subsiding as a result of the financial market turbulence. Finally, from the summer, they increased again in response to the improved economic outlook and the weakening of the US dollar. During the year, financial investments on the commodity markets also recorded renewed growth, which may have been partly speculative and may have contributed to the increased volatility and upward trend in commodity prices.

Although the increase in commodity prices was practically universal, there were some significant differences between the main product categories.

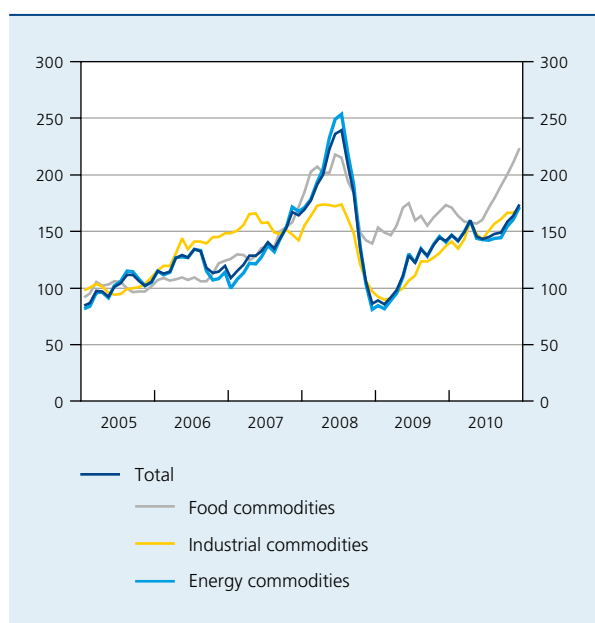
The average price rise was strongest for industrial commodities, at 38.7%, mainly under the impetus of the economic recovery in Asia. The gold price, which is not included in the HWWI index discussed here, increased by 26%, reaching an all-time record of \$1,418 per ounce during the year. As in 2009, the surge in demand for gold as a secure investment in uncertain times was

a major factor behind the rise. The gold price was also underpinned by the weakening of the US dollar during the second half of the year, and by purchases made by a number of central banks in emerging countries.

Energy commodity prices increased by an average of 28.7%. Brent crude oil prices went up by 28.8% and remained within the range of \$ 70 to \$ 80 for much of the year. From the beginning of October, as a result of unexpectedly sustained demand combined with a decline in inventories and weakening of the dollar, they passed the \$ 80 mark, reaching \$ 93.5 at the end of December, or about 20% above the year-end 2009 figure. Prices of other key energy commodities such as natural gas and coal recorded a rise similar to that of crude oil in 2010.

Over the year as a whole, the rise in food commodity prices did not exceed 10.9%. Unlike the prices of industrial and energy commodities, food prices are much less sensitive to the business cycle, as their fluctuations are largely determined by supply. During the first half of the year, supplies were very abundant, and in view of the modest growth of demand, that helped to drive prices down. However, that decline was halted from the summer owing to the downward revision of the forecasts for a number of crop harvests, particularly wheat, following a severe drought in Russia. This caused food commodity prices to start climbing again, to beyond the record level reached in the summer of 2008.

CHART 3 COMMODITY PRICES
(monthly data, US dollars, indices 2005 = 100)



Source: HWWI.

Exchange rates

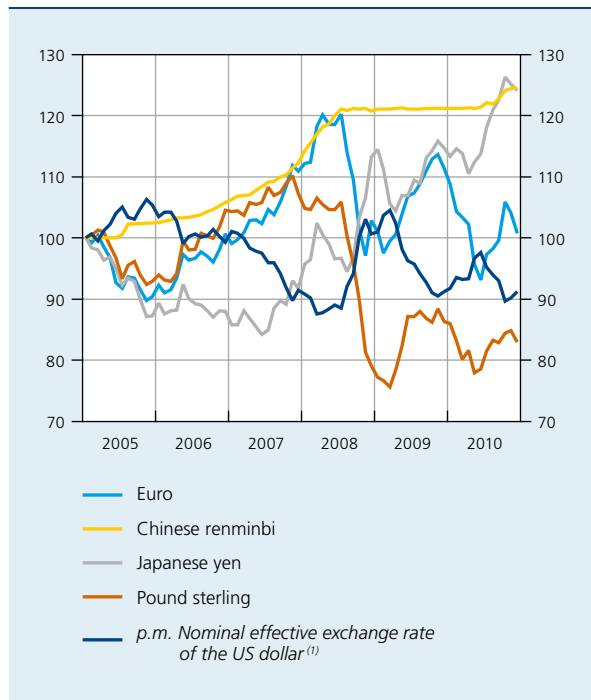
In the first half of 2010, the euro depreciated against the dollar, owing to the narrowing of the interest rate spreads between the two economic regions. In addition, the single currency was increasingly affected by the uncertainty and nervousness on the sovereign securities markets in some euro area countries. After the tensions had reached a peak in May, the exchange rate was down to \$ 1.1942 per € 1 on 8 June, its lowest level during the year and around 17% below the rate at the beginning of 2010.

However, from the second half of the year the euro began to rise again, as the tension on the sovereign debt markets had eased somewhat, and – following hints by a number of Federal Reserve officials at the time of the publication of adverse macroeconomic figures – the market players considered it increasingly likely that there would be a new relaxation of US monetary policy, in the form of additional purchases of government bonds. As a result, after the announcement of this purchase programme, the euro strengthened to \$ 1.4244 per € 1 on 4 November, a rise of around 19% compared to the beginning of June. Renewed tensions on the European government bond markets and the disclosure of more favourable transatlantic economic figures – which encouraged market players to revise upwards their expectations regarding the monetary policy stance in the United States – caused the euro exchange rate to decline during the closing two months of the year, to around \$ 1.3362 per € 1 on 31 December, which was about 7% down against the year-end 2009 figure.

Unlike in 2009, it was not carry trades that caused the appreciation of the yen in 2010. At the beginning of May, uncertainty over the Greek debt crisis was at its peak, causing a flight into currencies regarded as a safe haven, and driving the yen exchange rate higher. A number of weaker than expected indicators presaging a slowdown in the US economy and the subsequent quantitative easing by the Federal Reserve contributed to the weakening of the dollar against most currencies, including the yen. From April to September 2010, the yen appreciated by around 11% against the dollar and 16% against the euro; in mid-September, this prompted the Bank of Japan to intervene directly on the foreign exchange market for the first time in six years, by selling over 2,000 billion yen, in order to support the fragile Japanese economic recovery. This one-off intervention immediately caused the yen to weaken, albeit only temporarily.

After having fallen sharply against both the dollar and the euro during the financial crisis, the exchange rate of the pound sterling against those two currencies fluctuated throughout the year at a level close to the 2009

CHART 4 BILATERAL EXCHANGE RATES OF THE LEADING CURRENCIES AGAINST THE US DOLLAR
(monthly averages, indices January 2005 = 100)



Sources: BIS, Thomson Reuters Datastream.

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

average, i.e. a depreciation of 23 and 20 % respectively against 2007.

Whereas the Chinese renminbi had again been linked to the US dollar since mid-2008, on 19 June 2010 the Chinese central bank announced that it was going to increase the "flexibility" of its currency's exchange rate. In the wake of that decision, the renminbi strengthened slightly against the dollar, appreciating by 2.7 % overall by December.

1.1.3 Developments in the main regions

Economic activity

In the United States, the revival in economic activity which had begun in 2009 continued in 2010, driven by the recovery of domestic demand which was still partly sustained by the policy of the American central bank and that of the federal government. Over the year as a whole, growth came to 2.8 % and was based mainly on household consumption expenditure and changes in

inventories; conversely, net exports of goods and services made a negative contribution.

On a quarterly basis, GDP growth slowed, dropping from 1.2 % at the end of 2009 to an average of 0.5 % in the second and third quarters of 2010. That loss of momentum was due to the smaller contribution of the change in inventories, the very negative contribution of net exports, and the contraction of investment in housing in the third quarter. The current recovery of the US economy, like that of other advanced countries, can be called relatively feeble compared to the past, as is typical of recoveries following recessions which are widespread and/or triggered by a financial crisis (cf. box 1). The impact of the federal government's measures, which was mainly significant during the second half of 2009 and at the beginning of 2010, rapidly faded thereafter. The transition from expansion supported largely by fiscal policy to more autonomous growth was not smooth, primarily on account of the weakness of the two main drivers of activity prior to the crisis, namely private consumption and investment in housing.

After having contracted for two years, household consumption expenditure grew by only 1.7 %, a key factor being that the increase in the real disposable income of households was very meagre. The labour market situation remained severely depressed, with a very small decline in the unemployment rate during the year. Private consumption was also curbed by the continuing effort to save on the part of American households aiming to rebuild their net assets: at the end of the third quarter, those assets were still around 16 % below their 2007 peak. The private savings ratio averaged 5.7 %, well in excess of the level prevailing before the crisis, and hardly any lower than in 2009.

For the fifth consecutive year, households cut their investments, which were down by 2.6 % in 2010. The modest recovery which had emerged during 2009, under the impetus of a number of public initiatives, ran out of steam when most of those measures were withdrawn in the spring of 2010, while the large number of homes up for sale or repossessed, and the prudent attitude of financial institutions in regard to mortgage lending, continued to depress the property market. Business investment, which had fallen sharply in 2009, regained its strength and expanded by around 6 %, in the light of the improvement in the economic outlook, more favourable financing conditions and strong profits. At the same time, American companies began rebuilding their inventories at a rapid rate during 2010, thus making a significant contribution to growth. On the other hand, in contrast to the three preceding years, net exports made no contribution to growth, as imports grew faster than exports. Moreover, the US terms of trade deteriorated, mainly because of the

CHART 5 QUARTERLY PROFILE OF GDP AND OF THE MAIN EXPENDITURE CATEGORIES IN THE LEADING ADVANCED ECONOMIES
(seasonally adjusted data; contribution to the volume change in GDP compared to the previous quarter, percentage points, unless otherwise stated)



Sources: EC, BEA, ESRI, ONS.

(1) Data also adjusted for calendar effects.

(2) Percentage changes compared to the previous quarter.

higher prices of commodities, so that the current account deficit on the balance of payments, which had improved from 2007, increased again from 2.7 to 3.4% of GDP.

In Japan, GDP grew by 4.3% during the year under review, whereas it had fallen by 1.2% in 2008 and 6.3% in 2009. The economic recovery ongoing since the second quarter of 2009 was mainly export-based. The rebuilding of inventories of products relating to information technologies in the western economies and the vigorous demand for investment goods for infrastructure projects in Asia, especially China, revitalised Japanese exports and output, and caused a surge in

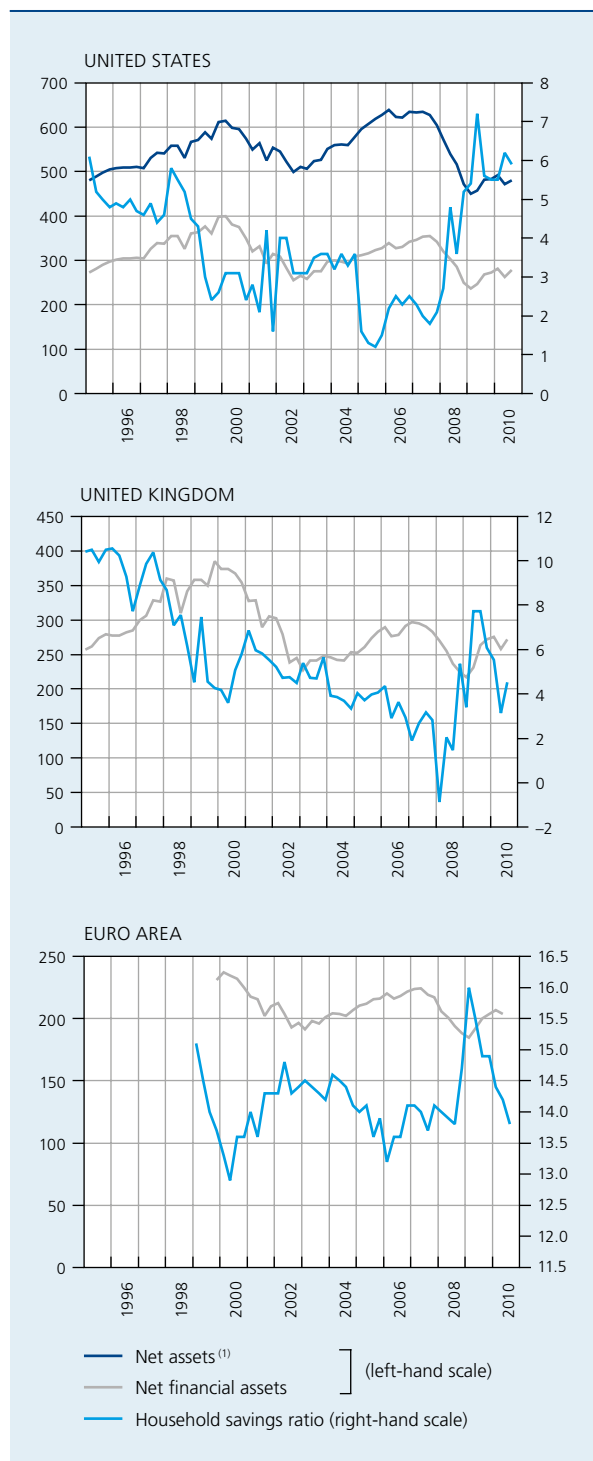
the profits of export firms. Thus, in the second quarter of 2010, growth was actually driven almost exclusively by business investment and exports, while household consumption hardly expanded at all owing to the persistently high unemployment rate. The assets of Japanese households recorded only a negligible improvement, partly because of the continuing downward trend in house prices.

During the year, the strength of the yen and the weakening of external demand, mainly from China, began to inhibit the volume of exports and corporate profit margins so that, in the third quarter, net exports and business

investment made hardly any contribution to growth. However, economic activity picked up thanks to private

CHART 6 NET ASSETS AND SAVINGS RATIO OF HOUSEHOLDS IN THE MAIN ADVANCED ECONOMIES

(quarterly data, in % of disposable income)



Sources: EC, OECD, ONS, Federal Reserve, ECB.

(1) Net financial assets plus assets in the form of real estate.

consumption expenditure, which recorded the strongest growth rate for more than a year, though there were several temporary factors involved, such as a hot summer, the scheduled increase in tobacco taxes and the impending abolition of the subsidies for the purchase of eco-friendly vehicles. The first nominal wage increase in two years, in the second quarter, probably also played a role. The other expenditure categories remained sluggish during the year. In contrast to other countries, the overall change in inventories did not contribute to growth. Investment in housing was 7.3% down against the previous year. Finally, the worrying fiscal situation restricted the government's scope for investment.

The recovery in activity in the United Kingdom, which had begun in the final quarter of 2009, was maintained, so that GDP grew by 1.7% in 2010, after a 4.9% decline in the previous year. The slackening pace of de-stocking and, from the second quarter of 2010, the first signs of a trend towards re-stocking, played a major role in the growth of GDP during the first quarters of 2010. To a lesser degree, activity was also supported by the investment revival, and especially housing construction which had slumped during the recession. The pattern of household consumption was uneven during the year owing to the VAT increases in January 2010 and 2011, which caused British households to cut consumption in the first quarter of 2010 and, conversely, to increase their consumption slightly in the last quarter in anticipation. Over the year as a whole, consumer spending growth was rather sluggish, restrained by the decline in real disposable income and the uncertain economic outlook, particularly owing to the high unemployment and the austerity budget adopted in the autumn; nevertheless, it did contribute to overall growth as a result of a decline in the savings ratio of households. That development was encouraged by the recovery of their net worth, brought about by the rising prices of financial assets and property. Public consumption provided only a modest stimulus to domestic demand throughout the year, while public investment was cut.

Despite the 22% depreciation in the effective exchange rate of the pound sterling since the start of the financial crisis, the growth of the UK's exports remained modest as a result of the weak demand from its main trading partners, the euro area and the United States, the increase in the profit margins of British exporters and finally, the stagnation of exports of services, which had accounted for around 40% of total UK exports before the crisis. Since imports were more dynamic, net exports made a negative contribution to GDP growth and the current account deficit increased from 1.3% of GDP in 2009 to 2.2% in 2010.

The Chinese economy continued to impress: GDP grew by 10.3% in 2010. After having risen strongly at the end of 2009 and the beginning of 2010, however, the expansion of activity began to lose momentum from the second quarter, owing to the policies designed to moderate the overheating of the economy. In particular, the Chinese authorities tightened the rules on mortgage loans in order to curb the speculation on the housing market and property prices, which had soared in the first quarter, propelled by easy credit conditions and negative real interest rates. At first, sales of property fell sharply and the rise in property prices decelerated in a number of major urban centres, but from August onwards both prices and the volume of transactions began rising again, prompting the government to take additional adjustment measures at the end of September. The slowdown in economic activity continued in the third quarter – even though year-on-year growth remained surprisingly vigorous overall, at 9.6% – when the authorities took action against the industries causing the worst pollution. Finally, the tightening of monetary policy and the gradual withdrawal of the recovery plans towards the end of the year were also factors curbing growth.

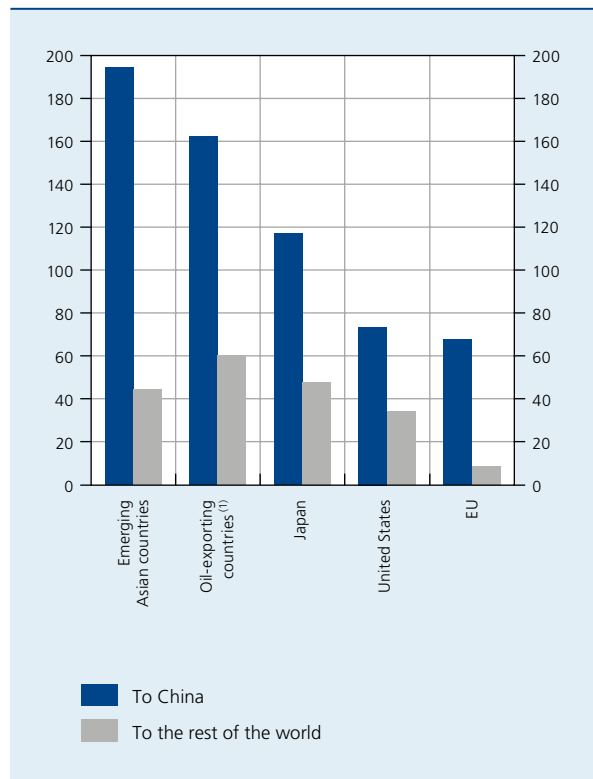
During the year, retail sales maintained their very rapid expansion, one possible reason being the government measures to support consumption, mainly favouring sales of motor vehicles. Buoyant consumer confidence and the accelerating pace of urbanisation and wage increases underpinned the persistent vigour of private consumption in the second half of the year, despite the growing pressure exerted on real household budgets by the rising prices of food and property. Gross fixed capital formation played an even bigger role than household spending in supporting GDP growth. That support came from private investment, principally in the property sector, since public investment – particularly in large-scale infrastructure projects – contracted with the gradual withdrawal of the recovery plans.

Owing to the vigour of domestic demand, the Chinese current account surplus diminished slightly, falling from 6% of GDP in 2009 to 5.8% in 2010.

While most other export markets contracted, the continuing rapid growth in China in recent years gave a clear boost to the recovery in other countries, even outside Asia. Thus, since the beginning of 2009, for the various countries and regions of the world, exports to China increased much faster than their exports to the rest of the world. Under the Chinese recovery plans, some major infrastructure projects were started and investment in property was very substantial, augmenting China's need for commodities and investment goods. Demand for the

CHART 7 GROWTH OF EXPORTS TO CHINA AND THE REST OF THE WORLD, JANUARY 2009 TO SEPTEMBER 2010

(percentage changes in value)



Source: IMF.

(1) Algeria, Angola, Azerbaijan, Bahrain, Congo, Ecuador, Equatorial Guinea, Gabon, Iran, Kuwait, Libya, Nigeria, Norway, Oman, Qatar, Russian Federation, Saudi Arabia, Syria, Turkmenistan, United Arab Emirates, Venezuela and Yemen.

latter particularly benefited Japan and the EU (especially Germany), in view of their specialisation in the production of that type of goods.

China also played a positive role in financing the sovereign debt of struggling euro area countries. In October and December, it offered to invest part of its foreign exchange reserves in the purchase of Greek and Portuguese government bonds.

Monetary policy

During 2010, as the economic situation developed, the US Federal Reserve adjusted its policy. During the first half of the year, in view of the improvement in the financial and economic situation, the emphasis was placed on reverting to a normal policy by abolishing a number of measures adopted to cope with the crisis. For instance, in February, following the increase in the discount rate from 0.5 to

0.75 %, the differential between that interest rate and the federal funds target rate was partially normalised. In regard to the unconventional measures, the first move came in late March when the Federal Reserve stopped taking over the debts of the American government-sponsored mortgage agencies (Fannie Mae, Freddie Mac and Federal Home Loan Banks) and buying mortgage-backed securities (issued by Fannie Mae, Freddie Mac and Ginnie Mae). Over the ensuing months, the Federal Reserve allowed its portfolio of this type of assets to decline as they reached maturity or were redeemed. Next, at the end of June, as the financial market recovery became stronger, all the special liquidity programmes created in 2007 and 2008 to assist financial institutions were terminated altogether. One exception was the conclusion, in May, of new dollar swap agreements between the Federal Reserve and a number of central banks, as short-term financing in dollars was causing new problems in Europe.

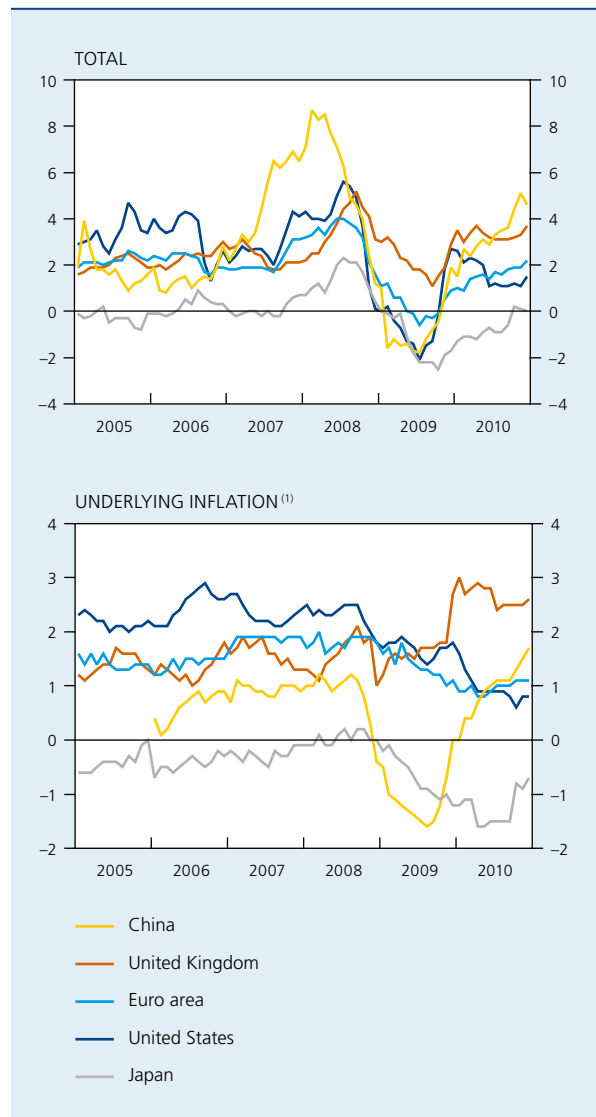
However, from the summer, disappointing growth figures, uncertain prospects and low inflation caused the Federal Reserve to ease its monetary policy. During the rest of the year, the federal funds target rate remained within the 0 to 0.25 % range, introduced at the end of 2008, and the Federal Open Market Committee of the Federal Reserve (FOMC) repeatedly stated its desire to keep it at a low level as long as warranted by the economic conditions. Monetary policy was eased by unconventional measures: at the beginning of August, the FOMC announced that the proceeds from the redemption of the government-sponsored mortgage agencies' debts and of the mortgage-backed securities would be entirely reinvested in government loans, so that the amount of the long-term securities recorded on the balance sheet would be held constant; at the beginning of November, a series of additional purchases of long-term sovereign securities was announced. Those purchases will continue until the end of the second quarter of 2011, and should increase the balance sheet of the Federal Reserve System by \$ 600 billion, or around \$ 75 billion per month.

During the year, after the Bank of Japan closed most of the temporary facilities, the continuing decline in underlying inflation and the strength of the yen caused that institution to expand the fixed-rate operations supplying funds to the banks. At the beginning of October, it also decided to cut the key rate, held at 0.1 % since mid-December 2008, to between 0 and 0.1 % and to acquire a broad range of securities, though for a fairly modest amount of 5,000 billion yen (or around 1 % of GDP).

The monetary policy of the Bank of England remained very accommodating, with its key rate held steady at 0.5 % throughout the year under review and maintenance of

CHART 8 INFLATION IN THE MAIN ECONOMIES

(monthly data, changes compared to the corresponding period of the previous year)



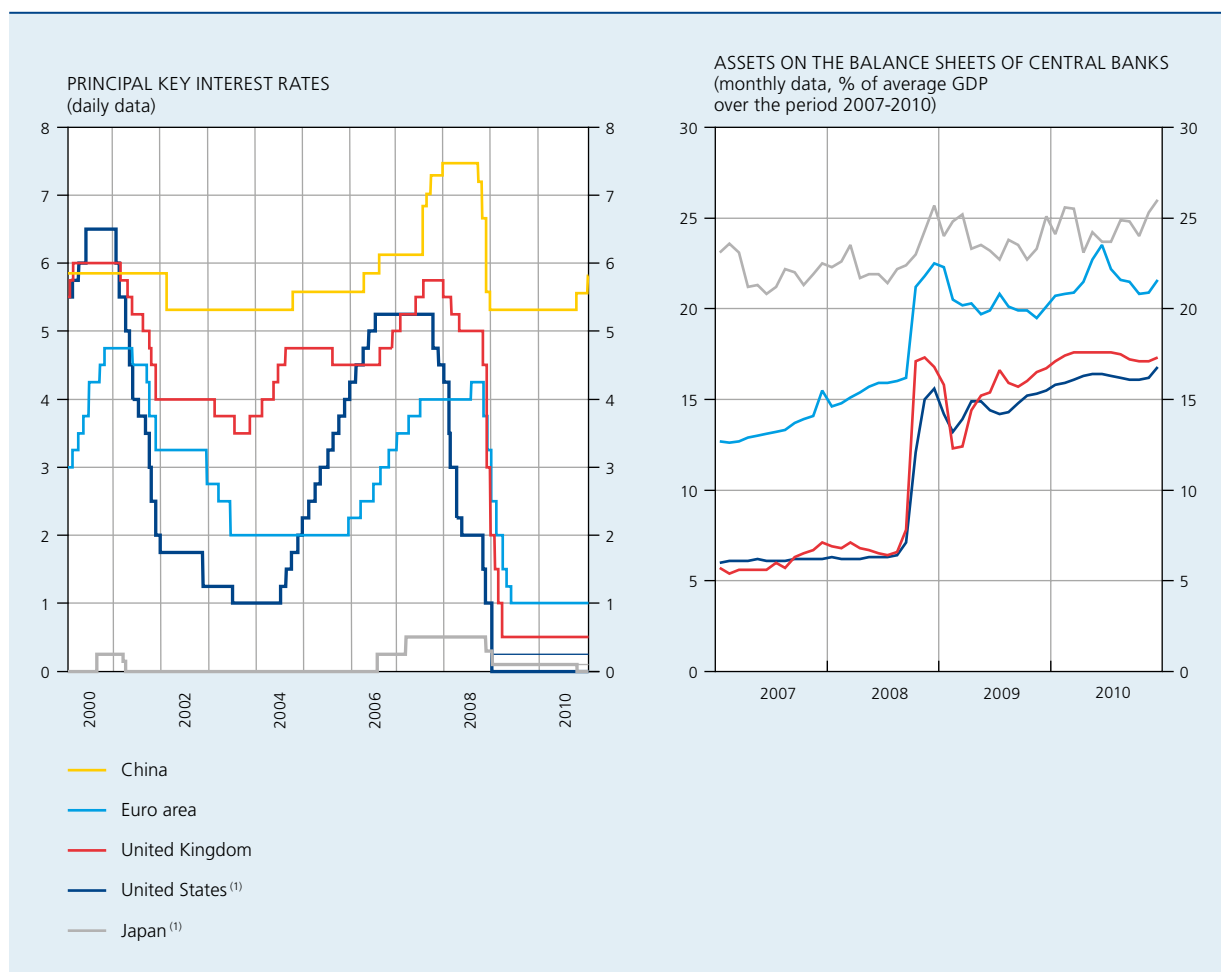
Sources: CEIC, Thomson Reuters Datastream, Statistics Bureau of Japan.
(1) Measured by the consumer price index excluding food and energy.

the quantitative easing plan approved in 2009, amounting to £200 billion (or almost 14 % of GDP).

The Chinese central bank also maintained its accommodating policy in 2010, but nevertheless took a number of targeted measures to slow the rise in property prices and the growth of lending and the money supply. The banks' reserve requirements were increased several times, and lending was curbed by new quantitative restrictions. The monetary authority thus aimed to limit the amount of new lending over the year as a whole to RMB 7,500 billion (or around 20 % of GDP). Making the renminbi more "flexible" was also meant to reduce the inflationary

CHART 9

KEY INTEREST RATES AND ASSETS ON THE BALANCE SHEET OF THE MAIN CENTRAL BANKS



Sources: IMF, Bank of England, Bank of Japan, Federal Reserve, People's Bank of China, ECB.

(1) For the key rates, the line is divided if the central bank has set a target range, the ceiling being indicated by a narrower line in the same colour.

pressures. Finally, on two occasions – 20 October and 24 December – the Chinese central bank raised the deposit interest rate by 25 basis points, thus increasing it from 2.25 to 2.75 %, while it put up the bank lending rate at one year to 5.81 %. These were the first tightening measures in two years.

Public finances

In the United States, the general government budget deficit diminished slightly, as some of the fiscal stimuli implemented after the crisis came to an end and the recovery generated higher revenues. It thus declined from 11.3 to 10.5 % of GDP. Though the feebleness of the recovery prompted the federal authorities to take a new series of expansionary initiatives during the year, the scale of those measures remained modest in 2010.

The gross public debt therefore increased further from 84.4 to 92.8 % of GDP.

In Japan, on the other hand, the fiscal policy stance remained expansionary overall. In view of the hesitancy of the economic revival, the government further reinforced that policy in September and October, by adopting a new set of recovery measures geared to employment, and supplementary emergency measures amounting to 980 and 5,050 billion yen respectively, or 1.2 % of GDP altogether. A substantial increase in public spending drove up the budget deficit by 0.6 percentage point to 7.7 % of GDP. In that context, the gross public debt continued to rise, approaching 200 % of GDP.

In the United Kingdom, there was only a very small reduction in the public deficit in 2010, from 11.4 to 10.5 % of GDP. That improvement was due mainly to

the expiry of the measure reducing the rate of VAT at the beginning of the year and the fact that the public investment expenditure which had been approved in the wake of the crisis in order to counteract its effects was brought forward to 2008 and 2009. In addition, draconian cuts were approved in June. The consolidated gross public debt recorded a substantial further rise from 68.2 to 77.8 % of GDP.

While the fiscal situation in most of the advanced economies is clearly unsustainable and will require drastic consolidation measures in the years ahead, China maintained sound public finances, despite substantial recovery plans: thus, the public deficit in 2010 remained at its previous year's level of around 3 % of GDP, while the public debt represented only 19.1 % of GDP at the end of 2010.

TABLE 2 GENERAL GOVERNMENT BUDGET BALANCE AND DEBT IN THE MAIN ECONOMIES
(in % of GDP)

	Budget balance ⁽¹⁾				Gross debt ⁽²⁾			
	2007	2008	2009	2010	2007	2008	2009	2010
United States	-2.9	-6.3	-11.3	-10.5	62.0	71.1	84.4	92.8
Euro area	-0.6	-2.0	-6.3	-6.3	66.2	69.8	79.2	84.2
Japan	-2.4	-2.1	-7.1	-7.7	167.1	173.9	192.8	198.4
United Kingdom	-2.7	-5.0	-11.4	-10.5	44.5	52.1	68.2	77.8
China	0.9	-0.4	-3.0	-2.9	19.8	16.8	18.6	19.1

Sources: EC, IMF, OECD.

(1) For the euro area and the United Kingdom, under the rules laid down for the excessive deficit procedure (EDP), the figures include net interest gains on certain financial transactions such as swaps.

(2) For the euro area and the United Kingdom, the figures concern the consolidated gross debt, i.e. excluding debts which have as their counterpart assets in the general government sector.

1.2 Euro area and the monetary policy of the Eurosystem

1.2.1 Main economic developments in the euro area

Economic activity and labour market

After the euro area had returned to positive growth in the third quarter of 2009, the recovery continued in 2010: GDP expanded by 1.7 %, whereas it had fallen by 4.1 % in 2009. However, the economic revival was gradual in comparison with the average recovery seen following previous recessions, or the revival evident in other advanced economies such as the United States and Japan, even taking account of the particularly vigorous growth recorded in the euro area in the second quarter. All in all, in the third quarter of the year under review the volume of GDP was still lower than its average 2007 level.

The economic recovery in the euro area was relatively widespread, with most Member States recording a rise in their GDP in 2010. That rise was particularly strong in certain countries such as Germany, Slovakia and Finland where activity had contracted sharply in 2009. In Belgium, the Netherlands and France, the recovery was comparable to the average for the euro area. Conversely, in other economies, such as Portugal and Italy, it lagged significantly behind the average, and GDP actually declined again in Ireland, Spain and especially Greece. Excluding Greece, there was nevertheless a noticeable improvement in activity everywhere, compared to 2009.

The revival in activity in the euro area was largely export driven. Exports had begun to grow strongly by mid-2009, but their expansion was particularly vigorous in the second quarter of 2010. The export growth was sustained by the recovery of the global economy and

TABLE 3 GDP GROWTH IN THE EURO AREA COUNTRIES⁽¹⁾

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

	2008	2009	2010	<i>p.m.</i> 2009, share of euro area GDP
Germany	1.0	-4.7	3.7	26.8
France	0.2	-2.6	1.6	21.3
Italy	-1.3	-5.0	1.1	17.0
Spain	0.9	-3.7	-0.2	11.8
Netherlands	1.9	-3.9	1.7	6.4
Belgium	1.0	-2.8	2.0	3.8
Austria	2.2	-3.9	2.0	3.1
Greece	1.3	-2.3	-4.2	2.6
Finland	0.9	-8.0	2.9	1.9
Portugal	0.0	-2.6	1.3	1.9
Ireland	-3.5	-7.6	-0.2	1.8
Slovakia	5.8	-4.8	4.1	0.7
Luxembourg	1.4	-3.7	3.2	0.4
Slovenia	3.7	-8.1	1.1	0.4
Cyprus	3.6	-1.7	0.5	0.2
Malta	2.6	-2.1	3.1	0.1
Euro area ⁽²⁾	0.3	-4.1	1.7	100.0

Sources: EC, OECD.

(1) The euro area countries are ranked in order of the size of their GDP in 2010.

(2) Excluding Cyprus and Malta; calendar adjusted data.

TABLE 4 GDP AND MAIN EXPENDITURE CATEGORIES IN THE EURO AREA ⁽¹⁾

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

	2008	2009	2010
Final consumption expenditure of households	0.3	-1.1	0.6
Final consumption expenditure of general government	2.3	2.4	1.0
Gross fixed capital formation ...	-1.0	-11.3	-1.0
Housing	-5.3	-10.7	-3.6
Enterprises	0.3	-14.9	0.7
General government	1.6	5.1	-3.4
<i>p.m. Final domestic expenditure</i>	<i>0.4</i>	<i>-2.6</i>	<i>0.3</i>
Change in inventories ⁽²⁾	-0.2	-0.7	0.6
Net exports of goods and services ⁽²⁾	0.1	-0.8	0.8
Exports of goods and services ⁽³⁾ ..	1.0	-13.2	10.7
Imports of goods and services ⁽³⁾ ..	0.8	-11.9	8.7
GDP	0.3	-4.1	1.7

Sources: EC, OECD.

(1) Excluding Cyprus and Malta, except for exports and imports.

(2) Contribution to the change in GDP, percentage points.

(3) Non calendar adjusted data.

international trade, especially in the countries where it had collapsed during the crisis. It could be that the weakening of the euro at the end of 2009 and in the initial months of 2010 also played a role. Most of the euro area countries recorded a revival in their exports, but this export engine was clearly particularly powerful in Germany. In the second quarter, the marked acceleration in growth was essentially due to the progress of exports in that country, which benefited from Germany's specialisation in investment goods and the growing focus of its exports on the emerging economies, especially China. If import growth is also taken into account, net exports of goods and services contributed an average of 0.8 percentage point to growth in 2010.

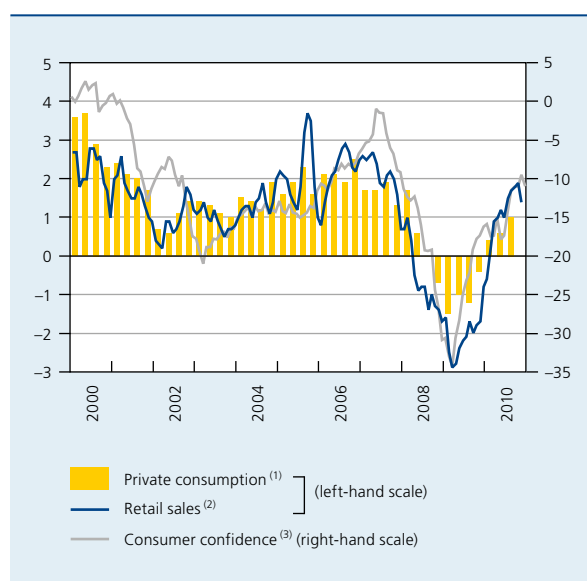
Total domestic demand made a contribution of 0.9 percentage point to euro area growth in 2010. However, most of that, namely 0.6 percentage point, was due to the change in inventories. The contribution of this volatile component of expenditure was particularly substantial in the first half of the year. Conversely, final domestic demand remained weak in comparison with the figures in the years preceding the crisis, contributing only 0.3 percentage point to GDP growth.

After having fallen by just over 1% in 2009, private consumption showed a very modest rise of 0.6%. In Germany, there was no increase on average, over the year as a whole. In Greece and Ireland, the correction of the macroeconomic imbalances actually caused a significant fall in private consumption. In contrast, in Spain where these adjustments were also decisive for economic developments during the year, private consumption grew further. In other countries too, including France and Belgium, private consumption exhibited some dynamism.

The sluggishness of private consumption must be viewed in the light of the continuing adverse situation prevailing on the labour market. Overall, employment in the euro area declined by a further 0.5%, while unemployment increased to 10% of the labour force. Nonetheless, the number of job losses recorded during the year was significantly lower than in 2009, when employment contracted by 1.8%.

The economic recovery brought ever-increasing signs of stabilisation on the labour market during the year under review: though employment remained depressed, for the first time since the start of the crisis there was a clear decline in job losses in terms of the year-on-year change, and employment more or less stabilised on a quarterly basis. The branches most affected by job losses since

CHART 10 PRIVATE CONSUMPTION, CONSUMER CONFIDENCE AND RETAIL SALES IN THE EURO AREA



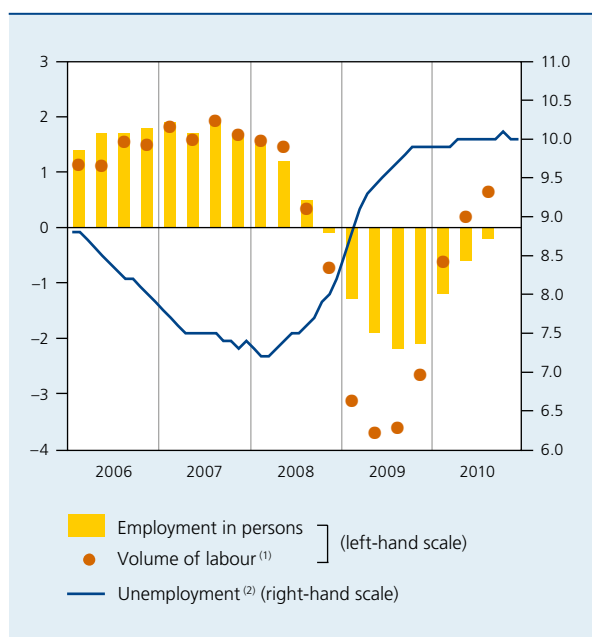
Sources: EC, ECB.

(1) Seasonally and calendar adjusted data, percentage changes compared to the corresponding quarter of the previous year.

(2) Calendar adjusted data, annual percentage changes, three-month moving average.

(3) Seasonally adjusted data, balance of replies to the monthly survey.

CHART 11 LABOUR MARKET IN THE EURO AREA
(percentage changes compared to the corresponding quarter of the previous year, unless otherwise stated)



Sources: EC, ECB.

(1) Total hours worked.

(2) Ratio in % between the number of unemployed persons and the labour force.

mid-2008, namely manufacturing industry and construction, continued to suffer cuts in employment, but to an ever diminishing degree. In contrast, the “financial and business services activities” branch has actually been generating new jobs continuously since the end of 2009. However, the labour market improvement has remained fragile overall and is still modest, varying from one euro area country to another.

During the crisis, the deterioration of the labour market was reflected more in a decline in the number of hours worked and hourly productivity, rather than in recourse to redundancies, which helped to curb the job losses. Conversely, when economic activity picked up, firms initially endeavoured to make better use of their existing employees, and hence to increase productivity, by stepping up the number of hours worked per employee and hourly productivity.

Unemployment, which had surged by mid-2008, flattened out at a high level for much of 2010, rising from 9.9 to 10 % from April onwards, with a 10.1 % spike in October. However, this relative stabilisation masks a structural deterioration in unemployment evident, for example, from the rise in long-term unemployment as a percentage of the total, which reached 43.5 % in the third quarter.

The employment picture in the euro area in 2010 was relatively varied between Member States, with some countries recording a rise while others were still affected by net job losses. There were in fact net job creations in some countries, such as Germany, France and Belgium. Conversely, job losses persisted in other economies, such as Spain, Greece and Ireland, posing a serious problem in those countries where unemployment reached an extremely worrying level, for example in Spain where it peaked at 20.6 % in September and October. A recovery in employment was noticeably lacking in countries where construction – a branch which is relatively labour intensive – was a very important sectoral component of national output (Greece, Ireland, Spain). This is precisely the branch that was particularly vulnerable to the crisis and which has continued to feel the effects of restructuring.

This geographical disparity is also evident in unemployment, which maintained its upward trend for much of the year, notably in Greece, Spain and Ireland. Conversely, it actually began to fall in some countries, such as Germany and Austria.

While the employment situation and the resulting meagre increase in household incomes were contributory factors, the weak growth of private consumption was also due to households maintaining their savings ratio at a high level compared to that prevailing before the crisis. The uncertainty surrounding the prospects for economic activity and employment continued to encourage individuals to accumulate more substantial precautionary savings than in normal times. Moreover, the decline in their net worth in the wake of the crisis probably also motivated households to save more in order to rebuild their assets.

Gross fixed capital formation was down by a further 1 %, albeit a much smaller reduction than in the previous year. The weakness of investment was due largely to activity in the housing construction branch. On average, investment in housing declined further by 3.6 %, with a particularly steep fall in Ireland, Greece and Spain. Overall, house prices showed signs of stabilising in the euro area, though there were further sharp falls in certain countries, notably Ireland and Spain.

The gradual improvement on the housing markets was in line with the improving financial conditions on the property market. First, bank lending for house purchase expanded continuously during the year. At the same time, mortgage interest rates on long-term fixed-rate loans continued to fall. While there was a further tightening of mortgage loan conditions in the first quarter of 2010, lending conditions reached a neutral threshold in the third quarter for the first time in more than two years.

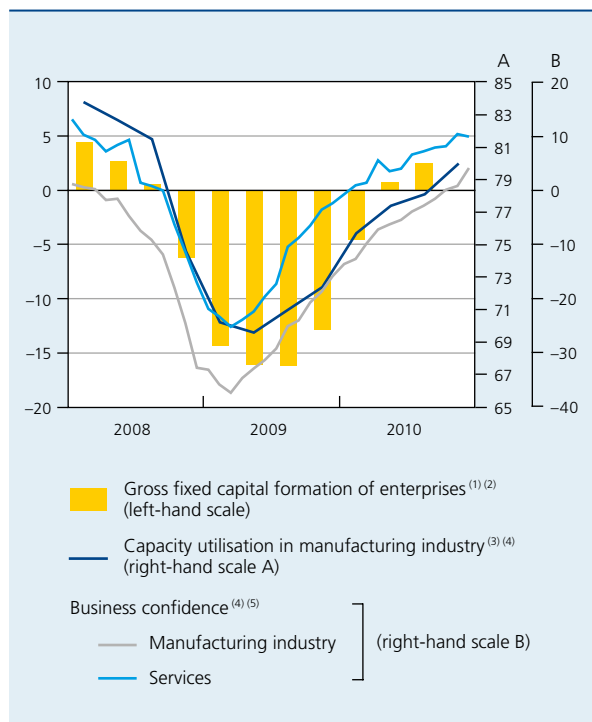
However, in the fourth quarter, conditions reverted to a level comparable to that prevailing at the beginning of the year. Investment in housing strengthened particularly in the second quarter, notably because of a rise in that investment in Germany. This improvement was partly due to the catching up following the effects of bad weather on building activity in the first quarter. Conversely, in Spain and Ireland, where the slump in demand which occurred when the property bubble burst had not been immediately followed by an adjustment in the supply of housing, the resulting gradual absorption of the stock of unsold homes brought a further steady contraction in investment in housing in 2010.

In contrast, business investment edged upwards in 2010, by 0.7 %. The improvement seen during the year reflected the growing confidence of business managers in industry and services. It was also in line with the steady increase in capacity utilisation rates in manufacturing industry since the third quarter of 2009, and the improvement in corporate profitability in the euro area.

As explained below in the section on monetary developments, lending to businesses by credit institutions nevertheless continued to fall in 2010 compared to the situation a year earlier. However, the decline slowed during the year. Moreover, this tallies with the pattern seen in other business cycles, where the revival in business lending tended to lag slightly behind the pick-up in activity.

There was a strong rise in the gross fixed capital formation of enterprises in Germany, where the expansion of exports was accompanied by a marked increase in capacity utilisation in manufacturing industry, and where business confidence was considerably improved. It is also possible that some business managers in Germany brought forward investment decisions in view of the withdrawal of certain tax incentives at the end of the year, particularly the favourable rules on depreciation. The situation also improved in other countries during the year, notably in Italy, France and Belgium. Thus, in France, measures such as the local business tax reform may have had a beneficial effect on investment.

CHART 12 BUSINESS INVESTMENT AND BUSINESS CONFIDENCE IN THE EURO AREA
(seasonally adjusted data)



Sources: EC, OECD.

- (1) Data also calendar adjusted, percentage volume changes compared to the corresponding quarter of the previous year.
- (2) Excluding Cyprus and Malta.
- (3) Measured by the quarterly survey, in %.
- (4) From May 2010, the survey data were subject to an adjustment in the classification of activities (updated version of NACE rev. 2). This methodological change may have caused a break in the historical series on that date.
- (5) Balance of replies to the monthly survey.

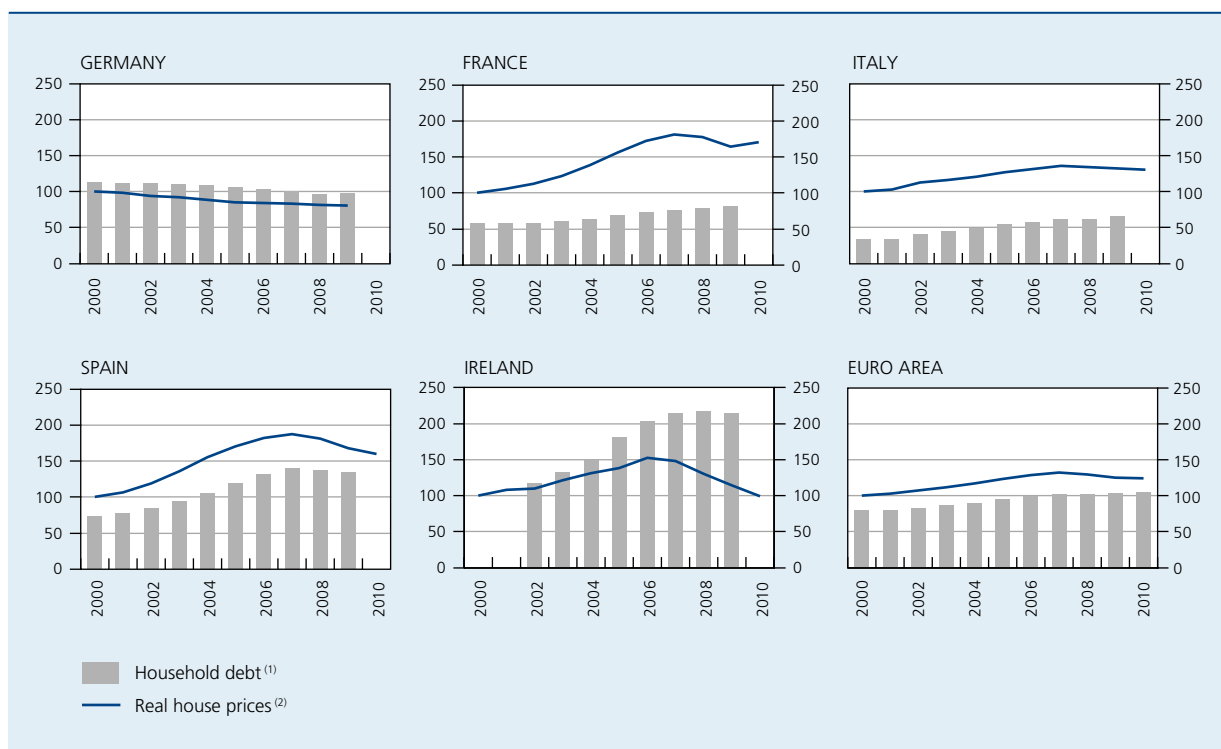
In 2009, public investment had expanded strongly in the euro area in the light of the infrastructure projects launched by a number of countries under the European recovery plans. In 2010, owing to the expiry of these plans and the start of public finance consolidation in a number of countries, public investment receded by an average of 3.4 %. This contraction was relatively widespread throughout the euro area, with the notable exception of Germany, since some major infrastructure projects were still being implemented there under the fiscal recovery plan.

Constraints on recovery in the euro area

As in other advanced economies, the recovery of domestic demand in the euro area was hampered by the ongoing correction of the macroeconomic imbalances which had arisen before the outbreak of the crisis.

One inhibiting factor was the need for households and firms to restore the balance between their assets and their liabilities, in view of the substantial accumulation of debts during the years preceding the crisis.

In the case of households, their debts as a percentage of net disposable income have increased throughout the euro area, by around 30 % since the advent of the new millennium. In some countries, such as Greece, Ireland and Spain, debt levels soared in the space of a few years, reaching particularly high levels in Ireland. In these countries, that rise was often accompanied by a

CHART 13 HOUSEHOLD DEBT AND REAL HOUSE PRICES IN THE EURO AREA COUNTRIES

Sources: BIS, EC, OECD, ECB.

(1) In % of net disposable income of households; for the euro area, first half of the year in 2010.

(2) Indices 2000 = 100, nominal house prices deflated by the corresponding national HICP; for 2010, average of the available months.

strong expansion of the housing market and a house price boom. Consequently, the countries where that market displayed clear signs of overheating were the ones where the decline in investment in housing first made its appearance and was most marked. The effects of the substantial correction on the housing market, further exacerbated by the financial crisis, had a severe impact on households and seriously affected their spending pattern. In view of the importance of housing construction in these economies, the property market crisis in Spain and Ireland caused a sharp slowdown in economic activity and massive job losses. As a result of the greater uncertainty and the growing need to consolidate their balance sheets, households there increased their savings ratio to a greater extent than in the rest of the euro area. In some respects, this situation can be compared to that of Germany in the aftermath of the reunification with the former East Germany. That reunification was similarly followed by strong overheating of the economy and the property market. The effects of the ensuing correction took a long time to fade. Thus, over the past decade the debt level of German households has gradually fallen. That decline has been accompanied by an almost continuous fall in house prices. The savings ratio of German households has risen constantly over the past ten years.

While the debt ratio of households increased a little further in the euro area as a whole, it has stabilised or even fallen slightly since 2007 in some of the countries where domestic demand had been overheating. Those economies could still have a long way to go in the debt reduction process, in view of the continuing high debt levels of their households in 2010.

In the past decade, the debt level of euro area businesses as a percentage of GDP has also risen considerably, to reach a relatively high level compared to that in the United States. In this respect, too, there are significant differences between countries in the euro area. For instance, the corporate debt ratio is relatively low in Germany, compared to the figure in most other euro area countries. The healthier state of German businesses may therefore be part of the reason for the more vigorous investment revival in that country, and also helped them to preserve more jobs when activity contracted than was the case in other countries.

Another factor undermining the recovery of domestic demand is the serious deterioration in public finances in the euro area, caused by the financial crisis and the economic recession. On the one hand, in many countries the

government took action to rescue the financial system, more particularly the banks. Also, numerous fiscal measures were adopted in order to contain the seriousness of the recession as far as possible by means of recovery plans. Moreover, the operation of the automatic stabilisers led to a deterioration in budget positions. Consequently, the public deficit for the euro area as a whole increased from 0.6% of GDP in 2007 to 6.3% in 2009. Once again, that masks sometimes very significant differences between Member States. For instance, there was a dramatic deterioration in the budget position and the public debt in Ireland and Spain, though the starting position there in 2007 had been more favourable than the average for the euro area. In those countries, the fiscal deterioration was due largely to the loss of the revenues which the government had been collecting previously on the rising asset prices. Conversely, in Greece, the derailment caused by the crisis exacerbated an already substantial deficit and debt. The adverse impact of these developments on domestic demand may have materialised in various ways. First, households may have increased their savings because they expected the consolidation of public finances to depress the future growth of their disposable income via taxes, additional contributions or cuts in public spending, particularly social benefits. Next, the doubts which had emerged as to the sustainability of the budget position of certain countries contributed to tensions on the financial markets. Those tensions depressed domestic demand owing to mounting uncertainty and – especially in the countries concerned – less ready access to bank credit. Finally, many countries speeded up their decisions on the restoration of sound and sustainable public finances and announced massive consolidation plans.

Fiscal policy

In view of the existence of excessive public deficits in almost all euro area countries in 2009, the Ecofin Council decided, in October 2009, that it was time to define a substantial fiscal consolidation strategy. To that end, it set 2011 as the deadline for the correction of the excessive deficits in Malta and Finland, 2012 for Cyprus, Belgium and Italy, and 2013 for the other countries except Greece and Ireland, which were given until 2014 and 2015 respectively, in view of the severity of the recession in those two countries. For Ireland, the original deadline was 2014, but it was postponed under an aid plan in November 2010. With the exception of France, Ireland and Slovakia, all countries with a deficit in excess of the euro area average in 2009 reduced it in 2010. Some with a below-average deficit, such as Belgium and Italy, also achieved a reduction in 2010. Conversely, the Netherlands, Austria, Germany, Finland and Luxembourg,

which had smaller deficits in 2009, allowed those deficits to rise slightly during the year under review.

According to the EC's November 2010 economic forecasts, the general government budget deficit in Germany increased from 3% of GDP in 2009 to 3.7%. That was due to a deterioration in the cyclically adjusted primary balance of almost 2 percentage points of GDP, partly offset by the effects of the sustained GDP growth. The deterioration in the primary balance was due to factors such as the measures concerning the tax deductibility of health care contributions, the reform of business taxes and a reduction in the rate of VAT applied to hotels and restaurants.

In France, the general government deficit came to 7.7% of GDP in 2010, up slightly against 2009. This deterioration in the budget balance was due mainly to new measures taken in 2010, such as the reform of the local business tax and the cut in the VAT rate in the restaurant sector, the effect of which was only partly offset by the gradual phasing-out of the stimuli applied under the economic recovery programme.

In Italy, the general government deficit was cut from 5.3% of GDP in 2009 to 5% in 2010, in accordance with the budget targets set in the January 2010 update of the stability programme. That improvement was due to the economic upturn and the expiry of the recovery measures adopted in the wake of the crisis.

In Greece, the fiscal adjustment programme adopted in May 2010 when an emergency financing plan was set up by the EU and the IMF (see below) aimed to cut the general government deficit from 13.6% of GDP in 2009 to 8% in 2010. The recommended measures concerned both revenue – with an increase in the VAT rate and extension of the tax base – and expenditure, with a particular impact on civil service pensions and salaries.

Up to the summer of 2010, Greece met all the budget targets set by this programme. However, the deterioration in economic activity was subsequently reflected in lower than expected revenues. Moreover, in November, Eurostat made a substantial upward revision in the 2009 figures for the Greek public deficit and public debt, raising them respectively from 13.6 to 15.4% and from around 115 to 127% of GDP. This revision obviously invalidated the budget target for 2010, as the deficit amounted to 9.6% of GDP. It caused the Greek government to announce new austerity measures for 2011, for an amount equivalent to 2.5% of GDP, in order to adhere to the consolidation path laid down in the joint EU/IMF rescue plan.

TABLE 5 GENERAL GOVERNMENT BUDGET BALANCE AND DEBT IN THE EURO AREA COUNTRIES⁽¹⁾⁽²⁾
(in % of GDP)

	Budget balance				Fiscal consolidation efforts recommended under the excessive deficit procedure (EDP)		Consolidated gross debt		
	2007	2008	2009	2010 ⁽³⁾	Correction period	Average annual rate of structural adjustment ⁽⁴⁾	2008	2009	2010 ⁽³⁾
Germany	0.3	0.1	-3.0	-3.7	2011-2013	0.5	66.3	73.4	75.7
France	-2.7	-3.3	-7.5	-7.7	2010-2013	1	67.5	78.1	83.0
Italy	-1.5	-2.7	-5.3	-5.0	2010-2012	0.5	106.3	116.0	118.9
Spain	1.9	-4.2	-11.1	-9.3	2010-2013	1.5	39.8	53.2	64.4
Netherlands	0.2	0.6	-5.4	-5.8	2011-2013	0.75	58.2	60.8	64.8
Belgium	-0.3	-1.3	-6.0	-4.6 e	2010-2012	0.75	89.6	96.2	97.5 e
Austria	-0.4	-0.5	-3.5	-4.3	2011-2013	0.75	62.5	67.5	70.4
Greece	-6.4	-9.4	-15.4	-9.6	2009-2014	n.	110.3	126.8	140.2
Finland	5.2	4.2	-2.5	-3.1	2011	0.5	34.1	43.8	49.0
Portugal	-2.8	-2.9	-9.3	-7.3	2010-2013	1.25	65.3	76.1	82.8
Ireland	0.0	-7.3	-14.4	-32.3	2011-2015 ⁽⁵⁾	2	44.3	65.5	97.4
Slovakia	-1.8	-2.1	-7.9	-8.2	2010-2013	1	27.8	35.4	42.1
Luxembourg	3.7	3.0	-0.7	-1.8	-	-	13.6	14.5	18.2
Slovenia	0.0	-1.8	-5.8	-5.8	2010-2013	0.75	22.5	35.4	40.7
Cyprus	3.4	0.9	-6.0	-5.9	2011-2012	1.5	48.3	58.0	62.2
Malta	-2.3	-4.8	-3.8	-4.2	2010-2011	0.75	63.1	68.6	70.4
Euro area	-0.6	-2.0	-6.3	-6.3			69.8	79.2	84.2

Sources: EC, NBB.

(1) The euro area countries are ranked according to the size of their GDP in 2010.

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

(3) According to the EC's economic projections in November 2010, except for Belgium, for which the figures are based on the Bank's estimate.

(4) Balance adjusted for the influence of the economic cycle and non-recurring measures.

(5) Period as adapted by the Ecofin Council under the aid plan granted in November 2010.

Several countries, mainly Spain, Portugal and Ireland, were hard hit by the contagion effects of the crisis in Greek public finances, which drove them to strengthen the consolidation of their budget position during May 2010.

In Spain, the effort to consolidate public finances was already well under way in the 2010 budget, partly thanks to a rise in the VAT rate planned from July 2010 and the withdrawal of many temporary recovery measures. The package of supplementary measures in May 2010 related solely to a reduction in public spending, particularly the cut in civil service pay. It helped to reduce the budget deficit from 11.1 % of GDP in 2009 to 9.3 % in 2010, or 0.5 percentage point less than the original target figure under the stability programme.

In Portugal, in line with the targets set out in the stability programme, the 2010 budget already made provision for

cutting the budget deficit from 9.3 % of GDP in 2009 to 8.3 %, e.g. via the civil service pay freeze. A new plan announced in May succeeded in cutting the target for the budget deficit to 7.3 % in 2010.

In Ireland, the massive rise in the general government deficit, up from 14.4 % of GDP in 2009 to 32.3 % in 2010, was due mainly to the government intervention to rescue the banking system. While the net effect of such non-recurring measures on the public deficit amounted to 2 % of GDP in 2009, it came to almost 20 % in 2010. Excluding these measures and the effect of the business cycle, the deterioration nevertheless continued, since the structural deficit expanded from 9.8 to 11.1 % of GDP, despite the major austerity measures adopted by the government as of mid-2008, which implied drastic spending cuts, particularly via a reduction in civil service pay, social spending and public investment. A new austerity

programme covering the years 2011-2014 therefore had to be approved at the time of an EU and IMF rescue package in November.

Taking the euro area as a whole, the budget deficit was steady at 6.3 % of GDP. However, leaving aside the substantial expenditure by Ireland in 2010 to rescue its banks, it would have improved by 0.3 percentage point of GDP. The general government debt ratio continued to rise in 2010, increasing from 79.2 % of GDP in 2009 to 84.2 %, or at a slower pace than in the previous year when an increase of 9.4 percentage points of GDP had been recorded. That deceleration is due solely to the movement in nominal GDP, which began growing again, and the fact that the debt had been swollen in 2009 by a large volume of recapitalisation transactions in the financial sector which, in view of their nature, did not have to be included in the calculation of the general government budget balance according to the accounting conventions used in ESA 95.

Crisis in public finances in the euro area

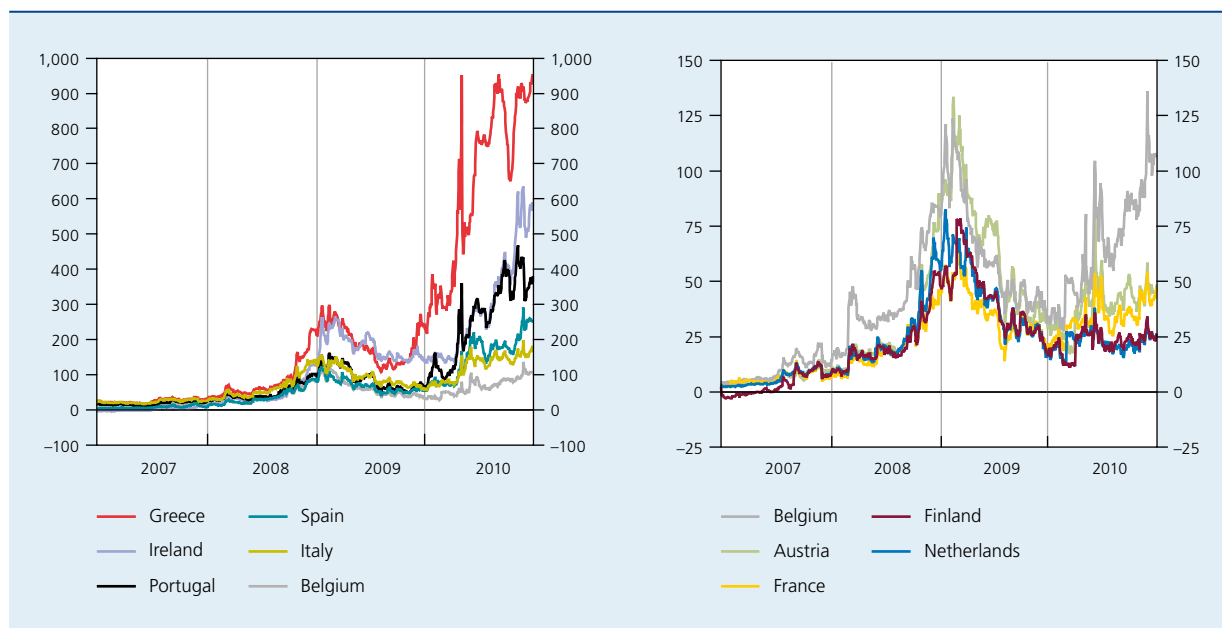
The substantial upward revision in Greece's public deficit in October 2009 led to mounting concern about the reliability of the statistics and the sustainability of the public debt in that country, with a corresponding sharp increase

in interest rate differentials between Greek government bonds and the German Bund. During the first quarter of 2010, in a still highly uncertain economic context, the anxieties spread to the most vulnerable countries in the euro area which combined to varying degrees a large public debt, chronic current account deficits indicating structural problems with competitiveness (e.g. Portugal, Spain and to a lesser extent Italy), or a particularly fragile banking system which could jeopardise their budget position (e.g. Ireland).

The rise in the interest rates at which the Greek State could raise finance continued during April, reinforcing fears of a sovereign default. This self-fuelling process caused the market in Greek sovereign debt securities to dry up altogether, triggering a liquidity crisis which affected a number of financial market segments beyond Greece. In addition to the contagion effects on the sovereign debt securities of the countries already mentioned, the exposure of European banks to the risk of a sovereign default on the part of those countries caused an increase in the cost of financing for banks on the interbank markets, a fall in stock market prices throughout the euro area, particularly for financial sector shares, plus a rise in risk premiums on corporate bonds and a depreciation of the euro.

The European authorities and the IMF responded by taking various measures to contain the rising loss of confidence

CHART 14 SPREADS ON TEN-YEAR GOVERNMENT BONDS COMPARED TO THE GERMAN BUND IN THE EURO AREA COUNTRIES
(daily data, basis points)



Source : Thomson Reuters Datastream.

in sovereign debts, particularly those of Greece. On 25 March 2010, the heads of State and government of the euro area countries reached an agreement in principle on emergency finance for Greece. Following the official request by the Greek State on 23 April, the Eurogroup, comprising the ministers of finance of the euro area countries, granted Greece conditional financial assistance on 2 May for a three-year period. Within this time span, the country should be able to effect a radical consolidation of its public finances and regain sufficient credibility

to ensure access to the markets at an affordable cost. This emergency plan was financed by bilateral loans from the other euro area countries amounting to € 80 billion (distributed among them according to the same sharing key as the ECB's capital), and € 30 billion from the IMF. For its part, Greece was obliged to take drastic measures not only to restore a sound budget, as stated above, but also to reform its banking system and to implement structural reforms to improve the functioning of its labour market and its competitiveness.

Box 2 – Effects of the public deficits on spreads on government loans in the euro area

Since the onset of the financial and economic crisis, spreads on government loans of euro area countries in relation to the German Bund have formed the subject of numerous articles in the economic literature. Before the crisis, those spreads were attributed mainly to fluctuations in global market sentiment regarding risk and the degree of liquidity on national markets⁽¹⁾, while opinions on their link with fiscal performance were somewhat divided. Following the crisis, there was a change in the analysis of the determinants of yield differentials between the euro area countries, and greater importance was attached to the role of national fiscal indicators as an explanatory factor. Thus, an interaction between national and international factors relating to credit risk was demonstrated, e.g. the fact that differences in the level of the budget balances play a greater role when a general feeling of risk aversion dominates the market. In other words, a deterioration in the situation of public finances leads to a bigger increase in yield differentials in periods of uncertainty. According to a study conducted by the IMF in 2009⁽²⁾, an increase in the budget deficit of 1 percentage point of GDP causes interest rates on long-term government loans to rise by between 10 and 60 basis points. The scale of that change depends not only on fiscal performance but also on institutional or structural aspects, and on contagion effects.

In practice, the financial markets seem to pay attention to a range of fiscal factors, such as the scope available to governments in view of their budget position and the scale of the implicit commitments which they have taken on via financial guarantees or social security (particularly the pension scheme). Thus, the higher the initial level of the deficit or the public debt, the more limited the government's scope in the event of a shock. The existence of large potential debts, such as government guarantees granted to certain financial institutions, and the presence of a fragile financial sector may also threaten the stability of public finances. Moreover, an ageing population means the expectation of higher social expenditure in the medium term, which limits the scope for fiscal adjustment. The markets' concerns about the sustainability of public finances also increase when budget imbalances are combined with the existence of public institutions featuring weak governance and with economic imbalances, such as a low private sector savings ratio, a property market bubble, a high unemployment rate or a weak inflow of foreign capital. An increase in the international supply of government securities or in inflationary pressures will also tend to heighten the financial markets' perception of the risk.

The movement in yield differentials between the long-term government loans of the euro area countries at the time of the financial and economic crisis can be analysed in the light of the above factors. When the subprime crisis erupted in July 2007, the spreads increased on the basis of common international factors: risk aversion was then the key factor accounting for the movement in yield differentials. Later, factors specific to the countries gradually

(1) In principle, since the introduction of EMU, the exchange risk between euro area countries has become irrelevant.
 (2) IMF (2009), *The state of public finances cross-country fiscal monitor*, SPN/09/25, November.



played a bigger role. There was also a change in the perception of the sources of risk itself. Whereas at the start of the crisis the focus had been on the countries hard hit by the financial crisis, it later shifted towards countries presenting higher risks for the short-term refinancing of their public debt, and raising question marks over the viability of their long-term public finances.

Since the rescue of Bear Stearns in the United States in March 2008, the spread between yields on government loans has widened between countries, suggesting that the markets have taken account of the deterioration in the situation of the financial sector specific to each country. Following the collapse of Lehman Brothers in September 2008, yield differentials also increased faster for countries with high government debt levels, illustrating the close link between the vulnerability of the financial sector and the degradation of public finances. Finally, when the Anglo Irish Bank was nationalised in January 2009, the sovereign interest rate spreads in the euro area widened substantially, with a more marked differentiation between countries on the basis of the fragility of the financial sector and the level of public debt. The announcement of government rescue packages for banks caused investors to reassess the sovereign credit risk.

In May 2010, the crisis in Greek government securities reached its peak, putting strong pressure on spreads between government loans of the euro area countries. That contagion effect was concentrated mainly on the peripheral countries, exhibiting an adverse trend in their fiscal and structural indicators. The risk of Greek default concentrated the markets' concerns on the solvency problems of the euro area countries. During the last quarter of 2010, the concerns over the fragility of the banks in Ireland and the implications for that country's public finances confirmed the importance of fiscal performance and the soundness of the financial sector in determining yield differentials in relation to the German Bund. Those differentials increased for Ireland, but also – by contagion – for the other euro area countries. The scale of these divergences reflected the markets' perception of the degree of vulnerability of the public sector of the countries concerned.

The growth of the public deficit therefore had a significant and non-linear impact on the interest rates on government loans. The scale of that impact seems to depend in particular on the initial level of the deficit and on the institutional and structural conditions, as well as on the contagion effects emanating from the financial markets. The financial and economic crisis therefore had a major impact on the interest rates on government securities in the euro area, especially in the case of countries with less sound fundamentals. To attenuate the uncertainty over the sustainability of public finances and reduce the upward pressure on interest rates, especially for countries with a high level of public debt, it is vital to implement a credible fiscal consolidation plan. In particular, for countries where significant imbalances have emerged, notably in regard to competitiveness, structural reforms may also help to calm the tensions in so far as they aim to increase the economy's potential and hence the viability of public finances. Finally, it is also desirable to strengthen the institutions at both national or European level, and in that regard the initiatives taken by the European authorities in 2010 to reinforce the economic and fiscal governance and to set up a crisis resolution mechanism are a step in the right direction (for more details, see box 3).

That decision brought only a brief respite on the financial markets, so that on 9 and 10 May 2010 the Ecofin Council decided to establish two financial stabilisation mechanisms for a three-year period, aimed at giving conditional financial assistance to countries confronted with financing difficulties following exceptional events beyond their control. The first, the European Financial Stabilisation Mechanism (EFSM), is intended for all EU countries and supplements the existing mechanism providing financial support for the balance of payments of countries outside the euro area. It is financed by EC borrowing for up to € 60 billion. The

second, the European Financial Stability Facility (EFSF), is to issue bonds guaranteed by the euro area Member States in proportion to their share in the ECB's capital up to a volume of € 440 billion, and is intended only for euro area Member States. In addition, the IMF is closely associated with these two mechanisms, making a contribution of € 250 billion and participating in drawing up the conditions for granting credit and monitoring the rescue packages. At the same meeting, the Council expressly stated that the fiscal consolidation and structural reforms would have to be speeded up where warranted.

Despite the establishment of these new financial assistance mechanisms, interest rate spreads began widening again, especially for Greece, Ireland and Portugal. Spain enjoyed a respite until the end of November, also thanks to particularly ambitious fiscal austerity measures announced by the Spanish government in May, the good results achieved by the large Spanish banks in the European stress tests at the end of July, and the government's determination to tackle the in-depth restructuring of that sector.

