# BELGIAN PRIME NEWS

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**Next issue :** December 1998
**Sources :** NBB, unless otherwise mentioned

**Special topic :**

*The Belgian government securities market in the wake of EMU*

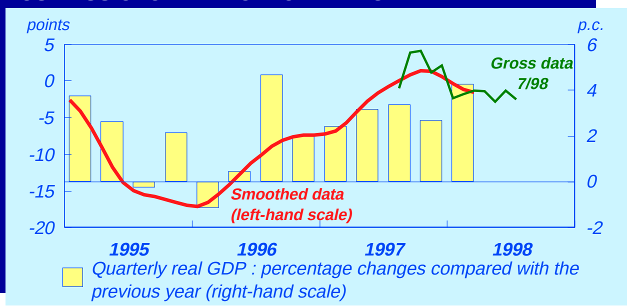
## CONSENSUS FORECAST

| | 1997 | | 1998 p | | | | 1999 p | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Belgium | Eur 11[3] | Belgium | | | Eur 11[3] | Belgium | | | Eur 11[3] |
| | | | Consensus | Max. | Min. | | Consensus | Max. | Min. | |
| Real GDP [1] | 2.9 | 2.5 | **2.8** | 3.0 | 2.7 | 3.0 | **2.6** | 3.1 | 2.2 | 3.2 |
| Employment [1] | 0.3 | 0.2 | **1.0** | 1.1 | 1.0 | 0.9 | **1.0** | 1.0 | 1.0 | 1.2 |
| Consumer prices [1] | 1.5 | 1.7 | **1.2** | 1.5 | 1.0 | 1.7 | **1.5** | 1.7 | 1.4 | 1.9 |
| Unit labour costs [1] | 0.1 | 0.3 | **0.5** | 0.8 | 0.4 | 0.4 | **0.8** | 0.8 | 0.8 | 0.9 |
| Current account [2] | 5.3 | 1.7 | **5.5** | 5.6 | 5.3 | 1.9 | **5.4** | 5.8 | 5.2 | 1.9 |
| General government balance [2] | -2.0 | -2.5 | **-1.4** | -1.2 | -1.7 | -2.4 | **-1.3** | -1.1 | -1.4 | -2.0 |
| Primary balance [2] | 5.9 | 2.6 | **6.1** | 6.3 | 6.0 | 2.4 | **6.0** | 6.3 | 5.6 | 2.5 |
| Public debt [2] | 122.1 | 75.2 | **117.6** | 118.2 | 116.3 | 73.9 | **113.9** | 115.0 | 112.7 | 72.5 |

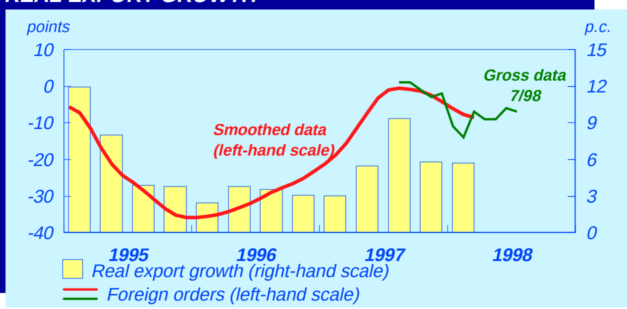
[1] P.c. change. [2] In p.c. of GDP. [3] Forecast from the European Commission (available since March 1998; next publication in autumn 1998).

## MACROECONOMIC DEVELOPMENTS

**BUSINESS CYCLE INDICATOR AND GDP**




**REAL EXPORT GROWTH**




*Although the Belgian economy is not completely isolated from the financial crisis affecting a large number of countries, economic activity remained more than satisfactory during the first half of the year. Industrial output rose 5.3 p.c. year-on-year in the second quarter, after a 4.6 p.c. rise in the first quarter.*

*The business climate indicator remained broadly stable (with a weakening tendency) during the first half of 1998. However, the foreign order book component had a negative impact. This means that although 75 p.c. of Belgium's exports remain within the European Union, where domestic demand is booming, the slowdown in the emerging markets is having an impact on Belgium's export growth. Moreover, Belgium's relative specialisation in semi-manufactures implies weaker export growth as the economic cycle advances.*

