BELGIAN PRIME NEWS

June 1999
No. 4

Published by : National Bank of Belgium (NBB)
Participating institutions : NBB, Debt Agency (Ministry of Finance), Artesia, ASLK-CGER Bank, BACOB Bank, Bank Brussels Lambert, Crédit Communal de Belgique, Generale Bank, KBC Bank
Updated to : 11.06.1999
Next issue : September 1999
Sources : NBB, unless otherwise mentioned

Special topic :
Reverse transactions in Belgian securities: repurchase agreements, securities lending and securities swaps

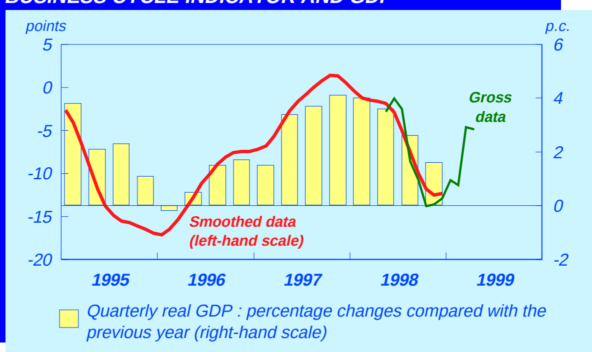
CONSENSUS FORECAST

	1998		1999 p			2000 p		
	Belgium	Eur 11[3]	Belgium Consensus	Belgium Previous consensus	Eur 11[3]	Belgium Consensus	Belgium Previous consensus	Eur 11[3]
Real GDP [1]	2.9	3.0	**1.9**	2.0	2.2	**2.8**	2.7	2.7
Employment [1]	1.1	1.1	**1.0**	0.7	0.9	**0.9**	1.0	0.9
Consumer prices [1]	1.0	1.3	**1.2**	1.1	1.2	**1.5**	1.4	1.5
Current account [2]	4.4	1.9	**4.1**	4.2	1.5	**4.1**	4.3	1.5
General government balance [2]	-1.3	-2.3	**-1.1**	-1.3	-1.9	**-0.8**	-0.9	-1.7
Primary balance [2]	6.1	2.4	**6.0**	6.0	2.4	**5.9**	6.1	2.4
Public debt [2]	115.8	73.8	**113.0**	113.5	72.6	**108.6**	109.5	71.2

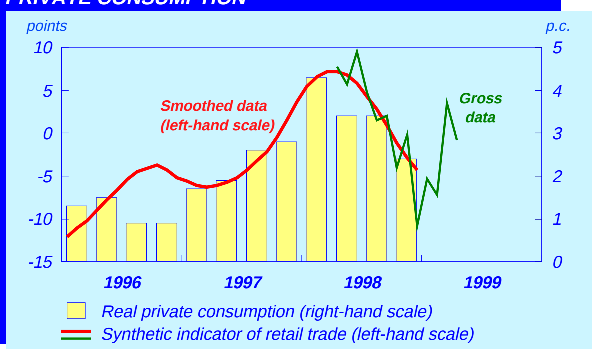
[1] P.c. change. [2] In p.c. of GDP. [3] Forecast from the European Commission (available since March 1999; next publication in Autumn 1999).

MACROECONOMIC DEVELOPMENTS

BUSINESS CYCLE INDICATOR AND GDP



PRIVATE CONSUMPTION



In 1998, economic growth in Belgium amounted to a healthy 2.9 p.c. This strong average, however, masked divergent developments in the first and second half of 1998. In the first half of 1998, the Belgian economy grew at a brisk pace (3.8 p.c.). In the second half, however, the deceleration of production in the manufacturing industry put a brake on GDP growth. In the fourth quarter economic growth was only 1.6 p.c. Since the end of 1998, however, there have been clear signs of an economic recovery. The National Bank's synthetic indicator began climbing in November 1998, picking up pace in the spring of 1999. While initially due to manufacturing industry, the recovery has in recent months also been supported by other sectors. Business confidence in the trade sector rose sharply in March, while confidence also returned in the construction sector.