After the summer, the spreads narrowed significantly thanks to an improvement in the overall economic situation and Greece's encouraging results in the first joint review mission by the EC and the IMF concerning the implementation of the adjustment programme.

The European Council of 28 and 29 October decided to make the EFSF permanent by amending the Lisbon Treaty accordingly. Also, on 28 November, the Eurogroup endorsed the principle whereby the EFSF would be converted in 2013 into a European Stability Mechanism (ESM), with rules similar to those of the IMF in view of the possible involvement of private holders of sovereign debt in the event of debt restructuring.

The announcement of the possible involvement of the private sector triggered a renewed rapid increase in bond yield differentials vis-à-vis Germany of the three countries with the most fragile financial health, namely Greece, Ireland and Portugal. That movement forced the Irish government to accept international aid on 28 November 2010. The aid comprised a financial package amounting to € 85 billion, consisting of a conditional loan for seven and a half years granted jointly by the EFSM (in the sum of 22.5 billion), the EFSF (in the sum of 17.7 billion), the United Kingdom, Sweden and Denmark (for a total of 4.8 billion) and the IMF (for 22.5 billion). Ireland itself was required to contribute 17.5 billion to this package, partly via a loan financed by its national pension fund. This package was conditional upon recapitalisation of the Irish banking system, structural reforms and the introduction of additional budget cuts totalling € 15 billion over four years, of which 40% must take effect in 2011. Finally, at its meeting on 16 and 17 December the European Council approved the text of a limited amendment to the Treaty necessary for the creation of the ESM as the future permanent mechanism to safeguard financial stability throughout the euro area, replacing not only the EFSF but also the EFSM, both of which would remain in force until June 2013. According to this text, the euro area Member States may establish a stability mechanism to be activated if that is indispensable to safeguard the stability of the euro area as a whole. The granting of any financial assistance under this mechanism will be made

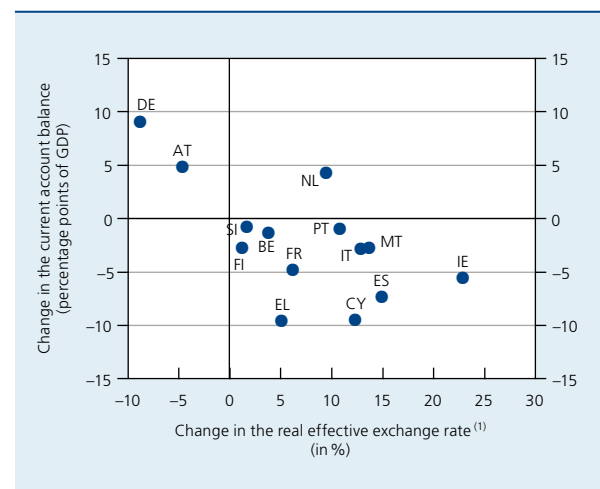
subject to strict conditionality. This amendment is to enter into force on 1 January 2013.

Towards better economic governance in the European Union

These developments show that the loss of confidence prevailing on the sovereign debt markets was not confined to the sustainability of the public finances in the countries concerned but that doubts also emerged on the financial markets over the smooth functioning of the economic and monetary union itself.

As already stated, the debt ratio of households and businesses in the euro area had risen considerably in the years preceding the financial crisis. In some countries, such as Ireland, Greece and Spain, the rise in household debt was accompanied by overheating of domestic demand. For the last two countries mentioned, that added to the current account deficits on the balance of payments via sustained growth of imports. In addition, the failure to adjust wages to the decline in productivity gains (in Spain and Italy), and the role of other factors such as the composition of the basket of exports and their geographical focus (in Greece), impaired the competitiveness of those countries. Conversely, progress in terms of productivity and wage moderation helped Germany and Austria to secure substantial gains in competitiveness. These developments left their mark on the current account balance:

CHART 15 COMPETITIVENESS AND BALANCE OF PAYMENTS
CURRENT ACCOUNT IN THE EURO AREA
COUNTRIES, 1999 TO 2007



Source: EC.

(1) Effective exchange rate relative to 35 industrialised countries (34 countries in the case of Belgium, where the rate is calculated for the BLEU), deflated by the unit labour costs of the economy as a whole.

for the euro area as a whole, it stayed more or less in equilibrium, but that position conceals large divergences between surplus and deficit countries. More particularly, countries such as Germany, the Netherlands and Austria accumulated growing surpluses, whereas Greece, Spain and Portugal recorded chronic and mounting deficits.

Against this backdrop of macroeconomic imbalances, the Eurogroup had already resolved by 2008 to conduct regular reviews of trends in competitiveness within the

euro area. The financial and economic crisis, and – in its wake – the crisis on the sovereign debt markets accentuated the need to prevent and correct these imbalances. Under these circumstances, the European authorities took some important initiatives during the year under review to strengthen economic governance within the EU, with the adoption by the European Council on 28 and 29 October of proposals concerning this matter formulated by the economic governance task force which it had asked its President to set up earlier in the year (see box 3).

Box 3 – Towards stronger economic governance in the European Union

The economic and financial crisis has brought to light some clear weaknesses in the coordination of economic policies in the EU, in regard to both the prevention of macroeconomic imbalances – including public deficits – and their correction. Moreover, the Greek debt crisis underlined the need for the EU to acquire a robust crisis management framework.

The European Council of 25 and 26 March 2010 decided to strengthen the coordination of economic policies, notably in the euro area, by taking particular account of public finances, competitive positions and the balance of payments. It agreed to improve the alignment of the timing of the submission and examination of national reform programmes and stability or convergence programmes. It also asked its permanent President, Herman Van Rompuy, to set up a task force, in cooperation with the European Commission (EC), which would draw up proposals for improving the crisis resolution framework and reinforcing fiscal discipline. On 8 May, the heads of State or government extended the task force's mandate to include examining proposals for broadening and strengthening economic surveillance and the coordination of economic policies in the euro area, with close monitoring of debt levels and competitiveness.

Furthermore, on 25 March 2010, as described elsewhere in this chapter, the heads of State and government of the euro area concluded an agreement in principle on emergency aid for Greece. Against the background of that country's debt crisis, a number of measures were taken to guarantee the financial stability of the euro area.

On 21 October 2010, the task force on economic governance, chaired by Herman Van Rompuy, submitted its final report to the European Council, which endorsed it at its meeting on 28 and 29 October. The aim is that, on that basis, the Council and the European Parliament should reach agreement by no later than the summer of 2011 on the legislative proposals which the EC had presented on 29 September with a view to reinforcing fiscal discipline and macroeconomic surveillance. The recommendations made by the task force coincided to a large extent with those proposals.

The task force recommended improving fiscal discipline by strengthening the stability and growth pact from both the preventive and the corrective angles. It first considered that more prominence should be given to the public debt and the sustainability of public finances, and notably recommended putting into operation the criterion relating to the public debt in the excessive deficit procedure. The preventive arm of the stability and growth pact should contain a faster adjustment path for Member States with a debt level in excess of 60 % of GDP or those exposed to pronounced risks in terms of overall debt sustainability. Under the corrective arm of the pact, countries with a debt ratio of more than 60 % of GDP would be subject to an excessive deficit procedure unless their debt declined at a satisfactory pace, even if their public borrowing requirement is below 3 % of GDP. The criteria and the method to be used to implement this recommendation are to be laid down in the European Union legislation, and its application should also take due account of all the factors deemed relevant, such as the position in the business

cycle, the structure of the public debt, the level of private sector debt and the implicit liabilities of the government on account of population ageing, e.g. via their pension or health care system. The task force also proposed that the pact be made more effective, in particular by introducing new measures and sanctions of a reputational/political and financial nature, to be included in both the preventive and the corrective parts of the pact and to be activated at an earlier stage. The financial sanctions would range from an interest-bearing deposit to a straightforward fine – on the understanding that, initially, they would apply only to Member States belonging to the euro area. To increase the assurance that the thus amended pact would be enforced, the decision-making process would be rule-based to a greater extent, a reverse majority rule being introduced in regard to the new sanctions. This means that the recommendations would be adopted unless the Council rejected them by a qualified majority. A range of minimum requirements concerning the national fiscal frameworks would also have to be met before the end of 2013.

Since stronger surveillance and enforcement mechanisms need to be based on transparent and reliable statistics which are produced in good time, the task force also recommended that additional measures be taken to strengthen the professional independence of the European statistical system and the auditing powers of Eurostat.

Regarding the macroeconomic imbalances and competitiveness, it recommended introducing a new surveillance mechanism supported by a new legal framework, additional to the stability and growth pact and applicable to all EU member countries, taking account of the specific characteristics of the euro area. This mechanism would imply an annual risk assessment by means of an alert system using a scoreboard comprising a limited number of indicators. For countries which, according to this preliminary assessment, seem to display signs of vulnerability, an in-depth analysis would then be conducted by the EC. In critical cases, i.e. for countries with serious macroeconomic imbalances or those posing a threat to the functioning of EMU, the Council could record the existence of an “excessive imbalance position” which could lead to sanctions, at least in the case of Member States belonging to the euro area.

From 2011, in order to improve the *ex ante* coordination of economic policies, the national reform programmes and stability or convergence programmes would already be submitted in the spring, within the framework of a European Semester. The task force also felt that the euro area needed to establish, in the medium term, a credible crisis resolution framework, to cope with problems on the financial markets and avoid contagion. Finally, it considered that both national and European institutions should be strengthened to improve the economic governance of the EU.

As explained in this chapter, the European Council of 16 and 17 December approved the text of a limited amendment to the Treaty concerning the establishment of a future permanent crisis resolution mechanism.

In addition, this Council reaffirmed its intention to reach agreement by the end of June 2011 on the legislative proposals relating to economic governance in order to strengthen the economic pillar of Economic and Monetary Union. It welcomed the Council’s report on the treatment of the systemic reform of pensions under the stability and growth pact, and asked that the report be taken into account in the specifications concerning the implementation of the reformed stability and growth pact.

Prices and costs

Inflation in the euro area, measured by the change in the harmonised index of consumer prices (HICP), rose from 0.3 % in 2009 to 1.6 %. Having stood at –0.6 % in July 2009, its lowest level since the creation of monetary union, it gradually climbed back from the second half of 2009 and during 2010, reaching 2.2 % in December.

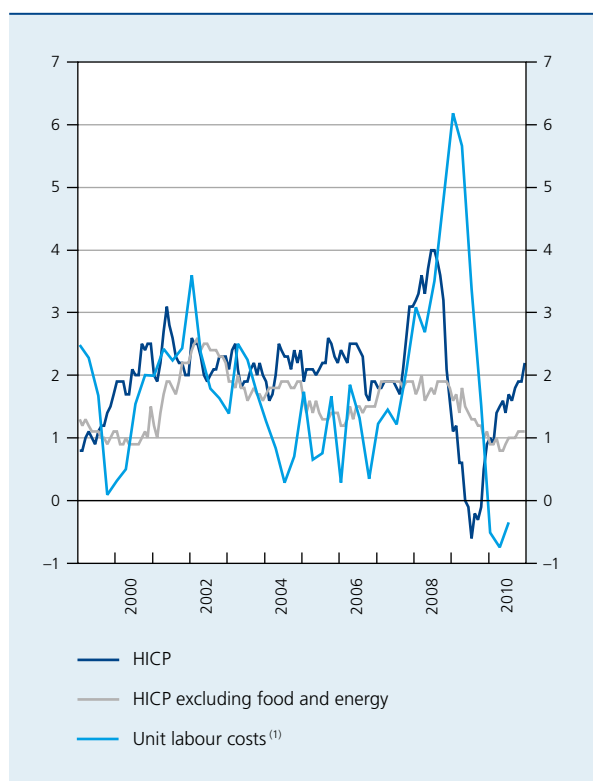
The energy component was the main factor driving the increase. In the context of a marked rise in food commodity prices on the international markets, the increase in food prices also accelerated, though it remained modest.

Underlying inflation, i.e. the change in the HICP excluding food and energy, averaged 1 %, compared to 1.4 % in 2009. That fall reflects very moderate domestic inflationary

CHART 16

INFLATION IN THE EURO AREA

(percentage changes compared to the corresponding period of the previous year; monthly data, unless otherwise stated)



Source : Thomson Reuters Datastream.

(1) Quarterly data.

pressure in the euro area, where production capacity was still considerably under-utilised. Moreover, the HICP excluding food and energy is an indicator which tends to overestimate slightly the pressure exerted on prices by market forces, since it is influenced by the effect of measures taken by the authorities to adjust indirect taxation or regulated prices. Thus, in 2010, some countries increased their indirect taxes under fiscal consolidation programmes: between July and November, the mechanical upward effect of indirect taxes on overall inflation in the euro area came to around 0.3 percentage point.

A hesitant recovery and a high unemployment rate moderated the pace of negotiated wage increases and labour costs per hour worked. The rise in labour costs per worker accelerated slightly, however, to reach 1.7% on average over the first three quarters of 2010, against 1.5% in 2009, reflecting an increase in the number of hours worked per worker, one reason being the gradual abolition of working time reduction programmes set up during the crisis. As stated earlier, labour productivity increased, bringing a decrease in unit labour costs averaging 0.5% between the first three quarters of 2009 and 2010. In

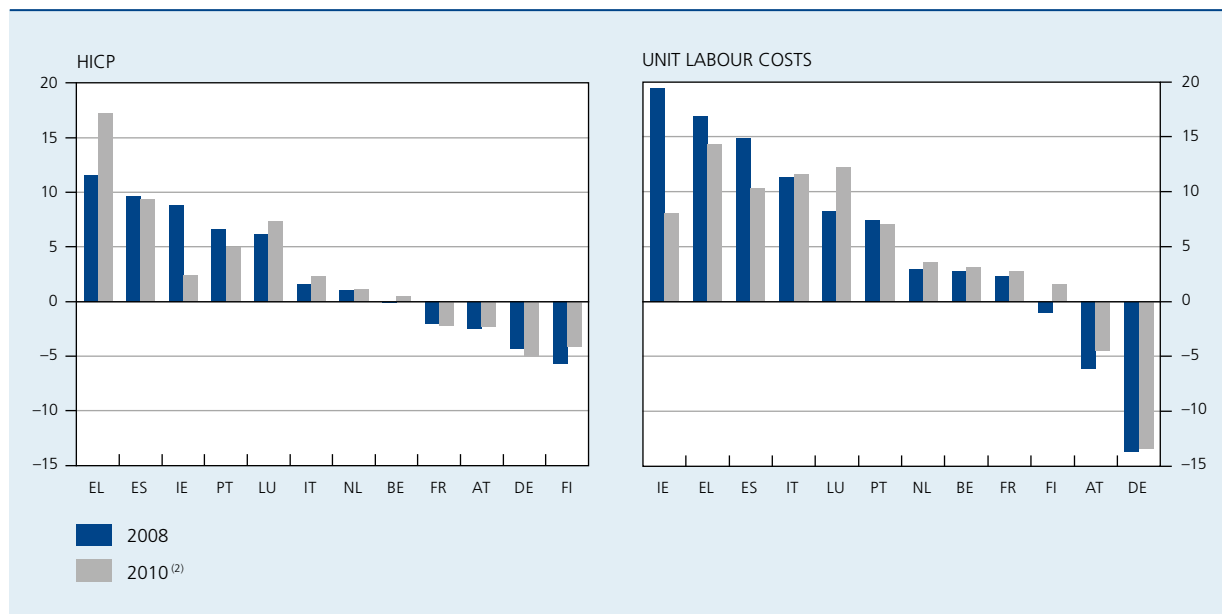
2009, unit labour costs had risen by a further 3.9% against the previous year. The decline in unit labour costs is the main factor behind the fall in underlying inflation, even if their relatively pronounced cyclical profile is partly absorbed by corporate profit margins.

The inflation rate of the euro area masks divergent developments in the member countries. For instance, since the outbreak of the crisis, inflation was well below the average in Ireland, Portugal and Spain, in particular – countries which had accumulated significant competitive handicaps but were hard hit by the crisis. Ireland actually recorded some fairly steep price falls. The accelerating inflation in Greece, Spain and Portugal in the second half of the year under review can be attributed to the sharp increases in indirect taxes under their respective fiscal consolidation plans, and therefore does not imply that the process of adjustment in competitive positions is already coming to an end. Despite the corrections which have occurred in recent years, these countries still suffer from a competitive handicap. That is also the case if competitiveness is analysed on the basis of unit labour costs, although the trend in those costs has been particularly favourable in Ireland and Spain in the past few years.

The restoration of competitiveness in terms of prices and costs is achieved partly by measures designed to have a direct moderating effect on domestic costs, e.g. via wage moderation in the public sector or labour market reforms, as in Spain. It is also achieved more indirectly by the recession reducing the power of the economic agents to set prices and wages. Although these adjustments exert direct downward pressure on inflation in the euro area, they are inevitable and even desirable in a monetary union, because – for a country belonging to the monetary union – wage and price moderation is the only way of securing a real exchange rate depreciation and restoring competitiveness.

1.2.2 Monetary policy of the Eurosystem

The global financial crisis which reached its peak in the autumn of 2008 triggered the most serious recession since the Second World War and exerted a considerable downward influence not only on economic activity but also on inflation, the money supply and lending in the euro area. In order to respect the primary objective of price stability, the ECB Governing Council reduced the central key rate in several stages, cutting it from 4.25% in October 2008 to 1% in May 2009. Money market interest rates – the overnight interest rate and three-month Euribor, particularly important for the transmission

CHART 17 HARMONISED INDEX OF CONSUMER PRICES AND UNIT LABOUR COSTS IN THE EURO AREA COUNTRIES(cumulative difference in relation to the euro area since 2000, seasonally adjusted data⁽¹⁾)

Sources: EC, NBB.

(1) For the HICP and, in the case of Portugal, unit labour costs, own calculations for seasonal adjustment.

(2) Average of the first three quarters of 2010 for unit labour costs.

of monetary policy – actually dropped below 1%. The reason was the policy of enhanced credit support pursued by the Eurosystem which, combined with the support given to the bank transmission channel – which is essential for the economy of the euro area – exerted an additional downward effect on money market interest rates. During the year under review, at each of its discussions on the monetary policy stance, the ECB Governing Council concluded on the basis of the economic and monetary analysis described below that the particularly accommodating character of monetary policy remained appropriate. The central key rate was therefore kept unchanged at 1%, throughout the year.

Conversely, at the beginning of the year, the Governing Council decided to phase out certain non-standard measures which it deemed no longer necessary in view of the evident improvement on the financial markets in general and the money market in particular. However, it did reverse that move to some extent in May, following the outbreak of the sovereign debt crisis. It then also launched the Securities Markets Programme permitting the purchase of public and private debt instruments on the secondary market, in order to address the malfunctioning of the hardest hit securities markets and restore an appropriate monetary policy transmission mechanism. The Governing Council thus demonstrated the flexibility

needed to respond appropriately to changing conditions on the financial markets, while at the same time reaffirming the temporary nature of the non-standard measures introduced.

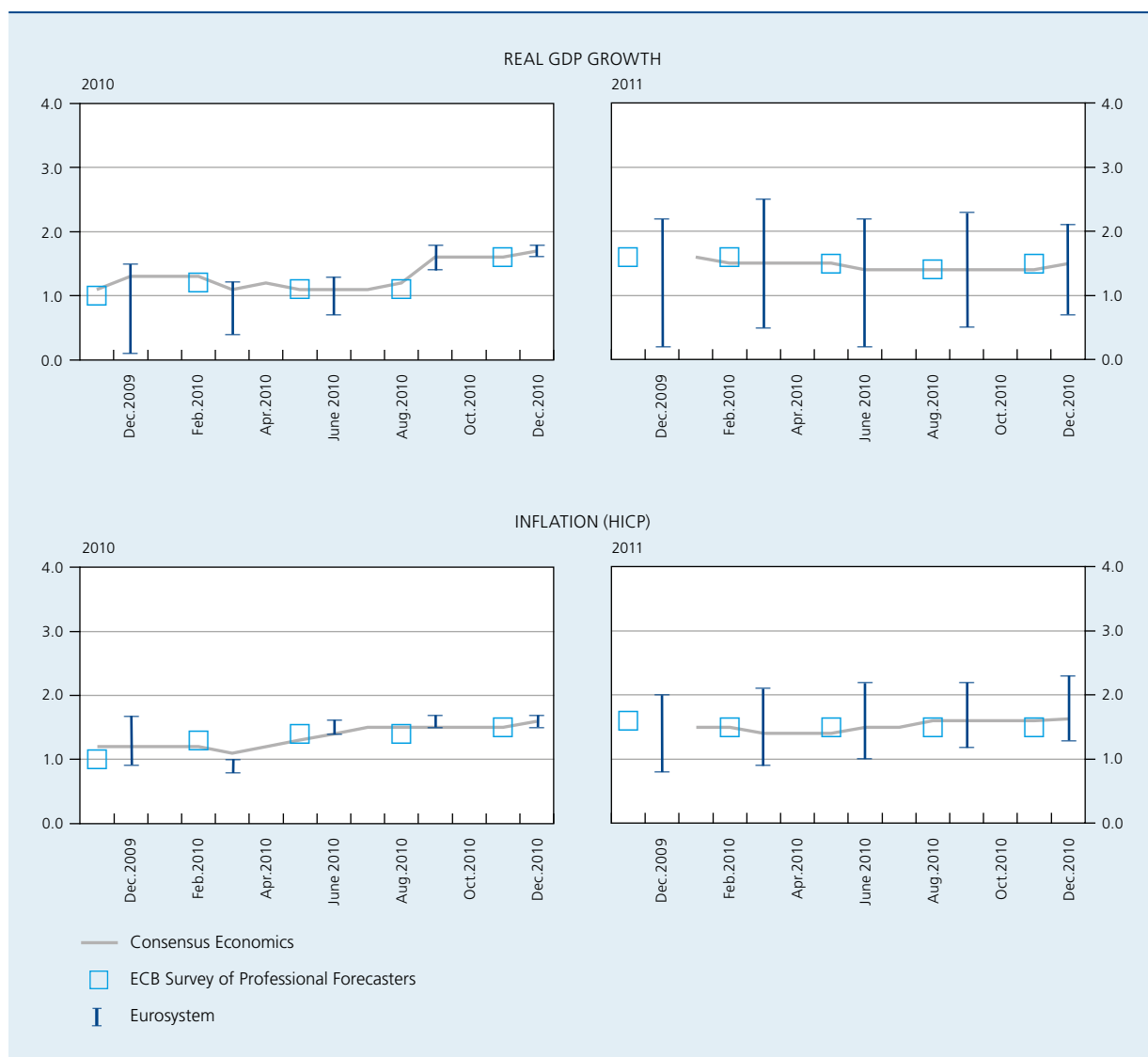
Monetary policy stance of the Eurosystem

In the light of a hesitant and uneven recovery, the Eurosystem and most professional forecasters continued to predict very weak economic growth in 2010 and 2011. Their forecasts were also surrounded by a high degree of uncertainty. During the year, however, some macro-economic figures proved better than expected. That was the case, in particular, for GDP growth in the second quarter, which came to 1% on a quarterly basis. These good figures prompted the Eurosystem to revise upwards its growth forecasts for 2010, but without making any fundamental revision to its baseline scenario: it still expected a moderate revival in activity with considerable heterogeneity between countries. That was also the forecast made by other international institutions and professional forecasters who, like the Eurosystem, left the outlook for 2011 practically unchanged.

The expectation was in fact that economic activity would continue to suffer from the balance sheet adjustment

CHART 18 PROJECTIONS OF REAL GDP GROWTH AND INFLATION IN THE EURO AREA

(annual percentage changes according to the projection publication dates)



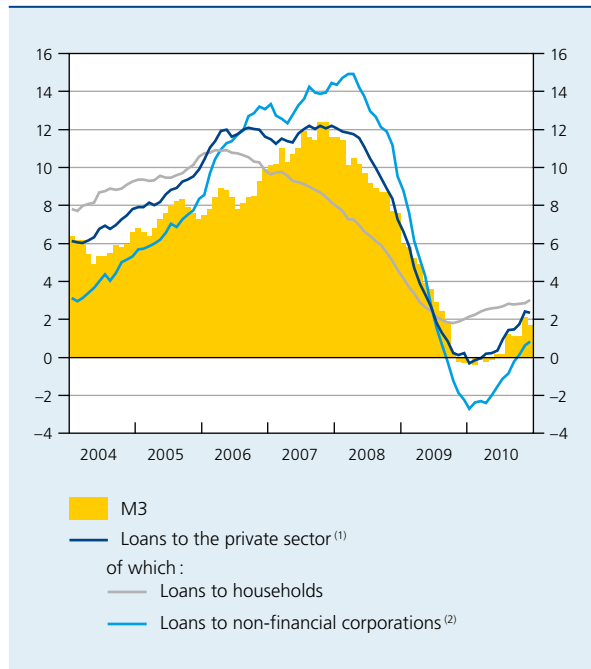
Sources : Consensus Economics, ECB.

which is ongoing for households, firms and governments alike. A number of countries were also forced to consolidate their public finances faster than expected in order to reassure the financial markets and restore their access to them. Although it is essential for public finances to be sustainable in a long-term perspective, these changes nevertheless depress domestic demand in the short term. External demand was supposed to support the recovery, but that support was uncertain, and the uncertainty increased in the second half of the year, in view of the growing doubts about the vigour of the economic recovery in the United States and fears that the euro's appreciation in the third quarter might depress the euro area's foreign demand.

Owing to the slow pace of the recovery, the level of economic activity in the third quarter of 2010 was still around 3.1 % below its pre-crisis figure, and the economy still faced substantial excess production capacity. Having averaged 81.5 % since 1985, the capacity utilisation rate came to 77.8 % on average in manufacturing industry, considerably easing the domestic inflationary pressure. While inflation measured by the HICP gathered pace during 2010, thus slightly exceeding the upper limit of the Eurosystem's quantitative definition of price stability in December, underlying inflation – i.e. the change in consumer prices excluding food and energy – remained very moderate. Regarding the outlook for inflation, in line with the weakness of the expected economic recovery,

CHART 19 M3 AND LOANS TO THE PRIVATE SECTOR IN THE EURO AREA

(percentage changes compared to the corresponding month of the previous year, data adjusted for seasonal variations and, in the case of loans, for securitisation, unless otherwise stated)



Source: ECB.

- (1) Households, non-financial corporations, insurance companies, pension funds or occupational pension institutions and other non-monetary financial intermediaries.
 (2) Data not adjusted for securitisation before February 2010.

professional forecasters and financial market participants expected inflation of less than 2% for the horizon relevant for monetary policy.

In conjunction with the economic growth recovery, there were encouraging developments in lending by monetary financial institutions to the private sector; however, lending remained modest, with large variations between economic agents.

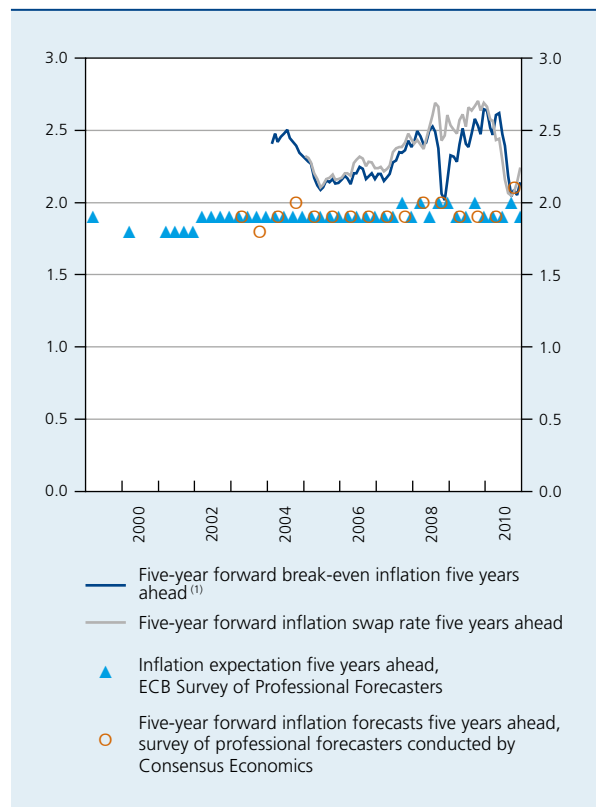
After reversal of the downward trend towards the end of 2009, there was a moderate rise in the growth of lending to households, to reach 3% in December 2010. Conversely, lending to non-financial corporations remained negative for much of the year. However, having stagnated up to May, it picked up and recorded positive figures from October onwards. These developments were in phase with the slow revival in economic activity, and matched the usual profile over the business cycle: the turning point for the growth of lending to households occurs early in the economic cycle, whereas there tends to be a time lag before lending to non-financial corporations picks up. A key factor here is that loans for house purchase enjoy better collateral, while

firms generally resort to self-financing in the initial stages of the recovery.

After having been slightly negative during the first half of the year, the growth of the money supply regained momentum during the summer, confirming the revival in activity. Nevertheless, in view of the risks still depressing activity, it remained moderate. That weakness was due not only to the persistent effects of the economic gloom on demand for loans, but probably also to a correction of excess liquidity accumulated previously, and a yield curve which still remained steep, favouring investments other than those included in the monetary aggregate M3. The widening spreads between deposits at less than two years and overnight deposits was reflected in a rebalancing within M3 itself. In contrast to what had been seen since the autumn of 2008, the annual growth of M1, i.e. currency in circulation and overnight deposits, slowed sharply while the year-on-year change in M3-M1 and, especially,

CHART 20 LONG-TERM INFLATION EXPECTATIONS IN THE EURO AREA

(annual percentage changes)



Sources: Bloomberg; Consensus Economics; Ejsing, J., J.A. Garcia and T. Werner (2007)⁽²⁾; ECB; NBB.

- (1) Break-even inflation rates correspond to the difference between the yields on fixed-interest rate bonds and the yields on inflation-indexed bonds issued by the same issuer and with comparable maturities.
 (2) *The term structure of euro area break-even inflation rates: The impact of seasonality*, ECB, Working Paper 830.

deposits for a term of up to two years, became decidedly less negative as the months went by.

Overall, the economic and monetary analysis reinforced the diagnosis of a moderate recovery in activity and limited inflationary pressure in the medium term. At each of the meetings held during the year under review, the ECB Governing Council therefore considered that the current interest rates were appropriate, and decided to leave the central key rate on hold at 1%, the lowest level since the start of Stage 3 of Economic and Monetary Union, in 1999.

Long-term inflation expectations obtained from survey data and financial market data are still firmly anchored. Thus, the outlook for long-term inflation according to surveys conducted by the ECB and Consensus Economics remained more or less stable at around 2%, or even slightly lower. The inflation expectations based on financial market data were generally heading downwards during the year under review, reaching just over 2% in December. As a rule, these readings are more volatile and higher than those of the survey data, since they include – alongside genuine inflation expectations – risk premiums which vary over time and obscure the signal which these instruments give for inflation expectations, especially in the event of financial turbulence. The swift and significant reduction in interest rates therefore seems to have avoided a downward de-anchoring of inflation expectations, a potential source of deflation, without the

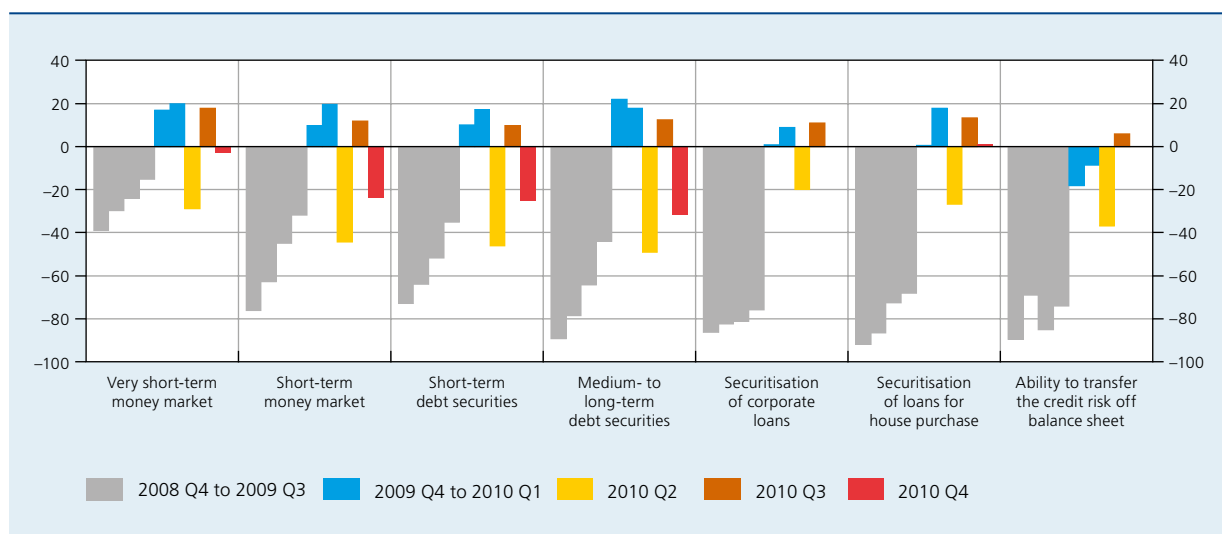
accommodating monetary policy causing any upward derailment in longer-term inflation expectations.

First steps towards the gradual withdrawal of certain non-standard measures

The closing months of 2009 and the start of the year under review brought a gradual improvement in the situation on the interbank market. Moreover, the deceleration in the growth of bank lending to the private sector seemed to come to an end, and in the Eurosystem's bank lending surveys for the last quarter of 2009 and the first quarter of 2010, banks reported an improvement in their access to market finance. The Governing Council therefore considered that the time had come to phase out some of the exceptional measures.

Since the intensification of the financial turbulence in the autumn of 2008, the Eurosystem had in fact not only significantly eased its monetary policy stance, but also taken exceptional measures in regard to the provision of liquidity, in order to preserve financial stability and thus avoid any disruption in the transmission of monetary policy which might jeopardise macroeconomic stability in general and price stability in particular. These measures were termed enhanced credit support. The financial crisis had made it more difficult for banks to gain access to market financing, so that in the absence of specific intervention by the Eurosystem, the economy as a whole

CHART 21 ACCESS TO MARKET FINANCE FOR CREDIT INSTITUTIONS IN THE EURO AREA COUNTRIES ⁽¹⁾
(quarterly data)

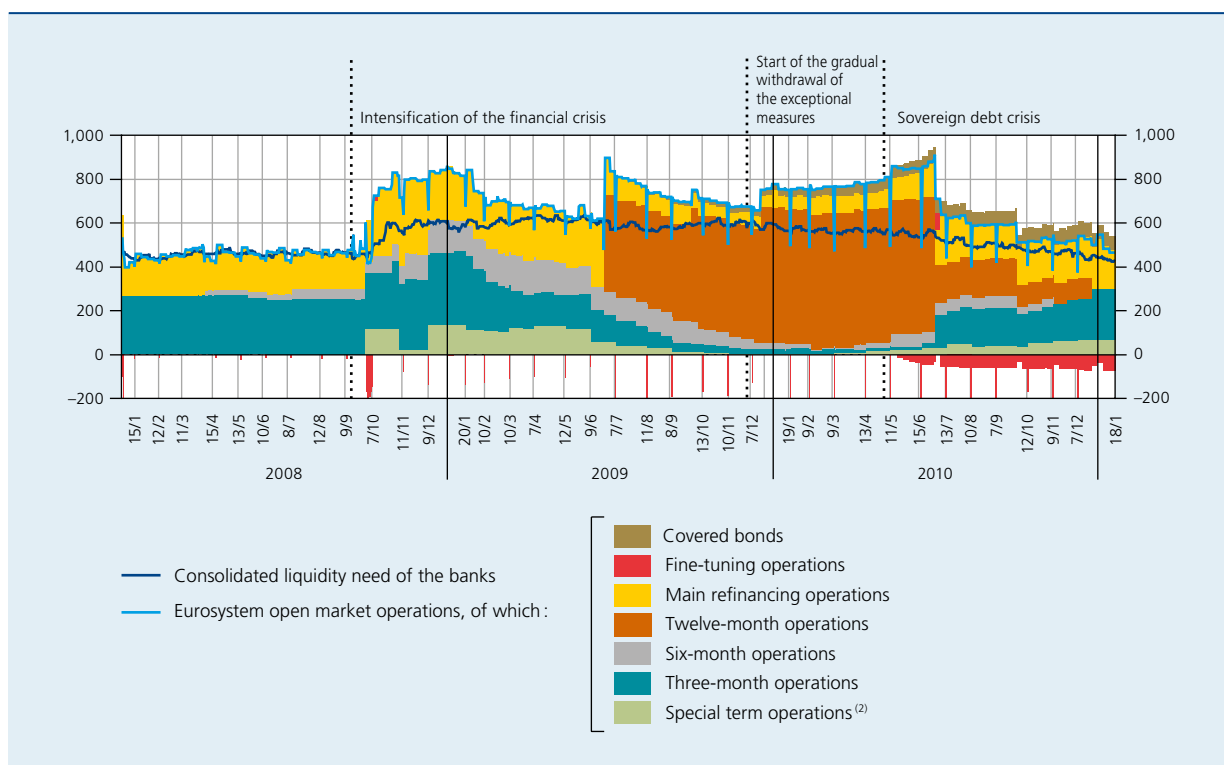


Source: ECB.

(1) Net percentages (unweighted) of replies by banks to the Eurosystem bank lending survey. These percentages indicate the extent to which these institutions' access to market finance has deteriorated (-) or improved.

CHART 22 CONSOLIDATED LIQUIDITY NEED AND EUROSYSTEM OPEN MARKET OPERATIONS ⁽¹⁾

(daily data, € billion)



Source: ECB.

(1) In this chart, purchases under the Securities Markets Programme appear as a liquidity providing autonomous factor and therefore reduce the liquidity need of the banks.

(2) The term of these transactions corresponds to that of one reserve maintenance period, i.e. about one month.

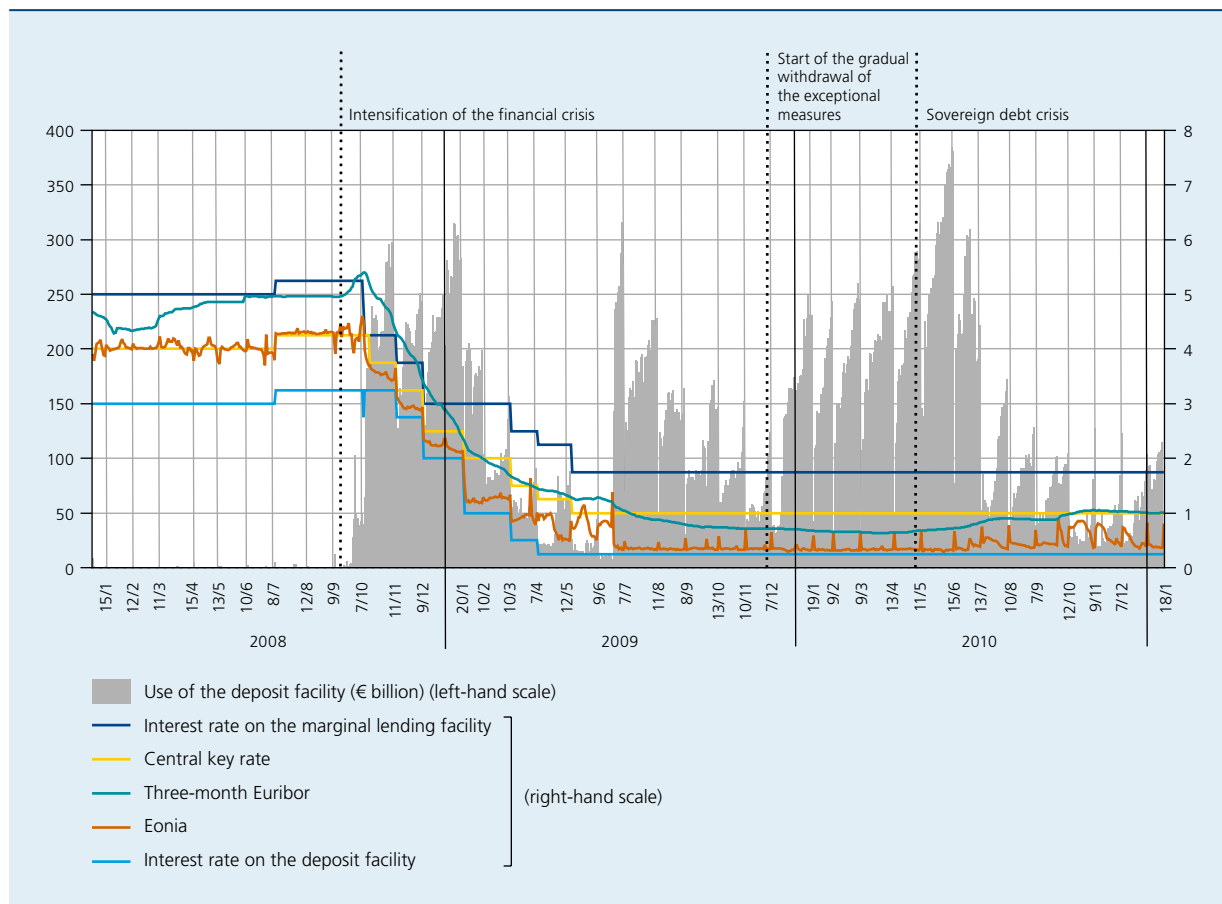
was liable to encounter problems in obtaining credit. First, the Eurosystem played a key intermediation role on the money market by organising all refinancing operations from 15 October 2008 in the form of tenders allotting the full amount demanded at a fixed rate. Credit institutions short of liquidity were therefore assured of obtaining the liquidity that they needed so long as they could put up the necessary collateral, whereas the other banks – which had become particularly reluctant to lend them their surplus – preferred to deposit excess liquidity with the Eurosystem. In this way, the Eurosystem interposed itself between commercial banks in surplus and those with a deficit, and acted as a substitute for the interbank market, paralysed by the great uncertainty over the health of the banking system. Next, larger volumes of liquidity were granted via longer-term operations. For instance, it was decided to conduct one-year refinancing operations in June, September and December 2009. The Eurosystem also extended the list of assets eligible as collateral for all refinancing operations. In order to ensure their refinancing in foreign currencies, the Eurosystem also offered European credit institutions financing in US dollar and Swiss franc. A programme for the purchase of covered

bonds – instruments of great importance for bank financing – amounting to € 60 billion over the period from July 2009 to June 2010 was also set up. Finally, the Eurosystem recognised the European Investment Bank as a potential counterparty.

At the meeting held in early December 2009, against the backdrop of the financial market recovery and the improvement in the economic outlook, the Governing Council had decided that the first stage in the process of gradual withdrawal of these non-standard measures would take place in the first quarter of 2010. After the final twelve-month refinancing operation was conducted in December 2009, the last six-month refinancing operation was effected on 31 March 2010. In these operations, all bids were fully allotted at a fixed rate corresponding to the average central key rate over the life of the operation. At the beginning of the year under review, the refinancing operations in foreign currencies had also been terminated.

With the return to a system of variable rate tenders for the three-month refinancing operations, 28 April marked a new stage in the process of the gradual withdrawal of

CHART 23 USE OF THE DEPOSIT FACILITY AND MONEY MARKET INTEREST RATES IN THE EURO AREA
(daily data)



Sources: Thomson Reuters Datastream, ECB.

the non-standard measures. The Governing Council had specified that the allotment amounts of these operations would be set to ensure the smooth functioning of the money markets and would help to avoid any significant spread between the bid rates and the prevailing central key rate. Although, in view of the weakness of demand, only € 4.8 billion was allocated, or considerably less than the € 15 billion announced, the weighted average of the bid rates paid still came to 1.15%. This means that some Eurosystem counterparties were very willing to pay in order to obtain term financing. However, since the financial market situation remained fragile and uncertain, it was appropriate to continue offering the banks some flexibility in regard to access to liquidity. The main refinancing operations and the refinancing operations with a term corresponding to that of a reserve maintenance period therefore continued to be fully allotted at a fixed rate. At the beginning of March 2010, the Governing Council decided that this would continue at least until 12 October 2010. Also, the acquisitions made under the

covered bond purchase programme continued throughout the first half of 2010, as announced by the Governing Council in June 2009.

The enhanced credit support policy had generated considerable excess liquidity on the money market, especially from July 2009, following the allotment of some € 442 billion requested at the time of the first twelve-month refinancing operation. This substantial excess liquidity brought down the Eonia overnight interest rate to a level close to the interest rate on the deposit facility, which had been cut to 0.25% in April 2009. This is the absolute minimum for the overnight rate, since it is the rate at which credit institutions can deposit their surplus liquidity with the Eurosystem until the next day. It is therefore this rate, and not the central key rate, which serves as the benchmark for the overnight rate in the case of persistent excess liquidity. Financial market expectations regarding interest rates imply that, at the beginning of the year under review, operators were expecting surplus

liquidity on the money market to be mopped up from July, the date when the first twelve-month refinancing operation matured. Only after that did they expect the overnight rate to return to a level close to the central key rate. Consequently, longer-term interest rates on the secured interbank market remained well below the central key rate. Interest rates on the unsecured market also remained low; they actually dipped further, since the credit and liquidity risk premiums which they contain continued to decline as confidence picked up on the interbank market. As a result, the three-month Euribor – a key benchmark for short-term retail interest rates – dropped to 0.63 % at the end of the first quarter of 2010.

Sovereign debt crisis

The steady improvement in the situation on the interbank market was interrupted at the beginning of May, owing to the worsening tensions on the market in government debt securities of a number of euro area Member States – see section 1.2.1. Thus, the Eurosystem was forced to adopt a new set of anti-crisis measures and to reintroduce certain measures which it had previously withdrawn.

By the end of 2009, the markets in government debt securities of a number of euro area countries were becoming increasingly nervous. The tensions reached an unprecedented level on 6 and 7 May in a climate of uncertainty over the support programme for Greece. Those tensions not only spread to the markets in government debt securities of other countries, but were also accompanied by increased volatility on the stock markets and foreign exchange markets. Moreover, in a climate of great uncertainty over the exposure of the banks to sovereign risk, the interbank market was in danger of becoming paralysed again. On 3 May, considering that the Greek economic and financial adjustment programme was adequate, the Governing Council decided to suspend the application of the minimum requirements concerning the credit rating of marketable debt instruments issued or guaranteed by the Greek government. On 10 May, it announced a new package of measures.

Thus, a Securities Markets Programme was set up. This permits the purchase of both public and private debt securities on the secondary market, in order to restore the smooth functioning of securities markets, thereby preserving the monetary transmission mechanism. The central bank can in fact only exert a direct influence over very short-term interest rates, while the transmission of monetary policy stimuli to the real economy takes place via the financial markets and bank lending. The government debt market plays a prominent role in this

process via three channels, namely, prices, liquidity and the balance sheet.

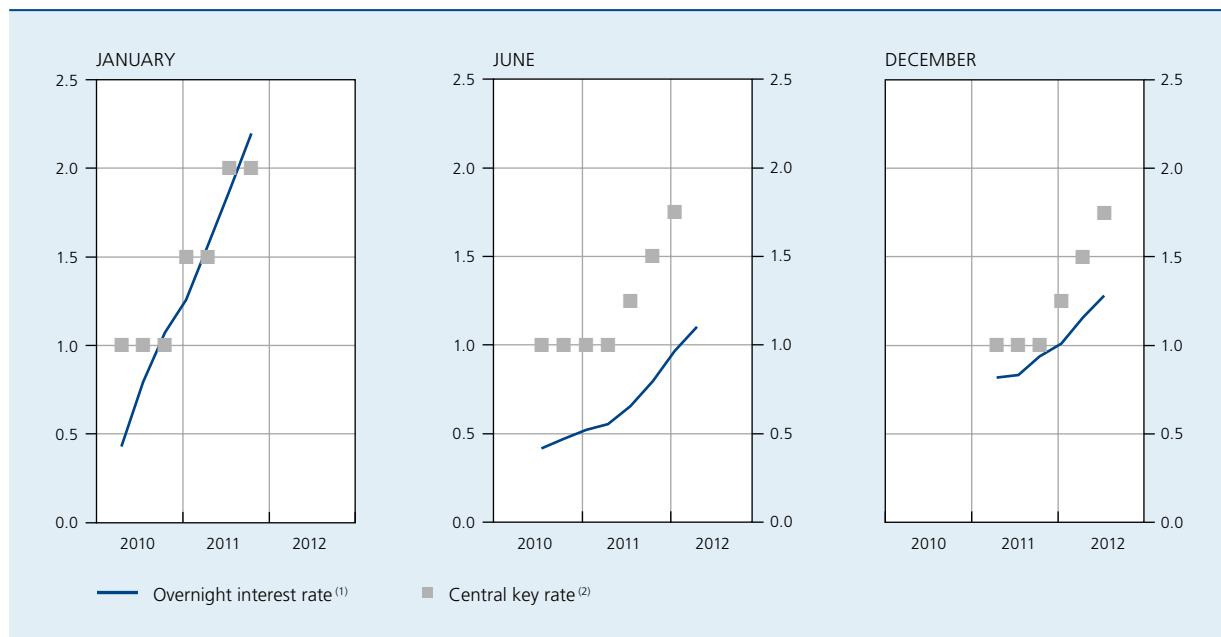
Via the price channel, interest rates on the bonds of sovereign borrowers influence the financing conditions of the economy, since they generally serve as the benchmark for setting the longer-term interest rates applied to households and firms. When the risk premiums contained in the interest rates on government debt securities reach levels which are no longer justified, as a result of market malfunction, they threaten to disrupt the transmission of monetary policy by generating upward pressure on financing costs in the economy. The liquidity channel operates because government debt securities are the main form of collateral for market financing of banks. If the liquidity of these instruments dries up, that can paralyse the interbank market as happened at the beginning of May, hampering access to market financing and jeopardising lending to the economy. The balance sheet channel operates by the fact that a decline in government bond prices leads to losses for the bond holders. That affects the capital of the banks, and may cause them to cut the volume of their lending. Also, this situation rekindles doubts about the solvency of certain banks, thus making it harder for them to obtain market finance. In fact, the Eurosystem bank lending survey covering the second quarter of 2010 revealed a further significant deterioration in banks' access to market financing. That applied especially to credit institutions originating from the countries most affected by the sovereign debt crisis.

Since the Securities Markets Programme was set up solely in order to safeguard monetary transmission and is not in any way intended to modify the monetary policy stance, the liquidity injected into the money market via this programme was mopped up: during the year under review, weekly fine-tuning operations were conducted to absorb liquidity, the amounts systematically corresponding to those of the purchases settled on the preceding Friday. The Securities Markets Programme therefore had no direct influence on money market liquidity conditions. However, on two occasions the amounts reabsorbed fell short of the target: first at the beginning of July and again at the end of December. These isolated instances occurred when the situation was particularly tense, the respective reasons being the arrival at maturity of the first one-year operation, and the transactions which credit institutions traditionally effect at the end of the year in order to close their balance sheet.

Under this programme, between 10 May and 31 December 2010 the Eurosystem bought debt instruments for a total of € 73.5 billion, which corresponds

CHART 24 INTEREST RATE EXPECTATIONS IN THE EURO AREA

(quarterly data, interest rate expectations prior to meetings of the Governing Council at the beginning of January, June and December)



Sources: Bloomberg, Reuters, NBB.

(1) Measured on the basis of the one-month forward rate derived from Eonia swaps with varying maturities.

(2) Median of the expected central key rate in the Reuters survey of economists.

to around 3.7% of its consolidated balance sheet total. Most of these purchases took place during the initial weeks of the programme. They declined significantly during the summer months, but increased again in the final quarter, when the financial turbulence worsened again.

In view of the repercussions of the sovereign debt crisis on the smooth operation of the interbank market, the ECB Governing Council also decided on 10 May that – at least until 30 June – the monthly three-month refinancing operations would again be conducted with full allotment. It also decided to arrange a six-month operation on 12 May, in accordance with the full allotment system, at a fixed rate corresponding to the average of the central key interest rate over the life of the operation. Finally, Eurosystem counterparties were again offered the opportunity to obtain liquidity in US dollars against appropriate collateral. While the provision of US dollar liquidity by the Eurosystem was modest – demand peaked at \$ 9.2 billion on 12 May – demand for liquidity in euro increased considerably in May and June; it originated mainly from counterparties of countries seriously affected by the sovereign debt crisis. The surplus liquidity therefore expanded again and the deposit facility was heavily used in May and early June. In that situation, the Governing Council

decided at its June meeting to extend the full allotment in the case of the three-month refinancing operations up to and including the third quarter of 2010.

During the same period, professional forecasters seemed to take the view that the debt crisis would affect the macroeconomic outlook and the monetary policy stance, since they expected a later increase in the central key rate than at the start of the year. Market participants expected that the liquidity surplus on the money market would remain substantial, even after the first twelve-month operation matured at the beginning of July. They therefore expected the overnight rate to remain below the central key rate for a longer time.

On 30 June, it was announced that the covered bond purchase programme would end – as planned – and that the target of € 60 billion had been achieved. The Governing Council also stated that the covered bonds which had been purchased would, in principle, be held to maturity.

During the summer, the financial market tensions remained palpable, even though there were some visible signs of improvement on the money markets. At the beginning of improvement, the liquidity surplus had in fact contracted sharply, following the arrival at maturity on 1 July

of the first twelve-month refinancing operation – which had led to the allotment of € 442 billion. The Eurosystem had nonetheless given the banks the opportunity to cope more easily with the effects of that due date by arranging an additional fine-tuning operation maturing on 7 July, the settlement date for liquidity provided by the following weekly main refinancing operation. However, the counterparties of the Eurosystem renewed only part of the finance which they had obtained from it, indicating that they wished to be less dependent on the Eurosystem for managing their liquidity. Consequently, the liquidity surplus on the money market dropped to an average of € 113 billion in July, against an average of € 297 billion in June. In August, the average surplus fell below 100 billion.

In a still uncertain climate, the Governing Council announced at its 2 September meeting that the tender system of full allotment at a fixed rate would be extended at least until 18 January 2011 for all the refinancing operations; in the case of the three-month operations, that fixed rate corresponded to the average of the central key rate over the life of the operation. Since certain vulnerabilities were still apparent, it was considered appropriate to continue to ensure easy access to liquidity in the fourth quarter. Moreover, during that quarter the last twelve-month refinancing operation and the six-month operation conducted on 12 May were both reaching maturity. There was a need for particular caution therefore, especially as the end of the year usually brings increased nervousness on the money market. As had been the case in June and September when the first two twelve-month refinancing operations matured, a special fine-tuning operation to provide liquidity was arranged at each significant due date in the fourth quarter, to encourage a smooth transition until the next weekly main refinancing operation. In the case of the twelve-month refinancing operation maturing on 23 December, the period of the special operation was actually set at thirteen days so as not to aggravate the year-end tensions.

At the end of September, on the maturing of the three longer-term operations – for periods of three, six and twelve months respectively – credit institutions renewed only part of their earlier demand for liquidity. As a result, the average liquidity surplus declined to € 36 billion in October. In parallel with the reduction in the liquidity surplus during the period from July to October, the Eonia followed an upward trend, averaging 0.70 % in October compared to 0.35 % between 1 January and 30 June. It also exhibited greater volatility during that period. The financial markets then gained the impression that the overnight interest rate would remain closer to the central key rate. From October, longer-term secured

money market rates therefore also increased steadily, and the three-month Euribor again exceeded 1 % from mid-October, despite a fall in the risk premiums which it includes.

Towards the end of October, however, the financial market situation deteriorated again, particularly on account of the uncertainty surrounding the costs of rescuing the Irish banking system. There was a resurgence of fears about the public finances of several euro area countries, and new tensions emerged on the interbank market. This was confirmed by the results of the Eurosystem's bank lending survey for the fourth quarter, which revealed that it had become more difficult for credit institutions to gain access to market financing. Demand for refinancing from the Eurosystem and the resulting liquidity surplus on the money market again became more volatile and expanded steadily in November, and more particularly in December. That exerted downward pressure on secured money market interest rates. In those circumstances, the Governing Council considered that it was desirable to continue offering the banks very flexible refinancing facilities. At its 2 December meeting, it therefore announced that it would extend the existing exceptional measures, while drawing attention to their temporary nature. In particular, it decided to maintain the current arrangements for providing liquidity, at least until 12 April 2011. In order to preserve the efficient transmission of monetary policy, the Governing Council also confirmed that it would maintain its Securities Markets Programme, while asserting that it would continue to sterilise the purchases so as not to influence liquidity conditions on the money market.

The developments on the money market in the second half of the year under review clearly showed that the liquidity surplus obeys a market mechanism. When tensions are rising, institutions in surplus are more reluctant to lend on the interbank market. They prefer to place their surplus liquidity with the Eurosystem and are prepared to pay the price – in the form of meagre remuneration at the deposit facility rate. It therefore becomes harder for banks in deficit to raise finance on the market, and many of them are forced to turn to the Eurosystem to obtain refinancing. That situation leads to an increase in the liquidity surplus and a decline in the overnight rate on the money market. When the climate improves, on the other hand, institutions in surplus are more inclined to lend directly to other banks. In that case, the liquidity surplus on the money market shrinks and the overnight interest rate tends to rise. If these movements in the overnight interest rate are viewed as persistent, they affect the movement in longer-term secured money market rates. That in turn tends to compensate for the fluctuations in the risk

premiums contained in the unsecured interbank market interest rates, and the fluctuations in the overnight rate therefore act as an automatic stabiliser for interest rates on that market. That explains why the three-month Euribor remained close to 1 % throughout the second half of the year under review, despite sometimes significant changes in the money market situation.

The enhanced credit support which the Eurosystem introduced in October 2008 helped to avert a more serious financial crisis and hence a deeper recession which would have threatened price stability. Although the comfort thus offered to the banks was intended to enable them to effect the gradual consolidation of their balance sheets, it was also necessary to give them sufficient incentive actually to embark on that process. For that reason, the Governing Council systematically underlined the exceptional and temporary nature of the enhanced credit support, and highlighted the dangers of excessive recourse to the Eurosystem by certain counterparties.

Recourse to the Eurosystem is not problematic in itself. On the contrary, it is to some extent inevitable, given the existence of a structural liquidity deficit on the money market. However, in the case of certain credit institutions, that recourse has become systematic and disproportionate, e.g. in view of the size of their balance sheet. Such behaviour is symptomatic of serious financing problems facing certain banks. Those problems must be resolved at source, possibly with the intervention of the prudential authorities and governments, and not by perpetuating recourse to the Eurosystem. Moreover, having certain counterparties so dependent on the Eurosystem may, in the future, complicate the return to variable rate tenders. It also increases the risk that the Eurosystem faces in its monetary policy operations by increasing the concentration of its assets. For these reasons, the Governing Council became increasingly concerned during the year under review about the heavy and persistent dependence of certain counterparties on the Eurosystem.



2.

Economic developments in Belgium

2.1 Activity and employment

2.1.1 Summary

After a relatively small contraction at the height of the global recession in late 2008 and early 2009, activity in Belgium subsequently took full advantage of the improvement in the economic environment. In all, following a 2.7 % decline in 2009, GDP grew by an average of 2 % in real terms over 2010 as a whole. Those are better than the figures for the euro area, where GDP contracted by an average of 4.1 % in 2009 and the recovery in 2010 amounted to only 1.7 %.

The revival in activity in Belgium was based on the strong upturn in foreign demand – due in particular to the end of the widespread reduction in inventories –, the easing of the financial tensions and, more generally, the restoration of business and household confidence. These were precisely the determinants that had deteriorated in 2008, reinforcing one another in a recessive spiral. Growth therefore became more broadly based in 2010. While only final public expenditure – on consumption and investment – had made a positive contribution in 2009, both net exports and domestic demand excluding the change in inventories supported GDP growth to varying degrees in 2010.

In parallel with the consolidation of the revival in activity, the negative effects which the crisis had exerted on corporate profitability were largely reabsorbed in 2010. That improvement was due first to the growing volume of sales and the more favourable trend in prices for producers, two effects directly connected with the strengthening of demand. In addition, the gradually increasing use of production capacity tended to moderate costs. In particular, after being driven down by the decline in the level of activity in 2009, productivity per hour worked began rising again during the year under review, thus curbing the increase in unit labour costs. Following a decline

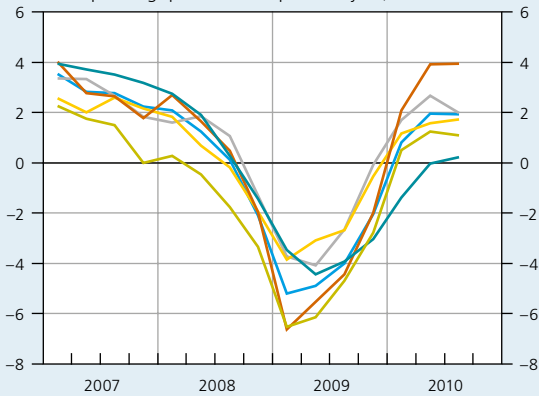
in 2009, the gross operating surplus in the broad sense – including the gross mixed income of self-employed persons – recovered as a percentage of value added in 2010, whereas the percentage represented by compensation of employees broadly reverted to its 2008 level.

The relatively favourable pattern of activity in Belgium compared to the euro area, both in the recession phase and during the recovery, was accompanied and supported by the exceptional resilience of domestic employment, which has in fact already expanded, whereas there is normally a longer delay after a revival in activity. That expansion totalled 0.6 %, following a contraction of just 0.4 % in 2009. It was all the more remarkable in that the scale of the 2008-2009 recession had been unprecedented in all the business cycles of the past six decades. Compared to those other episodes, the greater labour retention is probably due in part to the temporary measures taken at the time of the crisis in order to augment recourse to temporary lay-offs and facilitate the reduction in working time, but another significant factor is that firms are facing structural shortages of skilled labour and were in a sound financial position when the crisis erupted. In comparison with other euro area countries, the labour market was also more resistant because Belgium did not have to contend with a property crisis.

Generally speaking, the Belgian economy weathered the recent severe turbulence without the handicap of major structural imbalances, unlike some of the euro area countries. Thus, the balance of transactions with the rest of the world remained slightly positive, and the indebtedness of both households and non-financial enterprises remained sustainable. In particular, the property market in Belgium did not undergo any severe adjustment, unlike in Spain and Ireland, in particular, or, beyond the euro area, the United States. In fact, viewed over fifteen years, house prices have generally followed a pattern comparable

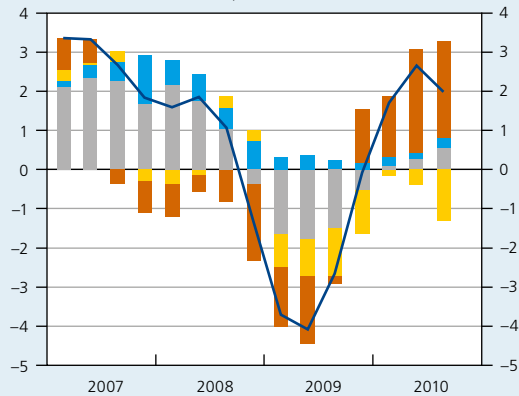
CHART 25 ECONOMIC RECOVERY IN BELGIUM

GDP IN BELGIUM AND IN THE EURO AREA⁽¹⁾
(percentage changes in volume compared to the corresponding quarter of the previous year)



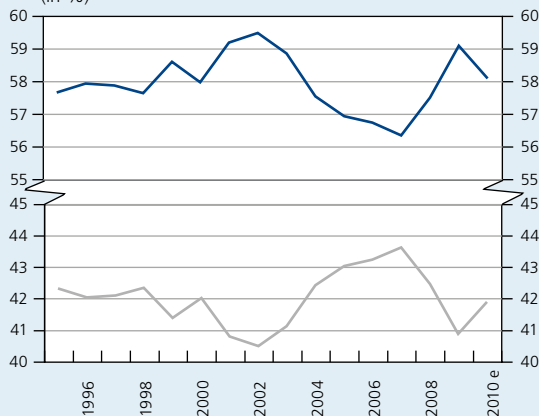
— Belgium
— Euro area
— France
— Germany
— Spain
— Italy

GDP AND MAIN EXPENDITURE CATEGORIES IN BELGIUM⁽¹⁾
(quarterly data; contributions to the annual change in the volume of GDP, percentage points unless otherwise stated)



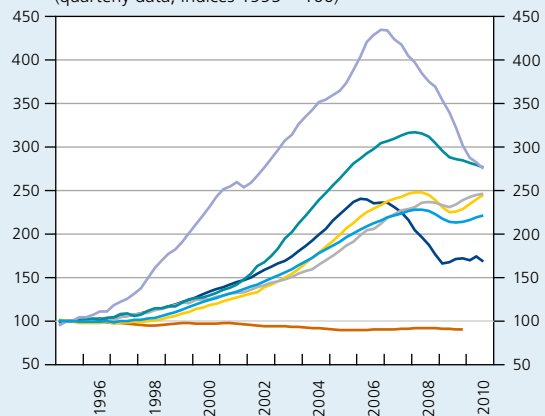
■ Private expenditure, excluding change in inventories
■ Public expenditure
■ Change in inventories
■ Net exports of goods and services
— GDP⁽²⁾

SHARE OF INCOMES IN VALUE ADDED
(in %)



— Compensation of employees
— Gross operating surplus and gross mixed income

RESIDENTIAL REAL ESTATE PRICES⁽³⁾
(quarterly data, indices 1995 = 100)



— United States
— Germany
— France
— Belgium
— Spain
— Ireland
— Average for euro area countries⁽⁴⁾

Sources: EC, OECD, Standard & Poor's, NAI, NBB.

(1) Data adjusted for seasonal and calendar effects.

(2) Annual percentage changes.

(3) Nominal indices. The series were obtained from the OECD database, except for the United States, where the Case-Shiller index was used.

(4) Average for France, Italy, the Netherlands and Finland, weighted by GDP.

to that seen in most other European countries, but the increase has been steady, with no exaggerated boom and no abrupt correction. Even at the height of the financial crisis, the fall in house prices was modest and short-lived. Prices began rising again in 2010.

2.1.2 Trends in activity and employment

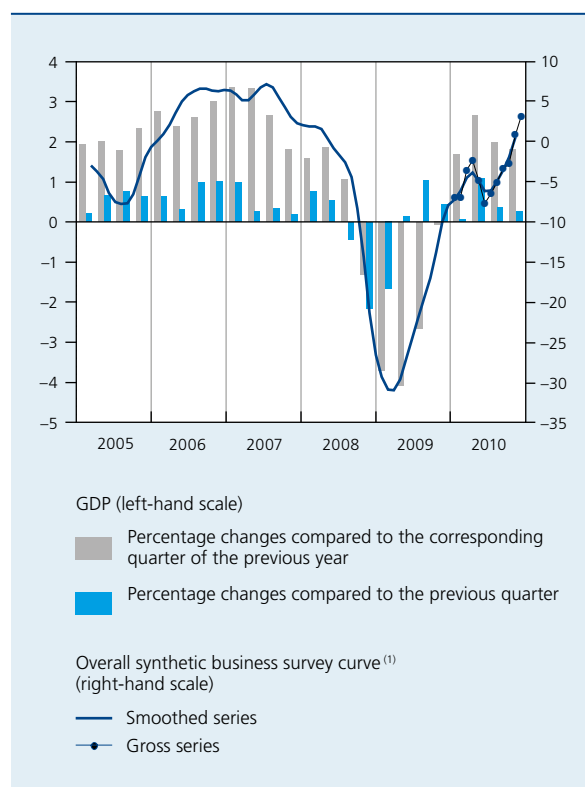
As in the euro area, the economic recovery which had begun in Belgium in mid-2009 continued and gained strength during 2010. Following a year-on-year decline of 4.1 % in the second quarter of 2009, GDP picked up by the first quarter of the year under review. GDP growth peaked at 2.7 % in the second quarter. Subsequently, as in other euro area countries, the initial rebound in activity lost some of its momentum, and the growth rate stabilised at around 1.9 % in the third and fourth quarters. While it contrasts with the previous year's contraction, the GDP growth was therefore nonetheless relatively moderate in 2010. Moreover, the quarter-on-quarter GDP growth bears witness to an uneven recovery, due partly to severe weather conditions which hampered activity in the construction industry in the first quarter.

The improvement in the economic situation was also apparent in the overall synthetic business survey indicator which the Bank produces on the basis of the replies to its monthly survey of business leaders. Thus, after a steep fall when the economy contracted, the synthetic indicator recovered steadily from the spring of 2009, driven by a revival in all the branches covered by the survey, regarding both the assessment of the current business situation and the outlook. That trend continued at the beginning of 2010, thanks to better prospects for demand and more favourable expectations regarding employment, taking the overall indicator to a level comparable to the average calculated since 1980. Following a temporary dip in business confidence during the second quarter of 2010, against the backdrop of increased uncertainty about foreign orders, the synthetic indicator resumed its recovery during the second part of the year. That recovery was supported in particular by a more marked improvement for service businesses, construction and trade, in parallel with the gradual strengthening of domestic demand. It gained momentum at the end of the year, following a strong improvement in the outlook for employment and demand for manufacturing industry.

At the end of 2010 – seven quarters after the low point reached at the beginning of 2009 – and despite the rapid revival in economic activity, GDP in Belgium was still 0.9 % below the peak level reached just before the

CHART 26 GDP AND BUSINESS SURVEY INDICATOR

(data adjusted for seasonal and calendar effects, unless otherwise stated)



Sources: NAI, NBB.

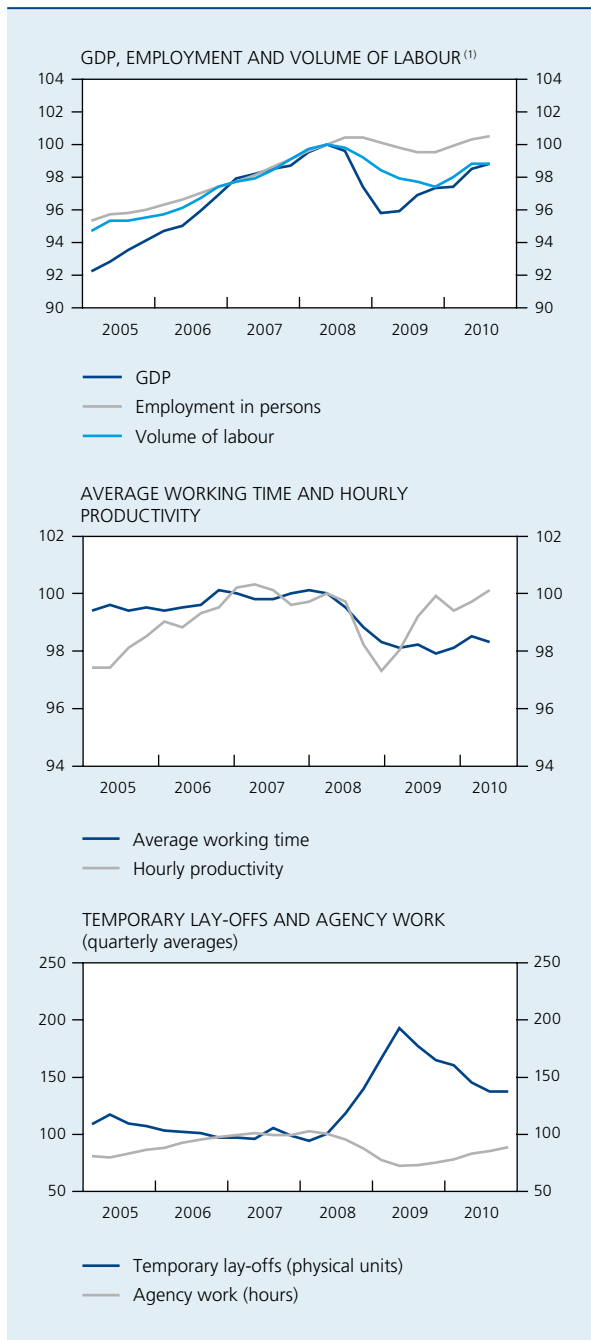
(1) Balance of replies to the monthly survey, non calendar adjusted data.

great recession. From that point of view, the negative effect of the shock which hit the economy in 2009 was therefore significantly longer lasting than at the end of the three preceding recession phases since, on average, it had then taken only five quarters after the trough for economic activity to regain the level prevailing before the contraction. That difference is due mainly to the scale of the recession, which – it should be remembered – was the most severe for sixty years. The pace of the recovery was similar, on average, to that in previous episodes.

Conversely, employment has performed surprising well over the past two years. Overall, domestic employment proved remarkably resilient during the recession, declining by only 0.4 % in 2009 and picking up relatively quickly after the crisis, since it has already expanded by 0.6 % in 2010. Thus, at the end of the year under review, there were around 16,000 extra jobs, compared to the peak in the fourth quarter of 2008. That limited adjustment of employment was due largely to the change in the average number of hours worked per person and in hourly productivity. Faced with the weakening of activity, firms had in fact shown a widespread preference for forms of

CHART 27 GDP, EMPLOYMENT, PRODUCTIVITY AND TEMPORARY LAY-OFFS

(data adjusted for seasonal and calendar effects, indices 2nd quarter of 2008 = 100)



Sources: Federgon, NAI, NEO, NBB.

(1) Total hours worked, i.e. the sum of the volume of labour by employees as published by the NAI and the estimated volume of labour by self-employed persons.

internal flexibility, such as cutting overtime and making greater use of temporary lay-offs and time credit.