*While the global economy is clearly losing momentum, domestic demand in Belgium remains strong. In the first quarter, the latter increased by 5.2 p.c. An improvement on the labour market during the first half of 1998 and a neutral budget led to a spectacular rise in consumer confidence and to substantial growth in consumption (+3.4 p.c. in the first quarter). Strong car sales during the spring and summer months augur well for growth in consumption in the second and third quarters. Business investment also held up well, which is not surprising as the capacity utilisation rate in manufacturing industry reached 83.1 p.c. in June, its highest level since the early 1970s.*

*Residential construction does not seem to be suffering too much from the ending of the temporary VAT reduction, as mortgage rates continue to decline. Thanks to solid economic growth, the net borrowing requirement of the federal government for the first eight months of the year worked out at BEF 180 billion, down 38 p.c. from the level a year earlier. Budget plans for this year are firmly on course and, given the reduction in interest rates and the positive activity expectations, the public deficit should be further reduced next year without new budgetary measures.*

*Inflation was down to just 0.44 p.c. in August. Although this low figure is partly due to a revision of the consumer price index at the beginning of 1998, an upsurge in inflation does not appear likely. The substantial decline in raw material prices will continue to have a beneficial impact on inflation during the next few months.*

# The Belgian government securities market in the wake of EMU

*The advent of the euro will profoundly change the nature of European financial markets. Given its central position and its dependence on global macroeconomic patterns directly affected by EMU, the government securities market will undergo a particularly radical overhaul, both during the changeover to the euro and in the longer term.*

*Government bond markets have long been segmented according to national currencies. The Belgian banks, in particular, used to allocate a large proportion of their Belgian-franc-denominated liabilities to the purchase of Belgian government securities. Such a pattern will no longer prevail in the new environment shaped by EMU, which will create various advantages as well as new challenges for the Belgian Treasury.*

*Firstly, adverse stock-flow impacts on the public debt brought about by exchange-rate volatility will disappear. This advantage is not really new, however, as most intra-European exchange rate parities have already displayed a remarkable degree of stability since 1993. Secondly, the new integrated European securities market will make it easier for the Belgian Treasury to focus its bond issues on other euro area markets. However, this new opportunity will be counterbalanced by easier access to the Belgian market by foreign governments. Owing to this two-way spillover effect, country risks and bond market liquidity will become increasingly important.*

*At first sight, country risk is bound to increase in the wake of EMU. Owing to the establishment of the European Central Bank and to the Maastricht rules, participating countries will no longer be able to escape their public debt problems by resorting to the inflation tax. It is however unlikely that the euro will trigger any real change in this respect, since European central banks have already been maintaining an orthodox stance over the last few years. A move towards monetisation of public deficits would indeed not have been consistent with adherence to the ERM's fixed exchange rate regime. Moreover, from the beginning of January 1994 at the latest, national central banks had to comply with the Maastricht provisions prohibiting any direct monetary financing of government deficits. Credit risk will all the more remain unchanged as EMU participants will be able to collect taxes in euros, so that they will have no difficulty in servicing either their national currency (i.e. euro) debt or their foreign currency debt.*

*The high Belgian public debt gives, at first sight, more grounds for concern. It should however be borne in mind that Belgium's public debt in p.c. of GDP has been decreasing continuously since 1993 owing to sustained consolidation efforts. The dynamic at work, which is greatly aided by a much larger primary surplus than in the other countries of the euro area, should gradually align Belgium's fiscal position with that of the other participants in EMU. Provided that the current rigorous budgetary policy is adhered to, Belgium will acquire an unprecedented reputation for sound management, enabling it to reduce its long-term interest rate differential vis-à-vis Germany, France and the Netherlands.*

