3. Financial developments in Belgium

Belgium's net external position remains robust, at 35.4 % of GDP. In the persistently fragile economic climate and given the low returns on low-risk investment instruments, households have focused their investment on both liquid assets and – more than in previous years – investment funds. Net mortgage loan growth remained moderate, with the exception of refinancing transactions to take advantage of lower interest rates. The pace nevertheless picked up by the end of the year, partly in anticipation of the introduction of a less generous tax treatment of mortgage loans, particularly in Flanders. Generally speaking, household debt ratio rose further, but remained sustainable, although some categories – particularly young people – are more exposed than others. Company demand for bank loans also stayed subdued, despite lower interest rates and easier credit standards. The anaemic economy and protracted low interest rates are posing challenges to banks and insurance companies ; they have to make a real effort to bolster their capital positions and make sustainable profits if they are to also meet the more rigorous solvency requirements imposed by regulators.

3.1 Overall financial position of the Belgian economy

Belgium's net external position : strong, but weakening

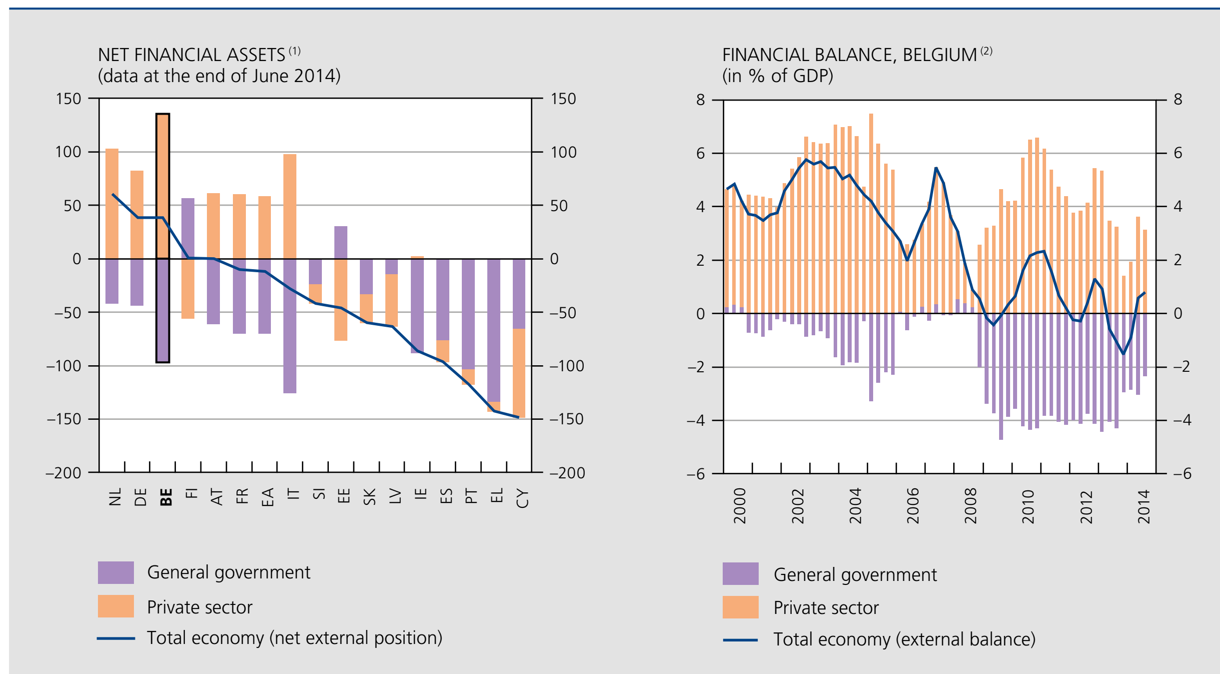
Belgium ranks among a small group of euro area countries – together with the Netherlands, Germany and Finland – reporting positive net financial wealth. Serving as a factor of financial stability, this net claim of all domestic sectors on the rest of the world amounted to € 142 billion or 35.4 % of GDP at the end of September 2014. This is largely down to the considerable net financial assets of Belgian individuals, the highest as a percentage of GDP (225 %) of the euro area Member States for which these data are available. Other sectors, with the exception of financial corporations, report net liabilities.

Belgium's external position may still be robust, but it has been falling since peaking at 57.6 % of GDP in 2011. This is attributable to the development of the economy's overall balance and to changes in the position primarily related to the revaluation of outstanding assets and liabilities. The downward trend persisted into the first nine months of 2014 and Belgium's net assets fell by € 25.7 billion, or 6.5 % of GDP.

Whereas Belgium had recorded major current account surpluses in the past and so built net claims on other countries, the situation has reversed since 2009. The country has from then on seen periods of current account deficits, during which it contracted net liabilities abroad. In the first nine months of 2014, the current account was positive and € 2.6 billion – i.e. 0.6 % of annual GDP – worth of net foreign assets were acquired. The positive financial balance was due to households and financial institutions, with the latter preferring to use a large part of their profits to shore up their balance sheets.

Other changes, including revaluations, amounted to a negative € 28.3 billion or –7.1 % of GDP in the first three quarters of 2014, more than wiping out the effect of the positive financial balance. Traditionally, the Belgian economy suffers negative revaluation effects when financial markets recover, primarily concentrated on non-financial corporations and the general government. Rising stock market prices in 2014 pushed up the value of non-financial corporations' outstanding liabilities, much more so than the increase in the value of their financial assets, in which equities represent a smaller share. In addition, declining yields in the secondary market for general government debt pushed up its market value, while private households as a net creditor sector enjoyed gains on their capital on the back of rising asset prices.

CHART 44 NET FINANCIAL ASSETS AND FINANCIAL BALANCE
(in % of GDP)



Sources: EC, ECB, NBB.
(1) Difference between the outstanding amount of financial assets and liabilities. Luxembourg and Malta are not included in view of the high volatility of their data.
(2) Difference between transactions in financial assets and liabilities, cumulative over four quarters.

Financial institutions also posted gains, as price effects were more significant for their assets than their liabilities.

Financial assets and liabilities turn back up, albeit moderately

For the first time since 2011, Belgium's domestic sectors taken together recorded an increase in financial assets of € 77 billion, although this was still lower than the average since 1999. The financial assets portfolio mainly grew in the financial sector (€ 67.6 billion), in stark contrast with the balance sheet contraction of the 2008-2013 period. As described in Box 7, the financial sector is defined more broadly than the sector of banks and insurance companies mentioned in section 3.4, although banks did account for three-quarters of its asset formation in the first three-quarters of 2014. Households grew their financial assets to much the same degree as in 2013, while those of non-financial corporations shrank for the second year running. The general government sector also saw financial assets come down, by € 4.5 billion.

At € 74.3 billion, growth in financial liabilities fell behind that in assets and remained below its historical average. And yet, the outstanding amount in financial liabilities reached new all-time highs in all sectors except financial services.

Gross debt ratio of non-financial private sector still inching up, but remains at sustainable levels

Against a backdrop of subdued bank lending and GDP growth, the consolidated gross debt ratio of the Belgian non-financial private sector still inched up, from 162.8 % of GDP at the end of 2013 to 163.2 % in September 2014. The debt ratio of Belgian households rose further, by 1.2 percentage points of GDP, to 57 % of GDP, while non-financial corporations reported a 0.7 percentage point fall to 106.3 % of GDP. This latter result is all down to positive GDP growth, as non-financial corporations are still actively incurring mainly non-bank debt.

In the euro area, the process of deleveraging, which had started in 2010, continued apace in the non-financial private sector, reducing the debt ratio from 139.8 % of GDP at the end of 2013 to 139 % of GDP at the end of June 2014. At that point, debt ratios of households and

TABLE 11 FINANCIAL ASSETS AND LIABILITIES BY SECTOR

(non-consolidated, in € billion, unless otherwise stated)

	Outstanding amounts at the end of September 2014			Change since December 2013			
	Assets	Liabilities	Net financial wealth	Total [1]	Transactions [2]		
				Net financial wealth	Assets	Liabilities	Financial balance
Households	1 146.6	245.6	901.0	22.1	18.7	8.0	10.7
Non-financial corporations	1 268.2	1 637.2	–369.0	–22.2	–4.8	–5.3	0.5
General government	161.2	559.2	–398.0	–42.3	–4.5	7.1	–11.7
Financial corporations [3]	2 372.2	2 364.6	7.6	16.7	67.6	64.6	3.0
p.m. Total of domestic sectors	*4 948.3*	*4 806.6*	*141.7*	*–25.7*	*77.0*	*74.3*	*2.6*
Idem, in % of GDP	*1 235.2*	*1 199.8*	*35.4*	*–6.5*	*19.2*	*18.6*	*0.6*

Source: NBB.
(1) Change over the first nine months of 2014.
(2) Cumulative flows over the first nine months of 2014.
(3) Financial corporations comprise mainly monetary financial institutions (NBB, credit institutions and monetary UCIs), non-monetary UCIs, other financial institutions (stockbroking firms, financial head offices and holding companies), in addition to insurance companies and pension funds.

non-financial corporations amounted to 62.1 % and 77 % of GDP respectively, i.e. 2.4 and 6.1 percentage points of GDP below their all-time highs of 2010. Deleveraging is mostly taking place in the periphery of the euro area, but is modest compared with previously accumulated debt. That said, most of these countries are engaged in active deleveraging and their debts are falling in nominal terms.

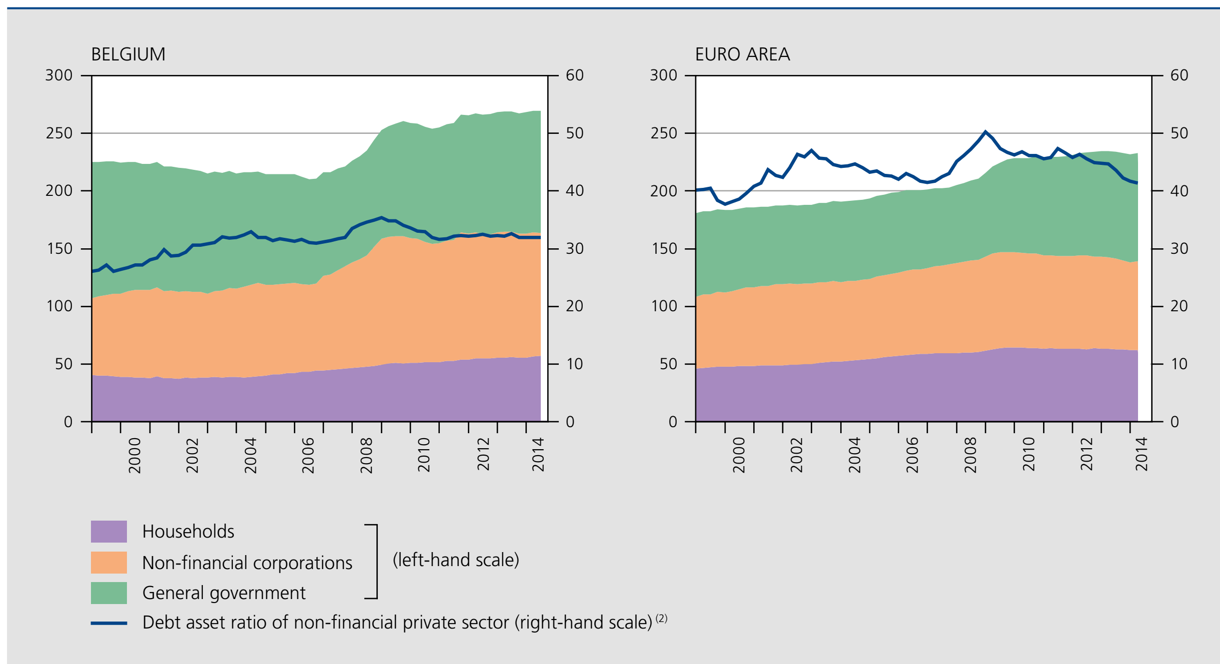
Factoring in public debt, the deleveraging process in the euro area becomes less clear-cut and the non-financial sector ends up close to its peak of 235 % of GDP, compared with 270 % in Belgium. Like net external positions, gross debt ratios, which include both the general government and the non-financial private sector, feature in the scoreboard that the European authorities use for the purpose of the macroeconomic imbalance procedure (MIP). The EC uses consolidated gross debt thresholds of 60 % of GDP for general government and 133 % of GDP for the non-financial private sector, and posits that any breach of these might suggest a macroeconomic imbalance. Belgium exceeds both threshold values: for its public and non-financial private sector debt.

However, the heavy debt level of the non-financial private sector in Belgium requires additional explanation. In reality, a large proportion of non-financial corporations' debt ratio (106.3 % of GDP) is made up of intra-company debt, even on a consolidated basis. Although funding received from other resident non-financial corporations is stripped out in line with the consolidated concept – as the counterpart assets are held by other entities in the same sector – these calculations do factor in loans by foreign affiliates, even if these frequently belong to the same group. Non-bank debt financing from abroad typically involves resources for head offices resident in Belgium and will typically also be transferred abroad, directly or indirectly. Financial flows between associated companies need to be monitored closely, of course, as significant amounts of money are involved, but these represent a much smaller risk of macroeconomic imbalances in Belgium – a fact recognised by the EC in its assessment of the Belgian economy's structural position. At the end of September 2014, foreign non-bank loans stood at € 90 billion or 22.4 % of GDP. With the implementation of new accounting rules for national accounts (ESA 2010), funding of non-financial corporations by "captive financial institutions and non-institutional money lenders" is also included in the consolidated debt ratio (see Box 7). Rather than meeting external borrowing requirements, these holding companies are incorporated in Belgium to redistribute financial resources within groups. Any funding from these holding companies will typically return to them or go to other group entities, without any net debt resulting. At the end of September 2014, loans by "other financial institutions" (OFIs), which comprise these holding companies, amounted to € 127 billion, or 31.6 % of GDP.

Setting aside these qualifications regarding non-financial corporations' debt level, various factors point to the

CHART 45 GROSS DEBT RATIO OF THE NON-FINANCIAL SECTOR (1)

(consolidated debt in % of GDP, unless otherwise stated)



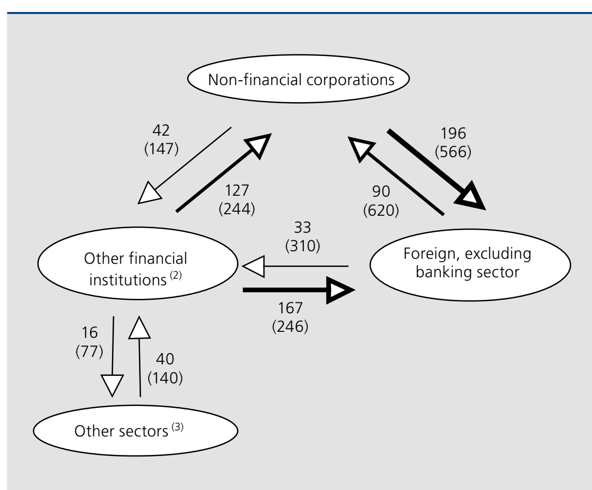
Sources: EC, ECB, NBB.

(1) Data up to the third quarter of 2014 for Belgium, up to the second quarter for the euro area. Quarterly data for the non-financial private sector debt ratio. Annual data for public debt (end of period, forecast for 2014), interpolated linearly on a quarterly basis. Euro area public debt before 2010 is defined in accordance with the ESA 95.

(2) Non-consolidated debt in %.

CHART 46 MUTUAL CLAIMS AND LIABILITIES BETWEEN NON-FINANCIAL CORPORATIONS AND (QUASI-) FINANCIAL CORPORATIONS (1)

(outstanding amount in September 2014, in € billion)



Source: NBB.

(1) The arrows indicate the amount involved in debt instruments or, in brackets, total assets held by the sectors relative to one another.

(2) Primarily "captive financial institutions and non-institutional money lenders".

(3) Households, general government, the (resident and non-resident) banking sector, non-monetary institutions for collective investment (UCIs), insurance companies and pension funds.

sustainability of private debt. At 56.5 % of GDP in mid-2014, the household debt ratio was below that for the euro area, although the gap has steadily narrowed. Looking at the relationship between the debt and the value of the financial assets held by households and companies – i.e. the debt-to-asset ratio – the non-financial private sector in Belgium has a much lower debt ratio than the euro area. And unlike debt expressed as a percentage of GDP, this ratio has remained relatively stable over the past decade. Lastly, it appears that debt service burdens – *ex ante* from the debt-service ratio and ex post from both the level and trend in arrears on loans as registered by the Central Individual Credit Register (CICR) – are manageable for most households. More generally, the financial position of households and companies in Belgium does not seem to point to any special debt sustainability issues.

