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Belgian Prime News

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Next issue: September 2013

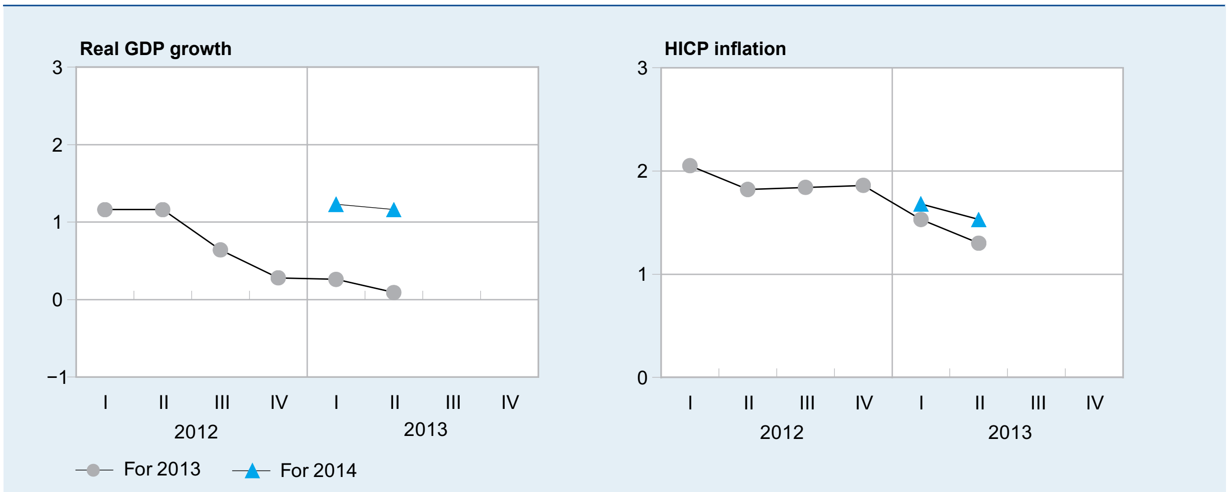
- Activity and demand remained sluggish in the euro area and in Belgium, in a context of low confidence among entrepreneurs and consumers.
- Although limited, improvements in foreign demand and in households' disposal income, on the back of lower inflation, are expected to lead to a muted recovery. GDP is expected to grow by a mere 0.1 % in 2013 and by 1.2 % in 2014.
- The Belgian financial sector made further progress in restoring a sound position. Challenges remain huge in view of the new economic environment (see Special Topic).
- Aiming at larger buy-back of securities maturing in 2014, the Belgian Treasury updated its 2013 Borrowing Requirements and Funding Plan (see Treasury highlights section).

Consensus: Average of participants' forecasts

	2012		2013 p				2014 p			
	Belgium	Euro area	Belgium		Euro area		Belgium		Euro area	
Real GDP(1)	-0.3	-0.5	0.1	(0.3)	-0.6	(-0.2)	1.2	(1.2)	0.9	(0.9)
Inflation (HICP)(1)	2.6	2.5	1.3	(1.5)	1.5	(1.8)	1.5	(1.7)	1.5	(1.6)
General government balance(2)	-3.9	-3.7	-2.8	(-2.4)	-2.8	(-2.6)	-2.3	(-1.8)	-2.3	(-2.2)
Public debt(2)	99.8	90.7	100.7	(99.8)	95.2	(94.7)	100.8	(98.8)	95.7	(94.7)

Numbers in parentheses refer to the previous consensus forecast of April 2013.
(1) Percentage changes.
(2) EDP definition; percentages of GDP.

SUCCESSIVE FORECASTS FOR BELGIUM



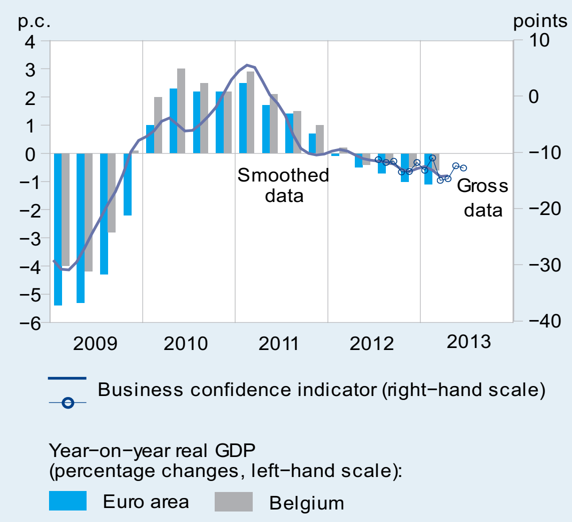
Source: Belgian Prime News.