The volume of labour was therefore adjusted mainly by a reduction in the average hours worked per person. Thus,

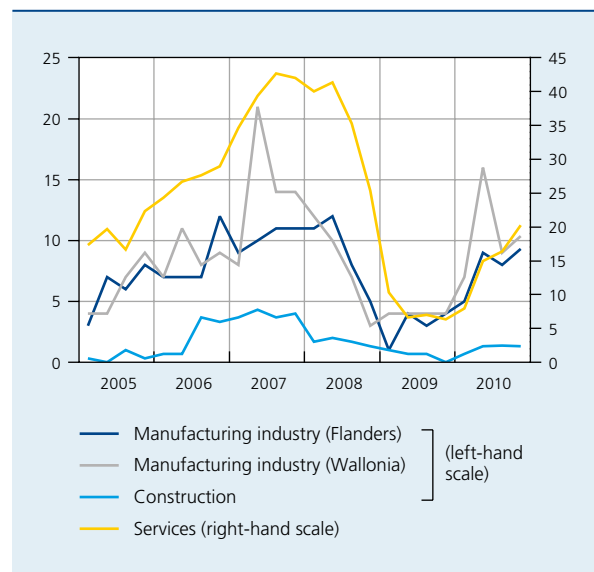
in 2009, while there was only a marginal reduction in the number of persons in work in the economy as a whole, the volume of labour fell by 1.8 %, reflecting a reduction of around 1.5 % in the average working time per person. In 2010, contrary to expectations, the average working time remained relatively low, increasing by only 0.2 %. Recourse to temporary lay-offs and other systems of cutting working time in fact only declined very gradually, so that the individual working time still remained well below its pre-recession level. Overall, the volume of labour grew by 0.8 % in 2010, while activity expanded by 2 %.

Among the options available for avoiding job losses, firms also allowed the hourly productivity of their workers to fall. In view of the sudden slump in activity, that effect had been particularly marked at the start of the recession, as labour hoarding led to a decline in hourly productivity, amounting to 0.6 % in 2008, and 0.8 % in 2009. From the fourth quarter of 2009, apparent productivity per hour worked gradually recovered year-on-year, but increased on average by only 1.2 % in 2010.

Initially, external flexibility, via the non-renewal of temporary contracts and the dismissal of workers on permanent contracts, mainly took the form of a reduction in the use of agency workers. The volume of agency work had constantly declined up to the second quarter of 2009, but began to pick up thereafter. That increase was based

CHART 28 IMPEDIMENTS TO ACTIVITY OWING TO A SHORTAGE OF SKILLED LABOUR

(proportion of firms facing a shortage⁽¹⁾)



Source: NBB.

(1) According to the replies to the quarterly survey in manufacturing industry and the monthly survey in the other branches, weighted according to the relative size of the firms measured on the basis of turnover or employment.

mainly on the revival in the employment of blue-collar agency workers, although white-collar workers also made a contribution from the second quarter. Nonetheless, the share of agency work in total employment still remained lower than before the recession.

The Bank's business surveys also reveal that the proportion of firms whose activity is hampered by a shortage of skilled labour, a percentage which had declined steeply from the start of the crisis though without disappearing, began to rise again in the year under review, especially in

manufacturing industry and services. This indicator, which illustrates the structural mismatches which have long affected the labour market in Belgium, explains the scale of the labour hoarding practised by firms through the cycle. Its profile in 2010 is due partly to the fact that workers temporarily laid off are not available on the labour market to meet the labour needs of firms whose activity has already picked up, since they are still under contract to their employer. Continued use of this device beyond a certain period of time may therefore act as a brake in an economic recovery phase.

Box 4 – Management of the workforce during the crisis

When activity declines, a firm has several options for adapting the volume of labour, and hence labour costs. Initially, owing to the uncertainty surrounding the scale and duration of the cyclical downturn, firms in a financial position to do so limit recourse to redundancies, in particular, by cutting the individual working time of their staff. Firms practise labour hoarding because they do not want to compromise their production potential. Redundancies entail not only financial costs but also a loss of human capital, plus the expense and difficulty of recruiting skilled staff once activity picks up.

EMPLOYMENT AND VOLUME OF LABOUR BY EMPLOYEES IN THE PRIVATE SECTOR

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

	2008		2009		2010	
	1st half year	2nd half year	1st half year	2nd half year	1st half year	2nd half year e
Volume of labour by employees	2.4	0.6	-2.9	-3.2	0.1	2.0
Number of employees	2.3	1.8	-0.4	-1.7	0.0	1.5
Number of hours worked per employee	0.2	-1.1	-2.5	-1.5	0.1	0.5

Sources: NAI, NBB.

The developments seen in the latest cyclical episode illustrate the point. In the second half of 2008, the rise in the total number of hours worked by employees in the private sector had weakened as a result of the slowdown in activity, while the number of persons in work continued to grow. That means that, at the same time, the average working time per employee was falling. It was not until the following half year that employment had begun to decline, and then only very slightly compared to the reduction in individual working time. In the second half of 2009, the adjustment in terms of employment had finally exceeded that in terms of hours worked per employee. Altogether, the contraction in the volume of labour recorded had not led to a proportionate adjustment in the number of workers. Then, in the first half of 2010, the volume of labour employed in the private sector stabilised, reflecting the fact that average working time remained steady while employment ceased to decline. Owing to the revival in activity, the number of employees increased sharply in the second half year, whereas the rise in individual working time lagged behind.



In the first instance, firms can cut the total volume of labour by reducing regular overtime work, getting staff to take leave days previously saved up, etc. If that is not sufficient, the ordinary systems for reducing working time can be used, and part-time work or time credit may be encouraged. Non-renewal of temporary employment contracts, including agency contracts, is another option which enables firms to retain staff on permanent contracts. For the latter, the labour laws offer the option of temporary lay-offs. These may be due to various reasons, for which different schemes apply. The commonest are temporary lay-offs for economic reasons: if it is temporarily impossible to maintain the rate of work, e.g. because of a decline in orders, the employment contract may be partially or totally suspended for a certain period. This scheme only applies to blue-collar workers with a permanent employment contract, but under the recovery plan it was extended to include temporary workers, including agency workers, from 1 January 2009.

In the spring of 2009, a comparable system, the “temporary collective scheme for total or partial suspension of employment contracts”, was set up for white-collar workers. At the same time, two other schemes were launched to permit individual or collective reductions in working time. The “crisis time credit” was aimed at a temporary, individual reduction in the work done. The “temporary adjustment to working time in a crisis” consisted of a reduction in working time applicable to all workers in a firm, or to a specific category of workers. These measures, described in detail in the Bank’s 2009 Report, are temporary by nature. At the request of the social partners, they were extended until 31 March 2011. For the future, the draft central agreement for 2011-2012 concluded on 18 January 2011 provides for gradual alignment of the rules on blue-collar and white-collar workers. In 2016, a single system of temporary lay-offs should apply, based on the system currently applicable to blue-collar workers. Harmonisation of the rules also concerns redundancy procedures.

In the last resort, if the firm is forced to cut its permanent staff, it may make its workers redundant, individually or collectively. In that case, under certain conditions, it is possible to resort to pre-pensions for older workers. The relevant regulations were tightened up following the conclusion of the Generation Pact in December 2005. At present, when a firm restructures, it has to create an employment unit or collaborate with such a unit as soon as it announces collective redundancies. All the workers made redundant on that occasion, except for those aged 58 years or more, or those with an employment record of at least 38 years, must be registered with an employment unit for the purpose of outplacement. In addition, all workers who, as a result of collective redundancy after 30 March 2006, receive a full-time pre-pension must remain available to the labour market up to the age of 58 years or for one year if they have an employment record of at least 38 years.

The available statistics for the measures to reduce working time illustrate the scale of recourse to these schemes before, during and after the crisis.

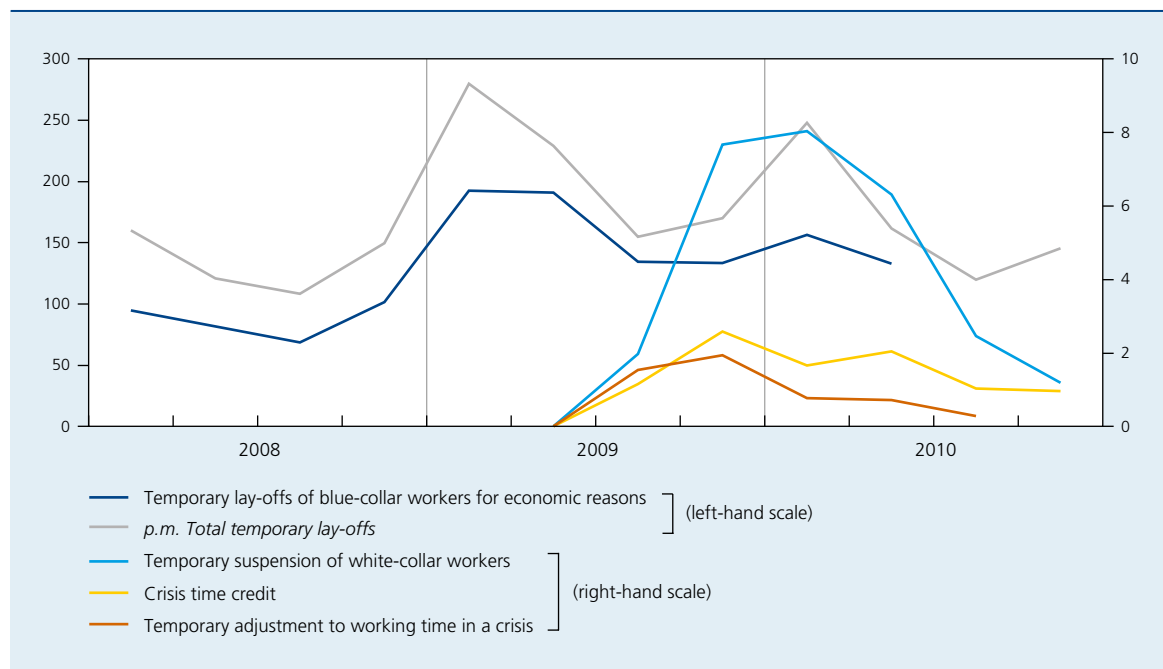
The number of persons covered by temporary lay-offs for economic reasons has increased since the end of 2008, reaching a peak in the first half of 2009. At that time, it concerned around 200,000 blue-collar workers, or more than double the pre-crisis figure. Their number subsequently declined as activity picked up. In the second quarter of 2010, around 130,000 workers were recorded as temporarily laid off. The total numbers drawing temporary unemployment benefits (taking all schemes together), for whom more recent statistics are available, have declined, suggesting that temporary lay-offs on economic grounds – by far the principal reason – have continued to fall, to close to the pre-recession level. The increase seen at the end of the year reflects the impact of the bad weather.

The success of a similar scheme applicable to white-collar workers, launched in mid-2009, has been very moderate. At its maximum level, in early 2010, it concerned around 8,000 people. Since then, their number has declined steadily, to no more than 1,000 in the fourth quarter.

Even less use was made of crisis time credit, with a maximum of 2,500 beneficiaries in the fourth quarter of 2009. By the fourth quarter of 2010, that had already fallen to around 1,000 workers. However, it should be noted that recourse to the ordinary time credit scheme had risen sharply from the start of the crisis onwards. The number

RECOURSE TO WORKING TIME REDUCTION MEASURES

(thousands of beneficiaries, quarterly averages)



Sources: NEO, NSSO.

of employees opting for that scheme in order to reduce their volume of work, increased from 106,000 at the beginning of 2008 to 119,000 at the end of 2009 and 124,000 at the end of 2010.

At its peak, i.e. in the final quarter of 2009, temporary adjustment to working time in a crisis led to a collective reduction in working time for almost 2,000 people. As in the case of the other temporary crisis measures, the numbers concerned fell significantly during 2010, to just 300 in the third quarter.

Finally, the numbers drawing full-time pre-pensions have risen only slightly since the start of the recession, up from 115,000 at the beginning of 2008 to 120,000 in the fourth quarter of 2010. Of these persons, around 3,000 were not exempt from registering as job seekers; at the beginning of 2008, that figure was only 900 workers.

After suffering the effects of the recession in the previous year, the main market sector branches all recorded an improvement in their activity during 2010. However, depending on the case, that improvement was variable in scale, and in particular, the response in terms of employment was specific to each branch.

As usually happens when cyclical developments are determined mainly by foreign demand, the movements in activity were most pronounced in industry, a branch which left its mark on the profile of the economy as a whole. After

a cumulative decline in volume of almost 10% during the recession phase, value added in industry picked up from the third quarter of 2009 and maintained a relatively sustained growth rate of around 1.2% per quarter during the first three quarters of 2010. In particular, the chemicals, metallurgy and transport equipment branches, which have a relatively high degree of international openness, benefited directly from the recovery of world trade, and recorded better growth rates than the branches more dependent on domestic demand. Nonetheless, this consolidation of industrial activity was not enough to restore

a level of activity comparable to that before the recession. In the third quarter of 2010, the volume of value added in industry was still 5 % below its previous peak.

Against the backdrop of a sharp fall in output in 2009, the adjustment of paid employment in industry initially took the form of a reduction in the average hours worked per person, and – after a lag of two quarters – a decline in the

number of persons employed. The cuts in the workforce continued during the first three quarters of the year under review, albeit more slowly than in the previous year. As activity picked up, industrial firms quickly restored and improved their productivity and reduced their recourse to temporary lay-offs. Therefore, in the third quarter of 2010, the level of apparent productivity per hour worked was almost 7 % higher than in the second quarter of

CHART 29 VALUE ADDED, PAID EMPLOYMENT, HOURLY PRODUCTIVITY AND HOURS WORKED PER EMPLOYEE IN THE MAIN BRANCHES OF ACTIVITY

(data adjusted for seasonal and calendar effects, indices 2nd quarter of 2008 = 100)



Source : NAI.

2008, while the average number of hours worked per person began to pick up from the first quarter of 2010, though without yet regaining its pre-recession level.

In market services, which cover trade, hotels and restaurants, transport and communications and financial services, real estate activities and business-related services, activity picked up slightly faster than in industry, since a small revival became apparent by the second quarter of 2009. It continued in 2010 at an average rate of 0.3% quarter-on-quarter. Overall, however, the revival in activity in this branch was noticeably weaker than in industry, even though – taking account of its weight in the economy – it made the biggest contribution to GDP growth. This lesser dynamism is probably due partly to two factors, one being that, initially, it was mainly foreign demand that led the way out of the crisis, and the other being that this branch had been less seriously affected by the economic crisis than industry. Mirroring the scale of the movements in value added, the changes in paid employment in market services were much more moderate than in manufacturing industry. Indeed, employment was up by 0.1% on a quarterly basis by the end of 2009, then grew at a more sustained pace of around 0.6% during the first three quarters of the year under review. In contrast, the hours worked per person, which had recorded a smaller decline at the start of the recession, displayed very weak growth from the beginning of 2010, while productivity fluctuated little.

In construction, the recovery was far more volatile and set in later. After a short-lived rebound of 0.7% between the first and second quarters of 2009, the volume of activity contracted constantly thereafter until the start of the year under review, as the economic and financial crisis depressed the property investments of firms and households. Moreover, the harsh winter hampered activity during the first quarter of the year under review, so that value added in construction declined temporarily by 3.5% at that time. More fundamentally, the downward trend seen since early 2009 in the level of applications for building permits was reversed from the first quarter of 2010. That turnaround was due largely to the surge in applications at the beginning of the year because when the tax relief measure which had originally been introduced under the recovery plan was extended, it was stipulated that building permit applications had to be submitted before 1 April 2010 in order to qualify for the reduced VAT rate of 6% on a maximum tranche of € 50,000 excluding VAT spent on the construction or completion of new housing. The fluctuations in activity in this branch were almost entirely absorbed by changes in the average hours worked per person, as recourse to temporary lay-offs is widespread here, including in the event of adverse weather

conditions. According to the temporary lay-off figures broken down by branch, 27% of the persons temporarily laid off in 2009 were construction workers, representing almost 8% of the number of employees in that sector. Employment in construction, which had hardly declined throughout 2009, began edging upwards again during the first three quarters of 2010. Overall, hourly productivity remained steady throughout the period of the cycle.

Finally, the recession had no adverse impact on the dynamism of non-market services. On the contrary, this branch, which represents almost 25% of the value added of the total economy, maintained a positive quarterly growth rate throughout the slowdown phase. This uncoupling from the economic cycle was also evident in the current recovery phase. After the Belgian economy bottomed out, the growth rate of activity in non-market services remained constant, at 0.4% quarter-on-quarter. These developments were not accompanied by any significant changes in productivity or individual working time, so that they were largely reflected in employment. The increase in the number of persons employed in the “other non-market services” branch, essentially in “health and social work”, largely subsidised directly or indirectly by the government, thus continued steadily at a quarterly rate of around 1% over the first three quarters of 2010. Employment in the “general government and education” branch was more or less stable during this period, after expanding slightly in the preceding years.

Thus, the expansion in paid employment recorded in 2010 for the economy as a whole was largely supported by services. Between the last quarter of 2009 and the third quarter of 2010, the workforce increased by 26,000 units in market services and 18,000 units in non-market services. It remained virtually unchanged in construction. In contrast, industry recorded a further 9,000 job losses.

2.1.3 Labour supply and demand

Overall, net job creations in 2010 as a whole came to 28,000 units. Following a net fall of 21,000 persons recorded in 2009, paid employment expanded by 24,000 persons. The growth in the number of self-employed persons which, despite the rise in the number of bankruptcies, was still maintained during the crisis, slowed down again in 2010. All in all, the harmonised employment rate increased slightly in 2010, though it remained below the level seen before the recession: on average, 61.9% of the population of working age was in work, compared to 61.6% in 2009 and 62.4% in 2008.

TABLE 6 LABOUR SUPPLY AND DEMAND

(annual averages; changes in thousands of persons compared to the previous year, unless otherwise stated)

	2006	2007	2008	2009	2010 e	<i>p.m.</i> 2010 e, level ⁽¹⁾
Population of working age ⁽²⁾	63	70	59	44	40	7.154
Labour force	47	18	51	36	42	5.109
<i>p.m.</i> Harmonised activity rate ⁽³⁾	66.5	67.1	67.1	66.9	67.6	
National employment	53	71	76	-15	28	4.545
<i>p.m.</i> Harmonised employment rate						
15 to 64 years ⁽³⁾	61.0	62.0	62.4	61.6	61.9	
20 to 64 years ⁽⁴⁾	66.5	67.7	68.0	67.1	67.4	
Brussels	57.9	59.4	60.2	59.5	58.8	
Flanders	70.6	71.9	72.3	71.5	71.9	
Wallonia	61.6	62.6	62.8	61.7	61.9	
Frontier workers	2	2	1	1	0	79
Domestic employment	50	70	76	-16	28	4.466
Self-employed	4	7	10	6	4	725
Employees	46	63	66	-21	24	3.741
Unemployment ⁽⁵⁾	-5	-53	-26	50	14	565
<i>p.m.</i> Harmonised unemployment rate ⁽⁶⁾	8.3	7.5	7.0	8.0	8.4	
Brussels	17.7	17.2	16.0	15.9	17.4	
Flanders	5.0	4.4	3.9	5.0	5.5	
Wallonia	11.8	10.5	10.1	11.2	11.4	

Sources: FPB, DGSEI, NAI, NEO, NBB.

(1) Thousands of persons.

(2) Population aged from 15 to 64 years.

(3) According to the labour force survey, in % of the population aged from 15 to 64 years.

(4) According to the labour force survey, in % of the population aged from 20 to 64 years. The 2010 figures for the Regions concern the average of the first three quarters.

(5) Unemployed job seekers, comprising totally unemployed persons claiming benefits (except older unemployed persons not seeking work), and other job seekers registered on a compulsory or voluntary basis. Employees of the local employment agencies who are already included in employment are excluded from this total.

(6) According to the labour force survey, in % of the labour force aged from 15 to 64 years. The 2010 figures for the Regions concern the average of the first three quarters.

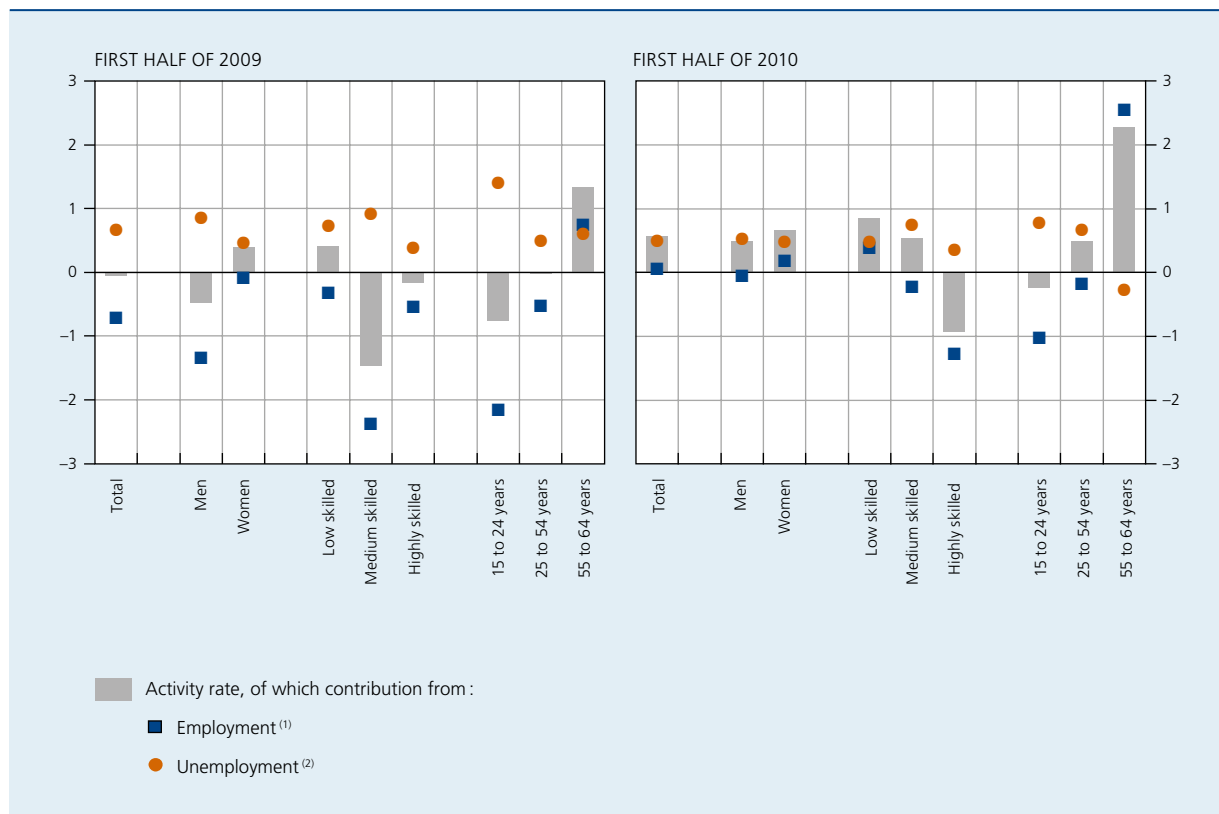
During the year under review, the labour force – which comprises workers and job seekers combined – increased by 42,000 units, rising to 5,109,000 persons. It thus grew faster than in 2009, despite the further deceleration in the growth of the population of working age. The activity rate therefore increased, following a slight fall in the previous year.

The activity rate corresponds to the sum of the employment and unemployment rates expressed as a percentage of the population of working age. On the basis of the data from the labour force survey, it is possible to analyse the variations per population group during and after the crisis by looking at the year-on-year changes in the first half of 2009 and 2010.

For persons not in work, the decision on whether or not to be active on the labour market depends, for instance, on the prospects of finding a job which meets their expectations in terms of pay, working conditions, commuter journey, etc. During a recession, there is less chance of finding suitable work, and that may discourage some potential labour market participants. In 2009, the upward trend in the activity rate thus came to a halt. The fall in employment following the crisis was then almost entirely reflected in a rise in unemployment. When employment, and hence the prospects of finding work, picked up, the activity rate began rising again. However, net job creations were not enough to absorb the additional supply of labour, so that unemployment recorded a further marked rise during the year under review.

CHART 30 ACTIVITY RATE: CONTRIBUTIONS OF EMPLOYMENT AND UNEMPLOYMENT PER POPULATION GROUP

(population of working age, percentage point change compared to the corresponding half of the previous year)



Source: EC.

(1) This contribution is equal to the change in the employment rate.

(2) This contribution differs from the change in the traditional unemployment rate since the latter is expressed in % of the corresponding labour force and not, as here, in % of the corresponding population.

The decline in employment caused by the recession affected almost all population groups, but some more than others. The movement in the activity rate generally reflected this diversity, so that the rise in unemployment was more comparable.

The crisis had a greater impact on the employment and unemployment of men than of women, because men are more strongly represented in the branches of activity which are most sensitive to the business cycle, such as manufacturing industry. The female employment rate only declined slightly during this period, notably as a result of the continuing employment growth in the non-market sectors. The upward trend in the activity rate of women was maintained because of the structural increase in the participation of women aged from 55 to 64 years in the labour market. This fundamental trend is attributable not only to the gradual increase in the statutory retirement age for women since 1997 – raised from 64 to 65 years on 1 January 2009 – but also to a cohort effect, since women with higher skills remain active on the labour

market until a more advanced age. As the crisis ended, the male activity rate picked up, regaining the level recorded in the first half of 2008. While the difference between the genders has declined in recent years, the male activity rate is still significantly higher than the female rate, at 73.2 as opposed to 61.4% of the corresponding population of working age in the first half of 2010.

The employment of low-skilled persons, i.e. those with no more than a certificate of lower secondary education, had already felt the effects of the cyclical downturn at the beginning of 2008, so that the decline recorded between the first half of 2008 and the first half of 2009 was limited overall. Their activity rate had then even increased slightly. At the point when the crisis reached its peak, it was persons with medium skills who recorded the steepest fall. The number of highly-skilled persons in work increased constantly during the period under review, in the context of the steady rise in the average educational level of the population and of persons in work. However, the employment rate of highly-skilled persons did decline, as did the

rate for other skill levels, but that was because the growth in the percentage of the population with higher education qualifications outstripped the expansion of employment within this group during and just after the recession.

This demonstrates once again that the sensitivity of employment to the business cycle varies according to the level of education. Lower-skilled workers are not only the first to feel the impact of fluctuations in activity, they are also more severely affected. Highly-skilled personnel are retained to a greater extent because, since they have specific knowledge and skills, they are less easily replaced, so that they will only be made redundant in the last resort, if the decline in activity is protracted and there is no immediate prospect of a recovery. Moreover, it is highly-skilled persons who recorded the smallest increase in unemployment.

The breakdown by age shows that the situation of young people on the labour market is relatively more sensitive to the economic cycle, as they often do not yet have a permanent job or can only claim little professional experience compared to other age groups. As in the case of persons aged from 25 to 54 years, there was a decline in the employment rate of young people aged from 15 to 24 years both in 2009 and in 2010, but for young people, the decline was almost three times as great. This is also the population group which saw the biggest rise in unemployment during those two periods; in 2009 this also applied for highly-skilled young persons.

The group of persons aged from 55 to 64 years is the only one where the employment rate increased during the crisis. This upward trend remained strong thereafter, once the worst of the crisis was over. Their unemployment rate according to the ILO definition also declined in the first half of 2010. Overall, the activity rate of seniors rose significantly, from 35.1% in the first half of 2008 to 38.7% in the first half of 2010. The economic crisis therefore did not halt the upward trend which has been apparent for several years, and which is due partly to the increased participation of women in the labour market, the measures taken under the Generation Pact, and the use of part-time work, e.g. on the basis of the time credit, in order to continue being active to a more advanced age. Nevertheless, fewer than four out of ten persons aged between 55 and 64 years are active in Belgium, whereas the average in Europe is one in two.

As already stated, although employment began expanding again, unemployment continued to rise in 2010. According to the NEO's administrative data, this concerned an average of 565,000 persons nationwide. However, the increase amounting to 14,000 persons was

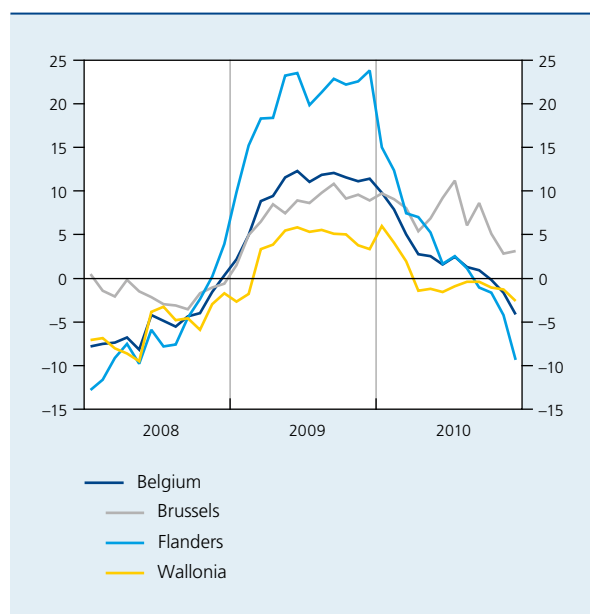
less than a third of the figure for the previous year. The harmonised unemployment rate was up by 0.4 percentage point, at 8.4% of the labour force.

The year-on-year rise in the number of unemployed job seekers flattened out from mid-2009, but it did not slow significantly until the beginning of 2010, and it was only from October 2010 that the number of unemployed dropped below the previous year's figure. The fall mainly concerned men and young people under the age of 25 years. At the end of 2010, the fall in unemployment was more pronounced in Flanders, but that was also the region where the number of unemployed job seekers had risen soonest and most strongly during the crisis, since the proportion of employment in the branches of activity sensitive to the business cycle is greater there than in the other two regions. In 2009, the number of unemployed persons there had been more than a fifth higher than in the previous year, whereas in Brussels and Wallonia the increase had been only 8 and 3.5% respectively.

The crisis affected not only the number of unemployed persons but also the average unemployment duration, as is evident from the change in the breakdown of the number of job seekers according to this duration. An unemployment ratio is used here which links the number of job seekers to the total population of working age, and not to the labour force as is generally the case.

CHART 31 UNEMPLOYMENT IN BELGIUM AND IN THE REGIONS

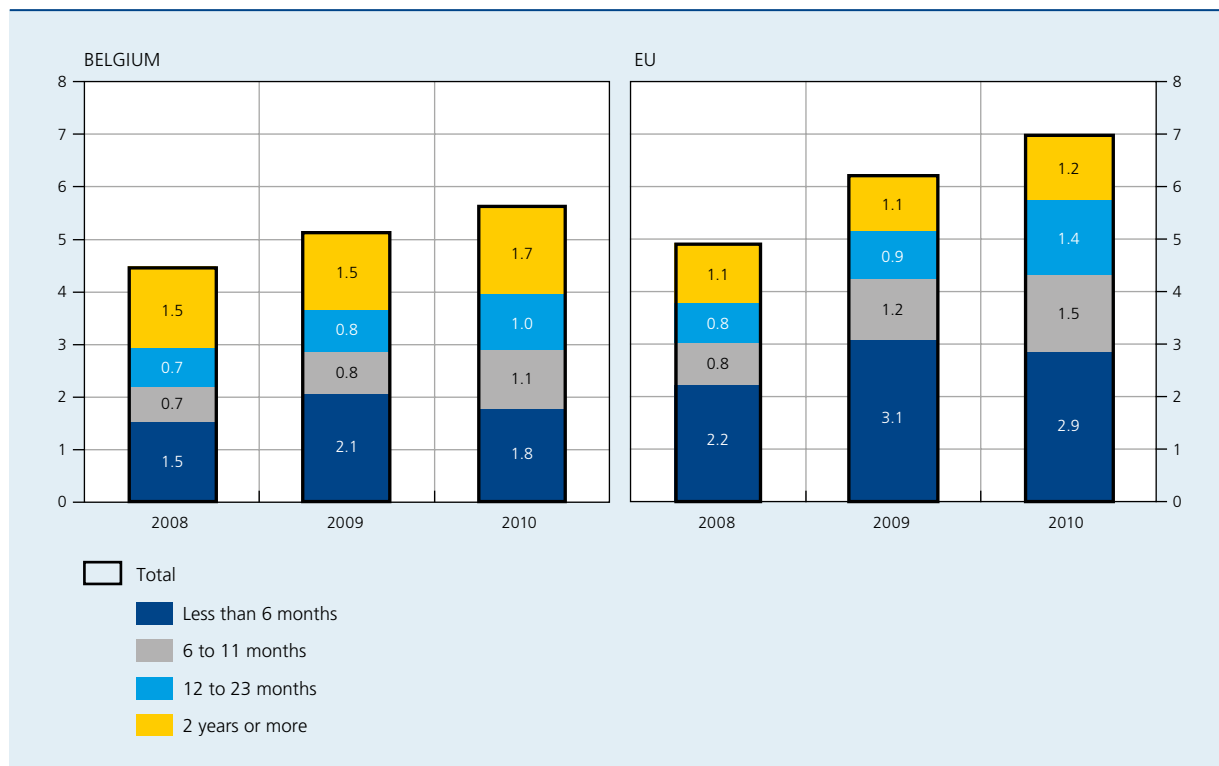
(percentage changes in the number of unemployed job seekers compared to the corresponding month of the previous year)



Source : NEO.

CHART 32 UNEMPLOYMENT BY DURATION IN BELGIUM AND IN THE EU

(data relating to the 1st half of the years considered, in % of the population of working age)



Source : EC.

As illustrated above, the latter is itself influenced by the economic cycle, which may distort the conclusions. In the first half of 2008, before the crisis started to affect unemployment, job seekers represented 4.5% of the population of working age in Belgium. A year later that had risen to 5.2%, mainly because of the influx of new unemployed persons caused by the increase in redundancies and non-renewal of temporary contracts, and by the arrival on the labour market of young people who had failed to find work on leaving education. In fact, the proportion of the population of working age recording a brief period of unemployment (six months maximum) grew from 1.5 to 2.1%, while the impact on the other groups broken down according to the duration of unemployment remained limited at first. The situation subsequently changed, as the chance of moving into employment diminished with the crisis, and job seekers recorded a steady increase in their periods of unemployment. This situation was reflected in expansion of all groups unemployed for six months or longer. The lengthening of the average period of unemployment was therefore the main factor accounting for the subsequent rise in the overall unemployment ratio, which reached 5.7% in the first half of 2010.

A broadly similar pattern was recorded, on average, for the EU but the unemployment ratio – already higher at the start – increased more strongly there. As in Belgium, short-term unemployment was the first to increase, followed by longer-term unemployment. Nonetheless, it is noticeable that the percentage of very long-term unemployment, lasting two years or more, which is an indication of structural unemployment, increased proportionately less there, whereas it was already significantly lower than in Belgium. Even when the economy picks up, these long-term unemployed experience the greatest difficulty in getting back into the labour market, partly because – as time goes by – they may have lost certain skills and abilities necessary to meet the labour demand requirements, and partly because some employers use long-term unemployment as a de-selection criterion, therefore giving preference to other job seekers. That attitude may in itself discourage the long-term unemployed and lead them to make less effort to look for a job.

2.1.4 Demand and incomes

Main components of demand

The severe recession from which the Belgian economy has been gradually recovering since mid-2009 was due largely to the collapse of world trade and the simultaneous drastic reduction in inventories. It was the turnaround in the first of these factors that generated the recovery, while the effect of the inventory reduction was halved. These developments were accompanied by the recovery of private consumption in 2010, in parallel with the improvement in the general economic situation, while investments continued to be scaled down, though at a more modest rate than in 2009. In all, the recovery exhibited a relatively classic pattern, except that the scale of the movements was exceptional during this economic cycle.

Belgian exporters took full advantage of the recovery in world trade which began in mid-2009. Aided somewhat by the euro's depreciation during the first half of 2010, exports staged a particularly strong recovery up to the middle of the year. The revival was supported mainly by the dynamism of demand from the emerging economies, particularly those in Asia. Belgian firms capitalised on the vigour of those markets either directly, by exporting their products there, or indirectly, by supplying partners in other countries – particularly Germany – who themselves have trade links with Asian customers. The export recovery was

particularly marked in the case of intermediate products, such as those of the chemical and iron and steel industries.

As the effect of the support measures which had been set up in many countries to stem the crisis ebbed away, foreign demand slowed down during the second part of the year. That deceleration, which was soon reflected in business leaders' assessment of their order books, except in December, also led to a weakening of the growth rate of Belgium's exports. As an annual average, following an 11.4% slump in volume in 2009, exports recovered by 10% in 2010. These results are largely in line with the pattern of foreign demand. According to estimates, Belgium's share of the export market declined by 0.3%, a performance comparable to that of the previous year and better than during the period 1995-2008, when the loss of market share averaged 1.6% per annum.

The pattern of imports was fairly similar to that of exports, largely reflecting the fact that production processes increasingly involve entities located in different countries, e.g. via subcontracting. In 2010, however, their annual growth rate, at 7.7%, was significantly below that of exports, owing to the less dynamic domestic demand, and particularly the further contraction in inventories. In all, over the year as a whole, net exports of goods and services made a very large contribution to the volume growth of GDP, at 1.9 percentage points. That positive contribution followed a negative result in the two previous years, of -1 and -0.5 percentage point respectively.

TABLE 7 GDP AND MAIN EXPENDITURE CATEGORIES

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

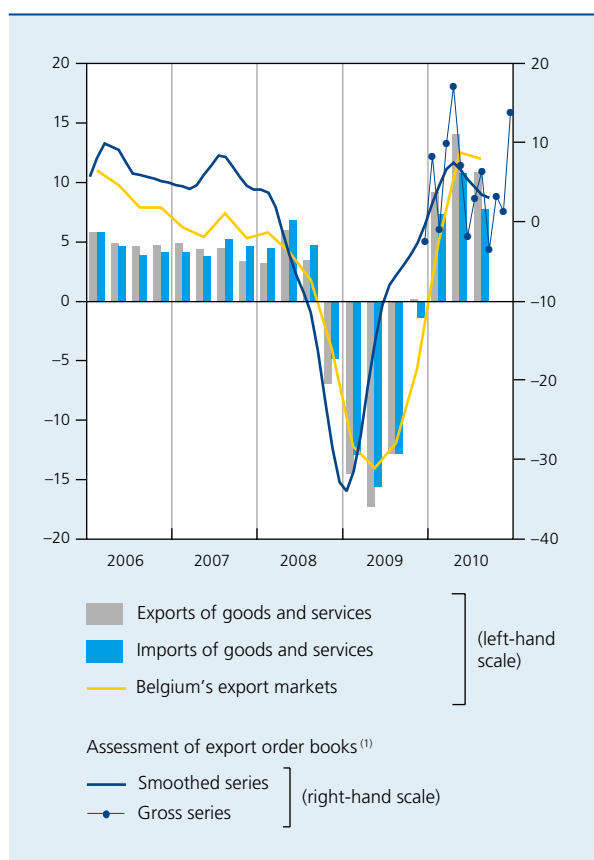
	2006	2007	2008	2009	2010 e
Final consumption expenditure of individuals	1.8	1.7	1.4	-0.2	1.4
Final consumption expenditure of general government	0.6	2.1	2.5	0.4	1.1
Gross fixed capital formation	2.0	6.3	2.4	-4.9	-1.8
Housing	6.4	3.4	-0.6	-3.0	-3.5
Enterprises	2.0	7.9	3.4	-7.5	-1.2
General government	-11.8	4.2	5.5	10.3	-0.9
<i>p.m. Final domestic expenditure</i> ⁽¹⁾	1.5	2.7	1.8	-1.1	0.6
Change in inventories ⁽¹⁾	0.7	0.1	0.0	-1.0	-0.5
Net exports of goods and services ⁽¹⁾	0.5	0.1	-1.0	-0.5	1.9
Exports of goods and services	5.0	4.3	1.4	-11.4	10.0
Imports of goods and services	4.6	4.4	2.8	-10.9	7.7
GDP	2.7	2.8	0.8	-2.7	2.0

Sources: NAI, NBB.

(1) Contribution to the change in GDP, percentage points.

CHART 33 EXPORTS, IMPORTS AND EXPORT MARKETS

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



Sources: ECB, NAI, NBB.

(1) Balance of replies to the monthly survey, non calendar adjusted data.

The process of destocking by firms, which had particularly depressed activity in 2009, slowed down in 2010. Altogether, the contribution of the change in inventories to the annual volume growth of GDP was again negative, at -0.5 percentage point in 2010, compared to -1 point in the previous year.

The other components of demand played a less dominant role than foreign trade in the substantial fluctuations in activity during the past two years. However, their movement in 2010 was still, in varying degrees, affected by the financial crisis and the recession, even though they made a positive contribution to growth overall.

Of those components, public expenditure was the only one to expand in volume in 2009. Public consumption was up by a further 1.1% , in 2010, while public investment declined slightly this time. Households, which had drastically reined in their consumption expenditure at the end of 2008 and the beginning of 2009, increased

it again from the middle of that year, albeit at a modest rate. In 2010, that trend was maintained so that, on average, household consumption grew by 1.4% in real terms, after a fall of 0.2% in 2009. Conversely, business investment continued to decline during the year under review, although far less steeply than in 2009: it was down by 1.2% , compared to a decline of 7.5% in 2009. Finally, housing construction was still seriously depressed in 2010, with household investment in housing contracting slightly more than in the previous year, by 3.5% , against 3% .

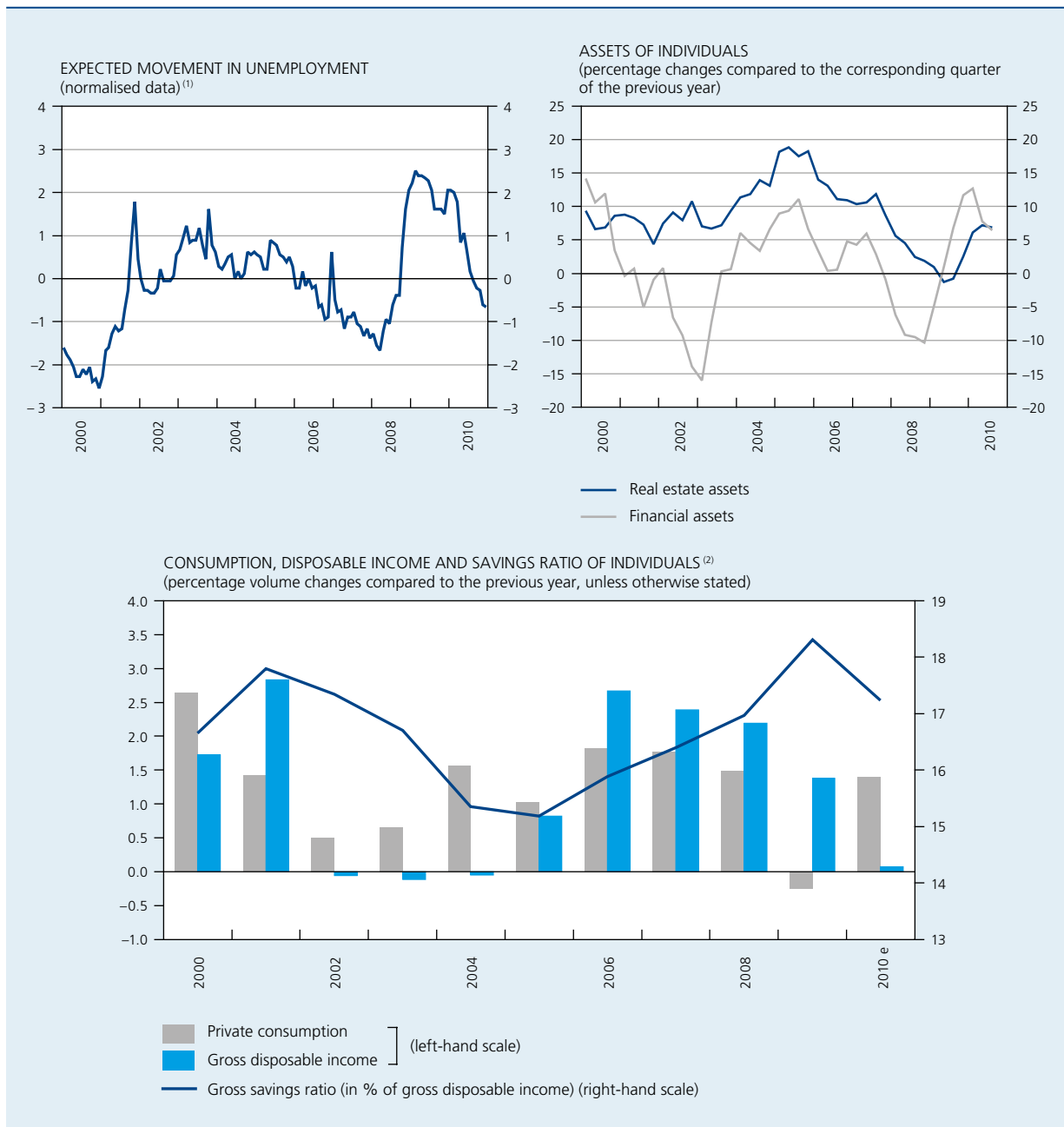
Individuals

For individuals, the restoration of normal economic and financial conditions was more important than the movement in purchasing power in 2010. Thus, the uncertainty which surrounded their future income prospects and which had been at its height in early 2009 rapidly faded, as is clear from the household confidence indicator, and more specifically the component which asks about household expectations regarding unemployment over the coming twelve months. After having fallen very sharply from March 2008 to reach a record level of pessimism in February 2009, the indicator then improved almost continuously. In August 2010, it had regained its long-term level, indicating that households took a more or less neutral view of their future labour incomes. As already mentioned in section 2.1.2, in view of the scale of the contraction of activity, the performance in regard to employment over the past two years has been a pleasant surprise.

Moreover, household assets which had been seriously eroded by the crisis have recovered since then, as explained in detail in box 9 in section 3.3.2. While individuals had lost a substantial part of their assets owing to the stock market crash, financial market tensions and the – albeit small – decline in house prices, those assets were subsequently rebuilt by additional accumulation of savings, the rising stock markets and the recovery of property prices.

The better outlook for employment and the upward valuation of their assets encouraged households to relax the curbs on their consumption spending. When deciding what resources to allocate to consumption, individuals take account not only of current incomes but also of future revenues which they can expect, in accordance with the “permanent income” theory. That smooths out their consumption over time, while the sometimes irregular fluctuations in current disposable income are absorbed by the savings ratio. Thus, in 2009, when – despite a continuing sustained rise in their current disposable

CHART 34 DETERMINANTS OF THE GROSS SAVINGS RATIO OF INDIVIDUALS



Sources : NAI, NBB.

(1) Balance of replies to the monthly survey ; original series reduced by its average over the period from 1985 to 2010 and divided by its standard deviation.

(2) Non calendar adjusted data deflated by the private consumption deflator. Disposable income and the savings ratio include the change in the net claims of households on occupational pension institutions.

income – households anticipated weaker growth in their future incomes, in view of the gloomy employment outlook, the erosion of their assets and the very sharp deterioration in public finances, their savings ratio had jumped to 18.3 % of their disposable income. As the economic situation returned to normal, the savings ratio dropped sharply during the year under review, reverting to 17.2 %, or close to its pre-crisis level. In retrospect, households

considered that in 2009 they had been over-pessimistic about their future incomes.

Individuals stepped up their consumption expenditure by 1.4 % during the year under review, whereas they had drastically curbed that expenditure in 2009. The relatively buoyant final consumption of individuals materialised despite the stagnation of their real disposable income – in

other words their purchasing power – in 2010. These developments are in stark contrast to those of the previous year, when private consumption had dropped by 0.2 %, while the disposable income of households had risen by 1.6 % in volume.

Several factors account for this pattern of real disposable income contrasting with the profile of economic activity, with an increase at the height of the crisis in 2009, followed by stagnation in 2010, against the backdrop of a recovery in economic activity.

First, there is generally a time lag between the movement in consumer prices and wage indexation. The time lags resulting from the wage indexation mechanisms in force in the various joint committees imply that wages are only adjusted in line with higher inflation after a certain delay. Thus, following a surge in inflation in 2008, nominal hourly wages had risen by 3.6 % in 2009, of which 2.5 % was due solely to automatic indexation whereas, at the same time, measured on the basis of the HICP, inflation had dropped to 0 %. In 2009, the indexation of wages – and also that of social benefits – well in excess of the rise in consumer prices had therefore been a major factor bolstering household purchasing power. In 2010, the indexation mechanisms worked in the opposite direction. The indexation of

remuneration was very limited, at around 0.5 % year-on-year, in view of the very small rise in the health index a year earlier, whereas – in contrast – inflation surged, thus temporarily depressing household purchasing power.

Moreover, as explained in more detail in section 2.2.3, the rise in hourly labour costs excluding indexation – which had accelerated in 2009 – slowed significantly.

Taxation was another factor which had bolstered household purchasing power in 2009, but depressed it in 2010. Some of the tax cuts which households had enjoyed in 2009 were curtailed in 2010. First, the tax reduction granted to all workers resident in the Flemish region in 2009 was only retained for certain categories of workers in 2010. Also, the speedier assessment of personal income tax no longer had the same effects in the year under review. In 2009, it had led to two tax refunds for many taxpayers, because the refund which would have been payable in 2010 – without the accelerated assessments – was brought forward.

Taking account of this factor and the influence – discussed above – of the fluctuations in the rate of the automatic indexation of social benefits, net transfers from individuals to general government increased by 1.9 % at current prices.

TABLE 8 DETERMINANTS OF THE GROSS DISPOSABLE INCOME OF INDIVIDUALS, AT CURRENT PRICES
(percentage changes compared to the previous year, unless otherwise stated)

	2006	2007	2008	2009	2010 e	<i>p.m.</i> 2010 e, in € billion
Gross primary income	4.9	5.5	5.4	-1.3	2.4	262.7
Compensation of employees	4.8	5.2	5.4	1.3	1.8	187.5
Volume of labour of employees	1.4	2.0	1.5	-2.1	0.8	
Compensation per hour worked	3.2	3.1	3.9	3.6	0.9	
Gross operating surplus and gross mixed income	6.1	4.9	1.4	-3.0	3.6	46.0
of which income from self-employed activity ..	5.4	2.6	0.3	-1.8	2.3	
Property income ⁽¹⁾	3.7	8.2	11.3	-13.6	4.8	29.1
Current transfers ⁽¹⁾	0.8	7.3	5.5	-12.3	1.9	-42.0
Current transfers received	2.3	3.9	5.6	7.1	3.3	81.6
Current transfers paid	1.8	5.2	5.6	-0.4	2.8	123.7
Gross disposable income	5.8	5.1	5.4	1.1	2.5	220.6
<i>p.m. In real terms</i> ⁽²⁾	2.8	2.2	2.1	1.6	0.0	

Sources: NAI, NBB.

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

(2) Data deflated by the private final consumption expenditure deflator.

The other determinants of household disposable income on which the crisis had exerted significant downward pressure did recover in 2010 as economic activity picked up, albeit to a limited extent. The volume of paid employment, which had fallen by 2.1 % in 2009, expanded by around 0.8 % in 2010, driven mainly by the rise in the number of persons in work. That development was largely counterbalanced by the marked slowdown in the increase in hourly labour costs so that, overall, compensation of employees hardly increased any faster than in 2009. Following a 3 % fall in 2009, the total of the gross operating surplus and gross mixed incomes of self-employed persons began growing again, albeit at a modest pace, namely 3.6 % at current prices. This revival seems to have boosted the incomes of the liberal professions, except for building-related occupations, which continued to suffer from the weakness of the construction industry. Finally, after a sharp fall in their property incomes in 2009, individuals saw those incomes increase in 2010, by around 4.8 % in nominal terms. Firms paid out higher dividends overall, in a climate of improved profitability. Conversely, other investment incomes continued to decline: individuals, who are traditionally net lenders of funds to the other sectors, were once again particularly affected by the fall in interest rates.

After recording average volume growth of over 6 % during the period 2003-2007, the household investment cycle entered a downward phase. Investment in housing had thus fallen in real terms by 0.6 % in 2008 and 3 % in 2009. The increase in mortgage interest rates and more stringent conditions applied to new loans at the outbreak of the financial crisis, but especially – at a later stage – the erosion of confidence and the deterioration in their employment prospects had encouraged households to adopt a wait-and-see approach, in the light of the deceleration, or even decline, in house prices on the secondary market.

In 2010, house building contracted again. As an annual average, the reduction in the volume of investment in housing, at 3.5 %, is even steeper than in the two preceding years. In view of the time lag between the decision to build or renovate a house and the project start date, the low level of gross fixed capital formation of individuals in 2010 probably still reflected the high level of uncertainty, including expectations regarding unemployment, which had prevailed throughout 2009. However, the quarterly data indicate that the decline in investment in housing reached its maximum in the first quarter of 2010 and has gradually slowed since then. The low mortgage interest rates and extension of the reduced rate of VAT on new building have probably helped to provide some support for household demand for housing.

As already mentioned, this slump on the real estate market in Belgium was nothing compared to what happened in several other European countries. The property price correction was very limited in Belgium, since price falls persisted for only three consecutive quarters, from the last quarter of 2008 to the second quarter of 2009, resulting in a cumulative decline of only around 3.5 %. Since then, prices have begun rising again reaching year-on-year growth of 5.6 % in the third quarter of 2010. Moreover, though building activity slowed down in Belgium, at the time of the 2008-2009 recession, that downturn was modest compared to what happened in other countries, especially those where construction had been the engine of growth during the pre-crisis period.

Companies

While firms had faced an unprecedented decline in demand at the end of 2008 and in early 2009, which had seriously impaired their operating results, they benefited from the revival in world trade and thus posted positive results again in 2010. Their gross operating surplus, which had fallen by 0.1 % at current prices in 2008, and then by 6.5 % in 2009, grew by 7.5 % in 2010. This improvement was due both to the increased volume of sales and the larger gross operating margin per unit of sales. The strong growth in their exports, in the context of the recovery of global demand, accounts for the rise in the turnover of Belgian firms, while sales on the domestic market – including the change in inventories – were somewhat sluggish, with a slight fall of 0.4 %.

Against the backdrop of strengthening demand, selling prices increased in 2010, after a marked decline in the previous year. This movement was due partly to the higher cost of imports, resulting from the rise in commodity prices. Conversely, production costs of domestic origin were curbed by the particularly modest rise in labour costs: the weak increase in hourly labour costs, already mentioned, combined with the rise in productivity caused unit labour costs to fall by 0.3 % in 2010.

The improvement in their profitability enabled firms to pay out more dividends than in the previous year. Firms also paid more taxes on income and capital than in 2009, mainly because the tax base – which had been significantly eroded by the crisis – was restored during the year under review.

The increase in the gross operating surplus of firms also implies that firms have more internal resources available to finance any necessary investment expenditure. Firms' access to external financing also improved in 2010. As

TABLE 9 DETERMINANTS OF THE GROSS OPERATING SURPLUS OF COMPANIES, AT CURRENT PRICES
(percentage changes compared to the previous year)

	2006	2007	2008	2009	2010 e
Gross operating margin per unit of sales ⁽¹⁾	1.2	4.0	-2.0	0.9	2.6
Unit selling price	2.8	2.0	4.1	-3.8	4.7
On the domestic market ⁽¹⁾	2.9	1.8	4.1	-2.3	3.4
Exports	2.7	2.2	4.1	-5.3	6.2
Costs per unit of sales ⁽¹⁾	3.0	1.7	5.2	-4.6	5.1
Imported goods and services	3.4	2.0	6.6	-8.5	8.3
Costs of domestic origin per unit of output ⁽¹⁾⁽²⁾	2.2	1.0	2.6	2.4	0.2
of which unit labour costs	2.0	2.3	4.5	3.7	-0.3
Final sales at constant prices	3.7	4.0	1.9	-7.3	4.8
On the domestic market ⁽¹⁾	2.2	3.5	2.2	-2.6	-0.4
Exports	5.1	4.4	1.7	-11.6	10.0
Gross operating surplus of companies	5.0	8.2	-0.1	-6.5	7.5

Sources: NAI, NBB.

(1) Including the change in inventories.

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

explained in chapter 3.3, the cost of bank credit continued to fall, and financing via the financial markets was facilitated by the buoyancy of share prices and declining risk aversion among investors.

Despite the better outlook for sales and improved opportunities for financing, the volume of business investment continued to fall this year, by 1.2 %, though more slowly than in 2009 when a 7.5 % drop had been recorded. However, the quarterly data indicate a gradual recovery in the gross fixed capital formation of firms, with a limited revival apparent at the end of the year under review.

It must be said that the very gradual improvement in investment is taking place in the context of a noticeable recovery in the rate of capacity utilisation by firms, starting from an unprecedentedly low point. The crisis had in fact depressed output, and the rate of capacity utilisation in manufacturing industry had fallen to a record low of 70.1 % in April 2009. It then recovered from the second quarter of 2009 and throughout 2010. In the last quarter of 2010, it reached 80 %, close to the average for the past three decades. However, taking firms as a whole, the capital-output ratio – defined as the ratio between the capital stock and GDP, both expressed in real terms – remained high, even though the decline in investment which had begun at the end of 2008 was a factor restoring it to its long-term trend. Taking account of the sharp fall in output during the recession, the excess production capacity was thus not entirely reabsorbed. In the wake of

a recession, it is logical for business investment to take time to recover, since firms generally wait for confirmation of a sustained strengthening of final demand before resuming their gross fixed capital formation.

Rest of the world

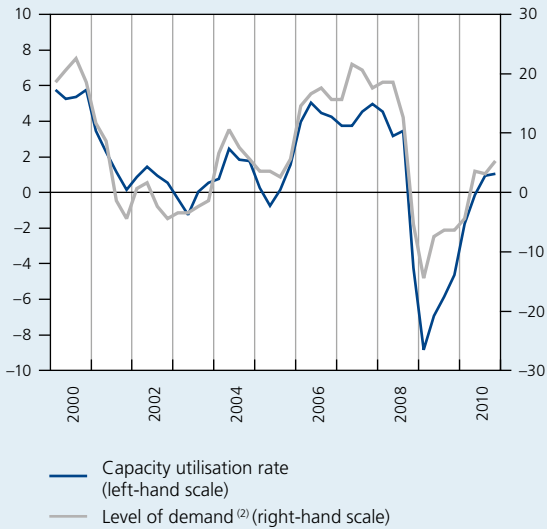
If the incomes of the domestic sectors are taken into account alongside their expenditure on consumption and investment, the net result indicates their financing requirement or capacity. Aggregation of that net figure for all the domestic sectors – i.e. the individuals and companies, discussed above, but also general government whose transactions are described in chapter 2.3 – gives the financing requirement or capacity of the economy, which corresponds to net borrowing from or lending to the rest of the world.

The financing capacity of individuals came to 4.6 % of GDP during the year under review, against 5.2 % in 2009. That decline was due to the contraction of the savings of individuals, itself attributable entirely to the fall in their disposable income as a percentage of GDP, whereas their consumption expenditure remained steady from 2009 to 2010. Their investments, which mainly concern housing, diminished.

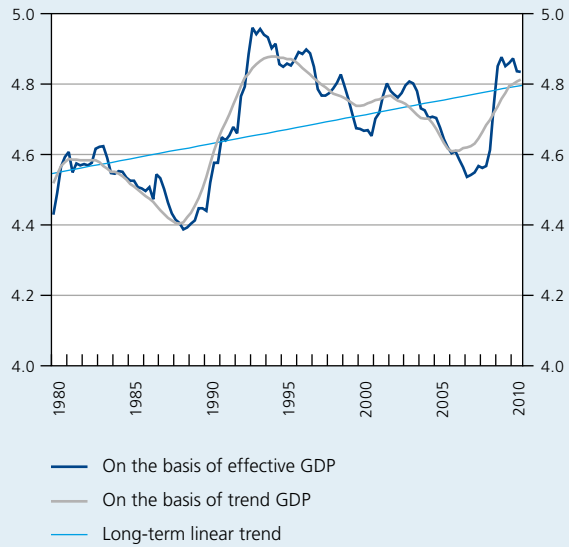
The financing balance of companies improved sharply in 2009, mainly as a result of the drastic adjustment to

CHART 35 INVESTMENT BY ENTERPRISES: MOVEMENT AND DETERMINANTS

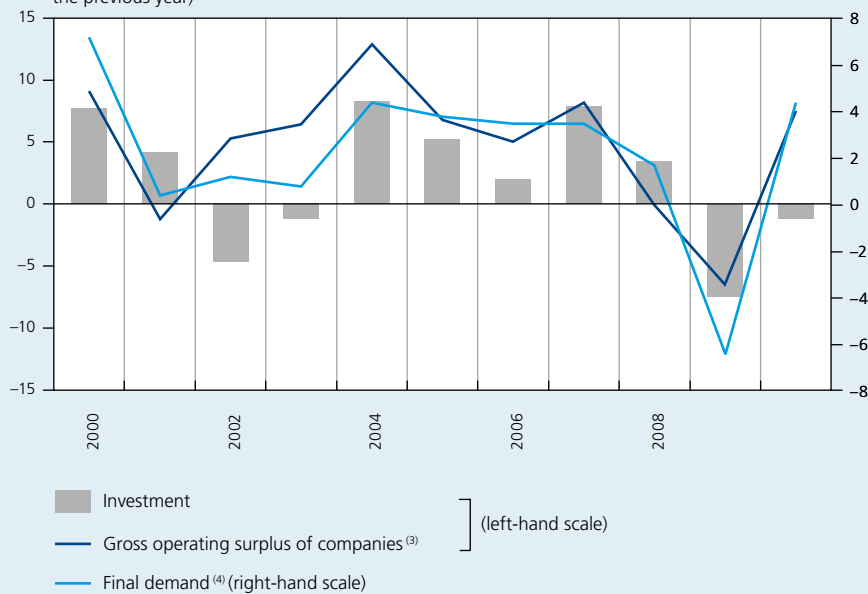
CAPACITY UTILISATION RATE AND LEVEL OF DEMAND IN MANUFACTURING INDUSTRY
(seasonally adjusted quarterly data, unless otherwise stated; difference compared to the average 1980-2009, percentage points)



CAPITAL-OUTPUT RATIO ⁽¹⁾



INVESTMENT, GROSS OPERATING SURPLUS AND FINAL DEMAND
(calendar adjusted volume data, unless otherwise stated; percentage changes compared to the previous year)



Sources: NAI, NBB.

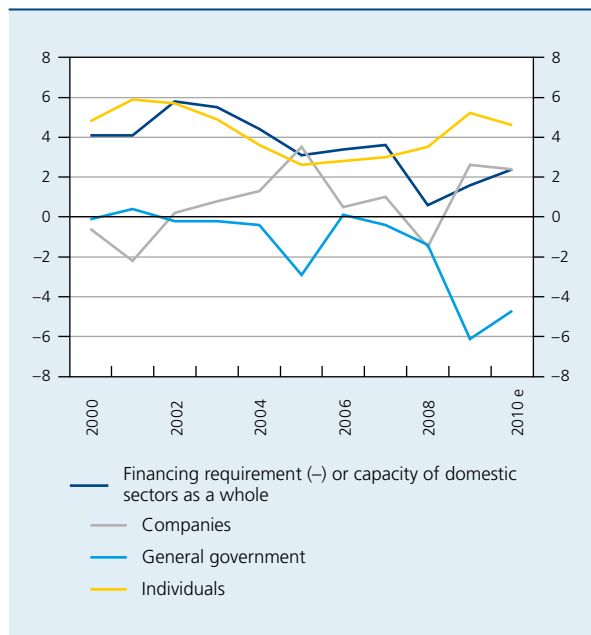
(1) Ratio between the capital stock and GDP, in real terms.

(2) According to the replies to the quarterly survey of manufacturing industry, proportion of firms which did not mention insufficient demand as a factor explaining the under-utilisation of production capacity; data not seasonally adjusted.

(3) Non calendar adjusted value data.

(4) Total of domestic expenditure and exports of goods and services.

CHART 36 FINANCING BALANCE OF DOMESTIC SECTORS AS A WHOLE
(in % of GDP)



Sources : NAI, NBB.

their gross capital formation, but declined slightly during the year under review, falling to 2.4 % of GDP, despite a small increase in disposable income following their good operating results. The decline in net capital transfers is the reason for this contraction in their financing capacity.

However, the deterioration in 2010 in the financing capacity of households and companies was more than offset by the reduction in the financing requirement of general government, down by 1.4 percentage points of GDP. Consequently, the positive financing balance of the domestic sectors as a whole rose from 1.6 % of GDP in 2009 to 2.4 %.

This increase in the balance has its counterpart in foreign trade in goods and services, as the revival in foreign demand led to an increase in the volume coverage ratio of imports by exports. The terms of trade deteriorated by 2 % in 2010, following a 3.4 % improvement in the previous year. In the context of the recession, export and import prices were down in 2009, but the recovery drove them back up in 2010: they increased by 6.2 and 8.3 % respectively.

According to the balance of payments data, the trade surplus increased in the case of goods and services, from € 4 billion in 2009 to € 5.7 billion in 2010. This growth was

a factor in the recovery of the current account balance, the surplus increasing from 2.9 to 5.2 billion in the meantime.

This improvement in the balance of payments current account confirms the recovery which had begun in 2009, following the dramatic fall in 2008 caused by the combined effects of soaring energy prices, which had seriously impaired the terms of trade, and the strength of Belgian final domestic demand compared to that in neighbouring countries, which had caused imports to rise faster than exports. Nonetheless, the level of the current surplus was still well down against the figure recorded in the late 1990s and in the early years of this century. While it had averaged around 4.4 % of GDP during the period 1998-2002, it came to only 1.5 % of GDP in 2010. Transactions in goods were the main factor behind the trend deterioration in the current balance, whereas the surplus on trade in services between Belgium and the rest of the world tended to expand slightly.

According to the data available for the first nine months of 2010, the surplus generated by service transactions increased again in 2010. For instance, the surplus on transport operations grew in the wake of the revival in world trade, and income from licence fees increased. These improvements were partly offset by a reduction in the surplus on business services.

The surplus of factor income also increased slightly in 2010. On the one hand, the structural surplus of labour income, due mainly to wages paid by European institutions to their staff resident in Belgium, edged upwards. Also, the balance of income from direct and portfolio investment recovered over the year as a whole, as the reduction in the dividend deficit, favoured by the economic recovery, was not totally offset by the decline in the balance of interest payments. However, that last movement masks a noticeable reduction in gross flows, as interest received from the rest of the world and that paid by Belgian residents declined owing to the general fall in interest rates.

Finally, the balance of current transfers, traditionally negative as Belgium is a net contributor to the EU budget, also improved in 2010.

The recovery of the capital account also participated in the improvement in the financing balance of the economy as a whole. Over the first nine months of the year, capital account transactions recorded a surplus of 0.2 billion, as opposed to a deficit of around 0.5 billion during the same period in 2009. That improvement was due in particular to the fact that Belgian firms bought fewer CO₂ emission licences.

TABLE 10 NET LENDING TO THE REST OF THE WORLD
(balances; in € billion, unless otherwise stated)

	2007	2008	2009	2010 e	First nine months	
					2009	2010
1. Current account						
Goods and services	4.9	-8.1	4.0	5.7	2.5	3.9
Goods	0.6	-11.3	-2.1	-1.2	-0.4	0.4
Services	4.3	3.2	6.2	6.9	2.9	3.5
Income	5.2	8.1	5.3	5.6	7.0	7.1
Earned income	4.5	4.5	4.9	5.0	3.6	3.7
Investment income	0.7	3.5	0.4	0.6	3.4	3.4
Current transfers	-4.6	-6.5	-6.4	-6.0	-4.9	-4.7
Transfers of general government	-4.6	-5.1	-4.8	-5.2	-3.7	-4.1
Transfers of other sectors	0.0	-1.5	-1.6	-0.8	-1.2	-0.6
Total	5.4	-6.5	2.9	5.2	4.6	6.3
<i>p.m. Idem, in % of GDP</i>	<i>1.6</i>	<i>-1.9</i>	<i>0.8</i>	<i>1.5</i>	<i>1.8</i>	<i>2.4</i>
2. Capital account	-1.3	-1.9	-1.3	-0.4	-0.5	0.2
3. Net lending to the rest of the world (1 + 2) ..	4.1	-8.5	1.6	4.8	4.1	6.5
<i>p.m. Idem, in % of GDP</i>	<i>1.2</i>	<i>-2.5</i>	<i>0.5</i>	<i>1.4</i>	<i>1.6</i>	<i>2.5</i>
<i>Financing requirement (-) or capacity of the domestic sectors, according to the national accounts, in % of GDP</i>	<i>3.6</i>	<i>0.6</i>	<i>1.6</i>	<i>2.4</i>	<i>2.8</i>	<i>3.7</i>

Sources: NAI, NBB.

2.1.5 Structural developments

The structural imbalances have attracted much attention in recent years, as the economic and financial crisis showed that they could have disastrous consequences for the macroeconomic stability of the economies. That is especially true in a monetary union like the euro area. The consequences of these imbalances are felt not only by the country in question, but may also – by contagion – damage confidence in other euro area countries, particularly owing to the exposure of their financial institutions and hence, perhaps, their governments. Ultimately, these imbalances are liable to endanger the very functioning of the euro area as a whole. Moreover, since the exchange rate instrument can no longer be used, the policies to be implemented in order to eliminate the imbalances between partners in the euro area are essentially structural, and need time to take effect. It is therefore crucial to launch the necessary adjustment measures without delay.

Since it is often hard to detect the emergence of structural imbalances in real time, it is common practice to use indicators which can provide an early warning. In that regard, the balance of current transactions with the rest of the world is an appropriate benchmark, in that it reflects not only the competitive position of the country in relation to the rest of the world, but also any domestic imbalances, such as inappropriate wage movements, excessive expansion of lending or seriously overvalued property markets. A current account deficit of this type is unsustainable in the long term. Such imbalances therefore need to be corrected as quickly as possible by means of a structural policy designed to control costs and support productivity, so as to restore external competitiveness and move towards a balanced development between output potential and the demand of the population.

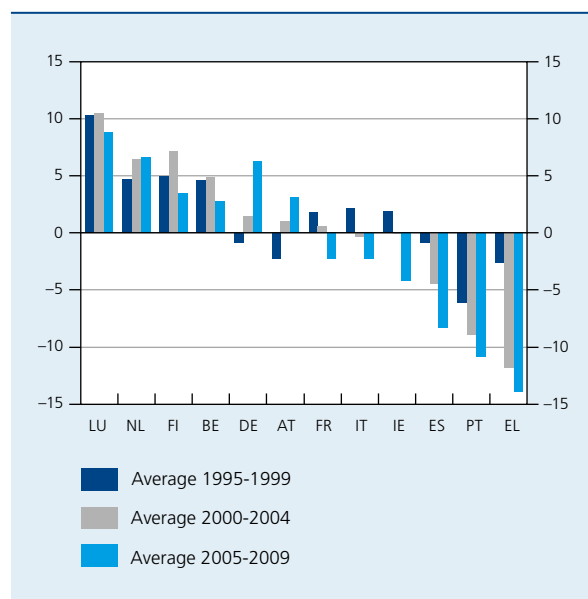
The current account balance in a medium-term perspective

With an average current account balance, according to the national accounts data, amounting to 4.1 % of GDP during the period 1995-2009, Belgium holds an intermediate position in the euro area, particularly among the countries which joined in 2001 at the latest. On the one hand, there are countries such as Greece, Portugal and Spain which, during the period in question, had to cope with a substantial current account deficit. On the other hand, there are Luxembourg, the Netherlands and Finland with a current account recording an average surplus of over 5 % of GDP. Although such surpluses seem at first sight less problematic than large deficits, they too may prove inconvenient since they make adjustments more necessary, but more difficult, for countries facing a structural current account deficit.

However, the analysis cannot be confined to the average balance over a long period, as it is hard to estimate the optimum current account balance for each individual country. Moreover, since it is more important to detect structural imbalances in good time, it is also necessary to take account of the dynamics of the current account balance: for example, a downward trend in that balance may point to the emergence of underlying structural problems which could ultimately lead to serious and persistent imbalances. In Belgium, according to the national accounts data, the balance of current transactions with the rest of the world fluctuated between 4 and 5 % of GDP over the period 1995-2001; after reaching a peak of 5.9 % of GDP in 2002, it steadily declined to 2 % in 2009. Among Belgium's main neighbouring countries, only France also recorded a decline in the current account balance, whereas that balance tended to rise in the Netherlands, and especially in Germany. Together with Austria, those countries therefore gradually strengthened their competitive position and augmented their current account surplus. The opposite situation was seen in Greece and Spain, where the current account deficit expanded considerably, and to a lesser extent in Portugal. The divergences within the euro area have therefore increased substantially over the past fifteen years.

In Belgium, the balance of current transactions with the rest of the world therefore followed a gradual but steady downward trend during the 2000s. In that regard, the limited improvement seen in the last two years can be considered mainly as a correction of the deterioration in 2008, which was due largely to temporary factors. The trend reduction in the current account balance is attributable principally to the decline in the balance of transactions in goods. It is important to examine the factors

CHART 37 INTERNATIONAL COMPARISON OF THE BALANCE OF CURRENT TRANSACTIONS WITH THE REST OF THE WORLD ⁽¹⁾
(in % of GDP)



Sources: EC, NAI.