*This rather favourable situation is all the more solidly based because the liquidity of Belgian securities has also improved during the nineties, owing to far-reaching reforms introduced by the Belgian authorities. Belgian Treasury certificates and bonds were transformed many years ago into dematerialised securities issued by means of competitive auctions. They are traded through an efficient clearing and settlement system with the support of primary dealers who ensure the smooth functioning of the secondary markets. In order to increase the liquidity of the secondary market for linear bonds, the Treasury has also reduced the number of lines and standardised the coupon dates so that there are two dates a year (28 March and 28 September). The procedures used to exchange old linear bond lines for new lines with more distant maturities have also been made more attractive, offering a wider choice of lines for each exchange.*

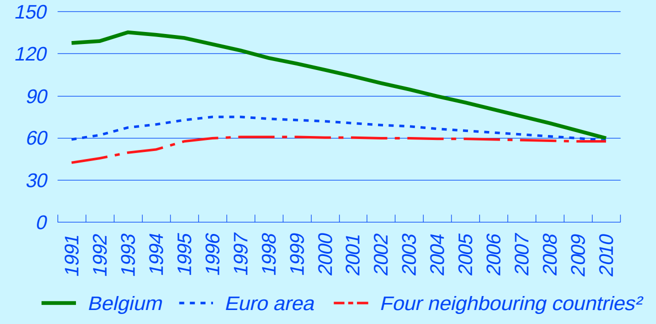
*The competitive advantage secured through these reforms will be further enhanced by Belgium's intensive preparation for the advent of EMU. Through the establishment of a new "Commission for the Euro" and the designing of a national financial centre scheme by representatives of general government, the banking community and the financial authorities, the Belgian authorities have helped to frame a coherent set of rules governing the changeover to the euro. This scheme requires, inter alia, not only that new issues of linear bonds and Treasury certificates be made in euros from the beginning of the third stage of EMU but also that existing linear bond lines be translated into euros on the same date[1].*

*Such a move is of course stimulating current thinking on these subjects. From the start of the third stage of EMU, existing OLOs in Belgian francs, French francs and German marks will merge, thereby promoting the liquidity of the OLO market in euros. Furthermore, the status of primary dealers and the market organisation are being scrutinised with a view to furthering market access, liquidity and transparency and to taking into account new technology-driven opportunities in the primary and secondary markets. In the risk management area, the establishment of the "debt benchmark portfolio" two years ago allowed the Treasury to integrate major market developments.*

[1] *For more details on the rules governing this conversion, please contact the Fin Euro unit of the Commission for the Euro (fax 32 2 221 31 53)*

## GROSS CONSOLIDATED DEBT RATIOS[1]

*percentages of GDP, end-of-year levels*




*Sources : European Central Bank, European Commission, NBB.*

*[1] From 1999 onwards each country's primary surplus is maintained at the 1998 level. Implicit interest rates converge gradually towards a single euro area rate of 6 p.c. in 2006. Nominal growth rates are put at 4.3 p.c. all over the euro area. Stock-flow adjustments are disregarded.*

*[2] France, Germany, Luxembourg and the Netherlands; weighted average.*

## FISCAL SITUATION OF GENERAL GOVERNMENT IN 1998

*percentages of GDP*

| | Primary surplus | Total deficit | Gross debt |
|---|---|---|---|
| Belgium . . . . . . . . . . . . | 6.2 | 1.3 | 117.3 |
| Euro area[1] . . . . . . . . . . | 2.4 | 2.4 | 73.9 |
| Four neighbouring countries[1] . . . . . . . . . . . | 1.3 | 2.5 | 60.7 |

*Sources : European Commission, NBB.*

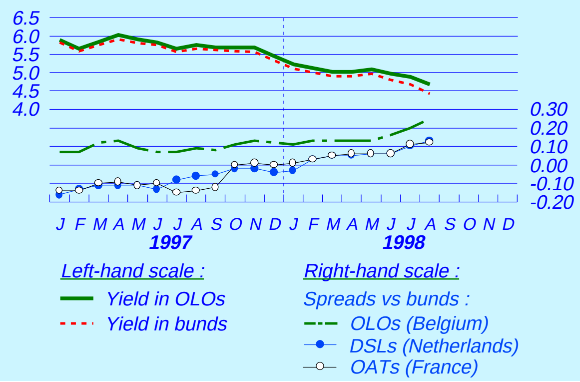
*[1] As estimated by the European Commission (spring 1998 forecast).*