In this context, the participating institutions saw no reason to alter their forecast of a further improvement in the economic situation in the second half of 1999. Mainly due to a low carry-over effect resulting from a weaker than expected fourth quarter of 1998, the consensus forecast for economic growth in 1999 was, nevertheless, lowered from 2 p.c. to 1.9. p.c. The rise in the consensus forecast for 2000 from 2.7 p.c. to 2.8 p.c. is, therefore, a better reflection of the encouraging development of economic indicators in recent months. Mainly as a result of the rise in oil prices, the consensus forecast for inflation in 1999 rose from 1.1. p.c. to 1.2 p.c. and the consensus forecast for the external surplus declined from 4.2 p.c. to 4.1 p.c.

The consensus forecasts that are presented here, date from before the dioxin contamination-scare, that erupted in early June. The participating institutions, however, agreed that the crisis would probably be temporary and that the negative economic impact should remain modest.

SPECIAL TOPIC

Reverse transactions in Belgian securities: repurchase agreements, securities lending and securities swaps

Reverse transactions with securities as the underlying assets are an essential element of modern securities markets, necessary to permit flexible and versatile use of the portfolios. Modernisation of the Belgian financial markets, and more particularly the introduction of dematerialised securities, has not only created a growing repo market but also generated substantial activity in securities lending and swaps.

1. Definitions and uses

*The **repurchase agreement** or **repo** is a contract whereby one party sells securities for a nominal amount to a counterparty in a spot transaction and at the same time agrees to buy back securities with the same characteristics at a future date for the same nominal amount at a fixed price from the counterparty. The difference between the spot price and the forward repurchase price is determined by the repo interest rate. The standard conditions of contract for the Belgian market were laid down in the PSA/ISMA Global Master Repurchase Agreement and the Belgian annex thereto.*

*The **sell/buy-back** is likewise a spot sale of securities with simultaneous repurchase of those securities at a future date, but in this case two separate legal transactions are concerned: the commitment to buy back is not given in the spot sale agreement. In economic terms, the sell/buy-back is used for the same purposes as the repo.*

*The **securities loan** is a contract whereby the lender lends securities for a charge and the borrower has disposal of the securities as the owner for the duration of the loan. In general, the borrower of the securities provides collateral, which may take the form of pledged securities.*

*The **securities swap** is a contract whereby the parties exchange securities with different characteristics for a specified period.*

Like sell/buy-backs, repurchase agreements serve mainly to permit investment of liquid resources in the short term - usually for seven days or less - with securities pledged as collateral, so that the financial intermediaries are under no prudential obligation to provide cover via their own resources, or to permit borrowing on generally more competitive terms because of the above-mentioned advantages enjoyed by the lender. In addition, they may be used to overcome a temporary shortage of securities. The repo technique also makes it easier to take a bull or bear position. For instance, a bull position in the form of a spot purchase can be financed by a repurchase agreement in which the underlying assets are the securities concerned in that position, as the spot element of the repo generates the cash to finance the above-mentioned purchase. If the bull position is closed by a spot sale, the execution of the forward element of the repo makes it possible to comply with the obligation to deliver the securities under the above-mentioned sale. Since the flows of cash more or less compensate for one another, a leverage effect is created whereby a modest capital stake is sufficient for taking a significant position on the market.

Securities loans and swaps are used primarily to meet a delivery obligation. Like the repo, they may also be used for other purposes, such as taking a bear position.

2. Recent developments

2.1 Repurchase agreements (repos)[1]

In 1998, repo transactions totalling EUR 1,865 billion (BEF 75,238 billion) were recorded, compared with EUR 1,662 billion (BEF 67,029 billion) the previous year, representing 12 p.c. growth. Linear bonds were used as collateral for 82 p.c. of the total repo volume in government securities, a figure which is well up on the previous year's 74 p.c.. This shift in favour of linear bonds was at the expense of Treasury certificates.