Macroeconomic developments

In Belgium, as in the euro area as a whole, the improvements in the financial market conditions observed for almost a year have still failed to trigger a recovery in economic activity and demand. The latest confidence indicators show tentative signs of bottoming out. However, these results would need to be confirmed before gaining broader traction. This would only be possible if the conditions for sustainable growth are restored in a durable way in the euro area economies. Besides better prospects in the main partner economies, which should shore up export demand, resolute implementation of structural reforms and fiscal consolidation, at an appropriate pace, is essential in the euro countries.

In Belgium, GDP growth has stalled or been slightly negative since mid-2011, on the back of subdued foreign demand and weak confidence among entrepreneurs and consumers. In real terms, GDP declined by 0.1 % in the fourth quarter of 2012 and stagnated in the first quarter of 2013. Most forecasters expect a gradual recovery to gain pace in the second part of the year and in 2014. However, some expect the stagnation to last longer, on the back of protracted weak demand in the euro area. **On average, the participating institutions' forecast for GDP growth in Belgium is at 0.1 % for 2013, down from 0.3 % in the April consensus, as the most recent outcome was slightly below expectations. For 2014, the average expected growth is unchanged at 1.2 %.** As such, Belgium is expected to continue to slightly outperform the average GDP growth predicted for the euro area, at respectively -0.6 % in 2013 and 0.9 % in 2014.

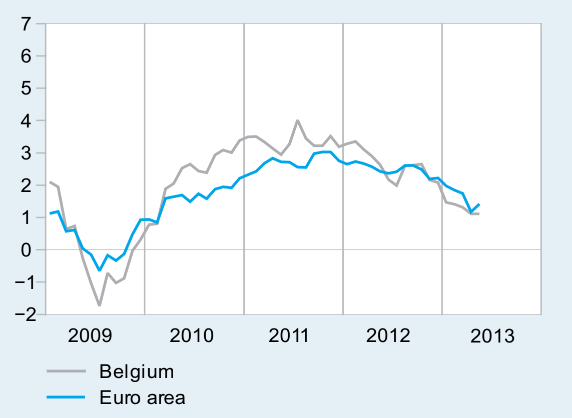
GDP GROWTH AND BUSINESS CYCLE INDICATOR



Sources: EC, NAI, NBB.

Since the beginning of 2013, HICP inflation has been running well below the 2 % mark in Belgium. It declined from 1.5 % in January to 1.1 % in April and May 2013, following a profile similar to the euro area, but at a rate of about 0.2 to 0.3 percentage point lower. This difference reflects a stronger sensitivity of Belgian inflation to lower oil prices, an effect that has played in the opposite direction in previous times. Inflation also receded for the service component, in a context of anaemic economic activity. The current low inflation context should contribute to containing wage developments, curbing temporarily the effect of automatic index-linking, while the government has imposed a freeze on wage increases in 2013 and 2014, except for wage indexation or pay scale increases. **The participating institutions expect Belgian HICP inflation to decelerate from 2.6 % in 2012 to 1.3 % in 2013, before reaching 1.5 % in 2014. This is a downward revision of 0.2 percentage point for each year compared to the April forecast.**

HARMONISED INDEX OF CONSUMER PRICES
(annual percentage changes)



Source: EC.

According to the official data submitted to the EC, Belgium's budget deficit reached 3.9 % of GDP in 2012. This outcome was worse than expected; it is largely the result of the one-off capital injection in Dexia in December 2012, but also stems from the deterioration of economic conditions during the course of the year. Based on this result, and due to limited structural improvements in the previous years, the EU Council has stepped up the excessive deficit procedure for Belgium. It calls for the headline deficit to be cut to 2.7 % of GDP in 2013, consistent with an improvement in the structural balance of 1 % of GDP. When finalising this BPN, the government was still in the process of reviewing the 2013 budget and preparing the 2014 budget. However, when making their forecasts, most participants anticipate, at least partially, consolidation measures. **According to the average of the participating institutions' forecast, the general government deficit in Belgium was estimated at 2.8 % of GDP in 2013 and 2.3 % in 2014. The debt ratio is expected to increase moderately from 99.8 % of GDP in 2012 to 100.7 % in 2013 and to 100.8 % in 2014.** The government has indicated that it will take measures to limit the public debt to a maximum of 100 % of GDP, including with exogenous measures, if needed besides the endogenous effect of a lower deficit.