# GOVERNMENT SECURITIES MARKET

## PRIMARY MARKET (billions of BEF)

| | OLOs | | | | | TREASURY BILLS | |
|---|---|---|---|---|---|---|---|
| | Gross issues | | | Net issues | | | Net issues | |
| | 1997 | 1998 | | 1997 | 1998 | | 1997 | 1998 |
| J | 49.5 | 111.1 | J | - 5.9 | - 20.1 | J | 107.8 | 108.6 |
| F | 97.5 | 83.3 | F | 21.7 | 46.5 | F | 5.0 | - 62.4 |
| M | 77.1 | 31.7 | M | 24.9 | - 0.6 | M | 40.6 | 71.6 |
| A | 59.3 | 113.4 | A | 23.7 | 89.7 | A | - 71.8 | -143.5 |
| M | 66.0 | 63.6 | M | -47.0 | 50.3 | M | 175.3 | 98.1 |
| J | 12.2 | 71.2 | J | - 0.1 | - 7.9 | J | 3.4 | 36.0 |
| J | 53.7 | 114.1 | J | 53.0 | - 14.0 | J | -109.9 | 19.7 |
| A | 37.6 | 26.0 | A | -38.5 | - 2.9 | A | - 12.9 | 25.4 |
| S | 39.9 | | S | 29.0 | | S | 118.1 | |
| O | 59.4 | | O | 36.1 | | O | - 90.0 | |
| N | 57.3 | | N | 24.9 | | N | - 65.9 | |
| D | 76.6 | | D | 52.9 | | D | - 77.3 | |

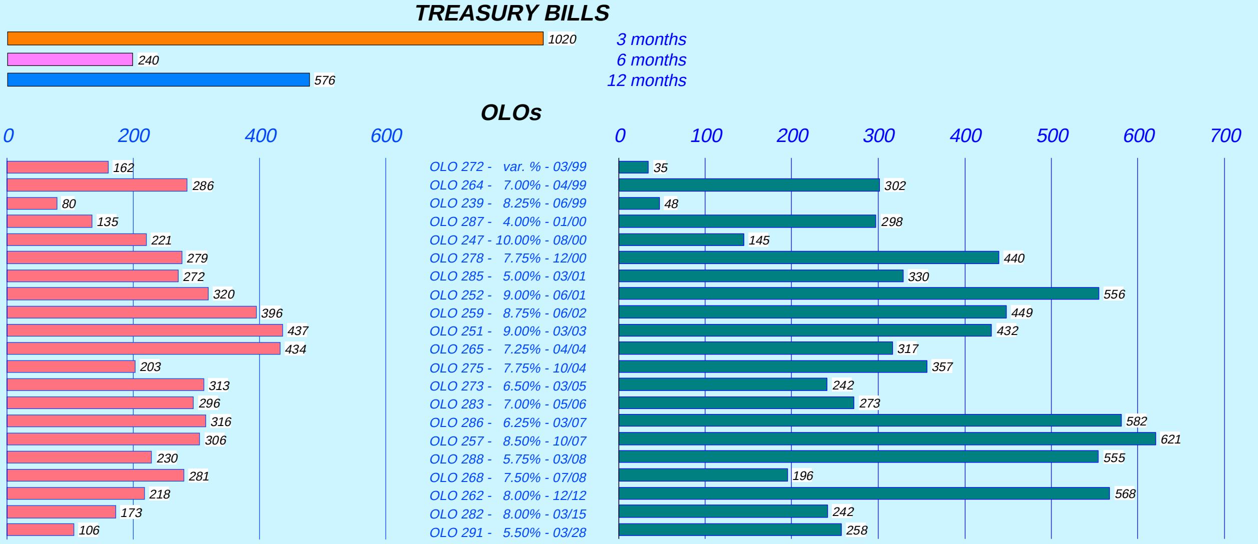
## BENCHMARK 10-YEAR BOND YIELDS (p.c.)