Box 7 – Impact of ESA 2010 on Belgium's financial accounts

The new ESA 2010 methodology will bring numerous changes to the financial accounts. Providing a new delineation between institutional sectors, it also introduces a reclassification of and increase in the number of financial instruments. What is more, valuation effects and other volume changes in assets and liabilities will be separately recorded, alongside outstanding amounts and transactions (1).

The methodological changes have a significant effect on the financial assets and liabilities of the various sectors, as well as on various indicators of their financial position, such as the debt ratio, net assets and financial balance. With these indicators taking on a more central role in macroeconomic and prudential policies, this Box describes the changeover from the ESA 95 – the previous methodology – to ESA 2010, and the main effects of this on the key indicators.

Assets, liabilities and net financial assets of the various sectors

Assets and liabilities of the Belgian economy as a whole, as estimated according to the new methodology, were virtually unchanged compared to ESA 95. Data for the situation at end-2013 were revised by –1.1 % and –0.7 % respectively. However, the change in the definition of the institutional sectors has quite a significant impact on the size of the assets and liabilities of the different sectors. The financial sector, in particular, was expanded to include sub-sector S.127 "captive financial institutions and non-institutional money lenders" (mainly holding companies),

FINANCIAL ASSETS AND LIABILITIES PER SECTOR

(non-consolidated, in € billion, end 2013)

	ESA 2010			ESA 1995			ESA 2010 – ESA 1995 differences		
	Assets	Liabilities	Net financial assets	Assets	Liabilities	Net financial assets	Assets	Liabilities	Net financial assets
Households	1 114	235	879	1 090	220	870	24	15	9
Non-financial corporations	1 266	1 613	–347	1 936	2 295	–359	–670	–682	12
General government	162	518	–356	137	457	–321	25	60	–35
Financial corporations	2 267	2 276	–9	1 700	1 699	1	566	577	–10
of which:									
Monetary financial institutions (MFIs)	1 095	1 078	17	1 090	1 095	–5	5	–17	22
Other financial institutions (OFIs) (1)	869	908	–39	307	315	–8	562	593	–32
Insurance corporations and pension funds (ICPFs)	303	290	13	303	289	14	0	1	–1
p.m. Total of the domestic sectors	*4 809*	*4 641*	*167*	*4 863*	*4 672*	*191*	*–54*	*–31*	*–24*

Source: NBB.
(1) Including non-monetary UCIs.

(1) Please refer to the methodological note for an overview of the changes made to the national accounts.

which had previously mostly ranked in the non-financial corporations category. The change makes for a key shift in assets and liabilities from non-financial to financial corporations.

Compared with other countries, Belgium is facing a major impact from this sector shift, as many holding companies and treasury centres are incorporated in this country. Assets of OFIs, which now cover the new sub-sector S.127, were revised upwards by 140 % of GDP at the end of 2013, i.e. € 562 billion. This and other changes sparked an overall upward revision of the financial corporations sector's assets from 444 % to 573 % of GDP. By contrast, total financial assets of non-financial corporations came down to 320 % of GDP from 506 % at the end of 2013, due to this and a number of other smaller revisions.

The introduction of a new sub-sector "captive financial institutions and non-institutional money lenders" also widens the definition of the financial sector in the financial accounts, with a wider gap emerging between the credit institutions and insurance companies as discussed in section 3.4 of this Annual Report. The nine sub-sectors now making up the financial sector in the financial accounts can be broken down into monetary financial institutions (MFIs), other financial institutions (OFIs), and insurance corporations and pension funds (ICPFs). Under ESA 95, MFIs accounted for around 64 % of the entire financial sector, but their relative proportion fell to 48 %, with the share of OFIs and ICPFs now at 38 % and 13 % respectively.

Although the changes mainly affect outstanding amounts, in some cases they also provide a different take on developments. The balance sheet total of non-financial corporations, for one, edged down after touching record highs in 2011. The contraction of the financial sector's assets in the wake of the financial crisis – caused by the banking sector, in particular – looks a lot less significant, as it was not as visible in the non-banking financial sector. This also has repercussions on the EC scoreboard used for the macroeconomic imbalance procedure (MIP), one of the headline indicators being the year-on-year change in financial sector liabilities. The debt-to-asset ratio, which serves as an additional indicator, is also strongly affected.

Total assets and liabilities of the other sectors (households and general government) have been revised to a lesser extent. That said, for end-2013, the (non-consolidated) liabilities of the general government were revised upwards by 11.5 % of GDP to 130.9 % of GDP, to reflect the new boundary of general government. Differences with the Maastricht concept of debt used in the European excessive debt procedures (104.5 % of GDP) are that this debt only refers to deposits, debt securities and loans, excluding other liabilities such as tax refunds or pending invoices, and that liabilities on other entities of the general government sector are consolidated. In addition, general government debt will now be recognised in the financial accounts at market values, whereas the Maastricht definition prescribes nominal values for recognition. The slight increase in household assets and liabilities particularly reflects new basic information on non-profit institutions serving households (NPISHs).

In most cases, the impact on assets and liabilities is similar, and thus, overall the revision of the net financial assets of the various sectors is minor.

Debt ratio of non-financial corporations

The reclassification of "captive financial institutions and non-institutional money lenders" also has a major effect on the debt ratio of non-financial corporations. On a non-consolidated basis, the debt ratio was adjusted by around 58 % of GDP, which brought it back down to 136 % of GDP at the end of 2013, the direct effect of the shift of holding companies from the financial corporations to the non-financial corporations sector.

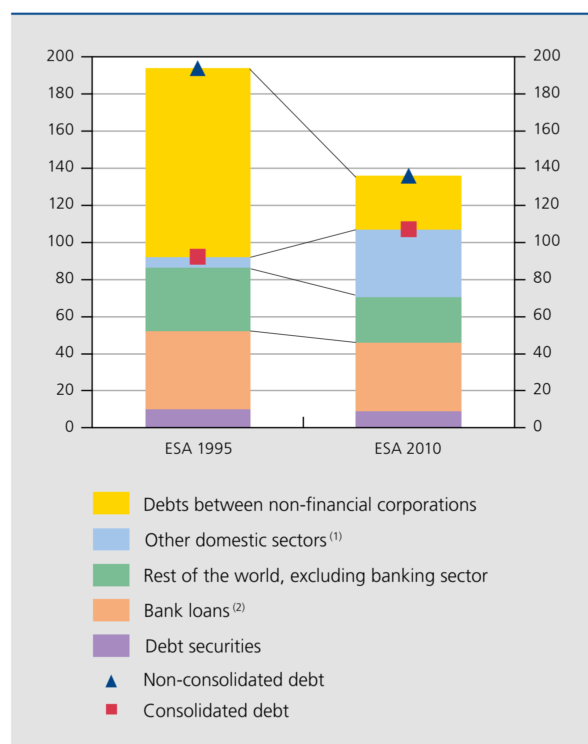
On a consolidated basis, the reclassification of the holding companies meant that the debt ratio was increased by around 15 % of GDP. This increase stems from two opposing factors. On the one hand, any debt contracted by holding companies in other sectors is no longer recognised in the non-financial corporations sector, but on

the other hand, the liabilities of non-financial corporations on holding companies are now recognised in their consolidated debt, as they relate to two different sectors, whereas these used to be consolidated.

At the end of 2013, the consolidated debt ratio stood at 107 % of GDP. Bank loans and debt securities only account for 46.2 % of this debt ratio.

IMPACT OF THE METHODOLOGICAL CHANGES ON THE DEBT RATIO OF NON-FINANCIAL CORPORATIONS

(at end-2013, in % of GDP)



Source: NBB.

(1) Households, general government, non-monetary UCIs, insurance corporations, pension funds and "other financial institutions". In ESA 2010 this latter category also includes "captive financial institutions and non-institutional money lenders".

(2) Loans granted by the resident and non-resident banking sector, including securitised loans.

3.2 Households

In 2014, the financial behaviour of households was primarily influenced by three factors. First, economic agents' confidence remained fragile and was eroded during a large part of the year, even though – unlike in the two previous years – both purchasing power and housing investment were up. Second, financial market developments have widened the gap between returns on low-risk and riskier investment instruments, which may have triggered a search for returns. Nominal interest rates on deposits and loans plunged to historic lows in the year under review, whereas returns on the equity markets held up well, even though they were volatile. Lastly, changes in a number of tax conditions – in particular the reforms of the tax treatment of mortgage loans – heavily influenced loan demand at the end of the year.

As confidence in the economy fell, the year started off with a lull in new loans taken out by households, a continuation of 2013 trends. By the second half of the year, activity picked up on the back of loan refinancing inspired

by lower interest rates or early implementation of planned transactions to lock in more favourable tax treatment. In view of the economic climate, households amassed fewer financial assets than the average in the first three quarters of the years 2006 to 2012, but about as much as that observed in 2013. In terms of categories, households kept their assets very liquid in the first nine months of the year, to face down prevailing uncertainty. At the same time, though, they moved quite a significant proportion of their savings to riskier assets, particularly investment funds, in search of higher returns.

Net household wealth continues to grow at a moderate rate

Total net wealth of households, representing the sum of their financial assets and real estate, amounted to € 2 077 billion at 30 September 2014, an increase on end-2013 by € 64 billion. Both real estate and household financial assets contributed to the increase.

The increase in real estate from € 1 135 billion at the end of 2013 to € 1 176 billion on 30 September 2014 reflects net housing investment as well as higher values of land and buildings in the first three quarters of 2014. Box 8 describes the development of property prices in Belgium and the valuation methods used for its residential property market.

Financial household wealth in Belgium continued to rise in 2014. Estimated at € 1 147 billion at the end of September, compared with € 1 114 billion on 31 December 2013, this exceeds the average increase between 2006 and 2013. Belgian households have also seen their financial wealth increase as a percentage of GDP, from 268.5 % at the end of 2010 and 281.9 % at the end of 2013 to 286.1 % in September 2014. This means that they remain among the wealthiest in the euro area, which as a whole recorded households' financial wealth at 207.2 % of GDP in June 2014.

Belgium's higher household wealth showing reflects both new financial asset accumulation and other flows, including revaluations of existing assets, reclassification and other one-off adjustments. These other flows, which between them amounted to € 13.5 billion, were driven by favourable financial market trends.

TABLE 12 HOUSEHOLD ASSETS AND LIABILITIES
(in € billion)

	Outstanding amount		Change from December 2013		
	End of 2013	End of September 2014	Total	Transactions	Other flows [1]
Real estate	1 134.7	1 176.3	41.6	25.4	16.1
Financial assets	1 114.4	1 146.6	32.2	18.7	13.5
of which:					
Notes, coins and deposits	347.4	353.5	6.2	8.9	–2.7
Debt securities	87.4	81.4	–6.0	–6.5	0.5
Equities	268.7	275.0	6.3	0.9	5.4
Investment fund units	125.9	144.7	18.7	10.7	8.0
Insurance products	269.1	275.7	6.5	4.4	2.1
Other	15.9	16.4	0.5	0.3	0.2
Financial liabilities	235.4	245.6	10.2	8.0	2.3
of which:					
Mortgage loans	181.8	185.5	3.8	3.8	0.0
Other loans	38.9	42.6	3.7	3.5	0.2
Other liabilities	14.7	17.4	2.7	0.7	2.0
Total net assets	2 013.7	2 077.3	63.6	36.2	27.3

Source: NBB.
(1) Other flows comprise both "valuation effects" and "other volume changes". Amongst those, one-off elements such as reclassification of transactions with regard to other sectors may be included.

Box 8 – Valuation of Belgium's residential property market

In Belgium, nominal residential property prices have practically doubled since the beginning of the century, and the drop seen during the great recession was very limited in both scale and duration compared with that in many other euro area member countries. However, the pace of the increases has slowed down markedly in the past two years, and the rise in property prices over the first three quarters of 2014 was only 0.4 % compared with the same period of the previous year. In real terms, prices have come down slightly.

Against this backdrop, the affordability of housing improved somewhat in 2014, as measured by the indicator developed by the NBB and presented in Box 4 of its 2012 Annual Report. After all, the debt service burden on mortgage loans as a part of household disposable income generally eased during the year under review, as both property prices and mortgage rates fell.

The empirical literature describes a range of methodologies for assessing property market valuations, which roughly break down into two categories. The first comprises traditional indicators, i.e. simple ratios of macroeconomic variables expressed as the deviation from their long-term average. Two of the most commonly used – price-to-income and price-to-rent – compared property price developments with household incomes and rents, and both ratios typically point up a strongly overvalued Belgian property market. OECD figures put this overvaluation in the third quarter of 2014 at 50.2 % and 55.3 % respectively.

These yardsticks, which are relatively easy to apply, have their limitations and their outcomes need to be interpreted with caution. The theoretical concept of equilibrium underlying this method of valuing the property market is approached on the basis of the indicators' long-term averages. This is a weighty hypothesis, as it presumes that the equilibrium value is constant over time, whereas it fluctuates in line with changes in the fundamental determinants of property prices, such as interest rate levels, demographics, the preferences of economic agents, mortgage contract features and applicable tax treatment.

VALUATION OF THE BELGIAN RESIDENTIAL PROPERTY MARKET

(percentage deviation from the long-term average, in the third quarter of 2014, unless otherwise stated)

Indicator	Value
Ratio price-to-rent	55.3
Ratio price-to-income	50.2
Interest-adjusted affordability index	28.0
Econometric regression [1]	3.6

Sources: OECD, NBB.
(1) Percentage deviation from the equilibrium value as estimated by the model.

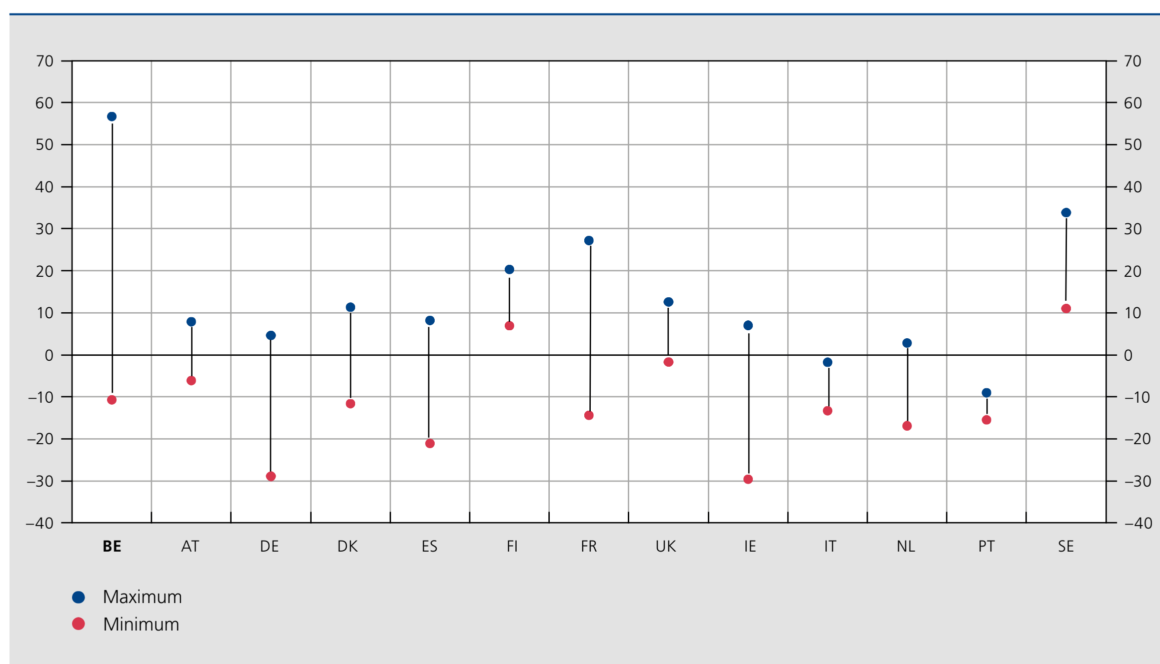
In the case of the price-to-rent ratio, there is a key conceptual difference in that house prices (in the numerator) are based on new secondary market transactions and therefore reflect market conditions, while rents (in the denominator), which in Belgium correspond to the rent component of the consumer price index, usually reflect the rents under existing leases rather than new leases. In addition, as rents in Belgium are subject to various legal rules restricting increases over time, such as (non-obligatory) annual indexation on the basis of the health index,

the results obtained essentially reflect those index movements. Lastly, Belgium’s relatively small rental market also detracts from the relevance of the price-to-rent ratio.