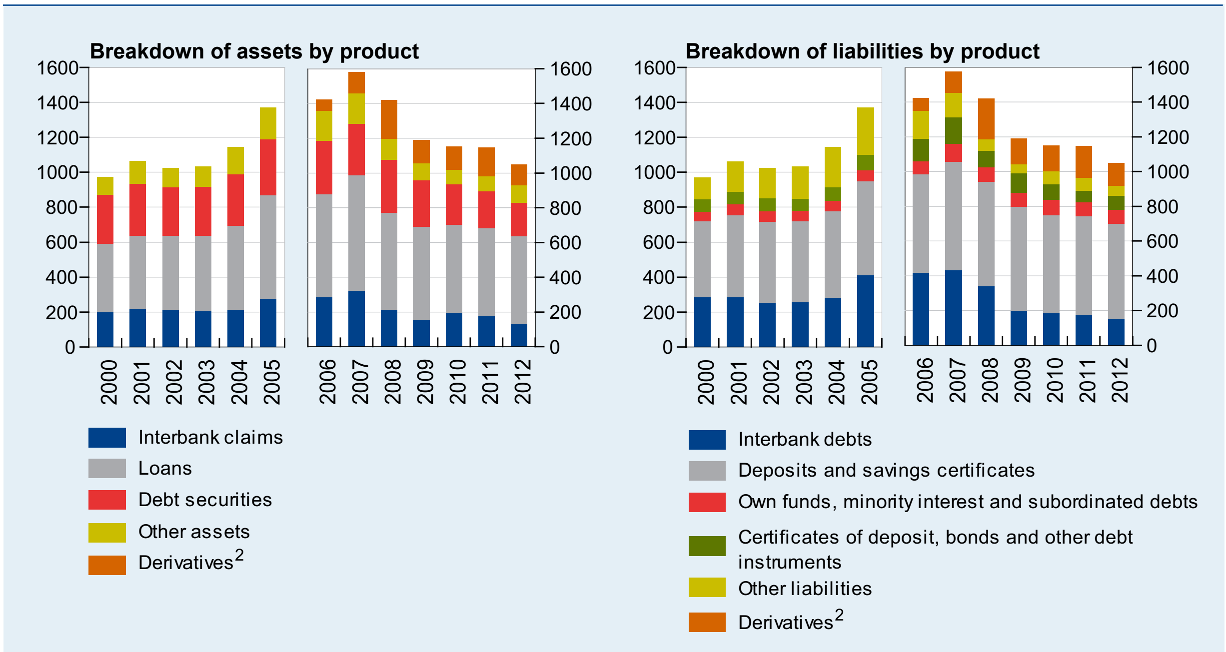
Special Topic: Positive developments and remaining challenges for a stable financial system serving the economy in Belgium: lessons from the 2013 NBB Financial Stability Review

Financial institutions have a major role to play in promoting the growth potential of the economy, by protecting the savings of creditor agents - mainly households - and insuring efficient allocation of financing for productive investment. They face the daunting challenges of correcting the flaws revealed by the financial crisis and adapting to the new environment of muted growth and low interest rates. In Belgium, fears that the essential restructuring of the financial sector may lead to severe restrictions on lending have so far proved largely unfounded. However, as in other countries, the situation of the Belgian financial sector deserves close monitoring. Hence, the Special Topic draws on the main assessment and messages put forward in the 2013 NBB Financial Stability Report.

Banking Sector

As already shown in previous releases of the Financial Stability Review, the Belgian banking sector has undertaken major restructuring since the start of the global financial crisis almost six years ago. In 2012, one-off operations and underlying business developments resulted in a further € 99 billion decline in total assets. From almost € 1 600 billion six years ago, the Belgian credit institutions' balance sheet had thus come down to € 1 049 billion at the end of last year.

BALANCE SHEET STRUCTURE OF BELGIAN CREDIT INSTITUTIONS[1]
(consolidated end-of-period data, in € billion)



Source: NBB.
[1] Data compiled in accordance with the Belgian accounting rules until 2005 (Belgian GAAP) and IAS/IFRS from 2006.
[2] Derivatives are recorded at their market value including, from 2007, income receivable and expenses payable.

This deleveraging took place without banks forfeiting their role as key credit providers in the Belgian economy, resulting in a major geographical rebalancing of the loan and bond portfolios towards Belgian counterparties. The rebalancing of the business models towards more traditional activities was also confirmed by a further rise in the share of retail activities on both the assets and liabilities sides of the balance sheet. In combination with the first issues of covered bonds under the new Belgian covered bond framework and substantial increases in the stock of unencumbered liquid assets on the assets side of the balance sheet, this led to a further improvement in the Belgian regulatory liquidity ratios in 2012. Regulatory solvency ratios also improved again last year, on the back of a further decline in risk-weighted assets.

With a return on equity of only 3.0 % in 2012, the Belgian banking sector is nevertheless still facing major challenges in overcoming the negative impact on profitability of the financial crisis and the associated restructuring of activities, in an operating environment characterised by weak economic growth and very low interest rates. In this connection, the accounts for 2012 clearly show the negative impact of the low interest rate environment on banks' net interest income, while operating expenses grew for the first time in four years. The resulting marked increase in the cost-to-income ratio puts Belgium among the European banking systems with the highest average cost-to-income ratios during the last three years. In response, all major credit institutions have announced cost-saving programmes, and these are likely to form an important element of banks' transition towards new sustainable business models in an environment that is fundamentally different from several years ago.

