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7. Financial developments

7.1 The tightening of monetary policy was reflected in interest rates on loans to households and businesses

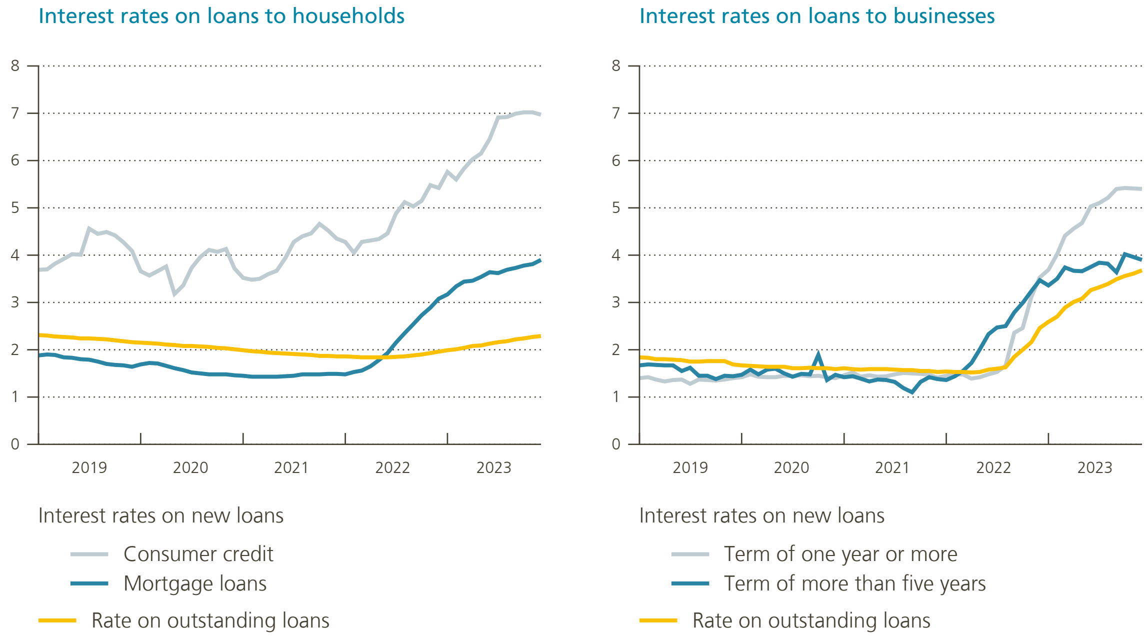
The increase in the Eurosystem's key rates, which began in the summer of 2022, continued to push up the interest rates charged by Belgian banks on new loans in 2023. In particular, new household mortgage rates rose from an average of 1.9 % in June 2022 to 3.9 % in December 2023. Rates on consumer credit and business loans followed the same trend. However, as on the financial markets, the rise in long-term rates slowed in 2023. As mentioned in chapter 2, this development was linked to the expectation that the ECB would stop raising its key rates.

Overall, however, the effective burden of higher interest costs for households remained limited. The interest rate hikes only concerned loans granted from mid-2022 onwards and a limited number of outstanding variable rate loans. In fact, 90 % of the outstanding loans to households in June 2022, i.e. before

Figure 7.1

Lending rates have been rising since 2022

(average interest rates, percentage)



Source : ECB.

the rate increases, were for the purchase of real estate, most of which were taken out at a fixed rate. In other words, the vast majority of Belgian households that had to repay a loan were protected against the rise in interest rates. As a result, the latter was only very partially reflected in the interest actually paid by households as a whole and hence in the return on the loan portfolios of Belgian banks. According to the results of the MIR survey, the average interest rate on outstanding loans to households rose from 1.8 % in June 2022 to 2.3 % in December 2023. Moreover, in many cases, the burden of fixed-rate debt contracted before the resurgence of inflation in 2022 was also alleviated by the sharp rise in nominal personal income due, among other things, to wage indexation (see chapter 4).

In contrast, interest paid by businesses increased more significantly. The average rate on outstanding loans to non-financial corporations rose from 1.6 % in June 2022 to 3.7 % in December 2023. This was due to the fact that a large proportion of the lending by banks to Belgian companies takes the form of revolving credit agreements or other types of credit lines with variable rates.

However, banks did not substantially tighten their business lending policies in 2023. At least this is what emerges from the lending survey (BLS) of the four largest banks in Belgium. The results of the survey on the access to finance of enterprises (SAFE), conducted jointly by the ECB and the European Commission, support this view, as they do not point to an increase in the number of credit applications from Belgian SMEs being declined. Nevertheless, respondents to the Bank's quarterly survey on business credit conditions mentioned a slight tightening of constraints in terms of the volume of loans issued and the guarantees required by banks.

The conditions for household mortgage lending remain somewhat shaped by the prudential expectations formulated by the Bank in order to limit the origination of high-risk loans. In force since 1 January 2020, these expectations urge lenders to restrict, among other things, the proportion of loans with a high loan-to-value ratio, i.e. those where the amount of the loan exceeds 90 % of the value of the property, if it is intended for owner-occupation, or 80 % of that value for buy-to-let properties. However, tolerance limits allow the loan-to-value threshold to be exceeded in some cases. These margins are wider for loans granted to first-time buyers. On the other hand, they are narrower for credit agreements combining a loan-to-value ratio of more than 90 % with a monthly repayment burden equivalent to more than 50 % of the borrower's income or where the value of the loan is more than nine times the borrower's annual income. The effects of this measure have been clear since its introduction: while loans with a loan-to-value ratio of more than 90 % accounted for 33 % of new mortgages originated by Belgian banks in 2019, this share fell to 19 % in 2020 and to 14 % in 2021. It remained at this level through the first half of 2023.

This implies that lenders once again did not exceed the acceptable tolerance limits provided for by the prudential expectations, for both first-time buyers and other loans for owner-occupied dwellings. In the first half of 2023, only 22 % of new loans granted to first-time buyers had a loan-to-value ratio of more than 90 %, whereas the tolerance limit set by the Bank is 35 %. In the case of loans to non-first-time buyers for owner-occupied homes, 8 % of new mortgages exceeded the 90 % loan-to-value ratio, whereas the tolerance limit for this type of loan is 20 %.

However, as interest rates have risen, lenders have demonstrated greater flexibility towards their customers. On the one hand, in order to reduce the annual repayment burden, lenders are allowing payments to be spread over time through longer maturities. As a result, the proportion of new mortgages granted to first-time buyers with a maturity of more than 20 years was 72 % in the first half of 2023, compared with 59 % in 2021. On the other hand, the proportion of these mortgages for which the repayment burden exceeds 40 % of the borrower's income gradually rose, from 27 % in 2021 to 33 % in the first half of 2023.

7.2 Rising interest rates reduced household borrowing capacity and changed the structure of household financial assets

The residential property and mortgage markets slowed sharply as interest rates rose

The sharp rise in mortgage rates had a negative impact on activity in the residential property market and weighed on house prices, but this was largely offset by rising income and longer maturities for new loans. The sharp rise in mortgage rates means that, for the same monthly payment, the amount households can borrow is significantly lower than at the start of 2022, which has dampened housing demand. In addition, the rise in interest rates is also likely to have weakened demand for investment property, which had been high in previous years due to low rates and a resulting search for yield. However, the negative effects of the rise in interest rates on house prices were largely offset by longer maturities for new mortgages, as mentioned above, and by the significant increase in income, which pushed up the amount households could borrow to purchase a home.

After two years of intense activity, the number of transactions involving existing homes fell sharply. In the first three quarters of 2023, the number of residential property transactions fell by 18 % compared with the same period in 2022 and by 7 % compared with 2019. While all regions and types of housing were affected, this fall in the number of transactions mainly concerned houses and the Flemish Region. In Flanders, this was probably due to the fact that sales of certain homes with an EPC rating of E or F were moved forward at the end of 2022, so as not to fall under the energy renovation obligation that entered into force in Flanders on 1 January 2023, requiring such dwellings to have an EPC rating of at least D.

Activity on the new-build market also contracted sharply, with rising construction costs compounding the effect of higher interest rates. While new properties still accounted for 22 % of apartment sales and 2.9 % of house sales in 2021, these shares fell by more than a third to 14.3 % and 1.7 %, respectively. Household investment in housing also continued to fall in 2023 (see section 4.2). Finally, forward-looking indicators point to a further slowdown in expansion of the housing stock. Indeed, the number of building permits granted for new residential dwellings in the first three quarters of 2023 fell by 20 % compared with the corresponding period in 2021, while order books and demand expectations in the structural building works sector also deteriorated significantly. This slowdown on the new-build market was due not only to the rise in interest rates, but also to the sharp increase in construction costs, which have jumped by 22 % compared with the start of 2021.

Growth in the prices of existing houses slowed in the first three quarters of 2023, but remained positive. After rising strongly, by 7 % annually on average from 2020 to 2022, nominal house prices climbed by 2.7 % year-on-year in the first three quarters of 2023. Despite this significant loss of momentum, price growth was more robust in Belgium than in the euro area, where prices fell by 1.1 %. Price growth was stronger in the Flemish Region (3.4 %) than in the Walloon Region (2.0 %) and the

Brussels-Capital Region (–1.5 %), but the figures for Flanders somewhat overstate the actual increase for an identical dwelling, as sales of energy-inefficient homes were probably weaker than usual. Finally, house prices in real terms, which take into account the high inflation seen in recent years, fell by 6.4 % in the first three quarters of 2023 compared with the end of 2021.

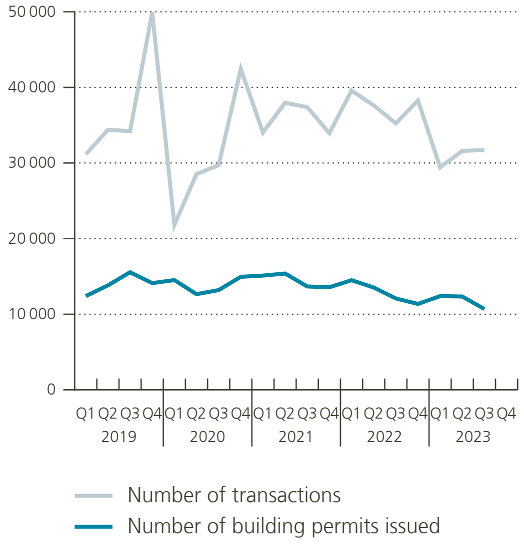
Prices for new homes rose more than for existing homes. In the first nine months of 2023, sales prices rose by 4.9 % year-on-year. On the one hand, this was due to the significant rise in construction costs. On the other hand, it could also be the result of increased demand for energy-efficient homes, due to high energy prices and the introduction or announcement of increasingly stringent renovation requirements (see Box 5). Finally, rising prices for new properties sustained demand for existing homes, which act as substitutes.