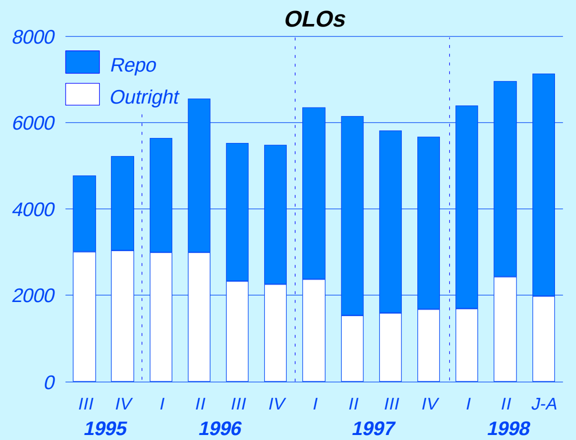

## OUTSTANDING AMOUNT AND TURNOVER (billions of BEF)

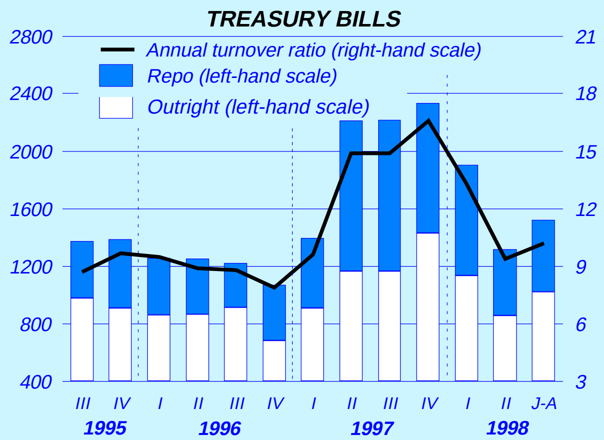
OUTSTANDING AMOUNT AT 31 AUGUST 1998

TURNOVER IN AUGUST 1998




## SECONDARY MARKET ACTIVITY (billions of BEF, standardised monthly averages)




*During the summer, activity remained strong in the primary and secondary markets for OLOs and Treasury bills. The strains on international financial markets induced a general widening of risk premiums incorporated in bond yields, which was accentuated by a technical shortage of German bunds.*

## TREASURY HIGHLIGHTS

*Belgian Treasury Bills ("BTBs") denominated in the foreign currency programme will from 24 September be adjusted to include the issuance of bills denominated in BEF, and thus in euros from 4 January 1999. Like its predecessor, the new programme provides for the issuance of bills with maturities of up to one year. BTBs are expected to smooth out some short-term fluctuations in the amount of Belgium's financing needs. They will therefore enhance the standardisation and transparency of the existing Treasury certificate market inasmuch as the order of magnitude of the amount of these certificates auctioned weekly might then become more consistent. In addition, BTBs denominated in BEF and euros will increase the depth of the Belgian commercial paper market and further foster the internationalisation of Belgium's investor base.*

## MONETARY POLICY HIGHLIGHTS

*The standing facilities and the open market operations that the ESCB plans to implement are quite similar to those which the National Bank of Belgium already uses ; reserve requirements, however, will be a completely new instrument for Belgian money market participants. To allow for a learning process, the National Bank proposed to Belgian and Luxembourg credit institutions that they should participate in the last four months of 1998 in a transitional system of reserve requirements in order to be prepared for the new monetary environment. Unlike the ESCB's system, the NBB's system is applied on a voluntary basis. Participating credit institutions have access to the Bank's open market operations, while access to the standing facilities remains open to all Belgian and Luxembourg credit institutions.*

*Many characteristics of the transitional reserve requirements (reserve base, lump-sum allowances, remuneration and sanctions) are very similar to the features of the ESCB's minimum reserves. The reserve requirements are defined as the average of the holdings at the end of each calendar day of the reserve period of one month, so that credit institutions will be able, through those averaging provisions, to cope with fluctuations in money market liquidity. To enable this monetary stabilisation function to be efficiently performed, a global minimum reserve amount of around 25-30 billion Belgian francs is targeted. Consequently a reserve ratio of 0.3 p.c. is applied, which is much lower than the ratio the ECB will set.*