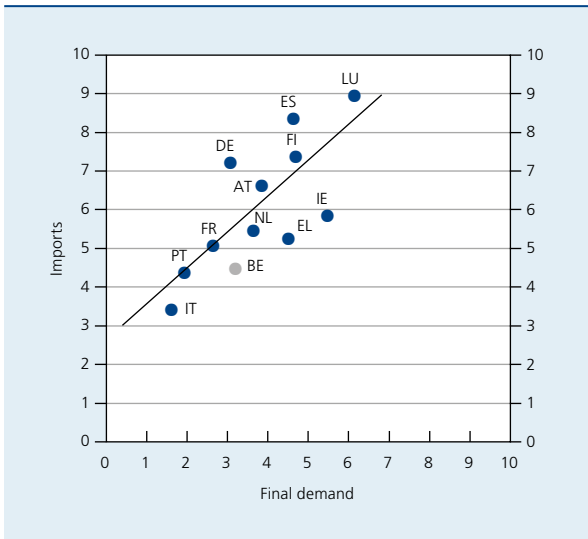
(1) The data come from the national accounts.

behind these developments and, more particularly, the extent to which this is a structural deterioration or a succession of temporary, benign factors.

If imports are considered first as an explanation for the movements in the foreign trade balance, a comparison with the other euro area countries shows that, in Belgium, their growth was not as strong as suggested by developments in final demand. A clear positive link can be established between these two variables, since final demand can be satisfied either by domestic output or by imports. In countries where final demand is not very dynamic, imports also record only moderate growth. Thus, during the period 2003-2007, when the current surplus declined steadily without being affected by the exceptional movements due to the widespread recession in 2008 and 2009, the average volume growth rate of final demand in Italy and Portugal was less than 2 % per annum, and imports there expanded by 3.4 and 4.4 % per annum respectively. In contrast, in Luxembourg, Ireland, Finland, Spain and Greece, final demand grew by an average of around 5 % per annum. In those countries, imports were also more dynamic. As shown by chart 38, the figures for Belgium come below the regression line obtained from the results for the various countries, indicating that – overall – the growth of final demand was absorbed to a greater extent than in the other countries by domestic output and to a lesser extent by imports.

CHART 38 IMPORTS OF GOODS AND SERVICES AND FINAL DEMAND

(annual percentage changes in volume, average over the period 2003-2007)

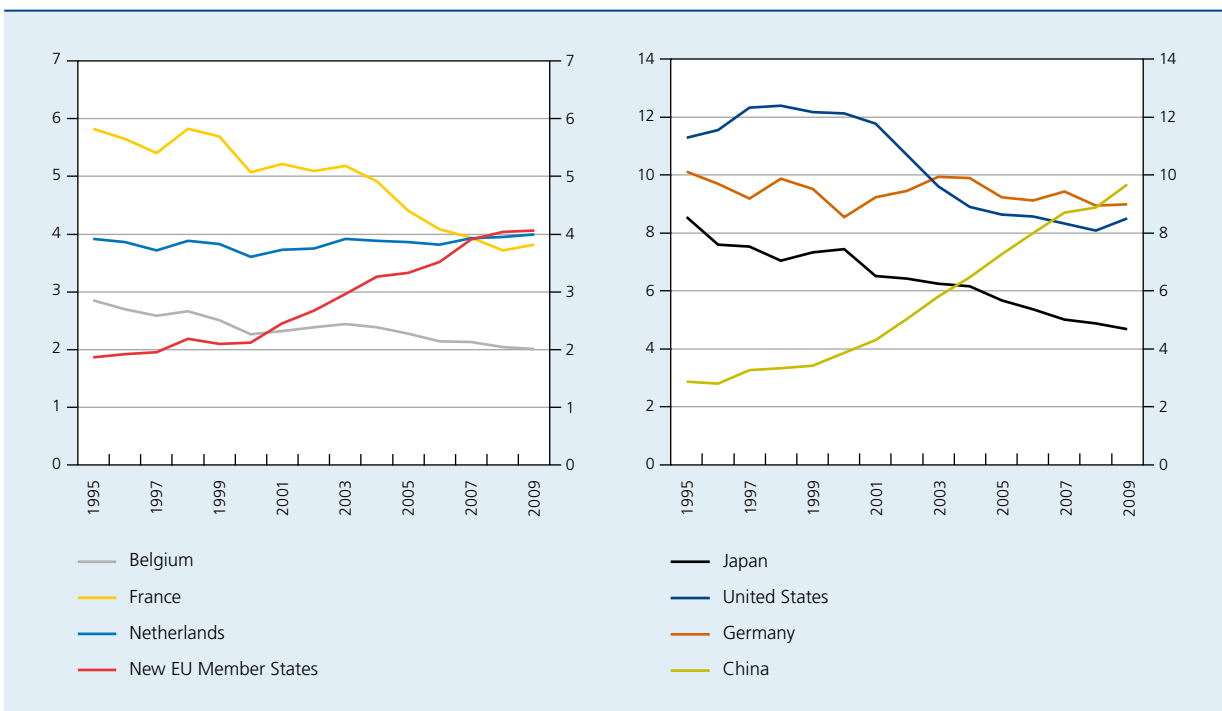


Sources : EC, NAI.

In Belgium, the decline in the balance of transactions in goods is therefore due mainly to insufficiently dynamic exports, a feature seen since the mid-1990s. In that regard, while the rapid emergence of new economic centres – such as the BRIC countries and the Central and East European economies – had opened up new markets and boosted international trade, it has also led to the entry of new competitors on the world market. For instance, China's share in total world exports of goods rose steadily from 2.9% in 1995 to 9.7% in 2009. Meanwhile, the new EU Member States doubled their share from 1.9 to 4.1%. As a result, most of the economies traditionally active in international trade, including Belgium, have declined in importance. Nevertheless, they were not all equally affected, since the share of countries such as the Netherlands and Germany in world exports of goods has remained more or less stable.

More specifically, between 1995 and 2007, the average annual growth in the value of Belgian exports of goods was 1.5 percentage points below the average for the other countries which joined the euro area by no later than 2001. France alone recorded slower export growth than Belgium, while the Netherlands, Austria, Ireland, Spain and Germany performed much better.

CHART 39 SHARE IN WORLD EXPORTS OF GOODS, BY VALUE (in %)



Sources : UNCTAD, NAI.

Export performance

Of course, exports are not the only means to secure economic development. However, for a small, open economy in which domestic sources of demand are liable to weaken as the population ages, the presence on foreign markets is crucial for maintaining and enhancing the prosperity of the population. Moreover, the liberalisation of trade, the decline in transport costs and progress in information and communication technologies are leading to increasing fragmentation of the production chain. The various phases in production – from the initial development, through the actual production itself, to final distribution – are increasingly divided among various countries according to their comparative advantages. To secure their full place in that system of organising production, and to generate sufficient value added, Belgian firms must play the biggest possible role in the development of international trade. Moreover, exports are a catalyst for productivity gains.

Analyses based on data concerning industrial firms have shown that exporters are noticeably more productive than firms active solely on the domestic market. Not all firms are capable of gaining access to foreign markets, owing to the high entry costs (market research, distribution networks, product modifications, etc.). Exports are therefore concentrated on a small number of firms which are generally bigger, more capital intensive and more productive than firms active only on the domestic market. It also seems that export firms can have a positive influence on the growth of productivity in non-exporting firms. Those spillover effects are linked, for instance, to the use of more advanced technologies and the establishment of higher quality standards. It seems to be mainly geographical proximity to export firms and the supply of inputs to these firms that contribute the most to the increase in productivity of Belgian firms concentrating solely on the home market⁽¹⁾.

The more modest growth of Belgian exports compared to those of other euro area countries is due partly to the dynamics of the export markets. The growth of the markets deemed relevant for a given country is calculated here as the average of the import growth of its trading partners, weighted by the share which each of them represents in its exports. During the period from 1995 to 2007, the markets relevant for Belgium expanded by an average of 8.2 % per annum, whereas the markets relevant for the reference area recorded average annual growth of 8.6 %. Although Belgian exports therefore face

an adverse location effect, that is not the main factor explaining why its export growth is less dynamic. Loss of market share is the principal reason for the less favourable growth of Belgian exports.

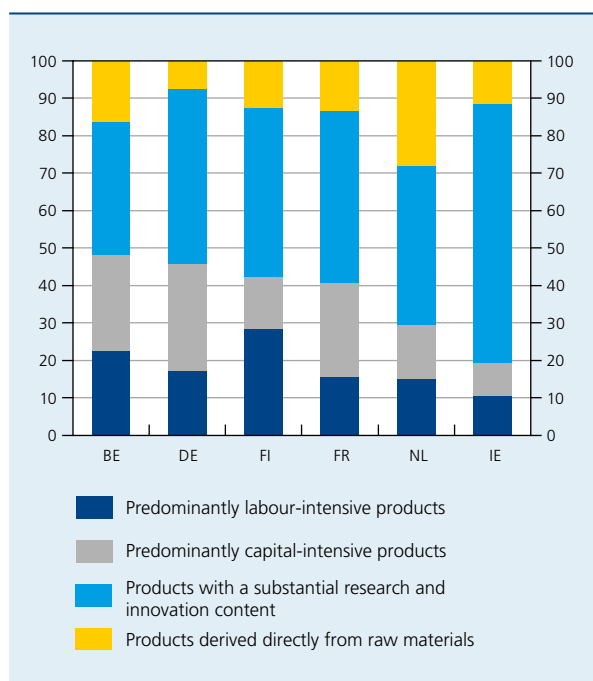
That loss of market share is due partly to over-specialisation by Belgium in products for which the competition from the new economic centres is strongest. Those emerging economies have not only abundant labour reserves, but also ever-increasing access to sophisticated equipment and technology. Thus, among the various products traded internationally, labour- and capital-intensive goods are subject to growing competitive pressure. Countries which specialise relatively more in that type of products are therefore liable to lose their comparative advantages and be forced to give up market shares.

This adverse specialisation in terms of products plays a considerable role for Belgium, as explained in detail in the article entitled "Belgium's position in world trade" in the Bank's June 2010 Economic Review. On the basis of work by the ECB, various product categories were identified according to the intensity of the production factors used. Between 1995 and 2007, on average 23 % of Belgian exports were labour-intensive products, such as precious stones, paper, textiles and clothing. In contrast, in Ireland these products accounted for only 11 % of total exports, and in the three main neighbouring countries for 16 % on average. Excessive specialisation in products of this type impairs a country's export performance, not only because of the increased competition from the emerging economies, but also because of the weaker growth of global demand for these products. Capital-intensive products – such as motor vehicles and steel – are also relatively over-represented in Belgian exports, since they made up 26 % of the total, on average, compared to 9 % in Ireland, 14 % in Finland and 15 % in the Netherlands, for example. This specialisation depressed Belgium's export performance as the emerging economies focused increasingly on these products.

Next come knowledge-intensive products. Products with a substantial research and innovation content – such as electrical and electronic equipment, medicinal and pharmaceutical products, or plastics in primary forms – represented only 35 % of Belgium's total exports of goods, compared to around 46 % for Germany and France, and as much as 69 % for Ireland. Although competition from the emerging economies is likely to increase steadily, especially in the case of products which are easy to imitate, exports will continue to benefit from particularly strong demand for these products, especially from the most buoyant markets. For completeness, mention should also be made of the last category comprising products derived

(1) Dumont M. et al. (2010), *The productivity and export spillovers of the internationalisation behaviour of Belgian firms*, NBB, Working Paper 201.

CHART 40 STRUCTURE OF EXPORTS OF GOODS ACCORDING TO PRODUCTION FACTOR INTENSITY⁽¹⁾
(in % of total exports, average over the period 1995-2007)



Sources: EC, NBB.

(1) Countries are ranked according to the share of their products which are predominantly labour- or capital-intensive.

directly from raw materials, such as energy products, fruit and vegetables, and metals which represented a fairly large proportion of Belgian exports, except in comparison with the Netherlands which still exports considerable quantities of natural gas.

Export performance measured on the basis of the market share indicator was particularly modest in the case of products for which the predominant production factor is capital: losses of market share reached 2.2 % per annum from 1995 to 2007. For labour-intensive products and those derived directly from raw materials, the losses of market share were less substantial, at 0.6 and 1.3 % per annum respectively over the same period. Conversely, in the case of products with a substantial research and innovation content, Belgium's market share increased.

Taking account of the structure and pattern of Belgian exports and the growth of the relevant markets, losses of market share are due essentially to products with a low research and innovation content. Competition in those product categories mainly concerns prices. One possible strategy for confronting the growing competition from the emerging countries is for firms in advanced countries to improve the quality of their products so that they stand

out from those of the emerging countries, or to extend their product range in order to exploit new markets. Research based on data for individual firms indicates that this last tactic is often adopted by Belgian firms active in branches making intensive use of the factors labour and capital and exporting standardised products⁽¹⁾. It involves improving the characteristics of the products offered, particularly by innovation.

General conditions of competitiveness

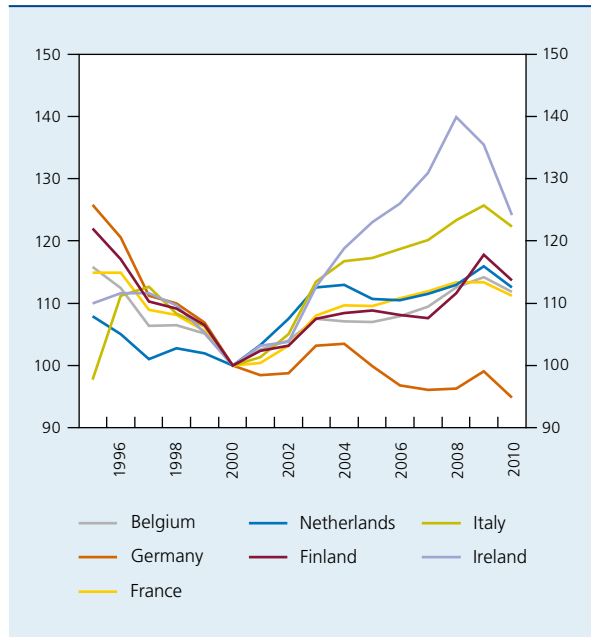
In view of the importance of relatively standardised products, the moderation of production costs remains vital to competitiveness. That applies in particular to the cost components which are determined in Belgium, rather than by the international markets. That is true to some extent of energy costs (electricity and gas) and especially of labour costs. Cost competitiveness and price competitiveness are therefore generally measured by effective exchange rates deflated by unit labour costs. While Belgium's real effective exchange rate in relation to a large group of industrialised countries depreciated by 13.7 % between 1995 and 2000, it appreciated by 11.8 % between 2000 and 2010, indicating a loss of competitiveness. That was due partly to the appreciation of the euro against other currencies, especially the US dollar. The real effective exchange rates of most of the other euro area countries actually appreciated more strongly between 2000 and 2010. In some cases, one reason could be a process of catching up, even if it also reveals an inappropriate response by labour costs to productivity shocks. Germany is the big exception. Since the second half of the 1990s, that country has pursued a policy of wage moderation, in response to the steep rise in labour costs following German reunification. In addition, productivity has risen more there than elsewhere, although in terms of level, apparent labour productivity is still higher in Belgium.

On the basis of information obtained from the EU KLEMS database, the Federal Planning Bureau compared the movement in productivity in Belgium with that in the three main neighbouring countries, and concluded that the stronger productivity growth in Germany is due entirely to the greater increase in total factor productivity (TFP). In regard to capital intensity and the quality of the labour force, Belgium outperformed Germany.

TFP is regarded as a measure of technological development and economic efficiency, since it indicates the extent to which more can be produced with a given quantity of

(1) Abraham F. and J. Van Hove (2010), *Can Belgian firms cope with the Chinese dragon and the Asian tigers? The export performance of multi-product firms on foreign markets*, NBB, Working Paper 204.

CHART 41 REAL EFFECTIVE EXCHANGE RATES⁽¹⁾
(indices 2000 = 100)



Source : EC.

(1) Effective exchange rates against 35 industrialised countries (34 in the case of Belgium whose exchange rate is calculated for the BLEU), deflated by unit labour costs for the economy as a whole.

labour and capital. In practice, however, TFP is obtained as a residual figure, and the disadvantage of that method is that the result is affected by any measurement or estimation errors and is influenced by the business cycle.

Yet the importance of TFP growth should not be underestimated, because a productivity gap explains the difference seen in terms of not only export performance but also value added. Thus, the study by Kegels (2009) shows that in manufacturing industry the sub-branches recording higher labour productivity than their counterparts in the EU15 can increase the percentage which they represent in the total value added created by those same sub-branches in the EU15 as a whole⁽¹⁾.

In view of the already high level of apparent labour productivity in Belgium, there may be little scope for additional productivity gains. Belgian firms therefore need to specialise further in high-technology, knowledge-intensive products, putting the emphasis on quality, innovation, entrepreneurial spirit and creativity. Such an approach will support the economy's growth potential, estimated at 1.5 % for the year under review. Given the impact of

population ageing on the future expansion of employment, it is vital to boost labour productivity still further by concentrating on higher value added products. Against the background of progressive globalisation and the efforts needed to combat climate change, it has become more important for firms to be able to respond rapidly and flexibly to changing circumstances.

A number of conditions need to be met in order to foster the spread of innovative products or production processes. First, sufficient resources must be invested in education and training. In a constantly evolving economy, it is crucial – for example – that labour should be able to make effective use of new technologies. Belgium has performed relatively well in that respect. For instance, in 2009, around a third of the population aged between 25 and 64 years had tertiary education qualifications, while the average was 29 % in the three main neighbouring countries. Finland tops the ranking with 37 % holding degrees. Conversely, relatively few students in Belgium opt for scientific or technological training. In 2008, those disciplines represented only 16.6 % of all tertiary education graduates, compared to an average of 22.2 % in the three main neighbouring countries, and almost 27 % in Finland. Moreover, interest in scientific or technological training seems to be waning in Belgium, since between 2000 and 2004, the figure for graduates in these subjects was 19 %. As regards continuous training, Belgium also does less well: only 7 % of the population aged from 25 to 64 years followed a training programme in 2009, against an average of 10 % in the three main neighbouring countries, and as many as 22 % in Finland. Continuous training of this kind is important to consolidate the lessons of basic education. Despite good basic training, there is therefore a danger that Belgian firms may ultimately encounter problems in finding suitable staff, given the structural challenges facing the economy.

The extent to which the economy uses highly skilled workers can be assessed by the share of their remuneration in total value added. According to the EU KLEMS database, in which the most recent harmonised data available at this level for the EU countries relate to 2005, that share came to 15.1 % in Belgium, slightly above the average for the three main neighbouring countries – which stood at 13.5 % – but considerably lower than in Finland, where it was 30.4 %.

The spread of information and communication technologies (ICT) also promotes innovation and productivity gains. On the one hand, the use of ICT means that production and sales can be organised more efficiently, both in individual firms and in the economy as a whole. It also makes it easier to adopt the know-how and innovations of other

(1) Kegels C. (2009), *Alternative assessment of Belgian competitiveness*, Federal Planning Bureau, Working Paper 9-09.

firms. According to the EU KLEMS data, ICT expenditure represented 4.3 % of total value added in Belgium in 2007, exceeding the figure of around 3.5 % in Germany and France, and equalling the figure for the Netherlands. In Finland, ICT expenditure represented an even bigger share, at 5.6 %.

An innovative economy also needs to pay sufficient attention to research and development (R&D). In terms of expenditure on R&D, Belgium's score – like that of most other euro area countries – is not satisfactory. In 2009, as was roughly the case in the preceding ten years, R&D expenditure represented only 2 % of GDP in Belgium, well below the target of 3 % set for the EU as a whole under the Lisbon strategy and reiterated in the "Europe 2020" strategy. Among the three main neighbouring countries, only Germany came close to that target, with 2.8 % of GDP. Finland is in the lead, investing 4 % of GDP in R&D in 2009. The 3 % target is divided between the private sector and the public sector, with the former expected to account for two-thirds. In that regard, Belgium is notable

mainly for a particularly low level of government funding. Nonetheless, the differences between the euro area countries primarily concern the R&D expenditure of the private sector. In this respect, too, the figures for Belgium are not very good. Moreover, R&D expenditure is concentrated on a few branches, or even a few firms, often subsidiaries of foreign companies, and that makes the Belgian economy especially vulnerable, as the expenditure does not necessarily lead to applications which are productive for the domestic economy, and may be affected by changes in the location policy of foreign companies.

Apart from adequately trained labour and the efforts made in regard to ICT and R&D, performance in terms of innovation depends on the degree to which the knowledge developed is passed on to the business world in general and leads to practical applications generating economic growth. Not all firms are capable of developing innovative products or processes themselves. There must therefore be sufficient cooperation and exchange of information within the business community (with

TABLE 11 DETERMINANTS OF INNOVATION AND TOTAL FACTOR PRODUCTIVITY GROWTH⁽¹⁾
(in %, unless otherwise stated)

	Belgium	Germany	France	Netherlands	Finland
Tertiary education graduates (in % of the population aged from 25 to 64 years, 2009)	33.4 (6.3)	26.4 (2.6)	28.7 (7.1)	32.8 (8.8)	37.3 (5.0)
Share of scientific or technological graduates in tertiary education (2008)	16.6 (-2.3)	26.4 (-0.2)	26.2 (-4.3)	14.0 (-1.7)	26.8 (-1.2)
Continuous training (in % of the population aged from 25 to 64 years, 2009)	6.8 (0.6)	7.8 (2.6)	6.0 (3.2)	17.0 (1.5)	22.1 (4.6)
Remuneration of highly-skilled labour (in % of value added, 2005)	15.1 (1.0)	11.8 (0.7)	15.5 (0.0)	13.2 (3.0)	30.4 (2.3)
ICT expenditure (in % of value added, 2007)	4.3 (-0.1)	3.6 (0.0)	3.4 (-0.3)	4.3 (0.1)	5.6 (0.1)
R&D expenditure (in % of GDP, 2009)	2.0 (0.0)	2.8 (0.4)	2.2 (0.1)	1.8 (0.0)	4.0 (0.6)
Share of innovative enterprises which cooperate (2006-2008) . .	48.8 (27.2)	20.7 (3.3)	42.4 (14.0)	40.2 (16.2)	36.9 (-13.1)
Entrepreneurial activity recently launched (in % of persons polled, 2009)	5 (0)	7 (1)	6 (4)	8 (3)	14 (10)
Never thought of setting up a business (in % of persons polled, 2009)	63 (23)	48 (10)	53 (22)	50 (17)	44 (11)
Product market regulation ⁽²⁾ (2008)	1.4 (-0.7)	1.3 (-0.7)	1.5 (-1.1)	1.0 (-0.7)	1.2 (-0.9)

Sources: EC, OECD, EU KLEMS.

(1) The changes compared to 2000, in points of the unit in question, are shown in brackets, except for the last three indicators for which the results are compared respectively with the years 2002, 2001 and 1998.

(2) Score of 0 to 6; a higher score indicates stricter legislation.

suppliers, customers and workers), on the one hand, and with universities and research institutes on the other. Belgium performs better than the average here, and that is also in line with the efforts by the regional authorities to support such cooperation agreements, at financial and organisational level. In Belgium, according to the 2008 Community Innovation Survey, almost half of the innovative firms cooperated with one or more partners during the period 2006-2008. For comparison, that proportion was around 40% in France and the Netherlands, and only 21% in Germany. Moreover, in recent years, it has risen more significantly in Belgium than in the three main neighbouring countries.

Entrepreneurship acts as a catalyst for innovation. In addition, owing to their small scale, new businesses are able to respond more flexibly to changes. According to a survey of entrepreneurship commissioned by the EC in 2009, the proportion of respondents actively involved in establishing a business, or who had recently set one up, was only 5% in Belgium. For comparison, that proportion averaged 7% in the three main neighbouring countries, and amounted to as much as 14% in Finland. Conversely, 63% of Belgian respondents stated that they had never thought of starting their own business, compared to 50% in the main neighbouring countries and only 44% in Finland. In the past ten years, a number of obstacles to entrepreneurship – as measured by the OECD in its product market regulation indicator – have been abolished in Belgium, but that appears to have had hardly any impact on entrepreneurial activity. According to the World Bank's latest report on "Doing Business", it is now easier to establish a business in Belgium than in any other European country, at least from the point of view of the number of procedures and length of time involved. The entrepreneurship shortfall in Belgium therefore seems to have less to do with such obstacles than with cultural factors, such as a very marked preference for employee status, on grounds of stability and security. Education can play a key role in remedying this situation, by encouraging the creativity of students and – for example – putting them in contact with young entrepreneurs, via internships or projects.

Market regulation may also influence the innovative performance of a country. Thus, strict regulations may make it difficult for newcomers to enter the market, and restrain competition, thereby hampering the development of new products and processes. According to the OECD indicator, product market regulation in Belgium is roughly as strict as in Germany and France, whereas the Finnish and Dutch markets do better in that regard. As in France, the government in Belgium still exercises close control. Although the government had less control over the pricing of certain products in 2008 than in 1998, little progress was achieved over that period in regard to the other channels through which it influences the economy. In that respect, the OECD takes account of the importance of public enterprises, particularly in the network industries, the government's stake in the capital of private enterprises, and the scope of coercive regulations in the services sector.

Overall, Belgium has a number of significant assets which support the economy's growth potential. First, firms operate in a relatively stable macroeconomic environment, without any notable internal or external imbalances. In that regard, apart from the necessary increase in the employment rate and reduction in the public debt to safeguard the long-term growth potential, it is nevertheless vital to pay constant attention to production cost moderation. Next, concerning more specifically the structural position, Belgium scores fairly well in terms of human capital and knowledge, so that the workers should be able to adapt smoothly to technological developments or changes in methods of organisation. Belgian firms also have a relatively high level of ICT intensity. Conversely, Belgium still has plenty of room for improvement when it comes to innovation. Thus, firms and the government should invest more in R&D, and entrepreneurial spirit and creativity should be encouraged. Finally, product market regulation should be made more flexible, to strengthen competition and offer new businesses sufficient chance of success, in order to modernise the economy. Such developments would enable a larger number of Belgian firms to seize the opportunities which are emerging, particularly in the context of globalisation and efforts to combat climate change.

2.2 Prices and costs

Inflation gathered pace during the year to reach an average of 2.3 %, whereas it had been non-existent in 2009. This acceleration was due entirely to the renewed rise in prices of energy and food, which had responded strongly to the increase in commodity prices. Conversely, the rise in labour costs slowed significantly as a result of the delayed effect of the sharp deceleration in the health index in 2009. Hourly labour costs in the private sector increased by 0.6 %, following a 3.9 % rise in the previous year. Combined with the cyclical upturn in labour productivity, that very moderate rise resulted in a 0.2 % fall in unit labour costs, whereas

in the previous year those costs had risen by 4.7 %. In line with the movement in labour costs, the underlying inflation trend subsided to 1.1 %, against 2.1 % in 2009.

While prices and wages displayed a comparable profile, on average, in the three main neighbouring countries – Germany, France and the Netherlands – they did not fluctuate to the same extent: inflation there increased from 0.3 % in 2009 to 1.4 % in 2010 and, according to the estimates of the Secretariat of the Central Economic Council (CEC), the rise in hourly labour costs declined

TABLE 12 HARMONISED INDEX OF CONSUMER PRICES AND LABOUR COSTS
(percentage changes compared to the previous year)

	2005	2006	2007	2008	2009	2010	<i>p.m.</i> 2010, three main neighbouring countries ⁽¹⁾
HICP	2.5	2.3	1.8	4.5	0.0	2.3	1.4
Energy	12.7	7.3	0.2	19.8	-14.0	10.0	5.4
Unprocessed food ⁽²⁾	1.7	3.3	3.0	2.8	0.4	3.5	2.4
Processed food	2.0	2.1	4.7	7.8	1.7	1.0	0.7
Underlying inflation ⁽³⁾	1.3	1.5	1.4	1.8	2.1	1.1	0.8
Non-energy industrial goods	0.3	0.9	0.9	1.3	1.4	0.8	0.3
Services	2.1	2.1	1.9	2.3	2.6	1.4	1.1
<i>p.m. Health index</i> ⁽⁴⁾	2.2	1.8	1.8	4.2	0.6	1.7	-
Labour costs in the private sector							
per unit of output	1.1	2.1	1.9	3.8	4.7	-0.2 e	-1.4 ⁽⁵⁾
per hour worked	2.0	3.3	3.1	3.6	3.9	0.6 e	1.3

Sources: EC, OECD, CEC, DGSEI, NAI, NBB.

(1) As in the other tables and charts in this chapter, weighted average based on GDP.

(2) Fruit, vegetables, meat and fish.

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

(4) National consumer price index excluding products deemed harmful to health, namely tobacco, alcohol, petrol and diesel.

(5) Average of the first three quarters; business sector (NACE branches of activity C to K).

from 2.1 to 1.3%. During the year under review, the cumulative gaps in inflation and unit labour costs vis-à-vis these three competing countries therefore widened again whereas, during the crisis, they had narrowed for a time. In contrast, the difference in terms of hourly labour costs declined slightly. The three economies mentioned are not only Belgium's main trading partners, they also feature a comparable level of economic development. That is why the relative movement in prices and costs in relation to those economies is still the best indicator of Belgian competitiveness in terms of prices and costs, even though Belgium has been part of a wider monetary union since 1999. Moreover, those are the countries which the 1996 Law on the promotion of employment and the preventive safeguarding of competitiveness takes as the benchmark for ascertaining Belgium's competitive position.

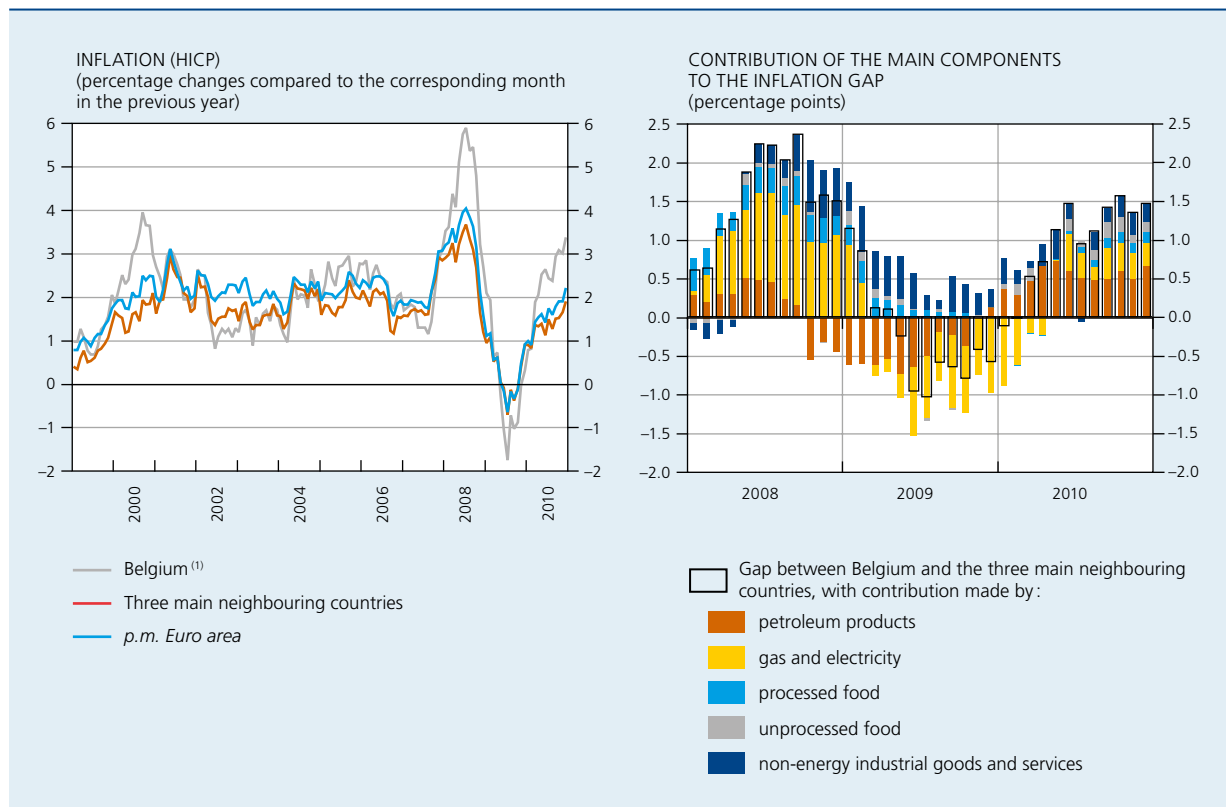
2.2.1 Energy and food prices and inflation gap

Measured by the harmonised index of consumer prices (HICP), inflation in Belgium rose from 0% in November

2009 to 3.4% in December. As has been the case since 2007, it was thus highly volatile, much more so than in the euro area or in the three main neighbouring countries. At the end of 2010, inflation in those two groups of countries came to 2.2 and 1.9%, i.e. respectively 1.2 and 1.5 percentage points less than in Belgium. Both the rise in inflation in Belgium and the widening of the inflation gap in relation to those economies were attributable largely to energy products, whose prices steadily escalated from the first quarter of 2010. In a context of rising energy commodity prices, it was the prices of petroleum products that first caused the gap to widen, followed a few months later by gas and electricity prices. Food prices also played a role in this rise, albeit to a lesser extent, as a result of bad weather and the increase in food commodity prices – from the beginning of 2010 in the case of unprocessed foods, and a little later, from the summer, in the case of processed products.

The reappearance of excess inflation in 2010 compared to neighbouring countries is very similar to the situation which had prevailed in 2008. At that time, too, it was mainly the direct effects of commodity price increases,

CHART 42 INFLATION GAP BETWEEN BELGIUM AND THE THREE MAIN NEIGHBOURING COUNTRIES



Sources: EC, NBB.

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

known as first-round effects, which had been more marked in Belgium. They had subsequently given rise to second-round effects – i.e. price increases due to pay rises granted in order to compensate for the loss of purchasing power resulting from the first-round effects – which had caused the prices for non-energy industrial goods and services to rise by more than in neighbouring countries. Since the presence of an automatic wage indexation system tends to favour such effects, there is certainly a risk of a recurrence, and that is a major challenge for the preservation of the Belgian economy's competitiveness. While underlying inflation had continued to slacken pace during the first three quarters of the year under review, it picked up again in the fourth quarter. Moreover, the excess in underlying inflation in relation to the three main neighbouring countries, which had emerged in 2008 and diminished slightly in 2009, stopped declining in 2010.

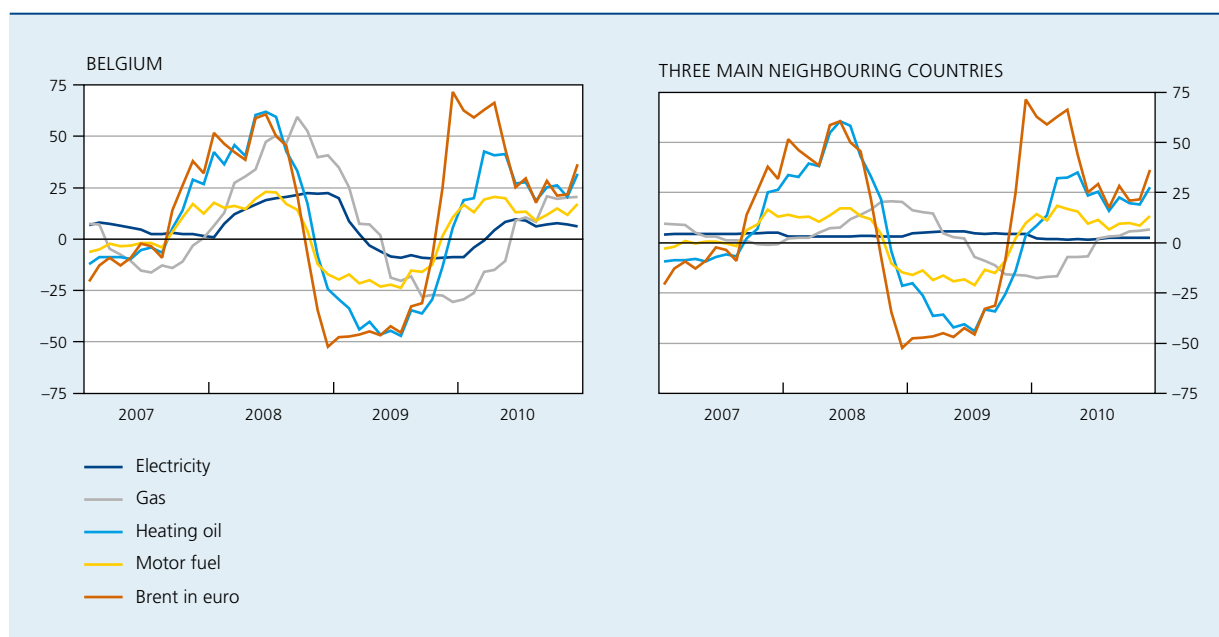
Energy

In 2010, energy prices displayed an upward trend in the wake of the rise in crude oil prices on the international markets. After reaching a record level of over \$ 145 per barrel during the summer of 2008, the monthly price of Brent crude dropped on average to around \$ 40 at the end of 2008, then climbed back steadily from \$ 45 to \$ 75 between January and December 2009. In 2010, the

upward trend was maintained overall, though the price increase was more modest than in 2009 and was concentrated mainly on the final quarter, when the price of Brent reached around \$ 87. Thus, taking an average over the year, that price was 29 % higher than in 2009. Expressed in euro, however, the rise was much larger, amounting to 37 %, in view of the single currency's depreciation against the dollar during the year. That contrasts with the situation seen in recent years when the exchange rate had tended instead to cushion commodity price fluctuations.

During the first two months of 2010, the energy component of the HICP remained below the level which it had reached during the corresponding period of 2009. Although consumer prices of heating oil and road fuel had risen strongly year-on-year by the beginning of 2010, reflecting almost instantly the movement in Brent oil prices, the prices of electricity, and particularly gas, still remained lower than in the previous year. It was only from April onwards, in the case of electricity, and from June for gas, that the rise in energy commodity prices was reflected in a year-on-year increase. Although these prices took several months to react to the change in commodity prices, the increase was nevertheless much more marked than in the three main neighbouring countries. Whereas between January and December 2010, electricity prices rose by only 2.3 % in those countries, they went up by 5.9 % in Belgium. At the same time, consumer prices of

CHART 43 CONSUMER PRICES OF ENERGY
(percentage changes compared to the corresponding period of the previous year)



Source: EC.

gas soared by 18.4 %, while in the neighbouring countries that increase was no more than 6.2 %. Prices of heating oil and road fuel in Belgium increased respectively by 21 and 13 % on average over the same period. In the case of road fuel, the increase was reinforced to a small extent – by 1.3 percentage points – by the rise in excise duty on diesel, totalling 4 cents per litre excluding VAT, owing to the application of the ratchet mechanism.

Taking energy products as a whole, the average year-on-year price increase in 2010 was larger than in the three main neighbouring countries, at 10 % compared to around 5 %, contributing to the widening of the inflation gap in 2010. The tendency of these prices to make an adverse contribution to the inflation gap when commodity prices increase – as was already the case in 2008 – and to have the opposite effect when they decline – as in 2009 – shows that Belgian inflation is more sensitive

to energy price fluctuations. This greater sensitivity is the principal driver of the movement in the inflation gap in relation to other countries, and the explanatory factors are described in box 5. The effect is symmetrical in the case of petroleum products. Conversely, in the case of gas and electricity, it is noticeable that the price falls in 2009 were less marked than the increases in 2008, whereas energy commodity prices in those two years – and more especially the price of Brent – did not exhibit such asymmetry. In the case of gas, that asymmetry is due mainly to the change which the biggest gas supplier made in October 2007 to the constant term in the pricing formula; other suppliers largely followed suit, leading to a price increase which can be considered permanent, whatever the level of the oil price. In regard to electricity, the asymmetry is due to strong increases in the network tariffs in 2008 and 2009, while pricing is symmetrical at the level of the energy component.

Box 5 – What are the factors behind the greater sensitivity of inflation to energy commodity prices in Belgium ?

In a number of recent articles in the *Economic Review*, the Bank has looked at the various aspects involved in setting consumer prices of energy and at the contribution of those prices to inflation. It emerges that three factors may explain the greater sensitivity of inflation to energy commodity prices in Belgium, namely the higher household consumption of energy, a lower level of excise duty on energy than in other countries, on average, and certain characteristics of the pricing of energy excluding taxes in Belgium, notably the quicker and more pronounced transmission of energy commodity prices to consumer prices of gas and electricity.

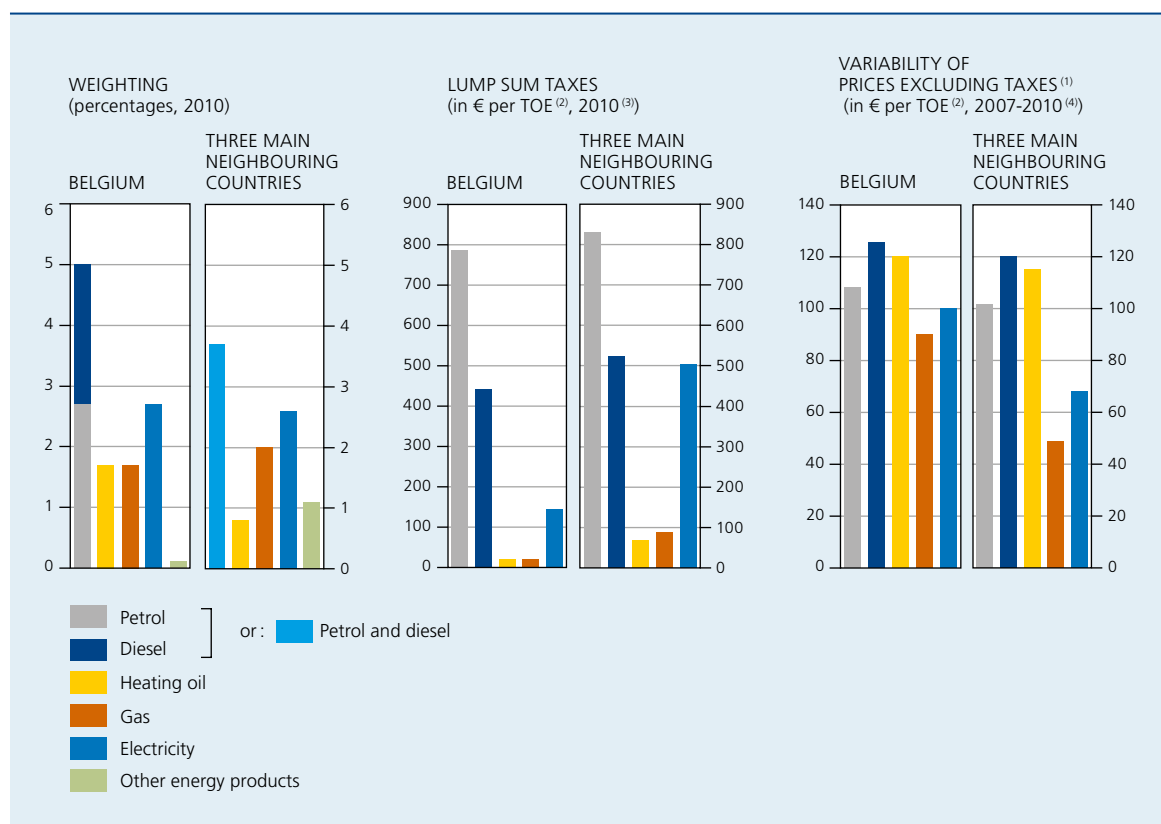
The high level of energy consumption by households in Belgium is reflected in a high weighting for energy products in the consumer price index. The greater their weight, the more headline inflation will react to changes in energy prices. As described in Bagnat and Dury (2010)⁽¹⁾, there are various factors which determine this different level of consumption, such as bigger houses, the lower level of insulation in existing housing, and the greater use of cars by individuals as a means of transport. Controlling and, as far as possible, reducing the energy intensity of the Belgian consumption profile therefore presents a major challenge, not only from an ecological perspective but also from a macroeconomic point of view. Encouraging energy-saving investments, particularly insulation, and influencing the price signal, e.g. by increasing excise duty – currently at one of the lowest levels in Europe for heating products – or other taxes on energy consumption are just two of a range of options. However, it is necessary to ensure that any increase in indirect taxes on energy products included in the health index (heating oil, gas and electricity) does not have an adverse short-term effect on labour costs via indexation. Moreover, an increase in excise duty would have the desirable effect of automatically making consumer prices less sensitive to energy commodity prices.

The second factor explaining why inflation in Belgium is more sensitive to oil shocks is the fairly low level of excise duty and other flat-rate taxes on diesel, heating oil, natural gas and electricity, especially in relation to the three main neighbouring countries. The mechanism at work can be summarised as follows: owing to the relatively low level of excise duty, the (implicit) weight of energy commodities in consumer prices of energy is higher, which makes those prices correspondingly more elastic to movements in commodity prices.

(1) Bagnat V. and D. Dury (2010), "Energy markets and the macroeconomy", NBB, *Economic Review*, September, 61-82.



DETERMINANTS OF THE SENSITIVITY OF INFLATION TO ENERGY COMMODITY PRICES



Sources: EC, NBB.

(1) Standard deviation of fluctuations in prices excluding taxes.

(2) One TOE (tonne of oil equivalent) corresponds to 1,285 litres of petrol, 1,166 litres of diesel or heating oil, 46.52 GJ of gas and 11,630 kWh of electricity.

(3) Difference between prices excluding taxes and prices excluding VAT. Data for the first half year in the case of electricity and gas, and for the first eleven months of the year for petroleum products.

(4) Calculated on the basis of monthly data.

The third factor identified results from the characteristics of the transmission of commodity prices to consumer prices excluding taxes in Belgium. In the case of petroleum products, that process is generally comparable in the various countries, at least when the change is expressed in cents per litre, and it therefore does not account for the greater sensitivity in Belgium. Nevertheless, since the average level of prices excluding taxes is slightly higher in Belgium than in neighbouring countries for petrol and diesel – but not for heating oil – and in so far as that may be due to differences in market structure, there is still a little scope for reducing the level of petrol and diesel prices by increasing competition and making greater use of the opportunities for economies of scale in the distribution of these products in Belgium. Conversely, in the case of gas and electricity, Baugnet and Dury (2010), Coppens (2010)⁽¹⁾ and Swartenbroeckx (2010)⁽²⁾ show that the transmission is faster and more marked in Belgium than in the neighbouring countries. That greater sensitivity is due to the very specific character of consumer pricing of gas and electricity in Belgium. The monthly indexation based on tariff formulas which refer, in particular, to the movement in energy commodity prices is a very widespread practice in Belgium, whereas consumer prices are adjusted far less frequently in neighbouring countries. Moreover, some countries such as France and the Netherlands, still have a form of *ex ante* price regulation, whereas in Belgium, since the liberalisation of the market, suppliers are free to set their tariffs.

(1) Coppens F. (2010), "The increased volatility of electricity prices for Belgian households", NBB, *Economic Review*, September, 83-110.

(2) Swartenbroeckx C. (2010), "Implications of liberalisation for methods of setting retail gas prices in Belgium", NBB, *Economic Review*, December, 39-71.

In addition, the transmission of gas and electricity prices to the consumer price index is faster compared to the pre-2007 period, since prices are now recorded by the “acquisition” approach – every month, the tariff applied in that month is taken as the reference for recording the prices as close as possible to the moment of consumption or acquisition – whereas previously it was the notional annual invoice price relating to the preceding twelve months that was recorded each month, i.e. a “payment” approach since it was calibrated on the annual invoices paid by consumers receiving their statements in that month. As the “acquisition” approach – which is in line with the relevant Eurostat rules – has been applied for much longer in the neighbouring countries, the change of calculation method has chiefly highlighted the greater intrinsic sensitivity of gas and electricity prices in Belgium, because the smoothing of price fluctuations under the old method had tended to conceal that sensitivity in the pre-2007 period (see, for example, Cornille, 2009⁽¹⁾).

The principle of transmission to the consumer of lasting changes in commodity prices should not be called into question, since it is a key signal which may encourage more rational energy consumption. However, the question is whether the tariff formulas faithfully reflect the real movement in the suppliers’ costs, and whether it is ideal for every fluctuation in commodity prices to be passed on immediately to the consumer. On the basis of the information in the public domain, it is not possible to state whether or not these indexation formulas are fair. It therefore seems appropriate for the regulators and competition authorities to play a more active role in the matter. In accordance with its price monitoring mandate, the electricity and gas regulator (CREG) has indeed been able, since 2008, to react *a posteriori* against any anomalies on the liberalised market segment, and, when required, subsequent investigation has to be conducted by the Competition Council. However, there is room for improvement in this model of *a posteriori* price monitoring. For example, it was only at the end of the year under review that the CREG decided that, in view of doubts about the representativeness of the parameters deemed to represent fuel costs and other costs in the electricity price indexation formulas, it would no longer publish those parameters from February 2012. In regard to consumer prices of gas, the CREG had promptly conducted a critical analysis of the unilateral adjustment to the tariff formula, made by the leading gas supplier in October 2007, but that did not result in any more thorough investigation by the Competition Council. Since the operation of the model of *a posteriori* price monitoring seems less than perfect, one option that the Belgian authorities might consider is the implementation of a system of *ex-ante* price supervision, e.g. on the lines of the model applied in the Netherlands. The Dutch regulator examines the justification for the tariffs set by energy suppliers and adjustments to them before they are implemented, and in the absence of a valid justification, it can impose maximum prices.

(1) Cornille D. (2009), “Methodology or pricing: how can the greater volatility of consumer gas and electricity prices in Belgium be explained?”, NBB, *Economic Review*, December, 47-57.

Food

Unprocessed food prices went up by 3.5 % in 2010, compared to 0.4 % in 2009. The increase gathered pace from 1.6 % in the first quarter of 2010 to 5.3 % in December. That acceleration was due mainly to rather unfavourable supply conditions, especially during the second half of the year, whereas in 2009, given the exceptionally good weather, prices had remained at relatively low levels. However, it was also due to a methodological change concerning the Belgian HICP, as regards the method of recording the prices of products which are subject to significant seasonal fluctuations in supply, such as fruit, vegetables and, to a lesser extent, fish.

In order to further harmonise the HICP, the EC adopted a Regulation in 2009 on the preferred statistical methods for the treatment of seasonal products; Member States must conform to the Regulation by no later than the publication of the January 2011 HICP. While most countries introduced this change in 2011 – except for those which, like Austria and Ireland, already satisfied these requirements – Belgium decided to introduce this measure a year in advance, in January 2010. In practice, this means that a method in which the weightings of unprocessed foods could vary according to the season has been replaced by a method in which they are fixed regardless of the season – so long as the prices can be recorded. The year-on-year movement in prices is therefore distorted by this change

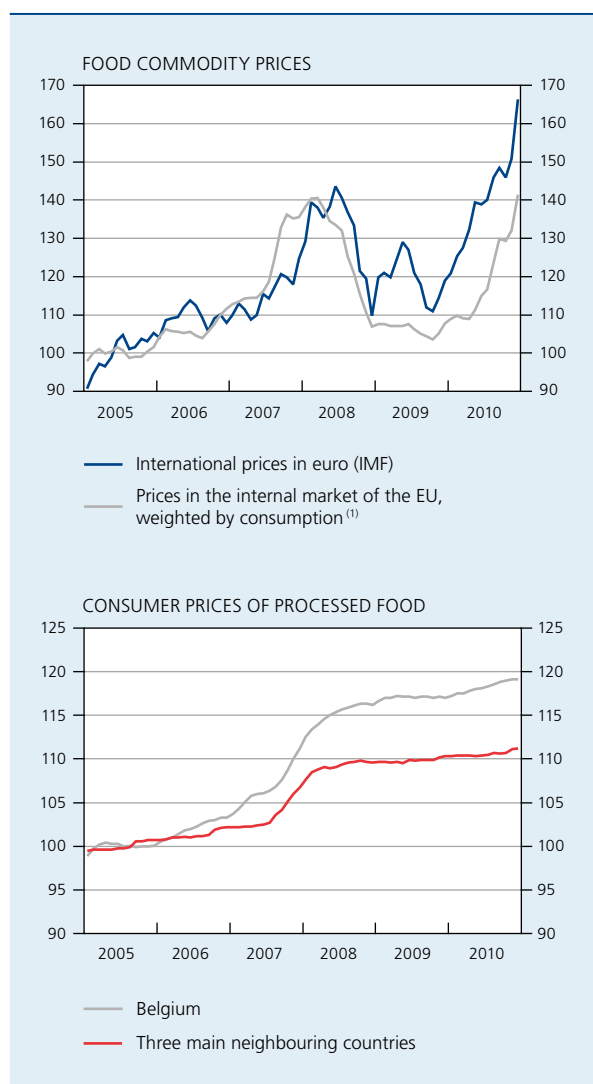
in 2010. Comparison with the national index, which is unaffected by this change, indicates that it had an average impact of +0.5 percentage point on the component concerned: according to the national index, the average price increase for unprocessed food was only 3%, which is closer to the 2.4% change recorded in the three neighbouring countries.

A sharp acceleration in the rate of processed food price increases was recorded from the summer, although – taking the year as a whole – inflation remained below the previous year's level for this category, at 1% compared to 1.7% in 2009. The acceleration was due to the increased price of food commodities from the end of 2009, caused

mainly by the supply situation (see chapter 1.1). As illustrated by the price indices summarising the movement in prices of a selection of food products such as cereals, oils, meat, cocoa and coffee, particularly the one calculated by the IMF, the recent rise was especially marked in euro, even significantly outstripping the rise seen at the time of the 2007-2008 food crisis. However, the relevance of that indicator for analysing the transmission to consumer prices in Belgium is limited by two factors. First, the share of the various products in household consumption is very different from their share in world trade; moreover, the IMF index does not include products such as milk. Next, in Europe, the common agricultural policy (CAP) tends to protect producers – partially – against prices falling below a certain threshold. Consequently, the movement in prices prevailing in the EU may diverge from international prices. Thus, if we refer to an indicator based on prices on the EU's internal market and weighted by the consumption profile of households in Belgium, it is evident that the impact of the rise in food commodity prices in 2010 was less pronounced, though it reached a level comparable to that in the period 2007-2008.

Even though processed food price inflation did not exceed 1.8% at the end of 2010, there is still a need for particular vigilance. In 2008, the increase had been steeper in Belgium than in neighbouring countries, and had therefore made a big contribution to the adverse inflation gap seen at that time. Moreover, that contribution had not been counterbalanced in 2009 when commodity prices had fallen, which suggests a relatively high degree of asymmetry in the setting of food product prices in Belgium. Similarly, in those countries, the first signs of transmission of the latest rise in commodity prices only appeared at the end of 2010. In the months ahead, it is therefore important to keep a close eye on the way in which food commodity price increases are transmitted for all food products. In its report on the third quarter of 2010, the Price Observatory undertook to present such analyses in its 2010 annual report to be published at the end of February 2011.

CHART 44 FOOD PRICES
(indices 2005 = 100)



Sources: EC, IMF, NBB.

(1) Average of prices prevailing on the internal market of the EU in cases where the CAP is a factor, and international prices where that is not the case (cocoa, coffee), weighted by consumption in Belgium (HICP weightings).

2.2.2 Health index and underlying inflation trend

The developments described above had a substantial influence on the movement in the health index. Fluctuations in food prices are reflected in full, whereas energy price movements are only partly disregarded. While the health index excludes petrol and diesel, it includes heating oil, gas and electricity, which together represent around 60% of the weight of energy products. In addition, as mentioned earlier, the movement in gas and electricity prices

TABLE 13 INFLATION AND HEALTH INDEX

(cumulative annual percentage changes, unless otherwise stated)

	1999-2006		2007-2010	
HICP	17.2		8.9	
HICP, excluding tobacco and alcohol	17.0] 1.7]] 1.5]	8.7] 0.2]] 0.6]
Health index ⁽¹⁾	15.3		8.5	
Health index ⁽¹⁾ , excluding energy	13.8	3.2	7.9	0.8
<i>p.m. Idem, average annual percentage changes</i>	1.6		1.9	

Sources: EC, DGSEI.

(1) National consumer price index, excluding products deemed harmful to health, namely tobacco, alcohol, petrol and diesel.

proved far more volatile in the past four years than previously, partly because of the switch to the “acquisition” approach, so that in practice the health index – though conceptually unchanged – was less protected against fluctuations in energy commodity prices than before 2007.

Thus, the health index had made it possible to neutralise just over half of the impact of the higher cost of energy over the period 1999-2006 as a whole. That is evident from comparing the rise in the health index with the rise in the HICP, if account is first taken of the fact that the health index also excludes tobacco and alcoholic beverages, as well as certain energy products. The cumulative rise in the health index over that period had in fact been 1.7 percentage points lower than the rise in the HICP adjusted to exclude tobacco and alcohol, namely 15.3% compared to 17%, whereas a fictitious health index excluding all energy products would have recorded a cumulative rise of 13.8%, or 1.5 percentage points less than the health index. In contrast, during the period 2007-2010, the health index only neutralised about a quarter of the rise in energy prices – 0.2 percentage point out of a total of 0.8 point.

In addition, the ability of the health index to limit the effects of price volatility has been seriously reduced since 2007. If, as in chart 45, volatility is measured by the standard deviation over moving periods of forty-eight months, it is evident that in recent years the volatility of the health index and that of its moving four-month average – the smoothing method used in wage indexation mechanisms – have largely mirrored the increase in volatility calculated for headline inflation. Only part of that increase is attributable to the switch to the “acquisition” approach for the electricity and gas components, since the volatility of the moving twelve-month average of the health index

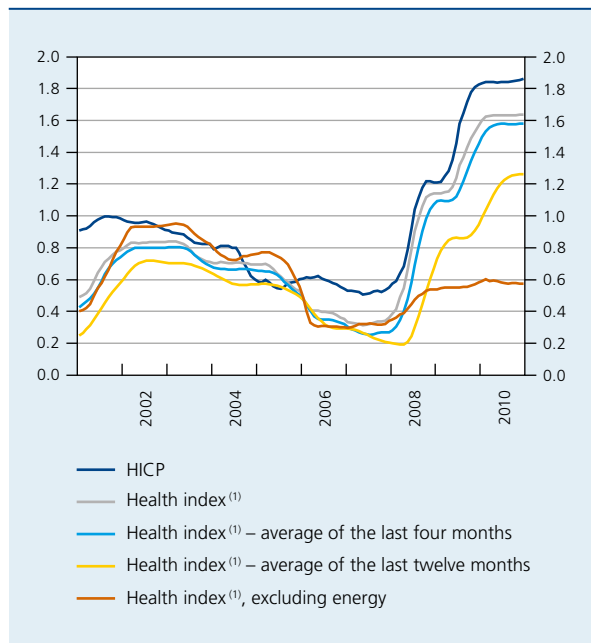
– which may be seen as an approximation for the movement in the health index if the “payment” approach had been maintained – also increased considerably. The major part of the higher volatility of the health index is therefore due to the intrinsic variability of the prices of the energy products which it includes, i.e. heating oil, electricity and gas, because the volatility of a fictional health index excluding those products has only shown a small increase in the past few years.

It is therefore unsurprising that the rise in the health index accelerated sharply during the year under review. Whereas it had been slightly negative in the final quarter of 2009, from June onwards it constantly exceeded 2%, and at the end of the year under review it actually reached 2.6%.

The health index is the reference indicator for the indexation of wages and of certain consumer prices such as rents, postal services, and transport services, and is therefore a key factor accounting for the movement in the prices of non-energy industrial goods and services, albeit after a certain time lag. Unlike the prices of energy and food, these prices are less sensitive to fluctuations in commodity prices, and are therefore a measure of underlying inflation, attributable mainly to the movement in domestic costs. As an annual average, that figure fell sharply in 2010, dropping from 2.1% in 2009 to 1.1%. However, that trend was interrupted during the year. In the last quarter, the figure was 1.3%. While the rate of price increases for non-energy industrial goods slowed further at the end of the year – amounting to 0.7% in December –, for services it accelerated in the second half of the year, increasing from a low point of 1.1% in July to 1.6% in December. Apart from the movement in prices in the hotel and restaurant trade – despite the cut in the

CHART 45 VOLATILITY OF INFLATION

(measured by the standard deviation over moving forty-eight-month periods)



Sources: EC, DGSEI, NBB calculations.

(1) National consumer price index, excluding products deemed harmful to health, namely tobacco, alcohol, petrol and diesel.

VAT rate in that sector – and the end of the decline in telecommunications prices, that rise is attributable to a number of services for which prices are indexed on the basis of the health index itself or another reference index such as the ABEX index. Overall, the prices of around a quarter of services, or 10% of the HICP, are subject to more or less formal indexation. For these services, it is evident that the rise in prices, which had already slowed in 2009, declined sharply during the first two quarters of 2010, but regained momentum from the third quarter, mainly because of the rise in the health index. During the second half of the year under review, the pace of the price increases came to 0.9%, compared to 0.2% in the first half year.

The fact that underlying inflation declined sharply in Belgium from the third quarter of 2009, while remaining slightly above the rate recorded in the three neighbouring countries, is due largely to the movement in labour costs in the business sector. This sector, used for the purpose of international comparison as an approximation of the private sector, comprises manufacturing industry, construction and market services. The movement in labour costs per person employed is less relevant in this context, especially as – during and after the crisis – it was largely influenced by substantial fluctuations in the hours worked

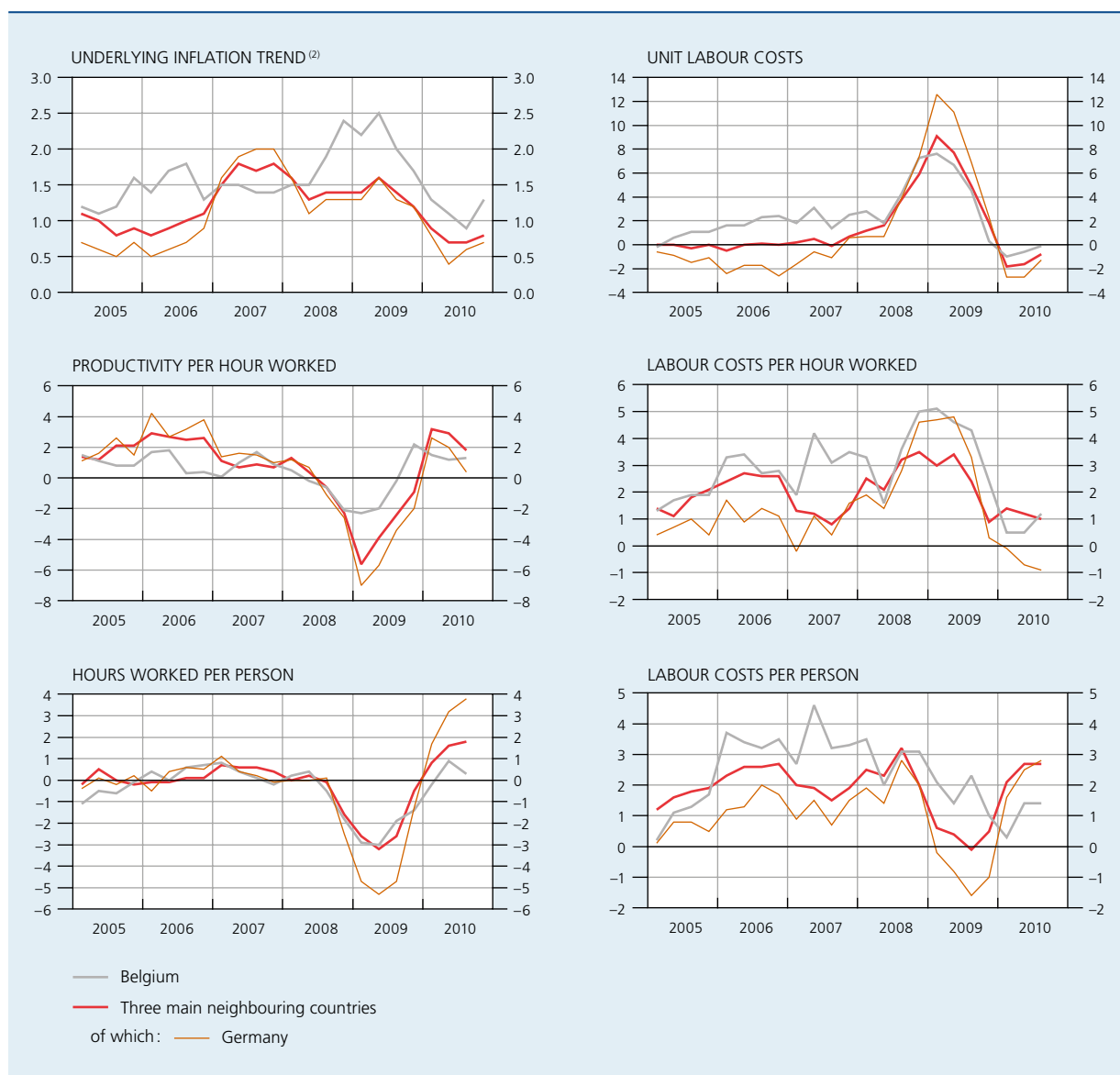
per person, which fell in 2008 and in 2009 and increased in the year under review. The impact of those fluctuations was particularly marked in Germany because firms in that country, more so than in Belgium, made extensive use of measures such as *Kurzarbeit*, which make it possible to cut working time while retaining the staff employed.

Despite the reduction in the number of hours worked per person and, to a lesser extent, the contraction in employment in terms of persons, the adjustment of the volume of labour during the economic crisis was smaller than the fall in output, so that hourly labour productivity declined sharply. This led to a steep rise in unit labour costs in 2008 and early 2009, which was attenuated from mid-2009 as a result of the cyclical upturn in productivity and the moderation of hourly labour costs. It was only then that the underlying inflation rate also slowed, and that deceleration continued for much of the year under review. These developments were seen both in Belgium and in the three main neighbouring countries, but not in the same proportions. At the beginning of 2009, the rise in unit labour costs had been higher for a time in the three main neighbouring countries; the fall in hourly labour productivity had been comparatively weaker in Belgium, compensating for the more adverse movement in hourly labour costs. That difference is due largely to the strong decline in productivity in Germany where, despite a sharp reduction in hours worked per person, the adjustment of the total volume of labour was significantly outweighed by the particularly substantial contraction in activity.

Such variations in unit labour costs caused by cyclical fluctuations in productivity are temporary by nature, and are less important for pricing. In fact, short-lived cost fluctuations are often neutralised by temporary adjustments to margins, whereas – conversely – the impact on prices of changes in costs which are deemed permanent is generally rapid and total. The cyclical profile of underlying inflation is therefore far less pronounced than that of unit labour costs, both in Belgium and in the three neighbouring countries. Short-term adjustments to margins also largely explain why underlying inflation, though it undeniably declined, remained higher in Belgium in 2009 and 2010, while unit labour costs there had risen a little less steeply at the beginning of 2009. Leaving aside the cyclical fluctuations in productivity, the rise in hourly labour costs discussed below was in fact stronger in Belgium up to the end of 2009. It was only during the first half of 2010 that the relative movement in hourly labour costs was more favourable, owing partly to a marked slowdown in Belgium, due to the low level of wage indexation following the decline in the health index in 2009, and partly to stronger growth of hourly wages in France and the Netherlands, which

CHART 46 UNDERLYING INFLATION TREND AND LABOUR COSTS IN THE BUSINESS SECTOR⁽¹⁾ IN BELGIUM AND IN THE THREE MAIN NEIGHBOURING COUNTRIES

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



Sources: EC, OECD.

(1) The business sector comprises the NACE branches of activity C to K inclusive, and therefore includes manufacturing industry, construction and market services. It can be taken as an approximation of the private sector.

(2) The data on the underlying trend in inflation, i.e. inflation measured by the HICP excluding food and energy, relate to the total economy.

more than offset the fall recorded in Germany. However, that advantage in terms of hourly wages was more than counterbalanced by the relative movement in productivity, which increased more sharply in the neighbouring countries during the first three quarters of 2010, in line with the premise whereby the less favourable movement in productivity in 2009 was cyclical and therefore temporary. Overall, the decline in unit labour costs was therefore steeper there than in Belgium.

2.2.3 Hourly labour costs and wage handicap in the private sector

During the year under review, the rise in hourly labour costs in the private sector slowed considerably to an average of 0.6%, compared to 3.9% in 2009. That was evident in almost all components of the movement in labour costs. The real agreed increases hardly varied, remaining at a low level overall, as in 2009.

TABLE 14 HOURLY LABOUR COSTS IN THE PRIVATE SECTOR

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

	2005	2006	2007	2008	2009	2010 e
Gross wages per hour worked	2.5	3.6	2.5	3.5	3.4	0.5
Collectively agreed wages ⁽¹⁾	2.4	2.3	1.9	3.5	2.6	0.6
Real agreed adjustments	0.4	0.5	0.2	0.5	0.2	0.1
Indexations	2.0	1.8	1.6	2.9	2.5	0.5
Wage drift ⁽²⁾	0.1	1.2	0.6	0.0	0.8	-0.1
Employers' social contributions⁽³⁾	-0.4	-0.3	0.6	0.1	0.4	0.1
Social security	-0.2	-0.1	0.3	0.1	0.1	0.0
Other contributions ⁽⁴⁾	-0.2	-0.1	0.3	0.1	0.3	0.1
Labour costs per hour worked	2.0	3.3	3.1	3.6	3.9	0.6
<i>p.m. Including the effects of the payroll tax reductions⁽⁵⁾</i>	<i>1.9</i>	<i>3.0</i>	<i>2.8</i>	<i>3.3</i>	<i>3.5</i>	<i>0.1</i>

Sources: FPS Employment, Labour and Social Dialogue; General notes on the budget; NAI; NSSO; 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 social contributions which are not paid to the government, including group insurance premiums and pension funds or occupational pension institutions, and imputed contributions including redundancy pay.

(5) This concerns the part of the reductions in payroll tax granted to private sector firms. According to the national accounts methodology, the ESA 95, these should be recorded as a subsidy and not as a direct reduction in charges. They therefore cannot be taken into account in calculating labour costs.

For the period 2009-2010, the real collectively agreed increases decided by the joint committees at sectoral level came under the central agreement concluded at the end of 2008, in which the social partners had agreed that pay increases other than indexation granted for those years would be of fixed amounts in the form of payment instruments – in practice, eco-vouchers or meal vouchers, in view of the implementing arrangements at sectoral level – exempt from employees' and employers' social contributions. These fixed increases, which could not exceed € 125 in 2009 and € 250 in 2010, are not included in the pay scales and therefore do not affect the movement in the index of collectively agreed wages published by FPS Employment, Labour and Social Dialogue. From a statistical point of view, these pay components come under wage drift. Consequently, the real collectively agreed increases had hardly any impact on hourly labour costs during this period, at only 0.2 % in 2009 and 0.1 % in 2010.

It was only during the year under review that the consequences of the sharp slowdown in the rate of increase in the health index in 2009 were fully apparent at the level of automatic wage indexation. The effect of the latter averaged 0.5 %, or one-fifth of the previous year's figure. There is in fact a certain time lag before wages

are adjusted in line with purchasing power, regardless of whether they are indexed by a fixed percentage once the moving average of the health index exceeds a central index, or at set intervals ranging from monthly to annual. Since wages are indexed annually in the first quarter of the year for over a quarter of private sector workers, the year-on-year fall in the health index in the second half of 2009 was not taken into account until the first quarter of the year under review in the wages of more than half a million workers. It should also be remembered that, as described in detail in the Bank's 2009 Report, the application of the indexation system is not perfectly symmetrical: some joint committees which use the indexation mechanism at fixed and very frequent intervals excluded or limited any negative indexations.