Housing affordability for would-be buyers continued to deteriorate, but their annual repayment burden eased somewhat thanks to longer maturities and larger down payments. The change in affordability over time can be seen from the change in the repayment burden for a mortgage with a loan-to-value ratio of 80 % and a 20-year term. While it had already risen substantially in recent years, from 22.8 % of net disposable income at the start of 2020 to 27.4 % at the end of 2022, it rose again moderately in the first three quarters of 2023, to 27.9 %. However, the lengthening of mortgage maturities for first-time buyers tempered the rise in the average annual repayment burden somewhat. In fact, annual repayments for a 22-year loan were 1.7 percentage points lower than for a 20-year loan in the third quarter of 2023 (assuming the same interest rate and house price). In this case, the repayments obviously have to be spread over a longer period, which increases the total amount of interest to be repaid. The longer average maturity of new mortgages also pushed up house prices. In addition, the average down payment rose again in 2023, reducing both the amount borrowed and annual repayments. Finally, if the abovementioned affordability indicator is applied to a household with average income for the purchase of an average-price home, the repayment burden is

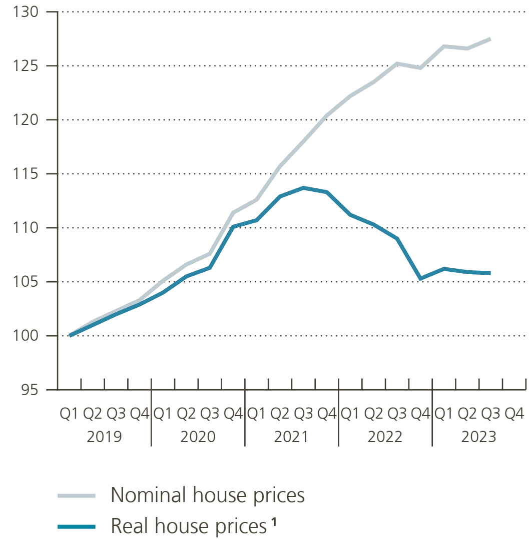
Figure 7.2

The housing market slowed in 2023

Number of transactions involving existing houses and number of building permits issued for new dwellings



Existing house prices
(indices, 2019 Q1 = 100, data adjusted for seasonal variations)



Sources: Statbel, NBB.
1 Deflated by the private consumption deflator.

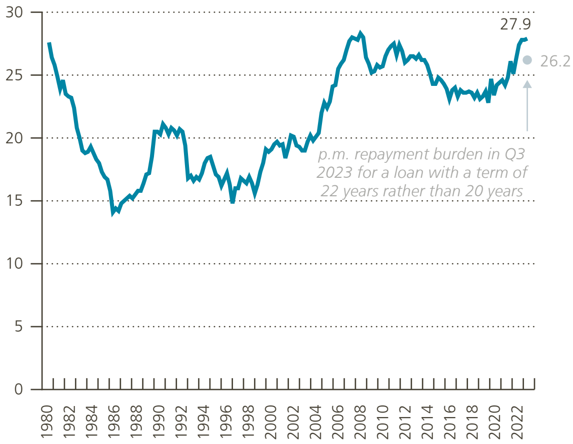
significantly higher for households with low incomes and limited financial assets, particularly in the more expensive regions.

In 2023, mortgage lending declined much more sharply than the number of property transactions. The rise in interest rates made it much more expensive to finance the purchase of a home with a new mortgage. Whereas in the past, when interest rates were falling, it was usually more advantageous to refinance a mortgage at a lower rate, it is now often advisable to maintain contracts concluded at low rates insofar as possible. As a result, if a mortgage has not been fully repaid at the time of purchasing a new home, the preferred option is often to continue to pay it off and, if necessary, only borrow the additional amount required. Furthermore, according to the responses of Belgian banks to the BLS, other sources of funding, such as savings or gifts from family, have been used more often since 2022. Lastly, new mortgages for renovation and construction works have

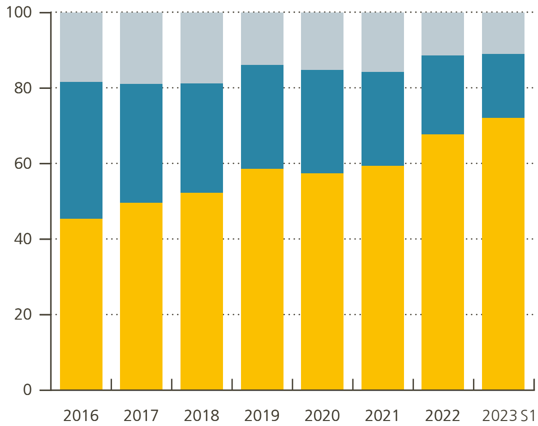
Figure 7.3

Housing affordability for would-be buyers continued to deteriorate, but the annual repayment burden was reduced somewhat by longer loan maturities

Repayment burden for a new 20-year mortgage loan [1]
(as a % of net disposable income)



Maturity of new mortgage loans for first-time buyers
(percentage, share in the total volume of new loans)



Source: NBB.

1 This indicator is based on the assumption that a household with average disposable income buys a home at an average price and finances 80 % of the purchase with a 20-year fixed-rate mortgage. The tax deductibility of the loan, transaction costs and future changes in income are not taken into account.

fallen significantly more than those for the purchase of existing homes.

Nonetheless, total mortgage loans outstanding rose again. Households with surplus cash probably made less use of the opportunity to repay their low-interest loans early. Overall, net new lending amounted to € 5.5 billion in 2023, compared with € 14.4 billion the previous year. As a result, overall annual growth in home loans fell from 5.8 % at the end of 2022 to 2.1 % in December 2023.

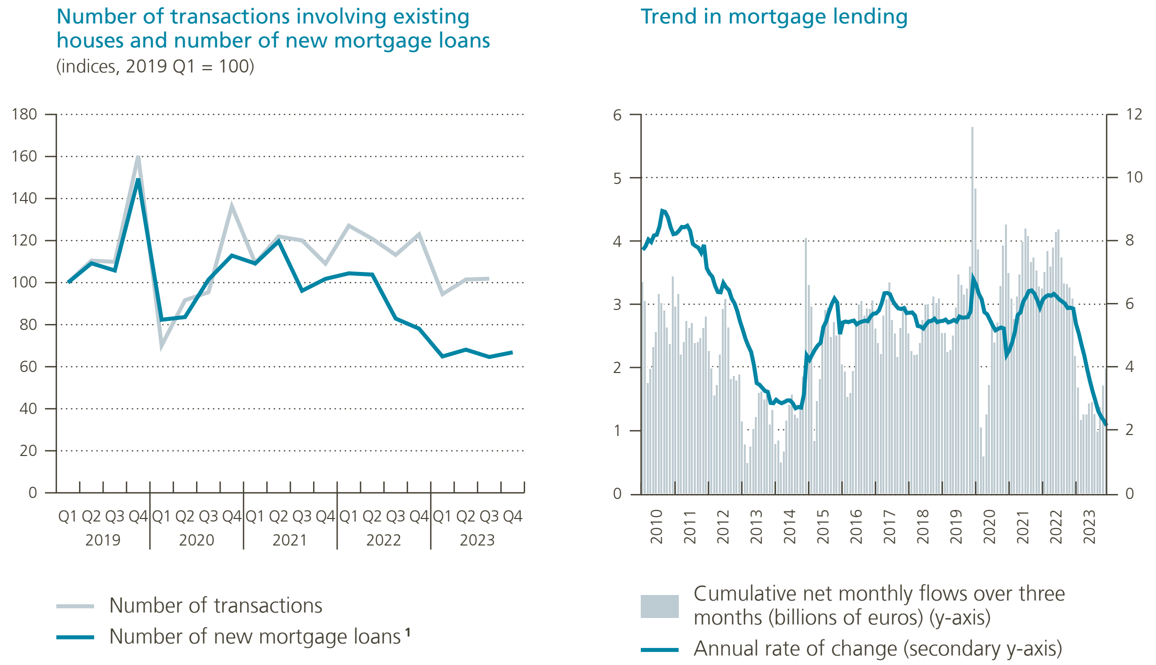
Despite the rise in interest rates, growth in consumer credit accelerated slightly. The annual rate of change peaked at 4.8 % in April, 1.7 percentage points higher than at the end of December 2022. However, it then fell back to 2.0 % in December. Other loans to Belgian households fell significantly. In total, non-mortgage loans account for around 9 % of the volume of loans taken out by households with Belgian banks.

Overall household debt rose only slightly. Growth was essentially determined by that of mortgages, which are its main component. Due to the slow growth in mortgage lending, the increase in total household debt was limited to 3.3 %, compared with around 5 % per annum in recent years. Thanks in part to exceptionally strong nominal economic growth, the overall household debt ratio as a percentage of GDP fell further. After peaking at 66.1 % of GDP at the start of 2021, it gradually fell back to 58.5 % of GDP in the third quarter of 2023. Belgium's debt ratio is thus following the trend seen in the euro area as a whole, where the debt-to-GDP ratio stands at around 54 %.

Belgian household debt therefore remains sustainable. This is also reflected in the fact that defaults on both mortgages and consumer loans remained limited. The default rate on home loans stabilised at 0.9 % in 2023, while the rate on consumer loans rose modestly over the year, although remaining moderate by historical standards at less than 4 %.