*The introduction of transitional reserve requirements implies a change in the use of the other instruments of monetary policy. Fine-tuning market interventions, previously performed every day to provide the main part of the liquidity to the market, will only be used in exceptional circumstances. The liquidity is now provided through weekly auctions with the same characteristics (two-week maturity, access by all credit institutions) as the ESCB's main refinancing operations. The end-of-day standing facilities are also adapted to make them as close as possible to the ESCB's instruments : a marginal lending facility and a deposit facility with unlimited access and without interest rate differentiation. Thus, the special primary dealer facility has disappeared.*

*On 11 September 1998 the NBB's interest rates were as follows :*

- *rate of the last weekly auction (replaces the central rate) : 3.30 p.c.;*
- *rate of the marginal lending facility : 4.50 p.c.;*
- *rate of the deposit facility : 2.30 p.c.;*
- *discount rate (applicable to a facility for refinancing of very small amounts of trade bills) : 2.75 p.c.*

## LIST OF CONTACT PERSONS

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*This publication is also available on the internet sites www.nbb.be, www.bnb.be, www.nationalebank.be, www.banquenationale.be, www.nationalbank.be.*

# TREASURY AUCTIONS

| TIMETABLE | OLOs | TREASURY BILLS |
|---|---|---|
| *Auction day :* | *normally the last Monday of each month for fixed-rate OLOs.* | *3-, 6- and 12-month every Tuesday.* |
| *Auction-day value :* | *payment and delivery on the Thursday following the auction.* | *payment and delivery on the Thursday following the auction.* |
| *Auction calendar :* | *announced before 1 January for the forthcoming year.* | *announced before 1 January for the forthcoming year.* |
| *Invitation to bid :* | *announced one week before the auction day via the Treasury pages on Reuters (BELA) and Telerate (36350), after 5 p.m. The Treasury also announces a range within which the total amount for the competitive bids will be awarded on the morning of the banking day before the auction.* | *announced at the latest at 11.00 a.m. on the banking day preceding the auction day via the Treasury pages on Reuters (BELJ, BELK).*<br>*Invitation to bid : Reuters (BELH) and Telerate (36354).* |
| *Bid submissions :* | *before 12.00 noon on the auction day by means of subscription forms provided by the Treasury.* | *before 11.30 a.m. on the auction day by means of subscription forms provided by the Treasury.* |
| *Bids :* | *in multiples of BEF 5 million with a minimum of BEF 50 million (nominal amount) and in steps of 2 basis points.* | *in multiples of BEF 1 million with a minimum of BEF 10 million (nominal amount) on a yield basis to two decimal places.* |
| *Results :* | *American-style auction; announced at 12.45 p.m. and at the latest at 2.00 p.m. on the auction day.*<br>*Published through Reuters (BELA) and Telerate (36350).*<br>*Non-competitive bids : on Reuters (BELD) and Telerate (36352).* | *American-style auction; announced at 12.45 p.m. and at the latest at 2.00 p.m. on the auction day.*<br>*Published via the Treasury pages on Reuters (BELI) and Telerate (36355).* |
| *Forthcoming auctions :* | *Fixed-rate OLOs :*<br>*28.09.1998 26.10.1998 30.11.1998 21.12.1998* | *15.09.1998 22.09.1998 29.09.1998*<br>*06.10.1998 13.10.1998 20.10.1998 27.10.1998*<br>*03.11.1998 09.11.1998 17.11.1998 24.11.1998*<br>*01.12.1998 08.12.1998 15.12.1998 22.12.1998*<br>*29.12.1998* |
| *Exchange offers :* | *Annual calendar is available on request from the Treasury before 1 January of each year.*<br>*Exchanges of lines are announced six days before each operation on Reuters (BELJ or BELK) and Telerate (21392 or 21393) after 4 p.m.*<br>*The results are announced on Reuters (BELE) and Telerate (36353). The auctions are held on Monday with settlement and delivery on Thursday (T+3).* | |

*For more information please contact Mr Lepoutre at the Treasury on TEL 32 2 233 71 01 - FAX 32 2 233 71 14*

*This part of the Belgian Prime News, which will be added only to each September issue of the publication, is available on request.*