The price-to-income ratio is then adjusted for movements in mortgage rates, a major influence on household borrowing capacity, giving “interest-adjusted affordability”. This indicator – which is invariably expressed relative to a long-term average – suggests that the Belgian housing market was 28 % overvalued in the year under review.

The second approach for assessing property market valuation is based on econometric techniques, the aim being to use fundamental determinants to fix an equilibrium price which can then be taken as the benchmark for measuring deviations in recorded prices. More specifically, this indicator corresponds to the residuals from the regression of a series of fundamental determinants of residential property prices, i.e. average household income, mortgage interest rates, the number of households plus a binary variable to help take account of changes in 2005 to the tax treatment of mortgage loans. This approach would put the Belgian property market at near-equilibrium, a stark contrast with the outcome of the traditional approach.

RESIDENTIAL PROPERTY MARKET VALUATIONS IN A SELECTION OF EUROPEAN COUNTRIES [1]
(in %)



Source : ECB.
(1) Estimates reflecting four different approaches, i.e. price-to-rent, price-to-income and two indicators based on econometric regressions. Minimum and maximum points reflect the lowest and highest estimates of the four methods. For more information, refer to Box 3 of the June 2011 Financial Stability Review (ECB).

As in the case of financial assets, assessment of the fundamental value of property remains a perilous exercise, and the results must be viewed with caution. Despite its unmistakable advantages – factoring in fundamental market determinants and not establishing the market’s equilibrium value on the basis of a long-term average – the econometric approach is not without its flaws. The gap between recorded prices and the equilibrium price might be down to the omission of one or more fundamental determinants, or to the explanatory variables deviating

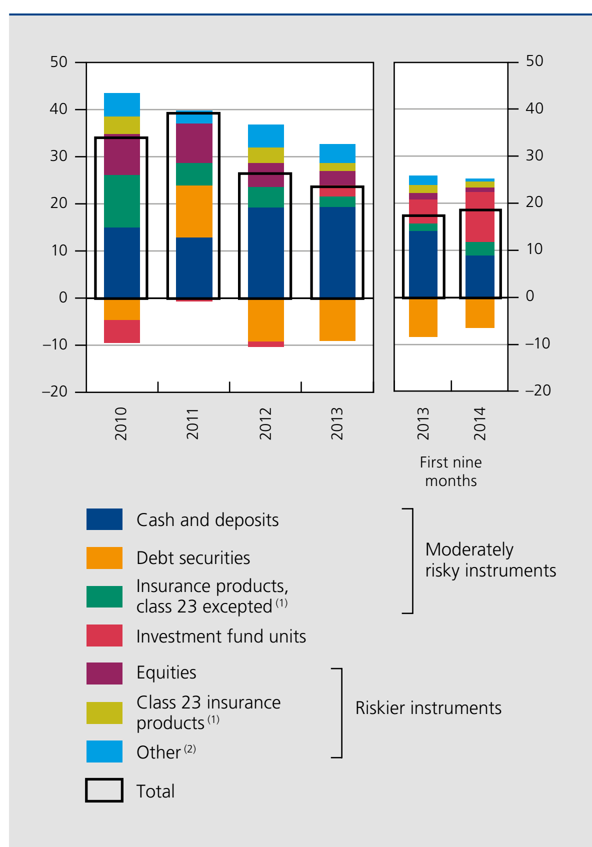
from their own long-term equilibrium values, as is the case with abnormally low mortgage rates. Another example would be the announcement – and in the case of the Flemish Region the early implementation – of measures reducing tax relief on mortgage loans, a decision that could significantly depress house prices in 2015.

The analysis for the euro area countries as reported by the European Systemic Risk Board reveals that major valuation gaps between methods are no typically Belgian phenomenon. However, price-to-rent and price-to-income are completely out of step in Belgium.

In the first three quarters of 2014, Belgian households accumulated new financial assets worth € 18.7 billion (compared with € 17.5 billion in the same period of 2013). That said, their new liabilities also exceeded those in the first nine months of 2013, at € 8 billion. Overall, the balance of households' financial transactions contributed € 10.7 billion to the increase in their net financial wealth between January and September – slightly down on the € 12.1 billion recorded in the same period of 2013.

CHART 47 FORMATION OF FINANCIAL ASSETS BY HOUSEHOLDS: BREAKDOWN BY ASSET CLASS

(in € billion)



Source: NBB.

(1) These items comprise the net claims of households on technical insurance reserves and on standardised guarantee schemes.

(2) This item comprises households' pension entitlements and, insofar as they have been recorded, export credit as well as miscellaneous claims on general government and financial institutions.

The financial liabilities of households comprise mainly mortgage loans. In net terms, refinancing of current loans are not included, as these do not affect total volumes of household liabilities. Like their assets, households' total net financial liabilities continued to rise in 2014 to reach € 245.6 billion at the end of September, compared with € 235.4 billion in the comparable nine-month period.

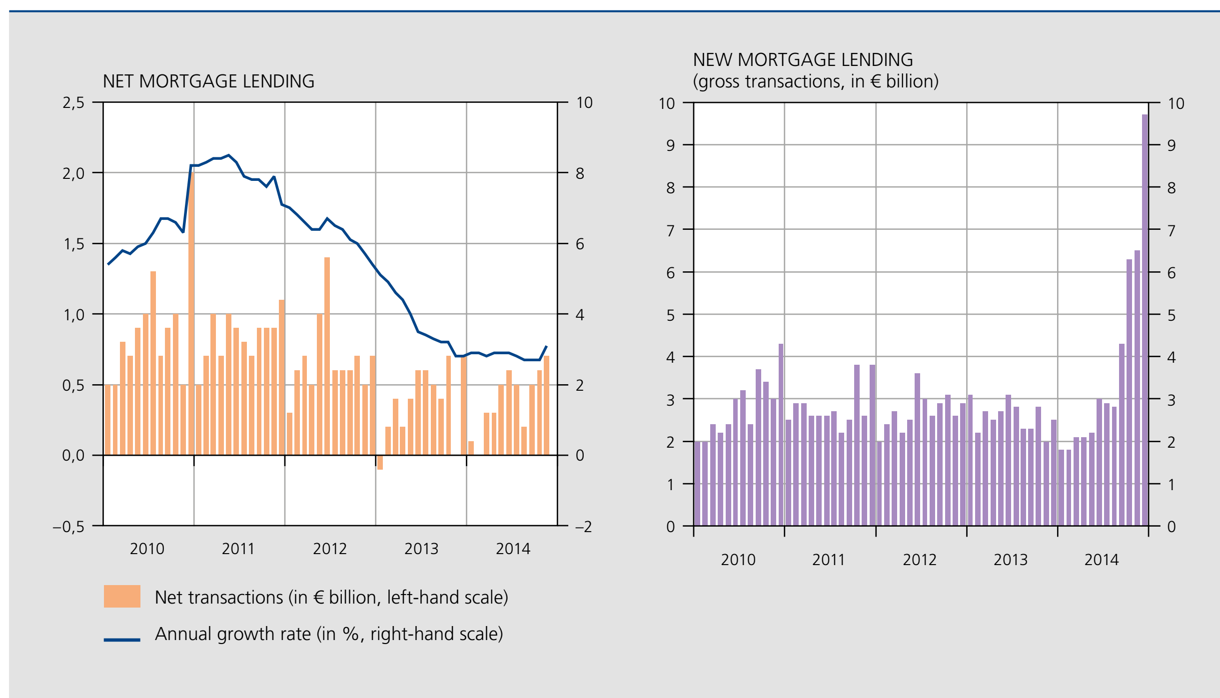
Households partially refocus new investment to riskier assets

In 2014, households redirected a greater proportion of their savings to investment products than in 2013. Falling consumer confidence and continued fragile economic prospects have led households to retain a significant amount of precautionary savings: short-term liquid assets accounted for a large proportion of savings in the first six months of the year.

The financial assets acquired by households can be divided into three categories of instruments, according to the nature of the associated risk: assets bearing a low risk, including cash, deposits, debt securities and insurance products (except class 23); higher risk products such as equities and class 23 insurance products; and finally, units in investment funds, which combine moderately risky products (bond UCIs) with other, riskier products (equity UCIs, mixed funds and funds of funds). According to data from the Belgian Asset Management Association, it was mainly the latter that attracted the interest of investors in 2014, which is why these are ranked among equities and class 23 insurance products in this Report.

According to this breakdown, riskier instruments would seem to account for a large proportion of new investment

CHART 48 MORTGAGE LENDING



Source : NBB.

in financial assets by Belgian households in the first nine months of 2014 (€ 13 billion, compared with € 8.2 billion in the comparable period of 2013). Although cash and deposits remain sought-after instruments, claiming € 8.9 billion of new investment, households have also invested in investment fund units and equities, for a total amount of € 11.6 billion.

As for moderately risky assets other than cash and deposits, € 2.8 billion of household savings went into insurance products, class 23 products excluded. This compares with € 1.6 billion in the first three quarters of 2013.

As in previous years, households completely ignored debt securities. Sales and redemptions of these instruments exceeded purchases and subscriptions by € 6.5 billion, compared with a € 8.4 billion negative flow in the first nine months of 2013.

Investment in investment fund units was sharply ahead of the 2013 figures : € 10.7 billion in the first three quarters of 2014, compared with € 5.2 billion in the same period of the previous year. Virtually all investment went into non-monetary investment funds.

Households invested a little less in equities than they had in 2013, with net equity investment amounting to € 0.9 billion in the first nine months of 2014, compared with € 1.3 billion from January to September 2013.

Class 23 insurance products, the other instruments in the riskier category largely linked to individual life insurance, attracted € 1.3 billion, one-third of total new insurance product transactions. These instruments had accounted for € 1.7 billion in the first three quarters of 2013.

Mortgage loans see moderate net growth despite intensive refinancing activity

Various factors influenced the growth of new household loans in the year under review, and more specifically the signing of new mortgage contracts, as the deteriorating economic climate of the spring of 2014 affected the formation of new financial liabilities by households. Specific developments such as the ongoing fall in mortgage rates and changes in the tax treatment of property loans (tax rebates on mortgage interest) sharply pushed up (gross) demand for loans. The demand spike was particularly noticeable in the second half of the year and took the shape of a significant increase in refinancing volumes – which did not affect net demand – and higher levels of new loans for the new construction, purchase and/or renovation of homes. As a result, annual growth rates of property loans

remained moderate – and relatively steady – in 2014, at around 2.8 %. This percentage shot up to 3.1 % by the end of the year, as households anticipated changes in the law on mortgage interest relief.

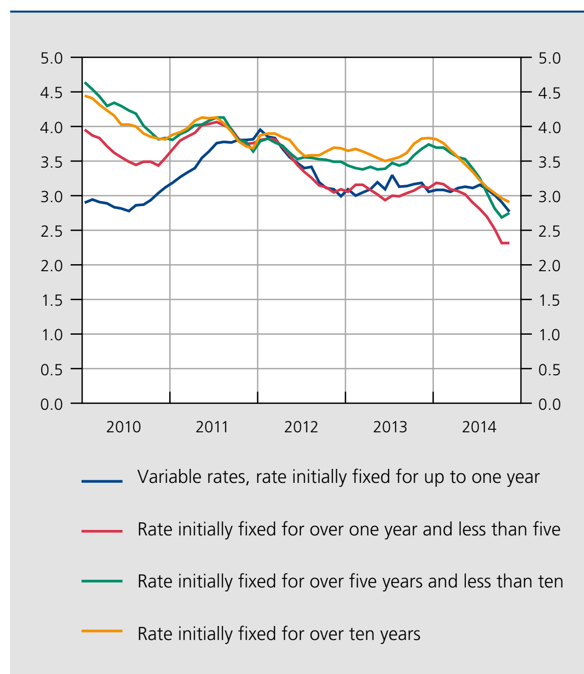
In the first nine months of 2014, net volumes of new loans contracted by households – both mortgage loans and consumer credit – rose from € 5.3 billion in the comparable period of 2013 to € 7.9 billion. On the one hand, new mortgage loans edged down from € 4.2 billion in 2013 to € 3.8 billion in the first nine months of 2014, reflecting households' wait-and-see attitude in the period. Taking account of reclassification and other adjustments, households' total mortgage debt came to € 185.5 billion by September 2014, compared with € 181.8 billion at the end of 2013. On the other hand, the total increase in new financial liabilities was partly attributable to new long-term non-mortgage loans, the net volume of which amounted to € 1.7 billion in the first nine months of 2014, compared with a slightly negative figure of € 0.1 billion in the same period of last year. Higher new financial liability volumes have further pushed up households' debt ratio, to 103.5 % of their disposable income in September 2014, as against 101.1 % at the end of 2013.

Housing investment and new mortgage contract growth remained subdued in the wake of restrictive bank lending conditions (disregarding interest rates) and the greater challenge for households to financially secure their new loans due to the rather limited rise in disposable incomes. The bank lending survey found that banks further tightened their mortgage lending criteria in the second and fourth quarters of the year in view of general economic conditions and housing market-related risk trends. Mortgage lending criteria remained fairly tough in 2014: banks have yet to ease mortgage loan conditions tightened up in 2012 during the sovereign debt crisis.

However, in the second half of the year, households were keen to lock in persistently falling mortgage rates, which have plumbed historic lows, particularly by refinancing. In keeping with benchmark rates, mortgage loans recorded uninterrupted falls in interest rates as the year progressed. Loans with original maturities of over ten years came down by 93 basis points to 2.9 % between December 2013 and November 2014.

From September 2014, the CICR recorded a significant increase in new mortgage loans: between September and December an average 67 300 mortgage contracts were agreed, compared with an average 22 000 a month between January and August. The amounts involved were also slightly higher. However, the overall number of loans has failed to keep up with this pace, suggesting that part

CHART 49 MORTGAGE LOAN COSTS
(in %)



Source: NBB.

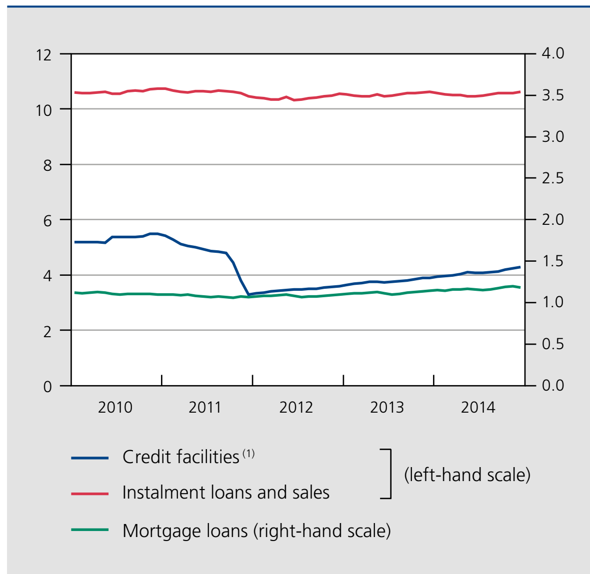
of the upturn was down to refinancing. But even ignoring any refinancing effect, the home loan market has become more dynamic since September. The situation may reflect some front-loading related to tax treatment reforms introduced by the Flemish government, which has decided to cut the maximum mortgage rate reduction for would-be buyers from 2015, from € 2 280 to € 1 520 (amounts increased by € 760 in the first ten years). Starting in 2015, the tax break will be reduced to 40 % in Flanders. The number of residential building permits, an indicator anticipating the start of construction work roughly three months before, reached record highs in March and April of 2014, exclusively due to figures from Flanders.

Risks related to private individuals' debt limited on balance, if a heavier burden on some categories

Statistics from the CICR reveal an upward trend in the number of non-regularised defaults on mortgage loans since mid-2012, amounting to 1.2 % of total loans outstanding at the end of November 2014, the highest level since 2007. Though this low percentage is no cause for concern, this indicator should be closely monitored, particularly in the event of economic stagnation. As Box 9 shows, some categories, including the young, those on the

CHART 50 NON-REGULARISED DEFAULTS

(in % of the number of current loans)



Source : NBB.

(1) Credit facilities showed a statistical break at the end of 2011, which was due to the Central Individual Credit Register's increased scope. Since the end of 2011, authorised current account overdrafts have needed to be recorded in the Register, whereas this did not previously apply if the facility was less than € 1 250 and was repayable within three months.