Figure 7.4

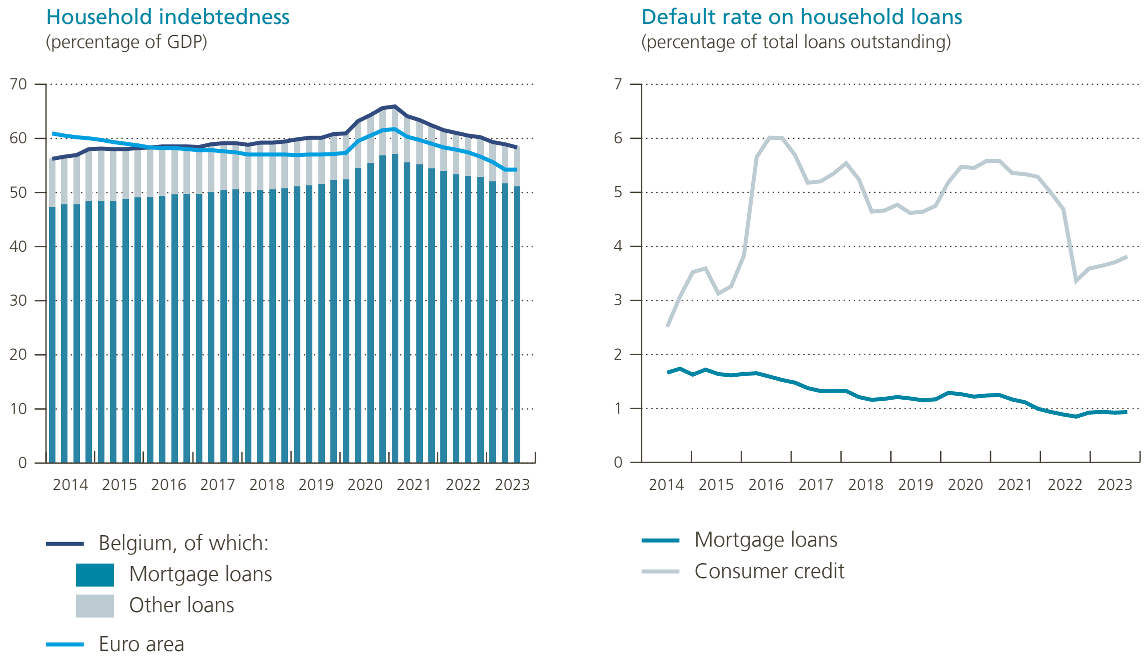
Mortgage lending is no longer in line with the property market



Sources: Statbel, NBB.
1 Excluding the refinancing of outstanding loans.

Figure 7.5

Household indebtedness remains under control and sustainable



Sources : ECB, NBB.

Investment decisions are geared towards higher‑yield financial assets

In the first nine months of 2023, households increased their overall holdings of financial assets, although total new investments were lower than in the previous three years. The latter reached € 13.1 billion in the first three quarters, compared with € 26 billion in 2020, € 28 billion in 2021 and € 15 billion in 2022.

Furthermore, 2023 was characterised by significant shifts between the various types of financial assets held by households. Throughout the year, interest rates on bank accounts and deposits remained low compared with those applicable to other short-term investment vehicles. As a result, from the start of the year and for the first time since 1999, individuals drained funds from their current accounts and invested them in term accounts. In August and September, this trend picked up steam and also affected the amounts held in savings accounts, following the issuance of a one-year State note by the federal government, whose yield was more advantageous than that of products offered by commercial banks (see Box 7).

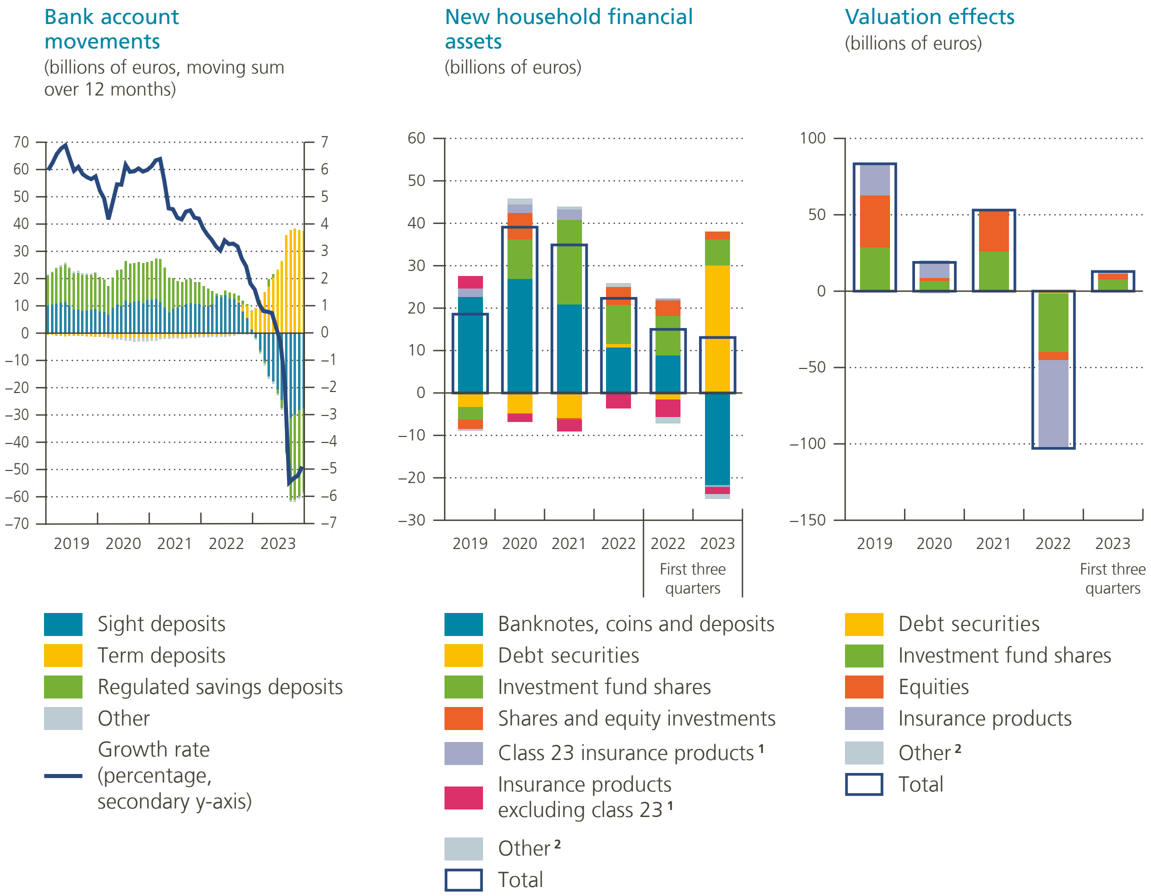
Between January and September, a total of € 56 billion was moved from current (or sight) accounts and savings accounts and mainly invested in term accounts (€ 32 billion) and State notes (€ 22 billion). As a result, the growth rate of bank deposits turned negative for the first time in 20 years, standing at –5.5 % in September.

Households also invested some of their savings in riskier instruments, mainly in the first quarter of the year. Between January and September, individuals bought shares in investment funds to the tune of € 6 billion. Similarly, shares, both listed and unlisted, and other equities were popular, accounting for a total of € 1.9 billion.

The valuation effects resulting from price changes on the financial markets were positive in 2023. However, these did not offset the valuation losses suffered by households on investment funds, equities and insurance products in 2022, given the rise in interest

Figure 7.6

Households transferred some of their bank deposits to higher-yield assets



Source: NBB.

1 This item includes net household entitlements to insurance technical reserves, pension funds and standard warranty reserves.

2 In the centre chart, this item includes commercial credit and miscellaneous assets on general government and financial institutions, insofar as they are recorded. In the right-hand chart, this item also includes banknotes, coins and deposits.

rates and the downturn on the stock markets. In the first nine months of 2023, households realised € 12.9 billion in valuation gains, mainly on assets invested in mixed and equity funds, as well as in share and equity investments. Insurance products were also affected.

As a result of shifts between different types of financial products, new investments and valuation effects, the structure of household financial assets changed slightly. Cash savings and deposits, as well as savings in the form of shares and equities, still represent the main categories (with, respectively, € 465 and € 438 billion, or 31 % and 29 % of financial assets at the end of the third quarter of 2023), but the share of debt securities grew thanks to the issuance of a State note in September. The amount allocated to debt securities totalled € 57 billion at the end of September 2023, compared with € 27 at the end of 2022.

As a whole, the financial wealth of Belgian households was estimated at € 1 510 billion in September 2023, up from € 1 484 billion at the end of 2022. In relative terms, however, the value of this wealth fell over the first three quarters of 2023, from 267.9 % to 261.4 % of GDP. This difference may seem small, but the trend has been ongoing for several years. Between 2011 and 2019, the financial wealth of Belgian households hovered around 300 % of GDP.

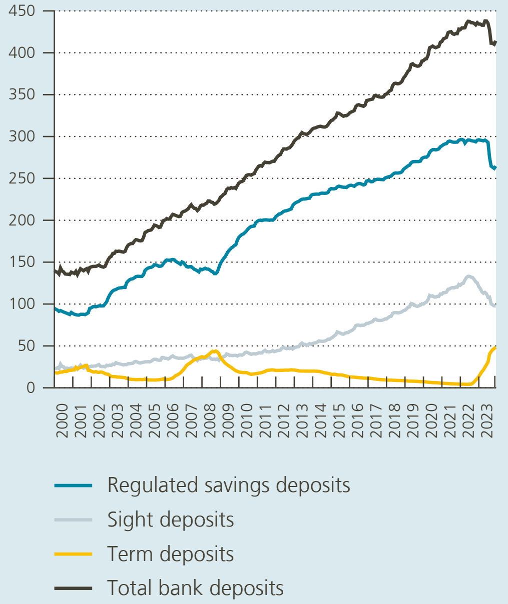
Issuance of the one-year State note

In 2023, the Federal Debt Agency issued its first one-year State note, maturing on 4 September 2024. By issuing a risk-free investment product with a short maturity, similar to a savings account, [1] the finance minister had three aims: to stimulate competition for savings and thus push up bank deposit rates; to send a positive signal to the financial markets about Belgians' ability to save; and, finally, to offer households a safe and attractive short-term investment option.

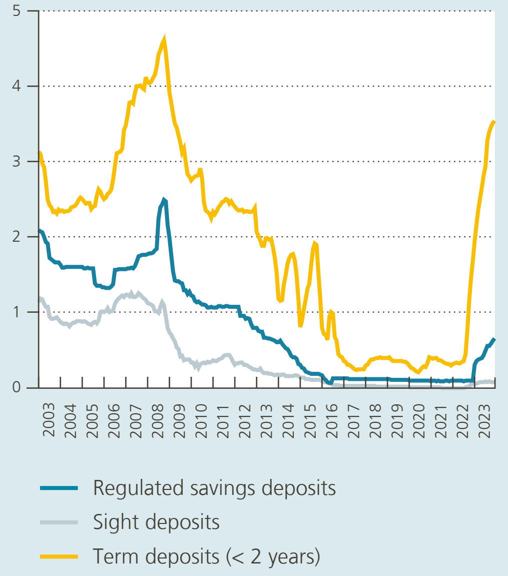
The response from households to the new State note was enormous: more than 500 000 savers subscribed, for a total amount of € 21.9 billion. The issue was so successful that it broke the record previously held by the "Leterme notes", which raised € 5.7 billion in December 2011. Subscriptions to the one-year State note also resulted in a considerable outflow of funds for banks. The € 21.9 billion raised represented 5 % of the total value of household deposits (measured in July 2023).