Yet, due to major changes in regulation and the decision by Belgian banks to scale down and refocus on a mature banking market, questions about the adequacy of current cost structures and business models are likely to remain centre-stage in the period ahead, especially if the adverse effects of very low interest rates and weak economic growth were to prove more persistent than currently expected.

Insurance sector

The Belgian insurance sector returned to a high level of profitability in 2012, following several years of low net profits or even losses. The net result for the sector came to € 2.6 billion, while in 2011, a loss of € 0.9 billion was posted. The main reason for this positive development was a significant increase in the net income from financial investments.

Non-life insurance activities confirmed their resilience to the financial crisis in 2012, with premiums up by 3.7 % and the combined ratio stabilising at close to 100 %. This combined ratio relates the total cost of claims plus operating expenses to net premium income, and is an inverted measure of the profitability of the underlying insurance underwriting activities.

Life insurance premiums also increased in 2012, rising by a considerable 10.7 %. The comparatively strong premiums in 2012 seem to be related to growth in mutual-fund-like class 23 contracts, but the biggest factor is most likely the anticipation by households of the tax increase (from 1.1 % to 2 %) on premiums paid for class 21 and class 23 contracts as from 1 January 2013. Taking into account this one-off and temporary effect, underlying demand for life insurance products in 2012 may thus not have recovered from the weakness witnessed in recent years, which mainly affected individual (rather than group) life insurance policies. An important factor weighing on the demand for individual life insurance policies are the low yields currently offered by these medium- to long-term saving contracts.

The outstanding amount of life insurance policies with guaranteed rates of return, as well as the level of these guaranteed rates, are important risk parameters for insurance companies when the interest rates on risk-free investments are at very low levels. The Belgian insurance sector has a large number of contracts offering high guaranteed rates of return for policy-holders. These liabilities are to a significant extent the legacy of contracts concluded a long time ago. At the end of 2011, the average guaranteed rate of return on class 21 contracts amounted to 3.17 %, down from 3.22 % at the end of 2010 and 4.5 % at the end of 1999. Preliminary figures for the year 2012 indicate an annual return on investment covering these policies of 4.6 %, reversing the negative gap between the return on investment and the average guaranteed rate of return on liabilities that had emerged in 2011, when the return on investment was only 2.8 %. Yet, if the current low interest rate environment were to persist, Belgian insurance companies may have to reinvest significant amounts of maturing AAA- and AA-rated bonds at yields that may be lower than the maturing coupon rates.

Housing market

In order to maintain the very high quality of Belgian mortgage loan portfolios, last year’s Financial Stability Review called for greater vigilance over ongoing market developments and stricter monitoring of whether sufficiently conservative credit standards and adequate risk pricing were being applied to all new mortgages. The available evidence suggests that a selective tightening of credit standards in mortgage loan origination has taken place since then, in particular for loans with comparatively long maturities and/or high loan-to-value ratios. So far, credit quality indicators for Belgian households show no deterioration in default rates for recent vintages of mortgage loans, while house prices are levelling off.

The Financial Stability Review is available on the NBB internet site.

Treasury highlights

As at 18 June 2013, the Belgian Treasury updated its 2013 Borrowing Requirements and Funding Plan. The main change compared to the initial plan is that the Treasury has increased its planned long-term funding and its pre-funding for 2014.

The gross borrowing requirements are up from € 39.99 to 42.43 billion, as the Treasury intends to buy back securities with a final maturity in 2014 for an amount of € 6.15 billion. This is € 1.93 billion more than the initial amount of € 4.22 billion.

Long-term funding, originally estimated at € 42.01 billion, has been raised to € 45.21 billion.

Issuance of OLOs has been revised upwards to € 40 billion (from the previously planned € 37.0 billion), while the targets for EMTN and Schuldscheine are also up € 500 million to € 3.50 billion.

Due to persistently low yields, the Treasury's product for private investors (State Notes) is now expected to result in only € 0.20 billion being issued instead of the € 0.50 billion set out in the original plan.

As at 31 May 2013, the Treasury had already realised more than half of its annual updated Funding Plan by issuing mainly OLOs (€ 23.98 billion) via 3 syndications and 3 auctions. During the first five months of the year, the Treasury also made use of other long-term instruments such as Euro Medium Term Notes, Schuldscheine and State Notes, as can be seen in the table below.