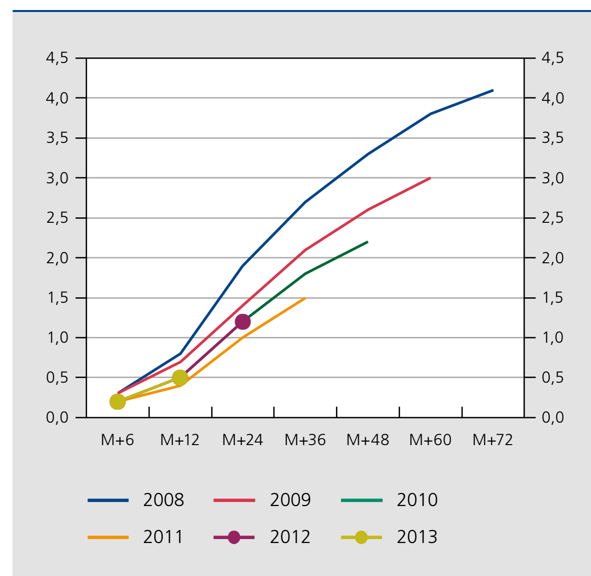
lowest incomes and highly leveraged households, are more at risk. Lastly, the average level of arrears and amounts due rose to € 38 400 at the end of November 2014 from € 36 400 at end-December 2013, a 5.5 % increase.

In the case of revolving credit facilities – which since end-2011 include current accounts allowing overdrafts – defaults continued to rise in 2014 : defaults recorded on this type of loan amounted to 4.3 % of all contracts in November, an increase of 0.4 percentage point on the end-2013 figure. The amounts involved are smaller than in the case of mortgages : an average of € 1 700 per default. Default rates on instalment loans and sales held steady in the year under review, accounting for 10.7 % of the total number of loans outstanding at the end of 2014. Default amounts stood at nearly € 1 200 for instalment sales and at around € 7 800 on instalment loans.

An analysis of annual default ratios for a range of credit types might show up changes to credit conditions imposed by banks or any post-financial crisis intensification of repayment problems. Instalment sales excepted (an unusual category anyway, as contracts have slumped in the past years), no significant increase in default rates has been recorded since the economic and financial crisis first took hold. In fact, for mortgage loans successive cohort curves fundamentally declined in the 2008-2011 period, which points to an improved – and downward – trend in defaults between these two years. Default rates edged back up from these record lows in 2012 and 2013, but have remained low.

CHART 51 DEFAULTS ON MORTGAGE LOANS (1) BY YEAR OF GRANTING (2)

(in % of the number of loans)



Source : NBB.

(1) A default is recorded if the sum due remains fully or partly unpaid three months after due date, or if the sum due remains fully or partly unpaid after a demand by registered letter, or if the sum is fully or partly unpaid a month after formal notice has been served by registered letter.

(2) Loans are grouped according to the year of origination. For each year, the curves show defaulting loans as a percentage of the original total number of loans after a certain number of months from the date the facility is granted. Any loan regularisations are disregarded.

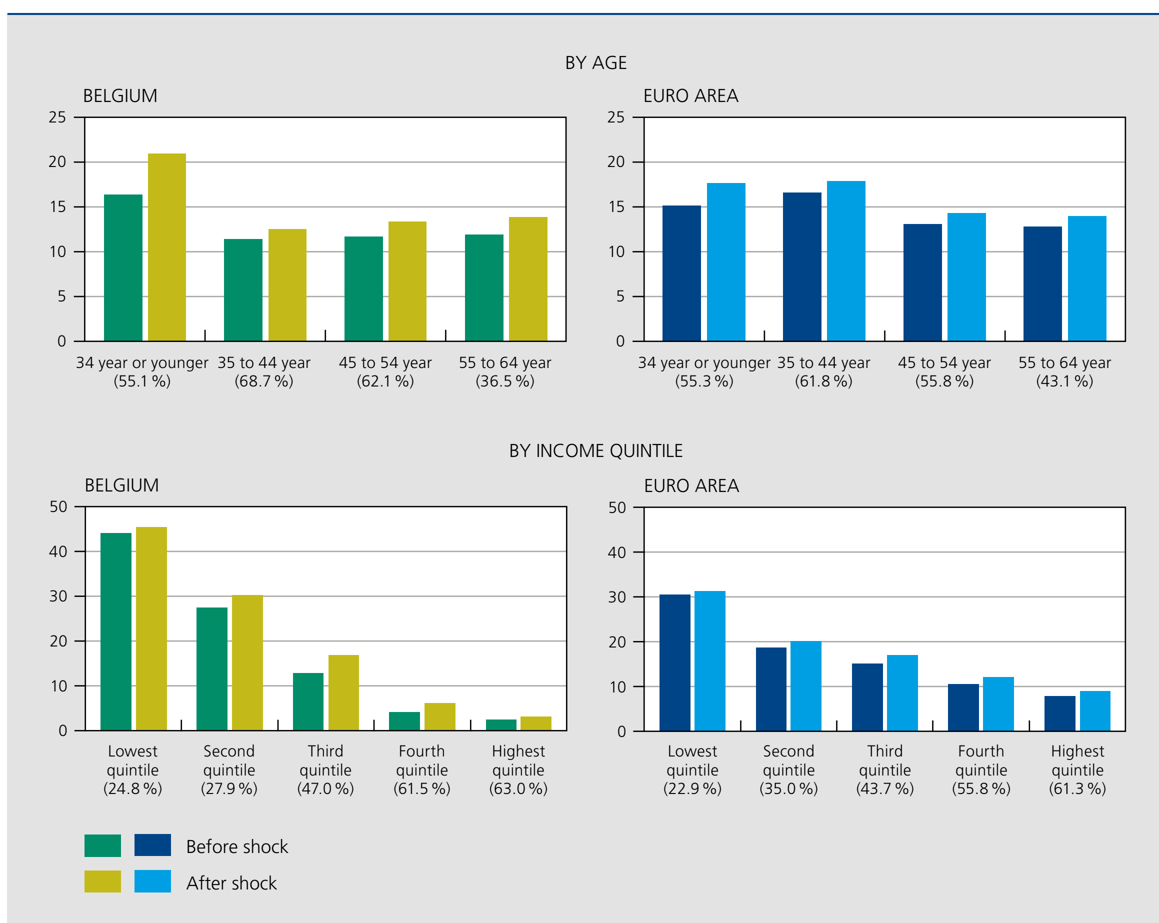
Box 9 – Household debt sustainability: effect of income shocks on the repayment capacity of Belgian households

The financial accounts data show total debt to be pretty favourable for Belgian households. However, these aggregate statistics provide a total debt overview for all households taken together, regardless of their levels of indebtedness, and do not enable deeper research into the borrowing capacity of specific groups or individual households. And so it is useful to estimate the effect of macroeconomic shocks on the debt sustainability of individual households based on microeconomic data. Using data derived from the Household Finance and Consumption Survey (HFCS) for 2010, this Box investigates the effects on household sustainability and, more specifically, on the repayment capacity of households.

HFCS data show that less than half of all Belgian households are indebted, by mortgage loans or otherwise. Participation in the credit market is 44.8 % in Belgium, compared with 43.7 % in the euro area. Belgian household

SENSITIVITY OF DEBT-SERVICE-TO-INCOME RATIO TO AN INCREASE IN UNEMPLOYMENT (1) (2)

(number of households with a debt-service-to-income ratio of over 0.3, in % of indebted households)



Sources: ECB, NBB (HFCS).

(1) In the simulated income shock, employees stand a 5 % chance of losing their jobs and income from employment (10 % for employees under 35 and over 55), after which they will have to draw unemployment benefit.

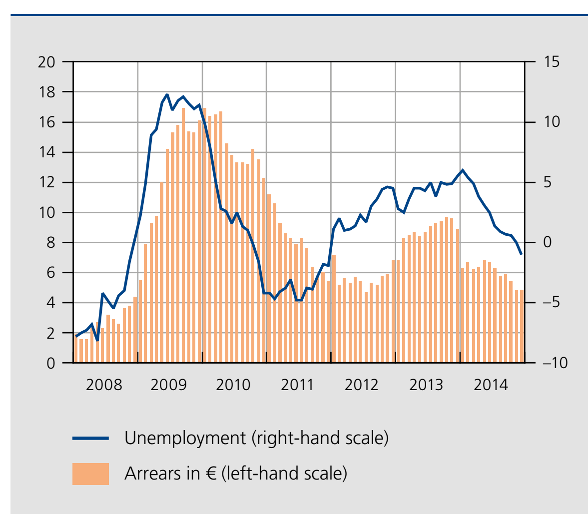
(2) In brackets: indebted households in % of total households of the comparable group.

debt can be analysed more closely by breaking down households into age groups and income quintiles[1]. Credit market participation exhibits a hump-shaped age profile both in Belgium and in the euro area, with participation initially rising with age, from 55.1 % for the youngest households (in which the reference person is under 35) to a peak of 68.7 % for the 35-44 age group, and then coming down again. Credit market participation increases with income, from 24.8 % in the lowest income quintile to 63 % for the highest. Households with higher incomes find it easier to get and repay loans. Outstanding loans typically exhibit age and income profiles similar to the participation rate.

Total outstanding debt levels for households provide no information on the repayment capacity of individual households. A frequently used indicator in this context is the debt-service-to-income ratio, which measures the proportion of income that is needed to repay the debt and meet interest payments. Academic studies suggest that households which spend more than 30 % of their income on servicing debt potentially run higher liquidity risks. According to HFCS data, the proportion of households with a debt-service-to-income ratio of over 0.3 stood at 12.9 % of all indebted households in Belgium, compared with 14.1 % for the euro area.

Not all household categories run the same risk of too high a debt-service-to-income ratio. Indebted young families potentially run a slightly higher risk, and the share of households with problem debt ratios also falls with income levels. Belgium's age and income profiles related to potential debt service issues are both slightly more pronounced than in the euro area: although the proportion of households with problem debt-service-to-income ratios is smaller in Belgium on average, the share of youngest households (16.3 %) exceeds the figure for the euro area (15.2 %). In the lowest income quintile, 44.2 % of Belgian indebted households exhibit debt-service-to-income ratios of over 0.3, compared with 30.6 % for the euro area. The share of indebted households with problematic

UNEMPLOYMENT AND HOUSEHOLD DEFAULT
(annualised percentage changes)



Sources: NEO, NBB (CICR).

debt ratios is bigger for Belgium's lowest income quintiles than for the euro area. Belgium's more pronounced age and income profiles – accounting for a relatively higher risk than in the euro area for the youngest households and households in the lowest income group – reflect different patterns in property ownership and related mortgage

(1) Du Caju Ph. (2013), "Structure and distribution of household wealth: An analysis based on the HFCS", NBB, *Economic Review*, September, pp. 41-63.

loans. Unlike the euro area, Belgium typically has the highest loans in the youngest indebted households, reflecting faster and more general access to home ownership: 46 % of households with a reference person under the age of 35 own their own home, compared with only 31.9 % in the euro area.

Drawing on HFCS data, a simulation can be used to gauge the effects of an income shock on the debt sustainability of households and their capacity to keep repaying their debts. More specifically, it analyses the consequences of an upturn in unemployment that threatens to destroy the jobs of 10 % of employees under the age of 35 and over the age of 55, with 5 % of employees in the middle age brackets hit (1). After all, youth unemployment tends to be more cyclical and corporate restructurings typically end in older employees being made redundant. All other things being equal, the shock would push up unemployment by nearly 4 percentage points. This static simulation does not factor in any behavioural adjustments, changes in the the labour force or feedback effects.

Loss of income from employment and its replacement by unemployment benefits can turn a family's debt position into a problem. The chances of this happening depend on their basic financial situation before the shock, the amount of outstanding debt and other sources of income. Under this simulated unemployment shock, the share of families with a debt-service-to-income ratio of over 0.3 would rise from 12.9 % to 14.9 % in Belgium and from 14.1 % to 15.5 % in the euro area, with the relatively stronger impact in Belgium affecting mostly young families. The share of indebted families in the under-35 bracket and with a debt-service-to-income ratio of over 0.3 would climb from 16.3 % to 20.9 % in Belgium and from 15.2 % to 17.7 % in the euro area. The unemployment shock's impact on household debt sustainability would be fairly evenly distributed across the income groups (quintiles). Belgian families in the lowest and middle income groups prove more vulnerable than those in the euro area. Middle incomes in Belgium have a lot of double-income, steeply mortgaged couples whose outstanding debt is generally higher than in the euro area.

The outcomes of these simulations are broadly confirmed by trends in arrears as registered with the CICR (2). Between 2008 and 2014, changes in the number and size of arrears in Belgium closely mirrored unemployment trends, with CICR data confirming that younger people struggle more with arrears on their loans. A more pronounced correlation between repayment problems and unemployment rates is also noted, with most of the defaults concerning non-mortgage loans.

(1) Du Caju, Ph., F. Rycx and I. Tojerow. Unemployment risk and financial fragility: a microeconometric perspective. NBB Working Paper, forthcoming
(2) Du Caju, Ph., Th. Roelandt, Ch. Van Nieuwenhuyze and M.-D. Zachary (2014). "Household debt: Evolution and distribution", NBB, *Economic Review*, September, pp. 65-85.

3.3 Non-financial corporations

In the first three quarters of 2014, the financial transactions of non-financial corporations were heavily influenced by historically low interest rates coupled with a fragile and tentative economic climate. Despite better funding conditions, corporations took on fewer new financial liabilities, although the net fall was not as steep as in the comparable period of 2013 and was the outcome of trends pulling in many different directions. Bank lending to large companies fell further, as they increasingly tapped the capital markets by issuing bonds and equities. By contrast, bank lending to small and medium-sized enterprises (SMEs) picked up slightly in 2014. As loan conditions have eased, the overall drop in total external funding would appear to point to ongoing relatively weak investment demand, possibly caused by increased uncertainty, sluggish final demand and a deteriorating outlook for economic growth. These factors also partly explain why corporations piled up liquid assets in anticipation of future investment.

Companies see their net financial liabilities increase on the back of rising stock market prices

In the first nine months of 2014, the financial liabilities of non-financial corporations grew by € 24.5 billion in total, whereas their assets added only € 2.3 billion, taking their net financial liabilities € 22.2 billion higher to € 369 billion (or 92.1 % of GDP) by the end of September 2014. As in 2013, the balance of financial transactions was negative in

TABLE 13 FINANCIAL ASSETS AND LIABILITIES OF NON-FINANCIAL CORPORATIONS
(in € billion)

	Outstanding amount		Change from December 2013		
	End of 2013	End of September 2014	Total	Transactions	Other flows (1)
Financial assets	1 265.9	1 268.2	2.3	–4.8	7.1
of which:					
Cash and deposits	112.2	116.6	4.4	1.5	3.0
Debt securities	20.2	11.6	–8.6	–8.4	–0.2
Listed shares	89.9	90.5	0.5	0.5	0.0
Unlisted shares and other equity	405.1	417.8	12.7	11.5	1.2
Loans	363.4	371.0	7.6	5.2	2.4
Trade credit	146.2	135.2	–11.1	–11.3	0.3
Other assets (2)	128.7	125.5	–3.2	–3.7	0.4
Financial liabilities	1 612.6	1 637.2	24.5	–5.3	29.9
of which:					
Debt securities	37.9	40.8	2.9	2.3	0.6
Listed shares	199.1	229.0	29.9	3.3	26.7
Unlisted shares and other equity	717.3	717.5	0.2	–5.4	5.6
Loans	499.8	504.5	4.7	6.0	–1.3
Bank loans	147.1	146.5	–0.5	–0.3	–0.2
Non-bank loans	352.7	358.0	5.2	6.3	–1.0
Trade credit	134.3	120.7	–13.6	–12.2	–1.3
Other liabilities (3)	24.3	24.7	0.4	0.7	–0.3
Net financial assets	–346.8	–369.0	–22.2	0.5	–22.7

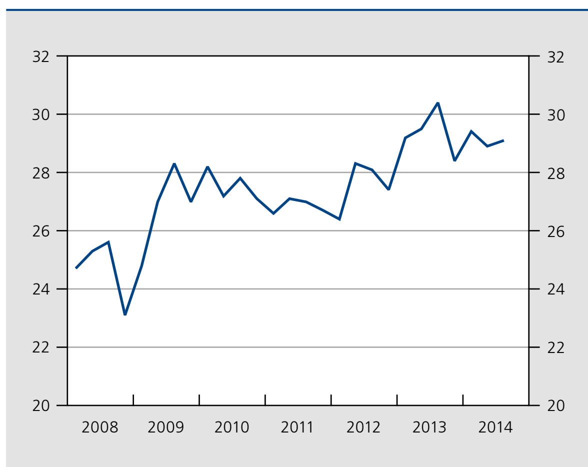
Source: NBB.
(1) Comprising both "valuation effects" and "other volume changes".
(2) Primarily statistical adjustments.
(3) Almost exclusively other debt, with the exception of trade credit.

the first three quarters of 2014, both for liabilities and for assets. The shortfall was more than offset by positive changes in corporate financial positions on the back of rising stock market prices and a number of reclassifications.