Amounts outstanding and deposit rates of Belgian households with banks active in Belgium

Amounts outstanding of household bank deposits
(billions of euros)



Interest rates on household bank deposits [1]
(percentage)



Source: NBB.
1 These data are from a bank interest rate survey. Prior to July 2016, the savings rate only included the base rate. Since July 2016, bonuses (such as loyalty or growth bonuses) have also been included, where applicable. In practice, it is possible to observe a certain time lag between the adjustment of loyalty bonuses by banks and their impact on the data.

Household withdrawals in August and September 2023 were the highest since the start of record-keeping for banking statistics. [2] In total, the decline between July and September 2023 was almost € 24 billion. Households mainly drew from their savings accounts to subscribe to the State notes. Regulated savings accounts fell by € 28 billion between July and September. This decline can be explained in part by the issuance of the State note and in part by increased demand for term deposits. These tend to offer a higher return than savings accounts, and transfers to this type of account were encouraged by the very attractive terms temporarily offered by some banks as an alternative to the State note. However, regulated savings accounts remain the largest category of deposit, with € 265 billion outstanding in December (equivalent to two-thirds of household deposits).

The success of the State note can be explained by its attractive yield, at a time when the transmission of the rise in interest rates on the capital markets to the rates offered on deposits by Belgian banks was particularly slow. The gross coupon of 3.30 %, combined with a reduction in the withholding tax applicable to the bond, translated into a yield of 2.81 % after tax. This yield was higher than the interest rates offered by banks on household deposits.

Even though issuance of the State note unsettled the savings market, interest rates on savings accounts remain low. In fact, compared with the trend in deposit rates observed in other countries and with the trend in rates on the financial markets, the rise in interest rates on personal savings accounts in Belgium has been slower than expected. The average rate applied to regulated savings deposits was 0.55 % in September 2023. It then rose slightly to 0.65 % in December.

1 In Belgium, savings accounts are partly remunerated by a loyalty bonus. This is fixed at the time of deposit and is added to the base rate, provided the amount deposited remains in the account for an uninterrupted period of twelve months. This period corresponds to the maturity of the one-year State note.

2 The subscription period ran from 24 August to 1 September. The drop in household deposits observed in August was mainly attributable to early payments made by investors who subscribed directly with the Federal Debt Agency rather than through commercial banks. Subscriptions made through commercial banks, which make up the largest proportion, appear in the September data.

Many households live in poverty

The net financial wealth of households (as measured by total financial assets less debt) has been rising steadily since 2000, with the exception of a few well-defined periods. Two periods in particular stand out in this respect: the financial crisis of 2008 and the energy crisis of 2021-2022.

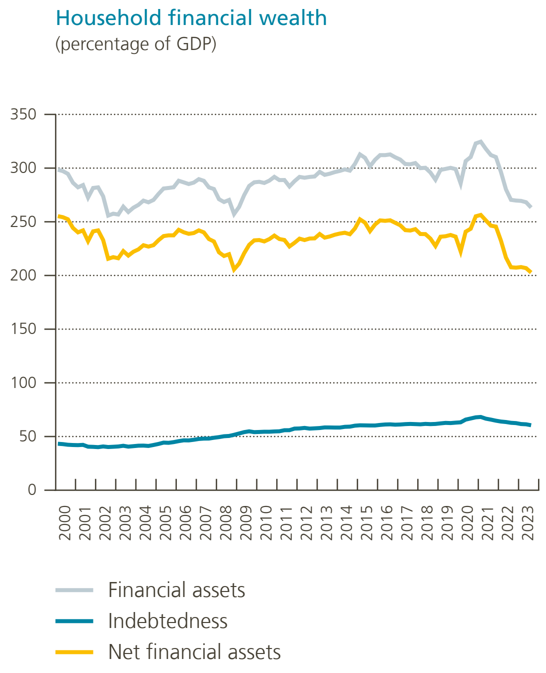
Expressed relative to GDP, which measures the annual production of wealth (and annual income) in Belgium, net financial wealth tends to hover around 230 % but in 2022 a significant fall was recorded. While the level was 235 % of GDP at the end of 2019, it fell to 206 % in the third quarter of 2022 and to 201 % in the third quarter of 2023. This period of decline has lasted longer than previous phases of weakening. During the Covid-19 and energy crises, which were characterised by high inflation and high interest rates, Belgian households as a whole therefore became relatively poorer.

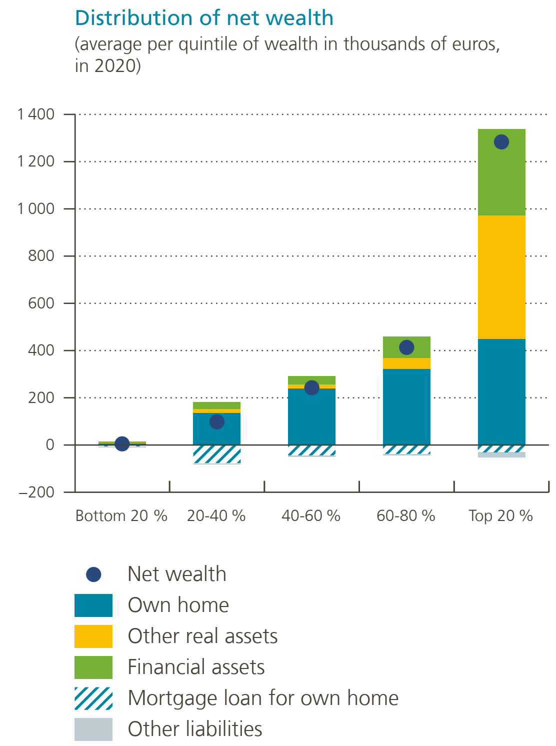
Although Belgian households have significant wealth, it is unevenly distributed. Much of this wealth is in the hands of the most affluent. As well as owning their own homes, they also hold most other property and financial assets. The poorest quintile of the population, on the other hand, has barely more assets than debts. Statements such as "Belgians are wealthy", which are based on aggregate household wealth, are therefore generalisations which should be qualified.

The unequal distribution of wealth makes certain groups of the population more or less vulnerable to financial vicissitudes. For example, less affluent households are relatively more likely to rent, while affluent households are more likely to own their own home. Changes in house prices, mortgage interest rates and rents will therefore affect different types of household differently. When looking at the financial components of wealth, it should be borne in mind that these are mainly held by the wealthiest households. Finally, in terms of indebtedness,

Figure 7.7

Household net financial wealth remained stable and at a low level in 2023, but wealth is unevenly distributed





Source: NBB.

the solvency and guarantee requirements of financial institutions often prove prohibitive for the poorest households, forcing them to turn to other, very costly, forms of credit.

Households with limited assets usually also have a low income. The number of people living in poverty is thus generally estimated on the basis of income, which is also easier to determine. While assets can include very disparate components whose present value is not always easy to calculate, income provides a quantified current indication of the monthly resources available to a household, which can be compared with the expenses to be covered.

Around one-fifth of the population is at risk of poverty. According to the AROPE indicator, [1] 18.7 % of the Belgian population was at risk of poverty or social exclusion in 2022, i.e. their income was below the poverty threshold, their labour potential was under-exploited or they were facing serious material or social deprivation. Certain categories are particularly vulnerable: the low-skilled, the unemployed and inactive, tenants, single people (especially single parents) and people born outside the EU. Residents of (large) cities also tend to have a more precarious profile, hence the high percentage recorded in the Brussels-Capital Region.

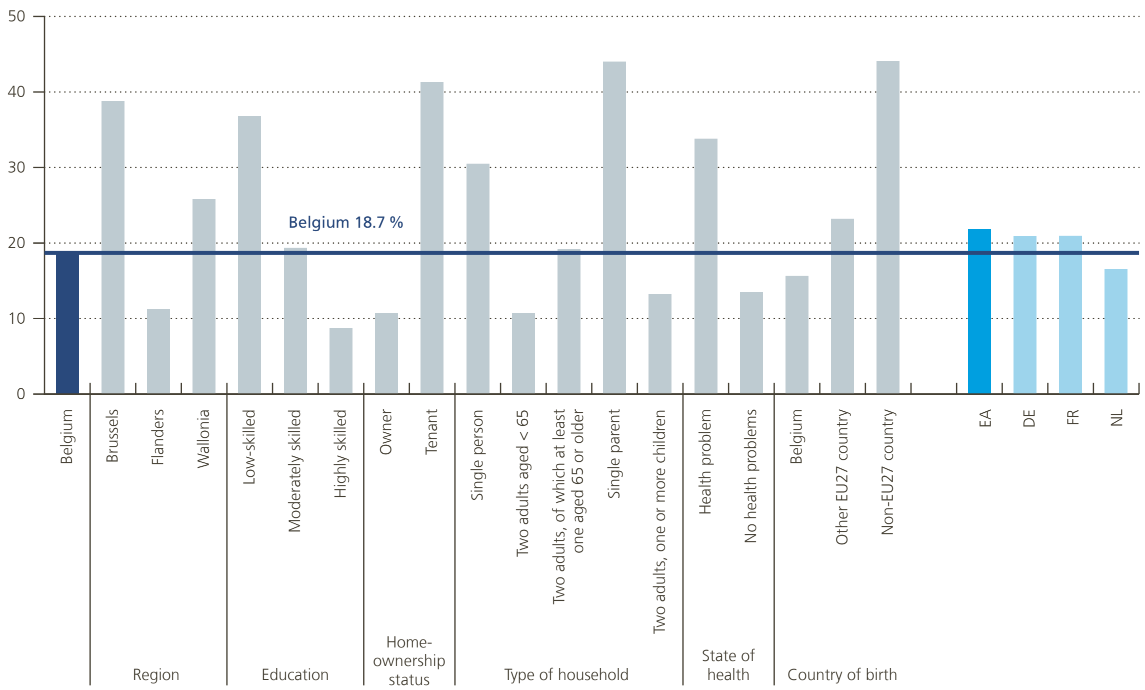
Aside from the structural risks to which certain sections of society are exposed, specific circumstances can also lead to poverty. For example, economic crises tend to increase the number of people living in poverty, as those in relatively more precarious situations are more likely to lose their job and, as a result, at least part of their income. When this occurs, a number of mechanisms can limit the loss of income. For example, workers who are made redundant are generally entitled to unemployment benefits. In addition to these "automatic stabilisers",

1 AROPE stands for "at risk of poverty or social exclusion". This is the indicator used to monitor the EU 2030 target on poverty and social exclusion.