2013 BORROWING REQUIREMENTS AND FUNDING PLAN: June 2013 update
(€ billion)

	2013		Archieved as of 31/05/2013	
I. Gross financing requirements		42.43		22.15
1. Federal State budget deficit		8.77		9.25
Budget deficit (sensu stricto)	8.64		8.24	
Participation in/loans to financial institutions and sovereigns	0.13		1.00	
Transfers to the Silver Fund	0.00		0.00	
2. Debt maturing during the year		27.26		11.83
Medium- and long-term debt in euro	27.26		11.83	
Medium- and long-term debt in foreign currencies	0.00		0.00	
3. Planned pre-funding (bonds maturing in subsequent years)		6.15		1.07
4. Other financing requirements(1)		0.25		0.00
II. Funding resources (Medium and long-term)		45.21		26.32
1. OLOs		40.00		23.98
2. Other medium and long term funding		5.21		2.34
Euro Medium Term Notes/Schuldscheine	3.50		0.82	
Securities for retail investors	0.20		0.01	
Treasury bonds - Silver Fund	1.51		1.51	
Other(2)	0.00		0.00	
III. Net change in short term foreign currency debt		0.00		1.18
IV. Change in Treasury Certificates stock(3)		-2.00		1.27
V. Net change in other short term debt and financial assets(4)		-0.78		-6.62

Source: Belgian Debt Agency.

(1) Including "put" options exercised on state notes and net redemptions of the treasury bonds representing Belgian participation in international organisations.

(2) Including net issues of treasury bonds representing belgian participation in international organisations.

(3) Outstanding stock of Treasury Certificates on 01/01/2013 : € 31,70 billion.

(4) This section includes residual financing instruments complementing the reference instruments mentioned in the previous section, including collateral margin changes. A positive figure represents an increase in the stock of residual financing and/or a reduction in financial assets.

The main issues for the months of April and May pertain to OLOs.

In April 2013, the Treasury issued its third syndicated loan which was a FRN with the following features: 3-Month Euribor + 12.5 basis points - 02/05/2018 (OLO 70) with an issue amount of € 2.5 billion.

During the same month (29/04/2013), the Kingdom of Belgium issued OLOs via an auction of 4 lines resulting in the issuance of € 4.9 billion:

1.25% 22/06/2018 (OLO69) € 1.419 billion – average yield 0.821; bid-to-cover 1.63
4.25% 28/09/2021 (OLO61) € 836 million – average yield 1.541; bid-to-cover 2.39
2.25% 22/06/2023 (OLO68) € 1.360 billion – average yield 1.971; bid-to-cover 1.68
5.50% 28/03/2028 (OLO31) € 1.285 billion – average yield 2.415; bid-to-cover 2.50

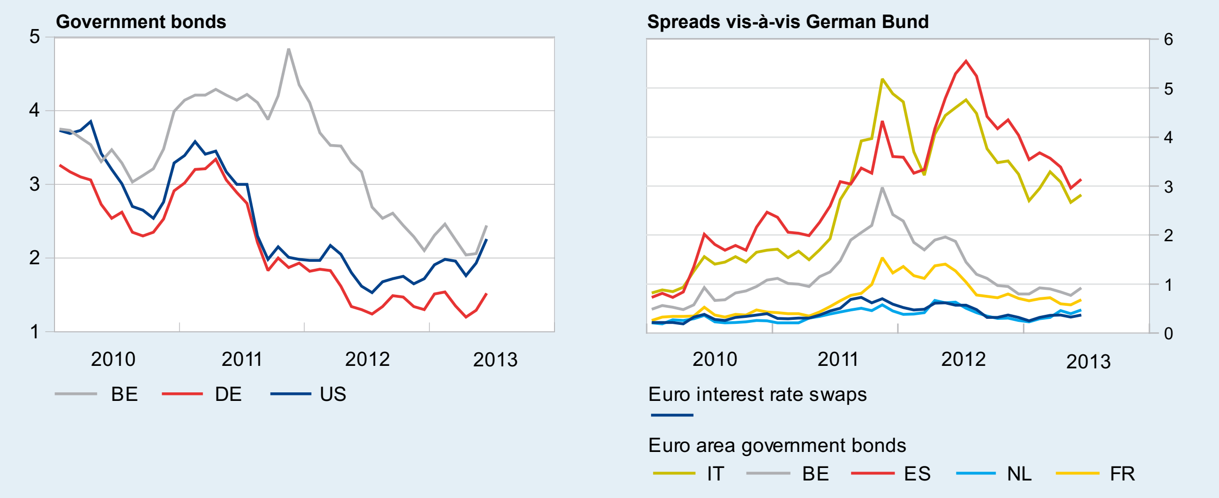
The May auction (28/05/2013) led to the issuance of € 3.895 billion concerning the following lines:

1.25% 22/06/2018 (OLO69) € 1.110 billion – average yield 0.962; bid-to-cover 1.82
2.25% 22/06/2023 (OLO68) € 1.340 billion – average yield 2.143; bid-to-cover 1.47
4.00% 28/03/2032 (OLO66) € 617 million – average yield 2.872; bid-to-cover 1.76
5.00% 28/03/2035 (OLO44) € 828 million – average yield 2.954; bid-to-cover 1.68

Finally, it should be noted that, for the issue of 4 June 2013, the Kingdom attracted investment totalling € 9.343 million for its retail instrument, i.e. its 5- and 8-year State Notes.