Total financial assets and liabilities of non-financial corporations mainly reflect cross-balance-sheet positions: almost one-fourth of non-financial corporations' liabilities are held by other resident non-financial corporations, often in the shape of inter-company positions, and about half by foreign companies and holding companies, which will henceforth be recognised under the financial sector (see section 3.1). Around 30 % of total financial assets of non-financial corporations have resident non-financial corporations as their counterparty; foreign companies and holding companies account for 60 %. It is of course quite likely that not all transactions with foreign companies or holding companies are inter-company transactions, but these figures probably serve as a reasonable approximation of such transactions. Instruments used in cross-positions are primarily unlisted equities and other equity, as well as non-bank loans.

Total financial liabilities grew less robustly than in the comparable period of 2013, and mostly advanced as listed shares, non-bank loans and debt securities. The € 29.9 billion surge in listed shares mostly reflects rising stock market prices and only slightly the net issuance of new shares. Outstanding debt securities at the end of September 2014 recorded a total value nearly € 3 billion up on the end of 2013, on the back of positive net issuance. Outstanding loans also increased, by € 4.7 billion, but these were exclusively facilities furnished by sectors other than MFIs. All in all, corporations tapped the financial markets for their external funding and relied less on bank loans, while also using less trade credit.

CHART 52 CASH AND DEPOSITS HELD BY NON-FINANCIAL CORPORATIONS
(outstanding amount, in % of GDP)



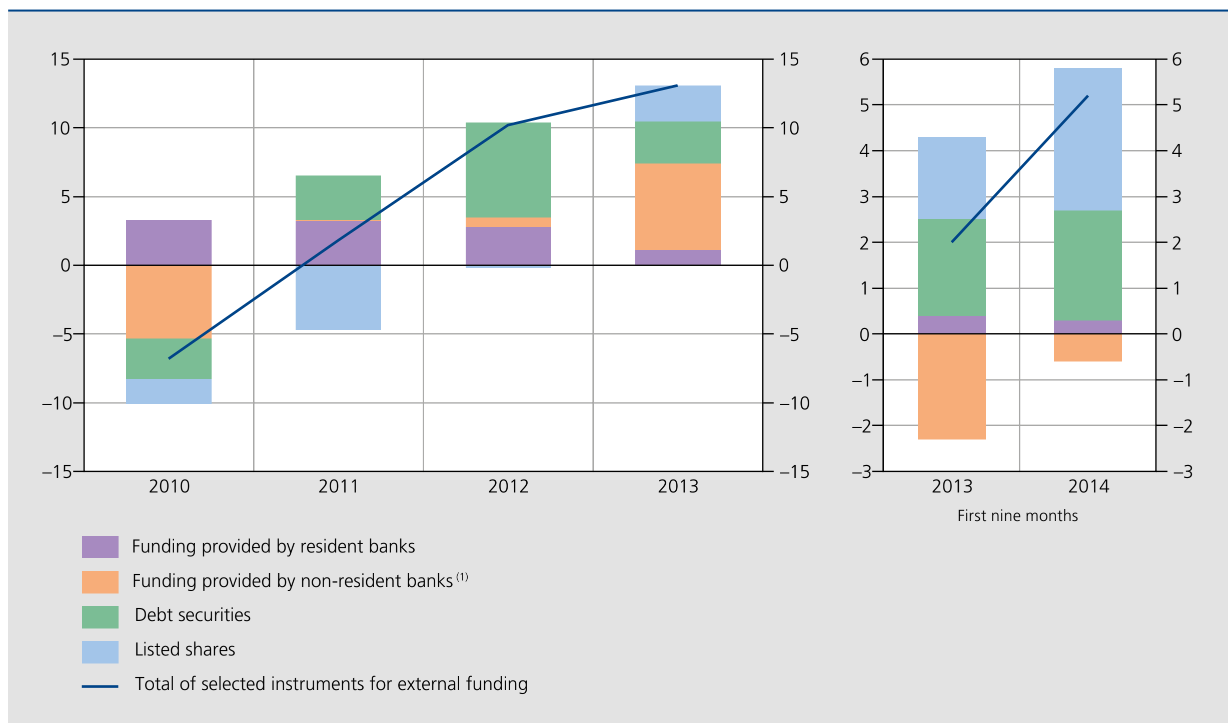
Source: NBB.

On the assets side, non-financial corporations' balance sheets recorded positive developments for unlisted shares and other equity, lending and cash & deposits. Conversely, they furnished fewer trade loans and held fewer debt securities.

Corporations continue to enjoy ample financial reserves

Recording a further increase of around € 4.4 billion in the first nine months of the year under review, cash and deposits outstanding at non-financial corporations amounted to € 116.6 billion by the end of September 2014, or 29.1 % of GDP – a hefty cash reserve when compared with the average since 1999 of 24 % of GDP. Non-financial corporations have been improving their profitability since 2013, but a dearth of attractive real and financial investment opportunities has kept them from dipping into their financial reserves. They will be able to draw on these reserves to complement external funding when implementing investment projects as soon as the economic recovery gathers momentum.

CHART 53 SELECTION OF NEW FINANCIAL LIABILITIES OF NON-FINANCIAL CORPORATIONS
(consolidated data, in € billion)



Source: NBB.
(1) Whereas net lending by non-resident banks was negative for the first nine months of 2013, the positive full-year figure reflected an exceptional transaction in the fourth quarter.

Companies used more long-term market instruments to finance their operations

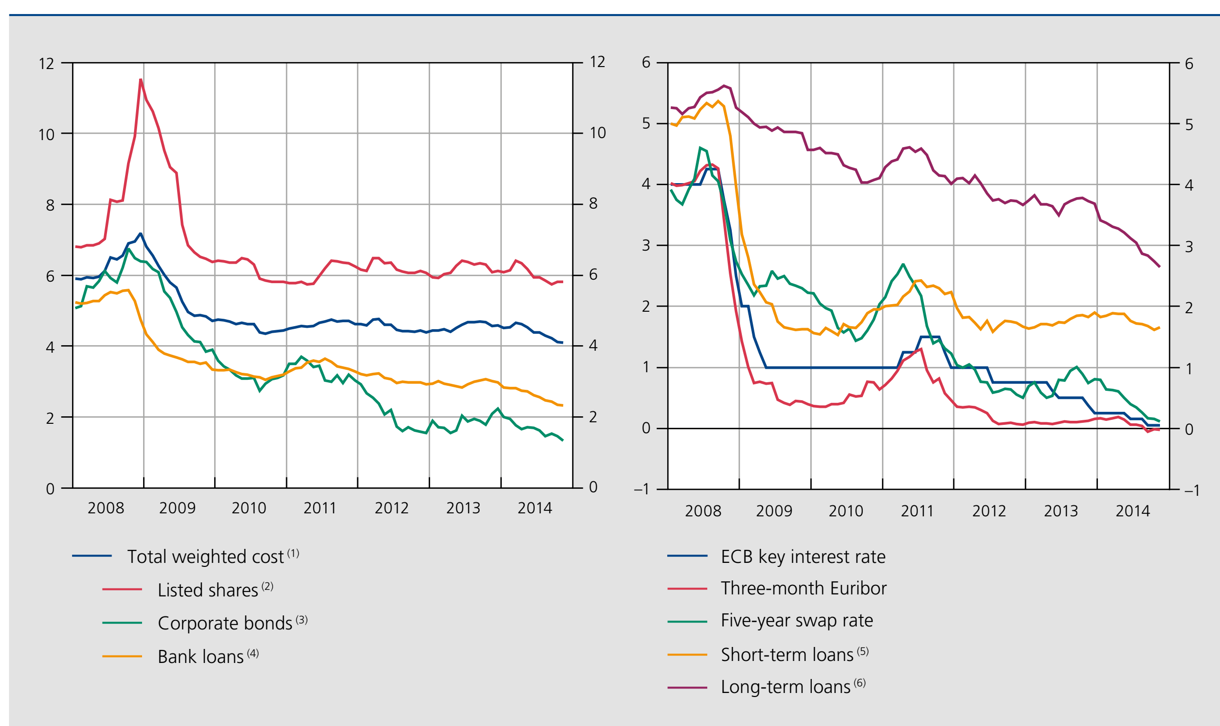
Funding transactions will now be reviewed on a consolidated basis and so ignore funding from other resident non-financial corporations. What results is still an unavoidably distorted view, however: the figures are not adjusted for any funding provided by holding companies and associated companies incorporated abroad, as sufficiently detailed information is lacking.

The consolidated data show corporations to have reduced their total financial liabilities by € 0.6 billion in the first three quarters of the year under review, compared with a net increase of € 5.1 billion in the comparable period of 2013. The figures primarily reflect a net € 7.1 billion fall in unlisted shares and other equity. A large proportion of this may well be down to cross-holdings within the same group, as holding companies and foreign companies together account for around 90 % of the fall. Non-financial corporations did tap the markets more in the first nine months of the year under review, using long-term market instruments in particular. They did not just increase the issuance of listed shares – the very embodiment of long-term financing – but also issued more debt securities, particularly long-term ones.

Corporations again borrowed less from banks in the first three quarters of 2014, but the net € 0.3 billion fall was wholly attributable to short-term credit trends. Resident banks granted as many short-term loans as there were repayments, but short-term lending by non-resident banks continued to decline. The same was true for their long-term loans, but this was offset by non-financial corporations drawing on more long-term credit from resident banks. Besides, non-financial corporations also issued new debt securities in the first nine months of the year under review. Consolidated net debt securities issuances totalled € 2.4 billion, compared with € 2.1 billion in the comparable period of 2013, breaking down into long-term debt securities at € 1.9 billion and short-term issuance worth only € 0.5 billion. For corporations able

CHART 54 EXTERNAL FUNDING COSTS OF NON-FINANCIAL CORPORATIONS

(monthly data, in %)



Sources: Barclays Capital, Thomson Reuters Datastream, NBB.

(1) Obtained by weighting the cost of funding by listed share issuance, 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 (see Box 19 in the 2005 Annual Report).

(3) Return on an index of euro-denominated bonds issued by Belgian non-financial corporations, with maturities of more than one year and with a rating in excess of Baa; the index is weighted according to the outstanding amounts.

(4) Weighted average rate applied by resident banks to business loans. The weighting is based on the outstanding amount of the various types of credit.

(5) Interest rate on new bank loans of more than € 1 million at variable rates, initially fixed for up to one year.

(6) Interest rate on loans of € 1 million or less, with a rate initially fixed for more than five years.

to issue bonds, this type of market funding was again relatively attractive when compared with bank loans, as interest charges on bank lending are invariably higher (see below). And although the issuance of listed shares comes at a steep cost, corporations increasingly draw on these instruments too: on a consolidated basis, they issued € 3.1 billion in listed shares, compared with € 1.8 billion in the comparable period of 2013.

Funding environment for corporations improved significantly

On the whole, non-financial corporations saw their funding environment improve massively from the end of 2013, which was reflected in lower costs of a range of external funding sources. A number of surveys of banks and entrepreneurs also found that general funding conditions – price and non-price – have improved both for large companies and to a lesser degree also for SMEs.

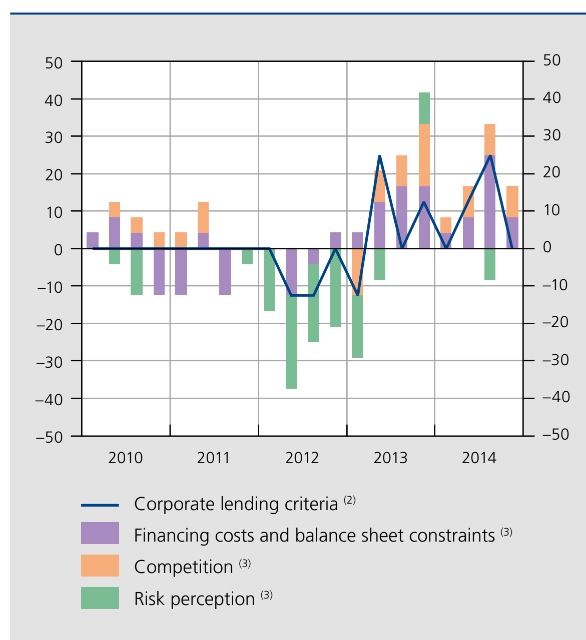
Corporations' total financing costs – calculated by weighting the nominal cost of each funding source according to its respective share in the total outstanding amount of its financial liabilities – fell further in the year under review, to historic lows. The average financing costs of all non-financial corporations taken together were estimated at 4.1 % in November 2014, compared with 4.6 % in December 2013. Note that this average masks sizeable differences between funding sources, with costs ranging between 1.3 % for corporate bonds and 5.8 % for listed shares. And although costs came down sharply in 2014 for all types of external funding, long-term bank loans and corporate bonds fell the hardest, by 105 and 90 basis points respectively.

In part, these reduced costs reflect accommodating monetary policies set by the ECB, which cut its key interest rate further and confirmed its forward guidance, sparking an immediate further drop in money market rates – and especially the long-term ones. The three-month swap rate fell by 18 basis points compared with end-2013, to –0.02 % in November 2014, while five-year swap rates were 70 basis points lower at 0.1 %. Effective interest rates on new bank loans to corporations also followed the downward trend: interest rates on short-term loans for amounts in excess of € 1 million fell from 1.9 % at the end of 2013 to 1.7 % in November 2014, while long-term loans initially fixed for more than five years dropped 105 basis points to 2.6 %.

The improved funding environment for non-financial corporations did not just reflect external borrowing costs but also non-monetary conditions. In a range of qualitative surveys both banks and entrepreneurs agreed that the availability of external funding, and in particular of bank loans, had improved in the course of 2014. The Eurosystem's bank lending survey found that Belgium's four resident major banks had further eased their credit standards for corporate loans in the second and third quarters of 2014, as they had seen their own financing costs and balance sheet restrictions relax and competition pick up, although risk perceptions had heightened again and affected credit standards in the third quarter. This easing of borrowing conditions primarily showed up in improved monetary conditions – lower margins on corporate loans with average risk profiles – but banks also proved more relaxed about term to maturity, volumes and clauses in loans agreed. Better non-monetary conditions generally benefited large companies more than they did SMEs.

CHART 55 CREDIT STANDARDS AND DETERMINANTS ACCORDING TO CREDIT INSTITUTIONS

(weighted net percentages of the responses by credit institutions [1])



Source: NBB (Eurosystem bank lending survey).

(1) The responses are weighted according to their distance from the "neutral" response: mention of a "considerable" change in the lending criteria is accorded double the weighting of a "slight" change.

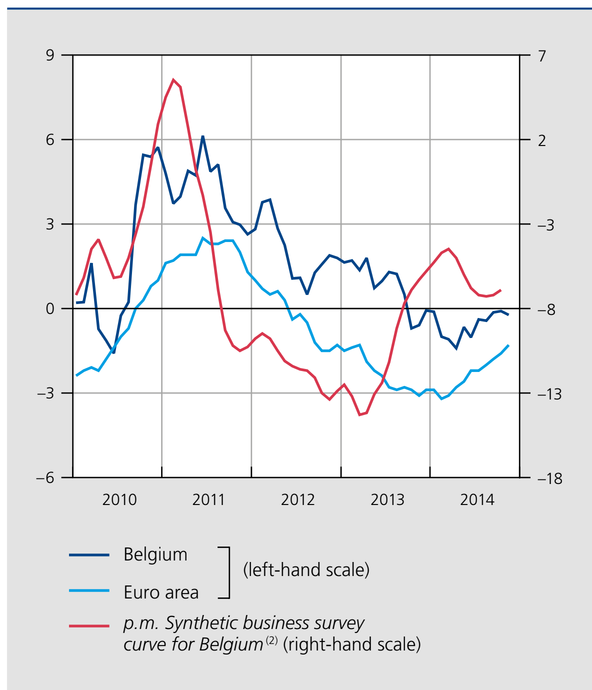
(2) The degree to which lending criteria were eased (+) or tightened (–).

(3) A positive (negative) net percentage corresponds to a factor contributing to easing (tightening) the lending criteria. Average of net percentages for the various sub-questions.