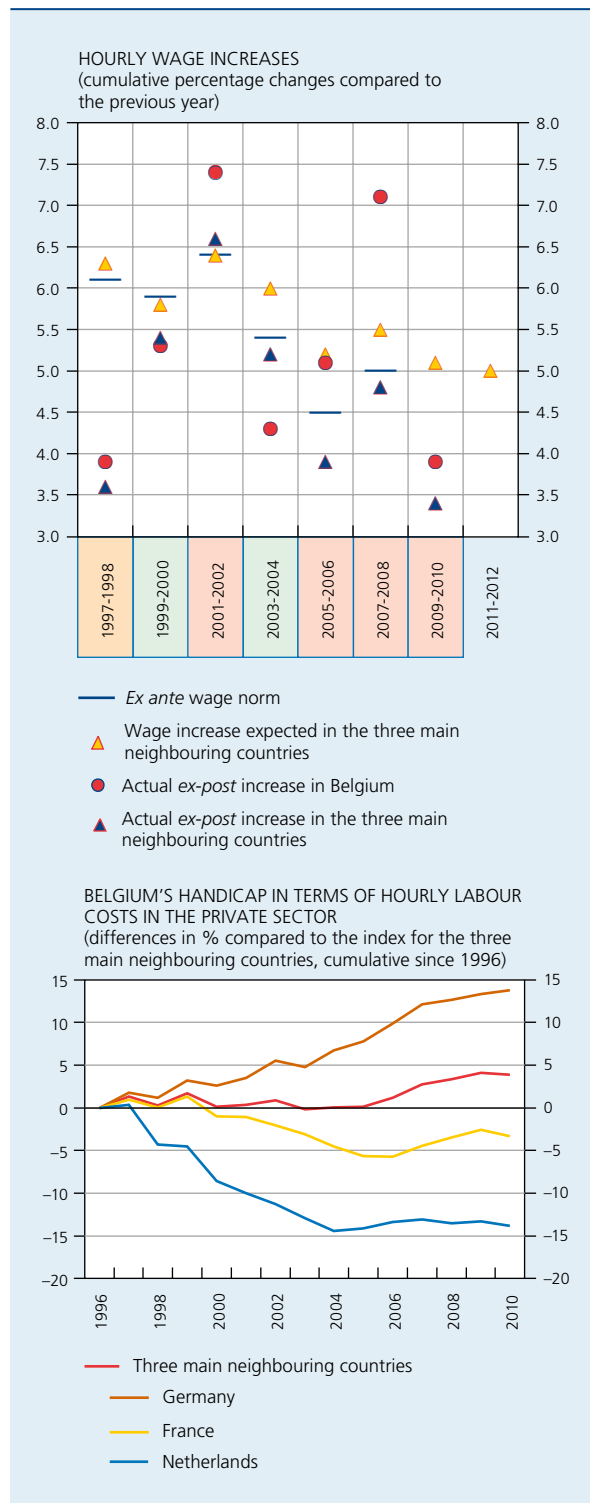
The wage drift made a negative contribution to hourly labour costs amounting to -0.1 percentage point, compared to +0.8 percentage point in 2009. During the year under review, the wage drift was influenced in opposing directions. As already stated, the fixed-rate increases of € 250 maximum per worker made a positive contribution in 2010. More notable was the contribution of the non-recurring performance-related benefits which can be granted to private sector workers since 2008 for achieving specific pre-set collective targets. Such a system is

introduced under a collective labour agreement concluded at company level, or an act of accession in the absence of a trade union delegation. These benefits, which cannot be granted automatically and recurrently, are not regarded as normal remuneration. So long as they do not exceed € 2,299 per worker in 2010, they attract a special 33 % social contribution payable by the employer, and are exempt from employees' social contributions. While non-recurring benefits came to less than 0.2 % of gross wages in 2008 and 2009, they increased to 0.3 % of gross wages in the first three quarters of the year under review. Against the background of the crisis, that increase is due mainly to new firms gradually joining what is still a recent system. However, the upward effect resulting from these two factors was more than offset by the downward effect of the marked decline in temporary lay-offs and the corresponding additional payments. Under the current collective agreements, employers in most branches of activity in fact pay supplements to blue-collar workers who are temporarily laid off, to top up their unemployment benefits. The specific measures adopted during the crisis in order to extend the system of temporary lay-offs to white-collar workers also provided for payment of benefits similar to those for blue-collar workers, or a sum of € 5 per day not worked, if the latter were not granted any additional benefits. The impact of these benefits could not be identified as a specific factor and is included in the wage drift. However, though there are no statistics on the subject, the figures for recourse to temporary lay-offs indicate that this factor made a positive contribution to the rise in labour costs in 2009 and a negative contribution in 2010.

The crisis also affected the social contributions paid by employers for their staff, more particularly the redundancy payments which are deemed to come under the employers' other contributions. Those payments, which had driven up hourly labour costs by 0.3 % in 2009, continued to exert upward pressure in the year under review of around 0.1 %, which was therefore slightly less despite the fact that the closure of the Opel plant in Antwerp was taken into account. For their part, employers' social security contributions had a neutral impact on hourly labour costs.

The reductions in payroll tax, which according to the national accounts methodology – the ESA 95 – are recorded as subsidies and are not deducted directly from labour costs, expanded again during the year under review. They represented 1.7 % of the private sector wage bill, compared to 1.2 % in the previous year. That increase is due, in particular, to new adjustments to the existing measures. The number of overtime hours qualifying for a reduction in payroll tax increased from 100 to 135 per worker per annum. The general wage subsidy was raised

CHART 47 WAGE NORM AND WAGE HANDICAP IN THE PRIVATE SECTOR, ACCORDING TO THE CEC



Source: CEC.

from the previous 0.75 % to 1 % of gross wages. If these reductions in charges had been taken into account in calculating the change in hourly wage costs, the increase

in the latter would have been held down by 0.5 percentage point in 2010. The effect of the reductions in payroll tax is disregarded in the comparison of hourly labour costs conducted by the CEC Secretariat under the 1996 Law in relation to Germany, France and the Netherlands. Those three countries in fact also apply the ESA 95 rules, and therefore also do not regard comparable measures concerning cuts in labour charges as reductions in labour costs. No detailed information is available on such measures. However, according to the Federal Planning Bureau, they are smaller in scale and scope than in Belgium.

Altogether, hourly labour costs increased by 4.5% in Belgium during the period covered by the 2009-2010 central agreement, which was more than the assumed 3.9% by the CEC Secretariat in its November 2010 technical report. For that agreement period, it is only possible to make a comparison on the basis of the actual *ex-post* figures in the three main neighbouring countries, since the social partners did not define an *ex-ante* wage norm, the maximum permitted wage increases being limited to the fixed amounts of € 125 and € 250 in 2009 and 2010. The comparison shows that the increase exceeded that in the three main neighbouring countries, where the average actual rise in hourly wages was estimated by the CEC Secretariat at 3.4% for 2009 and 2010 as a whole. Such slippages have been evident on a number of occasions in the past, more specifically in 1997-1998, in 2001-2002, in 2005-2006 and in 2007-2008.

These excess increases are due mainly to two factors. First, in a context of largely unexpected increases in energy commodity prices and the high sensitivity of Belgian inflation to this factor, the indexations were almost systematically higher than the forecasts used at the time of the wage negotiations, and the corrective mechanisms available – more precisely the all-in clauses (i.e. the clauses permitting compensation for the effect of quicker than expected indexation on the real increases granted during the actual period for which they were agreed) – did not adequately attenuate the repercussions of the price rises on wages. More generally, this shows that, despite its inclusion in the overall wage-setting framework by the 1996 Law, automatic indexation makes it considerably more difficult to determine a wage norm on the basis of forecasts, and means that rapid adjustments must be possible in order to preserve competitiveness. The recent increase in the volatility of the health index makes it more difficult than ever to accurately predict the impact of indexation on wage-setting. Second, the maximum margin for an increase based on forecasts of the rise in hourly wages in the three neighbouring countries – taken as the benchmark for setting the *ex-ante* wage norm – was overestimated for all periods except for 2001-2002.

These overruns are the reason for Belgium's wage handicap in relation to the three partners; according to the CEC, since 1996 it has grown to a cumulative total of 3.9% in the year under review. In comparison with 2009, a small 0.2 percentage point improvement was recorded thanks to the less marked deceleration in hourly labour costs in the Netherlands and France. On the other hand, the competitive position of Belgian firms in relation to their German counterparts continued to deteriorate, as Belgium's wage handicap reached 13.8%.

The negotiations conducted with a view to the 2011-2012 central agreement resulted in a draft agreement on 18 January 2011. They were based on the recent forecasts of the CEC Secretariat, which assumed an average increase in hourly labour costs of 5% in the three main neighbouring countries during the period in question, and an indexation effect on Belgian wages averaging 3.9% at sectoral level. The social partners agreed that, apart from indexation, a margin permitting a wage increase could only be considered in 2012, and that it must not exceed 0.3%. They also agreed to examine, during 2011, the operation of the indexation mechanism in order to reduce the disadvantages of price volatility for wage-setting.

2.2.4 Indicators of cost competitiveness and price competitiveness

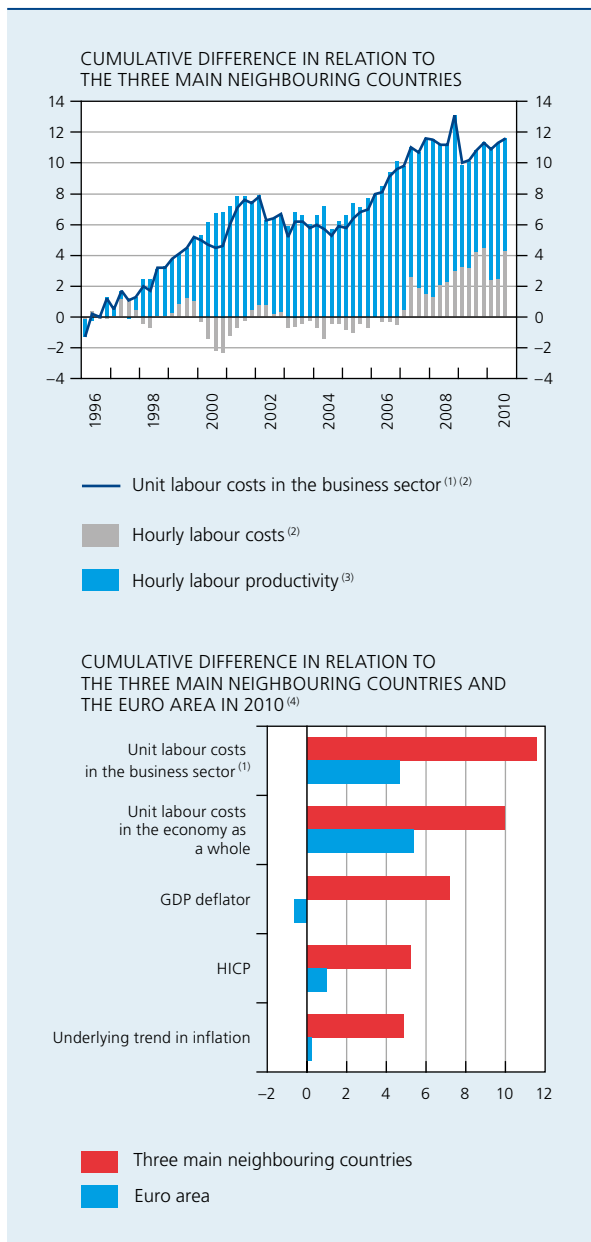
To safeguard competitiveness, any faster rise in hourly labour costs compared to the main competitors must be accompanied by an equivalent rise in labour productivity. The calculation of unit labour costs in the business sector takes account of the movement in both factors. However, since 1996, it is evident that these unit costs have constantly risen faster in Belgium than in the three main neighbouring countries, and for the first three quarters of 2010, the cumulative handicap since 1996 averaged 11.2%, or much more than the handicap in terms of hourly labour costs.

Several periods can be identified. The first covers the years 1996 to 2006, when the movement in hourly labour costs in the business sector had been more or less in line with that in the three neighbouring countries, but a less favourable trend in productivity had led to a faster rise in unit labour costs in Belgium. Between the beginning of 2007 and the end of 2008, the widening of the gap in terms of unit labour costs is due, conversely, to the slippage in hourly labour costs, as the productivity handicap remained relatively stable. In the first quarter of 2009, when the full impact of the economic crisis was being felt, the gap in unit costs narrowed. The less adverse trend in productivity

CHART 48

INDICATORS OF COST- AND PRICE-COMPETITIVENESS

(differences in % compared to the index for the three main neighbouring countries, cumulative since 1996)



Sources: EC, OECD.

- (1) The business sector comprises the NACE branches of activity C to K inclusive, and therefore includes manufacturing industry, construction and market services. It can be taken as an approximation of the private sector.
- (2) A positive sign implies that unit labour costs and hourly labour costs are rising faster in Belgium than the average for the three main neighbouring countries.
- (3) A positive sign implies that labour productivity is rising more slowly in Belgium than the average for the three main neighbouring countries.
- (4) Latest data: third quarter of 2010 for labour costs and GDP deflator; fourth quarter of 2010 for the other indicators.

the gap in relation to neighbouring countries began to widen again.

Comparison with other wage and price indicators over the same period shows that they all point to the same finding: in relation to the three main neighbouring countries, Belgium has seen a decline in its competitiveness in terms of prices and costs since 1996. As in the business sector, the cumulative rise in unit labour costs in the economy as a whole outpaced that in the three neighbouring countries by around 10%. The relative movement in the GDP deflator gives the same signal, while the cumulative increase in the HICP or underlying inflation was around 5% higher than in the three neighbouring countries. Each of these indicators primarily reveals a substantial decline in competitiveness in relation to Germany. The increase in costs and prices has been particularly moderate in that country, part of the reason probably being the deterioration in competitiveness following reunification and the weak performance of the German economy which initially ensued.

On the other hand, looking at the euro area as whole, Belgium's loss of competitiveness is much smaller, or even non-existent, for some of the indicators analysed. That is even more the case if the cumulative increase in costs and prices since the start of Economic and Monetary Union, in 1999, is taken as the basis.

In the future, it is not very likely that such divergences will recur between the trend in relation to the three main neighbouring countries and that in relation to the euro area as a whole. On the one hand, certain euro area countries which had accumulated substantial competitive handicaps since the start of EMU have embarked on an adjustment process, as described in chapter 1.2; also, it seems unlikely that the cost and price moderation in Germany will continue at the same level in the future. In any case, it is still appropriate to continue comparing the trend in costs and prices in Belgium with those in the three main neighbouring countries. Apart from the fact that these are the most important trading partners for the Belgian economy, their level of economic development is comparable to that of Belgium, implying that the relative movement in costs and prices in relation to that reference group is not greatly affected by an economic catching-up process (Balassa-Samuels effect) as is true for some less advanced Member States, and therefore does reflect intrinsic changes in the competitive position.

compared to the three main neighbouring countries – explained in detail above – had offset the growing wage handicap. But these relative gains in the productivity of Belgian firms, being cyclical, subsequently faded so that

2.3 Public finances

2.3.1 Overall balance

The severe recession which raged in 2008-2009 caused serious derailment of the general government accounts. Whereas the overall balance had been practically in equilibrium throughout the period 2000-2007 in a favourable economic context, it deteriorated in the two ensuing years. In 2009, public finances had thus recorded a deficit of 6 % of GDP, or twice the threshold beyond which a country is in an excessive deficit situation according to the current European budget rules.

In December 2009, pursuant to Articles 126(6) and 126(7) of the Treaty on the Functioning of the European Union and on the proposal of the EC, the Ecofin Council therefore recommended that Belgium should cut its public

deficit below the 3 % threshold in 2012, provided economic growth was no lower than the EC expected in its autumn 2009 projections. In the view of the EC, Belgium needed to make a structural budget effort averaging around 0.75 % of GDP per annum from 2010 to 2012 in order to achieve that.

In that context, the stability programme submitted by the Belgian government in January 2010 aimed at cutting the budget deficit to 4.8 % of GDP in the year under review and to 3 % of GDP by 2012. In 2010, the target was achieved, since the deficit was just below that figure at only 4.6 % of GDP. However, it should be pointed out that the government benefited from a more favourable than expected economic climate: GDP in fact grew by 2 % whereas the stability programme had assumed 1.3 %.

TABLE 15 TARGETS FOR THE OVERALL BALANCE OF BELGIAN GENERAL GOVERNMENT⁽¹⁾
(in % of GDP)

	2007	2008	2009	2010	2011	2012	2013	2014	2015
Stability programme									
April 2008	-0.2	0.0	0.3	0.7	1.0				
April 2009		-1.2	-3.4	-4.0	-3.4	-2.6	-1.5	-0.7	0.0
September 2009 (complement)			-5.9	-6.0	-5.5	-4.4	-2.8	-1.3	0.0
January 2010			-5.9	-4.8	-4.1	-3.0	-2.0	-1.0	0.0
Actual figures	-0.3	-1.3	-6.0	-4.6 e					
<i>p.m. Structural financing balance</i>									
According to the EC's method ...	-1.6	-2.2	-4.0	-3.8					
According to the ESCB's method ⁽²⁾	-0.8	-1.7	-4.9	-4.0					

Sources: NAI, FPS Finance, NBB.

(1) As in the other tables and charts in this chapter, including – in accordance with the rules laid down for the excessive deficit procedure (EDP) – net interest on financial transactions such as swaps.

(2) 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. Tujala (2001), *Cyclically adjusted budget balances: An alternative approach*, ECB, Working Paper 77.

Belgium is one of several euro area countries which reduced its public deficit during the year under review. However, this reduction is due largely to the disappearance of certain non-recurring factors which had caused the budget balances to worsen by 0.9 % of GDP in 2009. Thus, the structural financing balance – which is the budget balance adjusted for cyclical and similar factors – improved by only 0.2 percentage point of GDP according to the EC, which in its autumn estimates was still expecting a budget deficit of 4.8 % of GDP in 2010.

Nonetheless, the structural improvement in the budget deficit in 2010 is more substantial if account is taken of the composition effects in GDP growth, namely the fact that certain components of the income and expenditure of households which have a significant influence on the general government accounts – such as private consumption, and more particularly, labour incomes – grew less than economic activity in general during the year under review. The ESCB has devised a method which can identify these effects and, on that basis, it seems that Belgium's structural public deficit declined to 4% in 2010, an improvement of around 0.9 percentage point of GDP compared to the previous year.

2.3.2 Revenue

During the year under review, the fiscal and parafiscal revenues of general government returned to positive growth, increasing by 4.5 %, thus outpacing nominal GDP. Their share in GDP therefore increased to 43.3 %, which was 0.4 percentage point higher than in 2009. That increase was due to the expansion of the main fiscal revenue categories. The bases for the assessment of corporation tax, registration fees and VAT in fact increased faster than GDP. Social contributions alone declined, by 0.3 percentage point of GDP. Non-fiscal and non-parafiscal revenues increased by 0.2 percentage point, mainly as a result of the payments made by financial institutions.

Total levies on earned incomes as a percentage of GDP declined slightly, as a result of the fall in the share of GDP represented by earned incomes. While revenue from social contributions therefore declined, personal income tax revenues increased owing to the effect of structural measures and non-recurring factors.

In contrast to previous years, structural measures in fact contributed 0.1 percentage point of GDP to the rise in

TABLE 16 REVENUE OF GENERAL GOVERNMENT ⁽¹⁾
(in % of GDP)

	2006	2007	2008	2009	2010 e
Fiscal and parafiscal revenue	43.8	43.2	43.7	42.9	43.3
Levies weighing chiefly on earned income	25.2	25.1	25.8	26.0	25.9
Personal income tax ⁽²⁾	11.4	11.2	11.6	11.2	11.4
Social contributions ⁽³⁾	13.8	13.9	14.2	14.7	14.5
Taxes on company profits ⁽⁴⁾	3.6	3.5	3.4	2.5	2.8
Levies on other incomes and on assets ⁽⁵⁾	3.8	3.7	3.7	3.5	3.6
Taxes on goods and services	11.3	10.9	10.8	10.8	11.0
of which:					
VAT	7.0	7.0	6.9	6.8	7.0
Excise duties	2.2	2.2	2.0	2.1	2.1
Non-fiscal and non-parafiscal revenue ⁽⁶⁾	5.0	4.8	5.1	5.3	5.5
Total revenue	48.8	48.1	48.8	48.1	48.8

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

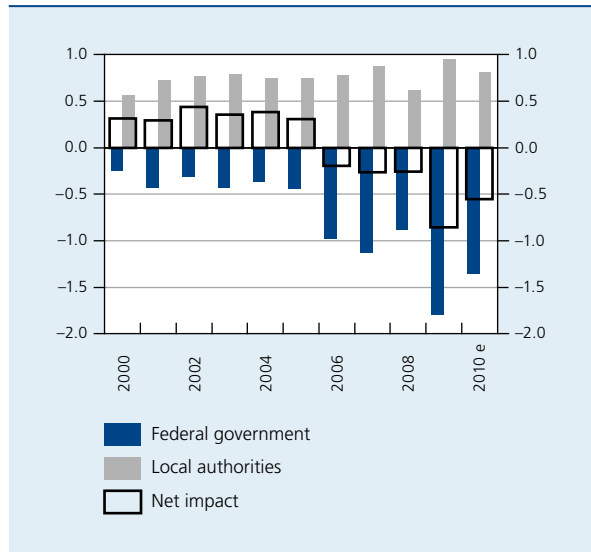
(3) Including the special social security contribution and the contributions of persons not in work.

(4) Mainly advance payments, assessments and withholding tax on movable property income of corporations.

(5) 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, including the remuneration on the guarantees granted by the State on individuals' deposits and interbank loans.

CHART 49 PERSONAL INCOME TAX ASSESSMENTS ⁽¹⁾
(impact on general government accounts, in % of GDP)



Sources: FPS Finance, NBB.

(1) This chart was produced according to the ESA 95 methodology whereby revenues are recorded on the date of the notice of assessment, i.e. in principle two months before actual payment. As a result, revenues on a cash basis exhibit a two-month lag, and revenues relating to January and February are allocated to the previous year.

personal income tax revenues. That was due essentially to the abolition of part of the standard reduction in personal income tax introduced in 2007, and extended in 2009, which the Flemish Region had granted to its residents, provided they were in receipt of earned income. That boosted revenues by € 367 million. Conversely, most of the other measures – which were taken at federal government level – eased the tax burden. This concerned in particular the 2010 increase in the amount of remuneration exempt from tax and contributions, up from € 125 to € 250, approved under the central agreement for 2009-2010. This measure, implemented mainly in the form of meal vouchers or eco-vouchers, resulted in a loss of revenue amounting to € 113 million.

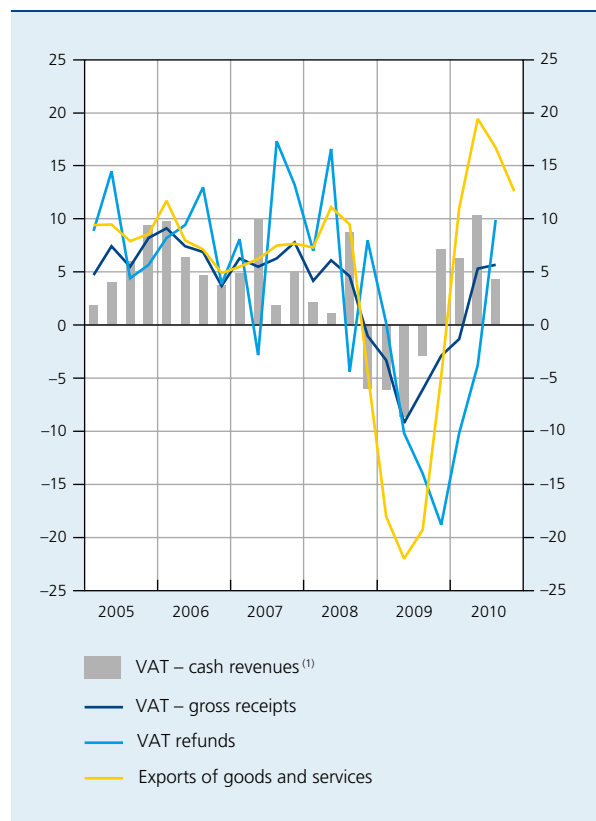
The personal income tax assessments, which had accelerated sharply at the end of 2009, were only moderately speeded up in 2010 so that, over the year as a whole, they declined. Since they systematically give rise to net refunds to individuals, their decline in 2010 led to an increase in revenues of 0.3 percentage point of GDP.

Apart from the reduction in the share of GDP represented by wages, social security contributions were also affected by the arrangements for implementing the wage increases granted under the 2009-2010 central agreement, as the specified exemption concerned not only tax but also social security contributions.

Taxes on company profits picked up slightly, by 0.3 percentage point, to reach 2.8 % of GDP, a level which is nevertheless rather low compared to the figures for the period 1997-2008. During the year under review, this revenue category was boosted by the sustained rise in the gross operating surplus of companies, which was itself favoured by the decline in wages as a percentage of GDP. Moreover, according to the general budget statement by the federal government, the reduction in the interest rate used as the reference for calculating the risk capital allowance generated an additional € 172 million in revenues. The more restrictive rules on tax-exempt dividends and on the tax allowance for company cars – based on their CO₂ emissions – brought in 140 and 91 million respectively.

Levies on other incomes and on assets increased by 0.1 percentage point during the year under review, mainly as a result of the 14 % rise in registration fee

CHART 50 DETERMINANTS OF THE CHANGE IN VAT REVENUES
(percentage changes compared to the corresponding quarter of the previous year)



Sources: NAI, FPS Finance, NBB.

(1) This concerns the cash revenues collected by FPS Finance. They differ from the revenues recorded according to the ESA 95 in the general government accounts, which are based on transactions and are subject to deduction of the revenues transferred to the EU.

revenues. That increase did not entirely offset the reduction in this type of revenues in 2009. That could be due partly to the accelerated purchase of new properties on account of the increase in certain taxes, effective from 2011. The VAT on new properties is now also payable on the value of the land included in the purchase, which is in principle no longer subject to registration fees. Similarly, the forthcoming termination of the temporary scheme concerning the reduced rate of VAT on a maximum tranche of € 50,000 for the construction or acquisition of new housing may have speeded up land sales at the beginning of the year, and that could have boosted registration fees.

Taxes on goods and services, expressed as a percentage of GDP, were up by 0.2 percentage point. VAT revenues benefited from the revival in private consumption. They also gained from the expansion of exports, which had produced negative growth in 2009. Firms can in fact reclaim the VAT that they have paid on purchases intended for the production of exported goods and services, but those refunds are made some time after the VAT has been paid. The increase in indirect tax revenues would have been greater even without the maintenance of the VAT rate at 6 % for the construction or purchase of new housing and social housing for which building permits were issued before 1 April 2010, and without the cut in the rate of VAT on restaurant bills to 12 %, which depressed revenues by € 150 million and € 255 million respectively. Excise duties were also up substantially, the main factor being the ratchet system for diesel, which increased revenues by 200 million.

Non-fiscal and non-parafiscal revenues again benefited from the State's interventions in favour of the financial system, as the commercial banks had to remunerate the

State for the guarantees which it grants on the deposits of individuals and on part of their loans; that remuneration totalled € 333 million more than in 2009. The higher dividends paid by the Bank to the federal government also generated additional receipts totalling € 586 million. Payments in that respect had been very low in 2009, owing to the change in the current rules on payments under the Law of 3 April 2009. Whereas, up to 2008, those dividends were included in the national accounts in the same year as the financial year to which they related, they are now recorded at the time of the decision on the profit allocation, at the beginning of the year following the financial year.

The federal government has extensive fiscal powers in relation to total Belgian public revenues, as it is in charge of VAT, corporation tax and the largest part of personal income tax. During the year under review, its revenues expanded by 0.9 percentage point of GDP, to 26.5 % of GDP. However, it had to pass on a substantial proportion of that to the other general government sub-sectors, so that the resources at its disposal for its own policies came to only 8.9 % of GDP, or barely 0.3 percentage point more than in 2009. Social security's own revenues declined as a result of the fall in earned incomes as a percentage of GDP, but this sub-sector benefited from a new increase in the transfers which it receives from the federal government: the final resources at its disposal thus increased from 20.6 to 21.3 % of GDP, a historically high level. The resources allocated to the Communities and Regions were up by 0.2 percentage point of GDP. That enabled those entities to offset part of the decline in the transfers which they receive from the federal government. Finally, local authority revenues dipped slightly, the 2009 revenues having been inflated by the acceleration of the personal income tax assessments.

TABLE 17 PUBLIC REVENUES PER GENERAL GOVERNMENT SUB-SECTOR
(in % of GDP)

	Before transfers between sub-sectors			After transfers between sub-sectors		
	2008	2009	2010 e	2008	2009	2010 e
Entity I	41.2	40.2	40.8	30.4	29.2	30.2
Federal government	27.1	25.7	26.5	10.3	8.6	8.9
Social security	14.1	14.6	14.3	20.0	20.6	21.3
Entity II	7.6	7.9	7.9	18.4	18.9	18.6
Communities and Regions	4.4	4.3	4.5	11.7	11.9	11.8
Local authorities	3.2	3.6	3.5	6.7	7.0	6.8

Sources: NAI, NBB.

Box 6 – Interventions and guarantees granted by the government to financial institutions

During the financial crisis, the Belgian authorities took various measures to safeguard the stability of the financial system. The government thus intervened in favour of the financial institutions by acquiring shares, granting loans and providing guarantees.

From the start of the financial crisis to the end of the year under review, net contributions of funds by the federal government, the Regions and the local authorities to financial institutions represented € 21 billion, or 6 % of GDP. Most of this aid had been granted during 2008. The federal government had acquired shares in the capital of Fortis Bank totalling € 9.4 billion. Three-quarters of this capital injection had then been converted into shares in BNP Paribas. Royal Park Investments, the defeasance structure created to take over the portfolio of structured products from Fortis Bank, had received a capital injection of 740 million. The government had also injected 2 billion into Dexia and 250 million into the Municipal Holding company. Ethias had received a capital injection of 1.5 billion. KBC had been granted two loans totalling 7 billion. The federal government had also granted a loan of 160 million to the Grand Duchy of Luxembourg for the purpose of intervention in Kaupthing Bank, more than half of which has been repaid.

Apart from capital injections and loans, the federal State also granted guarantees to financial institutions. At the end of the year under review, the amount actually guaranteed by the State was € 55.7 billion, comprising 26.9 billion for interbank loans by Dexia, 5.2 billion for Financial Security Assurance Asset Management, Dexia's American subsidiary, 3.9 billion for Fortis Bank, 4.6 billion for Royal Park Investments and 15.1 billion for KBC. The guarantee covering Dexia's interbank loans therefore represented almost half of the guarantees granted by the government. The outstanding amount of those guaranteed interbank loans is tending to decline. Only the interbank loans contracted by Dexia before 30 June 2010 and maturing by 31 October 2014 at the latest were still covered by the guarantee at the end of the year under review.

As a result of these interventions, the government had contracted additional debts which gave rise to extra interest charges. The latter declined slightly in 2010, as a result of the low interest rates on the market in government securities.

IMPACT ON THE OVERALL BALANCE OF THE GOVERNMENT INTERVENTIONS AND GUARANTEES IN FAVOUR OF FINANCIAL INSTITUTIONS

(in € million, unless otherwise stated)

	2008	2009	2010
Dividends	53	121	192
Guarantee premiums	25	508	682
Interest paid ⁽¹⁾	-96	-655	-622
Other ⁽²⁾	-10	-7	0
Impact on the overall balance	-27	-33	252
<i>p.m. Idem, in % of GDP</i>	<i>0.0</i>	<i>0.0</i>	<i>0.1</i>
<i>Deposit Protection Fund</i>	<i>25</i>	<i>93</i>	<i>251</i>

Sources: FPS Finance, NBB.

(1) In the case of the federal government interventions, the interest charges paid are calculated by the Treasury, which takes account in its estimate of the issues effected to finance them. An equivalent implicit interest rate is applied to the interventions of the Regions and local authorities.

(2) This item comprises an estimate of the management costs relating to public interventions in financial institutions (fees for consultancy and legal advice), and the interest received on the loan granted to Royal Park Investments (9 million in 2008 and 12 million in 2009).



These interventions also generated revenues. Thus, the federal State received dividends from BNP Paribas. The government has not so far received any remuneration on its other shareholdings, or on the loan to KBC. The increase in guarantee premiums received by the State is due to the fact that roughly half of those guarantees had been granted around mid-2009.

The government interventions therefore led to a substantial increase in the debt of general government, whereas their impact on the overall balance was relatively neutral.

As well as the guarantees granted to financial institutions, the government increased the maximum guarantee on bank deposits. That amount was raised from €20,000 to €100,000 per depositor and per financial institution, and the protection was extended to life insurance policies. The remuneration associated with that protection had a positive impact on the budget balance. Moreover, following the financial crisis, the banks made greater use of the liquidity provided by the Eurosystem and the Bank, and that also indirectly increased the revenues in favour of the State.

2.3.3 Primary expenditure

The primary expenditure of general government, i.e. expenditure excluding interest charges, was down by 0.6 percentage point of GDP against 2009. It thus came to 49.9% of GDP, which is still a particularly high level in historical terms. That decline was due to virtual

stabilisation of expenditure in real terms, compared to the previous year.

However, this apparent stagnation does not give a true picture of the underlying trend in the general government's spending policy. To ascertain that, it is necessary to eliminate a whole range of non-structural elements.

TABLE 18 PRIMARY EXPENDITURE OF GENERAL GOVERNMENT
(deflated by the HICP, percentage changes compared to the previous year, unless otherwise stated)

	2006	2007	2008	2009	2010 e	Average 1999-2010 e
Level recorded ⁽¹⁾	44.6	44.6	46.4	50.5	49.9	45.6
Real growth recorded	-4.5	3.3	2.5	7.1	0.0	2.8
Influence of non-recurrent or fiscally neutral factors ⁽²⁾	-5.8	1.3	-0.3	0.9	-1.3	0.1
Influence of cyclical factors ⁽²⁾	-0.2	-0.3	0.2	0.8	-0.6	0.0
Indexation effect ⁽²⁾⁽³⁾	-0.4	-0.2	-0.4	1.5	-1.1	-0.1
Real growth adjusted for cyclical non-recurrent or fiscally neutral factors and for indexation effects	2.0	2.5	3.0	4.0	3.0	2.8
<i>p.m.</i> Volume growth of GDP ⁽⁴⁾	2.7	2.8	0.8	-2.7	2.0	1.7

Sources: DGSEI, NAI, NBB.

(1) In % of GDP.

(2) Contribution to real recorded growth of primary expenditure.

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

(4) Calendar adjusted data.

TABLE 19 ADJUSTED PRIMARY EXPENDITURE BY GENERAL GOVERNMENT SUB-SECTOR ⁽¹⁾⁽²⁾

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

	2006	2007	2008	2009	2010 e	Average 1999-2010 e	<i>p.m.</i> 2010 e, in % of GDP ⁽³⁾
Entity I	1.7	3.4	3.4	4.3	3.8	2.8	30.6
Federal government	2.0	4.3	4.7	4.0	3.4	2.7	9.1
Social security	1.6	3.0	2.8	4.4	4.0	2.9	21.4
Entity II	2.4	0.8	2.3	3.5	1.5	2.7	19.4
Communities and Regions	2.7	1.5	2.6	3.8	1.2	2.6	12.3
Local authorities	2.0	-0.1	1.8	3.1	2.1	3.0	7.1

Sources: DGSEI, NAI, NBB.

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

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

(3) Consolidated data, not adjusted and not deflated.

These essentially comprise temporary factors, the impact of the business cycle on expenditure and, finally, the divergences between inflation and the impact on wages and social benefits of the automatic indexation in line with consumer prices.

In 2010, temporary factors moderated expenditure growth by 1.3 percentage points. Expenditure had in fact been inflated in 2009 by two substantial tax refunds which the State had been obliged to make, as a result of court decisions. This concerned taxes wrongly levied in the past in the case of companies receiving dividends from foreign subsidiaries, on the one hand, and married unemployed persons, on the other.

The rate of primary expenditure growth is also subject to cyclical variations as a result of the pattern of unemployment benefits. On the one hand, the number of persons totally unemployed and drawing benefits, which tracks the economic cycle after a certain time lag, continued to rise. On the other hand, the number of temporarily laid off, which responds faster to cyclical movements, declined significantly. Thus, overall, the cyclical component curbed the increase in expenditure in 2010 by 0.6 percentage point.

The indexation mechanisms for civil service pay and social benefits are a third external factor which influences the real movement in primary expenditure. Thus, wages and social benefits, which account for over 60 p.c. of that expenditure, are linked to the movement in the health index of consumer prices. In 2010, that index rose by 0.7 percentage point less than the HICP, the index used to deflate expenditure. Also, taking account in particular

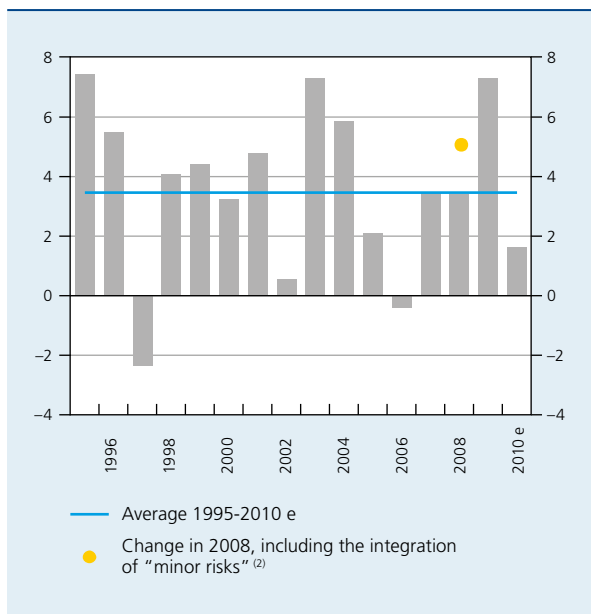
of the smoothing systems and the thresholds applicable under the indexation mechanisms mentioned above, there was a delay before the higher inflation during the year under review was reflected in indexation. Overall, the indexation method therefore curbed the real increase in primary expenditure by 1.1 percentage points. The other effects resulting from time-lags between inflation measured by the HICP and the movement in the price factor influencing the other expenditure categories, whether they are due to the indexation mechanisms or to a divergent pattern in the prices of certain expenditure categories, do not give rise to any adjustment in view of the absence of sufficient information or the complexity of the method to be used.

After adjustment for the effect of these various factors, the real growth of primary expenditure dropped from 4 % in 2009 to 3 % in 2010, though that is still 0.2 percentage point higher than the average increase since 1999 and well above the trend GDP growth. That deceleration concerned all levels of government, particularly the Communities and Regions and local authorities.

The adjusted primary expenditure of federal government increased by 3.4 % in real terms in 2010, compared to 4 % or more in the three preceding years. That deceleration occurred in a context in which various measures were still driving up expenditure. The expenditure caused by the general reduction in withholding tax on earned incomes and by the reduction for shift work and night work, and similarly the favourable tax treatment of overtime, recorded as subsidies to enterprises in accordance with the ESA 95, continued to rise. This further increase contributed 1.8 percentage points to the growth of federal expenditure.

CHART 51 PUBLIC 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) Insurance against "minor risks" concerning health care became compulsory for self-employed persons in 2008, and increased both social security contributions collected and social security expenditure.

The volume growth of the adjusted social security expenditure was down slightly in 2010, at 4%. That was due to a deceleration in disbursements in practically all the main social spending categories. Health care continued to make the biggest contribution, despite a rise in real terms which was much more moderate than in recent years, at 1.6%. Owing to its significant size – at over one-third of total social spending – and volatility, health care expenditure generally has a decisive influence on the movement in social security spending. Although there is no satisfactory information available on the exact impact of this factor in the health sector, it could be said that this deceleration is probably due amongst other things to a smaller contribution from wage and fee indexation than in 2009.

The increase in expenditure on pensions, which had been substantial in the preceding two years, also slowed significantly. On the one hand, there was only a small rise in the average number of pensioners in 2010. This was due to the modest growth in both the number of persons attaining the age of 65 years and the number of retired persons in 2009, as a result of the increase from 64 to 65 years in the statutory retirement age for women with

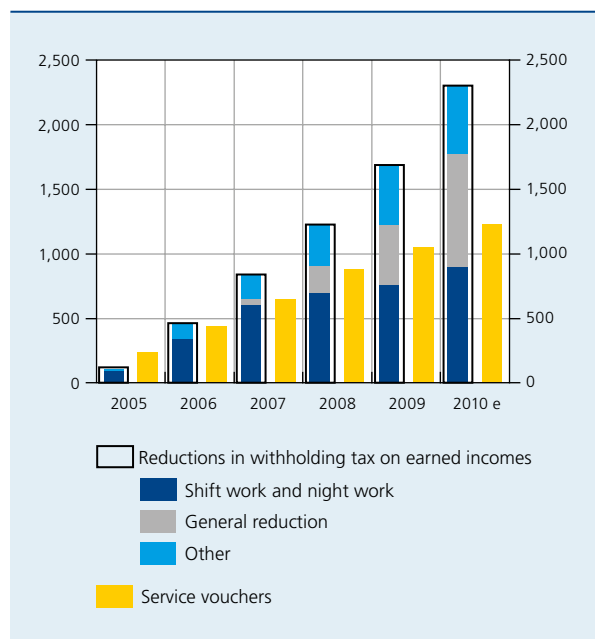
effect from 1 January 2009. Also the social adjustment measures taken by the government in favour of certain pensioners amounted to around € 180 million, or about half the previous year's figure.

Among the other social security expenditure categories, the strong rise in benefits paid by the National Institute for Health and Disability Insurance (INAMI-RIZIV) is nevertheless noteworthy. That growth seems to conform to a trend apparent in recent years. Measures to combat the impoverishment of vulnerable categories of persons only account for a rather limited part of that trend, which is due more to an increase in the number of labour market participants, a growing percentage of older workers, and the increase in the statutory retirement age for women, which implies that the latter are eligible for this type of benefit later and for longer periods.

Finally, as in previous years, the subsidies paid by social security to enterprises increased strongly, by more than € 200 million, mainly as a result of expenditure on service vouchers. The total budget allocated to the latter increased to over 1.2 billion. That figure disregards the tax allowances which are also granted to users of these vouchers when their personal income tax is assessed, and which are estimated at about 150 million.

CHART 52 SUBSIDIES GRANTED TO ENTERPRISES: SERVICE VOUCHERS AND REDUCTIONS IN WITHHOLDING TAX ON EARNED INCOMES

(in € million)



Sources: Budget documents, NAI, NBB.

Both the Communities and Regions and the local authorities reined in the growth of their adjusted primary expenditure, which slowed to 1.2 and 2.1 % respectively in real terms. In both cases, investment expenditure contributed to this movement. While the volume growth of investment slackened pace in the case of the local authorities, the strong acceleration for the Communities and Regions in 2009 gave way to a decline, which is due at least partly to the effect of the electoral cycle for this level of power. Indeed, this investment generally diminishes in the year following the regional elections, which were last held in 2009.

2.3.4 Interest charges

After having peaked at 11.6 % of GDP in 1990, the interest charges of general government declined constantly, falling to 3.4 % of GDP in 2010. This strong reduction in interest charges is attributable mainly to the steady decline in the implicit interest rate on the public debt, as a result of loans being refinanced at lower rates of interest at maturity or in the event of buy-back. Up to 2007, the reduction in the general government debt ratio also had a favourable influence on interest charges.

Thereafter, these charges declined at a more moderate pace than before. In 2010, they fell by only 0.2 percentage point of GDP, the sole factor being the reduction in the implicit interest rate, since the general government debt ratio increased again.

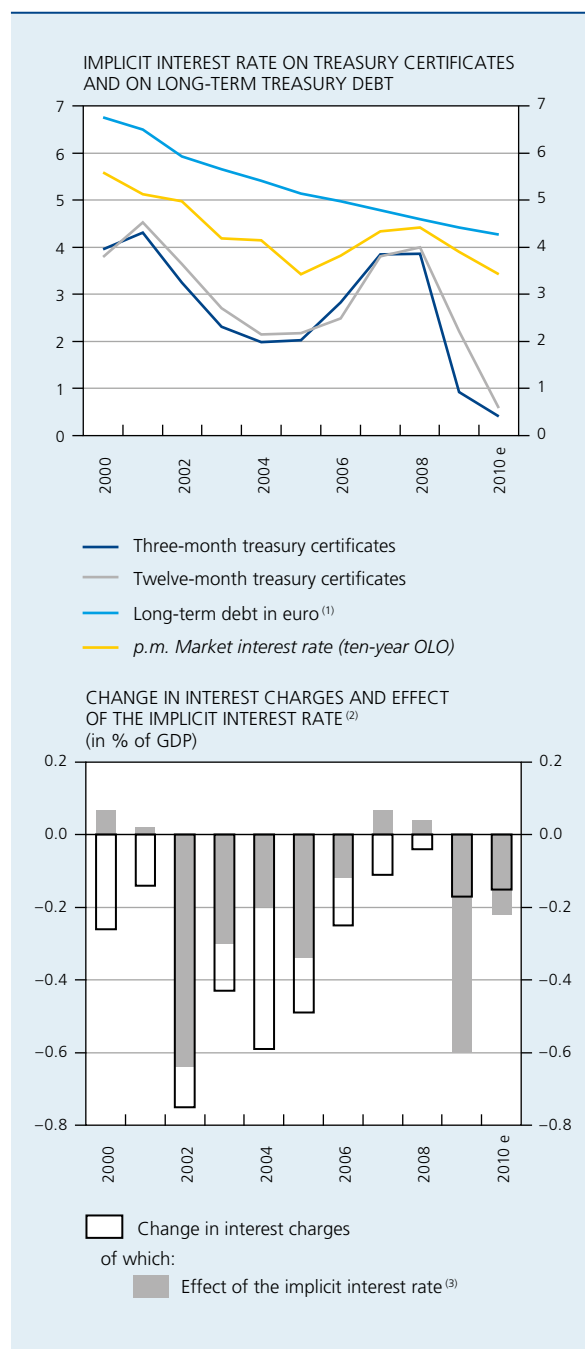
After having already halved in 2009, the implicit interest rate on the short-term debt declined further in 2010. In response to the financial and economic crisis, the Eurosystem held the rate on its main refinancing operations at an extremely low level. The downward pressure on short-term interest rates therefore continued, so that the implicit interest rate on twelve-month treasury certificates dropped from 2.2 % in 2009 to 0.8 % in 2010. The implicit interest rate on the long-term debt also declined, reaching 4.3 % at the end of the year. The market interest rate on long-term government securities fell to a historically low level in August 2010.

2.3.5 Overall balance of the general government sub-sectors

Following the developments described above, and the changes in the mutual transfers between the general government sub-sectors, their accounts exhibited a divergent picture. Thus, the deficit at the level of Entity I, comprising the federal government and social security,

CHART 53 BREAKDOWN OF THE CHANGE IN INTEREST CHARGES

(in %, unless otherwise stated)



Sources: FPS Finance, NAI, NBB.

- (1) Ratio between interest charges (including issue premiums) and the average monthly outstanding debt.
- (2) For general government as a whole.
- (3) Ratio between interest charges in the current year and debt at the end of the preceding year.

showed a marked fall. In Entity II, encompassing the Communities and Regions plus local authorities, the deficit remained practically stable, at a level considerably below that of Entity I.

TABLE 20 OVERALL BALANCE OF GENERAL GOVERNMENT, AND PER SUB-SECTOR
(in % of GDP)

	2006	2007	2008	2009	2010 e
Primary balance	4.1	3.5	2.4	-2.4	-1.2
Entity I	4.0	3.0	2.3	-1.7	-0.4
Federal government	3.8	2.5	2.0	-0.8	-0.1
Social security	0.3	0.5	0.5	-0.8	-0.2
Entity II	0.2	0.6	0.1	-0.7	-0.8
Communities and Regions	0.3	0.5	0.1	-0.6	-0.5
Local authorities	-0.1	0.1	0.0	-0.1	-0.2
Interest charges	3.9	3.8	3.8	3.6	3.4
Overall balance	0.2	-0.3	-1.3	-6.0	-4.6
Entity I	0.3	-0.6	-1.2	-5.0	-3.4
Federal government	0.0	-1.1	-1.6	-4.2	-3.3
Social security	0.3	0.5	0.5	-0.8	-0.2
Entity II	-0.1	0.3	-0.2	-1.0	-1.1
Communities and Regions	0.2	0.4	0.0	-0.8	-0.8
Local authorities	-0.2	-0.1	-0.1	-0.2	-0.4

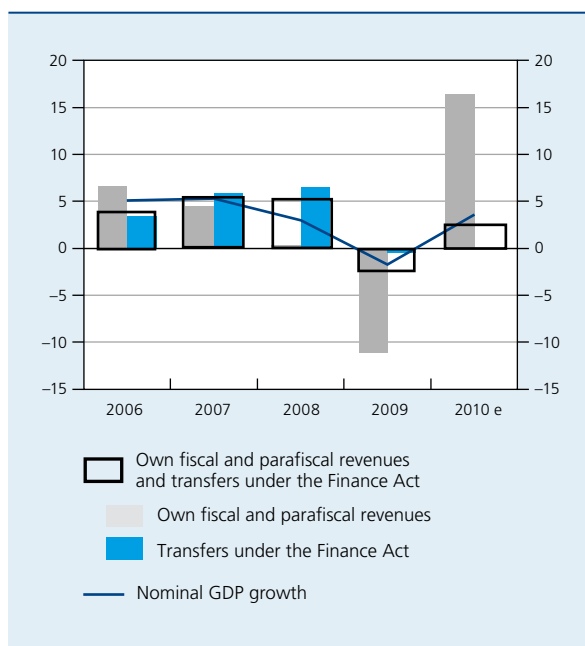
Sources: NAI, NBB.

The federal government deficit fell from 4.2 % of GDP to 3.3 %, as a result of a contraction in the primary deficit and interest charges. That improvement would have been still larger without a very marked increase in transfers paid to social security.

The reduction in the social security deficit, amounting to 0.6 percentage point of GDP, is in fact due solely to the increase in what it receives in the form of federal government allocations plus "alternative funding", which is based on the tax revenues collected by the Treasury being shared with social security. In the past few years, the increase in the various forms of transfer has enabled social security to cope with the growing needs in the form of expenditure or reductions in contributions not covered by its own fiscal and parafiscal revenues. The share of the latter in the total revenues of this sub-sector thus declined from 77 % in 2000 to 67 % in 2010.

The Communities and Regions ended the year with a deficit of 0.8 % of GDP, which was stable compared to 2009, as their expenditure and revenue increased to a comparable extent. The shares of personal income tax and VAT allocated to the federated entities under the Finance Act remained more or less unchanged compared to 2009 in

CHART 54 REVENUES OF THE COMMUNITIES AND REGIONS
(percentage changes compared to the previous year)



Sources: NAI, NBB.

nominal terms, which means that these revenues declined as a percentage of GDP. That fall was due to the settlement of the accounts for 2009, a year in which this level of power had received excess transfers, since they had been calculated on the basis of an over-optimistic estimate of economic activity and an exaggerated inflation forecast, two variables which largely determine the scale of those transfers. However, this fall was more than offset by the increase in the Regions' own fiscal and parafiscal revenues, owing to the abolition of a large part of the standard reduction in personal income tax granted by the Flemish Region. These revenues also benefited from good registration fee, gift and inheritance tax revenue performance, the increase in which counterbalanced their decline in 2009.

Finally, local authorities are the only sub-sector whose deficit recorded a further small increase in 2010, bringing it up to 0.4% of GDP, since revenues contracted by more than expenditure. The revenues generated by the additional percentages on personal income tax for this sub-sector dropped sharply, following an acceleration in the tax assessments in the previous year.

2.3.6 Public debt

Debt of general government

From 1993 to 2007, the consolidated gross debt of general government had fallen steadily from 134.1% of GDP to 84.2%. Owing to the government interventions in a number of financial institutions at the end of 2008, it had then risen back to 89.6%. In 2009, following the increase in the deficit and the decline in GDP, the debt grew further to reach 96.2% of GDP. In 2010, the rise continued, but more slowly than in 2009. At the end of 2010, the public debt thus came to 97.5% of GDP.

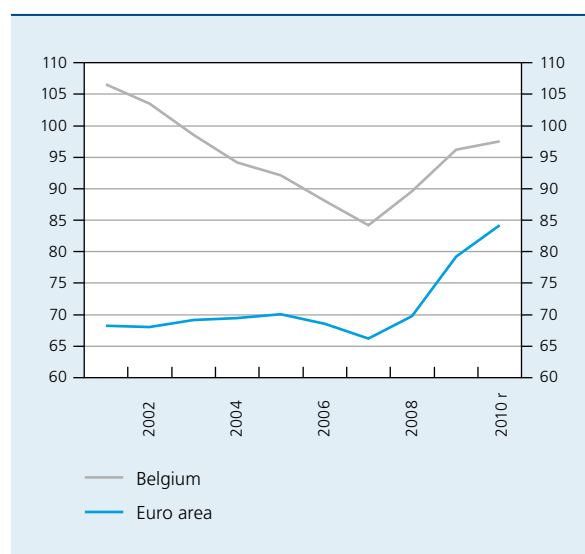
The factors said to be "exogenous" – because they affect the debt but not the overall balance – had an almost neutral influence on the debt in 2010, as various operations cancelled one another out. The loan granted by the Belgian government to the Greek State under the European aid plan for that country increased the debt ratio by 0.2 percentage point of GDP. Following various court decisions, the Belgian State has to effect tax refunds phased over several years. In accordance with the ESA 95, the impact of those court decisions had been recorded in full in the overall balances for 2007 and 2009, without a corresponding impact on the debt in those two years. Those court decisions gave rise to further payments in 2010, which did not affect the overall balance but did affect the debt as an exogenous factor, having an impact

of 0.1 percentage point. Two exceptional transactions concerning the unwinding of swap positions in August and October 2010 raised substantial revenues for the Treasury, reducing the public debt by 0.6 percentage point.

The increase in the debt ratio in 2010 was therefore essentially endogenous. Even though it improved, the effective primary balance was in fact insufficient to halt the way in which interest charges themselves fuel the debt; this is more commonly known as the "snowball effect". However, that effect was considerably less rampant than in 2009. It was curbed by the improvement in the primary deficit, the restoration of positive growth in the Belgian economy and, to a lesser extent, the continued reduction in the implicit interest rate on the public debt.

At the end of 2009, the debtor position of Belgian general government which, apart from the financial debt, takes account of the claims on other sectors of the economy, came to 80.1% of GDP, the highest level in the euro area after Italy and Greece. Conversely, the net financial assets of the Belgian private sector totalled 106% of GDP, the highest proportion in the euro area. This means that the Belgian economy is in a creditor position in relation to the rest of the world, fairly comparable to that of Germany, so that Belgium is less dependent on the rest of the world for financing the debt of its domestic sectors than many other Member States, be they peripheral countries or countries with sound fundamentals such as France and Austria.

CHART 55 CONSOLIDATED GROSS DEBT OF GENERAL GOVERNMENT IN BELGIUM AND IN THE EURO AREA
(in % of GDP)



Sources: EC, NAI, NBB.

TABLE 21 DETERMINANTS OF THE CHANGE IN THE CONSOLIDATED GROSS DEBT OF GENERAL GOVERNMENT
(in % of GDP, unless otherwise stated)

	1993	Average 1994-2006	2007	2008	2009	2010 e
Debt level (end of period)	134.1	110.4	84.2	89.6	96.2	97.5
Change in the debt		-3.5	-3.9	5.4	6.6	1.3
Endogenous change ⁽¹⁾		-2.8	-4.1	-1.1	7.5	1.3
Primary balance required to stabilise the debt ..		2.2	-0.6	1.4	5.2	0.2
Implicit interest rate on the debt		5.9	4.6	4.6	4.0	3.7
Change in nominal GDP ⁽²⁾		4.0	5.3	3.0	-1.7	3.5
Actual primary balance		5.0	3.5	2.4	-2.4	-1.2
Change resulting from other factors		-0.7	0.2	6.5	-1.0	0.0
Equity investment ⁽³⁾		-0.2	0.3	3.5	0.0	0.0
Securities other than shares ⁽⁴⁾		0.0	0.0	1.0	1.1	0.2
Deposits and cash ⁽⁵⁾		-0.2	0.4	1.9	-1.0	0.0
Financial derivatives ⁽⁶⁾		0.0	0.0	0.0	-0.1	-0.7
Other ⁽⁷⁾		-0.3	-0.4	0.1	-0.9	0.5

Sources: NAI, NBB.

(1) The endogenous change in the public debt is indicated 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 nominal GDP growth rate, multiplied by the ratio between the debt at the end of the previous year and the GDP of the period considered – and the actual primary balance.

(2) Percentage changes compared to the previous year.

(3) Net equity investment, excluding transactions with the NBB.

(4) The securities acquired by the Belgian government in 2008 and 2009 in connection with the refinancing of KBC are considered as loans. In 2010, this item essentially comprises the loan to the Greek State.

(5) The exceptional changes in this item in 2008 and in 2009 are due to a deposit placed on a bank account between the end of 2008 and the spring of 2009 by the FPIC, which is part of the general government sector.

(6) In 2010, this item corresponds mainly to two exceptional transactions concerning the unwinding of swap positions.

(7) Principally changes in sector classification, transactions with the NBB (particularly capital gains on gold), the net formation of other financial assets, the impact of foreign exchange differences and issue and buy-back premiums, the impact of accounts payable and receivable, and statistical discrepancies.

Management of the Treasury debt

In 2010, the gross financing requirements for the Treasury came to € 43.5 billion, compared to 28.8 billion in 2009. As well as a net balance to be financed of € 11.2 billion, the Treasury in fact had to renew medium- and long-term loans maturing for a total of 25.9 billion, whereas it also proceeded to buy back bonds maturing in 2011 for 6.5 billion.

For that purpose, the Treasury arranged medium- and long-term issues for a total of € 45.3 billion, which was 7 billion more than in 2009. This mainly concerned issues of linear bonds (OLOs). Following a substantial increase at the end of 2008 and in early 2009, as a result of the urgent need for liquidity for the massive public interventions in certain financial institutions, the share of the short-term federal debt then declined and stabilised at around 16 % during the first three quarters of 2010.

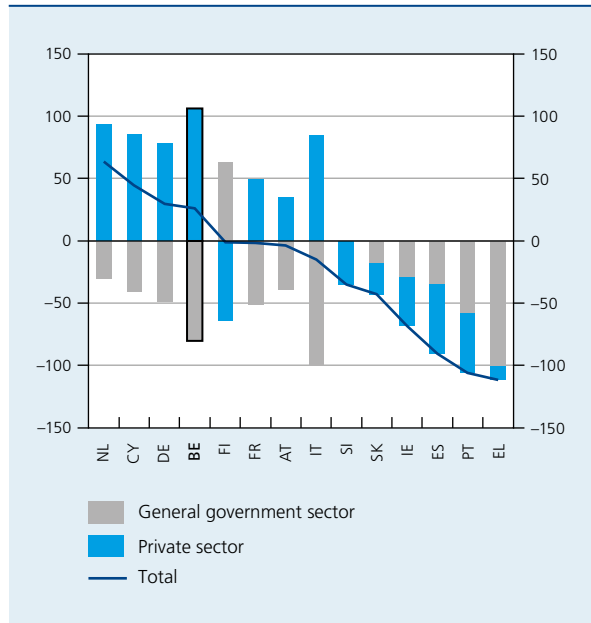
The refinancing risk is measured by the proportion of the loan portfolio which has to be refinanced on a

particular date. As is evident from the indicators which the Treasury uses to assess the risk twelve months and five years ahead, it diminished slightly in 2010: while the proportion of loans to be renewed came to 22.9 and 59.8 % respectively for these two horizons at the end of 2009, it was 20.9 and 58.2 % at the end of the year under review.

One of the strategies used by the federal government's Debt Agency to control the financing risk and smooth the financing requirements from one year to the next consists in buying back before they mature. In 2010, the Treasury effected the buy-back of bonds maturing in the following year for an amount more than double that in the previous year. This smoothing of maturities enabled the Treasury to avoid being confronted by excessive financing requirements over a short period, which might have meant a risk of being forced to borrow at an unfavourable interest rate. During 2010, the Treasury also revised upwards its targets for OLO issues, thus taking advantage of favourable interest rate conditions to cover part of its 2011 financing requirements.

CHART 56 NET FINANCIAL POSITION OF GENERAL GOVERNMENT AND THE PRIVATE SECTOR IN THE EURO AREA COUNTRIES⁽¹⁾

(end-2009 data unless otherwise stated; in % of GDP)



Sources: EC, NBB.

(1) Differences between outstanding financial assets and liabilities. No data are available for Luxembourg and Malta. 2005 data for Cyprus.

In 2010, the Treasury made substantial savings on interest by means of receiver swaps which it had concluded in previous years, particularly in 2009. As a result of these interest rate swaps, the Treasury collected the long-term interest while paying the three-month Euribor interest rate. In August and October, the Treasury made further considerable gains totalling almost €2.2 billion, by unwinding swap positions which it had thus contracted for a total of 22 billion.

During the first eight months of the year, the interest rate on Belgian ten-year bonds declined significantly, from 3.7 % at the beginning of January to 2.8 % at the end of August. Despite the low rates offered, Belgian debt securities were very popular. That enthusiasm is due mainly to the particularly high risk aversion among investors during this period, when uncertainty over the global economic recovery had generated renewed interest in sovereign securities considered safe. However, from September there was a gradual increase in the interest rates offered on OLOs; by the end of the year they had reached around 4 %.

In 2010, the spread between the yield on ten-year OLOs and German government bonds with the same maturity increased strongly again. During the first two months of

2010, the spread in relation to the German Bund remained relatively stable, at around 35 basis points. Thereafter, the contagion effect of the Greek crisis had an impact on the other euro area countries, particularly those whose public finances had suffered a greater deterioration. The Greek sovereign debt crisis and concerns about Ireland, Portugal and Spain caused investors to seek refuge in better quality bonds, particularly the German Bund. Up to the end of August, the Bund yield thus declined faster than the yield on Belgian securities and those of other euro area countries. A marked increase in the Belgian yield differential was evident at the beginning of June, peaking at 105 basis points. That movement coincided with a critical phase in the crisis concerning the public finances of the peripheral countries. In July and August, there was a period of calm, and the spread narrowed again to 56 basis points. From September, spreads began widening once more, and the Bund benefited from a renewed flight to quality. The

TABLE 22 FINANCING REQUIREMENTS AND RESOURCES OF THE FEDERAL STATE
(in € billion)

	2008	2009	2010
Gross financing requirements	57.3	28.8	43.5
Gross balance to be financed	54.0	25.7	37.0
Budget deficit or surplus (–) ⁽¹⁾	27.5	7.8	11.2
Medium- and long-term debt maturing during the year	26.5	17.9	25.9
In €	26.0	17.9	25.3
In foreign currencies	0.5	0.0	0.6
Buy-backs (securities maturing the next year or later)	3.3	3.1	6.5
Other financing requirements	0.1	0.0	0.0
Funding resources	33.8	38.3	45.3
Medium- and long-term issues in €	32.4	35.8	42.6
Linear bonds (OLOs)	31.8	35.0	40.9
State notes and others	0.7	0.8	1.8
Medium- and long-term issues in foreign currencies and/or structured products	1.4	2.5	2.7
Net change in the short-term debt in foreign currencies	4.3	–4.0	–0.0
Change in the outstanding amount of Treasury certificates	11.1	–1.4	0.3
Net change in other short-term debt in € and in financial assets	8.1	–4.1	–2.1

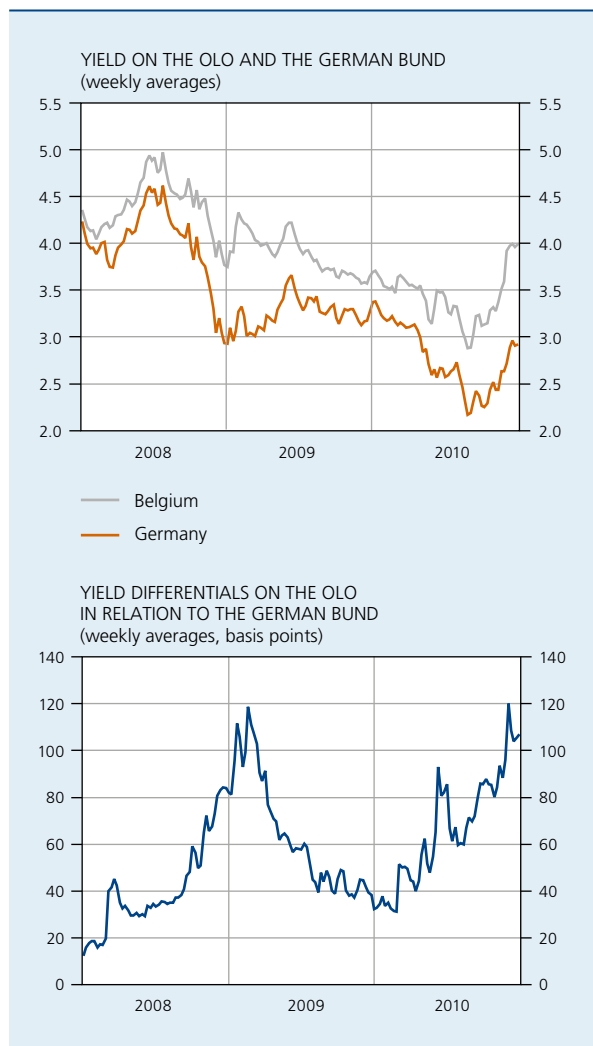
Source: FPS Finance.

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

increase in the yield differentials was also due partly to a contagion effect caused by the Irish crisis and by Belgium's slow progress in forming a fully operational federal government, and hence the delay in announcing a recovery plan for public finances. The importance of this contagion effect varied across the euro area countries, depending on investors' perception of each country's ability to meet its financial commitments. At the end of November, the Belgian yield differential reached 136 points, before subsiding to 107 points at the end of the year.

The proportion of Belgian government bonds held abroad increased again in 2010. In September 2010, the proportion of OLOs held abroad came to around 55%. In the same period, the share of Treasury certificates held by the rest of the world came to 90%. The proportion of these

CHART 57 YIELD ON TEN-YEAR GOVERNMENT BONDS⁽¹⁾

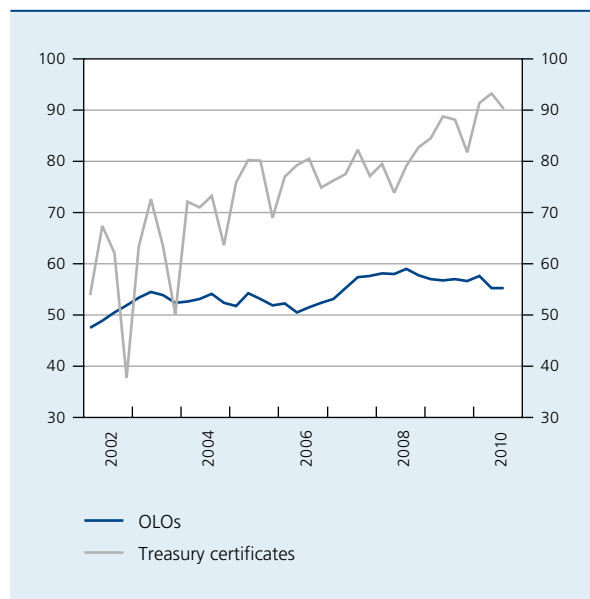


Source : Thomson Reuters Datastream.

(1) Secondary market yield on benchmark bonds issued by the Belgian State (OLOs) and the German State (Bund).

CHART 58 PROPORTION OF FOREIGN-HELD OLOS AND TREASURY CERTIFICATES ISSUED BY THE BELGIAN STATE

(end-of-quarter data, in % of the total)



Source : NBB.

securities held by foreign investors has risen constantly year on year.

As shown by box 2, in a period of financial market tensions, investors tend to distinguish between government securities to a greater extent according to national fiscal and structural criteria. Thus, the countries regarded as too vulnerable found that their interest rates soared. The lower volatility of the Belgian yield differential in comparison with the spreads of countries with comparable debt ratios is due partly to some of the Belgian economy's characteristics, in particular the low debt level of its private sector, the high savings ratio of that sector and the substantial outstanding amount of its net claims on the rest of the world. In order to maintain market confidence in the Belgian public debt, it is nevertheless vital to ensure political stability and to take the measures essential for fiscal consolidation.



3.

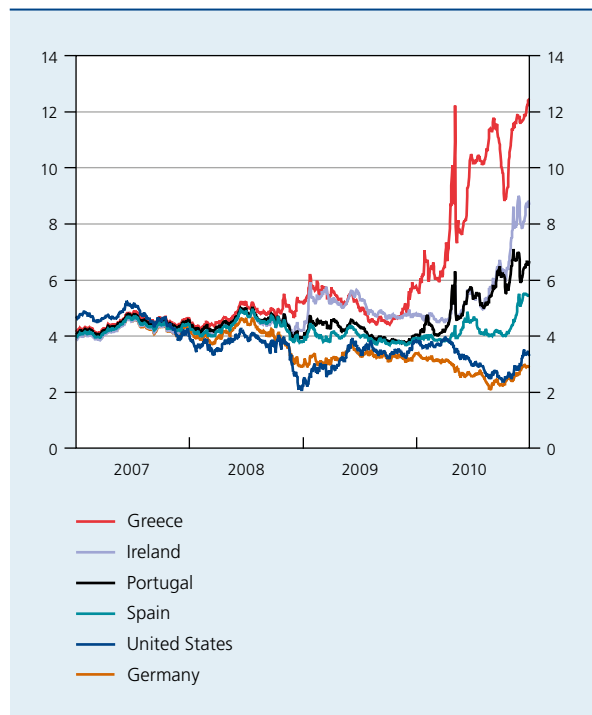
Financial markets and
financial stability

3.1 International financial markets

International financial markets continued to feel the repercussions of the serious crisis which followed the failure of Lehman Brothers in September 2008. Despite the exceptional support measures taken by the authorities, the markets still experienced periods of turbulence and retreat into 'safe-haven' securities. These developments were fuelled mainly by the uncertainty over the pace of the economic recovery in certain advanced economies, and by fears regarding the sustainability of the public

finances of several countries. They caused investors to postpone their expectations of a normalisation of monetary policy interest rates which contained the rise in short-term rates. The benchmark medium- and long-term interest rates in the United States and Germany also remained very low. They actually continued to fall during the year under review, owing to the weak inflation and the strong demand for low-risk assets, accentuated in the United States by the anticipation of the Federal Reserve's November decision to purchase US Treasury securities for a total of \$ 600 billion up to June 2011. In the third quarter of 2010, the yield on ten-year bonds issued by the German federal State thus dipped briefly below 2.25 %, before climbing back by around 75 basis points towards the end of the year.

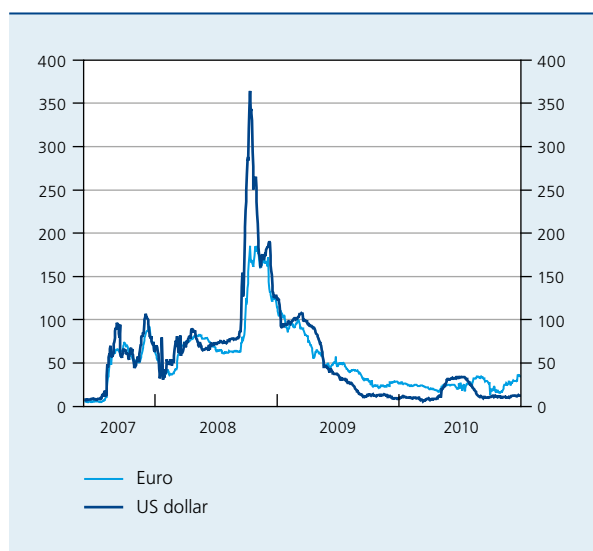
CHART 59 TEN-YEAR GOVERNMENT BOND YIELDS IN THE EURO AREA AND THE UNITED STATES
(daily data, in %)



Source: Thomson Reuters Datastream.

In stark contrast to developments on the German Bund market, yields on bonds issued by a number of other euro area Member States reached levels unheard of since the start of monetary union in 1999, so that the spread in relation to the Bund increased to an all-time high. While the budget situation in Greece and other euro area countries had already aroused market fears in November 2009, concern over the sovereign risk was heightened during the initial months of the year under review as new information appeared on the Greek budget position and on the substantial scale of the adjustments needed in that country to bring down the public deficit below 3 % of GDP. During that period, other euro area Member States facing a serious deterioration in their budget position and their economic growth as a result of the financial crisis – such as Ireland, Portugal and Spain – also recorded a marked widening of the spreads on their government bonds in relation to the Bund. The negative market sentiment regarding those countries was also exacerbated by the fact that the rating agencies were considering lowering their sovereign debt rating.

CHART 60 SPREADS BETWEEN THE LIBOR AND THE THREE-MONTH OVERNIGHT INDEX SWAP (OIS) RATE ⁽¹⁾
(daily data, basis points)



Source : Thomson Reuters Datastream.

(1) Spreads between the three-month Libor and the fixed interest rate paid by the counterparty of an interest rate swap contract receiving the overnight interest rate for a three-month period.

In view of the serious deterioration in Greek sovereign debt financing conditions – which was also beginning to affect the financial soundness and liquidity position of the Greek banks – the EU and the IMF announced a joint aid programme for Greece on 11 April. However, that programme, which provided for potential financial aid amounting to € 45 billion, failed to calm the markets, and the tensions gradually spread to the bond markets of other peripheral states. In April, the European interbank markets began to show new signs of tensions, as the liquidity of certain government securities used as collateral declined or even disappeared. Fears over the counterparty risk in relation to interbank transactions also re-emerged: the banks regarded as heavily exposed to the most vulnerable countries had to contend with a tightening of their financing conditions, a trend which became widespread. The indicators of conditions on the interbank lending market in euro – whether guaranteed or not – showed a tightening of the term loan criteria and growing problems for banks regarding the use of certain categories of securities for repo transactions. However, thanks to the authorities' response to the renewed tensions, the widening of the spreads between the three-month Libor and the fixed interest rate paid by the counterparty of an interest rate swap contract receiving the overnight rate for an equivalent period, in euro or in US dollar, remained moderate compared to the extreme levels reached following the collapse of Lehman Brothers.

The sharpest deterioration in market confidence in the euro area came at the end of April, when one of the main rating agencies downgraded the Greek sovereign debt rating by three levels, after Greece reported a bigger than expected budget deficit. The simultaneous downgrading of Portugal's rating, and subsequently that of Spain, exacerbated the negative sentiment. While the programme of financial aid for Greece was increased to € 110 billion on 2 May, investors remained sceptical about the outlook for sovereign risk on other bond markets of peripheral euro area states. Owing to a further intensification of the tensions on those other markets during the week of 2 May, kindling fears that the Greek debt crisis would infect other countries, spreads in relation to the German Bund reached record levels on certain sovereign debt markets. Liquidity on those markets was also greatly reduced. In the light of these developments, the European Council agreed at its meeting on 9 and 10 May to establish a European Financial Stabilisation Mechanism (EFSM), while undertaking to speed up fiscal consolidation in cases where that proved necessary, and to reinforce the budgetary surveillance mechanisms (cf. chapter 1.1). At the same time, the Eurosystem's Governing Council decided to intervene on the bond markets and took other measures to restore liquidity on the interbank markets (cf. chapter 1.2).