Government securities market

10-YEAR INTEREST RATES
(percentage points, monthly averages[1])

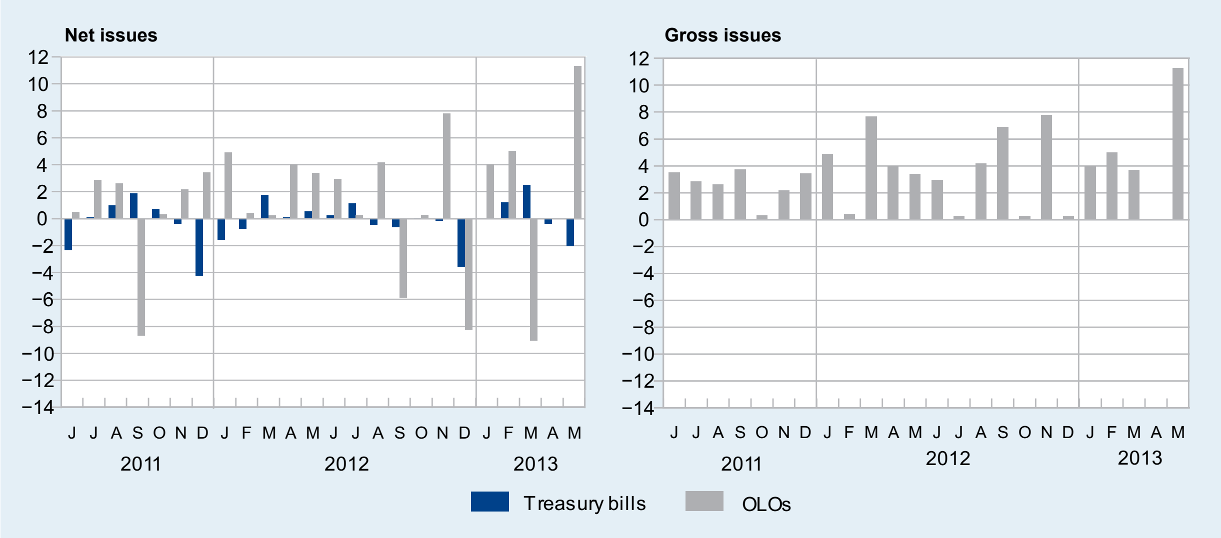


Sources: BIS, Datastream.
[1] Average over the first 26 days for June 2013.

Over the period under review, international bond markets were characterised by a substantial increase in volatility. While yields fell during the first part of the reporting period (April 2013) on the back of mixed data releases on the economic outlook, they have increased significantly since May 2013, especially in the US. Over the latter period, yields (monthly averages) of US and German long-term sovereign bonds were up respectively by 50 and 32 bp, to reach levels of 2.26 and 1.52 %. The latter developments are mainly driven by better than expected economic news releases and by the debate and communication on the "tapering off" of asset purchases by the FED. At the end of the reporting period (26 June), following the downward revision of downside risks to the economic outlook and ahead of the potential slowing of asset purchases in the context of QE, yields on US bonds rose substantially and reached the highest levels for more than a year, i.e. 2.60 %. Developments in German and Belgian bond markets also reflect this international market volatility.