In contrast, the number of repo transactions declined. During the year under review, roughly 34,100 deals were done, against some 43,500 in 1997. As a result, there was a large rise in the average value of repurchase agreements, up from EUR 37 million (BEF 1.5 billion) in 1997 to EUR 52 million (BEF 2.1 billion). Around 80 p.c. of the repo transactions were concluded for a term of seven days or less.

2.2 Securities loans

The volume of bilateral securities loans came to EUR 48 billion (BEF 1,955 billion), 22 p.c. down on 1997, when the figure was EUR 62 billion (BEF 2,515 billion). Roughly 88 p.c. of the securities loans concerned linear bonds, substantially more than the 70 p.c. recorded in 1997; the majority of these were concluded for a period of one day or seven days.

2.3 Securities swaps

The volume of securities swaps increased to EUR 97 billion (BEF 3,904 billion) in 1998, against just EUR 39 billion (BEF 1,574 billion) in 1997. Only 42 p.c. of the volume concerned exchanging OLOs for other OLOs, compared with 60 p.c. in 1997. This relative reduction in market share was in favour of the less liquid NBB certificates of deposit which were exchanged for linear bonds.

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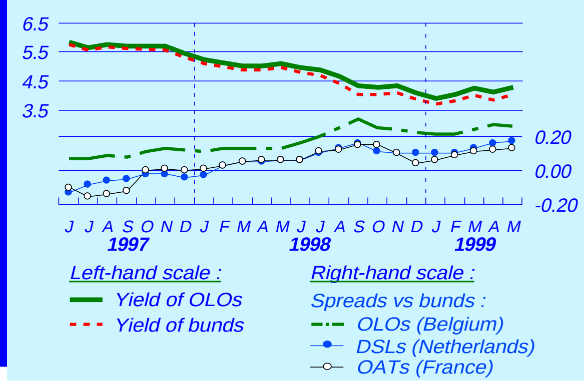
[1] *Including sell/buy-back transactions notified under the specific notification code.*

GOVERNMENT SECURITIES MARKET

PRIMARY MARKET (billions of EUR)

	OLOs Gross issues 1998	OLOs Gross issues 1999		OLOs Net issues 1998	OLOs Net issues 1999		TREASURY BILLS Net issues 1998	TREASURY BILLS Net issues 1999
J	2.754	3.811	J	-0.498	3.035	J	2.692	3.962
F	2.065	8.154	F	1.153	6.706	F	-1.547	-1.587
M	0.786	1.147	M	-0.015	-1.722	M	1.775	-0.196
A	2.811	5.427	A	2.224	1.203	A	-3.557	-1.524
M	1.577	0.485	M	1.247	-0.043	M	2.432	0.116
J	1.765		J	-0.196		J	0.892	
J	2.828		J	-0.347		J	0.488	
A	0.645		A	-0.072		A	0.630	
S	2.635		S	1.286		S	-2.531	
O	3.116		O	2.072		O	-3.024	
N	0.263		N	-0.027		N	-3.101	
D	2.083		D	1.728		D	-0.978	