The interactions which became apparent between the worsening of the sovereign risk in a number of countries and the resurgence of tensions in the euro area's financial sector are due to several factors. The banks generally hold very large portfolios of government securities which they can use as collateral for their borrowings. Fluctuations in the value of these securities or a reduction in their rating may affect the quality and eligibility of the collateral, so that external funding becomes more expensive, or even less accessible, for the banks. By generating losses on financial instruments, reductions in the market value of government bonds may also affect the level of their capital. As the financial crisis demonstrated, however, interactions between the financial sector and the sovereign debtor may also apply in the opposite direction, since fears about fiscal viability may be fuelled by problems arising in the national financial sector, in so far as the latter needs support programmes and thus increases the potential or actual liabilities of the public sector. These adverse interactions between public finances and the financial sector were the main factor behind the heightened market concerns about the sovereign risk of Ireland during the second half of the year, as evidence emerged of mounting losses suffered by the Irish banking system on property loans, while the Irish State had guaranteed all the deposits and unsubordinated debts of the banks since the autumn of 2008.

CHART 61 CREDIT DEFAULT SWAP INDICES FOR EUROPEAN SOVEREIGN AND SENIOR FINANCIALS' DEBT
(daily data, basis points)

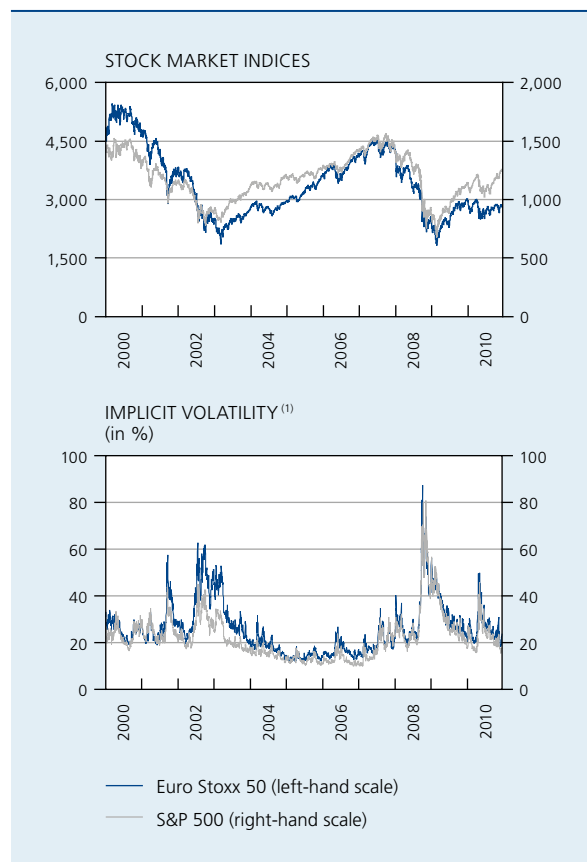


Sources: Bloomberg, Thomson Reuters Datastream.
 (1) Index measuring the average level of premiums on five-year credit default swaps referencing the sovereign debt of nineteen western European countries.
 (2) Index measuring the average level of premiums on five-year credit default swaps referencing the senior debt of twenty-five major European financial institutions.

While spreads on Irish government bonds in relation to the Bund reached record levels, the risk premiums on bonds of other peripheral euro area countries also regained or even exceeded the peak levels recorded during the week of 2 May. The deterioration in market sentiment even extended to non-peripheral euro area countries, as the premiums recorded for Belgium and France also climbed beyond the previous peaks. In November, the index measuring the average level of premiums on five-year credit default swaps referencing the sovereign debt of nineteen western European countries thus reached its highest level since the second half of 2009, when this series was calculated for the first time. However, the corresponding index for five-year credit default swaps referencing the senior debt of twenty-five major European financial institutions remained below the peak recorded in May. Despite the persistently high degree of correlation in the daily fluctuations between the SovX and iTraxx Senior Financials indices, this decoupling between risk premiums for financial institutions and those for sovereign debtors was evident from August onwards. It became apparent shortly after the publication of the results of the stress tests on ninety-one European banks on 23 July (cf. box 7) and the publication, by the Basel Committee on Banking Supervision, of new rules on capital and liquidity for the banking system worldwide, in which certain arrangements for the implementation of those rules were less strict than in previous drafts. These two events helped to provide temporary respite from the

markets' nervousness about the financial situation of the European banks, and contributed to a gradual improvement in interbank transaction conditions during the summer. After having had to contend with a substantial tightening on the primary bond markets at the time of the May and June issues, the European banks thus saw a substantial improvement in their access to financing via the issue of debt securities. Nevertheless, the banks regarded as weak or those active in the peripheral countries presenting serious sovereign risks continued to depend heavily on Eurosystem financing, since access to external financing was limited or even non-existent. Although the European interbank market became very fragmented during the second half of 2010, a widespread and significant deterioration in market conditions and risk premiums for Europe's leading credit institutions re-emerged during November, as a result of the mounting anxiety concerning both the situation in Ireland and the potential spread of these tensions to other euro area countries. This nervousness only ebbed away

CHART 62 STOCK MARKETS
(daily data)



Source: Thomson Reuters Datastream.
 (1) Based on the implicit volatility derived from options on the S&P 500 and Euro Stoxx 50 indices.

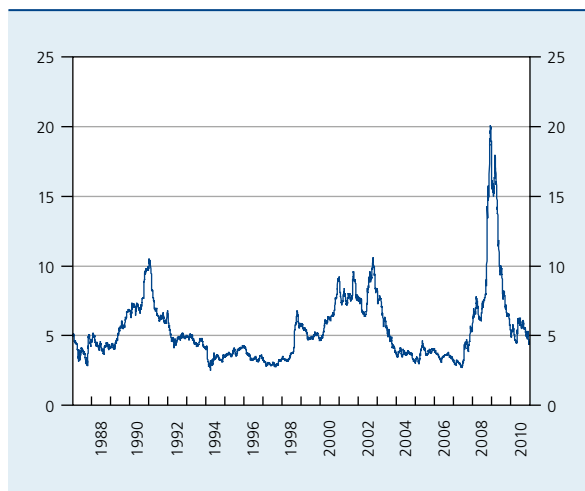
after the announcement of an aid programme for Ireland amounting to € 85 billion.

Financed partly by the European Financial Stabilisation Mechanism set up in May, this programme comprises a large financial assistance package for the Irish banking system's recapitalisation and restructuring. At the same time, the Eurogroup ministers of finance defined the contours of the permanent European Stability Mechanism to be introduced in 2013 when the European Financial Stabilisation Mechanism comes to an end. During the days which followed these announcements, however, market sentiment remained dubious about the possibility of avoiding a restructuring of the public debt in a number of euro area countries. A significant decline in risk premiums only came after the meeting of the Eurosystem's Governing Council on 2 December, when it was announced that certain non-standard measures for the provision of liquidity would be extended for a further three months, as described in chapter 1.2, while the Securities Markets Programme would remain operational as a tool for dealing with market malfunctioning.

The hesitant recovery in the advanced economies and the tensions on the bond markets of peripheral euro area countries created volatile conditions on world stock markets during the period under review, although those markets were buttressed by a marked improvement in corporate profitability.

Following a rise of 8.7 % in the first four months of the year, the S&P 500 index reached a peak on 26 April. It then dropped by over 15 % on account of the sovereign debt problems in Europe and signs that economic growth was slowing down in the United States. That fall was followed by a renewed rise due in particular to the expectation of a new Federal Reserve programme for the purchase of assets, which was actually announced at the beginning of November. Since European firms are more directly affected by the tough economic conditions facing a number of European countries, the Euro Stoxx 50 index recorded a more modest rise during the period up to 26 April, and after the 15 % correction in May and June. The index thus fell by a total of 5.8 % against the end of 2009. Despite the turbulence on the sovereign debt markets, the indices of implicit stock market volatility, which measure the expected volatility and reflect investors' risk aversion, remained well below the levels recorded after the collapse of Lehman Brothers, although volatility was higher in Europe than in the United States.

CHART 63 US HIGH-YIELD BOND SPREADS⁽¹⁾
(daily data, percentage points)

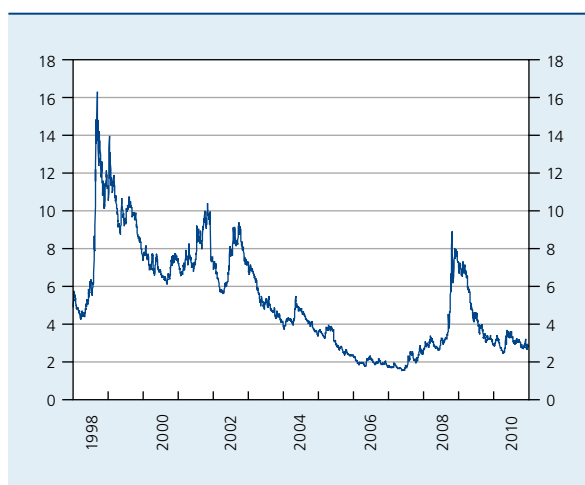


Source : Thomson Reuters Datastream.

(1) Difference between the yield on corporate bonds denominated in US dollar with a rating below BBB/Baa3 and the interest rate collected on ten-year US Treasury certificates.

Since the improvement in profitability in the private sector led to a considerable decline in corporate bond defaults in 2010, risk premiums on that market increased only moderately when concerns about the global economic outlook resurfaced in the summer of 2010. At the end of 2010, the premium on high-yield bonds in the United

CHART 64 SPREADS ON BONDS IN DOLLAR ISSUED BY EMERGING MARKETS⁽¹⁾ COMPARED TO US GOVERNMENT BONDS
(daily data, percentage points)



Sources : JPMorgan Chase, Thomson Reuters Datastream.

(1) EMBI Global composite.

States even dropped below its long-term average of 5.4 % for the period 1987-2010.

Spreads on emerging market bonds also widened slightly in mid-2010, though they remained close to the very narrow spreads prevailing in 2006 and 2007, before the eruption of the global financial crisis. The relatively robust economic growth in the emerging markets and the substantial improvement in the economic fundamentals in

certain emerging economies compared to the situation a few years ago contributed to a reduction in risk premiums on bonds issued by those countries. These developments were probably also due to the fact that those countries received massive inflows of capital, as interest rates were particularly low in the advanced economies. Such capital inflows sparked fears of domestic overheating, and a number of countries adopted measures to try to discourage new inflows.

Box 7 – Stress tests on European banks

At its meeting on 17 June 2010, the European Council decided to publish the individual results of the coordinated stress tests on European banks. These tests were conducted by the European supervisory authorities and by the national central banks of the EU, in cooperation with the Committee of European Banking Supervisors (CEBS), the ECB and the EC. The results for the banks participating in these stress tests, which were based on data supplied by the banks themselves, were published on 23 July.

The general aim was to inform the markets and the authorities of the European banking system's ability to withstand possible adverse economic developments, particularly in the form of a worsening of the sovereign risk. To that end, the tests focused on the banks' resistance to credit risk and market risk. Another aim was to improve the available information on each bank's exposure to European sovereign debt by publishing detailed figures.

To simulate the credit risks, two types of macroeconomic scenarios were developed. A baseline scenario provided for a modest recovery after the severe slowdown in 2008-2009, while an adverse scenario assumed a double-dip recession, and European GDP growth three percentage points lower than in the baseline scenario. The adverse scenario also included specific shocks per country on the yield curves, based on the assumption of mounting concerns about the sovereign risks. The market risk was tested by subjecting the banks' trading portfolio positions to a deterioration in the market parameters, including those concerning sovereign exposures.

The exercise was conducted on an individual basis on ninety-one European banks, using common models, a common methodology and common basic assumptions. The national supervisory authorities of twenty EU Member States were involved. Altogether, the banks' assets subjected to the exercise represented almost two-thirds of those of the European banking system. The banking institutions tested included KBC, Dexia, BNP Paribas and ING.

According to the adverse scenario including the sovereign shock, the aggregate Tier 1 ratio, used as a uniform measure of the banks' resistance to shocks, dropped from 10.3 % in 2009 to 9.2 % in 2011. The downward pressure on capital ratios according to this scenario is due mainly to loan losses (€ 472.8 billion over two years), while the losses associated with the additional sovereign shock came to 67.2 billion over two years. Seven banks saw their Tier 1 ratio fall below the 6 % mark, with the cumulative shortfall in Tier 1 capital amounting to € 3.5 billion. In agreement with their supervisory authority, those banks had to submit a plan to rectify the weaknesses highlighted by the stress tests. In this adverse scenario, the ratios remained above the 6 p.c. threshold in the case of KBC, Dexia, BNP Paribas and ING.

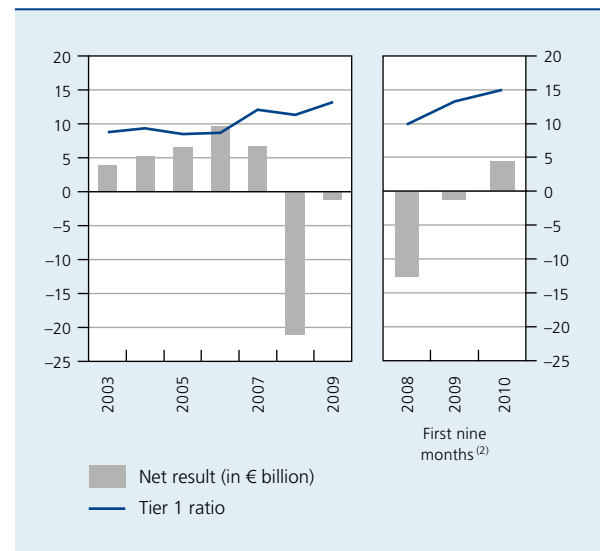
3.2 Financial stability

3.2.1 Belgian banks

After having suffered a heavy loss of € 21.2 billion in 2008 and recording a further – albeit smaller – loss of 1.2 billion in 2009, Belgian credit institutions became profitable again, recording net earnings of € 4.4 billion in the first nine months of 2010. This recovery was partly due to the restructuring of activities carried out by those institutions in response to the vulnerabilities highlighted by the financial crisis.

This restoration of profitability, and its maintenance, are essential for consolidating the solvency of Belgian banks. Reserving profits is one of the main ways of accumulating capital in a seriously challenging environment. For one thing, the banks will have to repay the capital injections received from the government in 2008 and in 2009. Moreover, the new solvency standards, known as Basel III, developed by the Basel Committee in response to the financial crisis, set considerably stricter requirements in certain respects, such as the definition of regulatory capital and the risk weight to be applied to certain assets. These new standards and their potential impact on various macroeconomic aggregates are discussed in more detail in box 8 in this report.

CHART 65 PROFITABILITY AND SOLVENCY OF BELGIAN CREDIT INSTITUTIONS
(data on a consolidated basis⁽¹⁾; in %, unless otherwise stated)



Sources: CBFA, NBB.

(1) The consolidated basis comprises all the banking entities established in Belgium and having one or more subsidiaries. For certain entities, such as ING Belgium and BNP Paribas Fortis, it may concern a sub-consolidation. In the case of Dexia, the data cover only the activities of Dexia Bank Belgium and its subsidiaries, i.e. excluding Dexia Crédit Local, Dexia BIL and Denizbank.

(2) Non-annualised amounts.

Box 8 – The new “Basel III” regulations and their potential impact

At the Seoul summit on 11 and 12 November 2010, the leaders of the G20 countries adopted the new standards proposed by the Basel Committee on Banking Supervision concerning solvency and liquidity, known as Basel III, and supported the development of new mechanisms to improve the management of crises affecting systemically important financial institutions. Combined with more effective supervision and control, these measures should strengthen the resilience of the financial system.

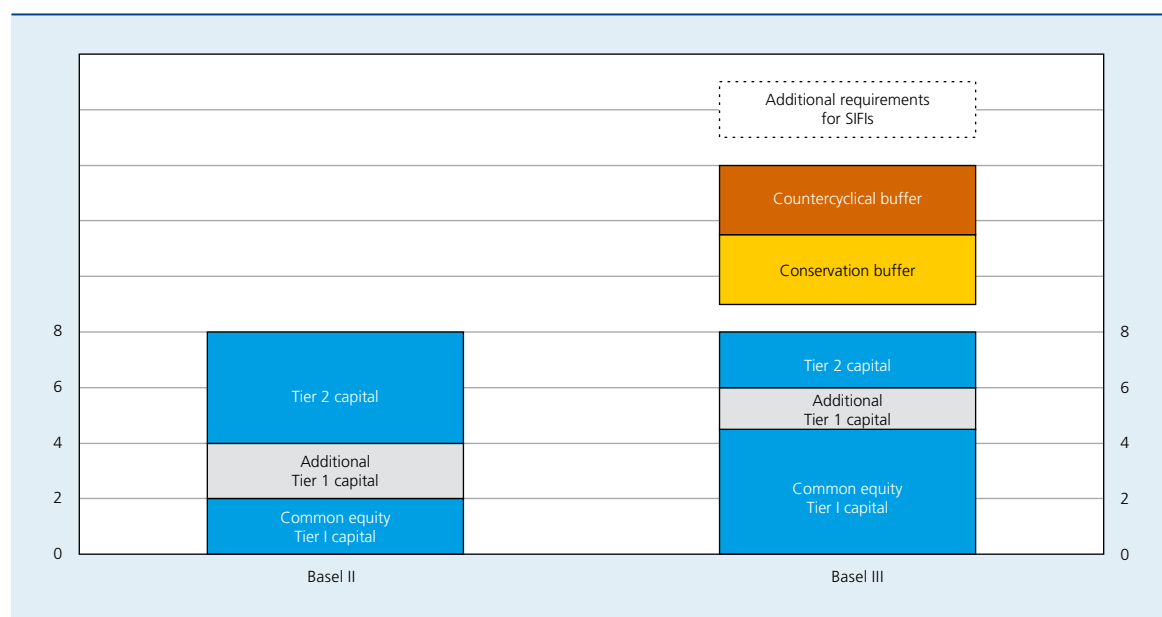


One of the key aims of Basel III is to improve the quality of the regulatory capital, and to harmonise its definition. In order to ensure that the available capital can absorb any losses, is permanently available and offers totally flexible remuneration in times of crisis, Basel III stipulates that capital in the narrowest sense, namely common equity Tier 1 capital, must consist predominantly of ordinary shares and retained earnings. In addition, the adjustments specified for prudential purposes in the form of deductions, such as goodwill, intangible fixed assets or certain deferred taxation recorded on the assets side of the balance sheet should be applied to this narrow definition of the capital base. Other capital instruments intended to absorb losses – under a going concern assumption – can be recognised subject to certain conditions as supplementary elements of the Tier 1 capital. Capital instruments which only absorb losses in the event of liquidation remain eligible as Tier 2 capital.

It was also decided to raise the minimum capital requirements in order to boost the resistance of both individual institutions and the financial system as a whole. On the one hand, in order to take better account of the risks confronting banks, the capital requirements were reinforced for certain risk factors which proved to be inadequately covered during the financial crisis, such as market risks, (re)securitisation, counterparty risks incurred in derivative contracts, repo transactions and securities financing transactions. This set of rules increases the capital requirements for the said exposures and therefore affects the denominator of the solvency ratios. Furthermore, raising the regulatory minimum ratios will mean an increase in the level of capital required. The most striking change concerns the raising of the minimum requirements for common equity Tier 1 capital, from 2 to 4.5 % of the risk-weighted assets, while the minimum level of the Tier 1 capital was raised from 4 to 6 % of the risk-weighted assets. Including the Tier 2 capital, the minimum total capital requirement is still 8 % of the risk-weighted assets, but the proportions of the components are different. The new rules also include a harmonised leverage ratio which relates Tier 1 capital to the bank's total unweighted assets while taking account of off-balance-sheet exposures. That ratio, which will be analysed during an observation period, is intended to form an absolute minimum for the risk-weighted capital requirements.

MINIMUM REGULATORY CAPITAL REQUIREMENTS UNDER BASEL II AND BASEL III

(in % of the risk-weighted assets)



Source: NBB.

Since the crisis confirmed that the financial system is closely interconnected and tends to amplify the fluctuations in the economic cycle, macroprudential tools will be introduced to take better account of the systemic dimensions of risks. The tools established for that purpose by Basel III can be divided into two main categories.

The first group concerns the creation of a “capital conservation buffer” which can be supplemented by a “countercyclical capital buffer”. The conservation buffer represents a fixed 2.5 % of the risk-weighted assets and must be covered exclusively by common equity Tier 1 capital. A “countercyclical” buffer between 0 and 2.5 %, again covered by common equity Tier 1 capital, may be added to the first buffer. For a given country, this second measure will be activated only in the event of excessive credit expansion leading to an increase in the risks facing the system as a whole, and will be relaxed in the case of credit contraction. The two buffers must be built up in favourable times, but they can be used if necessary in a crisis. Certain constraints on the discretionary payment of dividends by banks will be imposed on those without adequate common equity Tier 1 capital to cover these two safety buffers.

The second group, still being developed, aims to reduce the potential contagion effects which could be caused by banks which, owing to their size or their market share in certain segments of activity, present risks for the system as a whole. This group includes, in particular, specific standards to be imposed on “systemically important financial institutions” (SIFIs). It also includes rules promoting the use of central counterparties for private transactions in derivatives.

In order to limit the maturity mismatch between assets and liabilities, a major factor fuelling market tension during the crisis, two liquidity standards are being introduced. A liquidity coverage ratio obliges credit institutions to ensure that they have sufficient high quality liquid assets – capable of being mobilised in repo transactions on the money market or with the central banks – to withstand a crisis that severely limits the scope for refinancing net outflows of funds for a period up to one month. This measure, intended to contain short-term liquidity risks, is accompanied by a net stable funding ratio designed to limit the long-term differences between – on the one hand – illiquid assets and the potential absorption of liquidity relating to off-balance-sheet activities and – on the other hand – sources of funding considered to be stable. The aim is to limit the excessive financing of long-term illiquid assets by very short-term resources.

In order to ensure that the new regulatory framework intended to strengthen the resistance of the financial system does not prejudice the economic recovery, two complementary international working groups were given the task of examining the macroeconomic costs entailed in implementing the Basel III regulations. The Long-Term Economic Impact Group (LEI) concentrated on analysing structural costs and benefits following the transition to the new capital and liquidity ratios, while the Macroeconomic Assessment Group (MAG) assessed the macroeconomic impact of the transition to the stricter solvency and liquidity requirements. The LEI published its final report on 16 August 2010, while the MAG issued an interim report on that same date and its final report on 17 December.

The LEI group considered that a 1 % increase in the capital adequacy requirements would depress GDP by around 0.1 % in real terms. On the other hand, the group’s analysis suggests that an increase in the capital ratios would significantly reduce the risks of a crisis and the associated GDP losses, and would curb the scale of the fluctuations in output outside of crisis periods. The report’s key message is therefore that, within a broad range of increases in the solvency ratios, the positive impact of the reform outweighs the costs, but the net benefit tends to diminish or even become negative beyond a certain limit.

The MAG report identified the length of the transition phase as a decisive factor in the banks’ response to the new solvency and liquidity standards. If that period is short, the banks could decide to reduce their supply of credit in order to boost their solvency ratios and make speedy adjustments to the composition of their assets. Conversely, a longer transitional period would give them more time to adapt by allowing them to reserve part of their profits, issue shares or modify the structure of their liabilities.



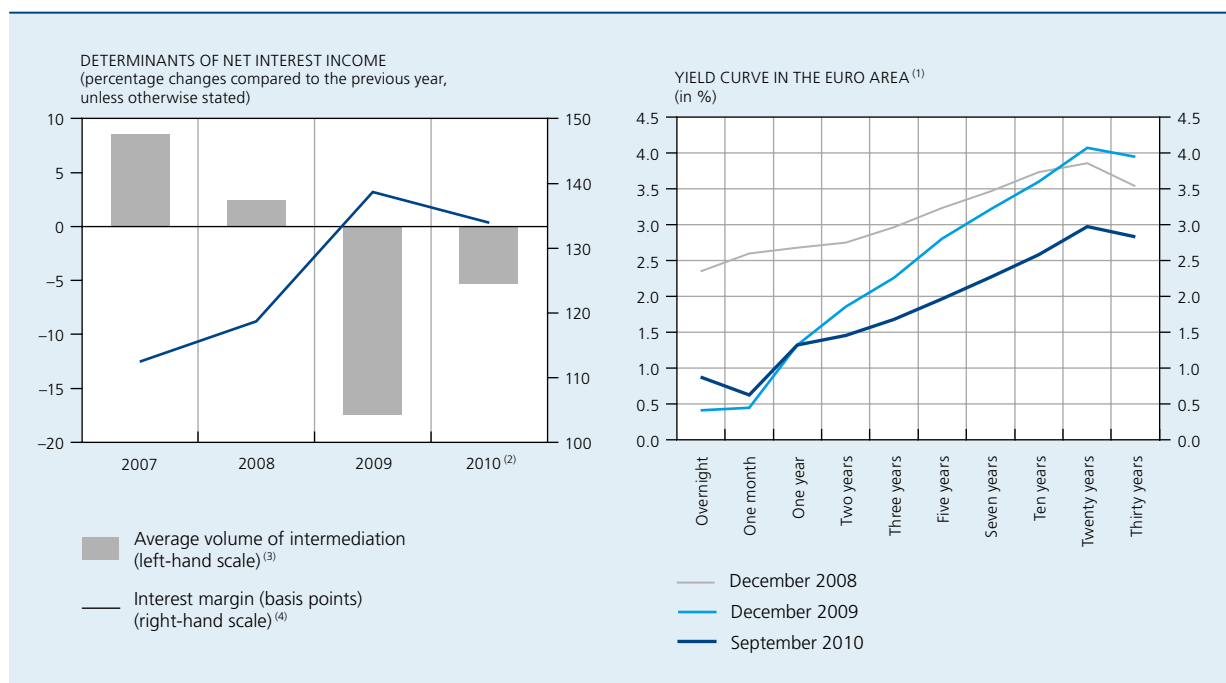
The leaders of the G20 countries took account of this conclusion by the MAG report in providing for a longer transitional period before full implementation of the regulations on capital and liquidity. That will help to attenuate any unintended effects, particularly in relation to the new measures such as the leverage and liquidity ratios. Implementation will begin on 1 January 2013, but the new framework will not be fully operational until 1 January 2019.

Taking account of the period of transition to the new Basel III capital adequacy requirements as approved by the G20 and the level of those requirements at the end of 2009, the MAG considered that the volume of GDP would contract after thirty-five quarters by around 0.2 % compared to the baseline path, equivalent to an annual reduction in the growth rate of 0.03 %.

Since the end of 2008, the solvency ratio of Belgian banks has risen, despite further losses in 2009. The ratio linking Tier 1 capital to risk-weighted assets reached 15 % at the end of September 2010. Capital recognised as Tier 1 consists mainly of issued capital and reserves, including income from current year, plus certain hybrid instruments which totalled € 57.9 and 7.1 billion respectively at the end of September 2010. These were subject to deductions totalling 8.5 billion, relating in particular to goodwill

and substantial stakes in other credit institutions. The increase in the ratio resulted from the combination of different developments in recent years. Initially, the banks' solvency was strongly influenced by the steep decline in their balance sheet total accompanied by a reduction in the average riskiness of assets. Apart from this deliberate risk reduction policy, in return for payment of premiums, banks benefited from government guarantees on certain assets, permitting a decline in the risk weighting

CHART 66 NET INTEREST INCOME AND YIELD CURVE



Sources: Thomson Reuters Datastream, CBFA, NBB.

(1) Structure based on Eonia, Euribor and swap rates.

(2) Annual percentages based on the first nine months.

(3) Average volume of financial assets other than assets recognised as "held for trading", according to the IAS 39 accounting standard.

(4) The interest margin corresponds to the difference between the average implicit interest rate received and paid respectively on the outstanding amount of financial assets and liabilities other than those recognised as "held for trading" according to the IAS 39 accounting standard.

applicable to those assets. Finally, in both 2008 and 2009, they benefited from government capital injections which limited the impact of losses on regulatory capital.

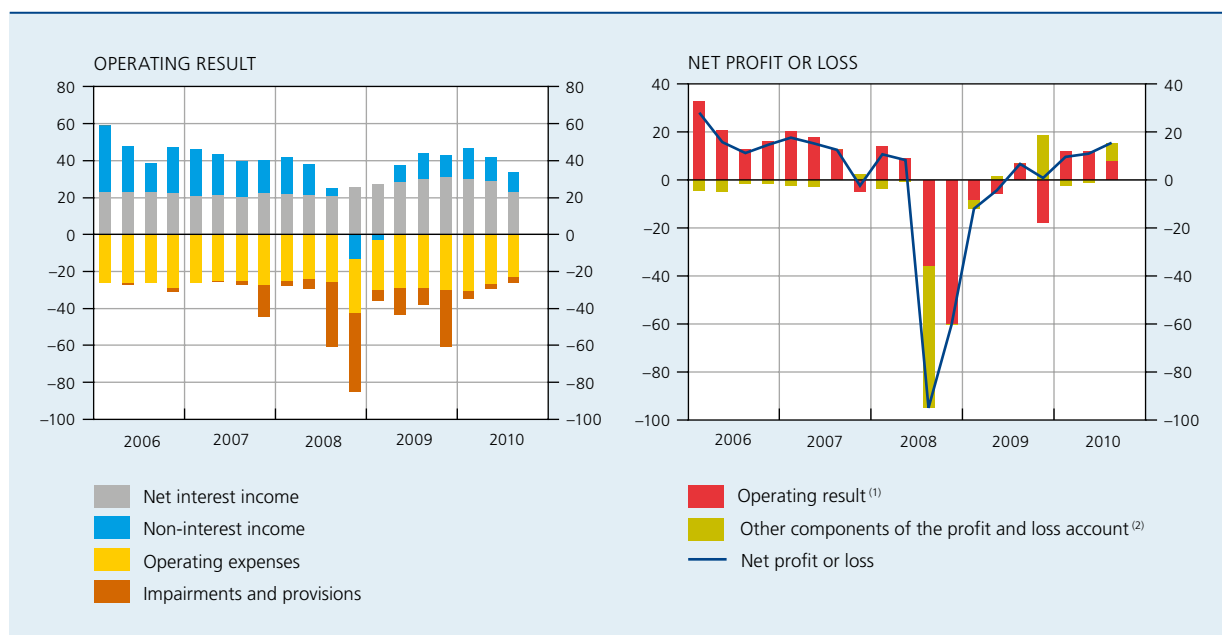
Although profitability improved, it became heavily dependent on net interest income which has been, since the crisis, the main source of income for credit institutions. In the first nine months of 2010, it represented 67 % of banking income, whereas before the crisis there had been a fairly equal balance between interest and non-interest income. The trading book losses and subsequent unwinding of trading book positions and fee-generating activities were major factors in the decline in non-interest income.

The level of net interest income depends mainly on two factors, namely the volume of interest-bearing assets and liabilities and the interest margin, which measures the difference between the average interest rate received on the assets and those paid on the liabilities. The decline in the average volume of interest-bearing assets, which had been particularly steep in 2009, continued during the first nine months of 2010 but at a more modest rate of 5.3 %. Conversely, the upward trend in the interest margin seen in 2008 and particularly in 2009 was reversed in 2010, and more specifically in the third quarter. Three factors contributed to this turnaround.

First, in 2009, the fall in the volume of intermediation was concentrated mainly on low-margin business, essentially interbank transactions, which – owing to a composition effect – led to an increase in the interest margin. That effect ceased to apply in 2010, since the asset reductions mainly concerned lending to non-bank counterparties and debt securities held in portfolio.

Second, the pattern of interest rates was less favourable. At the end of 2008 and in 2009, short-term interest rates had been driven to historically low levels as a result of the cuts in central bank key interest rates. Consequently, the spread between the 30-year interest rate and the overnight rate had risen from 119 basis points at the end of 2008 to 354 basis points twelve months later. Since banks generally borrow short term to lend at longer maturities, and since the fall in short-term interest rates rapidly affected the cost of deposits, this steepening of the yield curve had proved beneficial for maturity transformation activity, therefore propelling the interest margin upwards. However, in 2010 the yield curve flattened, and the differential between 30-year interest rates and the overnight rate declined to 196 basis points at the end of September. This flattening of the yield curve led to a reduction in the margin in 2010, in a context in which the low level of short-term interest rates squeezes the profits that credit

CHART 67 MAIN INCOME AND COST CATEGORIES OF BELGIAN CREDIT INSTITUTIONS
(non-cumulative quarterly data on a consolidated basis, in proportion to total assets, basis points)



Sources: CBFA, NBB.

(1) Comprises net interest income, non-interest income, operating expenses and impairments and provisions.

(2) This item comprises mainly exceptional items and taxes. In the third quarter of 2008, Fortis Bank posted losses of € 9 billion following the sale of its shares in the consortium RFS Holdings B.V. In the fourth quarter of 2009, BNP Paribas Fortis recorded the reversal of downward value adjustments on assets recorded in previous years as deferred tax assets. Finally, in the third quarter of 2010, the increase in the item is due to a change in the methodology of BNP Paribas Fortis consisting in the separate reporting of the results of discontinued operations.

institutions can make on very cheap resources, such as sight deposits.

Finally, to protect themselves against the potential risk of a rapid rise in interest rates, banks resorted to derivative contracts enabling them to collect payments based on short-term interest rates in return for making payments geared to long-term rates.

These risk-hedging transactions did not only contribute to a fall in the interest margin in 2010, but also led to losses, since the long-term interest rates declined in 2010. On the balance sheet, that was reflected in the market value of the derivatives recorded on the liabilities side rising by more than the value of the derivatives recorded on the assets side. The Belgian banks also recorded losses as a result of the rise in the interest rates applied to the sovereign debt of certain euro area Member States.

These losses on derivatives and on certain sovereign bonds depressed the non-interest income. Conversely, this income category was supported by the stabilisation of net commission income and, above all, the positive impact of the decline in interest rates which generated profits for the banks on numerous assets held in the trading portfolio.

Operating expenses continued to fall, a clear sign of the banking groups' efforts to refocus on their core activities both by selling off or scaling down certain branches of activity, and by rationalising certain entities. Operating expenses represented 66 % of banking income in the first nine months of 2010, which is close to the figure of 61 % recorded in 2007, before the crisis.

The movement in impairments and provisions played a key role in the growth of the net profit during the first nine months of 2010. While these impairments had been very substantial both in 2008 – when they had mainly concerned securities – and in 2009 – when loans and receivables were the principal factor – they declined in 2010 to well below the level of the previous two years.

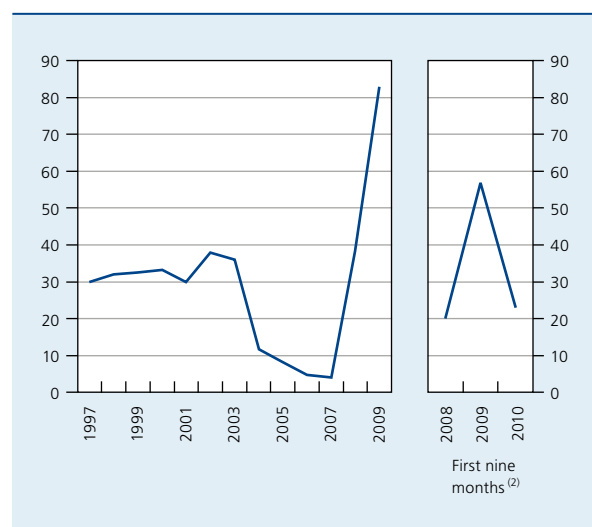
In the first nine months of 2010, loan loss provisions came to only € 1.2 billion, compared to 3.1 billion for the corresponding period of 2009. Expressed as a percentage of total outstanding loans, they came to 23 basis points, i.e. below the level for the same period in 2009, though still slightly above that of 2008.

The sharp fall in provisions for impaired loans may seem surprising in a climate still dominated by the economic crisis. Yet there are several factors which could explain this development. Since the crisis erupted, the banks

have adopted a more cautious attitude towards lending. Belgian households and companies – representing almost 39 % of exposures in the form of loans, and as much as 53 % on the basis of exposures to non-bank counterparties alone – maintained their relatively sound financial position (see chapter 3.3). The high coverage rate for impaired claims – i.e. the percentage of impaired claims covered by provisions – in 2009 may have reduced the need to form new provisions in 2010. Finally, the historically low level of interest rates enabled some customers experiencing difficulties in repaying their loan to refinance their borrowings at lower interest rates, and perhaps for longer periods, and some banks may have used that as an opportunity to delay the recognition of certain loans as being impaired.

The proportion of impaired loans dropped from 2.9 % of total outstanding loans granted by Belgian credit institutions in 2009 to 2.7 % in 2010, and the coverage ratio stabilised at around 40 %. A large share of these impaired claims is found in the portfolio of loans to non-bank private counterparties in foreign countries. Belgian banks hold substantial claims on the non-bank private sector in the United Kingdom, the Netherlands, Ireland, Germany and central and eastern Europe. Exposures to foreign public sectors consist mainly of claims on the Italian, Czech, French, Dutch and German public authorities. Finally, claims on the banking system are concentrated

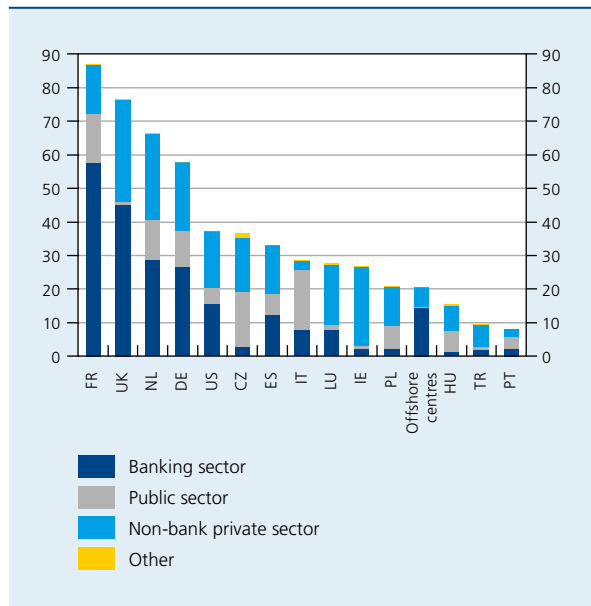
CHART 68 LOAN LOSS RATIO OF BELGIAN CREDIT INSTITUTIONS⁽¹⁾
(consolidated data, basis points)



Sources: CBFA, NBB.

(1) Net flow of new impairments for credit losses expressed as a percentage of the outstanding loans. Data from 2006 onwards relate to the loan loss ratio for the category "Loans and receivables" according to IAS / IFRS.

(2) Annualised.

CHART 69 BELGIAN CREDIT INSTITUTIONS' FOREIGN CLAIMS(data as at the end of September 2010, on a consolidated basis⁽¹⁾, in € billion)

Source : NBB.

(1) Data from the reporting of foreign exposures at the BIS, compiled in accordance with the Belgian accounting standards (Belgian GAAP). The assets are broken down according to the ultimate risk, i.e. after risk transfer.

mainly in France, the Netherlands, the United Kingdom, the United States and Germany. In the case of the first two countries, the exposures include intra-group transactions by Dexia Bank Belgium and ING Belgium respectively with sister entities in other countries, since Dexia and ING are only partly consolidated in the prudential reporting data used to assess the foreign exposures of the Belgian banks.

The nature of the credit risks incurred by the banks was affected by their restructurings, sales and transfers of certain of their activities. These operations mainly concerned exposures to foreign counterparties, as their principal aim was to remedy the vulnerabilities highlighted by the financial crisis. The year 2008 had brought the departure of Fortis Bank Nederland from the consolidation scope of Fortis Bank and a substantial reduction in interbank loans. In 2009 and in 2010, credit institutions continued to restructure their balance sheet in line with the agreements concluded with the EC, acting in its capacity as the competition regulator. They hived off some areas of activity, closed some – mainly interbank – positions and put certain portfolios of loans, debt securities and derivatives in run-off. BNP Paribas Fortis also transferred numerous foreign entities to its parent company, BNP Paribas, while the latter transferred its activities in Luxembourg to BNP

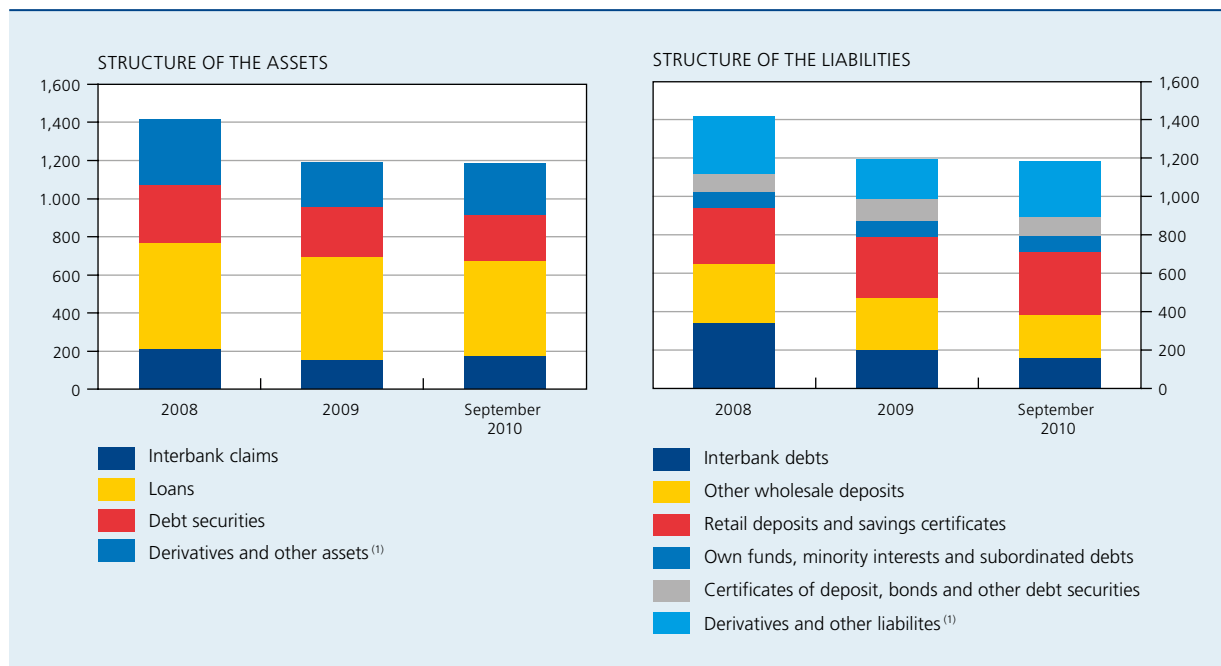
Paribas Fortis. In the near future, the Belgian banks also plan to sell off a significant proportion of their activities, mostly in other countries. In particular, between now and 2013, KBC will float some of the shares in its Czech subsidiary, ČSOB, on the stock exchange and will sell off certain activities, mainly in Belgium and central and eastern Europe, in order to meet the target agreed with the EC of a 25 % reduction in its risk-weighted assets. Dexia Group is also planning the future sale of some international activities, mainly in Spain and Italy. In the future, in connection with the internal restructuring of the BNP group, BNP Paribas Fortis will again transfer activities to its parent company.

These operations affected the balance sheet structure. On the assets side, the geographical distribution of loans and debt securities was modified. The share of exposures to Belgian counterparties has increased steadily over the past three years, reaching 43 % at the end of September 2010. By type of product, the restructuring mainly led to a reduction in interbank loans, down from € 212 billion at the end of 2008 to € 175 billion at the end of September 2010, and a sharp fall in the amount of debt securities held by the banking sector, from € 306 billion at the end of 2008 to € 240 billion at the end of September 2010. However, the main component of this portfolio, namely government bonds, was stable at around € 150 billion. These bonds are made up of 40 % Belgian government bonds and 45 % bonds of other euro area countries (mainly Italy, France, the Netherlands and Germany). The bonds of countries outside the euro area represent 16 % of the total and consist chiefly of bonds issued by central and eastern European countries, particularly the Czech Republic. After having diminished in 2009, loans to non-bank counterparties maintained their decline, principally as a result of the removal of certain entities from the consolidation scope of BNP Paribas Fortis and a change in that institution's reporting methodology, consisting in the separate reporting of assets earmarked to be sold.

On the liabilities side of their balance sheet, banks are endeavouring to rebalance their financing in favour of more stable sources, particularly retail deposits, at the expense of wholesale, especially interbank, funding. Retail deposits, bolstered principally by the success of savings deposits, amounted to € 327 billion at the end of September 2010, outstripping the figure of € 308 billion reached at the end of 2007 despite the sale of certain deposit-generating subsidiaries. The outstanding amount of interbank debts declined steadily from the end of 2008 to the end of September 2010, dropping from 341 to 159 billion, that decline having been speeded up by reduced recourse to the Eurosystem. That is reflected in

CHART 70 ASSETS AND LIABILITIES OF BELGIAN CREDIT INSTITUTIONS

(consolidated end-of-period data, in € billion)



Sources: CBFA, NBB.

(1) Derivatives are recorded at their market value.

the sharp fall in lending to credit institutions on the Bank's balance sheet, down from more than € 41 billion at the end of 2009 to less than 7.5 billion at the end of 2010.

Despite these various reductions, the overall size of the banks' balance sheet remained stable in 2010. That stabilisation was due to derivatives. Following a significant fall in 2009, the market value of derivatives – consisting mainly of interest rate derivatives whose value depends on interest rate movements and their volatility – increased again in the first nine months of 2010, to reach € 182 billion on the assets side and € 203 billion on the liabilities side. These developments also influenced other balance sheet items, especially interbank transactions, a rise in the market value of derivatives increasing the amount of collateral that banks are required to provide for those contracts. That collateral often takes the form of interbank deposits, but may also consist of government bonds. On the assets side, the effect of the change in the market value of derivatives on interbank deposits and loans led to an increase in interbank claims during the first nine months of 2010. There was no corresponding change on the liabilities side, as the increase in cash collateral posted to cover interest rate derivatives was more than offset by a reduction in the banks' underlying recourse to interbank financing.

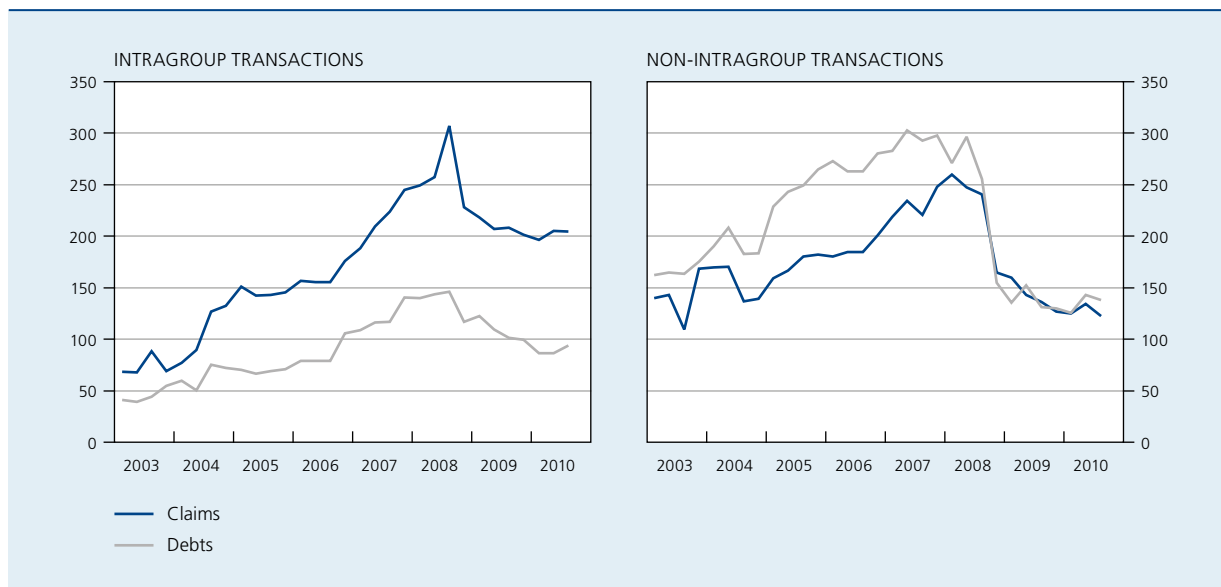
At the end of September 2010, as a result of these various developments, Belgian banks had a net credit position on the interbank market, whereas they had previously recorded a substantial net borrowing position.

This change was obviously made possible by the sale of various assets abroad, which the banks had previously financed via net borrowing on the wholesale market and, in particular on the interbank market. However, credit institutions retained numerous foreign activities which they must continue to finance. For that purpose, they can use part of the savings collected from Belgian households and companies which they recycle in order to finance the activities of their subsidiaries and/or their parent companies abroad.

These intra-group cross-border flows cannot be singled out in the consolidated data, but they are clearly apparent from the data compiled on a territorial basis. The latter make it possible to pick out transactions on the interbank market effected solely by banking entities established in Belgium by distinguishing between transactions with entities in the same group and transactions with other banks. It is evident that the cross-border intragroup interbank net financing granted by Belgian entities has gained in importance in recent years. The difference between the

CHART 71 CROSS-BORDER INTRAGROUP AND NON-INTRAGROUP INTERBANK POSITIONS

(end-of-period data on a territorial basis, in € billion)



Source : NBB.

amounts lent and the amounts borrowed via such transactions expanded from € 102 billion at the end of 2009 to € 111 billion at the end of September 2010. Conversely, the amounts of interbank claims and debts formed by credit institutions based in Belgium outside their own group have been in balance since the end of 2008.

The sharp decline in the banks' recourse to interbank financing was accompanied by a reduction in the use of other wholesale funding sources, especially in the form of deposits by institutional investors or issues of certificates of deposit. The banks made greater use of more funding sources, such as retail deposits. After having increased in 2008 and 2009, the gap between deposits collected from non-bank counterparties and loans granted to the latter stabilised during 2010. However, the gap between total deposits and loans diminished in 2009 and in 2010 because the decline in the banks' interbank transactions on the liabilities side outpaced the decline on the assets side.

To improve their liquidity position, banks also expanded their portfolio of financial assets that can be mobilised to generate liquidity, either via repo transactions or – in the event of tensions on the private market – via central banks. That increase mainly took the form of the expansion in the relative share of government bonds and other securities and loans eligible as collateral with the central banks, assets which are considered to be the most liquid.

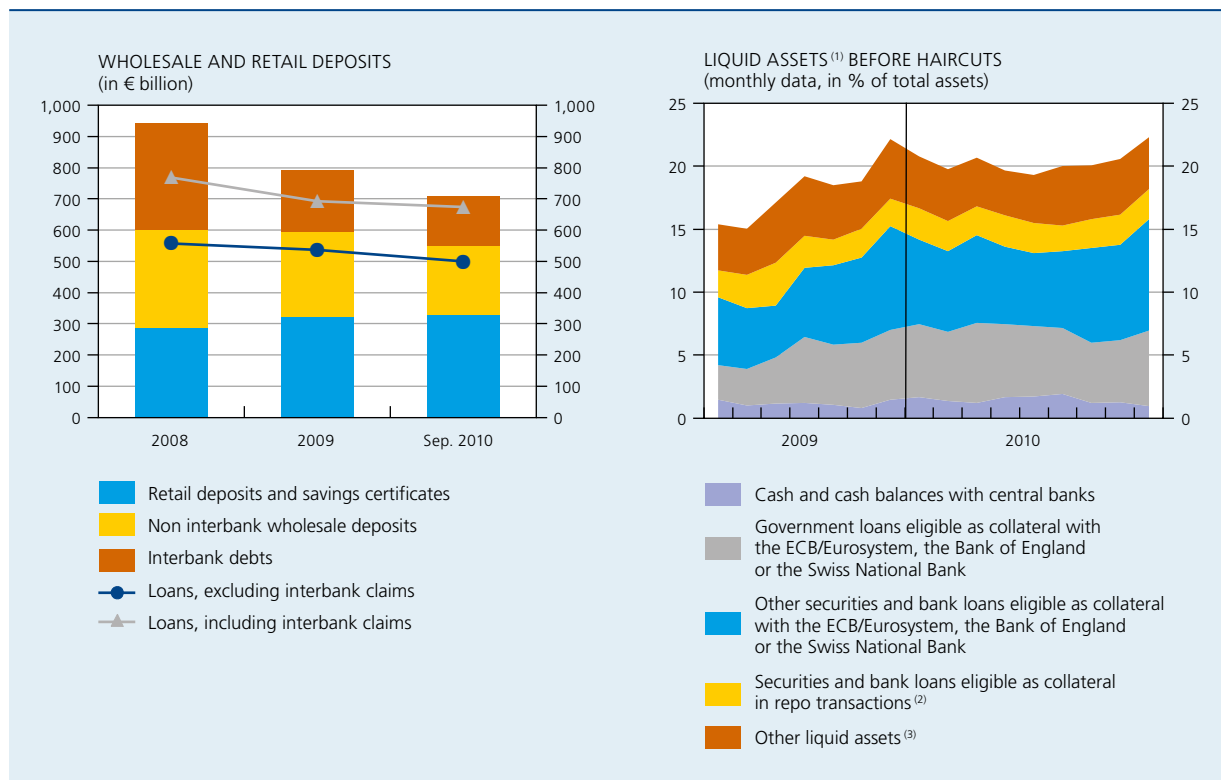
If these are added to the cash holdings and deposits with central banks, the share of these assets in the balance sheet total increased from less than 10% at the end of June 2009, to 15% at the end of 2009 and 16% at the end of September 2010.

Apart from these three categories, credit institutions may also resort to other liquid asset classes consisting in particular of securities and bank loans not eligible with the central banks but nonetheless capable of being mobilised in private repo transactions; these represented 7% of the total assets at the end of September 2010.

In response to the financial crisis and in preparation for the forthcoming entry into effect of the liquidity ratios devised by the Basel Committee, as described in box 8, the Banking, Finance and Insurance Commission (CBFA) adapted its prudential approach to liquidity risk. In September 2010, the CBFA published a circular on the management of this specific risk whereby – with effect from 1 January 2011 – the trial ratio for the liquidity of credit institutions, introduced by a circular dated May 2009, is converted to a regulatory standard. This ratio aims to measure the ability of Belgian credit institutions to withstand a liquidity shock caused by exceptional circumstances, both at the level of the market as a whole and at the level of each institution individually. This ratio can be used to assess whether, after application of haircuts proportionate to the degree of liquidity of the assets, an

CHART 72 LIQUIDITY OF BELGIAN CREDIT INSTITUTIONS

(consolidated end-of-period data)



Sources: CBFA, NBB.

(1) Liquid assets as defined by the CBFA for the calculation of the "stress test" liquidity ratio.

(2) Including additional securities and bank loans which can be mobilised with central banks other than the ECB/Eurosystem, Bank of England or Swiss National Bank.

(3) Including marketable securities and potentially reusable securities received as collateral.

institution holds sufficient liquid assets to cope with the outflow of funds that such a shock is likely to trigger in the ensuing week and month.

3.2.2 Belgian insurance companies

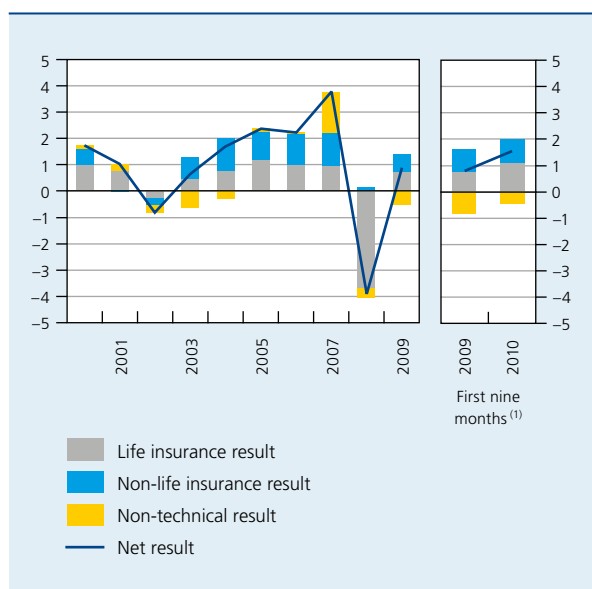
After having suffered substantial losses of € 3.9 billion in 2008 as a result of the severe tensions on the international financial markets following the collapse of Lehman Brothers, the insurance sector in Belgium was back in profit in 2009, recording a net result of € 0.9 billion. The supervisory data compiled on a quarterly basis show that the annualised net profits have continued to rise, reaching € 1.5 billion for the first nine months of 2010, or almost double the figure for the equivalent period in 2009.

The three main components of the profit and loss account of the insurance sector each contributed to the continuing revival in profitability in 2010. The deficit on the non-technical account declined as a result of the growth in net income from the corresponding financial investments

– namely insurance companies' investments not specifically attributed to life and non-life activities – which more than offset the fall in the exceptional result of the sector and the increase in its tax payments. A fairly similar development was seen in non-life insurance activities, where the growth of investment income more than outweighed a slight erosion of the net result on insurance activities as such. The latter is reflected in the renewed rise in the net combined ratio, which compares the total cost of claims and operating expenses to net premium income. During the first nine months of 2010, this inverted measure of the underlying profitability of non-life insurance operations reached its highest level since 2003. While this ratio remained well below the peak levels seen in 2000-2002, it probably increased again in the fourth quarter of 2010 as a result of an increase in claims relating to the floods which affected some regions of the country in November. After 2002, insurance companies restored a better balance between insurance costs and premium income, thanks to an increase in the level of premiums, better cost control and stricter underwriting conditions for certain loss-making insurance products and classes. In response

CHART 73 NET RESULTS OF BELGIAN INSURANCE COMPANIES

(unconsolidated data, in € billion)



Sources: CBFA, NBB.

(1) Amounts annualised on the basis of the quarterly supervisory data reports.

to the recent increase in the combined ratio, premiums have already been adjusted in a number of insurance classes, and that is probably a contributory factor in the 3.3% rise in the value of non-life insurance premiums collected during the first nine months of 2010, compared to the same period in 2009.

On the basis of the developments during the first nine months of 2010, the amount of the life insurance premiums collected by the sector increased, according to estimates, by over 7% in 2010, compared to the 2009 figure, though the latter had admittedly been rather low. During that year, the stronger preference of households for liquidity, against the backdrop of the economic and financial crisis, had in fact eroded demand for life insurance products. Consequently, life insurance premiums had fallen below € 19 billion in 2009, their lowest level since 2003. From 2004 to 2008, the average annual level of life insurance premiums had stood at 21.4 billion.

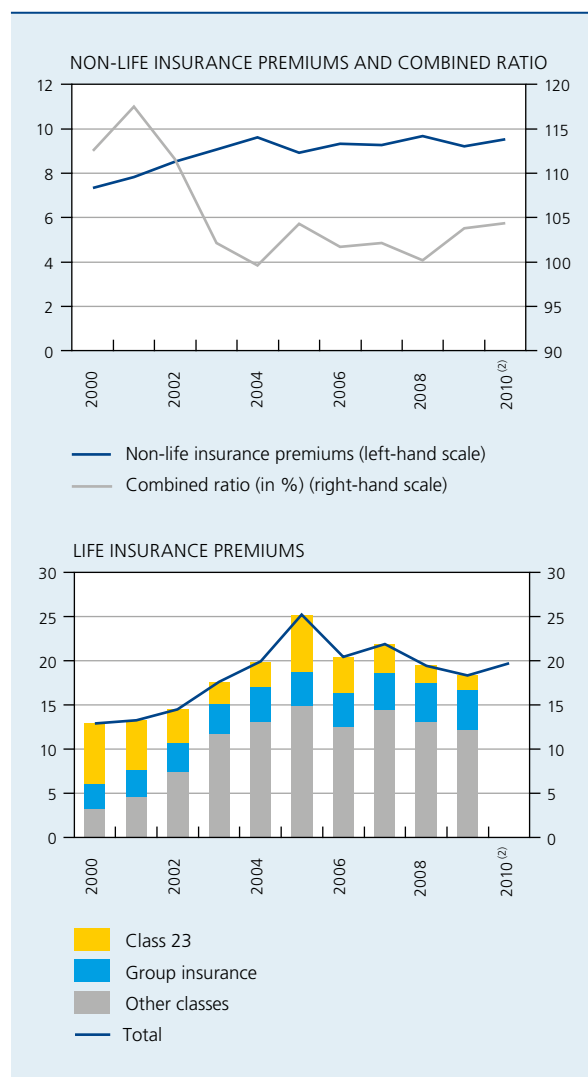
The great majority of life insurance premiums – for both individual and group policies – are collected on contracts under which the insurer bears at least part of the risks relating to financial market developments. Premiums for class 23 contracts, in which the policyholders themselves assume the financial risks on the investments, represented only around 15% of total life insurance premium income in the period 2004-2009. Among the individual

policies, those in class 21 – which offer a guaranteed yield – are still the most common. Although detailed statistics are not yet available for 2010, other information sources tend to confirm that class 21 policies remained by far the main source of new contracts during the year under review.

Unlike non-life insurance premiums, which are generally collected under contracts renewed annually, life insurance premiums are usually received under long-term contracts. In their case, the potential liabilities towards policyholders are far in the future. Since the premiums collected are invested, the investment portfolios built up to cover those future liabilities are much larger in

CHART 74 PREMIUM INCOME AND COMBINED RATIO⁽¹⁾

(unconsolidated data, in € billion, unless otherwise stated)



Sources: CBFA, NBB.

(1) The combined ratio is the ratio between the sum of the cost of claims plus operating expenses and net premium income.

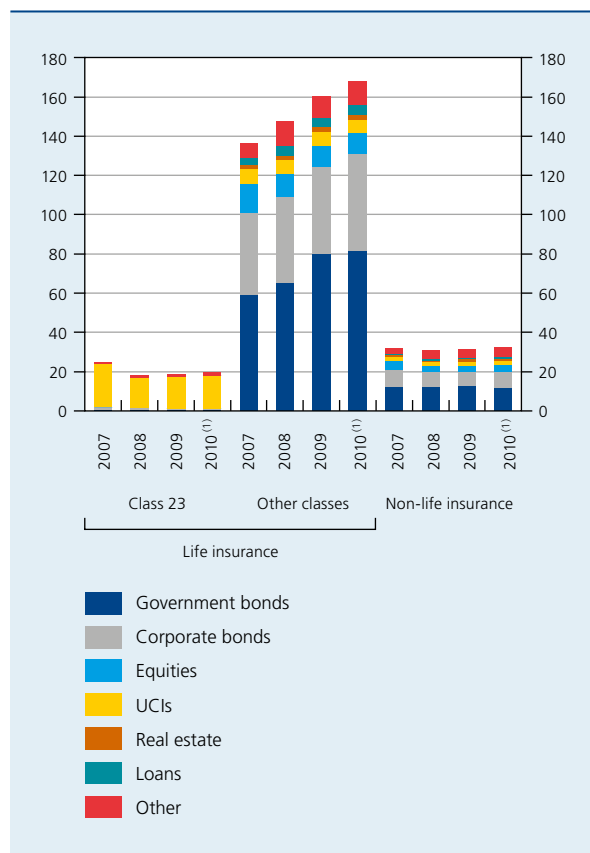
(2) Projections based on data for the first nine months.

the case of life insurance than in non-life insurance. The investment portfolio to cover the liabilities relating to class 23 policies is much smaller than the amount of the financial assets held for the account of policyholders in the other classes. In terms of outstanding amounts, the assets corresponding to those class 23 contracts, which do not imply any market risk for the insurance companies, make up barely 10% of the total assets intended to cover the life insurance liabilities. The breakdown of the assets covering the class 23 contracts shows that they are invested mainly in undertakings for collective investment (UCIs).

This explains why life insurance business is much more sensitive to financial market developments than non-life insurance business, as is evident from the steep decline in the net result on life insurance activities in 2008. In order to manage the associated financial risks, insurance companies have to ensure an asset mix which is geared to the structure and characteristics of their liabilities while establishing a balance between the risks on the asset portfolios and the expected yields. In the case of life insurance policies other than those in class 23, these assets are made up mainly of government and corporate bonds which represented 48.5 and 29.5% respectively of the portfolio at the end of September 2010. In the case of government bonds, that is an increase of around 5% compared to the situation at the end of 2007, even though insurance companies did to some extent reduce the proportion of those bonds during 2010, in response to the rocketing risk premiums applied to a number of sovereign debtors in the euro area. At the end of 2009, the sovereign bond portfolio held by the sector was essentially invested in bonds issued by governments in the euro area, the main sovereign exposures being concentrated on Belgium (around one-third of all government bonds), Italy (almost one-fifth) plus Germany and France (almost one-tenth each). The exposures on a number of peripheral euro area countries were revised downwards in 2010. The percentage of the investment portfolio composed of equities, including shares in associated or non-associated companies, declined from 11% of the total covering assets at the end of 2007 to 6.3% at the end of September 2010.

The insurance sector's exposure to market risk was thus largely concentrated on fixed-income instruments, making it vulnerable to interest rate fluctuations and changes in credit and liquidity risk premiums. The great sensitivity of the insurance companies' portfolio to fluctuations in the prices of fixed-income products is illustrated by the strong variations in the differential between the book value and the market value of the investment portfolio as a whole.

CHART 75 COMPOSITION OF THE COVERING ASSETS PER INSURANCE ACTIVITY
(unconsolidated end-of-period data, in € billion)



Sources: CBFA, NBB.
(1) Situation at the end of September 2010.

At the end of the third quarter of 2008, two weeks after the collapse of Lehman Brothers, insurance companies announced unrealised losses on bonds totalling € 5.8 billion. These substantial losses were due to the steep fall in the prices of certain categories of fixed-income financial instruments at that time, attributable largely to the soaring credit and liquidity risk premiums on bonds with a high rating. While some of these losses had been absorbed in the final quarter of 2008 in the form of substantial value reductions – downward adjustments in the book value of some of these instruments –, the gradual disappearance of the unrealised losses on the insurance companies' bond portfolios was due mainly to the general decline in risk premiums and the sharp fall in yields on the benchmark government bonds in the euro area and for the United States and the United Kingdom. These developments led to the re-emergence of gains on the bond portfolio. Those gains actually became very significant, since at the end of the third quarter of 2010 the positive gap between the market value and the book value of the

TABLE 23 COMPARISON OF THE MARKET VALUE AND BOOK VALUE OF THE INVESTMENT PORTFOLIO OF BELGIAN INSURANCE COMPANIES

(unconsolidated end-of-period data, in € billion)

	Difference between market value and book value									<i>p.m.</i> Book value at the end of the 3rd quarter of 2010
	2008		2009				2010			
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	
Real estate	1.5	1.2	1.2	1.2	1.1	1.1	1.1	1.1	1.1	3.0
Participations in associated companies	0.8	0.8	0.4	0.8	1.0	1.3	1.2	0.9	0.9	17.1
Equities	-1.5	-1.8	-1.6	-0.9	0.2	0.4	0.8	0.1	0.6	11.2
Bonds	-5.8	-1.5	-2.5	-0.3	4.3	3.1	5.7	5.0	8.1	162.0
Other	0.2	0.4	0.4	0.3	0.3	0.3	0.3	0.3	0.4	13.3
Total	-4.8	-0.9	-2.2	1.0	6.9	6.2	9.2	7.4	11.0	206.6

Sources: CBFA, NBB.

bond portfolios reached € 8.1 billion. With the unrealised gains on other assets, the sector posted total unrealised gains of 11 billion on its investment portfolio at the end of September 2010.

The regulatory solvency margin consists mainly of an explicit margin which includes own funds, subordinated debts and certain other balance sheet items, and an implicit margin which, subject to the approval of the supervisory authority (CBFA), comprises certain specific elements, the main one being a part of the unrealised gains on investment portfolios. In parallel with the decline in unrealised gains on the investment portfolio, the relative size of the implicit margin in the regulatory solvency margin diminished throughout 2008, and in the first quarter of 2009. If account is taken of all unrealised gains or losses – most of which are not accepted by the CBFA as part of the implicit margin, in which case they form a hidden reserve – it is evident that the additional solvency reserve resulting from the difference between the market value and the book value of the investment portfolio remained almost constantly negative from the second quarter of 2008 to the first quarter of 2009. Though the hidden reserve subsequently became positive again, thanks to the aforesaid increase in financial asset prices, the experience of 2008 and early 2009 shows that insurance companies cannot count on their hidden reserves to offset substantial losses on their investment portfolios.

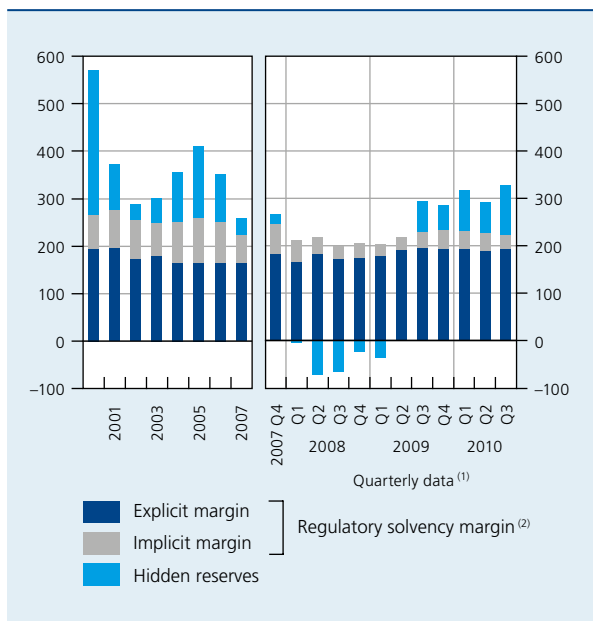
In so far as a large part of the losses incurred in 2008 on financial investments had to be absorbed by the explicit margin, in the form of a decline in the reserves, a number

of insurers were obliged to augment their capital in 2008 and in the first half of 2009. The total subscribed capital and issue premiums recorded a rise of € 5 billion between the end of 2007 and the end of 2009, before stabilising at around 9.7 billion in 2010. This increase in the capital base and the reserving of profits generated in 2009 and in 2010 enabled the sector to maintain an explicit solvency margin at least equal to 165 % of the required minimum for each quarter since the end of 2007, a level of over 190 % having been reached in the second half of 2009 and in the first nine months of 2010.

In accordance with the Solvency I prudential framework – to be replaced from 2013 by an entirely revised and more risk-centred regulatory framework, Solvency II – the calculation of the regulatory solvency margin takes no account of the effect of interest rate reductions on the discounted value of the insurance companies' liabilities to policyholders. In the case of long-term insurance contracts, such as life insurance or invalidity insurance, interest rate changes may have a major impact on the economic value of those policies, since the potential long-term liabilities do not have the same maturity as the associated financial investments. While it is true that, under Solvency I, the prudent valuation rules and restrictions on the investment of the assets compensate for the fact that the liabilities are not valued at market prices, the current regulations on solvency – by taking partial account of unrealised capital gains on financial investments, but not the valuation of the liabilities at market price – still do not accurately reflect the challenges which the low interest rate environment presents for insurance companies.

CHART 76 SOLVENCY MARGIN OF BELGIAN INSURANCE COMPANIES

(unconsolidated data, percentages of the minimum required margin)



Sources: CBFA, NBB.

- (1) The figures reported quarterly are not entirely comparable with the final figures reported annually. In particular, they take no account of any redistribution of profits to shareholders and policyholders.
- (2) This margin is composed of an explicit margin – including the own funds, subordinated debts and certain other balance sheet items – and an implicit margin which, subject to the approval of the CBFA, comprises certain other specific elements, the principal one being a part of the unrealised gains on investment portfolios.

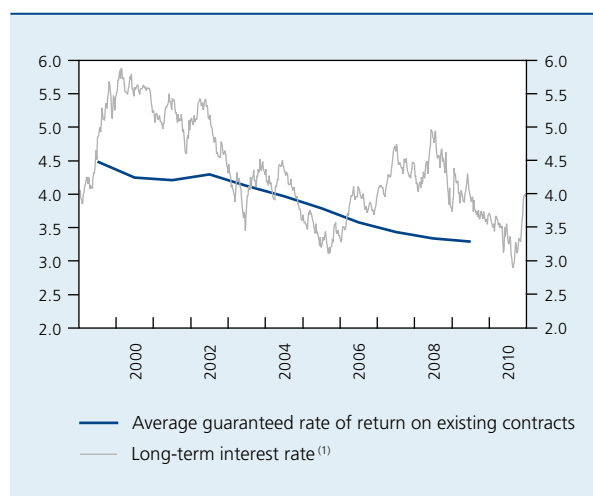
The level of guaranteed returns on life insurance policies is a particularly important parameter for insurance companies when the interest rates on risk-free products fall to very low levels, as happened during the year under review. In the 1990s, insurance companies had tended to offer their customers a guaranteed return of 4.75%, which at that time – and up to the end of June 1999 – was the statutory ceiling on the guaranteed minimum rate of return on individual life insurance contracts. In June 1999, a change in the law reduced that ceiling to 3.75%. In the case of exit from a supplementary pension plan, the current legislation requires institutions to guarantee a minimum return of 3.25% on employers' contributions and 3.75% on personal contributions. For competition reasons, insurance companies offer the same minimum return conditions for group insurance contracts.