Another NBB survey revealed that business leaders also took a favourable view of general conditions for new bank loans in the second and third quarters of the year under review – for the first time since the second quarter of 2011. Positive sentiment primarily reflected a more favourable perception of bank lending rates, while views

CHART 56 LENDING BY RESIDENT BANKS TO RESIDENT NON-FINANCIAL CORPORATIONS [1]

(end-of-month data; annualised percentage changes, unless otherwise stated)



Sources: ECB, NBB.
(1) Including securitised loans.
(2) Smoothed indicator, balance of responses.

of non-monetary conditions continued to deteriorate, albeit to a lesser degree. The total net percentage score assigned to loan volumes came to –6 % in the third quarter of 2014 for all companies together, compared with –26 % in the first quarter of 2013, while the percentage had already turned positive for very large companies. Both surveys point to significant across-the-board improvements for large companies, while small and medium-sized enterprises mainly benefited from lower interest rates but not (yet) so much from easing of non-monetary criteria. These findings are corroborated by a third qualitative annual survey, the Survey on the Access to Finance of small and medium-sized enterprises in the euro area (SAFE), in which Belgian SME respondents reported easier access to bank loans between April and October 2014, for the first time since the survey was launched in 2009. SMEs with robust balance sheets, in particular, appeared to encounter fewer challenges in attracting outside funding, despite the subdued general economic climate. Lower interest rates were primarily cited, but far fewer SMEs reported that their loan applications were wholly or partly rejected by their banks.

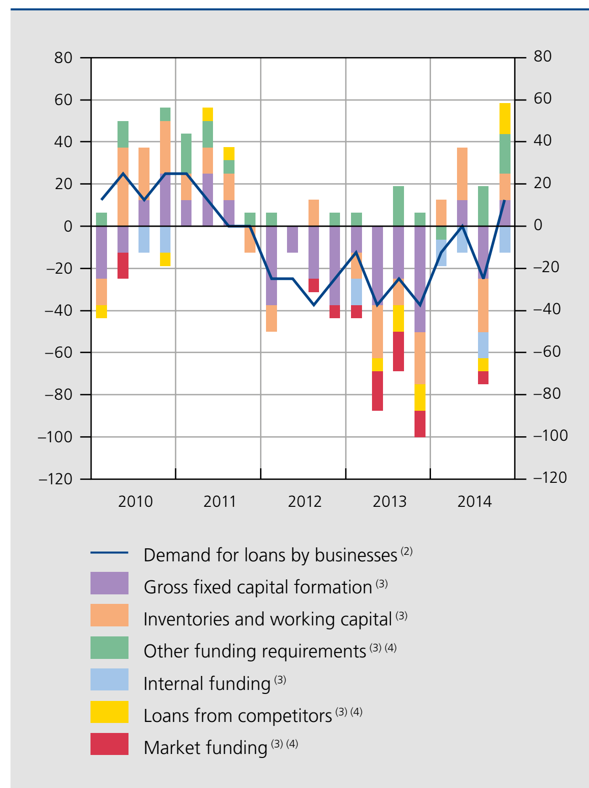
Weak bank loan growth mainly demand-related

Despite this robust improvement in the funding environment, bank lending to non-financial corporations continued to grow at a glacial pace in the first three quarters of 2014. With bank loans virtually the only source of debt financing for SMEs and given these companies' crucial role in Belgium's economy, the importance of stable bank lending cannot be underestimated.

According to resident banks' monthly statistics – still drawn up in keeping with the ESA 1995 definition of non-financial corporations – the annual percentage change in loans to corporations stayed negative in 2014. That said, the recent downtrend that started in May 2013 would now appear to have ended: by April 2014, the percentage change had plumbed an all-time low of –1.4 %. By November 2014, growth was at an annualised –0.2 %, comparable

CHART 57 LOAN DEMAND AND DETERMINANTS ACCORDING TO CREDIT INSTITUTIONS

(weighted net percentages of responses by credit institutions [1])



Source: NBB (Eurosystem bank lending survey).
(1) The responses are weighted according to their distance from the "neutral" response: mention of a "considerable" change in borrowing demand is accorded double the weighting of a "slight" change.
(2) The degree to which borrowing demand went up (+) or down (–).
(3) A positive (negative) net percentage corresponds to a factor contributing to borrowing demand going up (down).
(4) Average of net percentages for the various sub-questions.

to end-of-2013 levels. More relaxed loan criteria notwithstanding, loans provided by resident banks to non-financial corporations continued to exhibit very subdued growth, underlining the key influence of sluggish demand.

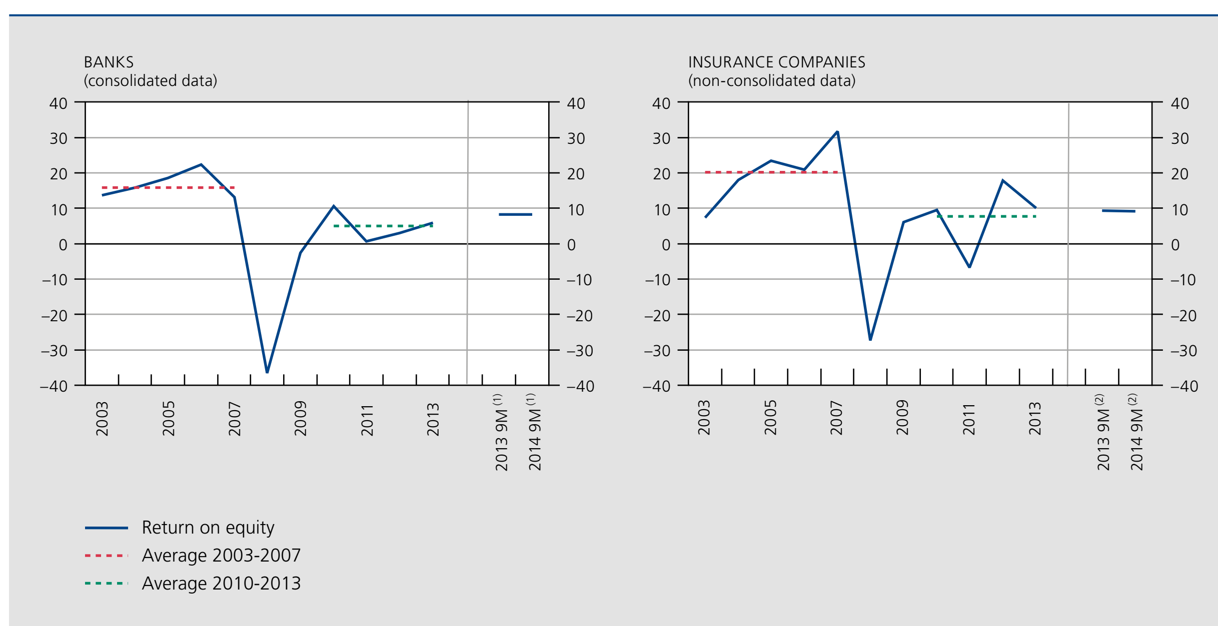
Two factors of a very different nature could explain the sluggishness: continued reticence on the part of corporations to launch investment projects and corporations increasingly tapping non-bank funding sources, such as corporate bonds or equities. In the latter case, subdued bank loan growth need not be regarded as acting as a brake on future investment, but rather as a positive trend towards a more diversified financing structure and a more robust financial base for non-financial corporations. What is more, this would give the banks more room to lend to SMEs, which are typically too small to tap resources in the equity or bond markets. It is important to establish whether subdued bank credit growth is down to substitution by large companies or to a dearth of suitable investment projects.

According to the Eurosystem bank lending survey, Belgium's four resident major banks did indeed report that the demand for loans remained very weak and that it has consistently fallen since the beginning of 2012, only starting to pick up again in the fourth quarter of the year under review. Initially, it was only loan demand by large companies that contracted, but SME demand has also been declining since the end of 2012. The situation for large companies improved in 2014, but for SMEs, the net percentage has again remained negative since the third quarter. The banks blame corporations' weak demand for loans in recent years both on reduced gross fixed capital formation, inventories and working capital, and on increased use of alternative funding. Both factors showed similar trends in 2014, but banks would appear to have attached more importance to alternative funding, primarily internal resources, as the year progressed. Unfortunately, the data do not enable a breakdown into large companies and SMEs.

However, the available figures do allow for a breakdown by company size, and Central Corporate Credit Register data – still drawn up in keeping with the ESA 95 definition of non-financial corporations – suggest that credit expansion contracted much more sharply for large companies than for SMEs. Large companies saw annual growth come down from 13 % in the 2005-2008 period to –4.4 % between 2009 and the third quarter of 2014. For SMEs, the trend was much less marked, with average growth figures of 9.7 % and 3 % respectively. All things considered, these data present a somewhat clearer picture of the negative loan growth at resident banks: the contraction is

CHART 58 RETURN ON EQUITY

(in %)



Source: NBB.

(1) Annualised.

(2) Annualised based on quarterly reporting. Quarterly figures do not completely coincide with the annual figures, as they do not take account of any dividend payments to shareholders and insurance policy-holders.

mainly attributable to large companies, which have mostly swapped bank loans for bond issuance. This is not to say that lacklustre borrowing requirements did not have a key part to play: both lending to SMEs and debt financing of large companies merely edged up compared to their long-term averages.

3.4 Financial institutions

Profitability vulnerable at financial institutions

In the first nine months of 2014, Belgium's banking and insurance sectors returned profits of € 3.6 billion and € 1 billion respectively, comparable to the same period of 2013. Return on equity at Belgian financial institutions remained significantly lower than before the financial crisis.

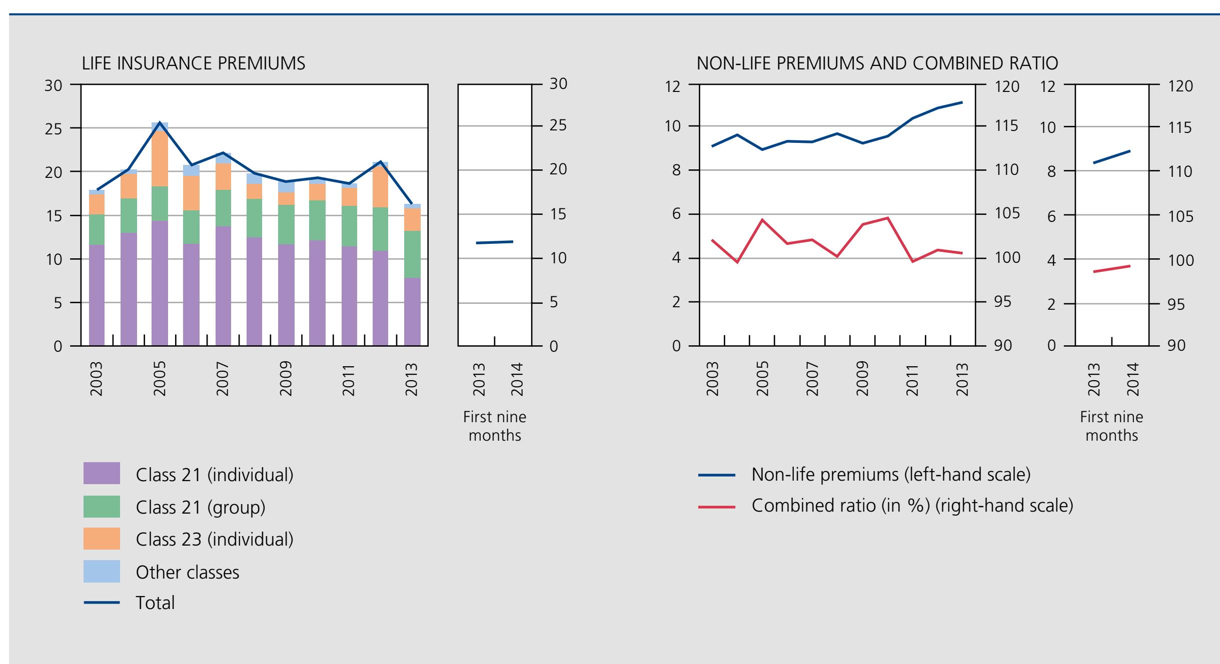
Economic conditions in Belgium and in the rest of the euro area – low interest rates coupled with weak economic activity – are squeezing the profitability of both banks and insurance companies. And although both have taken measures to combat their economic impact, continued poor conditions cannot be ruled out and financial institutions might feel compelled to adjust their business models and cost structures even further.

Weak economic growth curbs activity at banks and insurance companies

Recent sluggish economic trends have combined with the gloomy outlook to curb demand for core banking and insurance products. Weak loan demand has squeezed banks' net interest income, although some of them have been able to offset the shortfall with repo operations (loans collateralised by temporary transfer of securities), but repo-derived margins are typically much slimmer than those on traditional financial intermediation services. Against this backdrop, there was hardly any need for Belgium's banks to raise more funds via the Eurosystem in 2014, and their rather extensive call on the second targeted longer-term refinancing operation (TLTRO) was mostly prompted by the rollover of the three-year longer-term refinancing operations maturing at the beginning of 2015. Although banks tapped the two TLTROs to the tune of € 6.3 billion cumulative, total funding provided by the NBB as part of its monetary policy transactions fell from € 16 billion at the end of 2013 to € 11.7 billion at the end of 2014.

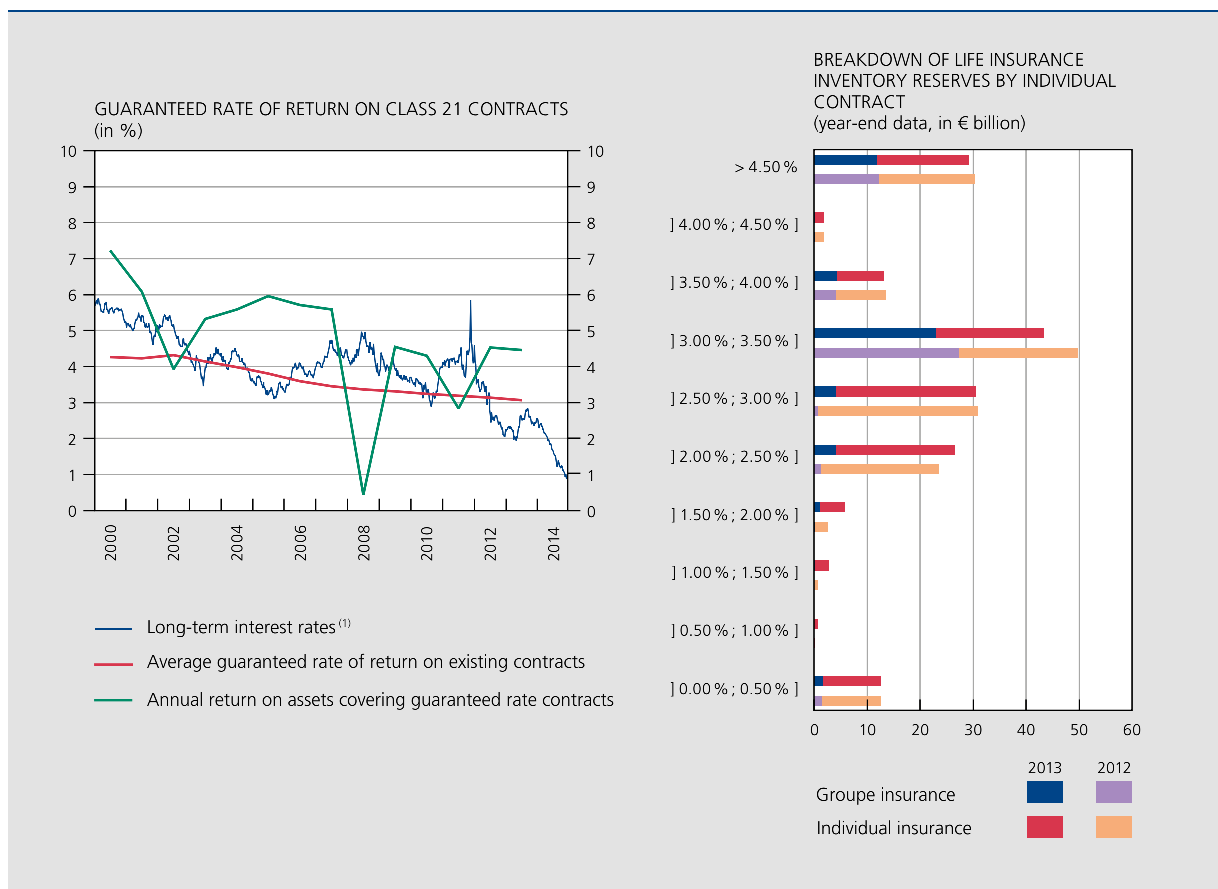
Flat macroeconomic conditions continued to hit demand for life insurance products from insurers, as households preferred to keep their assets liquid. The massive fall in 2013 premium income can largely be explained by the increase in the tax on premiums paid on life insurance

CHART 59 INSURANCE COMPANIES: PREMIUM INCOME AND COMBINED RATIO [1]
(non-consolidated data; in € billion, unless otherwise stated)



Source: NBB.
(1) The combined ratio is the ratio relating the sum of the cost of claims plus operating expenses to net premium income.