Figure 7.8

Poverty is concentrated in certain categories of the population

(risk of poverty or social exclusion, 2022, percentage of the corresponding population)

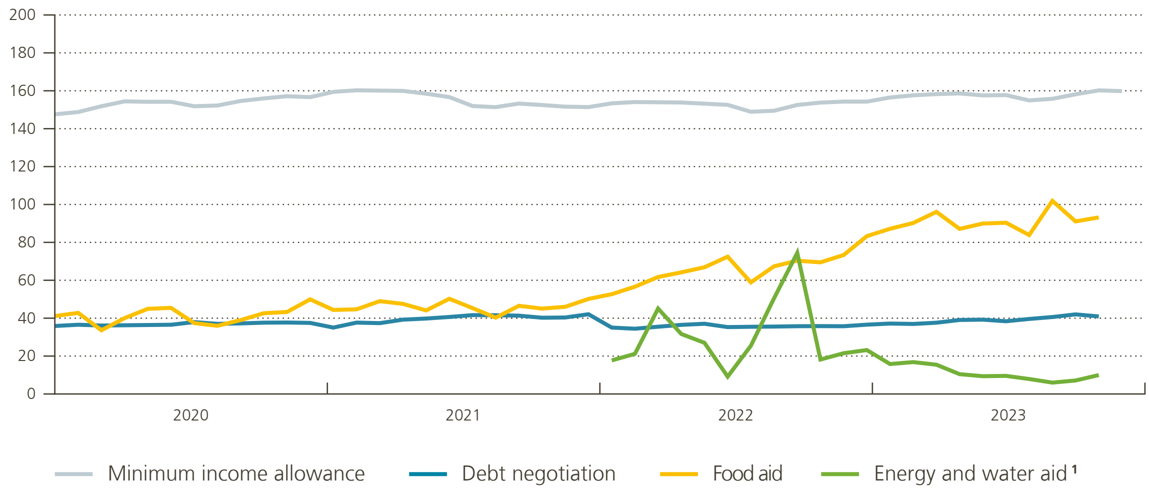


Source: Statbel (SILC).

Figure 7.9

In times of crisis, there is greater reliance on certain types of state support

(thousands of beneficiaries)



Source: PPS Social Integration.
1 Data for the "Energy and water aid" series are only available from 2022.

the authorities can also take specific measures to mitigate the consequences of a crisis. For example, during the Covid-19 pandemic and the energy crisis, large-scale government measures were adopted to reduce the loss of household income or to contain the increase in household bills (see the Bank's 2020 and 2022 Annual Reports).

The number of recipients of the minimum income allowance has barely increased since 2020, but demand for other forms of social assistance has risen. Since 2022, the number of people receiving food aid from the public centres for social welfare has increased significantly. In that year, significant support was also provided for the payment of energy and water bills. For this latter type of assistance, a drop in recipient numbers was observed in 2023, probably linked to the fall in energy prices. Income growth may also have contributed to this: indexation mechanisms operate with a time lag, meaning the high inflation of 2022 still continued to lead to an increase in wages and benefits in 2023. An average of 91 000 and 11 000 people, respectively, requested food aid or energy and water aid in 2023. Finally, the number of people involved in debt negotiation has remained fairly stable at around 40 000 since the start of the Covid-19 crisis. This confirms the above observation based on default rates.

Belgium has been more successful than other European countries in containing the impact of the Covid-19 pandemic and the energy crisis on poverty levels. Thanks in particular to vigorous intervention by the authorities, the AROPE indicator in Belgium actually fell by around one percentage point over the period 2019-2022, while the euro area recorded an average increase of the same proportion. The risk of poverty increased in Germany and France, while it stabilised in the Netherlands. As a result, Belgium is currently doing slightly better than many other European countries in terms of poverty. While the percentage of the population at risk of poverty in Belgium was around 19 % in 2022, it averaged almost 22 % in the euro area and around 21 % in Germany and France. Even so, Belgium falls squarely into the middle of the European ranking, with the Netherlands (16.5 %), among other countries, having a much lower risk of poverty.

7.3 Businesses took on less debt in 2023

Belgian companies entered 2023 in very good financial health overall, a situation they owed largely to the profits they were able to generate in previous years. As mentioned in chapter 4, corporate profit margins have increased significantly since 2014. This is due in particular to a structure of economic activity oriented towards more profitable sectors, lower consumption of fixed capital, and labour productivity trending above wage costs. In addition, against the backdrop of particularly accommodative monetary policy up to 2022, business profitability was boosted by the low cost of bank loans for investments and working capital.[1]

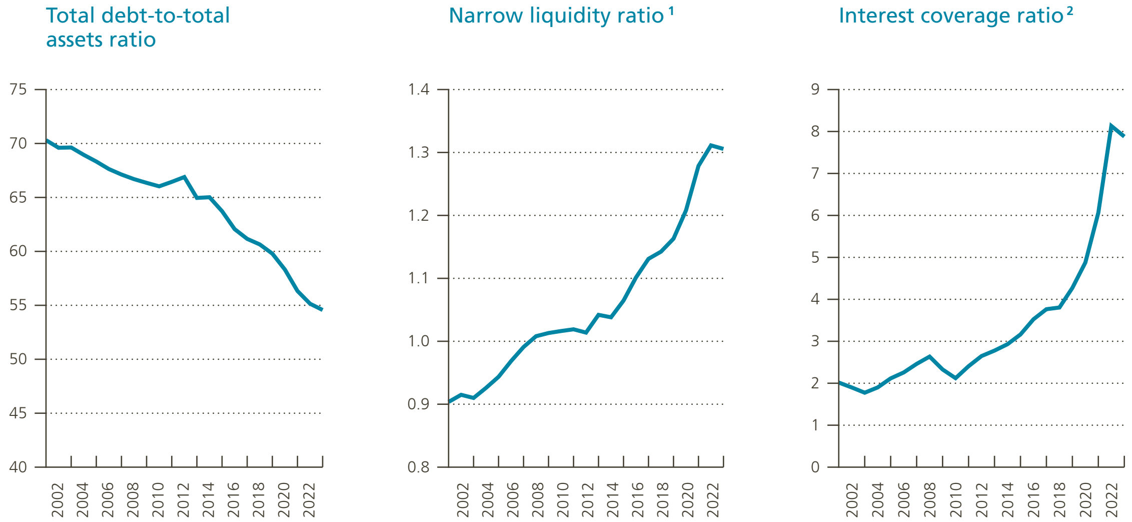
Rising profits enabled firms to strengthen their equity and cash reserves. As a result, the median debt-to-equity ratio for the entire population of non-financial corporations was only 55 % in 2022, compared with 65 % ten years earlier, while their liquidity buffers correspond in most cases to at least 130 % of their debts with a maximum maturity of one year. Combined with the fall in financing costs, this growing profitability made corporate debt burdens

1 See Ch. Piette and J. Tielens (2023), "How did Belgian firms benefit from three decades of declining interest rates?", NBB, *Economic Review*.

Figure 7.10

Corporate financial ratios followed very favourable trajectories up to 2022

(median values calculated for the entire population of non-financial corporations)



Source: NBB.

1 The ratio between the sum of the company's cash on deposit and in hand, cash investments and accounts receivable due within one year, on the one hand, and its accounts payable due within one year, on the other.

2 Ratio of profit before tax and financing costs to financing costs.

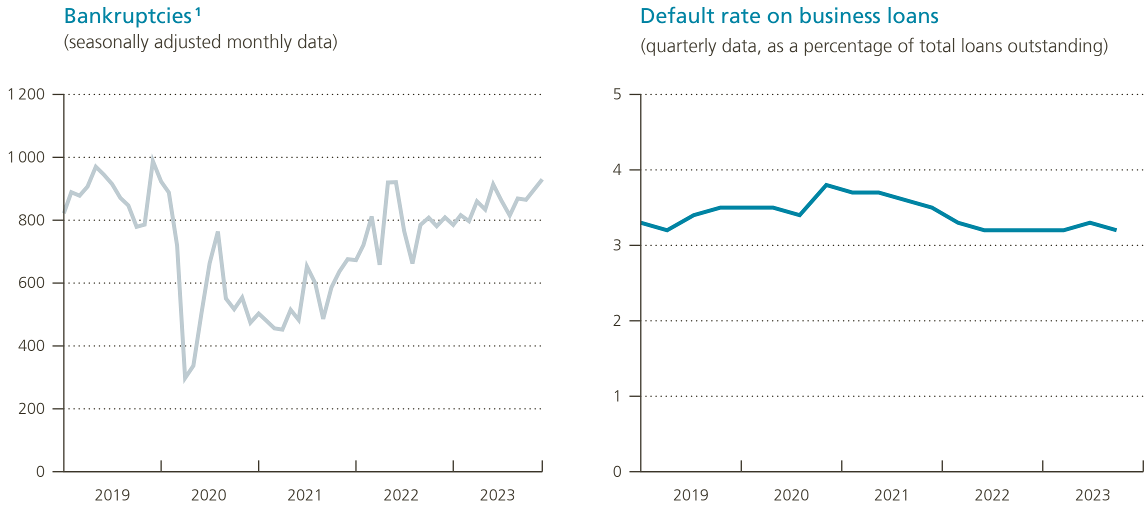
more sustainable. In 2022, the revenue of firms, again in median terms, was eight times their financing costs.

The slowdown in economic activity in 2023 and the gradual rise in lending rates charged by banks have thus far not had a substantial effect on companies' ability to honour their financial commitments. Despite the expectation of a rise after the ending of the support measures and various moratoria on bank, tax and social security debts put in place during the Covid-19 crisis, the increase in business bankruptcies remained moderate. At the end of 2023, the number of bankruptcies was lower than at the end of 2019, i.e. prior to the start of the pandemic. The good financial health of Belgian businesses is also reflected in the trend in the number of non-performing loans on bank balance sheets. The share of such loans in total outstanding bank loans to non-financial corporations had fallen to a low of 3.2 % by the end of 2022, a level that was maintained until the third quarter of 2023. The risks associated with lending to businesses were therefore still marginal for banks.

