

Foreword

by Guy Quaden, Governor



A year ago, when presenting the Bank's previous Report, I said that the recession which had begun in the second half of 2008, in the wake of the financial crisis, would probably be more severe than the other downturns in economic activity since World War II. But I also expressed the hope, and even the conviction, that thanks to the speedy and appropriate economic policy responses, this "great recession" would not degenerate, as in the 1930s, into a great depression, i.e. several years of negative growth.

The events of 2009 described in detail in this Report seem to confirm that scenario. However, there are no grounds to declare victory because, unless the recovery unexpectedly gathers speed, it will take quite some time to make up the loss of output suffered.

The authorities have learnt from the mistakes which followed the 1929 crash. Central banks responded to the escalating financial tensions, the risk of a credit crunch and the sudden deterioration in the economic situation by resorting to various non-standard measures and cutting their interest rates to extremely low levels (1 p.c. for the Eurosystem's refinancing operations). Apart from the assistance given to numerous financial institutions, governments made a major contribution towards supporting activity via their fiscal policy, in allowing the automatic stabilisers to operate (rising expenditure on unemployment benefits, falling fiscal and parafiscal revenues) and by implementing recovery plans. They also largely resisted the temptations of protectionism.

At the very least, that response halted a negative spiral. True, the 2009 growth figures are seriously in the red: around -1 p.c. for the world, -4 p.c. for the euro area and "only" -3 p.c. for Belgium. Yet these annual averages mask an even more dramatic deterioration at the beginning of the year, followed by a degree of recovery in the second half.

However, the recovery is fragile because it is based largely on fiscal stimuli and the rebuilding of stocks. Moreover, since firms still have excess production capacity, the crisis is unfortunately continuing to take its toll on employment and investment.

Price stability is the only area in which the 2009 results were satisfactory: inflation disappeared and deflation was avoided.

The priority must gradually shift away from crisis management towards future crisis prevention and consolidation of the foundations for sustainable growth.

Ending the exceptional measures too soon would risk a renewed decline in activity. Conversely, ending them too late would prepare the way for new financial derailment. In any case, a gradual approach is required.

Since the financial market situation has improved considerably, the Governing Council of the European Central Bank decided, at the end of 2009, to proceed with the initial dismantling of the non-standard liquidity management measures by announcing that certain longer-term operations would not be renewed in 2010. However, as the economic recovery is still precarious, and inflation expectations remain firmly anchored at a level consistent with the definition of price stability, the Governing Council did not adjust the particularly accommodating stance of its monetary policy, and kept the official interest rates at their very low level.

At budgetary level, governments will increasingly have to balance the desired economic stimulus against the budget deficits entailed, and the growing loss of confidence which they are liable to cause. Moreover, the restoration of growth will not be enough to wipe out these deficits, which are only partly due to the impact of the weakened economy.

In contrast to the 1980s, Belgium's public deficit (6 p.c. of GDP) is no higher than the average for its European partners. However, just when our country is about to face the fiscal consequences of population ageing, the spectre of the snowball effect has returned, namely the automatic effect of interest charges swelling the public debt, which will again exceed 100 p.c. of GDP in 2010. The modest reduction in the deficit provided for in the 2010 budget is welcome, but to enhance the credibility of the government's stated commitment to restoring a balanced budget by 2015, the proceeds from any economic growth windfalls in the years ahead will have to be used to speed up deficit reduction.

However, a long-term strategy cannot be based exclusively on fiscal consolidation. It must also include policies on innovation, employment and competitiveness to stimulate and support sustainable growth.

As noted by the Basel Committee on Banking Supervision, "the banking sector entered the crisis with an insufficient level and quality of capital, inadequate provisions, imprudent valuations, insufficient liquidity buffers, compensation policies that encouraged excessive leverage and risk taking, and excessive concentration of exposures among major financial institutions".

The words 'insufficient', 'inadequate' and 'excessive' clearly indicate the absolute necessity of improving the regulation and supervision of financial institutions and of the financial system. Various international bodies are addressing that issue, and that is indeed the level at which coordinated decisions should preferably be taken. In particular, the G20 has drawn up an ambitious road map, and the Basel Committee has proposed new regulatory requirements. However, the details of these proposals have yet to be defined.

I know that it will be anything but easy to return to greater simplicity in the banking world. Moreover, the solution to many technical questions will take time. Finally, there is clearly a need to introduce some of the new rules gradually – especially the additional capital requirements – so as not to impede the flow of lending necessary to sustain the nascent recovery. Nevertheless, as a result of the crisis, there is now acceptance of the urgent need for radical reform of the financial sector and we cannot allow that mood to evaporate.

In fact, while the “exit strategy” concerning the public measures supporting demand and the financial sector is being hotly debated, we should also be aware of the need for an “entry strategy” for the introduction of new regulatory standards.

The rapid spread of the financial crisis must also serve as a lesson for the supervisory authorities. No supervisory architecture can offer an absolute guarantee against financial accidents. However, a growing number of countries has opted for the “twin peaks” system, in which the central bank takes charge of supervising individual financial intermediaries and the system as a whole, while another institution is responsible for supervising the smooth operation of the markets, and ensuring information and protection for investors and consumers of financial services. The Belgian government has decided to set up such a structure by 2011.

The dramatic events of 2008 showed that, in a serious liquidity crisis, there were mass appeals to the central banks (and as we know, there were many requests addressed to the National Bank of Belgium, in particular). Central banks therefore need to be kept constantly informed of the situation of the various financial institutions. European central banks have the additional advantage of forming a network, while the crisis also demonstrates the need to organise much better cooperation between national supervisory authorities for the purpose of supervising cross-border institutions.

Prudential supervision is a complex and thankless task, no matter which institution is in charge. When the Bank becomes responsible for this new duty, it will endeavour to perform it to the best of its ability.

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