# THE ESCB'S MONETARY POLICY INSTRUMENTS

*From 1 January 1999 onwards, the European System of Central Banks (ESCB), consisting of the European Central Bank (ECB) and the national central banks, will conduct monetary policy in the euro area.*

***General principle of organisation***

- *Total centralisation of decisions : all monetary policy decisions will be taken by the Governing Council (comprising the 6 members of the Executive Board and the 11 governors of the central banks of EU Member States which have adopted the single currency) or by the Executive Board of the ECB.*
- *High degree of decentralisation in implementation : the ECB will have recourse to the national central banks to carry out monetary policy operations; the national central banks will continue to act as partners of the credit institutions located in their country.*

***Objectives***

- *The primary objective of the ESCB is to maintain price stability.*
- *Before the end of 1998 the Governing Council of the ECB will outline its monetary policy strategy and define its objectives more precisely.*

***Main functions of the operating framework***

- *The operating framework will enable the ESCB to steer money market interest rates and limit their volatility, and to send uniform signals within the euro area regarding monetary policy intentions.*

***Three categories of instruments***

- *The ESCB will mainly use open market operations.*
- *It will also offer two standing facilities, which will bound overnight market interest rates.*
- *A minimum reserve system will enlarge the structural liquidity shortage and help (through averaging provisions) to stabilise money market interest rates without requiring frequent fine-tuning operations.*

***Open market operations***

- *Main refinancing operations : weekly area-wide standard tenders (generally on Tuesday), repurchase agreements or collateralised loans for a two-week period; interest rate signal.*
- *Longer-term refinancing operations : monthly area-wide standard tenders, repurchase agreements or collateralised loans for a three-month period; no interest rate signal as the ESCB acts as a rate-taker.*
- *Fine-tuning operations (mainly in order to deal with unexpected fluctuations in liquidity) : area-wide quick tenders or bilateral procedures, various instruments.*
- *Structural operations (if needed) : area-wide standard tenders for repurchase agreements or collateralised loans and for the issuance of debt certificates, bilateral procedures for outright sales or purchases of securities.*

***Standing facilities***

- *Marginal lending facility : repurchase agreements or collateralised loans, overnight ; unlimited access provided that sufficient eligible assets are available as collateral ; interest rate as ceiling for the overnight market interest rate.*
- *Deposit facility : overnight ; unlimited access ; interest rate as floor for the overnight market interest rate.*

***Minimum reserves***

- *Institutions subject to minimum reserves : credit institutions established in the euro area.*
- *Reserve base : liabilities up to two years, except repos and liabilities vis-à-vis other institutions subject to the ESCB's minimum reserve system and vis-à-vis the ECB and the national central banks.*
- *Reserve ratio : to be determined (between 1.5 and 2.5 p.c.).*
- *Lump-sum allowance : EUR 100,000.*
- *Averaging provisions : compliance with the reserve requirement is determined on the basis of the average of the end-of-calendar-day balances on the reserve account over a one-month maintenance period, starting on the 24th of each month.*
- *Remuneration : holdings of required reserves are remunerated at the rate of the ESCB's main refinancing operations.*

***Collateral***

- *All liquidity-providing operations (including intraday credit) will be based on underlying assets provided by the counterparties either in the form of a transfer of ownership or in the form of a pledge.*
- *A distinction is made, essentially for purposes internal to the ESCB, between two categories of eligible assets : "tier one" consists of marketable debt instruments fulfilling uniform eligibility criteria specified by the ECB ; "tier two" consists of additional assets, marketable and non-marketable, which are of particular importance for national financial markets and banking systems, and for which eligibility criteria are established by the national central banks, subject to ECB approval. Government debt securities are generally included in tier one.*
- *Credit institutions may use eligible assets on a cross-border basis, i.e. they may borrow from the central bank of the Member State in which they are established by making use of assets located in another Member State. Consequently, OLOs and Belgian Treasury bills may be used as collateral for central bank credit in the whole euro area.*

*For more information please contact Mr Périlleux at the National Bank of Belgium on Tel 32 2 221 45 25 - Fax 32 2 221 31 62*

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