Several factors contributed to the slowdown in bank lending to Belgian businesses. One was the trend in short-term lending. Short-term loans were a major contributor to the peak in bank lending growth in July 2022, when it reached 6.4 % year-on-year. As a result of the sudden rise in energy costs, businesses faced more pressing liquidity needs, as higher input costs and wage indexation led to an increase in their working capital requirements. This effect subsequently faded and growth in bank lending to businesses was therefore receding up to September 2023.

Figure 7.11

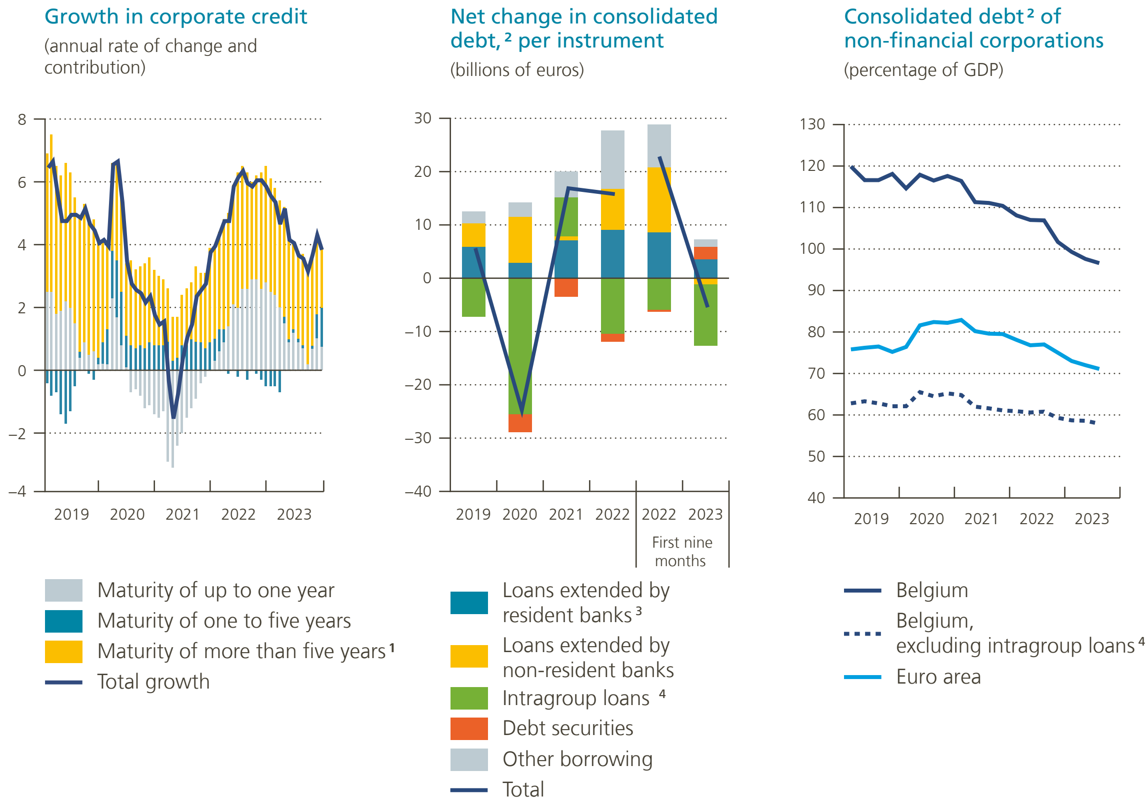
Bankruptcies and defaults on bank loans remained contained



Sources: Statbel, NBB.
1 The data cover bankruptcy filings by the self-employed, legal entities and organisations without legal personality.

Figure 7.12

Growth in bank loans to non-financial corporations slowed in 2023, and their total debt contracted



Source: NBB.
1 Including securitised or otherwise transferred loans.
2 Borrowings by resident non-financial corporations from other resident non-financial corporations are not included in the definition of consolidated debt.
3 Including loans appearing on the balance sheet of securitisation vehicles.
4 Intragroup loans are defined as those granted by captive money lenders and the foreign non-financial sector.

However, short- and medium-term borrowing picked up again in the final quarter of the year, taking total credit growth to 3.9 % by the end of 2023. The increase in longer-term borrowing was less marked than in 2022, which suggests that the substantial investments made by firms in 2023 were increasingly financed with cash reserves and less with bank loans.

While it had risen in 2022 as a result of substantial bank borrowing, corporate debt contracted by € 5.2 billion in the first three quarters of 2023. This was mainly due to changes in intragroup transactions between resident non-financial corporations, on the one hand, and companies established abroad or captive money lenders established in Belgium, on the other. In the first nine months of 2023, these transactions resulted in net repayments of € 11.5 billion by Belgian firms. Repayments of loans taken out with non-resident credit institutions also contributed to the € 1.1 billion reduction in corporate debt. The main source of external financing used by Belgian companies in 2023 was therefore borrowing from resident banks, whose outstandings increased by € 3.6 billion during the first three quarters. Their liabilities, in the form of debt securities or loans from financial intermediaries other than banks, increased by € 2.3 billion and € 1.4 billion, respectively. All in all, the outstanding consolidated debt of Belgian non-financial corporations stood at € 557.9 billion, or 96.6 % of GDP, at the end of the third quarter of 2023. If intragroup debt is excluded, this figure falls to € 334.4 billion or 57.9 % of GDP.

7.4 The financial sector remains resilient to various macroeconomic shocks

As mentioned in chapter 1 and in the "Prudential regulation and supervision" section of this report, the global banking sector experienced some turbulence in March and April 2023 following the collapse of several US regional banks and the Swiss bank Crédit Suisse. However, the crisis of confidence did not spread to other European countries or to the Belgian banking sector. In addition to negligible exposure to the severely affected institutions, the stronger financial position of Belgian banks and their diversified business model, improved risk management, effective supervision, and the quality and quantity of their liquidity and capital buffers all played an important role in this respect.

The Belgian financial sector had already demonstrated its resilience during the pandemic, the severe floods in the summer of 2021 and the energy price shock in 2022. This resilience enabled the sector to rely on its solid financial position, underpinned by the buffers it had built up, to absorb unexpected shocks when necessary, with the aim of providing solutions to severely affected customers.

While bank profits were boosted by the rise in interest rates, banks remain dependent on household deposits

The Belgian banking sector plays a crucial role in the financing of households and businesses, as credit mainly takes the form of bank loans. For the most part, Belgian banks follow a classic financial intermediation model whereby their customers' (short-term) deposits finance (long-term) loans. The remuneration for this maturity transformation corresponds mainly to net interest income : if the average return on assets exceeds that on liabilities, banks generate a positive interest margin.

With the rise in key rates and other market rates, the profitability of this banking activity improved significantly in 2022 and 2023, for both large and smaller (savings) banks. As the core business of Belgian banks is to attract deposits in order to grant loans, net interest income is the main component of the sector's financial earnings, accounting for 68 % of total operating income. In recent years, the environment of low or even negative interest rates put this business model under pressure. Indeed, the average interest income banks received on the loans they granted fell significantly, while the average interest rate they paid could not fall further, and the commercial margin on deposits shrunk sharply. However, banks increased their lending volumes during the period of low interest rates, which mitigated the impact on their bottom line. The rapid successive interest rate hikes since 2022 widened interest margins. In effect, banks' liquidity, short-term investments and new loans were immediately rewarded more strongly, whereas the return on a large proportion of deposits was only revalued very slowly and with a delay. As assets were revalued more quickly than liabilities, the interest margin improved. Interest flows on instruments used to hedge interest rate risk also contributed to this recovery in interest income.

Maturity transformation, for example when regulated savings account balances are used to finance long-term fixed-rate mortgages, involves credit, liquidity and interest rate risk. Banks must carefully manage and hedge this risk in order to preserve their financial stability. Credit or default risk arises when the customer is unable to repay the loan on time. Since loans are repaid over a long period, whereas savings deposits can be withdrawn immediately, the bank is also exposed to liquidity risk. Moreover, since the return on mortgage loans is immutable, whereas the interest rate on deposits can fluctuate, banks are also exposed to interest rate risk.

In order to manage interest rate risk properly, it is essential for banks to strike a structural balance between sensitivity to changes in the interest rates on sight and savings deposits, on the liabilities side, and loans, on the assets side. Figure 7.13 illustrates how the Belgian banking sector manages interest rate risk. It categorises rate-sensitive assets and liabilities according to the timeframe in which they are likely to be repriced. For example, for a mortgage whose interest rate will be revised within five years, the outstanding balance at that stage will be placed in category]3A, 5A]. Savings deposits are categorised on the rate scale based on the estimated extent to which a permanent interest rate shock will, after a given period, affect the returns on the deposits. Banks' internal models indicate the speed with which they have historically repriced their savings rates following a rate shock. According to bank models for savings deposits, 38 % of a rise in interest rates is passed on to savings rates in the first year following the shock, on average, and a further 29 % is passed on in the two following years. In other words, a permanent interest rate shock of one percentage point will lead to a 0.38 percentage point increase in the average deposit rate on outstanding amounts in the first year, followed by a further 0.29 percentage point increase in the following two years. For maturities where the gradual repricing of interest rates on sight and savings deposits does not (as was the case in the past) provide adequate coverage for fixed-income assets, banks use interest rate derivatives to balance the interest rate sensitivity of assets and liabilities across maturities. These derivatives are mainly used to balance the interest rate risk for instruments with (very) long repricing periods and

Figure 7.13

The interest rate repricing profile[1] of assets and liabilities is very balanced

(consolidated data for the six largest banks, based on modelling assumptions, June 2023, billions of euros)

Source: NBB.

1 The amounts shown on this chart include both principal and interest payments arising from interest-sensitive assets and liabilities, expressed in relation to the remaining term to their repricing, assuming a run-off balance sheet, and in line with the interest rate environment in June 2023. The modelling assumptions refer, for example, to those used in banking models concerning the maturities of items for which the rate review period is not fixed (such as savings accounts), early repayments of fixed-rate loans, early repayments of term deposits, etc. The data used are based on the banking book.

2 These include non-maturity deposits with companies and financial institutions, excluding term accounts.

3 These include outstanding debt securities and term deposits.

for which the size of sight and savings deposits plays a lesser role in managing risk.

The stability and gradual transmission of market rates to the remuneration of current and savings accounts enable Belgian banks to issue a large proportion of fixed-rate assets, thus protecting household borrowers from interest rate fluctuations. In countries where a large proportion of bank loans are variable rate, fairly sharp increases in deposit rates were recorded, as banks in those countries also benefited almost immediately from higher remuneration on their (mortgage) loan portfolios. In Belgium, on the other hand, a large proportion of loans are fixed rate, as is the case, for example, for over 70 % of Belgian household mortgages. This protects households from interest rate fluctuations and means that, for banks, the interest income they earn on loans increases less quickly when market rates rise. This state of affairs could in turn restrict the margin available to adjust interest rates on deposits.