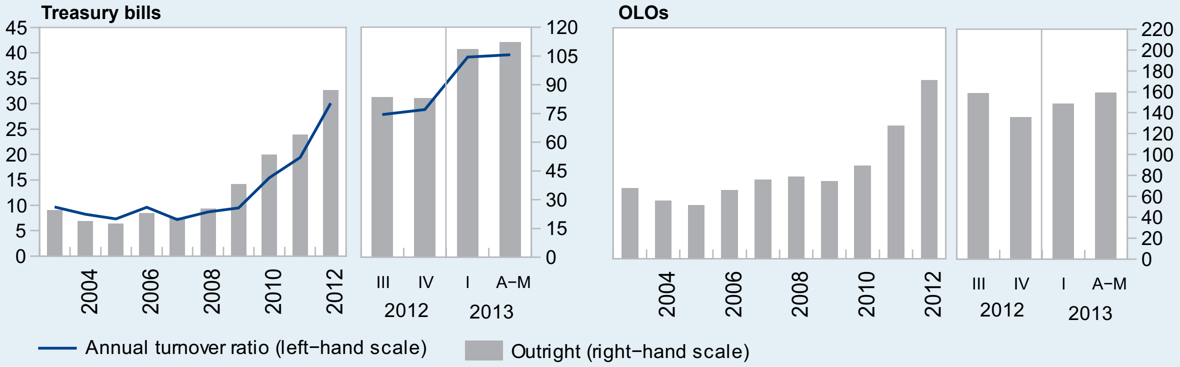
Spreads on long-term bonds vis-à-vis the German Bund have narrowed over the period under review in most euro area countries, although renewed tensions and wider spreads have been observed recently. The overall decrease in spreads reflects the positive news in April and May related to, among others, the extension of the loans granted to some financial assistance programme countries and improved conditions in primary markets for some of the stressed countries. However, a significant degree of dispersion in spreads relative to the Bund remains across the euro area countries. At that time the Belgian-German spread remained below 100 bp, corroborating the status of Belgium as a "close-to-core" country. Towards the end of the reporting period, reflecting greater market volatility, spreads vis-à-vis the Bund widened. Overall, uncertainty about near-term bond market developments, as measured by the implied volatility of options, increased towards the end of the second quarter of 2013.

PRIMARY MARKET
(billions of euro)

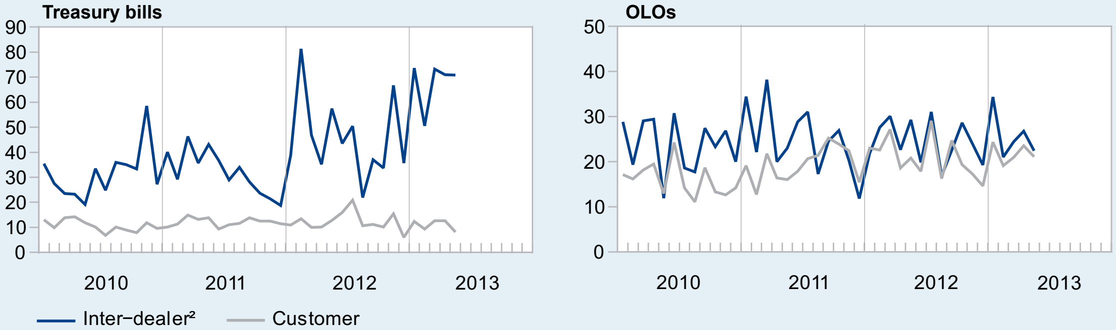


SECONDARY MARKET TURNOVER

As compiled by the Securities Regulation Fund[1]
(billions of euro unless otherwise stated, monthly averages)



As reported by primary and recognised dealers to the Treasury
(billions of euro)



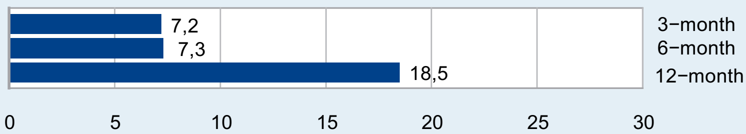
[1] As of January 2009, reporting information obtained via TREM is also included. The Securities Regulation Fund's turnover figures include some sell/buy-back transactions which are in fact repurchase agreements.
[2] Please note that inter-dealer turnover is double-counted in these figures.

OUTSTANDING AMOUNTS AND TURNOVER

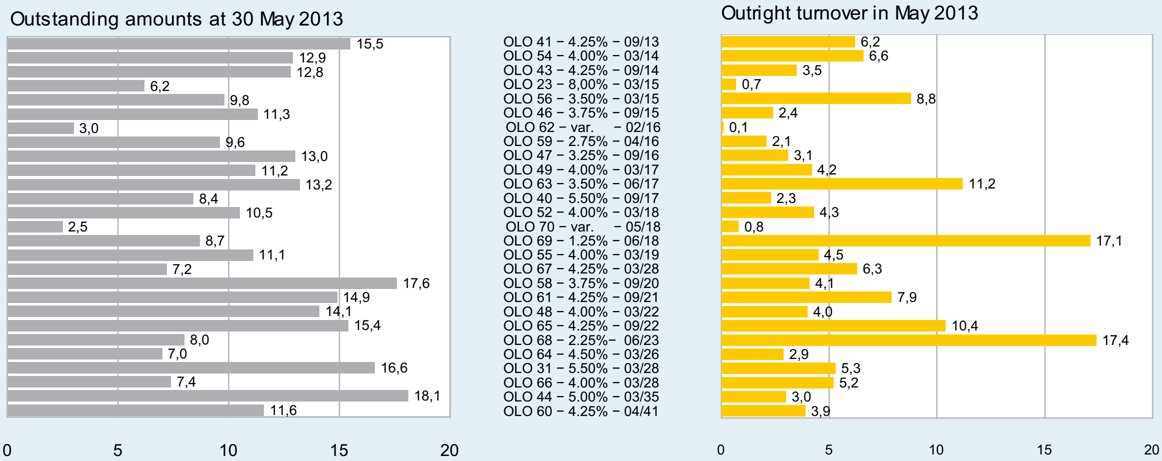
(billions of euro)