CHART 60 GUARANTEED RATES OF RETURN AND BREAKDOWN OF LIFE INSURANCE COMPANIES' INVENTORY RETURNS



Sources : Thomson Reuters Datastream, NBB.
(1) Secondary market yields on ten-year Belgian government loans (OLOs), weekly data.

products to 2 % at the beginning of that year, while anticipatory buying had caused a temporary spike in 2012. No one-off factors explain why 2014 premium income languished at the unusually low levels of the previous year, with this rather reflecting a fundamental downward trend that had got underway in 2008 and now appears to have accelerated. Given Belgium's *bancassurance* model, this general climate may have inspired banks to move household savings to more profitable investment instruments rather than to life insurance contracts.

Non-life insurance tends to be less sensitive to macroeconomic conditions than life insurance, with profitability generally satisfactory and some insurance companies preferring non-life operations anyway. In 2014, premium increases could not absorb the effects of higher storm-related claims in the first half of the year. Having recorded a steady upward trend since 2008, non-life results were slightly down in the year under review. The combined ratio, which reflects the sum of claims and operational costs as a ratio of net premium income, slid from 98.6 % in the first nine months of 2013 to 99.3 % in the same period of 2014.

Negative impact of low interest rate environment on profitability at banks and insurance companies offset by 2014 measures

Overall, the repercussions of the economic slowdown were cushioned by low interest rate levels – both short-term and long-term – thus supporting the activity of the financial sector and the broader economy. That said, low interest levels also affect the financial sector in a more specific way.

A long period of low interest rates does not benefit the insurance sector, particularly life insurance as its liabilities typically have longer maturities than its assets and it is also facing high interest rates guaranteed in the past. Annual returns on assets covering guaranteed-return contracts have dipped below guaranteed returns three times in the

past, in 2002, 2008 and 2011, i.e. the years of the financial crises and the sovereign debt crisis in the euro area. In 2013, the effective return on class 21 contracts (4.44 %) made it possible to cover interest rates guaranteed in the past. However, effective investment returns are showing a clear downward trend in line with financial markets and if current low interest rates are here to stay, significant amounts of high-rated securities (AAA or AA) will have to be replaced by lower-yielding investments. There is a real risk, then, that the effective return on assets will not be enough to cover the guaranteed interest rates on contracts entered into earlier.

The outstanding total of life insurance contracts with guaranteed return and the actual rates paid on them are therefore very important risk parameters for insurance companies in times of falling interest rates on risk-free investments.

Total inventory reserves related to guaranteed return contracts rose only slightly between end-2012 and end-2013, from € 165.6 billion to € 166.3 billion, on the back of group insurance growth at over 6 %. By contrast, individual insurance products contracted by nearly 2 % (€ –2.1 billion). This decrease only concerns guaranteed-return contracts of over 2 %. Inventory reserves of guaranteed-return contracts of up to 2 % added 33 %, albeit from a fairly low base.

Contracts agreed in the past whose guaranteed returns on future premium-based reserves exceeded 4.5 % accounted for € 29.2 billion – i.e. 17.5 % of inventory reserves, compared with € 30.2 billion in 2012 – € 26.1 billion of which related to contracts with guaranteed returns of 4.75 %, the legal maximum for this type of contract up to June 1999. This legacy of contracts with high guaranteed returns that cannot currently be funded profitably is the biggest risk currently facing the Belgian insurance sector.

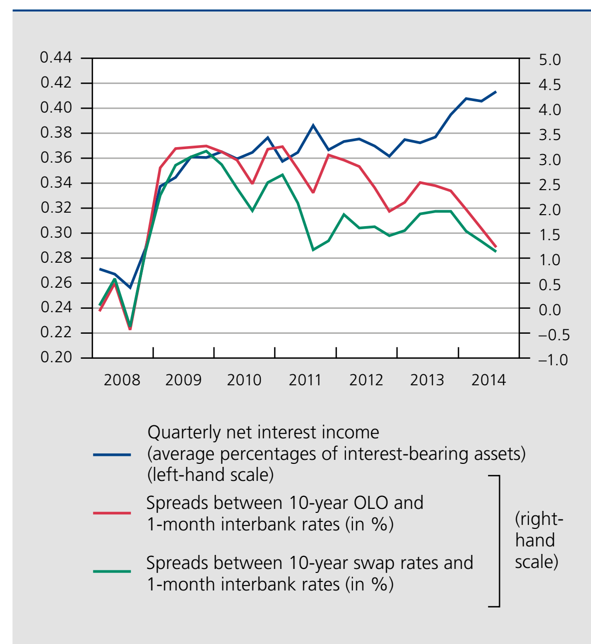
Persistently low interest rates are forcing insurance companies to offer contracts more in line with market conditions, taking the average guaranteed return of class 21 agreements down from 3.12 % in 2012 to 3.04 % in 2013 – which is the last year for which aggregate data are available – and also encouraging them to promote class 23 agreements that are linked to investment funds and offer no guaranteed return. What is more, some class 21 contracts impose time limits on guarantees and specify that the reserve built up will technically be considered a new premium after the agreed period, with guaranteed returns in line with market conditions that apply by that time. Meanwhile, insurance companies have also developed hybrid products to help reduce their risks, consisting of a guaranteed-return life insurance product (class 21) coupled with another life product in class 23, whose returns reflect the performance of an investment fund. Options to shift lower returns to those paid out to policy-holders are limited by intense competition between insurance companies and from other savings products. If returns stay too low, insurance companies run the risk of contracts getting taken over.

To support their net profits, insurance companies also made capital gains of € 1.3 billion in the first nine months of 2014. At times of low interest rates, prudential rules oblige insurance companies to include additional annual provisions in their accounts. These provisions, for which no exemptions were forthcoming in 2013 and which stood at a cumulative total of € 3.8 billion by the end of that year, made the sector less profitable and translated into the need to constitute a higher solvency margin.

Persistently low interest rates also depress total interest margins generated by Belgium's banks, against a backdrop of intensified competition as a result of banks refocusing their business on a highly saturated domestic market. Credit institutions have seen an erosion of the gains from very cheap resources, such as sight deposits, on which remuneration is only partly linked to market rates. At the same time, high-yield securities or loans reaching maturity had to be replaced with others offering

CHART 61 BELGIAN BANKS' NET INTEREST INCOME AND YIELD SPREADS

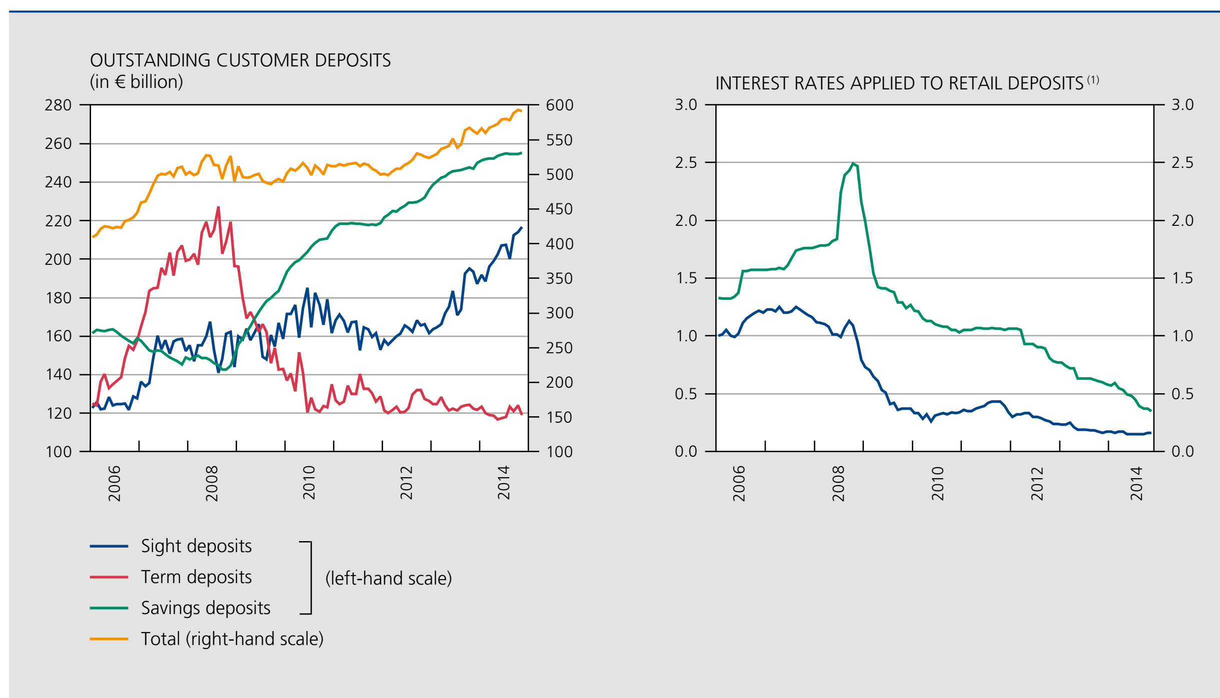
(quarterly data, on a consolidated basis)



Sources: Thomson Reuters Datastream, NBB.

CHART 62 BELGIAN BANKS' CUSTOMER DEPOSITS: OUTSTANDING AMOUNTS PLUS APPLIED INTEREST RATES

(non-consolidated data)



Source: NBB.
(1) New deposit data taken from monthly MIR survey.

lower yields, while lower interest rates also entice borrowers to refinance their mortgages.

Belgian banks were able to take temporary measures to offset the negative impact on their profitability and prepare for this impact to continue over the next few years.

On the other hand, Belgian banks in general kept their commercial margins on new loans at a high level, despite intensified competition in this market. Positive effects on total margins tend to be greater as the share of new business – which commands steeper commercial margins – in total outstanding loans increases. In the teeth of challenging conditions, Belgian banks still managed to increase their net interest income in 2014, both in absolute terms and as a percentage of interest-bearing assets.

Nevertheless, most of these effects are usually temporary. With balance sheets typically having more short-term liabilities relative to longer-term assets, banks benefit from falling interest rates, as the costs of their liabilities adjust more quickly to the new situation than do the returns on their assets. Although the intermediation interest rate structure continued to be favourable in 2014 – albeit it less so than in previous years – borrowing costs are not likely to come down any further, as interest rates offered on savings deposits have hit new lows while, conversely, returns on assets should gradually contract. A lengthy period of persistently low interest rates would pare down the interest income received by Belgian banks, which is precisely their most important source of net income. Return on equity, which averaged 8.2 % in the first nine months of 2014, might therefore come under pressure in the future.

Other factors also had positive or negative effects on bank profitability. In 2014, Belgian banks no longer notched up massive gains on financial instruments, unlike in 2013, when such gains were booked when selling securities. Loan loss provisions totalled € 1 billion in the first nine months of 2014, remaining below the figure for the same period of 2013. This was largely due to the slowing of the deterioration in the quality of certain foreign portfolios, such as Irish portfolios. Conversely, unexpected provisions were required in the Hungarian retail loans portfolios, in the wake of measures announced by the government in Budapest in the first half of 2014 which promised borrowers repayment of a proportion of amounts collected and in due course also the conversion of foreign currency-denominated loans into Hungarian forints.

Limited refocusing on investment policies

The current climate and pressures on their profitability might induce financial institutions to redirect their investment policies to higher-yielding asset classes. However, there were no clear signs of such a shift in Belgium by the end of September 2014, either at its banks or at its insurance companies.

Banks saw a minor rebalancing of their balance sheets in favour of foreign claims in the first nine months of 2014, but nowhere close to pre-crisis levels. More Italian and Spanish government bonds were taken on at the expense of Belgian ones, reducing the high concentration of government paper owned by Belgian banks that had been built up since the start in of the sovereign debt crisis in the euro area in 2011-2012.

Belgian insurance companies saw the outstanding amount in their government bond portfolios decline by 2.2 % in the course of 2014, as a result of the sale of bonds – creating capital gains – and because of the fact that they were compelled to change their investment strategies and focus on riskier asset classes to maintain return levels. Low-yielding fixed-income investments prompted some of them to redirect their assets to longer-term alternatives, such as corporate bonds or UCI units. Such alternatives promise higher yields but also imply greater credit and liquidity risks.

These changes in insurance companies' investment strategies are already partly dictated by the new prudential solvency rules due to come into force in January 2016. Class 23 products will be subject to more favourable capital requirements under the new rules. These products, which are less risky for insurance companies, have flourished since 2012.

Adjusting cost structures

To cope with the current flat economic climate – which is likely to last for a while longer – and with the repercussions for asset quality of any further deterioration of economic conditions or financial market corrections, financial institutions will have to bolster their profit-generating

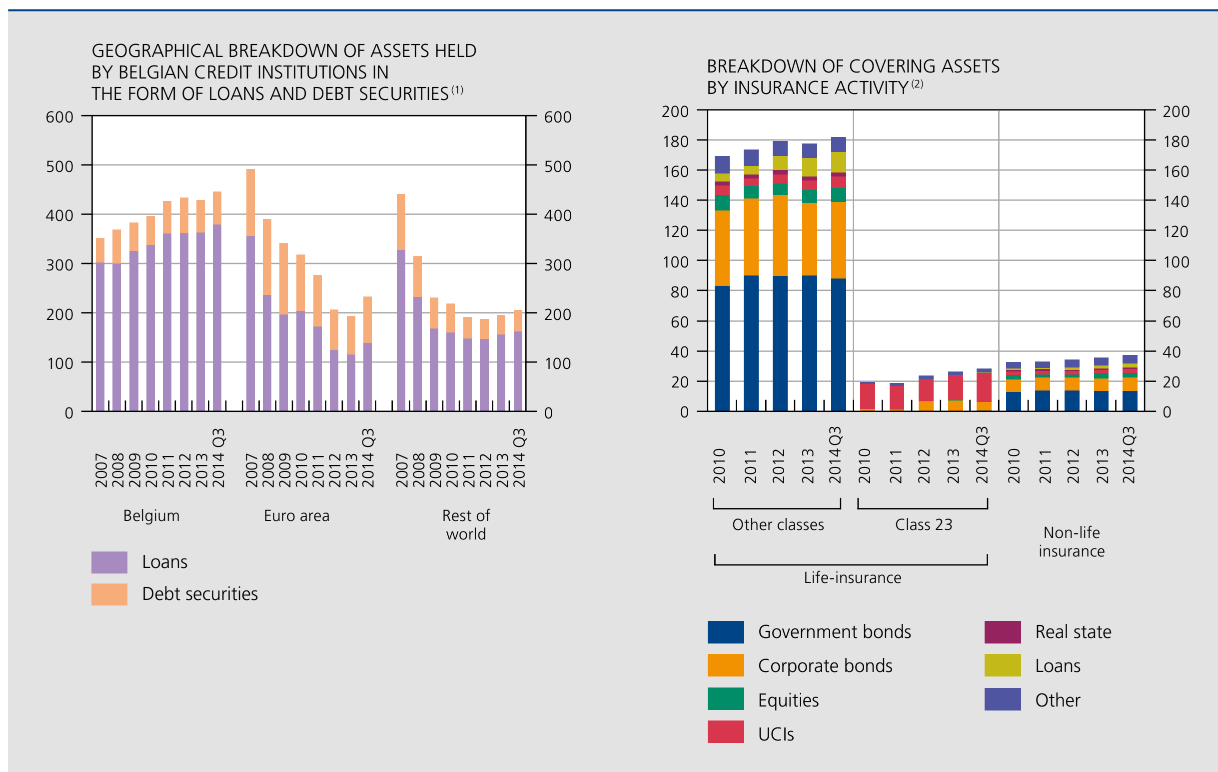
TABLE 14 INCOME STATEMENT OF BELGIAN CREDIT INSTITUTIONS
(consolidated data ; in € billion, unless otherwise stated)

	2010	2011	2012	2013	First nine months 2013	First nine months 2014	In % of operating income
Net interest income	13.8	14.0	13.6	13.3	9.9	10.8	68.4
Non-interest income	5.6	4.8	4.5	7.0	5.9	5.0	31.6
Net fee and commission income (including commission paid to agents)	4.3	4.4	4.5	5.0	3.9	4.1	26.1
(Un)realised gains or losses on financial instruments (1)	0.0	–0.8	0.0	0.8	1.1	0.3	
Other non-interest income	1.3	1.2	0.0	1.3	0.9	0.6	
Operating income	19.3	18.7	18.1	20.3	15.8	15.8	100.0
Operating expenses	–12.5	–12.3	–13.0	–12.4	–9.4	–9.6	60.8 (2)
Gross operating result	6.9	6.4	5.0	8.0	6.4	6.2	
Impairments and provisions	–1.8	–5.0	–2.6	–3.0	–1.4	–1.0	
Impairments on loans and receivables	–1.8	–3.0	–2.0	–2.3	–1.2	–1.0	
Impairments on other financial assets	–0.1	–1.4	0.8	0.0	0.0	0.0	
Other impairments and provisions	–0.2	–0.6	–1.5	–0.6	–0.2	0.0	
Other components of the income statement	0.5	–1.0	–0.8	–1.8	–1.5	–1.6	
Net profit or loss	5.6	0.4	1.6	3.3	3.5	3.6	

Source : NBB.
(1) This item also includes the net realised gains (losses) on financial assets and liabilities not measured at fair value through profit or loss, the net gains (losses) on financial assets and liabilities held for trading and designated at fair value through profit or loss, and the net gains (losses) from hedge accounting.
(2) Cost/income ratio of the Belgian banking sector.