Generally speaking, Figure 7.13 shows that the assets and liabilities of Belgian banks are fairly evenly distributed by maturity and that they are therefore well protected against interest rate risks. The fact that the savings rate did not rise as quickly as banks themselves had modelled in their interest rate risk management and that the credit margin on deposits recovered, indicates that there was a degree of latitude to apply a higher rate of remuneration to deposits than what was observed. As the limited remuneration of deposits became a societal issue, three legislative proposals were tabled, which stipulated that banks should offer higher remuneration by linking the interest rate on savings deposits to the European Central Bank deposit rate or the ten-year OLO rate. In this context, the finance minister sought the Bank's opinion (see also part B.2 of the "Prudential regulation and supervision" section of this report). The Bank warned of the considerable risks to interest rate risk management, solvency and profitability and, by extension, to financial stability posed by the proposals. However, in view of the balanced distribution of interest-sensitive assets and liabilities and the very high return on equity, the Bank confirmed that there was indeed room for a gradual increase in the remuneration of savings deposits.

In the context of financial stability, it is also crucial to preserve the stability of deposits as a source of funding for the Belgian banking

sector, which implies that their remuneration should remain in line with changes to market conditions. If savers find the return on savings insufficient, they will seek higher returns elsewhere. This was highlighted by the popularity of the State note issued in September 2023, which raised € 21.9 billion (see also Box 7 in this chapter).

The increase in net interest income (+€ 2.4 billion), due in part to the slow pace of the repricing of savings rates, but also to the recovery of the credit margin on sight deposits and the higher remuneration of variable-rate assets, sustained the high profitability of the Belgian banking sector in the first nine months of 2023. In fact, the sector's profitability reached an all-time high of € 7.2 billion in this period and rose by € 1.9 billion compared with the same period in 2022 (see Table 7.1). The return on equity (RoE) for the Belgian banking sector averaged 12.5 % (compared with 9.4 % in the corresponding period of 2022). The cost-to-income ratio also improved, falling from 63.3 % to 59.5 %.

Savings banks also recorded much more robust rates of return in 2023 than in the past, narrowing the gap with big banks and enabling them to raise interest rates on deposits. While the typical savings bank could expect an average return on equity of 8.5 % in the first nine months of 2023, this figure rose to 13 % for big banks. The main reasons for this long-standing discrepancy are that larger banks can achieve much greater economies of scale as they are able to spread their expenses (such as IT investment) over a wider asset base, while the typical small savings bank business model of collecting deposits to make loans came under severe pressure in the low interest rate environment. Nevertheless, Figure 7.14 shows that the widening of the interest margin enabled savings banks to boost their returns significantly over the period (from 4.8 % in the first nine months of 2022 to 8.5 % for the same period in 2023).

Table 7.1

The profitability of the Belgian banking sector increased

(income statement of Belgian credit institutions ; in € billion, unless otherwise stated)

				First three quarters	
	2020	**2021**	**2022**	**2022**	**2023**
Net interest income	14.2	14.4	15.3	11.1	13.5
Non-interest income	8.2	7.6	7.9	6.0	6.1
Net income from fees and commissions [1]	5.6	6.4	6.5	5.0	5.0
Realised and unrealised gains and losses on financial instrumentss	0.0	0.6	0.8	0.6	0.4
Other non-interest income	2.6	0.6	0.6	0.4	0.6
Operating income (banking income)	22.4	22.0	23.2	17.1	19.6
Operating expenses	–13.8	–13.3	–14.2	–10.8	–11.7
Gross operating profit (before impairments and provisions)	8.6	8.7	9.1	6.3	7.9
Impairments and provisions	–3.1	–0.2	–1.1	–0.7	–0.4
Other components of the income statement [2]	–1.2	–0.7	–0.3	–0.2	–0.4
Net profit or loss	4.3	7.8	7.6	5.4	7.2
Return on equity (in %)	5.9	10.2	9.9	9.4	12.5
Return on assets (in %)	0.4	0.7	0.7	0.6	0.8
Cost-to-income ratio (in %)	61.7	60.4	61.0	63.3	59.5

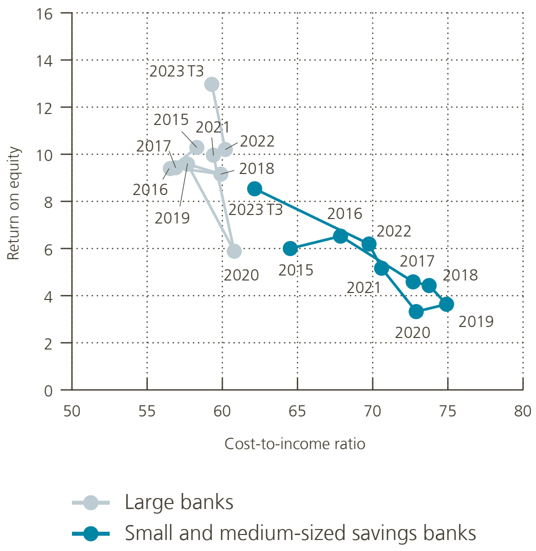
Source : NBB.

1 Including commissions paid to (self-employed) banking agents.

2 This item includes tax, exceptional items, negative goodwill recognised in profit or loss, and the share in profits or losses of investments in subsidiaries and joint ventures.

Figure 7.14

The return on equity and cost-to-income ratio of large banks and small and medium-sized savings banks improved significantly



Source: NBB.

Between the first three quarters of 2022 and the corresponding period of 2023, banks' expenses rose by € 0.9 billion, mainly as a result of higher operating costs. In particular, inflation and the associated automatic indexation of wages pushed up costs. At the same time, provisions for credit losses helped limit recorded costs. In fact, the stock of provisions for credit losses returned to its pre-pandemic level. In addition, credit losses were limited, falling by € 0.4 billion compared with the first nine months of 2022, despite the sharp rise in interest rates and the slowdown in economic growth. The good quality of loans to businesses and households explains this situation.

Net new provisions for credit losses fell. As the Bank considered that these provisions were too low at a time of macroeconomic uncertainty, the countercyclical capital buffer was reactivated in October 2023, to ensure that Belgian banks have sufficient liquidity to absorb unexpected future losses (see also part B.2 of the "Prudential regulation and supervision" section of this report).

The fact that the problems experienced by US banks and Credit Suisse did not spread to banks in the euro area, and to Belgian banks in particular, is a sign of their solidity and resilience. Thanks to their ample and robust capital and liquidity buffers, banks can continue to serve as a major lever to support the real economy, even when macroeconomic circumstances are less favourable. Capital and liquidity ratios are well above minimum requirements. The average common equity tier 1 ratio (CET 1 ratio) of the Belgian banking sector stood at 16.9 % in the third quarter of 2023, above the euro area average (16 % in June 2023). The liquidity coverage ratio (LCR) for the sector stood at 157 % at the end of the third quarter of 2023, whereas the minimum requirement is 100 %. Despite the high level of liquidity on bank balance sheets, this ratio declined slightly for a number of reasons. On the one hand, banks drew on existing liquidity reserves to repay some of the ECB's longer-term refinancing operations (TLTRO III), which will mature in full in the course of 2024. On the other hand, the outflow of deposits in favour of the State note had a negative effect on the liquidity position of Belgian banks. That being said, the impact of this situation on the liquidity coverage ratio seems more limited than initially expected, as most Belgian banks adopted several measures to strengthen their liquidity position, such as intragroup transactions and the issuance of covered bonds or other commercial debt securities.

Rising interest rates also had a positive impact on the insurance sector

The insurance sector has shown resilience in recent years and entered 2023 on a sound footing. In 2020, the Covid-19 pandemic had little effect on the sector, thanks in particular to containment measures that led to an overall reduction in claims. The sector was therefore in a robust position when it had to deal with the floods that hit the country hard in July 2021. It should be recalled that based on the legislative framework in force at the time, as well as the one-off agreements made in the wake of the floods, it was established that the burden of claims would be borne by a number of public and private players, including insurance companies and reinsurers. In 2022, the energy crisis that followed Russia's invasion of Ukraine was accompanied by an increase in credit risk in the insurance sector's investment portfolio. However, this increase did not have a significant negative impact. Finally, the direct impact of the current conflict in the Middle East on the sector remains very limited for the time being, but second-round effects cannot be ruled out. In terms of profitability, the sector posted a net profit of € 3.7 billion in 2022, compared with € 2.6 billion at the end of 2021. Net income on non-technical reserves was mainly responsible for driving up the sector's profitability, while the net income from life and non-life branches remained relatively stable between these two periods.

The rise in interest rates kept the solvency of insurance companies at a structurally higher level than in the low-rate environment. In 2022, the solvency of the insurance sector benefited greatly from the rapid rise in interest rates. The solvency capital requirement ratio (SCR ratio) reached 221 % in the third quarter of 2022. The increase in risk-free rates had pushed down the discounted market value of commitments to policyholders. Given that, at sector level, the average maturity of liabilities is structurally longer than that of assets (resulting in greater sensitivity to changes in interest rates), this fall in market value was relatively greater on the liabilities side than on the assets side. This had led, mechanically, to a positive effect on the sector's level of net capital. By the fourth quarter of 2022, the SCR ratio had fallen to 209 %, mainly as a result of the inversion of the yield curve . It then remained relatively stable during the first two quarters of 2023. In the third quarter of 2023, the SCR ratio deteriorated slightly, falling from 211 % to 207 %.

The rise in interest rates strengthened the guaranteed-rate life insurance business model. This model remained resilient in the low-rate environment. In order to generate sufficient margins to honour class 21 life insurance contracts concluded in the past with guaranteed rates that were at times still very high, life insurance companies continued to adapt. On the one hand, they continued to reduce the average guaranteed rate on the stock of existing contracts, thanks notably to programmes to sell portfolios of contracts with high rates to other insurance companies. On the other hand, life insurance companies continued to generate returns by redirecting their investments towards riskier and often less liquid assets (see below). In the environment of higher interest rates, insurance companies also had the opportunity to reinvest the proceeds generated by maturing assets into assets with higher returns. Between 2021 and 2022, the yield on assets held to cover class 21 contracts rose from 2.9 % to 3.2 %, while the average guaranteed rate on the stock of life insurance contracts fell from 1.9 % to 1.8 %. With regard to the latter point, it is important to emphasise that the current interest rate environment recently enabled several insurance companies to offer higher rates on new guaranteed-rate life insurance policies.