TREASURY BILLS

Nominal outstanding amounts at 30 May 2013

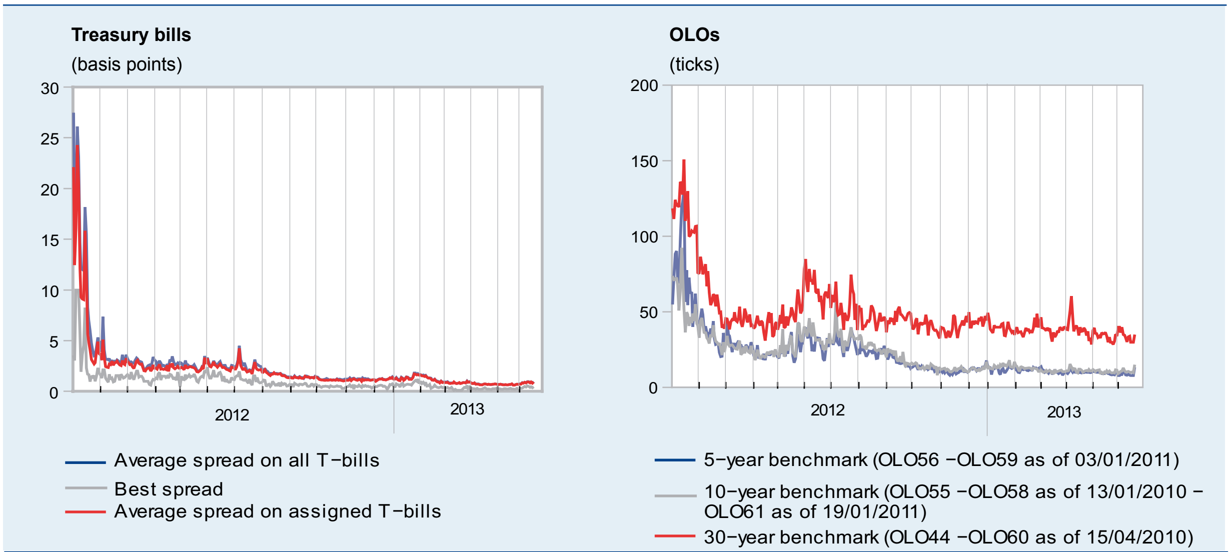


OLOs



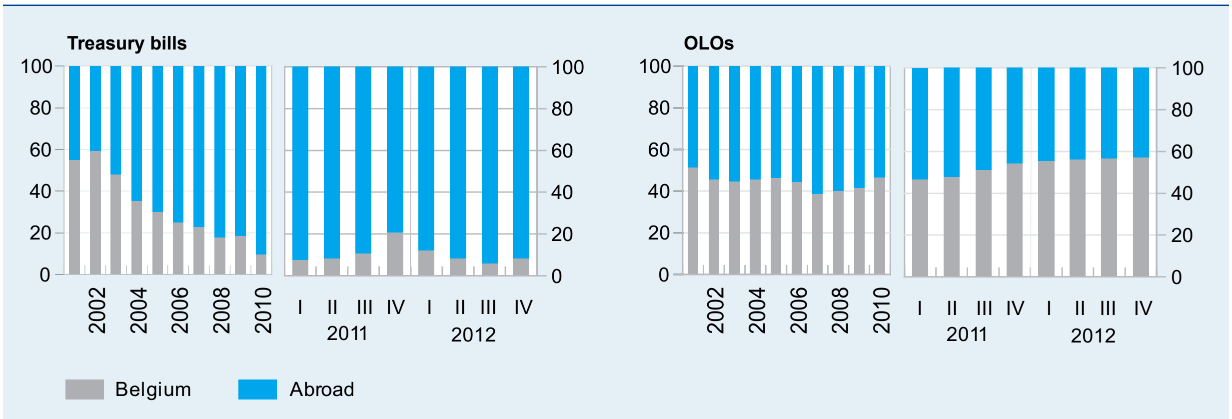
Source: Securities Regulation Fund.
[1] The turnover figures include sell/buy-back transactions which are in fact repurchase agreements.

BEST BID/OFFER SPREADS[1]



Source: Treasury.
[1] As reported by three electronic platforms (MTS, Broker Tec and BGC eSpeed).

LOCATION OF HOLDERS
(percentages of total)



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Sources: NBB, unless otherwise stated.

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General information on the Belgian government's action can be found on the website www.belgium.be.