The profitability of insurance contracts guaranteeing such returns was eroded when long-term interest rates began to drop below those levels. The sector has gradually modified that adverse structure by marketing contracts offering guaranteed yields which are more in line with risk-free interest rates and containing clauses which provide for

revision on the basis of changing market conditions. These measures contributed to a reduction in the guaranteed average return on class 21 contracts: it declined from 4.5% at the end of 1999 to 3.3% ten years later. This fall in the guaranteed average return on individual life insurance contracts was seen throughout the sector, since the proportion – measured by the volume of the technical reserves in class 21 – guaranteeing an average return of 4% or more dropped from 75% at the end of 2000 to less than 2% in 2008. At the end of 2009, over 80% of the sector's technical reserves were held by insurance companies offering a guaranteed average return of 3.5% or less.

The old contracts offering high guaranteed yields still represent a substantial and constantly growing amount of liabilities. The life insurance reserves associated with guaranteed yields of 4.75, 4.5, 3.75 and 3.5% came to €33.1 billion at the end of 2009. Since these returns are usually associated with contracts concluded a long time ago – on which premiums are nevertheless still being collected – the recent increase in life insurance reserves essentially concerned policies offering a lower guaranteed yield (including a large number of policies providing only a capital guarantee) plus a larger range of profit-sharing rates and mechanisms. However, having regard to the conditions prevailing up to the late 1990s, the biggest reduction in market risk for insurance companies resulted from the introduction of greater flexibility in the determination of the guaranteed yield. Whereas in the 1990s, the guaranteed yield prevailing at the time

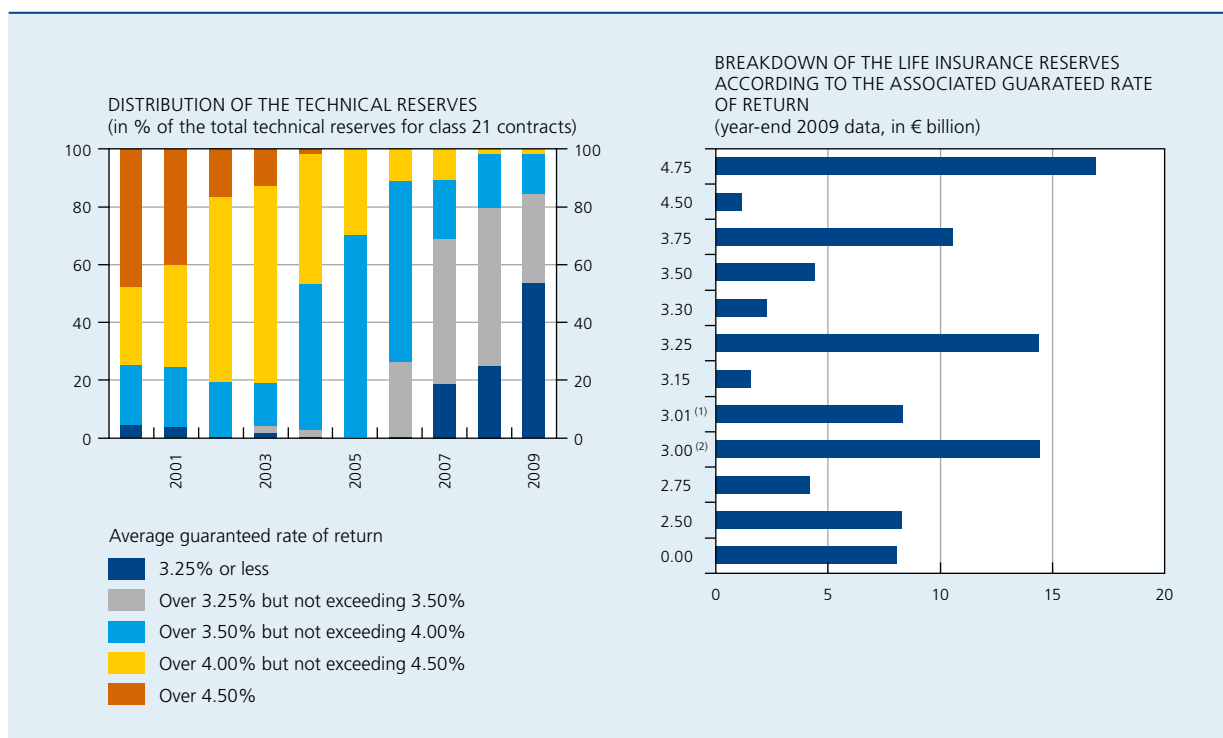
CHART 77 LONG-TERM INTEREST RATE AND GUARANTEED RATE OF RETURN ON CLASS 21 CONTRACTS



Sources: Thomson Reuters Datastream, CBFA, NBB.

- (1) Yield on the secondary market in ten-year Belgian government loans (OLOs) (weekly data).

CHART 78 DISTRIBUTION OF CLASS 21 LIABILITIES



Sources: CBFA, NBB.

(1) Outstanding amount of life insurance reserves guaranteeing a return different from those shown in the chart but with an average guaranteed return of 3.01%.

(2) Outstanding amount of life insurance reserves guaranteeing a 3% return.

of conclusion of the contract generally also applied to all future premiums, most of the contracts concluded during the past decade have only guaranteed the yield prevailing at the time of collection of the premium, it being possible to adjust that yield in line with changing market conditions. In return for this increased flexibility for insurers, most of these new contracts also offer the policyholders more flexibility, allowing them to terminate their policies more easily and without incurring heavy penalties. That exposes the insurance companies to a greater risk of cancellation, especially if interest rates rise strongly. In those circumstances, they would face a choice between increasing the yield on their contracts or accepting a

reduction in their volume of business; in both cases, that would impair their profitability.

In order to anticipate possible future losses on guaranteed-return contracts due to the low level of interest rates, insurance companies have to form an additional provision for cases in which the guaranteed return is 10 basis points higher than 80% of the average yield on ten-year government bonds on the secondary market over the past five years; when this Report went to press, that threshold was just below 3.3%. Insurance companies can spread the amounts to be allocated to this provision over a maximum of ten years.

3.3 Financial assets and liabilities of the Belgian private sector

3.3.1 Total financial assets and liabilities of the Belgian economy

A country's overall financial situation is determined by the total outstanding amount of the financial assets and liabilities of the various domestic sectors. Although those amounts may sometimes vary considerably from one year to the next, owing to the formation of new assets or liabilities, or price fluctuations affecting the outstanding amounts, it is possible to deduce a number of structural characteristics relating to Belgium's financial situation.

Individuals, who had net financial assets estimated at € 717 billion at the end of September 2010, form the only

net creditor sector in the Belgian economy. This means that households are directly or indirectly financing the other resident sectors and the rest of the world. At the end of September 2010, non-financial corporations had the highest net liabilities. However, it should be pointed out that their gross liabilities consist mainly of shares or other equity – representing approximately two-thirds in the period under review – the value of which depends on stock market prices. Thus, taking account of the stock market recovery and the associated new share issues, the net liabilities of non-financial corporations continued to expand in 2010, rising to € 371 billion. At the end of September, the net liabilities of general government amounted to around € 284 billion.

TABLE 24 FINANCIAL ASSETS AND LIABILITIES BY SECTOR⁽¹⁾
(data at the end of September 2010, in € billion, unless otherwise stated)

	Total				Towards the rest of the world			
	Assets	Liabilities	Net financial assets		Assets	Liabilities	Net financial assets	
			December 2009	September 2010			December 2009	September 2010
Individuals	909	192	690	717	135	–	128	135
Non-financial corporations	1,506	1,877	–313	–371	509	690	–131	–181
General government	112	396	–272	–284	10	199	–178	–189
Financial corporations ⁽²⁾	1,785	1,801	–18	–16	885	605	269	280
<i>p.m. Total of domestic sectors</i>	<i>4,312</i>	<i>4,267</i>	<i>88</i>	<i>45</i>	<i>1,539</i>	<i>1,493</i>	<i>88</i>	<i>45</i>
<i>Idem, in % of GDP</i>	<i>1,228</i>	<i>1,215</i>	<i>25.9</i>	<i>12.9</i>	<i>438</i>	<i>425</i>	<i>25.9</i>	<i>12.9</i>

Source: NBB.

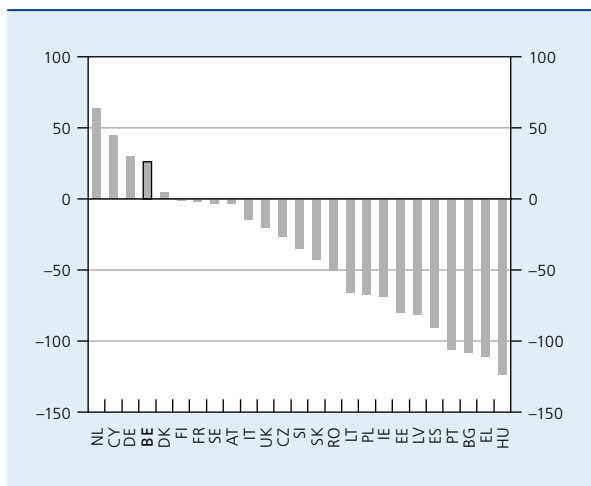
(1) Excluding monetary gold and special drawing rights.

(2) Financial corporations consist mainly of monetary financial institutions (the NBB, credit institutions and monetary UCIs) and institutional investors (non-monetary UCIs, insurance companies and occupational pension institutions). In accordance with the statistical conventions governing the compilation of the financial accounts, the net assets of financial corporations are generally very limited.

CHART 79

NET CREDITOR POSITION OF THE EU COUNTRIES⁽¹⁾

(year-end 2009 data, unless otherwise stated; in % of GDP)



Sources: EC, NBB.

(1) Difference between the outstanding amount of financial assets and liabilities. No data are available for Luxembourg and Malta. 2005 data for Cyprus, and 2008 data for the Czech Republic and Bulgaria.

As stated in chapter 2.3, Belgium is a net lender to the rest of the world: its positive net external position, resulting from the accumulation of current account surpluses on the balance of payments over the years, stood at € 45 billion at the end of September 2010.

The financial accounts also permit identification of assets and liabilities formed directly vis-à-vis other countries. They show that Belgium's positive net external position is attributable to individuals and to financial corporations, as they hold substantial net assets abroad totalling € 135 and € 280 billion respectively. The large percentage of claims and liabilities on the rest of the world in both total assets and total liabilities also illustrates the degree of financial integration of the Belgian economy.

An international comparison reveals that Belgium's external position is quite distinctive in relation to other EU Member States. Thus, at the end of 2009, in common with the Netherlands and Germany, Belgium was among the minority of European countries which were net lenders to the rest of the world. This favourable ranking is due essentially to individuals who had the highest net financial assets in the EU as a percentage of GDP. Conversely, a number of euro area countries, including Greece, Portugal, Spain and Ireland, were at the bottom of the ranking. In their case, the government's net debt is not adequately counterbalanced by the net financial assets of the private sector. That situation reflects the accumulation of external current deficits and, in most cases, a structural

lack of competitiveness in those countries. As a result, they have become structurally dependent on the rest of the world – primarily on the other euro area countries – for the financing of their overall debt, and they present a bigger potential risk to global financial stability.

In the current circumstances in which debt levels are attracting greater attention, the statistics on the net creditor position are among the indicators which can identify countries in a fragile financial situation. Overall, Belgium has a sound financial position despite the high level of its public debt.

Even though the balance of payments recorded another current account surplus in 2010, Belgium's net creditor position declined from 25.9% at the end of 2009 to 12.9% of GDP at the end of September 2010. That fall was due entirely to valuation effects, essentially at the level of non-financial corporations. During the first nine months of the year under review, the formation of financial assets by the domestic sectors in fact exceeded their new liabilities by € 6.9 billion. It was principally non-financial corporations and households that formed new net assets, amounting to 13.3 and 11.5 billion respectively. In contrast, the government increased its net liabilities by 15.4 billion.

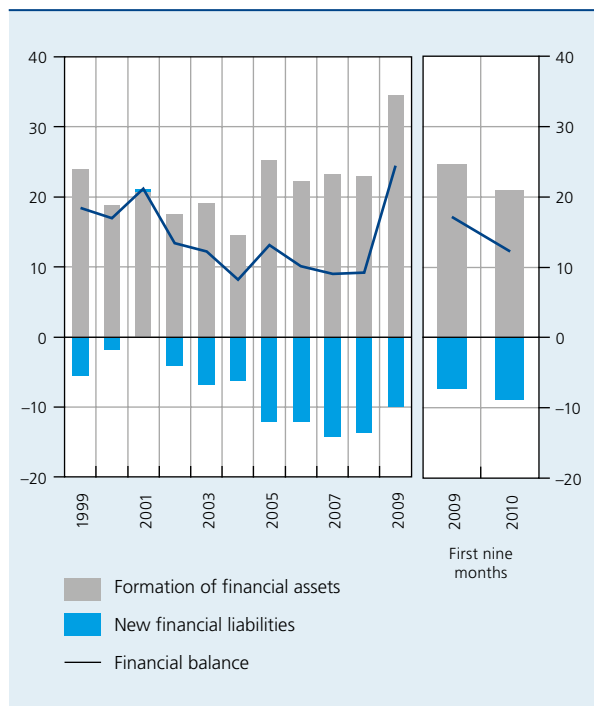
3.3.2 Households

In the first nine months of the year under review, households formed financial assets totalling € 20.3 billion, or slightly less than in the corresponding period of 2009 when growth of 24.6 billion had been recorded. Similarly, over the same period, the financial liabilities of households grew by 8.8 billion, against 7.4 billion in the previous year. This picture is due, on the assets side, to increased investment by households in low-risk assets and, on the liabilities side, to the stronger growth of mortgage loans. They resulted in a financial surplus of € 11.5 billion, whereas the figure had been 17.2 billion in the same period in 2009. Since investment in new housing construction or improvements to existing housing declined in 2010, this development only reflects the fall in the household savings ratio. As an annual average, that ratio came to 17.2% in 2010, whereas it had been 18.3% in 2009.

Formation of financial assets

The movement in the short-term assets of households was similar in structure to that in 2009. During the first nine months of 2010, savings in the form of sight deposits

CHART 80 FINANCIAL TRANSACTIONS OF HOUSEHOLDS
(in € billion)



Source: NBB.

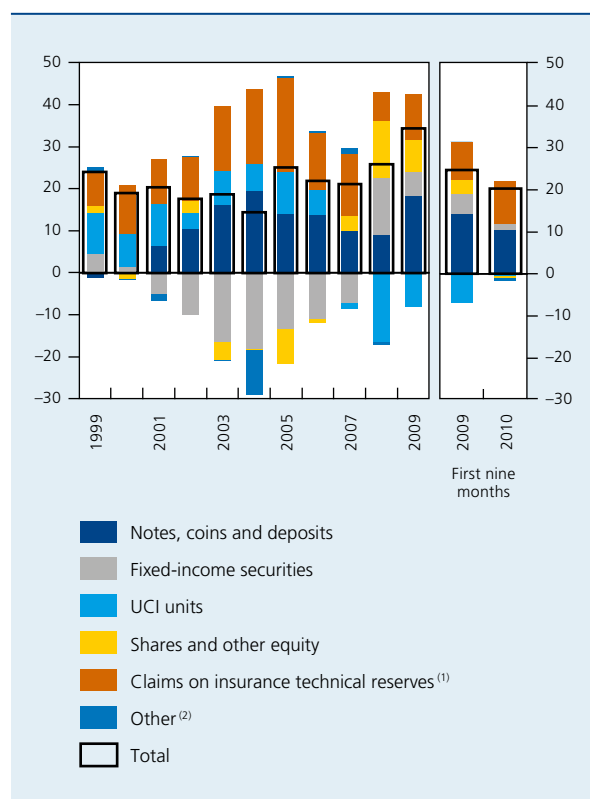
and cash grew by € 2.1 billion, while those in the form of regulated savings deposits expanded by 16.4 billion.

The outstanding amount of household savings deposits therefore continued to exceed what were already historically high levels. On the one hand, this instrument gained the full benefit of a number of its associated advantages: its liquidity – which individuals value in times of great uncertainty –, exemption from the withholding tax on movable property applicable to it (up to a maximum of € 1,730 in interest – 2010 tax year), and the deposit guarantee which includes this product in its scope, making it an instrument virtually free of credit risk. Also, the interest rate differential between term deposits – after deduction of the withholding tax – and savings deposits had become negligible, or even negative: the interest rate on term deposits, which is linked more closely to the market than the rate on savings deposits, in fact continued to fall owing to the reduction in the Eurosystem's central key interest rate and interbank rates. This situation probably influenced the preferences of households, causing them to choose savings accounts for their investment, rather than term accounts (at up to one year), the outstanding amount of which continued to fall by € 8.3 billion.

The success of savings deposits is also due to the marked decline in enthusiasm for long-term securities, compared to the previous year. On a net basis, households acquired fixed-income securities with a maturity of over one year for a total of € 1.8 billion during the first nine months of 2010, against 6.1 billion in the same period of 2009. After seven years of net sales, households began to rebuild their fixed-income securities portfolio by the second quarter of 2008. That move persisted in the two ensuing years, but steadily became more moderate in line with the fall in the benchmark long-term yields.

The acquisition of fixed-income financial assets seems to be influenced mainly by the level of long-term interest rates, and by expectations regarding those rates: net purchases are concentrated on periods when long-term yields are high or the interest rate cycle has entered a downward phase. The yield curve does not appear to have a decisive influence: households reduced their deposits during the few periods featuring a flat or inverted yield curve, since they then expected long-term yields to decline.

CHART 81 FORMATION OF FINANCIAL ASSETS BY HOUSEHOLDS
(in € billion)



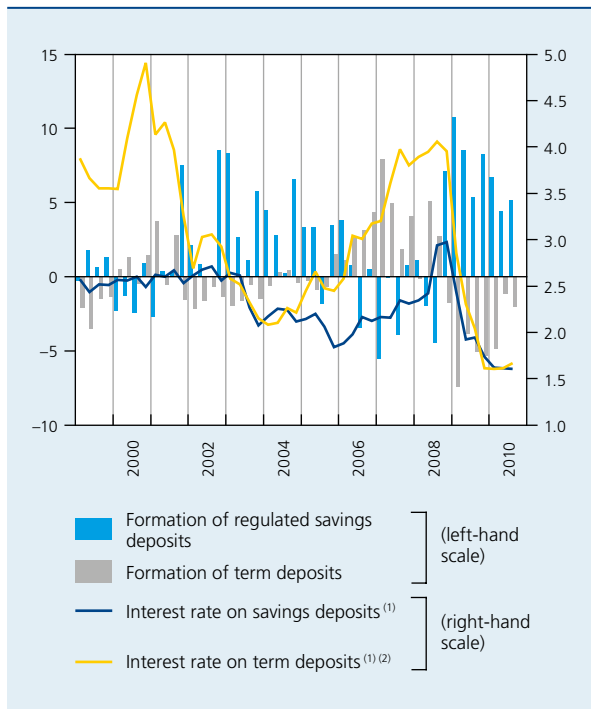
Source: NBB.

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

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

CHART 82 REGULATED SAVINGS DEPOSITS AND TERM DEPOSITS OF HOUSEHOLDS

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



Source : NBB.

(1) Implicit interest rate as indicated by the profit and loss accounts of credit institutions; quarterly averages.

(2) Less the 15 % withholding tax.

Whereas in 2009 households had mainly acquired savings notes at over one year issued by Belgian credit institutions and had disposed of bonds held on other countries (euro area and countries outside Europe), the opposite trend was seen in the first nine months of the year under review. During this period, the bonds which households bought were in fact issued almost exclusively by other countries, for a total of € 5.5 billion.

The State note – issued by the Treasury and specifically intended for individuals – represents only a marginal share of household savings, as illustrated once again by the result of subscriptions in 2010: individuals subscribed to State notes totalling € 0.2 billion, compared to 0.7 billion in 2009; these consisted exclusively of securities with a maturity of five or eight years. This limited success was due to the low yields offered by this type of securities and the preference for more liquid investments, pending a more profitable alternative.

Households sold more listed shares than they bought. Net investment flows in these instruments were € 1.7 billion negative in the first nine months of the year, whereas

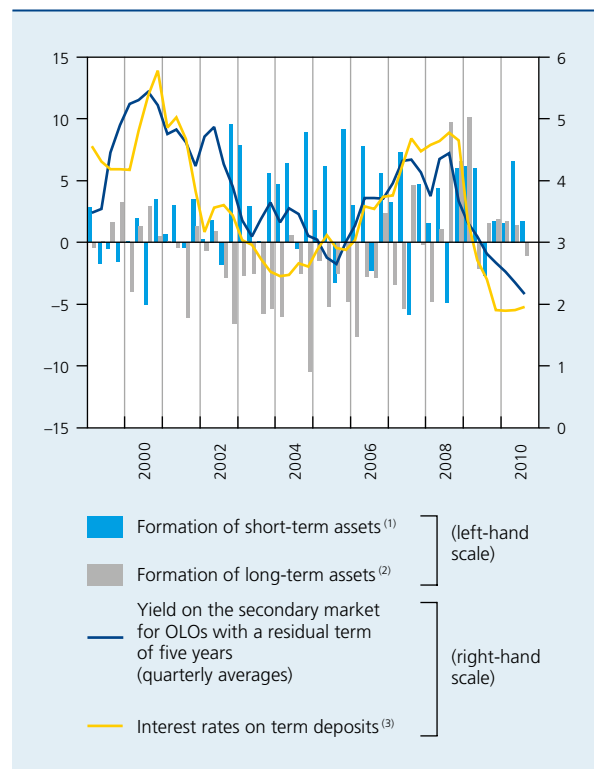
purchases had totalled 2.1 billion during the corresponding period in 2009. This was due mainly to net sales of shares on the stock markets during the first half of 2010. On the other hand, the movement was reversed in the third quarter.

Net sales of UCI units had been substantial in 2008 and in 2009, owing to the stock market collapse and the fiscal measures specifically affecting bond funds and certain mixed funds which capitalise their income. During the first nine months of 2010, this movement moderated, as households effected net sales of UCI units totalling € 0.4 billion. These sales solely concerned Belgian UCI units, whereas acquisitions of foreign units continued to rise. It was UCIs with capital protection and equity UCIs that suffered net withdrawals, while mixed UCIs and funds of funds recorded purchases.

Households invested part of the savings built up in the first three quarters of 2010 in insurance companies and occupational pension institutions, for a total of

CHART 83 FORMATION OF FINANCIAL ASSETS BY HOUSEHOLDS AND SHORT-TERM AND LONG-TERM YIELDS

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



Source : NBB.

(1) Short-term assets other than shares and financial derivatives.

(2) Long-term assets other than shares and financial derivatives.

(3) Implicit interest rate derived from the profit and loss account of credit institutions; quarterly averages.

€10.2 billion, against 8.9 billion in the corresponding period of the previous year. Certain guaranteed-yield products (class 21 products) benefited from high contractual interest rates, and therefore stood out from fixed-income securities on which the remuneration is in line with the market.

New financial liabilities

The bulk of the new financial liabilities of households took the form of mortgage loans. In the first nine months of 2010, those loans increased by €8.4 billion, exceeding the figure for the corresponding period of 2009 when growth had totalled 6.6 billion. This recovery occurred in a context in which credit institutions were charging lower interest rates while keeping their other lending criteria unchanged, following the moderate tightening seen at the end of 2008 and in the first half of 2009.

Demand for mortgage loans was underpinned by the continuing decline followed by stabilisation of the interest rates on these borrowings. The downward trend continued practically throughout the year in the case of semi-fixed or fixed interest rates. Conversely, the other types of rate (variable with the rate initially fixed for one year, and interest rate initially fixed for between one and five years) stabilised during the year before edging upwards at the end of the period.

The narrowing of the gap between fixed and variable interest rates explains why more fixed-rate or semi fixed-rate contracts were concluded in 2010 in comparison with the previous year. At the end of December, those contracts accounted for 84 % of the total number of new contracts concluded.

According to the results of the Eurosystem's bank lending survey, credit institutions kept their mortgage loan criteria unchanged in 2010. This stability applied particularly to loan-to-value ratios, collateral requirements and maximum loan terms, whereas the margins on loans compared to the benchmark interest rates, which had risen significantly during 2008, were reduced from the second half of 2009. At the same time, the banks considered that demand for home loans had expanded strongly from the second quarter of 2010.

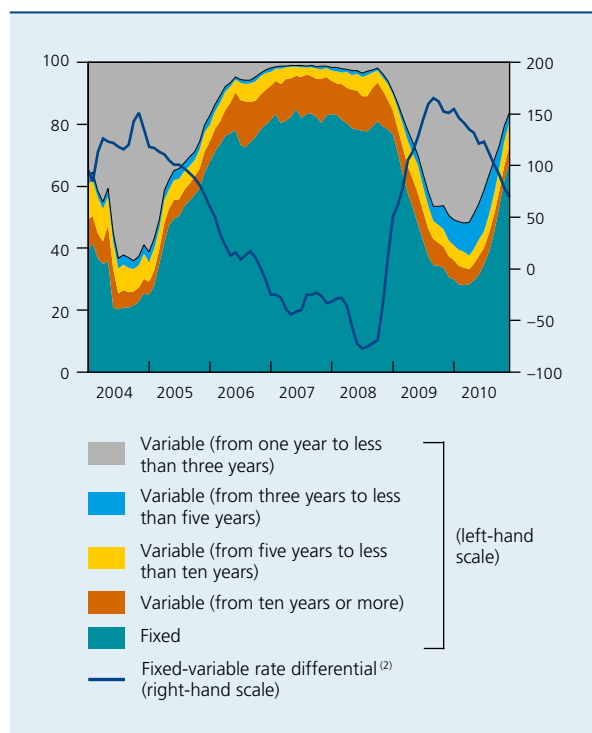
Whereas the average amount of new mortgage loans had totalled €103,300 in 2007, it maintained a gradual decline in 2010, from €92,900 in 2009 to €92,800. Although, following a slight fall in the previous year, property prices increased in 2010, the effect of that rise was nevertheless entirely offset by the growing proportion of loans for improvements to existing housing; the average amount of such loans is considerably smaller than that of loans granted for the purchase of a house or apartment.

Another factor supporting demand for mortgage loans may have been the temporary reduction in the rate of VAT to 6 %, which came into effect on 1 January 2009 and expired on 31 December 2010, applicable to work on the construction or completion of new housing, with a cumulative basis of assessment of up to €50,000 excluding VAT, so long as the building permit application was submitted before 1 April 2010.

Finally, at the end of the year, demand for mortgage loans was reinforced by the announcement that, from 1 January 2011, registration fees would no longer be payable on the value of the land included in the purchase price of a new property, and that those fees would be replaced by VAT. From that date, a new regime has

CHART 84 RATE DIFFERENTIAL AND BREAKDOWN OF NEW MORTGAGE CONTRACTS BY TYPE OF INTEREST RATE ⁽¹⁾

(monthly data; percentages of the total number, unless otherwise stated)



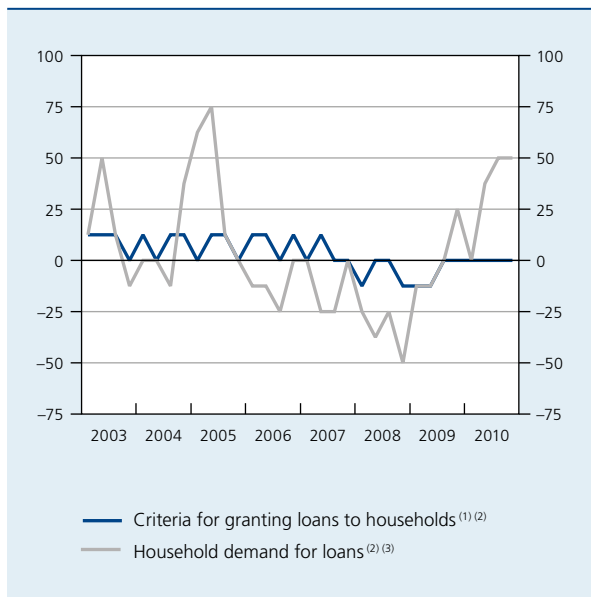
Sources: PLU, NBB.

(1) For the variable rates, the term mentioned corresponds to the initial fixed-rate period.

(2) Difference in basis points between the interest rate on new loans granted to households with an initial fixed-rate period of over ten years and the interest rate on new loans with an initial fixed-rate period of one year.

CHART 85 RESULTS OF THE EUROSYSTEM'S BANK LENDING SURVEY: MORTGAGE LOAN SUPPLY AND DEMAND IN BELGIUM

(quarterly data)



Source: NBB.

- (1) Weighted net percentages of responses by credit institutions to the Eurosystem's bank lending survey indicating the degree to which lending criteria were eased or tightened (-).
- (2) The responses are weighted according to the distance from a "neutral" response: mention of a "considerable" change in the lending criteria or demand for loans is accorded double the weighting of the mention of a "slight" change.
- (3) Weighted net percentages of responses by credit institutions to the Eurosystem's bank lending survey indicating the degree of increase or decrease (-) in demand for credit.

applied to such purchases: 21% VAT is payable on both the land and the new building, whereas up to 31 December 2010 the land was only subject to registration fees of 12.5% in Wallonia and Brussels, or 10% in Flanders. These measures increased the tax bill on the purchase of a new property, and that probably speeded up the conclusion of some contracts during the second half of 2010.

The Central Individual Credit Register statistics show that the number of non-regularised payment defaults remained stable at 1.1% of the total number of registered mortgage loans. Conversely, the average level of arrears and amounts due continued to rise, maintaining the trend begun in 2009.

During the first nine months of the year, €0.4 billion was granted in the form of new consumer credit, down slightly against the previous year's figure of 0.6 billion. In regard to total credit to households excluding mortgage loans, the proportion of non-regularised payment

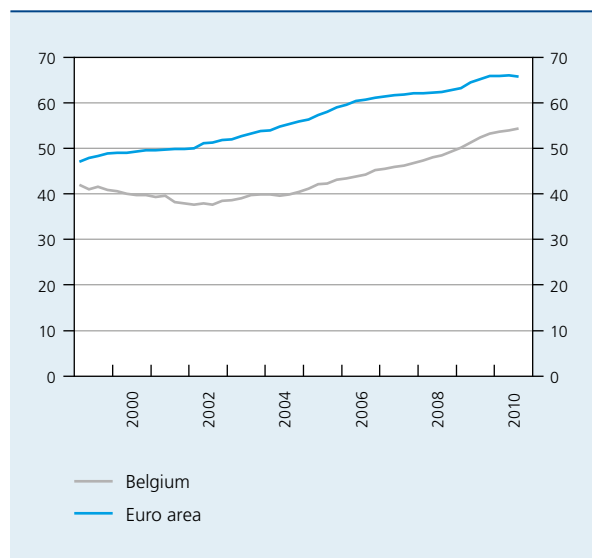
defaults showed a moderate increase. The rise in defaults is attributable mainly to hire purchase and credit lines.

Taking all loans together, 8,253,320 contracts were recorded by the Central Individual Credit Register at the end of December 2010, of which 448,725 presented a non-regularised default, representing 5.4% of the contracts.

Finally, household debt calculated on the basis of home loans and consumer credit continued to rise in 2010, but at a steadily decelerating pace. Whereas it had totalled 50.2% of GDP at the beginning of 2009, it reached 54.4% at the end of September 2010, an all-time record. Nonetheless, that is well below the figure for the euro area, where households recorded debts amounting to 65.8% of GDP at the end of September 2010. In the past ten years, the debt of households in the euro area was rising constantly, before stabilising at the end of the period. In Belgium, while individuals had tended to reduce their debt levels in the early 2000s, from mid-2004 to 2008 their debts grew at a rate comparable to that for the euro area as a whole, but outpaced it thereafter. The rise in Belgian household debt ratios from the end of 2004 coincided with an acceleration in the pace of price increases on the property market, and was subsequently sustained by the advantageous tax rules applied to mortgage loans concluded from 2005 onwards.

CHART 86 HOUSEHOLD DEBT⁽¹⁾

(end-of-quarter data, in % of GDP)



Sources: ECB, NBB.

- (1) All credit granted to individuals.

Box 9 – Total household wealth

The outstanding amount of the financial assets of households increased from € 873 billion at the end of 2009 to 909 billion at the end of September 2010. In 2009, a positive valuation effect of € 47.7 billion had enabled households to recoup part of the losses incurred in 2008 as a result of the financial crisis. That movement continued, but on a smaller scale, in 2010, with households making gains of 16 billion, attributable mainly to the rising stock markets.

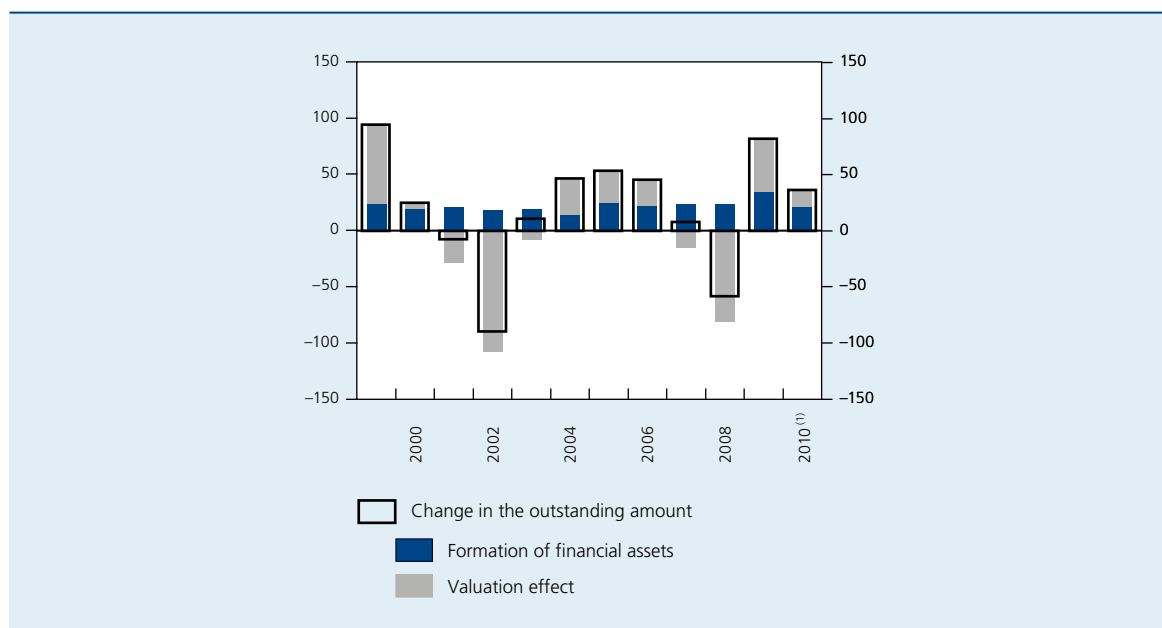
The value of the property owned by households increased in 2010, reaching € 1,075 billion at the end of September compared to 1,028 billion at the end of 2009. The property portfolio is estimated partly on the number of existing homes recorded by the Land Registry, and partly on the average price of property transactions on the secondary market. The housing stock continued to expand in 2010, though at a modest pace: in the third quarter, the number of homes was estimated to be 1.1 % up against the corresponding quarter in 2009. In view of this meagre growth, the rise in property assets essentially reflects the rise in property prices which, on the basis of the transactions effected, is estimated at around 5.6 % for houses and apartments over this period. This recovery, following a sluggish year on the property market, was due to strengthening demand for housing.

The financial liabilities of households, consisting mainly of mortgage loans, also continued to expand, totalling € 192 billion at the end of September 2010, against 183 billion at the end of 2009. Compared to the corresponding quarter of the previous year, that represents 6.4 % growth, whereas in the years 2000 to 2009 growth had averaged 6.1 % per annum.

In 2010, in view of the respective movement in their assets and financial liabilities, the total net assets of households continued the rise which had set in at the beginning of 2009. Whereas the total at the end of 2009 already came

BREAKDOWN OF THE CHANGE IN THE OUTSTANDING AMOUNT OF FINANCIAL ASSETS HELD BY HOUSEHOLDS

(in € billion)



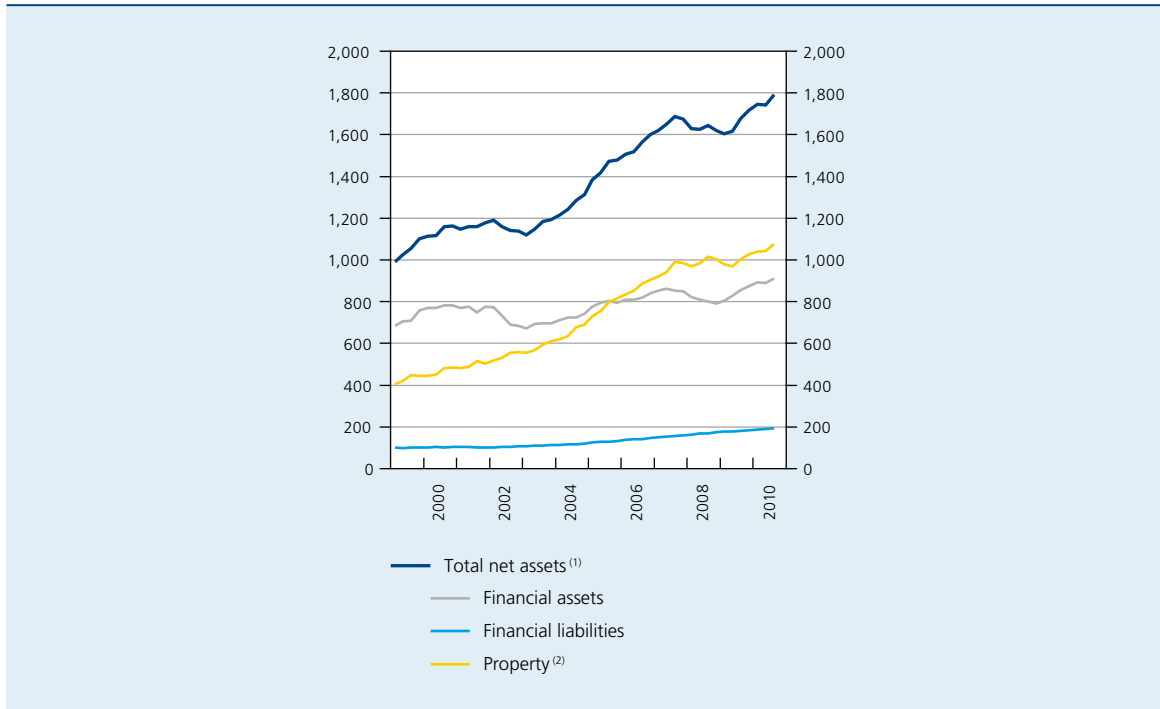
Source: NBB.

(1) Data for the first nine months.

to € 1,718 billion, thus exceeding the peak reached in mid-2007 before the outbreak of the international financial crisis, by the end of September 2010 it had risen to 1,793 billion.

HOUSEHOLD WEALTH

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



Sources: DGSEI, NBB.

(1) Sum of the financial and real estate assets of households, less the value of their liabilities.

(2) Estimate based on the number of houses and apartments recorded by the Land Registry in the three Regions of Belgium. The housing stock is valued on the basis of the average prices of property transactions (houses and apartments) and per Region. The value of building plots and other real estate (castles, rental property, etc.) is not included in the estimate, neither is the value of any property in other countries. Conversely, the estimate is based on the assumption that all the housing recorded in national territory belongs to resident households.

3.3.3 Non-financial corporations

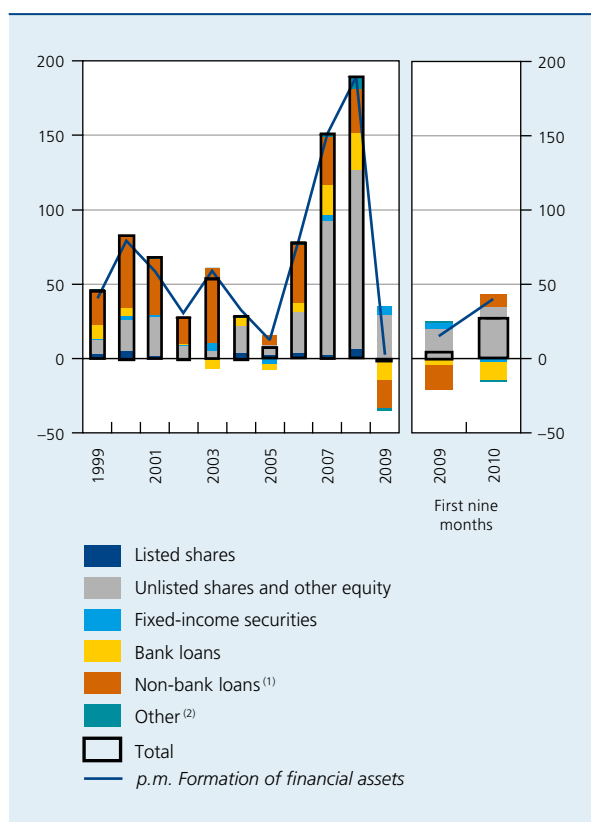
Financial transactions

Thanks to the recovery of economic activity and productivity, non-financial corporations recorded a positive financing balance during the first nine months of 2010, which means that firms were able to cover the whole of their fixed capital investments and the change in their inventories with internal finance. In the financial accounts, this financing surplus was reflected in the formation of net financial assets totalling € 13.3 billion.

During the first nine months of 2010, firms contracted new financial liabilities amounting to € 27 billion. While

that indicates a break in relation to the corresponding period of 2009 when the formation of new liabilities had been negligible, that figure is nevertheless well below the average for the preceding years. Apart from the still rather fragile recovery of fixed capital investments and the strengthening of internal financial resources, the relatively modest demand for new financial liabilities by firms reflected some reticence on their part in regard to financial investments such as mergers or acquisitions. New financial assets which are, as usual, closely linked to the scale of the new liabilities, in fact amounted to only 40.3 billion, or less than the average for the past ten years. Cash investments were down by 1.2 billion and equity investments were 1.7 billion lower, while loans – mainly to other firms – and the portfolio of fixed-income securities expanded by 29.1 and 2 billion respectively.

CHART 87 NEW FINANCIAL LIABILITIES OF NON-FINANCIAL CORPORATIONS: BREAKDOWN BY INSTRUMENT
(in € billion)



Source: NBB.

- (1) Mainly loans granted by Belgian and foreign non-financial corporations, also referred to as inter-company loans.
(2) Includes technical reserves of non-autonomous occupational pension institutions and transitory items.

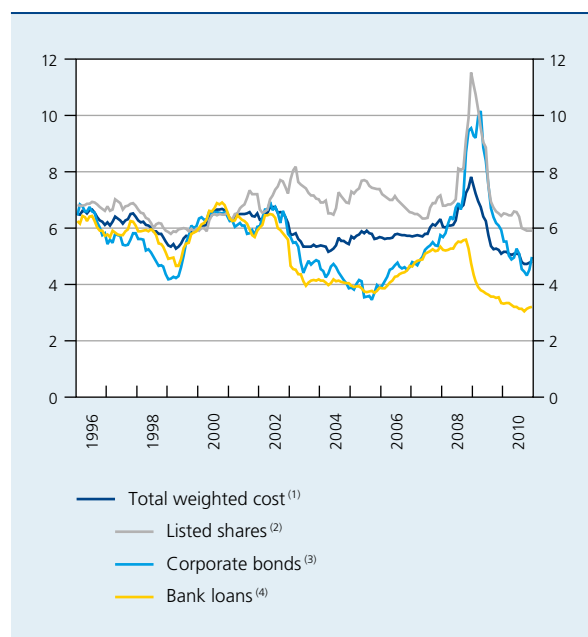
On the liabilities side, share issues and other capital instruments – which in Belgium make up the main source of finance for firms, notably on account of the activities of non-financial holding companies and the fact that multinationals centralise their cash management in Belgium – recorded a further increase of € 34.7 billion during the first three quarters of 2010. Fixed-income securities gave rise to net redemptions amounting to € 2.6 billion. Lending to businesses also declined by € 3 billion; however, this contraction was less pronounced than the 20.5 billion fall recorded in the corresponding period of 2009. While non-bank lending, consisting mainly of inter-company loans, expanded again by 8.5 billion, bank lending was down by around 11.5 billion. However, the reduction in bank lending is attributable to transactions with banks in other countries. During the year under review, lending by resident banks in fact recorded further growth.

Financial conditions

The formation of new liabilities and assets, which was modest overall, contrasted sharply with the continued decline in firms' nominal financing costs. Following the substantial fall recorded in 2009, the weighted financing cost of non-financial corporations – calculated by weighting the nominal cost of the various funding sources according to their respective shares in the total outstanding amount of the financial liabilities – showed a further decline, dropping to 4.8 % in December 2010, compared to 5.1 % a year earlier. While all financing channels contributed to this cost reduction, the steepest decline concerned funds raised on the capital market.

Up to September 2010, the interest rate applicable to new bank loans – weighted on the basis of the outstanding amounts of the various categories of lending by Belgian banks to firms – declined further from 3.3 % in December 2009 to a historical low of 3 %. At the end of the year, however, it increased slightly to 3.2 %. Interest rates

CHART 88 EXTERNAL FINANCING COSTS OF NON-FINANCIAL CORPORATIONS
(monthly data, in %)



Sources: Thomson Reuters Datastream, NBB.

- (1) Obtained by weighting the cost of financing by listed share issues, bond issues and bank loans according to their respective share in the total outstanding amount of these financial liabilities.
(2) Estimated on the basis of a dividend discount model. According to that model, the cost of financing by share issues declines (increases) following a rise (fall) in stock market prices and increases (contracts) in response to an increase (reduction) in dividends (not only those actually paid but also those expected).
(3) Yield on a euro-denominated bond with a maturity of five to seven years and BBB rating.
(4) Weighted average rate applied by Belgian banks to business loans. The weighting is based on the respective outstanding amount of the various types of credit. The interest rates are derived from two separate surveys (RIR until 2002, MIR from 2003), causing a break in the series in 2003.

on short-term loans, defined here as loans for an amount of over €1 million on which the interest rate is initially fixed for a maximum period of one year, remained stable at around 1.6%, at first, before edging upwards towards the end of the year, and reaching 1.9%. The transmission process following the reduction in the key interest rate by the ECB from October 2008 to May 2009 therefore came to a halt during the year under review. Interest rates on long-term loans maintained their downward trend, mainly as a result of the decline in long-term interest rates in Belgium. Thus, the interest rate on loans of less than €1 million with a fixed-interest period of five years or more fell by 50 basis points to 4.1% at the end of 2010.

Enterprises – and especially the largest ones – can also raise funds directly on the financial markets by issuing listed shares or debt instruments. Although the issuance of debt instruments by firms is a marginal activity in Belgium, the weighted total cost of financing for firms also depends to some extent on the conditions prevailing on the capital markets, since firms make considerable use of share issues, particularly via non-financial holding companies. These financing channels became more attractive during the year under review.

In nominal terms, the cost of financing by issuing debt instruments continued to diminish in 2010. The yield on euro-denominated corporate bonds with a maturity of between five and seven years and a BBB rating, i.e. the lowest rating for securities not regarded as speculative, declined from 6.1% at the end of December 2009 to 4.3% at the end of October 2010 before climbing back somewhat to 5% at the end of the year. However, the corporate bond market seems to have recovered, overall, from the strong risk aversion which, at the height of the financial crisis, had propelled the yields on BBB-rated bonds to an average of 10%. The spreads in relation to sovereign loans have narrowed since then, reverting to levels comparable to those at the end of 2007, at the start of the financial crisis.

The cost of financing by listed shares also continued to decline during the year under review, thanks to a favourable trend in stock market prices which, as for the euro area in general, benefited from the recovery of corporate profits. As explained in detail in box 19 of the Bank's 2005 Report, the cost of issuing the shares in question here is estimated on the basis of a dividend discount model. That cost, estimated at 6.4% in December 2009, remained stable overall during the first half of the year. From the third quarter, however, rising stock markets caused the cost of financing via shares to decline to 5.9% in December 2010, or around 1 percentage point below the 1996-2009 average of 6.9%.

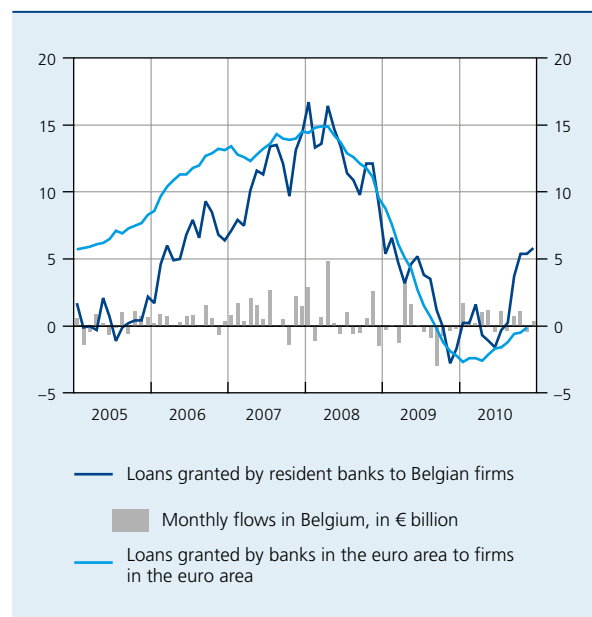
Generally speaking, taking account of the limited scale on which new financial liabilities were formed, firms do not seem to have responded fully to the particularly low level of nominal financing costs. There could be several reasons for that. First, over the year as a whole, gross fixed capital formation by firms contracted at current prices by 0.3% compared to 2009. Next, the recovery of activity and productivity augmented the financing capacity of firms. They probably preferred to tap their own internal resources rather than resort to external sources of funding to cover their expenditure, in order to continue consolidating their balance sheet. Although financing conditions have returned to normal, the financial crisis is therefore probably still affecting the behaviour of non-financial corporations in regard to investment and financing, be it because of the uncertainty over the long-term growth prospects or the persistence of a high level of risk aversion among investors.

Bank lending

Lending by resident banks to Belgian non-financial corporations nevertheless began rising again during the year under review. After dropping to a low point of -2.8% in November 2009, the annual growth of lending increased

CHART 89 LOANS GRANTED BY BANKS TO NON-FINANCIAL CORPORATIONS IN BELGIUM⁽¹⁾ AND IN THE EURO AREA

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



Sources: ECB, NBB.

(1) Data adjusted for securitisation effects.

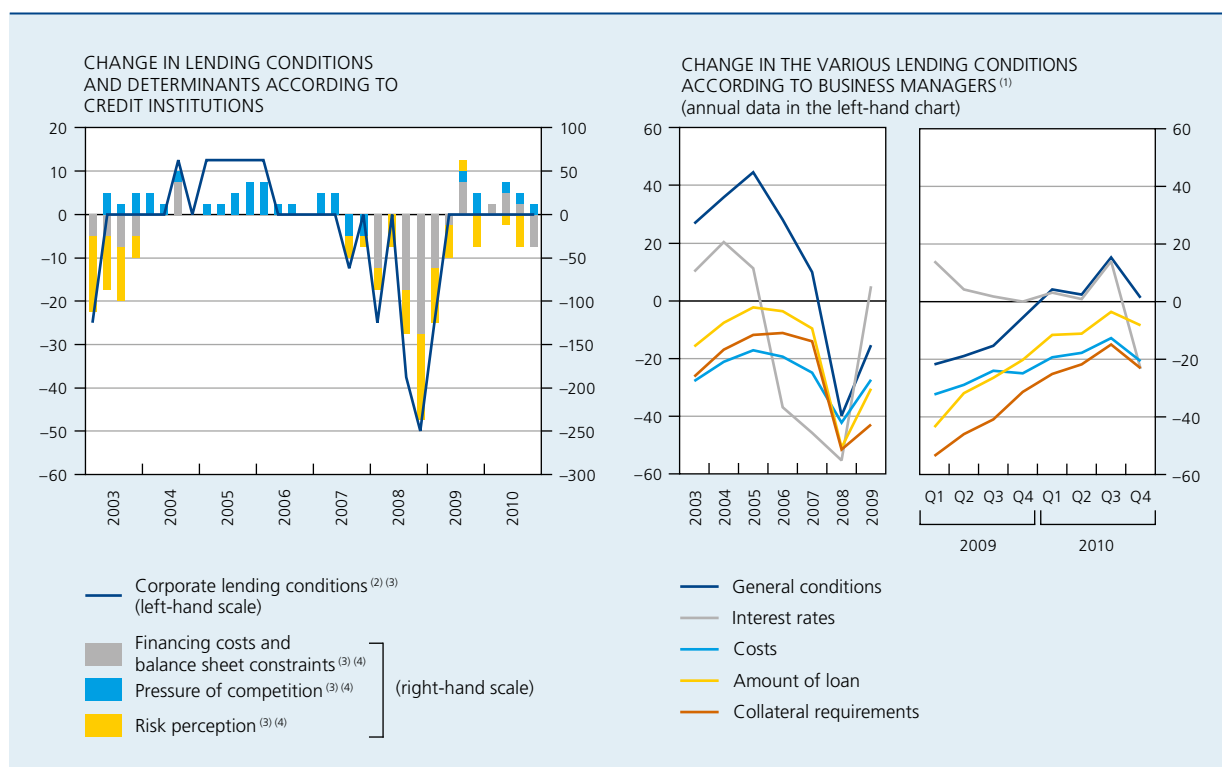
slowly at first, but clearly gathered momentum in the second half of the year, rising to 5.8 % in December 2010. Although the credit cycle reached a turning point at about the same time in the euro area, the revival in bank lending was less vigorous there.

During the first nine months of 2010, lending by resident banks expanded by € 5.1 billion, whereas it had fallen by 1.8 billion over 2009 as a whole. That development is in sharp contrast to lending by foreign banks to Belgian non-financial corporations, which was down by 5.6 billion over the first nine months of 2010. After having declined steadily from 1999 to the end of 2008, dropping during that time from around 80 % to a low point of 62.6 %, the proportion of resident credit institutions in total bank lending to Belgian firms began rising again, reaching 65.7 % in September 2010, possibly indicating that the banks have tended to focus more on their home markets since the financial crisis.

Even though, in the wake of the financial crisis, there had been fears of a “crediless recovery”, it seems that bank lending to firms has followed its traditional path overall, lagging slightly behind the revival in economic activity and lending to households. The favourable trend in bank lending should be viewed in the light of the historically low interest rates. In that context, the financial restrictions on the banks resulting either from past losses affecting capital or from the liquidity requirements – perhaps exacerbated by the anticipation of the new Basel III proposals concerning higher solvency and liquidity ratios – do not seem to have led to a significant decline in lending. During the period under review, there has in fact been hardly any sign that the banks anticipated the new regulations by imposing tougher lending conditions. After having tightened their lending conditions other than interest rates at the time of the financial crisis, they kept them unchanged in 2010.

CHART 90 RESULTS OF BANK LENDING SURVEYS AMONG BANKS AND FIRMS

(quarterly data, unless otherwise stated)



Source: NBB (Eurosystem bank lending survey and NBB survey of corporate credit conditions).

(1) Balance, as a percentage, of the responses by the business managers polled, indicating their favourable or unfavourable (-) assessment of bank credit conditions. Available on an annual basis from 2002 to 2008 inclusive, and on a quarterly basis from 2009.

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

(3) The responses are weighted according to the distance from a “neutral” response: mention of a “considerable” change in the lending criteria is accorded double the weighting of the mention of a “slight” change.

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

These were the findings of the Eurosystem's bank lending survey in which the banks supply qualitative information on changes in lending conditions, demand for bank loans, and the factors which explain these developments. During 2010, the four Belgian banks questioned stated that they had made no changes to the lending conditions which they apply to firms. That had already been the case since the second quarter of 2009, following the significant tightening which had applied from the third quarter of 2007 to the first quarter of 2009 in response to the financial crisis.

In regard to the factors determining developments during the year under review, it is evident that the banks' financing costs and balance sheet constraints which had made a negative contribution during the financial crisis, prompted the banks to relax their lending conditions slightly during the first three quarters. However, probably in view of the tensions on the sovereign debt markets, there was some worsening of the balance sheet constraints at the end of the year, with again a further adverse impact on lending conditions. In the second and third quarters, the banks remained rather cautious in view of the economic climate, but owing to pressure of competition, conditions remained unchanged during the year.

It is therefore notable that the tightening of these criteria during the financial crisis has not yet been reversed. On a cumulative basis, the unchanged conditions indicate *a priori* that the banks are still applying the more stringent conditions introduced at the time of the financial crisis.

The statistics collected by the Central Corporate Credit Register also reveal that the credit utilisation rate, which shows the degree to which firms draw on their credit lines, remained at a relatively high level during the year under review, particularly in the case of SMEs (at an average of around 87.1 % for small firms). This utilisation rate is inversely proportional to the firm's size, and reflects a certain reluctance on the part of banks to lend to these firms.

Nonetheless, the firms' assessment of overall lending conditions, including interest rates, improved during the first three quarters of the year under review, as is evident from the survey on the subject conducted by the Bank among business managers. From the first quarter of 2010, a larger number of business managers described the conditions as favourable rather than unfavourable. The net balance of responses rose from -5 % at the end of 2009 to 15 % in the third quarter of 2010. The more favourable assessment concerned interest rates, which had been falling until then. However, in the fourth quarter, the slight increase in interest rates on bank lending

seems to have had a noticeable impact on the sentiment of business managers, since the positive balance of their responses was down to only just over 1 %. In regard to the other lending conditions (other costs, credit volumes and collateral), the majority of business managers remained dissatisfied – as is structurally the case – although to a lesser degree. Even though there was some deterioration in the last quarter, the other lending criteria gradually changed during the year under review, moving towards levels which can be regarded as fairly favourable in historical terms, and similar to those indicated before the financial crisis.

Fixed-income securities

During the first nine months of 2010, non-financial corporations effected net redemptions of debt instruments for € 2.6 billion whereas, during the corresponding period of 2009, their net recourse to this form of funding came to 4 billion. Net redemptions of short-term securities – essentially commercial paper – broadly equalled those of long-term securities. Although the cost of bond financing was significantly reduced, this form of financing is still more expensive than bank credit for the great majority of firms, and that may have encouraged them to prefer the latter channel for their external funding.

In Belgium, firms traditionally make very little use of the fixed-income securities market for their external financing. At the end of September, this form of financing represented 4.3 % overall of the total outstanding amount of capital borrowed by firms, compared to 9 % in the euro area. At the end of 2010, in order to encourage corporate bond issues, the CBFA set up an accelerated prospectus approval procedure. In the case of ordinary fixed-rate bonds (including zero coupon) or variable rate bonds issued by reputable issuers, it should in future be possible to obtain approval of the prospectus within five working days. In addition, a range of measures should ensure that individuals have better access to this type of instruments.

Shares

During the first nine months of 2010, net issues of unlisted shares totalled € 34.4 billion. Although this represented a marked recovery compared to 2009, that figure is still well down on the amounts placed during the period from 2007 to 2008 when new issues of unlisted shares averaged 105 billion per annum, particularly owing to the success of the risk capital allowance. The issuance revival in 2010 is remarkable in a context of generally limited recourse by firms to the various sources of external

finance. It was mainly other countries that subscribed to the shares issued during the year under review. These flows consist primarily of direct investments by associated non-financial corporations located abroad.

Conversely, recourse to the stock market via net issues of listed shares came to only € 0.3 billion during the first nine months of 2010, representing a modest recovery after this financing channel had virtually dried up altogether at the beginning of 2009. This revival is attributable to the better stock market performance which led to a normalisation of the cost of equity financing. In line with the trend in preceding years, listed shares were mostly subscribed by foreign investors. Since the beginning of 2005, the proportion of foreign shareholders in the outstanding total of listed shares has risen steadily, from around 30 to 50.4 % at the end of September 2010.

Debt levels

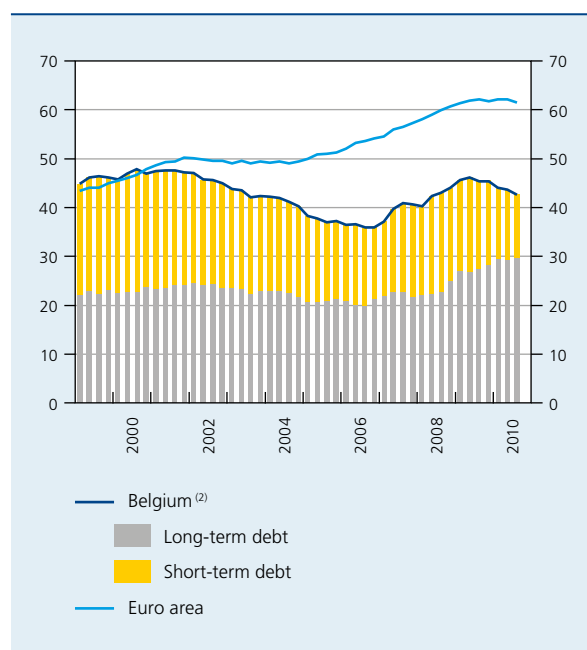
The low level of firms' new financial liabilities in 2009 and in the first nine months of 2010 caused the debts of non-financial corporations to contract as a percentage of GDP. If the analysis is confined to total lending by credit institutions in the euro area and fixed-income securities, the debt level in fact declined from 46.2 % of GDP at the end of June 2009 to 42.6 % at the end of September 2010. According to that same definition which, for reasons of economic relevance and international comparability, is the most appropriate measure of debt levels, the figure for firms in the euro area stabilised at around 62 % of GDP. During the past decade, the debts of firms in the euro area had risen considerably in comparison with those of Belgian firms. That is essentially a reflection of the weaker growth of bank lending in Belgium, as – during the period from 2001 to 2005 – Belgian firms concentrated in particular on consolidating their balance sheet following the bursting of the equity bubble in 2001. Subsequently, the possibility of deducting notional interest was especially conducive to internal funding.

However, it is hard to assess the extent to which the process of deleveraging seen since the beginning of 2009 is due to firms' deliberate intention to reduce their debt levels, or whether it is due to the investment climate. In both a historical and an international perspective, the debt ratio of Belgian firms is in fact relatively low, presenting few risks to their financial health. Nonetheless, the tightening of credit conditions by the banks and widespread fears of a shortage of financial resources owing to the vulnerability of the financial sector and the possibility

of being crowded out by substantial public deficits have probably led non-financial corporations to focus more attention on their balance sheet structure.

Apart from the decline in the debt ratio, it is also worth mentioning the greater proportion of long-term debts in the total debts of firms since the financial crisis. Whereas in mid-2008 short-term debts and long-term debts both represented around 20 % of GDP, long-term debts increased to 29.6 % of GDP at the end of September 2010, and short-term debts declined to 13 %. As a general rule, such a financing structure based more on long-term debts can be regarded as sounder than funding based mainly on short-term resources, as the latter means higher liquidity risks, due to a greater financing risk. Moreover, a high proportion of short-term financing may indicate that firms are only able to attract short-term financial resources, and that could be a sign of a higher risk of bankruptcy. An improvement in the financing structure of firms in terms of maturity was also apparent in the euro area, albeit to a lesser extent.

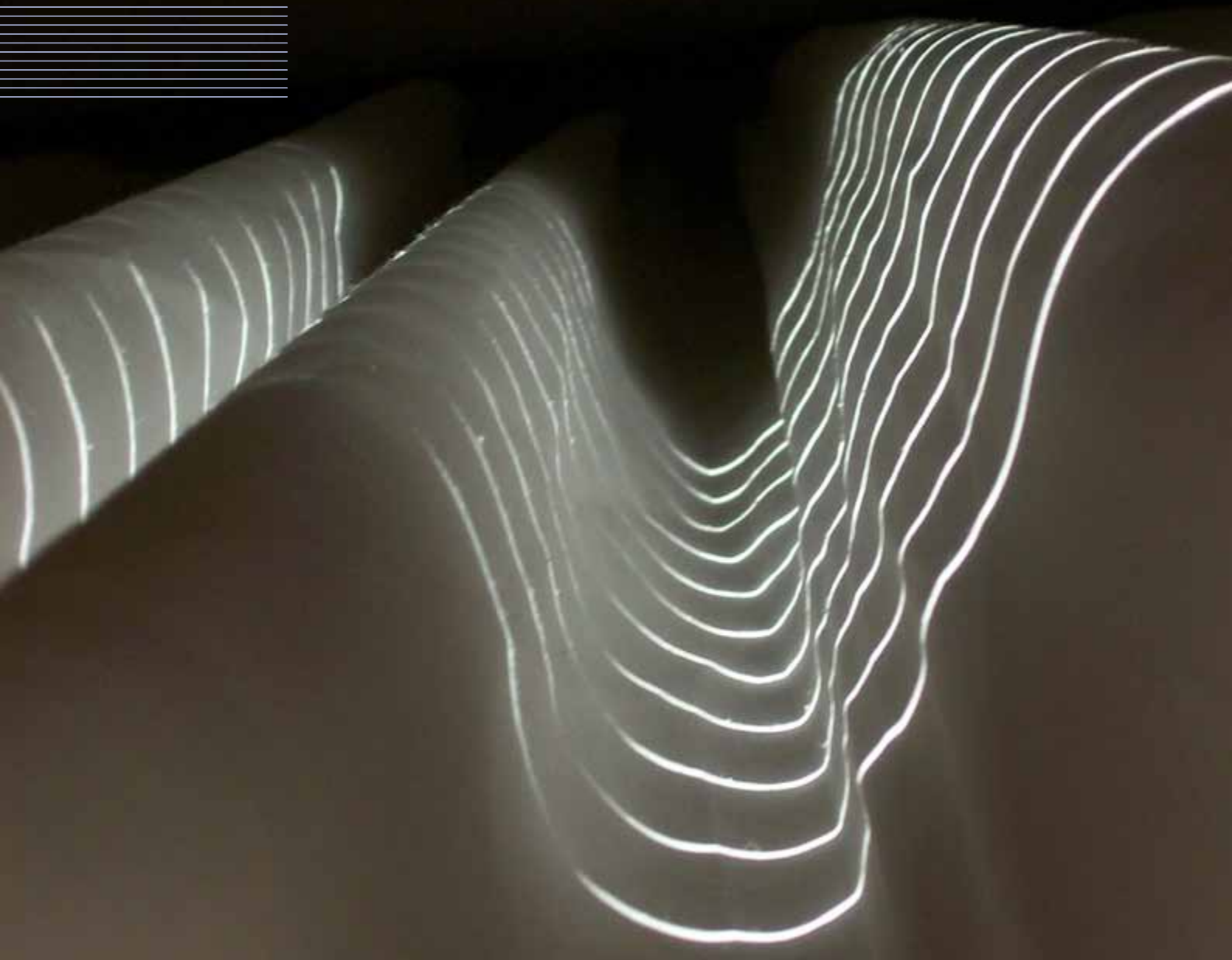
CHART 91 DEBTS OF NON-FINANCIAL CORPORATIONS⁽¹⁾
(end-of-quarter data, in % of GDP)



Sources: ECB, NBB.

(1) Loans granted by credit institutions in the euro area and fixed-income securities. For Belgium, bank lending data adjusted for securitisation effects; for the euro area, that adjustment was not made since the necessary data are not available (at the end of the third quarter of 2010, the cumulative total of the bank securitisations recorded since February 2009 was equivalent to 0.3 % of GDP, compared to 3.6 % in Belgium).

(2) Short-term debts have a maturity of up to one year; long-term debts have a maturity of over one year.



Statistical annexes

TABLE I GDP AND MAIN CATEGORIES OF EXPENDITURE, BY VOLUME

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

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010 e
Household final consumption expenditure	1.3	0.5	0.7	1.4	1.3	1.8	1.7	1.4	-0.2	1.4
Final consumption expenditure of general government	1.6	3.2	1.4	1.8	1.2	0.6	2.1	2.5	0.4	1.1
Gross fixed capital formation	1.1	-4.5	0.1	7.6	7.5	2.0	6.3	2.4	-4.9	-1.8
Housing	-2.7	-5.5	3.4	8.1	10.9	6.4	3.4	-0.6	-3.0	-3.5
Enterprises	4.2	-4.7	-1.2	8.3	5.2	2.0	7.9	3.4	-7.5	-1.2
General government	-11.6	0.7	0.9	0.6	15.4	-11.8	4.2	5.5	10.3	-0.9
<i>p.m. Final domestic expenditure</i> ⁽¹⁾⁽²⁾	1.3	0.0	0.7	2.6	2.4	1.5	2.7	1.8	-1.1	0.6
Change in inventories ⁽¹⁾	-1.4	-0.1	0.1	0.1	0.4	0.7	0.1	0.0	-1.0	-0.5
Net exports of goods and services ⁽¹⁾	0.8	1.4	0.0	0.3	-0.7	0.5	0.1	-1.0	-0.5	1.9
Exports of goods and services	1.0	2.7	0.8	6.3	5.0	5.0	4.3	1.4	-11.4	10.0
Imports of goods and services	0.0	0.9	0.8	6.3	6.4	4.6	4.4	2.8	-10.9	7.7
GDP	0.7	1.4	0.8	3.1	2.0	2.7	2.8	0.8	-2.7	2.0
Trade surplus or deficit (-) due to the change in the terms of trade ⁽³⁾	0.1	1.0	-0.1	-0.4	0.1	-0.5	0.3	-2.0	2.5	-1.4
Net primary incomes received from the rest of the world ⁽³⁾	-0.7	-0.2	0.2	-0.4	-0.4	0.3	0.1	0.5	-0.6	0.1
GNI	0.1	2.0	0.9	2.0	1.6	2.3	3.1	-0.7	-0.6	0.6
<i>p.m. Total domestic expenditure</i> ⁽⁴⁾	-0.1	-0.1	0.8	2.9	2.9	2.3	2.8	1.9	-2.1	0.1
<i>Final expenditure</i> ⁽⁵⁾	0.4	1.2	0.8	4.4	3.8	3.5	3.5	1.7	-6.4	4.4
<i>General government expenditure</i> ⁽⁶⁾	0.5	3.0	1.4	1.7	2.2	-0.4	2.2	2.8	1.1	1.0

Sources: NAI, NBB.

- (1) Contribution to the change in GDP.
(2) Final consumption expenditure of households and of general government, and gross fixed capital formation.
(3) Contribution to the change in GNI.
(4) Final domestic expenditure and change in inventories.
(5) Total domestic expenditure and exports of goods and services.
(6) Final consumption expenditure and gross fixed capital formation of general government.

TABLE II GDP AND MAIN CATEGORIES OF EXPENDITURE, BY VOLUME

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

	2008				2009				2010			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Household final consumption expenditure	1.8	1.8	1.5	0.5	-0.8	-0.8	-0.1	1.0	1.7	1.7	1.2	n.
Final consumption expenditure of general government	2.9	2.7	2.3	2.2	0.9	0.4	0.2	0.0	0.6	1.0	1.2	n.
Gross fixed capital formation	5.9	4.3	1.4	-1.6	-5.1	-4.7	-5.5	-4.1	-3.3	-3.3	-0.5	n.
Housing	1.0	-0.6	-1.2	-1.5	-1.7	-2.3	-3.4	-4.7	-5.3	-4.3	-2.6	n.
Enterprises	8.9	6.4	2.4	-3.7	-7.8	-8.2	-8.4	-5.4	-3.5	-2.3	0.7	n.
General government	-0.5	4.4	2.1	16.5	6.0	16.0	11.1	8.1	4.5	-6.3	-1.5	n.
<i>p.m. Final domestic expenditure</i> ⁽¹⁾⁽²⁾	2.8	2.4	1.6	0.4	-1.3	-1.4	-1.2	-0.4	0.3	0.4	0.8	n.
Change in inventories ⁽¹⁾	-0.3	-0.1	0.3	0.3	-0.8	-1.0	-1.2	-1.1	-0.2	-0.4	-1.3	n.
Net exports of goods and services ⁽¹⁾	-0.9	-0.4	-0.8	-1.9	-1.5	-1.7	-0.2	1.4	1.6	2.6	2.5	n.
Exports of goods and services	3.2	6.0	3.5	-6.9	-14.5	-17.3	-12.8	0.2	9.2	14.1	10.9	n.
Imports of goods and services	4.5	6.8	4.7	-4.8	-12.9	-15.6	-12.8	-1.4	7.3	10.8	7.8	n.
GDP	1.6	1.9	1.1	-1.3	-3.7	-4.1	-2.7	-0.1	1.7	2.7	2.0	1.8
<i>p.m. GDP, percentage changes compared to the previous quarter</i>	0.8	0.5	-0.4	-2.2	-1.7	0.1	1.0	0.4	0.1	1.1	0.4	0.3
<i>p.m. Total domestic expenditure</i> ⁽³⁾	2.6	2.4	1.9	0.6	-2.1	-2.3	-2.5	-1.5	0.0	-0.1	-0.6	n.
<i>Final expenditure</i> ⁽⁴⁾	2.9	4.1	2.7	-2.9	-7.9	-9.4	-7.3	-0.7	4.1	6.1	4.5	n.
<i>General government expenditure</i> ⁽⁵⁾	2.7	2.9	2.4	3.2	1.3	1.5	1.0	0.6	0.9	0.4	0.9	n.

Sources: NAI, NBB.

(1) Contribution to the change in GDP.