Inflation is impacting not only the assessment of claims but also, gradually, the (re)pricing of premiums in certain lines of business. According to the Bank's monitoring exercises, the negative impact of inflation has been relatively well absorbed by insurance companies. At the peak of inflation in 2022, simulations concluded that the sector's SCR would fall by three percentage points over the first three quarters of the year. Inflation affects the liabilities of insurance companies by increasing their overhead (salaries, operating expenses, etc.) and the cost of claims to be covered. This is mainly the case for non-life and health insurance, where cover is expressed at current prices. On the assets side, the pricing of premiums collected is adjusted gradually, particularly where premiums are calculated on the basis of indices which are themselves adjusted for inflation (home insurance, etc.). However, competition in certain non-life lines limits the scope to increase premiums. Changes in reinsurance conditions for insurance companies also play a role in the upward (re) pricing of certain premiums (see below).

Despite higher interest rates, insurance companies continue to face a number of risks

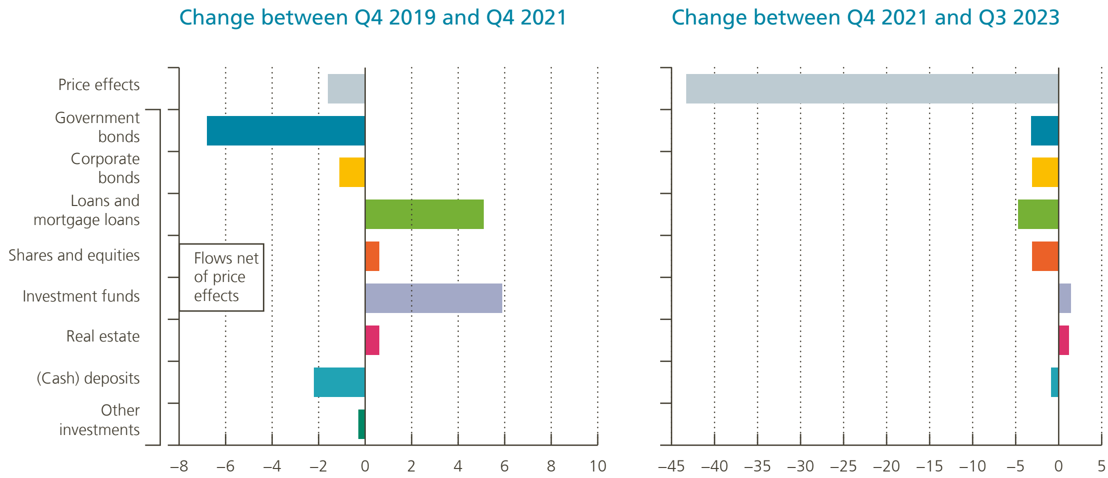
The rebalancing of the investment portfolio continued in 2023, mainly due to valuation effects. Following the rise in interest rates that began at the end of 2021, the value of a wide range of assets held in the portfolios of insurance companies depreciated. This was particularly the case for sovereign bonds. Although they still account for a large proportion of the sector's investments, especially for companies offering guaranteed-rate life insurance policies, their relative share fell from 44 % in September 2021 to 39 % in September 2023. This decline was mainly due to valuation effects, [1] while the falls recorded prior to 2022 were mainly due to volume effects in the context of a search for yield and an increased appetite for riskier, less liquid exposures. Over the years,

1 In the Solvency II regulatory framework, the balance sheets of insurance companies are expressed at market value. Changes in the value of the sector's investment portfolio are therefore the result of price effects (resulting from fluctuations in the market value of assets) and volume effects (net flows).

Figure 7.15

The rebalancing of investment portfolios (excluding class 23) continued in 2023, mainly driven by valuation effects, whereas volume effects had been more influential before the rise in interest rates

(Solvency II unconsolidated quarterly data, billions of euros)



Source: NBB.

the sector has increased its exposure to certain asset classes offering attractive returns, such as real estate, loans and investment funds. As a result, the insurance sector has become progressively more vulnerable to potential shocks on these markets.

Exposure to the property sector is significant and remains potentially subject to market correction. At the end of 2022, the estimated exposure to residential property was € 20 billion (at the low end) or 8 % of the investment portfolio excluding class 23 products. Direct or indirect exposure to commercial real estate (CRE) amounted to € 24.5 billion, equivalent to 10 % of the investment portfolio in the third quarter of 2023. Although there has been a significant reduction in CRE exposure since the end of the third quarter of 2022, due in particular to price effects, monitoring the valuation of some of these assets remains a key issue in the current macroeconomic context.

Vigilance is required when it comes to managing liquidity risk. In an environment of rising interest rates, life insurance companies face increased liquidity risk for two reasons. On the one hand, higher interest rates could prompt some households to terminate the lower-rate life insurance policies they had taken out in the past in order to switch to investments that have become more attractive. On the other hand, when interest rates rise, insurance companies that use derivatives, including interest rate swaps, to hedge (downward) interest rate risks could face margin calls. In order to offset variations in their positions in these transactions, these companies must be able to mobilise liquidity, often in the form of cash, on a daily basis, the amounts of which can be relatively substantial. In practice, with regard to the first point, the surrender rates for guaranteed-rate life insurance contracts recorded in 2023, expressed as a percentage of premium income, remained stable, although the situation varied widely from one insurance company to another, and were below those observed during the Covid-19 pandemic. Notably, taxation, among other factors, plays a considerable role in household redemption decisions. As for the second point, there was considerable heterogeneity between insurance companies in 2023, both in terms of how extensively derivatives were used and the size of related margin calls. From a sectoral point of view, liquid assets still represented 41 % of the sector's investment portfolio in the third quarter of 2023 (or 188 % of liquid liabilities), providing a comfortable margin in the event of an increase in liquidity risk.

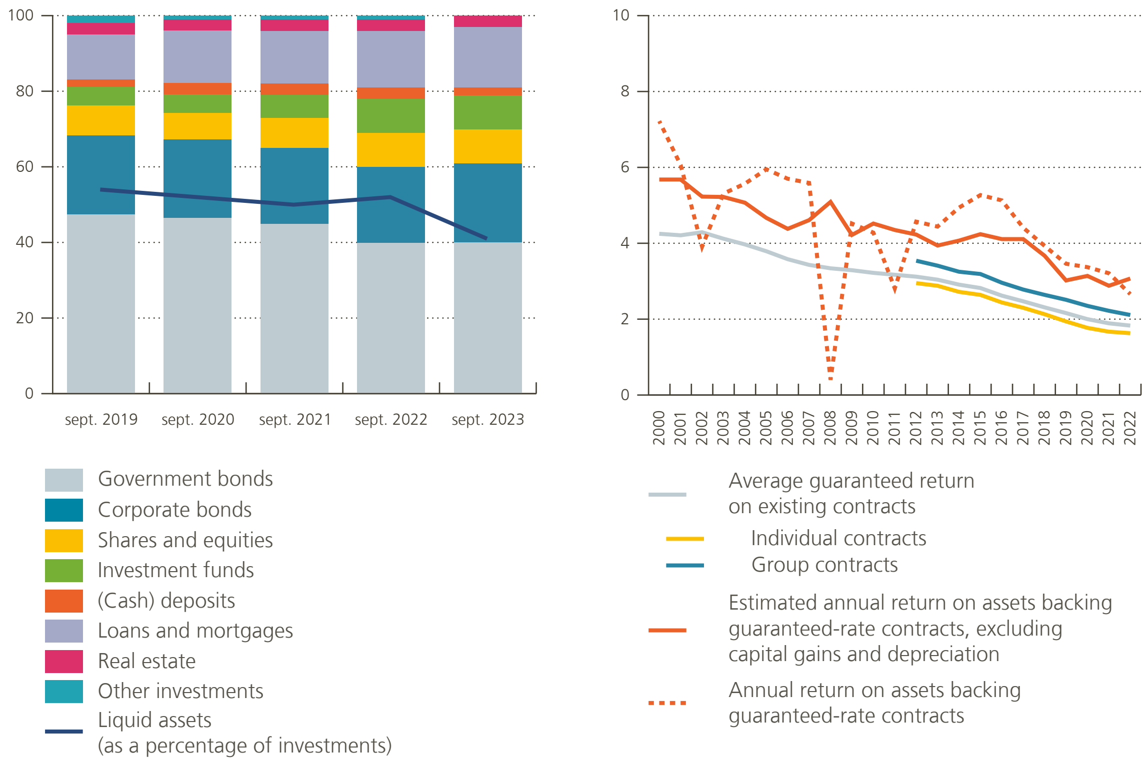
Climate-related and cyber risks continue to warrant close monitoring. The financial risks induced

Figure 7.16

Liquid assets still account for a significant proportion of the sector's investment portfolio, and the guaranteed-rate life insurance business model has been revived

Change in the sector's investment portfolio (excluding class 23), per type of asset
(percentage)

Change in the guaranteed average rate for class 21 contracts and the return on the assets held to cover them
(percentage)



Source: NBB.

by climate-related risks, both physical and transition risks, are not negligible for insurance companies. On the one hand, claims linked to the damage caused by climate change are on the rise in Belgium, and it is absolutely necessary to finalise the adaptation of the statutory framework for the coverage of natural disasters. Secondly, the investment portfolios of insurance companies are exposed to transition risk through the assets they contain. According to updated mapping by the Bank, around 48 % of the corporate bond portfolio, 51 % of the equity portfolio and 45 % of the commercial loan portfolio held by the insurance sector are exposed to sectors likely to suffer from the risks associated with the transition to a low-carbon economy. At an individual level, exposure to climate risk is very heterogeneous and can be very high for certain insurance companies. In view of growing climate-related risks and, more generally, the current macroeconomic context, reinsurance companies have significantly revised their conditions. Insurance companies are thus facing substantial rate increases and may have to adjust their reinsurance levels. Although the level of reinsurance remains adequate, the insurance sector is now subject to greater capacity constraints for the coverage of certain risks, against a backdrop of increasingly frequent small claims.

Lastly, the Covid-19 pandemic spurred digitalisation in the sector, while Russia's invasion of Ukraine highlighted growing cyber risk. The Bank continues to take initiatives in these areas. For more information on this subject, please refer to the discussion on digitalisation in the "Prudential regulation and supervision" section of this report.