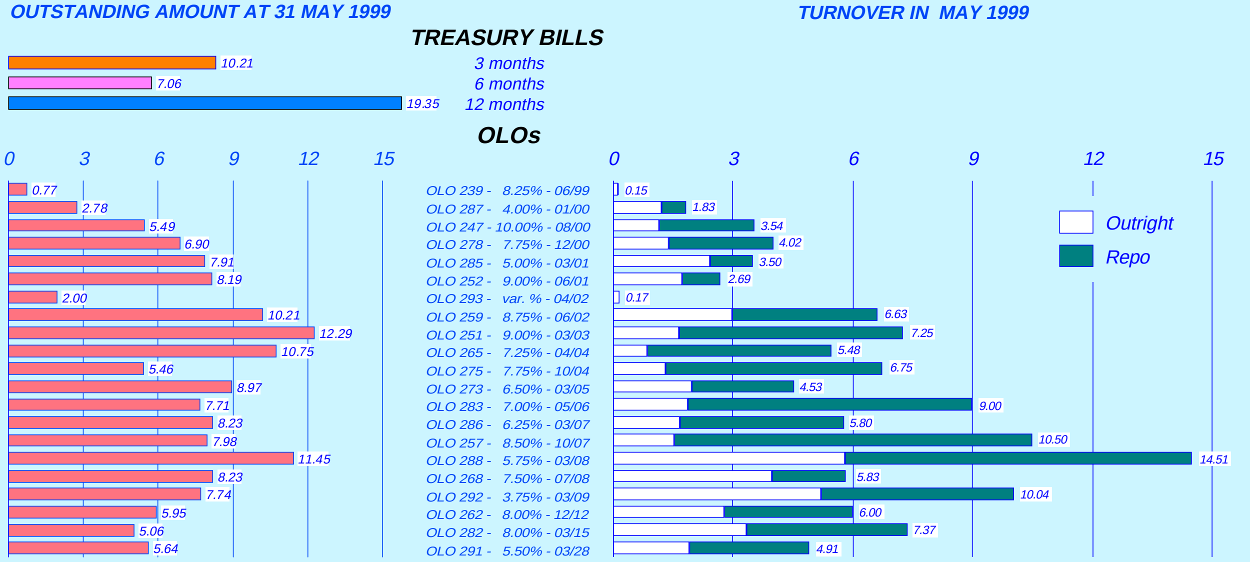
BENCHMARK 10-YEAR BOND YIELDS(p.c.)



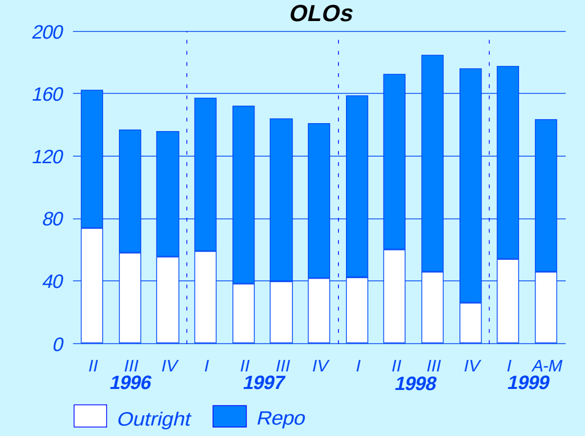
OUTSTANDING AMOUNT AND TURNOVER (billions of EUR)

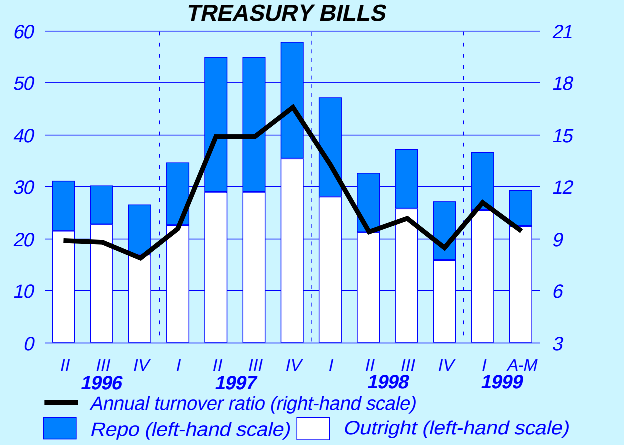
OUTSTANDING AMOUNT AT 31 MAY 1999

TURNOVER IN MAY 1999



SECONDARY MARKET ACTIVITY (billions of EUR, standardised monthly averages)