CHART 63 LOANS AND DEBT SECURITIES HELD BY CREDIT INSTITUTIONS AND INSURANCE COMPANIES' COVERING ASSETS

(end-of-period data ; in € billion)



Source : NBB.
(1) Data obtained from the consolidated financial reporting of Belgian credit institutions. Breakdown in line with FINREP prudential reporting.
(2) Non-consolidated data.

capacity. This will require a review of business models, cost structures and consolidations. As described in the "Prudential regulation and supervision" part of this Report, the review was one of the focal points of the NBB's macroprudential policies.

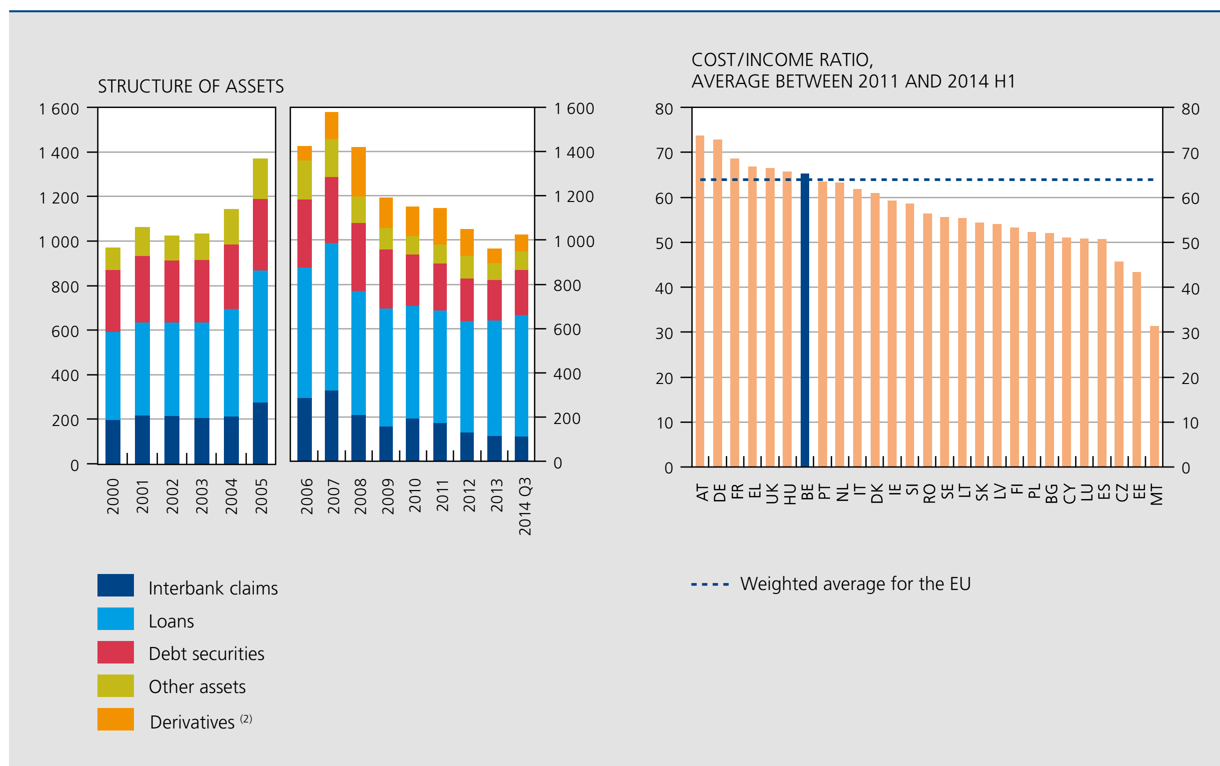
Between 2008 and 2013, Belgian banks significantly reduced the scope of their activities, particularly abroad, but they have yet to prune costs to the same degree. The country's major institutions have announced restructurings and have made a start on actually implementing them, but have so far failed to control operating costs : these added 2 % in the first nine months of 2014 compared with the same period of 2013. The increase largely reflects changes in the consolidation scope of a major bank and is thus also partly offset by the consolidation's positive effects on operating income. The cost/income ratio of the Belgian banking sector amounted to 61 % in the first nine months of 2014, dipping under the ratios observed in 2011 and in 2012. The average ratio between 2011 and the first half of 2014 puts Belgium among the highest in Europe, even though other banking sectors are facing similar challenges, in both big and smaller countries.

Insurance companies saw the ratio of operating expenses to technical result in non-life decline in 2014, continuing the steady downtrend since 2009. In life insurance, by contrast, the ratio increased in the wake of rising costs coupled with a weaker technical result.

Transition to new solvency framework

The new EU solvency regulations for insurance companies, known as Solvency II, which come into force on 1 January 2016, present a massive challenge for Belgium's insurance industry. Under Solvency I, solvency requirements are linked to insurance business as measured by premium income, claims numbers and technical reserves. By contrast, Solvency II imposes a calculation based on the risks of both the assets and the liabilities side of the balance sheet, at market values. The riskier the assets (equities, hedge funds, etc.), the bigger the required regulatory capital is likely to be. One of the first effects of the new rules is already visible : a shift from the most capital-intensive assets (equities) to assets that are much less capital-intensive (bonds) and a preference for liquid assets

CHART 64 BELGIAN BANKS' BALANCE SHEET [1] AND COST/INCOME RATIOS



Sources: ECB, NBB.
(1) Data compiled according to Belgian accounting rules until 2005 (Belgian GAAP) and in line with IAS/IFRS standards since 2006.
(2) Derivatives are recorded at their market values, including – from 2007 – income receivable and charges payable (which are not included in the data relating to 2006).

over long-term investments which are less favourable in terms of capital requirements. Capital requirements under Solvency II will be eased by a correlation matrix between different securities, measured by asset class, and insurance companies will do well to diversify their assets more. With assets no longer recognised at historical values, solvency margins will be much more sensitive to fluctuations in the interest rate and equity market movements, as well as to margin risks.

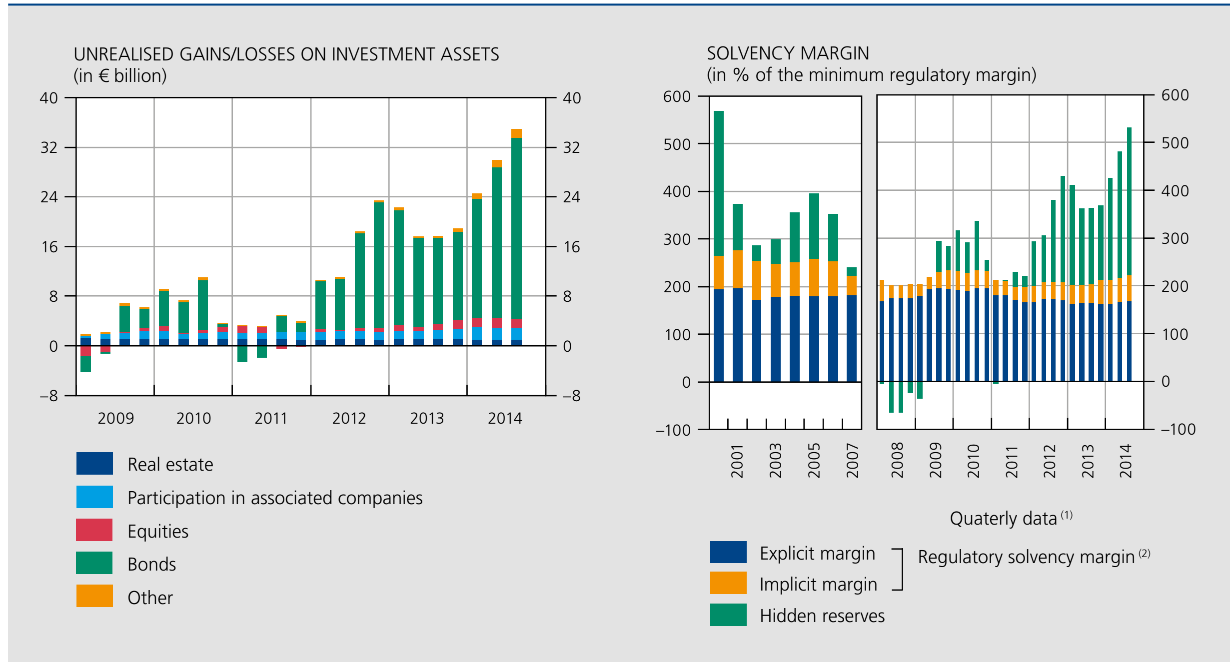
Interest rate falls pushed the solvency margin upwards in 2014 on the back of higher market values for the bond portfolio, and even more for much longer-dated bonds. The unrealised gains reached new highs in September 2014 at € 34.9 billion, 84 % of which derived from bond holdings. If approved by the NBB in its capacity as prudential regulator, these unrealised gains are recognised in the implicit component of the solvency margin, thus strengthening it. Factoring in the stability of the explicit component, which essentially includes own funds and subordinated debt, the regulatory solvency margin advanced by 4 % in the year.

In the life insurance business, slightly better solvency margins were attributable to the implicit margin, which has been stable since 2013. In non-life, which is better placed for the transition to Solvency II, the solvency margin is bolstered by the explicit margin, which has recorded an upward trend since June 2014.

Belgium's banks have also been subject to a new regulatory framework since 1 January 2014, known as Basel III. The transition to the new framework, of which the most recent developments are discussed in section A.1.4 of the "Prudential regulation and supervision" part of the Report, has led to an increase in risk-weighted assets. Credit-risk-related assets were up in the first nine months of 2014 as a result of the higher weighting assigned to exposures to credit institutions and because some banks were no longer able to apply a – more favourable – standard approach to sovereign debt exposures rather than an approach based on internal models. Basel III also introduces the Credit Valuation Adjustment (CVA), which aims to serve as a better hedge for the counterparty risk related to derivatives transactions, adding € 9 billion to risk-weighted assets. The decline in assets weighted for

CHART 65 UNREALISED GAINS/LOSSES AND SOLVENCY MARGIN OF BELGIAN INSURANCE COMPANIES

(non-consolidated data)



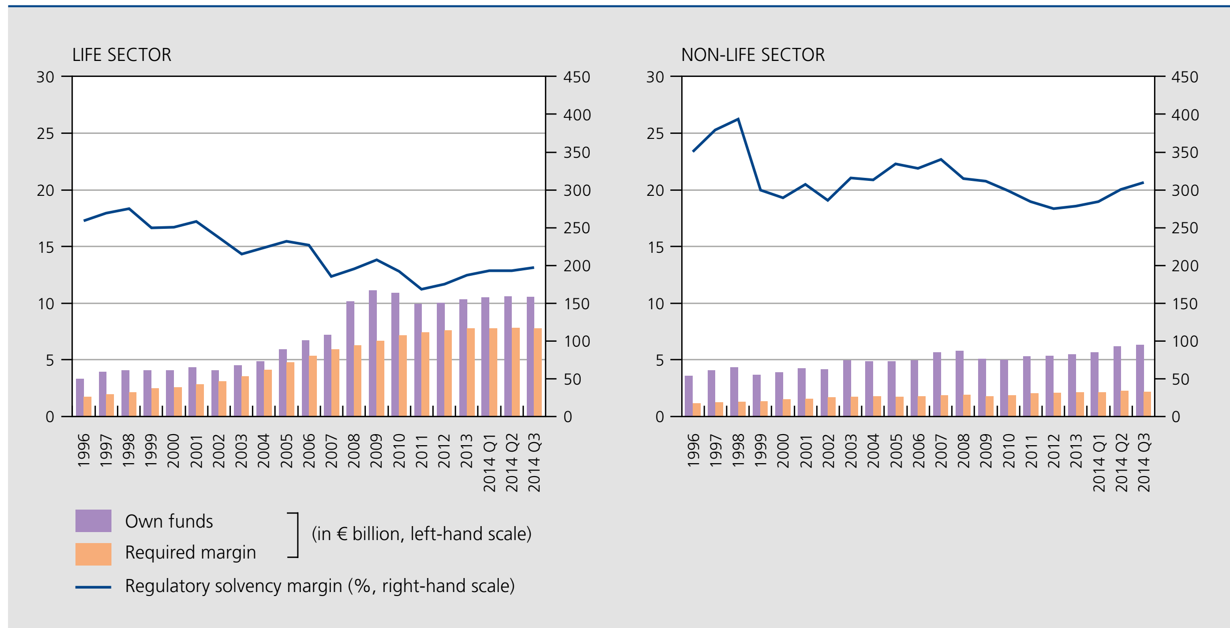
Source: NBB.

(1) The figures reported quarterly are not entirely comparable with the final annual figures. In particular, they take no account of any distribution of profits to shareholders and policy-holders.

(2) This margin is composed of an explicit margin including own funds, subordinated debt and selected other balance sheet items and an implicit margin which, subject to NBB's approval, comprises certain other specific elements, the principal one being a part of the unrealised gains on investment portfolios.

CHART 66 OWN FUNDS, REQUIRED MARGIN AND REGULATORY SOLVENCY MARGIN OF BELGIAN INSURANCE COMPANIES

(non-consolidated end-of-period data)



Source: NBB.

TABLE 15 BREAKDOWN OF TIER 1 CAPITAL AND RISK-WEIGHTED ASSETS

(end-of-period data, on a consolidated basis, in € billion, unless otherwise stated)

	2009	2010	2011	2012	2013	September 2014
Tier 1 capital	53.9	57.9	56.5	55.9	55.6	54.9
of which:						
common equity Tier 1	–	–	–	–	–	51.9
Risk-weighted assets	407.5	372.5	373.8	352.7	339.4	349.6
of which:						
Credit risk	352.3	322.8	312.9	301.0	287.7	289.4
Market risk	16.1	10.7	21.9	16.6	9.9	7.4
Operational risk	38.8	35.1	35.2	35.0	34.2	34.6
CVA	–	–	–	–	–	8.9
Other	0.2	3.9	3.8	0.1	7.6	9.3
Tier 1 ratio (in %)	13.2	15.5	15.1	15.9	16.4	15.7
Common equity Tier 1 ratio (in %)	–	–	–	–	–	14.9

Source: NBB.

market risk seen since the end of 2011 is primarily down to reduced securities trading by Belgian banks.

With capital relatively stable in 2014, the increase in risk-weighted assets caused the Belgian banking sector's solvency ratios to come down. Those ratios are much higher than the minimum requirements imposed by Basel III (4 % for common equity Tier 1 and 5.5 % for Tier 1 in 2014). These minimum requirements will gradually be raised and be linked to buffers, so that the new Basel III solvency standards will be in full force from 2019.

In the course of 2014, the ECB extensively tested banks' capacity to keep their solvency margins sufficiently high as part of its comprehensive assessment, consisting of an asset quality review and stress tests. This exercise is described in more detail in the "Prudential regulation and supervision" part.

The solvency position of Belgian banks is generally comfortable, but their average levels of return need to go up, particularly at institutions that have reported extremely weak returns on equity. This should enable them to achieve the best possible positions in a sector being restructured as part of regulatory framework changes, intensified competition and subdued profit generation.