(2) Final consumption expenditure of households and of general government, and gross fixed capital formation.

(3) Final domestic expenditure and change in inventories.

(4) Total domestic expenditure and exports of goods and services.

(5) Final consumption expenditure and gross fixed capital formation of general government.

TABLE III DEFATORS OF GDP AND THE MAIN CATEGORIES OF EXPENDITURE
(data not adjusted for calendar effects, percentage changes compared to the previous year)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010 e
Household final consumption expenditure	1.9	1.2	1.5	2.4	2.7	3.0	2.8	3.2	-0.5	2.5
Final consumption expenditure of general government	3.3	3.7	3.3	2.5	3.4	3.0	2.5	4.5	4.0	1.5
Gross fixed capital formation	0.4	-0.9	1.5	2.8	1.8	3.8	2.8	3.3	-1.3	0.9
Housing	2.8	2.2	2.6	5.2	4.8	5.7	4.5	5.1	-3.0	0.2
Enterprises	-0.4	-2.1	1.2	2.0	0.7	2.8	2.1	2.5	-0.3	1.0
General government	0.6	0.5	1.2	2.2	1.1	5.4	2.9	2.7	-2.5	1.3
<i>p.m. Final domestic expenditure</i> ⁽¹⁾	1.9	1.4	1.9	2.5	2.7	3.2	2.7	3.5	0.4	1.9
Terms of trade	0.1	1.2	-0.2	-0.9	-0.4	-0.7	0.2	-2.4	3.4	-2.0
Exports of goods and services	1.4	-0.6	-1.4	2.0	4.1	2.7	2.2	4.1	-5.3	6.2
Imports of goods and services	1.3	-1.8	-1.2	2.9	4.5	3.4	2.0	6.6	-8.5	8.3
GNI	2.1	2.0	2.0	2.2	2.4	2.3	2.3	1.9	1.1	1.5
GDP	2.0	1.2	2.3	2.9	2.6	2.9	2.1	4.0	-1.3	3.0
<i>p.m. Total domestic expenditure</i> ⁽²⁾	2.0	1.2	2.3	2.9	2.6	2.9	2.1	4.0	-1.3	2.9
<i>Final expenditure</i> ⁽³⁾	1.7	0.4	0.7	2.5	3.3	2.8	2.2	4.0	-3.1	4.4
<i>General government expenditure</i> ⁽⁴⁾	3.1	3.4	3.2	2.5	3.3	3.2	2.5	4.4	3.5	1.5

Sources: NAI, NBB.

(1) Final consumption expenditure of households and of general government, and gross fixed capital formation.

(2) Final domestic expenditure and change in inventories.

(3) Total domestic expenditure and exports of goods and services.

(4) Final consumption expenditure and gross fixed capital formation of general government.

TABLE IV GDP AND THE MAIN CATEGORIES OF EXPENDITURE AT CURRENT PRICES

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

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010 e
Household final consumption expenditure	3.2	1.8	2.1	3.9	4.0	4.9	4.6	4.7	-0.6	3.9
Final consumption expenditure of general government	5.0	6.9	4.8	4.5	4.3	3.6	4.8	7.0	4.4	2.6
Gross fixed capital formation	1.5	-5.3	1.6	10.6	9.4	5.9	9.3	5.8	-6.0	-1.1
Housing	0.0	-3.4	6.1	13.7	16.3	12.5	8.0	4.5	-5.9	-3.3
Enterprises	3.8	-6.7	-0.1	10.4	5.9	4.8	10.2	6.0	-7.7	-0.3
General government	-11.1	1.2	2.2	2.8	16.7	-7.0	7.2	8.4	7.6	0.3
<i>p.m. Final domestic expenditure</i> ⁽¹⁾⁽²⁾	3.1	1.3	2.5	5.0	4.9	4.5	5.4	5.2	-0.7	2.5
Change in inventories ⁽¹⁾	-1.2	-0.2	0.4	0.5	0.2	0.6	-0.5	0.5	-2.7	0.6
Net exports of goods and services ⁽¹⁾	0.9	2.2	-0.1	-0.2	-0.7	-0.1	0.3	-3.0	1.8	0.6
Exports of goods and services	2.4	2.0	-0.6	8.5	9.3	7.8	6.5	5.5	-16.1	16.8
Imports of goods and services	1.3	-0.9	-0.4	9.5	10.9	8.4	6.5	9.6	-18.4	16.7
GDP	2.8	3.4	2.8	5.3	4.4	5.0	5.2	2.8	-1.6	3.6
Net primary incomes received from the rest of the world ⁽³⁾	-0.6	-0.2	0.2	-0.4	-0.4	0.3	0.1	0.5	-0.6	0.1
GNI	2.1	3.1	3.0	4.9	4.0	5.3	5.3	3.3	-2.1	3.6
<i>p.m. Total domestic expenditure</i> ⁽⁴⁾	1.9	1.2	3.1	5.9	5.4	5.3	5.1	6.0	-3.4	3.1
<i>Final expenditure</i> ⁽⁵⁾	2.2	1.6	1.4	7.0	7.1	6.5	5.8	5.8	-9.3	9.0
<i>General government expenditure</i> ⁽⁶⁾	3.7	6.5	4.6	4.4	5.1	2.8	5.0	7.2	4.6	2.5

Sources: NAI, NBB.

(1) Contribution to GDP growth.

(2) Final consumption expenditure of households and of general government, and gross fixed capital formation.

(3) Contribution to GNI growth.

(4) Final domestic expenditure and change in inventories.

(5) Total domestic expenditure and exports of goods and services.

(6) Final consumption expenditure and gross fixed capital formation of general government.

TABLE V GDP AND THE MAIN CATEGORIES OF EXPENDITURE AT CURRENT PRICES

(data not adjusted for calendar effects; in € million)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010 e
Household final consumption expenditure	138,912	141,346	144,383	150,110	155,751	163,331	170,965	179,121	177,788	184,733
Final consumption expenditure of general government	56,394	60,306	63,179	65,941	69,024	71,505	74,813	80,021	83,681	85,899
Gross fixed capital formation	53,983	51,120	51,926	57,634	62,780	66,456	72,747	77,261	72,269	71,569
Housing	12,540	12,110	12,849	14,605	16,979	19,107	20,643	21,578	20,301	19,625
Enterprises	37,044	34,564	34,529	38,350	40,340	42,269	46,659	49,781	45,623	45,587
General government	4,399	4,446	4,549	4,679	5,461	5,080	5,446	5,902	6,346	6,357
<i>p.m. Final domestic expenditure</i> ⁽¹⁾	249,290	252,772	259,487	273,684	287,556	301,291	318,525	336,403	333,739	342,201
Change in inventories	680	61	1,304	2,828	3,355	4,707	3,655	5,640	-3,868	-2,131
Net exports of goods and services	9,464	15,423	14,925	14,313	11,935	12,152	12,905	2,963	9,292	10,991
Exports of goods and services	202,256	206,443	205,192	223,086	242,846	261,892	279,437	295,645	247,464	288,868
Imports of goods and services	192,793	191,020	190,267	208,773	230,911	249,740	266,532	292,681	238,173	277,876
GDP	259,433	268,256	275,716	290,825	302,845	318,150	335,085	345,006	339,162	351,062
Net primary incomes received from the rest of the world	4,164	3,608	4,253	3,155	1,970	2,822	3,281	5,094	3,100	3,316
GNI	263,597	271,864	279,969	293,980	304,816	320,973	338,366	350,100	342,261	354,378
<i>p.m. Total domestic expenditure</i> ⁽²⁾	249,970	252,833	260,791	276,512	290,910	305,998	322,180	342,043	329,870	340,070
<i>Final expenditure</i> ⁽³⁾	452,226	459,276	465,983	499,598	533,756	567,891	601,617	637,688	577,335	628,938
<i>General government expenditure</i> ⁽⁴⁾	60,794	64,752	67,727	70,619	74,485	76,584	80,259	85,923	90,027	92,256

Sources: NAI, NBB.

(1) Final consumption expenditure of households and of general government, and gross fixed capital formation.

(2) Final domestic expenditure and change in inventories.

(3) Total domestic expenditure and exports of goods and services.

(4) Final consumption expenditure and gross fixed capital formation of general government.

TABLE VI VALUE ADDED OF THE VARIOUS BRANCHES OF ACTIVITY, BY VOLUME
(data not adjusted for calendar effects, percentage changes compared to the previous year)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	p.m. In % of the 2009 GDP
Agriculture and fisheries	-5.5	4.3	-7.3	5.3	-12.0	10.0	-1.1	-1.9	-0.4	0.6
Industry	0.0	-0.8	-1.0	3.1	0.2	1.3	2.9	-0.6	-7.6	15.0
Mineral-extracting industry	-11.6	-5.1	0.1	3.2	6.9	9.7	4.0	20.9	-2.7	0.1
Manufacturing industry	0.3	-0.6	-1.1	3.7	0.5	0.4	3.3	-0.9	-8.7	12.9
of which:										
Food, beverages, tobacco	2.3	1.8	2.2	2.8	0.2	1.1	7.4	5.8	-2.5	1.9
Textiles, clothing and footwear	-0.3	-1.5	-8.5	0.2	-5.4	5.6	6.4	-3.3	-1.6	0.5
Chemicals and rubber	0.4	2.2	-0.4	6.4	-0.3	0.5	1.2	-0.1	-8.6	3.0
Metallurgy and metal-working industry	1.8	0.5	-2.4	4.5	-7.6	2.1	9.6	-6.8	-10.8	2.0
Transport equipment	4.6	-0.7	-3.7	0.4	10.0	-16.3	-8.4	0.5	-15.5	0.8
Electricity, gas and water	-1.7	-1.9	0.0	-1.9	-3.4	9.1	0.1	0.5	-0.3	2.1
Construction	1.1	-1.5	0.7	4.0	3.4	8.5	2.3	-0.1	-3.4	4.9
Services	1.9	1.9	1.7	2.5	2.2	2.4	3.0	1.9	-1.7	68.8
Market services	2.5	2.6	1.9	2.9	2.6	3.1	3.7	2.0	-2.9	46.6
Trade and repairs	3.8	4.1	4.7	4.0	-3.1	1.2	6.7	-0.4	-6.3	11.0
Hotels and restaurants	-1.8	-1.2	1.9	-0.1	0.9	2.0	1.2	0.6	-2.0	1.5
Transport and communications	3.3	0.6	2.4	-0.7	3.5	0.3	1.0	2.6	-4.1	7.4
Financial services	-0.7	10.2	-5.7	8.3	3.1	8.5	-1.2	-1.3	-2.8	4.7
Real estate, renting and business services	2.6	1.0	2.3	2.4	5.6	4.0	4.5	4.0	-0.9	22.1
Non-market services	0.6	0.4	1.1	1.5	1.5	0.8	1.3	1.7	1.1	22.2
Public administration	0.4	3.1	1.8	1.4	2.4	1.6	1.0	1.8	0.9	6.7
Education, health and social work	1.3	0.4	0.6	1.3	0.5	0.0	1.4	1.4	1.0	12.9
Other non-market services	-2.5	-7.0	1.5	3.1	3.7	2.7	1.0	2.7	2.5	2.6
Value added of branches, at basic prices	1.3	1.2	1.0	2.7	1.7	2.6	2.9	1.3	-2.8	89.3
Taxes net of subsidies on products ⁽¹⁾	-0.4	0.3	-0.1	0.8	0.2	0.4	0.4	-0.1	-0.3	10.7
GDP	0.8	1.4	0.8	3.2	1.7	2.7	2.9	1.0	-2.8	100.0

Source: NAI.

(1) Contribution to the change in GDP.

TABLE VII
LABOUR MARKET

(annual averages, thousands of units)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010 e
Population of working age ⁽¹⁾	6,743	6,774	6,805	6,835	6,879	6,942	7,012	7,070	7,114	7,154
Labour force	4,701	4,717	4,768	4,844	4,916	4,963	4,981	5,032	5,068	5,109
National employment	4,231	4,226	4,230	4,270	4,331	4,384	4,455	4,532	4,517	4,545
Frontier workers (balance)	66	67	69	72	73	75	77	78	79	79
Domestic employment	4,165	4,159	4,160	4,199	4,258	4,308	4,378	4,454	4,438	4,466
Self-employed	696	689	689	692	695	699	706	716	721	725
Employees	3,470	3,470	3,472	3,507	3,563	3,609	3,672	3,738	3,717	3,741
Branches sensitive to the business cycle ⁽²⁾	2,246	2,223	2,199	2,209	2,237	2,270	2,318	2,363	2,318	2,318
Public administration and education	710	721	730	742	757	764	771	779	787	790
Other non-market services ⁽³⁾	513	525	543	556	569	576	583	596	612	633
Unemployment ⁽⁴⁾	470	492	538	573	585	579	526	500	551	565

Sources: DGSEI, FPB, NAI, NEMO, NBB.

(1) Persons aged 15 to 64.

(2) The branches "agriculture, hunting, forestry and fisheries", "industry", "construction", "trade, transport and communication" and "financial, real estate, renting and business services".

(3) The branches "health and social work", "community, social and personal services" and "domestic services".

(4) 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. Job-seekers working via the local employment agencies were excluded since they are already included in employment.

TABLE VIII EMPLOYMENT RATE

(in % of the corresponding labour force aged 15 to 64⁽¹⁾, annual averages)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2009	2010
	Averages of the first three quarters										
Total	59.9	59.9	59.6	60.3	61.1	61.0	62.0	62.4	61.6	61.5	61.8
According to sex											
Women	51.0	51.4	51.8	52.6	53.8	54.0	55.3	56.2	56.0	55.9	56.2
Men	68.8	68.3	67.3	67.9	68.3	67.9	68.7	68.6	67.2	67.1	67.3
According to age											
15 to 24	29.7	29.4	27.4	27.8	27.3	27.6	27.5	27.4	25.3	25.2	25.0
25 to 54	76.6	76.5	76.5	77.3	78.3	78.4	79.7	80.5	79.8	79.8	79.7
55 to 64	25.1	26.6	28.1	30.0	31.9	32.0	34.4	34.5	35.3	34.9	37.2
According to Region											
Brussels	53.9	54.5	53.2	54.1	54.8	53.4	54.8	55.6	55.1	55.2	54.4
Flanders	63.4	63.5	62.9	64.3	64.9	65.0	66.1	66.5	65.8	65.5	66.1
Wallonia	55.4	54.9	55.4	55.1	56.1	56.1	57.0	57.2	56.2	56.5	56.5
According to educational level											
Lower secondary education or less	42.1	41.7	41.2	40.5	40.4	40.1	40.5	39.7	38.6	38.5	39.4
Upper secondary education	65.0	64.9	63.9	64.7	65.5	65.1	65.9	67.0	65.4	65.3	65.2
Higher education	83.3	82.5	82.2	82.5	82.8	82.4	83.7	83.0	81.9	82.1	81.7

Source : DGSEI.

(1) These employment rates are calculated on the basis of the harmonised data taken from the labour force survey.

TABLE IX UNEMPLOYMENT RATE

(in % of the corresponding labour force aged 15 to 64⁽¹⁾, annual averages)

	Averages of the first three quarters										
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	
Total	6.6	7.6	8.2	8.5	8.5	8.3	7.5	7.0	8.0	7.9	8.5
According to sex											
Women	7.5	8.7	8.9	9.6	9.6	9.4	8.5	7.6	8.1	8.2	8.7
Men	6.0	6.7	7.7	7.6	7.7	7.5	6.7	6.5	7.8	7.7	8.3
According to age											
15 to 24	16.9	17.7	21.8	21.2	21.5	20.5	18.8	18.0	21.9	21.6	22.8
25 to 54	5.6	6.6	7.1	7.4	7.4	7.2	6.6	6.1	6.8	6.7	7.5
55 to 64	3.2	4.1	3.0	3.9	4.4	4.8	4.2	4.4	5.1	5.3	4.7
According to Region											
Brussels	13.0	14.7	15.8	15.9	16.5	17.7	17.2	16.0	15.9	15.6	17.4
Flanders	4.0	4.9	5.7	5.4	5.5	5.0	4.4	3.9	5.0	5.0	5.5
Wallonia	9.9	10.6	10.9	12.1	11.9	11.8	10.5	10.1	11.2	11.0	11.4
According to educational level											
Lower secondary education or less	10.0	11.7	12.5	13.3	14.1	14.0	13.0	12.5	13.7	13.7	15.2
Upper secondary education	6.6	7.4	8.4	8.5	8.5	8.2	7.6	7.0	8.1	8.0	8.5
Higher education	3.5	4.1	4.4	4.7	4.5	4.5	3.8	3.6	4.5	4.5	4.5

Source: DGSEI.

(1) These unemployment rates are calculated on the basis of the harmonised data taken from the labour force survey.

TABLE X HARMONISED INDEX OF CONSUMER PRICES

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

	Total					Underlying trend in inflation ⁽²⁾	Non-energy industrial goods	Services	p.m. National consumer price index	p.m. National Health index ⁽³⁾
	Energy	Unprocessed food ⁽¹⁾	Processed food							
2003	1.5	1.7	2.8	1.5	1.0	1.9	1.6	1.5	1.5	
2004	1.9	0.9	2.2	1.3	0.3	2.1	2.1	1.6	1.6	
2005	2.5	1.7	2.0	1.3	0.3	2.1	2.8	2.2	2.2	
2006	2.3	3.3	2.1	1.5	0.9	2.1	1.8	1.8	1.8	
2007	1.8	3.0	4.7	1.4	0.9	1.9	1.8	1.8	1.8	
2008	4.5	2.8	7.8	1.8	1.3	2.3	4.5	4.2	4.2	
2009	0.0	0.4	1.7	2.1	1.4	2.6	-0.1	0.6	0.6	
2010	2.3	3.5	1.0	1.1	0.8	1.4	2.2	1.7	1.7	
2010 January	0.8	0.3	0.5	1.4	0.9	1.7	0.6	-0.1	-0.1	
February	0.8	1.3	0.5	1.2	1.2	1.2	0.7	0.1	0.1	
March	1.9	3.3	0.5	1.1	1.1	1.2	1.7	0.9	0.9	
April	2.1	2.4	0.5	1.0	0.8	1.2	1.8	1.1	1.1	
May	2.5	2.0	0.8	1.3	1.0	1.5	2.3	1.6	1.6	
June	2.7	3.9	0.8	1.1	0.8	1.3	2.5	2.0	2.0	
July	2.4	4.2	1.1	0.7	-0.1	1.1	2.6	2.2	2.2	
August	2.4	4.9	1.2	1.1	0.9	1.2	2.3	2.1	2.1	
September	2.9	5.8	1.5	1.1	0.8	1.3	2.9	2.6	2.6	
October	3.1	4.8	1.7	1.2	0.8	1.6	3.0	2.5	2.5	
November	3.0	4.4	1.8	1.4	0.7	1.9	2.9	2.5	2.5	
December	3.4	5.3	1.8	1.2	0.7	1.6	3.1	2.6	2.6	

Sources: EC, DGSEI.

(1) Fruit, vegetables, meat and fish.

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

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

TABLE XI SUMMARY ACCOUNT OF HOUSEHOLDS AT CURRENT PRICES⁽¹⁾

(data not adjusted for calendar effects, in € million)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010 e
1. Gross primary income	206,250	209,243	210,498	215,703	222,797	233,744	246,569	259,849	256,465	262,670
Wages and salaries ⁽²⁾	138,793	144,192	147,239	151,289	156,421	163,942	172,451	181,823	184,189	187,476
Property incomes ⁽³⁾	29,721	27,795	25,240	25,540	25,771	26,730	28,931	32,193	27,814	29,149
Gross mixed income	24,437	23,877	24,327	24,980	25,667	27,046	27,934	28,014	27,166	27,961
Gross operating surplus	13,300	13,380	13,692	13,894	14,938	16,025	17,253	17,819	17,296	18,084
2. Current transfers ⁽³⁾	-38,864	-39,785	-38,886	-40,221	-41,179	-41,522	-44,550	-47,003	-41,239	-42,022
Transfers received	55,874	58,467	60,890	63,190	65,742	67,281	69,872	73,803	79,042	81,648
Transfers paid	94,738	98,252	99,776	103,411	106,921	108,803	114,423	120,805	120,281	123,670
3. Gross disposable income (1 + 2)	167,386	169,458	171,612	175,482	181,618	192,222	202,019	212,846	215,226	220,648
<i>p.m. In real terms⁽⁴⁾</i>	197,743	197,734	197,323	197,103	198,625	204,100	208,561	212,846	216,277	216,370
<i>(percentage changes compared to the previous year)</i>	(2.8)	(0.0)	(-0.2)	(-0.1)	(0.8)	(2.8)	(2.2)	(2.1)	(1.6)	(0.0)
4. Change in net claims of households on institutions for occupational retirement provision	1,607	1,541	1,716	1,857	2,009	1,959	2,467	2,884	2,412	2,542
5. Final consumption expenditure	138,912	141,346	144,383	150,110	155,751	163,331	170,965	179,121	177,788	184,733
6. Gross savings (3 + 4 + 5)	30,081	29,654	28,945	27,230	27,875	30,850	33,521	36,609	39,849	38,457
<i>p.m. In % of gross disposable income⁽⁵⁾</i>	17.8	17.3	16.7	15.4	15.2	15.9	16.4	17.0	18.3	17.2
7. Capital transfers ⁽⁶⁾	-530	-296	-763	-850	-1,257	-1,239	-1,039	-1,116	-443	-914
8. Gross capital formation	14,139	13,971	14,563	16,004	18,750	20,704	22,547	23,480	21,906	21,229
9. Overall balance (6 + 7 + 8)	15,412	15,387	13,619	10,376	7,869	8,907	9,936	12,014	17,500	16,314

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.

(5) In % of gross disposable income in the broad sense, i.e. including the change in net claims of households on institutions for occupational retirement provision.

(6) 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.

TABLE XII SUMMARY ACCOUNT OF CORPORATIONS, AT CURRENT PRICES ⁽¹⁾

(data not adjusted for calendar effects, in € million)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010 e
1. Gross primary income	37,817	40,563	46,179	51,827	53,643	56,513	60,775	58,968	55,231	58,786
Gross operating surplus	51,581	54,295	57,755	65,191	69,610	73,072	79,047	78,984	73,874	79,416
Property incomes ⁽²⁾	-13,765	-13,732	-11,576	-13,364	-15,968	-16,559	-18,272	-20,017	-18,643	-20,631
2. Current transfers ⁽²⁾	-6,410	-6,562	-6,318	-7,409	-8,189	-9,453	-8,120	-8,576	-6,514	-7,421
Transfers received	15,944	16,877	16,907	16,859	17,391	18,068	19,698	20,291	20,349	20,579
Transfers paid	22,354	23,439	23,225	24,269	25,580	27,521	27,818	28,867	26,863	28,000
3. Gross disposable income (1 + 2)	31,407	34,001	39,861	44,417	45,454	47,060	52,656	50,392	48,718	51,365
4. Change in net claims of households on institutions for occupational retirement provision	-1,606	-1,540	-1,721	-1,853	-2,008	-1,956	-2,469	-2,880	-2,409	-2,538
5. Gross savings (3 + 4)	29,800	32,462	38,140	42,564	43,446	45,105	50,187	47,512	46,309	48,827
6. Capital transfers ⁽³⁾	736	817	-1,888	906	8,927	1,936	1,561	915	2,550	1,429
7. Gross fixed capital formation	35,359	32,601	32,715	36,851	38,471	40,572	44,649	47,775	43,920	43,885
8. Change in inventories	770	160	1,399	2,933	3,449	4,804	3,755	5,732	-3,781	-2,044
9. Overall balance (5 + 6 - 7 - 8)	-5,593	518	2,138	3,687	10,452	1,664	3,344	-5,080	8,721	8,414

Sources: NAI, NBB.

(1) The data in this table are calculated in gross terms, i.e. before deduction of consumption of fixed capital.

(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) 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.

TABLE XIII SUMMARY ACCOUNT OF THE REST OF THE WORLD, AT CURRENT PRICES⁽¹⁾
(data not adjusted for calendar effects, in € million)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010 e
1. Gross primary income	-4,164	-3,608	-4,253	-3,155	-1,970	-2,822	-3,281	-5,094	-3,100	-3,316
Compensation of employees ⁽²⁾	-3,175	-3,356	-3,813	-3,938	-4,071	-4,463	-4,640	-4,788	-4,914	-4,976
Taxes on production and imports ⁽²⁾	1,095	890	834	704	796	954	1,188	1,303	790	862
Property incomes ⁽²⁾	-2,084	-1,142	-1,274	79	1,305	687	172	-1,608	1,024	797
2. Current transfers ⁽²⁾	2,423	3,077	3,740	4,456	4,105	4,043	3,016	4,268	5,546	4,862
Transfers received	6,349	6,670	7,614	8,063	8,429	8,327	8,991	10,084	10,847	11,175
Transfers paid	3,926	3,593	3,874	3,607	4,324	4,284	5,975	5,816	5,301	6,313
3. Transactions in goods and services	-9,464	-15,423	-14,925	-14,313	-11,935	-12,152	-12,905	-2,963	-9,292	-10,991
Imports by Belgium	192,793	191,020	190,267	208,773	230,911	249,740	266,532	292,681	238,173	277,876
Exports by Belgium	202,256	206,443	205,192	223,086	242,846	261,892	279,437	295,645	247,464	288,868
4. Net current transactions (1 + 2 + 3)	-11,205	-15,954	-15,439	-13,013	-9,800	-10,931	-13,169	-3,789	-6,845	-9,445
5. Capital transfers ⁽³⁾	469	459	183	157	316	9	1,145	1,646	1,253	1,151
6. Overall balance (4 + 5)	-10,736	-15,496	-15,256	-12,856	-9,484	-10,922	-12,024	-2,143	-5,591	-8,294

Sources: NAI, NBB.

(1) In accordance with the national accounts conventions, transactions are recorded from the point of view of the rest of the world. A positive (negative) figure for the balances of the various items therefore corresponds to net expenditure (revenue) for Belgium in relation to the rest of the world. In particular, a positive (negative) overall balance corresponds to net borrowing (lending) by Belgium in relation to the rest of the world.

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

(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.

TABLE XIV REVENUE, EXPENDITURE AND OVERALL BALANCE OF GENERAL GOVERNMENT

(in € million)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010 e
Revenue ⁽¹⁾	128,518	133,295	140,452	142,568	149,466	155,102	161,089	168,386	163,260	171,273
Fiscal and para-fiscal revenue	114,988	119,384	121,325	128,577	133,824	139,348	144,909	150,679	145,359	151,924
Levies weighing chiefly on earned income	70,026	72,568	73,670	76,267	78,380	80,096	84,044	89,053	88,026	90,767
Personal income tax ⁽²⁾	32,712	33,440	33,677	35,014	36,189	36,258	37,548	39,955	38,004	39,937
Social security contributions ⁽³⁾	37,315	39,128	39,993	41,254	42,191	43,837	46,496	49,098	50,022	50,830
Taxes on profits of companies ⁽⁴⁾	8,091	8,142	7,912	8,991	9,816	11,368	11,758	11,701	8,611	9,798
Levies on other income and in respect of property ⁽⁵⁾	8,700	9,038	9,504	10,631	11,544	11,968	12,485	12,792	11,934	12,747
Taxes on goods and services	28,171	29,637	30,239	32,688	34,084	35,918	36,622	37,134	36,788	38,612
Non-fiscal and non-para-fiscal revenue ⁽⁶⁾	13,529	13,911	19,127	13,990	15,642	15,753	16,179	17,707	17,900	19,349
Expenditure excluding interest charges	110,754	118,250	126,240	129,859	145,219	141,996	149,359	159,944	171,336	175,315
Social insurance benefits	56,652	59,791	63,276	66,741	69,446	71,382	74,915	80,542	86,234	89,091
Replacement incomes	32,120	34,291	35,813	37,308	38,846	40,093	42,176	45,021	48,435	50,139
Pensions	21,866	22,942	23,812	24,777	25,921	26,892	28,724	30,799	32,543	33,600
Private sector pensions	15,110	15,722	16,253	16,664	17,321	17,823	18,441	19,792	20,857	21,509
General government pensions	6,757	7,220	7,559	8,113	8,601	9,069	10,283	11,007	11,686	12,092
Old persons' guaranteed income	258	258	264	283	276	269	340	430	390	400
Early retirement pensions	1,153	1,144	1,184	1,239	1,257	1,301	1,359	1,443	1,502	1,559
Unemployment benefits	4,637	5,356	5,747	6,024	6,121	6,097	5,772	5,848	6,984	7,064
Career breaks and time credit	274	352	432	488	556	590	647	700	750	784
Sickness and disability insurance benefits	3,023	3,208	3,366	3,485	3,636	3,839	4,144	4,554	4,943	5,354
Industrial accidents and occupational diseases	489	495	494	495	503	503	508	531	523	538
Integration allowance	420	536	514	517	575	604	683	717	800	840
Other social insurance benefits ⁽⁷⁾	24,532	25,501	27,464	29,432	30,600	31,289	32,739	35,522	37,799	38,952
of which:										
Health care	15,052	15,372	16,745	18,053	18,896	19,256	20,286	22,262	23,862	24,800
Family allowances	4,433	4,564	4,637	4,731	4,850	5,023	5,154	5,421	5,649	5,789
Other primary expenditure	54,103	58,459	62,964	63,119	75,773	70,614	74,444	79,402	85,102	86,223
Compensation of employees	30,326	32,532	33,833	34,661	36,422	37,859	39,324	41,635	43,288	44,332
Current purchases of goods and services	8,822	10,235	10,430	10,755	11,058	11,603	12,073	12,784	13,383	13,782
Subsidies to enterprises	3,200	3,209	3,680	3,397	4,809	5,469	6,479	7,282	7,506	8,624
Current transfers to the rest of the world	2,167	2,277	2,787	3,099	3,249	3,307	3,303	3,610	4,090	4,052
Other current transfers	3,044	3,177	3,484	3,773	4,029	4,170	3,766	4,195	4,699	4,803
Gross fixed capital formation	4,399	4,446	4,549	4,679	5,461	5,080	5,446	5,902	6,346	6,357
Other capital expenditure	2,144	2,435	4,202	2,756	10,746	3,128	4,054	3,994	5,790	4,273
Net amount excluding interest charges	17,763	15,045	14,212	12,708	12,045	12,755	11,730	8,442	-8,076	-4,042
Interest charges	16,847	15,454	14,713	13,916	13,083	12,105	12,985	13,232	12,554	12,413
Overall balance according to the ESA 95	917	-409	-501	-1,208	-8,837	351	-1,255	-4,791	-20,630	-16,455
<i>p.m. Overall balance according to the EDP⁽⁸⁾</i>	<i>1,056</i>	<i>-232</i>	<i>-291</i>	<i>-885</i>	<i>-8,433</i>	<i>573</i>	<i>-1,105</i>	<i>-4,622</i>	<i>-20,351</i>	<i>-16,028</i>

Sources: NAI, NBB.

(1) In accordance with the ESA 95, general government revenues do not include the tax revenues transferred to the EU.

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

(3) Total social contributions, including the special social security contribution and the contributions of non-active persons.

(4) Mainly advance payments, assessments and the withholding tax on income from movable property payable by companies.

(5) 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.

(6) Property incomes, imputed social security contributions, current and capital transfers from other sectors and sales of produced goods and services.

(7) 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.

(8) 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 XV OVERALL BALANCE OF GENERAL GOVERNMENT, BY SUB-SECTORS
(in € million)

	Entity I			Entity II			General government	
	Federal government	Social security	Total	Communities and Regions	Local authorities	Total	According to the ESA 95	p.m. According to the EDP ⁽¹⁾
2001	-2,385	1,678	-707	1,953	-329	1,624	917	1,056
2002	-691	1,258	567	-382	-594	-976	-409	-232
2003	767	-870	-103	26	-424	-398	-501	-291
2004	-706	35	-671	-41	-496	-537	-1,208	-885
2005	-8,031	-306	-8,336	354	-854	-500	-8,837	-8,433
2006	-202	829	628	504	-781	-277	351	573
2007	-3,851	1,637	-2,214	1,235	-277	958	-1,255	-1,105
2008	-5,749	1,559	-4,190	-129	-472	-600	-4,791	-4,622
2009	-14,537	-2,658	-17,195	-2,609	-827	-3,435	-20,630	-20,351
2010 e	-11,885	-602	-12,486	-2,656	-1,313	-3,968	-16,455	-16,028

Sources: NAI, NBB.

(1) 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 XVI CONSOLIDATED GROSS DEBT OF GENERAL GOVERNMENT⁽¹⁾

(end-of-period outstanding amounts, in € million)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
1. Official debt of the Treasury	257,163	262,752	263,018	265,518	269,160	270,601	285,226	310,215	321,389	341,193
In €	250,085	257,288	259,295	263,074	267,420	269,145	284,288	305,700	320,826	341,075
At up to one year	34,851	31,115	30,222	30,355	31,036	32,243	37,891	54,162	47,232	49,797
At over one year	215,234	226,173	229,073	232,719	236,384	236,902	246,397	251,539	273,593	291,278
In foreign currencies	7,079	5,464	3,724	2,444	1,740	1,456	937	4,515	563	118
2. Components of the official debt of the Treasury not included in the consolidated gross debt ⁽²⁾	4,572	3,996	3,459	0	0	0	0	0	0	0
3. Valuation difference ⁽³⁾	894	712	489	561	525	786	1,072	1,012	283	252
4. Other federal government liabilities ⁽⁴⁾	14,034	14,286	8,886	8,039	12,781	12,086	9,495	9,169	4,782	4,801 e
5. Consolidation between federal government units ⁽⁵⁾	7,796	13,084	17,416	21,291	22,687	21,454	30,814	29,749	27,161	35,361 e
of which Ageing Fund assets ⁽⁶⁾	374	1,087	4,266	12,492	13,504	14,661	15,494	16,183	16,901	17,628
6. Consolidated gross debt of federal government (1 - 2 + 3 + 4 - 5)	259,724	260,669	251,519	252,827	259,779	262,018	264,978	290,648	299,293	310,885 e
7. Consolidated gross debt of Communities and Regions	16,800	16,776	15,305	15,080	13,259	12,842	12,346	13,725	20,936	n.
8. Consolidated gross debt of local authorities	14,179	14,446	14,860	15,677	15,747	16,410	16,861	16,445	16,207	n.
9. Consolidated gross debt of social security	0	103	90	52	428	0	0	0	1,047	n.
10. Consolidation between the general government sub-sectors ⁽⁷⁾	14,056	14,280	10,138	9,754	10,199	10,858	12,080	11,690	11,227	n.
11. Consolidated gross debt of general government ⁽¹⁾ (6 + 7 + 8 + 9 - 10)	276,647	277,716	271,637	273,881	279,014	280,413	282,106	309,128	326,255	342,123 e

Sources: 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) Mainly treasury certificates presented to the IMF.

(3) Adjustment to the valuation of treasury certificates and treasury bills to convert the discounted value to the face value.

(4) Mainly the debudged Treasury debt, the debts of the "Caisse des dépôts et consignations - Deposito-en consignatiekas", SHLAF (up to 2006), CREDIBE (until 2002), and the RIF (from 2005 to 2008), and coins in circulation.

(5) Federal government debt, the counterpart of which is an asset of a federal government unit.

(6) Including the capitalised interest on "Ageing Fund Treasury Bonds".

(7) Debt of a general government sub-sector, the counterpart of which is an asset of another general government sub-sector.

TABLE XVII CURRENT AND CAPITAL TRANSACTIONS ACCORDING TO THE BALANCE OF PAYMENTS
(in € million)

	First nine months					
	2008		2009		2010	
	Credits	Debits	Balances	Credits	Debits	Balances
1. Current account	364,579	371,118	-6,539	297,780	294,918	2,862
Goods and services	284,414	292,487	-8,073	239,591	235,559	4,032
Goods	224,599	235,855	-11,256	180,802	182,939	-2,137
General merchandise	210,332	225,263	-14,931	169,857	175,559	-5,702
Goods for processing	11,841	8,847	2,994	8,436	6,044	2,392
Repairs to goods	410	275	135	457	145	312
Purchases of goods in ports	1,559	1,151	408	1,488	767	721
Non-monetary gold	457	319	138	564	424	140
Services	59,815	56,632	3,183	58,789	52,620	6,169
Transport	18,841	15,958	2,883	15,262	12,899	2,363
Travel	7,997	13,426	-5,429	7,146	12,863	-5,717
Communication	2,658	2,071	587	2,778	2,260	518
Construction	890	657	233	1,059	652	407
Insurance	860	755	105	900	792	108
Financial services	2,721	2,317	404	2,217	1,481	736
Data-processing and information services	2,563	1,869	694	3,011	2,143	868
Royalties and licence fees	808	1,324	-516	1,669	1,545	124
Other services to enterprises	19,275	15,629	3,646	21,961	16,288	5,673
of which merchanting (net)	4,332	-	4,332	3,966	-	3,966
Personal, cultural and recreational services	409	516	-107	424	489	-65
Services provided or received by general government, not included elsewhere	1,654	201	1,453	1,584	204	1,380
Services not allocated	1,139	1,909	-770	778	1,004	-226
Income	72,880	64,826	8,054	50,906	45,649	5,257
Earned income	6,913	2,374	4,539	7,385	2,524	4,861
Income from direct and portfolio investment	65,967	62,452	3,515	43,521	43,125	396
Current transfers	7,285	13,805	-6,520	7,283	13,710	-6,427
General government	1,675	6,743	-5,068	1,797	6,625	-4,828
Other sectors	5,610	7,062	-1,452	5,486	7,085	-1,599
2. Capital account	412	2,340	-1,928	461	1,722	-1,261
Capital transfers	26	599	-573	230	623	-393
Acquisitions and sales of non-produced non-financial assets	386	1,741	-1,355	231	1,099	-868
3. Net lending to the rest of the world (1 + 2)	364,991	373,458	-8,467	298,241	296,640	1,601
				247,701	241,180	6,521
				247,085	240,790	6,295
				205,088	201,175	3,913
				158,114	157,704	410
				150,252	151,793	-1,541
				6,165	4,616	1,549
				331	169	162
				944	668	276
				422	458	-36
				46,974	43,471	3,503
				14,353	11,706	2,647
				5,502	10,772	-5,270
				2,199	1,711	488
				839	602	237
				626	666	-40
				1,483	957	526
				2,119	1,512	607
				1,435	1,012	423
				16,188	13,044	3,144
				2,197	-	2,197
				353	379	-26
				1,182	155	1,027
				695	955	-260
				36,177	29,076	7,101
				5,523	1,849	3,674
				30,654	27,227	3,427
				5,820	10,539	-4,719
				944	5,017	-4,073
				4,876	5,522	-646
				616	390	226
				381	204	177
				235	186	49
				247,701	241,180	6,521

Source: NBB.

TABLE XVIII FORMATION OF FINANCIAL ASSETS AND NEW FINANCIAL LIABILITIES OF HOUSEHOLDS
(in € million)

	First nine months										p.m. Outstanding amount at the end of September 2010	
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2009		2010
Formation of financial assets	20,766	17,540	19,052	14,488	25,253	22,195	23,232	22,960	34,493	24,622	20,302	909,490
At up to one year	7,462	10,674	15,816	20,422	14,994	13,228	10,021	8,513	7,740	6,249	9,897	277,063
Notes, coins and sight deposits	-3,606	4,734	3,747	5,492	6,150	808	-58	1,405	6,176	5,910	2,125	61,892
Savings deposits	5,554	11,543	17,934	14,180	8,335	1,740	-8,774	1,792	32,856	24,626	16,362	192,660
Time deposits	4,248	-5,299	-4,908	92	294	11,241	17,494	2,508	-25,911	-19,821	-8,312	22,008
Fixed-income securities	575	-1,258	-357	-244	-113	238	739	1,364	-1,980	-1,303	-446	232
Units of monetary UCIs	691	954	-599	902	328	-798	620	1,445	-3,402	-3,163	169	271
At over one year	15,021	6,740	3,580	4,705	9,840	8,606	11,874	15,070	26,742	18,320	11,029	623,022
Time deposits	223	-503	-627	-371	-637	35	1,329	3,431	4,362	3,559	204	12,382
Fixed-income securities	-5,256	-8,815	-15,851	-18,054	-13,274	-11,028	-5,831	9,186	7,184	6,074	1,808	83,661
Shares and other equity	-1,381	1,510	-5,499	-1,208	-8,889	-1,261	3,578	11,544	7,233	3,398	-576	182,949
Units of non-monetary UCIs	10,792	4,185	10,045	6,732	10,162	7,490	-1,784	-16,032	-4,705	-3,598	-611	115,846
Net claims on insurance technical reserves ⁽¹⁾	10,643	10,363	15,513	17,607	22,479	13,370	14,582	6,941	12,669	8,887	10,203	228,184
Other assets ⁽²⁾	-1,716	127	-344	-10,639	419	361	1,337	-623	11	53	-624	9,405
New financial liabilities	-438	4,099	6,840	6,277	12,107	12,130	14,243	13,736	9,950	7,398	8,769	192,349
Loans at up to one year	-1,203	280	-998	-167	811	-54	154	425	-220	-334	175	6,465
Loans at over one year	2,557	4,426	7,999	6,009	11,650	11,867	13,260	13,574	10,445	7,384	8,608	183,149
Mortgage loans	2,394	5,042	7,659	6,478	10,268	10,748	11,949	11,780	10,752	6,643	8,398	153,605
Instalment loans	354	325	-208	-481	648	278	1,388	1,259	646	542	329	16,785
Other	-191	-941	548	12	735	841	-77	535	-953	199	-119	12,760
Other liabilities ⁽³⁾	-1,792	-607	-161	435	-354	317	830	-264	-276	348	-15	2,735
Financial balance ⁽⁴⁾	21,205	13,441	12,213	8,212	13,146	10,064	8,989	9,224	24,543	17,224	11,533	717,141

Source: NBB.

(1) Essentially life insurance and institutions for occupational retirement provision.

(2) This item comprises other accounts receivable within the meaning of the ESA 95, namely trade credit and miscellaneous assets on general government and financial institutions, including in particular interest accrued and not due.

(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 XIX FORMATION OF FINANCIAL ASSETS AND NEW FINANCIAL LIABILITIES OF NON-FINANCIAL CORPORATIONS
(in € million)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	First nine months			p.m. Outstanding amount at the end of September 2010
										2009	2010	2010	
Formation of financial assets	58,366	30,413	58,843	32,759	12,384	79,070	150,973	189,425	2,391	14,879	40,344	1,505,690	
At up to one year	46,108	-3,630	36,033	-10,613	12,545	37,732	33,149	76,944	50,368	51,263	31,626	504,262	
Notes, coins and sight deposits	502	805	1,797	1,260	2,099	4,950	3,286	-3,136	9,777	8,061	4,975	51,417	
Other deposits	3,462	327	-3,784	1,532	-4,282	16,465	14,032	-1,469	19,399	17,824	-5,725	65,952	
Other ⁽¹⁾	42,145	-4,762	38,020	-13,405	14,729	16,316	15,831	81,549	21,193	25,378	32,376	386,893	
At over one year	17,752	19,988	27,177	36,895	8,956	35,432	84,297	102,098	-29,416	-16,968	-2,776	935,775	
Shares and other equity ⁽²⁾	5,050	-2,905	2,442	18,766	9,521	-973	57,876	51,416	23,913	20,584	-1,752	711,605	
Fixed-income securities	-421	2,166	-1,753	-1,086	1,454	-2,457	3,546	3,198	4,249	1,879	-1,506	14,499	
Other ⁽¹⁾	13,124	20,727	26,488	19,215	-2,019	38,862	22,875	47,484	-57,578	-39,430	482	209,671	
Other assets and statistical adjustments ⁽³⁾	-5,494	14,055	-4,367	6,477	-9,117	5,906	33,528	10,383	-18,561	-19,416	11,494	65,653	
New financial liabilities	68,145	27,387	54,411	27,764	8,016	78,097	150,643	189,177	-184	4,503	27,004	1,876,889	
At up to one year	25,663	-4,761	21,091	-11,155	2,601	20,839	28,798	14,251	9,459	10,232	-2,583	273,579	
Loans granted by credit institutions	-1,276	-454	-2,249	2,506	-6,436	2,616	12,911	3,453	-7,643	-4,166	-13,211	42,510	
Other loans ⁽¹⁾	25,433	-5,021	23,509	-13,442	11,377	19,097	11,913	10,125	18,696	14,018	11,791	225,706	
Fixed-income securities	1,506	714	-170	-219	-2,340	-874	3,974	672	-1,593	380	-1,163	5,363	
At over one year	41,494	32,728	33,130	38,188	5,647	55,891	120,188	167,329	-7,920	-6,596	31,611	1,588,429	
Loans granted by credit institutions	1,531	1,863	-4,562	2,014	2,990	2,885	7,056	21,059	-6,747	-132	1,677	87,842	
Other loans ⁽¹⁾	12,276	22,546	26,746	13,487	-4,874	20,233	20,275	19,875	-37,511	-30,267	-3,261	169,115	
Shares and other equity ⁽²⁾	27,773	8,657	5,323	22,485	9,094	31,375	92,740	127,156	29,200	20,168	34,671	1,312,436	
Fixed-income securities	-86	-338	5,623	202	-1,563	1,398	118	-762	7,138	3,636	-1,475	19,036	
Other liabilities ⁽⁴⁾	988	-580	190	731	-233	1,368	1,657	7,597	-1,723	867	-2,024	14,882	
Financial balance ⁽⁵⁾	-9,779	3,026	4,432	4,995	4,369	973	331	248	2,575	10,376	13,340	-371,199	

Source: NBB.

(1) Including intrasectoral loans of non-financial corporations.

(2) Including reinvested profits made on foreign direct investments.

(3) This item comprises miscellaneous assets on financial institutions, including in particular interest accrued and not due. In addition, it covers errors and omissions on Belgium's financial account vis-à-vis the rest of the world which, for consistency between the accounts, are regarded as unrecorded capital movements.

(4) This item comprises the technical reserves of non-autonomous institutions for occupational retirement provision 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 XVIII.

TABLE XX FORMATION OF FINANCIAL ASSETS AND NEW FINANCIAL LIABILITIES OF GENERAL GOVERNMENT

(in € million)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	First nine months		p.m. Outstanding amount at the end of September 2010
										2009	2010	
Formation of financial assets	4,840	3,835	-4,497	3,412	456	942	12,756	22,238	-4,239	-5,869	235	111,599
Deposits, loans and securities other than shares	3,318	5,280	-3,871	4,059	1,368	-886	11,691	8,509	-2,437	-7,228	2,916	60,450
With general government	4,428	5,608	1,623	3,615	1,820	-532	10,587	-1,452	-2,927	-8,223	-291	38,512
With other sectors	-1,111	-328	-5,495	444	-452	-354	1,104	9,961	490	995	3,207	21,938
Other assets ⁽¹⁾	1,523	-1,445	-625	-647	-912	1,828	1,065	13,729	-1,802	1,360	-2,681	51,149
New financial liabilities	5,272	6,173	-4,116	4,444	8,728	601	13,424	25,810	15,304	12,396	15,658	396,026
In €	6,594	7,463	-2,835	5,744	9,479	729	13,917	22,074	19,261	15,329	15,301	394,953
At up to one year	-338	10	-518	-1,822	1,004	1,154	7,633	18,100	-4,752	-1,736	-1,663	68,686
of which:												
Treasury certificates	1,278	-49	-1,063	-133	869	334	3,738	11,132	-2,167	4,049	-733	39,684
Other securities	-1,759	-72	472	-457	-184	107	1,013	3,554	-3,835	-2,735	824	3,748
At over one year	6,931	7,454	-2,317	7,566	8,475	-425	6,284	3,973	24,013	17,065	16,964	326,266
of which:												
Linear bonds	12,570	11,628	7,790	4,968	4,125	-14	6,679	4,512	16,228	10,620	11,078	252,721
Other securities	-6,756	-5,440	-8,948	-5,334	664	-1,531	-1,128	-560	7,563	7,174	2,960	24,119
In foreign currencies	-1,322	-1,291	-1,281	-1,300	-751	-128	-492	3,736	-3,957	-2,933	357	1,073
At up to one year	427	-240	-761	11	-381	-55	-492	4,228	-3,957	-2,933	967	1,073
At over one year	-1,748	-1,050	-520	-1,310	-370	-73	0	-492	0	0	-611	0
Financial balance ⁽²⁾	-432	-2,338	-381	-1,032	-8,273	341	-669	-3,572	-19,543	-18,265	-15,423	-284,427

Source: NBB.

(1) Shares and other equity, UCI units, financial derivatives and other accounts receivable within the meaning of the ESA 95.

(2) See note 4 to table XVIII.

TABLE XXI FORMATION OF FINANCIAL ASSETS AND NEW FINANCIAL LIABILITIES OF MONETARY FINANCIAL INSTITUTIONS ⁽¹⁾

(data on a territorial basis, in € million)

	First nine months										p.m. Outstanding amount at the end of September 2010	
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2009		2010
Formation of financial assets												
Interbank claims	317	20,471	65,477	54,147	61,608	49,673	131,413	-53,598	-95,797	-76,972	-41,521	366,582
Belgian MFIs	-5,436	-6,903	8,112	7,093	15,998	2,901	32,006	27,669	-32,846	-30,886	-37,328	56,707
Foreign MFIs	5,753	27,374	57,365	47,054	45,611	46,772	99,407	-81,267	-62,951	-46,086	-4,193	309,875
Loans ⁽²⁾	14,280	21,091	14,943	19,465	51,718	31,170	40,886	-11,298	-30,227	-13,009	-13,707	367,403
of which:												
Households	2,076	3,284	5,625	6,734	13,367	12,129	7,634	-23,835	-9,982	-7,146	5,833	105,099
Non-financial corporations	-749	-1,700	-7,522	-1,281	1,191	463	15,260	5,245	-7,098	676	-5,932	85,604
Fixed-income securities	28,110	-11,453	2,178	9,195	10,585	-8,135	7,225	40,701	2,538	-15,705	-8,693	271,886
of which:												
General government	-9,497	-7,908	-7,937	-5,465	-138	-4,710	-13,469	676	7,005	4,503	6,197	62,726
Rest of the world	38,209	-2,423	9,753	14,409	11,487	-3,677	19,002	4,177	-29,199	-29,734	-16,512	139,988
Other assets	4,450	-381	7,700	28,767	6,627	21,833	46,637	39,279	-55,450	-58,937	34,068	226,810
Total	47,158	29,728	90,298	111,573	130,539	94,542	226,162	15,084	-178,936	-164,623	-29,877	1,226,681
Households	223	3,082	5,665	6,718	13,345	12,274	8,016	-23,884	-10,556	-7,603	5,672	106,283
Non-financial corporations	-838	-3,700	-6,981	-1,740	1,152	1,903	15,279	11,685	-13,831	-3,797	-9,757	92,173
General government	-10,949	-8,969	-7,856	-6,195	-604	-4,271	-13,869	1,654	2,597	3,511	9,518	89,391
Financial institutions	-4,508	-4,764	23,175	28,842	13,803	34,136	71,419	112,281	-34,824	-54,312	-5,032	329,951
Rest of the world	63,230	44,079	76,295	83,948	102,843	50,499	145,317	-86,652	-122,323	-102,421	-30,278	608,882
New financial liabilities												
Interbank liabilities	17,583	786	57,646	48,231	89,244	74,571	110,732	-98,296	-130,690	-115,531	-66,610	302,023
Belgian MFIs	-5,436	-6,903	8,112	7,093	15,998	2,901	32,006	27,669	-32,846	-30,886	-37,328	56,707
Foreign MFIs	23,019	7,689	49,534	41,138	73,246	71,670	78,726	-125,966	-97,844	-84,645	-29,282	245,316
Cash and deposits ⁽²⁾	28,182	27,071	28,030	44,220	49,826	9,145	50,652	35,714	-2,358	-7,713	14,663	570,981
of which:												
Households	5,820	11,613	16,837	18,336	14,772	11,310	8,541	9,223	18,698	14,883	12,239	274,081
Non-financial corporations	1,973	4,023	1,305	196	1,977	9,135	9,664	-2,965	5,694	4,829	8,778	87,085
Fixed-income securities	-5,777	-4,119	-8,900	-5,499	-9,558	-418	13,959	6,822	23,135	24,680	-8,333	86,568
Savings notes	-4,790	-4,033	-6,976	-7,357	-7,280	-2,863	1,358	2,405	7,661	6,923	-2,945	36,658
Other fixed-income securities	-987	-86	-1,924	1,858	-2,278	2,445	12,601	4,417	15,474	17,757	-5,388	49,910
Other liabilities and statistical adjustments ⁽³⁾	7,169	5,990	13,522	24,620	1,027	11,245	50,818	70,844	-69,023	-66,059	30,403	267,109
Total	47,158	29,728	90,298	111,573	130,539	94,542	226,162	15,084	-178,936	-164,623	-29,877	1,226,681
Households	396	8,366	8,738	12,140	7,005	7,432	12,692	12,446	23,560	22,422	11,363	324,450
Non-financial corporations	3,364	8,523	1,574	-3,798	1,516	12,557	8,693	-23,934	14,776	15,139	8,694	105,285
General government	-36	-1,180	55	13	25	-447	1,192	16,105	-10,911	-10,387	851	25,007
Financial institutions	-1,348	-6,024	21,822	37,572	19,376	11,614	65,349	86,583	-70,651	-76,616	-10,611	248,203
Rest of the world	44,781	20,043	58,108	65,646	102,617	63,385	138,234	-76,116	-135,702	-115,181	-40,173	523,736

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 XXII FORMATION OF ASSETS AND NEW LIABILITIES OF FINANCIAL INTERMEDIARIES OTHER THAN MONETARY INSTITUTIONS
(in € million)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	First nine months			p.m. Outstanding amount at the end of September 2010
										2009	2010	2010	
Non-monetary UCIs													
Formation of financial assets	12,110	3,586	4,029	6,240	6,492	7,935	-1,851	-13,982	242	1,774	-3,203	93,396	
Deposits	2,041	2,957	2,390	1,994	1,861	-655	-6,996	-2,990	-3,331	-2,871	-3,000	12,432	
Fixed-income securities	1,529	103	-489	4,728	-1,123	3,130	7,450	-1,192	-19	55	-581	30,336	
Shares and other equity ⁽¹⁾	5,444	1,553	338	-2,465	414	-1,222	-4,250	-798	4,017	4,194	-2,050	26,308	
UCI units	1,962	-2,653	205	-5	5,855	5,058	-141	-5,350	1,296	1,072	2,146	17,676	
Other assets	1,134	1,627	1,583	1,988	-515	1,624	2,086	-3,652	-1,720	-677	282	6,645	
New financial liabilities	12,110	3,586	4,029	6,240	6,492	7,935	-1,851	-13,982	242	1,774	-3,203	93,396	
UCI units held by Belgian households	8,993	4,698	5,335	4,222	1,471	5,092	-3,633	-6,663	-4,029	-3,021	-3,906	65,164	
UCI units held by other investors	3,117	-1,111	-1,307	2,019	5,021	2,843	364	-5,205	3,568	3,552	264	25,403	
Other assets	0	0	0	0	0	0	1,419	-2,114	704	1,243	438	2,829	
Financial balance ⁽²⁾	0	0	0	0	0	0	0	0	0	0	0	0	
Insurance companies and institutions for occupational retirement provision													
Formation of financial assets	9,983	10,520	16,405	20,422	22,478	15,522	17,704	8,505	12,742	9,487	11,424	261,805	
Deposits	430	1,784	3,320	2,587	75	-896	-885	3,215	-2,080	-1,912	1,123	12,931	
Fixed-income securities	3,115	1,733	11,737	14,847	15,964	14,977	12,187	1,423	21,068	18,307	6,689	159,594	
Loans	546	343	-104	-107	-672	241	126	1,433	1,072	1,139	141	13,396	
Shares and other equity	518	3,470	-1,258	97	2,164	-1,394	4,340	6,125	-6,652	-7,221	4,103	30,479	
UCI units	4,431	2,978	2,206	2,538	4,250	2,330	1,906	-5,594	-1,237	-1,237	-1,720	32,736	
Other assets	943	212	503	461	697	264	30	1,903	591	411	1,087	12,669	
New financial liabilities	10,689	10,758	16,390	20,380	23,925	16,709	15,563	10,455	12,055	8,918	10,522	257,084	
Net claims of households on life insurance reserves and institutions for occupational retirement provision	9,328	8,569	13,035	15,104	20,170	11,403	13,776	6,616	9,189	6,157	8,279	189,713	
Other insurance technical reserves	637	1,069	1,580	2,197	1,838	1,757	341	730	1,070	1,140	1,885	30,102	
Other liabilities	725	1,119	1,775	3,078	1,917	3,549	1,447	3,110	1,796	1,621	359	37,269	
Financial balance	-706	-238	15	42	-1,447	-1,187	2,141	-1,951	687	569	902	4,721	
Other⁽³⁾													
Formation of financial assets	5,026	7,704	7,277	-3,831	8,025	30,230	50,397	57,490	31,522	15,367	4,808	216,874	
Deposits	711	-298	3,592	149	1,778	299	-529	7,318	-4,489	-5,962	-896	6,890	
Loans	1,250	3,295	3,089	412	1,036	14,575	10,608	43,377	22,706	5,950	7,548	127,721	
Shares and other equity	2,099	3,671	-1,619	-2,461	4,913	4,145	29,375	5,808	4,124	4,189	-26	45,649	
Other assets	965	1,036	2,215	-1,931	297	11,212	10,942	987	9,181	11,190	-1,819	36,615	
New financial liabilities	4,578	6,100	8,300	-4,469	6,335	29,501	49,164	59,296	34,192	18,304	8,279	224,207	
Loans	3,450	804	8,461	-3,873	1,542	9,157	12,635	9,946	4,005	3,124	-852	56,514	
Shares and other equity	1,177	2,901	-68	-63	4,165	18,977	31,865	5,012	2,759	2,509	159	67,859	
Other liabilities	-49	2,395	-93	-533	629	1,367	4,664	44,339	27,429	12,671	8,972	99,834	
Financial balance	447	1,604	-1,023	638	1,689	729	1,233	-1,806	-2,671	-2,937	-3,471	-7,332	

Sources: Belgian Association of Pension Institutions, BEAMA, CBFA, NBB.

(1) Including real estate certificates.

(2) Non-monetary UCIs are treated as pure financial intermediaries, with no financial balance.

(3) Financial holding companies, real estate investment funds with fixed capital (Sicaf), undertakings for investment in claims, mortgage companies, regional social housing companies, finance companies, investment firms and UCI management companies.

TABLE XXIII NET ISSUES OF SECURITIES⁽¹⁾ BY FINANCIAL⁽²⁾ AND NON-FINANCIAL CORPORATIONS AND GENERAL GOVERNMENT
(in € million)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	First nine months			p.m. Outstanding amount at the end of September 2010
										2009	2010	2010	
Fixed-income securities	336	3,166	-6,255	-6,952	-7,809	776	31,317	70,659	74,190	62,466	11,250	528,951	
Financial and non-financial corporations	-4,382	-1,611	-3,222	-4,701	-12,531	2,009	21,507	48,285	60,362	45,935	-3,235	207,606	
Securities at up to one year	-1,212	1,048	-266	667	-3,181	-1,510	4,262	2,075	9,625	14,533	-1,627	28,278	
Securities at over one year	-3,170	-2,659	-2,956	-5,368	-9,350	3,518	17,245	46,210	50,737	31,402	-1,608	179,329	
General government	4,717	4,777	-3,033	-2,251	4,723	-1,233	9,810	22,374	13,828	16,530	14,485	321,345	
Securities at up to one year	651	-361	-1,355	-574	304	385	4,258	18,914	-9,962	-1,263	1,058	44,505	
Securities at over one year	4,066	5,138	-1,678	-1,677	4,419	-1,618	5,551	3,460	23,790	17,793	13,427	276,839	
Shares	29,232	12,132	4,022	22,699	13,262	53,507	144,571	145,035	37,208	27,909	35,044	1,434,315	
Listed shares	5,711	1,048	818	4,182	5,407	5,646	11,371	13,925	936	472	470	187,409	
Unlisted shares and other equity ⁽³⁾	23,522	11,084	3,205	18,518	7,855	47,861	133,200	131,110	36,273	27,437	34,575	1,246,906	
<i>p.m. Recourse by financial and non-financial corporations to the securities market</i>	24,851	10,521	800	17,999	731	55,515	166,078	193,321	97,570	73,844	31,810	1,641,922	

Sources: CBFA, Euronext Brussels, NBB.

(1) Excluding derivatives and units of UCIs.

(2) Excluding the Eurosystem.

(3) Including reinvested profits on direct investments effected in Belgium by foreign companies.

TABLE XXIV INTEREST RATES
(end of quarter, in % per year)

	Yield on the interbank market				Yield on the Belgian secondary market in securities issued by Belgian general government			Rates of the ten-year benchmark linear bond
	Yield on the interbank market		Three-month Treasury certificates	Linear bonds		At five years		
	Overnight ⁽¹⁾	Three-month ⁽²⁾		At one year	At two years			
2006 Q1	2.62	2.82	2.62	3.04	3.25	3.59	3.82	
Q2	2.89	3.06	2.82	3.33	3.55	3.87	4.09	
Q3	3.10	3.42	3.17	3.55	3.56	3.59	3.69	
Q4	3.69	3.73	3.49	3.82	3.87	3.92	3.99	
2007 Q1	3.90	3.92	3.78	4.01	4.02	4.02	4.11	
Q2	4.14	4.18	4.01	4.35	4.50	4.54	4.63	
Q3	4.16	4.79	3.93	4.04	4.18	4.26	4.49	
Q4	3.92	4.68	3.79	4.13	4.11	4.22	4.47	
2008 Q1	4.16	4.73	3.81	3.82	3.78	3.92	4.31	
Q2	4.27	4.95	4.22	4.64	4.79	4.87	4.87	
Q3	4.17	5.28	3.78	3.71	3.82	4.22	4.61	
Q4	2.35	2.89	1.76	1.99	2.51	3.32	3.77	
2009 Q1	1.64	1.51	0.77	1.01	1.70	3.21	3.94	
Q2	0.40	1.10	0.56	0.84	1.52	2.96	3.95	
Q3	0.53	0.75	0.38	0.70	1.40	2.68	3.65	
Q4	0.41	0.70	0.33	0.84	1.43	2.74	3.72	
2010 Q1	0.40	0.63	0.31	0.62	1.05	2.34	3.55	
Q2	0.54	0.77	0.35	0.69	1.06	2.38	3.46	
Q3	0.88	0.89	0.42	0.89	1.18	2.21	3.09	
Q4	0.82	1.01	0.63	1.57	2.04	3.24	3.97	

Sources: ECB, NBB.

(1) The weighted average interest rate on the interbank market of the euro area for unsecured overnight transactions (i.e. transactions not backed by securities) in euro (Eonia).

(2) Average interest rate offered on the interbank market of the euro area for unsecured three-month transactions in euro (Euribor).

TABLE XXV MAIN INTEREST RATES OF THE EUROSISTEM
(in % per year)

	Dates of announcement of changes	Rate on the main refinancing operations ⁽¹⁾	Rate on the marginal lending facility	Rate on the deposit facility
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
2007	8 March	3.75	4.75	2.75
	6 June	4.00	5.00	3.00
2008	3 July	4.25	5.25	3.25
	8 October	3.75	4.25	3.25
	6 November	3.25	3.75	2.75
	4 December	2.50	3.00	2.00
2009	15 January	2.00	3.00	1.00
	5 March	1.50	2.50	0.50
	2 April	1.25	2.25	0.25
	7 May	1.00	1.75	0.25
2010	–			

Source: ECB.

(1) For the transactions settled from 28 June 2000 to 14 October 2008, minimum bid rate at the tenders for the credit allotments. For transactions settled from 15 October 2008, fixed rate of the weekly one-week credit allotments.

TABLE XXVI
EXCHANGE RATES
(national monetary units per euro, annual averages)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
US dollar	0.896	0.946	1.131	1.244	1.244	1.256	1.370	1.471	1.395	1.326
Japanese yen	108.7	118.1	131.0	134.4	136.9	146.0	161.3	152.5	130.3	116.2
Swiss franc	1.511	1.467	1.521	1.544	1.548	1.573	1.643	1.587	1.510	1.380
Chinese yuan renminbi	7.413	7.827	9.363	10.297	10.196	10.010	10.418	10.224	9.528	8.971
Korean won	1,154.8	1,175.5	1,346.9	1,422.6	1,273.6	1,198.6	1,273.0	1,606.1	1,772.9	1,531.8
Hong Kong dollar	6.986	7.375	8.808	9.688	9.677	9.755	10.691	11.454	10.811	10.299
Singapore dollar	1.604	1.691	1.970	2.102	2.070	1.994	2.064	2.076	2.024	1.806
Canadian dollar	1.386	1.484	1.582	1.617	1.509	1.424	1.468	1.559	1.585	1.365
Norwegian krone	8.048	7.509	8.003	8.370	8.009	8.047	8.017	8.224	8.728	8.004
Australian dollar	1.732	1.738	1.738	1.691	1.632	1.667	1.635	1.742	1.773	1.442
Pound sterling	0.622	0.629	0.692	0.679	0.684	0.682	0.684	0.796	0.891	0.858
Swedish krona	9.255	9.161	9.124	9.124	9.282	9.254	9.250	9.615	10.619	9.537
Danish krone	7.452	7.431	7.431	7.440	7.452	7.459	7.451	7.456	7.446	7.447
Czech koruna	34.07	30.80	31.85	31.89	29.78	28.34	27.77	24.95	26.44	25.28
Estonian kroon	15.65	15.65	15.65	15.65	15.65	15.65	15.65	15.65	15.65	15.65
Hungarian forint	256.6	243.0	253.6	251.7	248.1	264.3	251.4	251.5	280.3	275.5
Bulgarian lev	1.948	1.949	1.949	1.953	1.956	1.956	1.956	1.956	1.956	1.956
Romanian leu ⁽¹⁾	26,004	31,270	37,551	40,510	3,621	3,526	3,335	3,683	4,240	4,212
Lithuanian litas	3.582	3.459	3.453	3.453	3.453	3.453	3.453	3.453	3.453	3.453
Latvian lats	0.560	0.581	0.641	0.665	0.696	0.696	0.700	0.703	0.706	0.709
Polish zloty	3.672	3.857	4.400	4.527	4.023	3.896	3.784	3.512	4.328	3.995
<i>p.m. Effective euro exchange rate⁽²⁾</i> <i>(index 1st quarter 1999 = 100)</i>	87.3	89.7	100.3	104.2	102.7	102.6	106.3	110.5	111.7	104.6

Source: ECB.

(1) From 2005, new Romanian leu.

(2) 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 2001-2003 and 2004-2006 with the trading partners 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 provide an update on various key economic data relating to Belgium in the year 2010 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 at the end of January 2011, are marked "e". They represent mere orders of magnitude intended to demonstrate the trends which already seem to be emerging. For the periods for which data are published, the sources used are mainly the NAI, the DGSEI and the Bank. The comments on the international environment and the comparisons between economies are usually based on the latest data or estimates originating from institutions such as the EC, the IMF, the OECD and the ECB.

The monetary unit used in the Report for the data concerning the euro area member countries is the euro. Amounts relating to periods before the introduction of the euro, on 1 January 1999 for Belgium and for most of the member countries, 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 wherever possible in this Report as consisting of all the EU countries which adopted the single currency during the period 1999-2010. Apart from Belgium, the area therefore consists of Austria, Cyprus, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, the Netherlands, Portugal, Spain, Slovenia, and Slovakia. 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. For some analyses, the preferred source was the OECD which includes in the euro area only the countries which are members of that international institution, i.e. excluding Cyprus and Malta. In view of the small size of those economies, the OECD data present a picture which is perfectly representative of the euro area as a whole.

Since 1999, the NAI, in accordance with the obligation imposed by Eurostat, has applied the ESA 95 methodology for compiling the national accounts⁽¹⁾. As far as possible, the Report incorporates the definitions and methods resulting from ESA 95. However, it still expresses the data in gross terms 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

(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 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*.

movements such as those of the gross operating surplus. For simplicity, 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 terms "corporations" and "enterprises" are also most frequently used as synonyms, whereas in the commentary from the GDP expenditure angle, "enterprises" also covers self-employed persons, who are included under households in the real and financial sectoral accounts.

The Belgian national accounts, like those of other European countries, has undergone a series of important methodological revisions in recent years, affecting in particular the breakdown of price and volume effects. A more detailed explanation of the changes thus made was supplied by the NAI in the publication of the detailed national accounts in December 2005, November 2006 and October 2009. Thus, since 2006, the volume series have been expressed in prices of the year preceding the one for which they were first published, while according to the previous practice they were expressed at prices of a fixed base year (2000, in the 2005 edition of the national accounts). This modification 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 2008, as in the official national accounts published in October 2010, that provides a measure of the volume change in "chained euros (reference year 2008)". The use of 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). This implies, for example, that in the case of chained level series, GDP is not equal to the sum of its components.

In the section 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, are not always uniform, because the period for which the methodological revision or the conversions from one 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 corporations 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
n.	not available
p.m.	pro memoria
e	estimate by the Bank
€	euro
\$	US dollar
£	British pound

List of abbreviations

Region or country

BE	Belgium
DE	Germany
IE	Ireland
EL	Greece
ES	Spain
FR	France
IT	Italy
CY	Cyprus
LU	Luxembourg
MT	Malta
NL	Netherlands
AT	Austria
PT	Portugal
SI	Slovenia
SK	Slovakia
FI	Finland
DK	Denmark
SE	Sweden
UK	United Kingdom
BG	Bulgaria
CZ	Czech Republic
EE	Estonia
LV	Latvia
LT	Lithuania
HU	Hungary
PL	Poland
RO	Romania
EU15	European Union excluding the countries which joined after 2003
TR	Turkey
US	United States

Other

ABEX	Belgian Association of Surveyors
BEA	Bureau of Economic Analysis
BEAMA	Belgian Asset Managers Association
BIS	Bank for International Settlements
BLEU	Belgian-Luxembourg Economic Union
BLS	Bank lending survey
BRIC	Brazil, Russia, India and China
CAP	Common agricultural policy
CBFA	Banking, Finance and Insurance Commission
CEBS	Committee of European Banking Supervisors
CEC	Central Economic Council
CEIC	CEIC Macroeconomic Databases For Emerging and Developed Markets
CEPR	Centre for Economic Policy Research
CPB	Centraal Planbureau (Netherlands)
CREDIBE	former Central Office for Mortgage Loans
CREG	Commission for Electricity and Gas Regulation
DGSEI	Directorate General of Statistics and Economic Information (FPS Economy, SMEs, Self-employed and Energy)
EC	European Commission
ECB	European Central Bank
ECOFIN	European Council of Ministers of Economic Affairs and Finance
EDP	Excessive deficit procedure
EFSF	European Financial Stability Facility
EFSM	European Financial Stabilisation Mechanism
EMBI	Emerging Markets Bond Index
EMS	European Stability Mechanism
EMU	Economic and Monetary Union
Eonia	Euro overnight index average
ESA	European System of Accounts
ESCB	European System of Central Banks
ESRI	Economic and Social Research Institute (Japan)
EU	European Union
Euribor	Euro interbank offered rate
Federgon	Federation of HR Partners
FISIM	Financial intermediation services indirectly measured
FOMC	Federal Open Market Committee
FPB	Federal Planning Bureau
FPIC	Federal Participation and Investment Company
FPS	Federal Public Service
FRA	Forward rate agreement
G20	Group of Twenty
GAAP	Generally Accepted Accounting Principles
GDP	Gross domestic product
GJ	Gigajoule
GNI	Gross national income

LIST OF ABBREVIATIONS

HICP	Harmonised index of consumer prices
HWWI	Hamburgisches Welt-Wirtschafts-Institut
IAS	International Accounting Standards
ICT	Information and communication technologies
IFRS	International Financial Reporting Standards
ILO	International Labour Office
IMF	International Monetary Fund
INAMI/RIZIV	National Institute for Health and Disability Insurance
KLEMS	Capital (K), labour (L), energy (E), materials (M) and service inputs (S)
kWh	Kilowatt hour
LEA	Local employment agency
LEI	Long-Term Economic Impact Group
Libor	London interbank offered rate
MAG	Macroeconomic Assessment Group
MFI	Monetary financial institution
MIR	Monetary financial institutions interest rates
NACE	Nomenclature of economic activities of the European Community
NAI	National Accounts Institute
NBB	National Bank of Belgium
NBER	National Bureau of Economic Research
NCPI	National consumer price index
NEO	National Employment Office
NSSO	National Social Security Office
OECD	Organisation for Economic Cooperation and Development
OIS	Overnight index swap
OLO	Linear bonds
ONS	Office for National Statistics (UK)
PLU	Professional Lenders' Union
Pricaf	Private equity sicaf (private closed-end equity fund)
R&D	Research and development
RFS	Fortis RBS Santander
RIF	Railway Infrastructure Fund
RIR	Retail interest rates
S&P	Standard & Poor's
SHLAF	Social Housing Loan Amortisation Fund
Sicafi	Société d'investissement à capital fixe immobilier (real estate investment fund with fixed capital)
SIFI	Systemically important financial institution
SME	Small and medium-sized enterprises
SNA	System of National Accounts
SNB	Swiss National Bank
TFP	Total factor productivity
TOE	Tonne of oil equivalent

UCI	Undertaking for collective investment
UNCTAD	United Nations Conference on Trade and Development
VAT	Value Added Tax

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