TREASURY HIGHLIGHTS

The number, rights and obligations of the Primary Dealers have recently undergone several changes. Moreover, a body of "Recognized dealers in Belgian government securities" has been set up. Further information about both can be found on the website of the Treasury at the following URL : http://www.treasury.fgov.be/interdette/en/products/Epd.htm.
On 15 April 1999, the Treasury of the Kingdom of Belgium issued its new 3-year floating-rate OLO benchmark pegged to the 3-month Euribor. The EUR 2 billion OLO, maturing on 22 April 2002, carries a coupon of Euribor minus 0.125 p.c. The issue price was 99.927 p.c. to yield Euribor minus 0.10 p.c. The issue was swapped to fixed rate on terms which were slightly better than if the Treasury had issued a 3-year fixed-rate OLO.
This new OLO line has been syndicated. The joint lead managers were Barclays Capital and Deutsche Bank. The other underwriting group members were the other primary dealers in Belgian government securities. A selling group was formed with the recognised dealers in Belgian government securities.
With the syndication of the first floating-rate sovereign issue in the euro market, the Belgian Treasury is pursuing its strategy aimed at ensuring the liquidity of its instruments (this is the first highly liquid instrument directly linked to the Euribor), at diversifying its investor base on a global scale and at enhancing its partnership with its primary dealers and its recognised dealers.
The line will be tapped in the future when appropriate in order to ensure an optimal level of liquidity.
The placement was a success. The main reasons for this success are the following:

- *lack of supply, as there has been virtually no top-quality sovereign FRN paper issued in a European currency in the last 2 years;*
- *further rate cuts were not expected after the half-point cut in the rate on the main refinancing operations by the ECB;*
- *it is a defensive instrument in an environment of expensive equity markets and volatile fixed-interest markets;*
- *liquidity, as mentioned before, due to the initial size of and future increase in the line;*
- *reinvestment from several sovereign FRN redemptions.*

The issue was placed mainly with central banks, other banks and fund managers. The regional placement was approximately 50 p.c. in continental Europe, 30 p.c. in the UK and 10 p.c. in Asia.

The '98 edition of the "Annual Report of the Public Debt" is now available in French and Dutch (the English version being due for the end of June).*
** You can order a copy by means of the "Our publications" page on the Treasury's website.*

MONETARY POLICY HIGHLIGHTS

Against the background of subdued inflationary pressures in the euro area, the Governing Council of the ECB decided on an interest rate cut at its meeting on 8 April 1999. The Governing Council announced that the forthcoming main refinancing operations would be conducted as fixed-rate tenders at an interest rate of 2.5 p.c., starting with the operation to be settled on 14 April 1999. This implied a reduction of 50 basis points from the rate of 3.0 p.c., which had been applied to all previous operations of this nature settled earlier in the year. In addition, with effect from 9 April 1999, the interest rate on the marginal lending facility was lowered from 4.5 p.c. to 3.5 p.c. and the interest rate on the deposit facility was reduced from 2.0 p.c. to 1.5 p.c.
In accordance with the Eurosystem's monetary strategy, this interest-rate decision was taken in a forward-looking perspective, focusing on the medium-term trends in inflation and the compatibility of these trends with the Eurosystem's definition of price stability. The Governing Council considers that increases in the Harmonised Index of Consumer Prices will remain consistently below 2 p.c. over the medium term, even after the cut in interest rates. Monetary growth is not, at the moment, regarded as being likely to endanger future price stability. This interest rate decision is thus keeping monetary policy on a longer-term stability-oriented course and, by doing so, contributing to the creation of an economic environment in which the considerable growth potential of the euro area can be exploited.
At its meetings held between 22 April and 2 June the Governing Council decided to keep the ECB interest rate unchanged. Bond yields and inflation forecast surveys suggest that market confidence in the medium-term prospects for price stability has remained strong since the policy move on 8 April. The decline in the exchange rate of the euro vis-à-vis the US-dollar was mainly due to cyclical divergences between the euro area and the United States.
The experience gained so far with the operational framework of the Eurosystem has been positive. The main refinancing operations have fulfilled the envisaged role of providing the bulk of the liquidity needed by the banking system and steering short-term interest rates. Moreover, overnight interest rates have been bound by the rates applied to the standing facilities and have reacted flexibly to the cut in ECB interest rates on 8 April 1999. Finally, the averaging provision of the minimum reserve system has helped to smooth daily liquidity fluctuations, thus making fine-tuning operations unnecessary.

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