

Belgian Prime News



QUARTERLY PUBLICATION

No. 32 June 2006

Special topic: House price developments in Belgium

Last update: 28 June 2006

Next issue: September 2006

■ Consensus: Average of participants' forecasts

	2005		2006 p			2007 p		
	Belgium	Euro area	Belgium		Euro area ⁽⁴⁾	Belgium		Euro area ⁽⁴⁾
			Consensus	Previous consensus		Consensus	Previous consensus	
Real GDP ⁽¹⁾	1.5	1.3	2.5	2.2	2.1	2.1	1.9	1.8
Inflation (HICP) ⁽¹⁾	2.5	2.2	2.2	2.1	2.2	1.9	1.6	2.2
General government balance ^{(2) (3)}	0.1	-2.4	-0.2	-0.5	-2.4	-0.8	-0.4	-2.3
Primary balance ⁽²⁾	4.5	0.6	3.9	3.8	0.6	3.3	3.6	0.6
Public debt ⁽²⁾	93.3	70.8	90.1	91.6	70.5	87.5	88.9	70.1

⁽¹⁾ P.c. change.

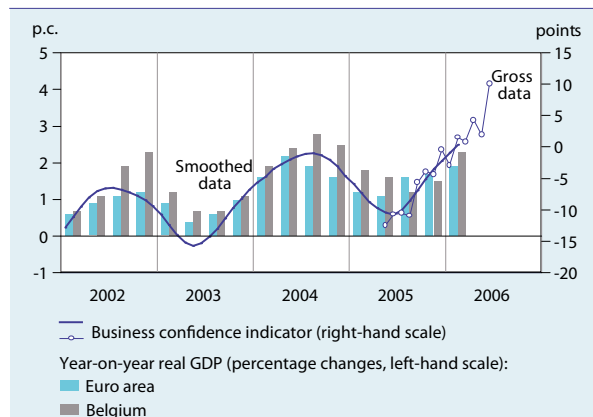
⁽²⁾ In p.c. of GDP.

⁽³⁾ EDP definition. Eurostat has to undertake further examination of some operations.

⁽⁴⁾ European Commission (forecast available since May 2006).

■ Macroeconomic developments

GDP GROWTH AND BUSINESS CYCLE INDICATOR



Sources: EC, NAI, NBB.

In Belgium, the upswing of economic activity that started in mid-2005 has remained on track. According to the NAI estimate, quarter-on-quarter GDP growth amounted to 0.8% in the first quarter of 2006. All branches and demand components are contributing to this strong performance. The NBB business survey indicator has risen further over the most recent months, pointing to a continuing high growth rate for the second quarter.

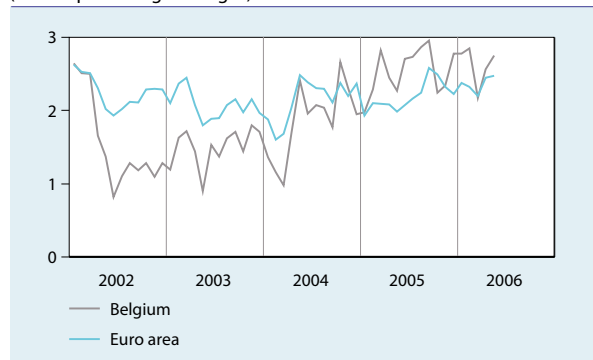
Combined with a better outlook for the euro area as a whole, the stronger starting point for the first quarter and the expectation of a high growth rate persisting for the second year prompted the primary dealers to further **upgrade their GDP growth forecast for 2006 from 2.2% in March to 2.5%, above potential. A deceleration to a 2.1% growth is expected for 2007.**

Since 2004, the trend in energy prices has been the main factor determining overall inflation movements, while domestic cost pressures are contained. Partly due to geopolitical tensions, oil prices peaked in May 2006, bringing the headline HICP inflation to 2.8% in Belgium and 2.5% in the euro area. On the back of persisting high oil prices, **the average of the participating institutions' inflation forecast has been revised upwards from 2.1% in March to 2.2% for 2006, and from 1.6% to 1.9% for 2007.**

According to provisional data published by the NAI in April 2006, the Belgian government closed its accounts with a surplus of 0.1% of GDP in 2005. Taking into account the stronger expected economic growth, **the primary dealers revised their forecast for the public deficit from 0.5% of GDP to 0.2%. For the year 2007, the deficit should deteriorate somewhat, reaching 0.8% of GDP.** It should be stressed that some - but not all - of the participants' forecasts include the effect of additional measures which may be taken by the government in drawing up the budget for 2007. **The debt ratio should continue to decline over the period, to 90.1% of GDP at the end of 2006 and 87.5% in 2007, converging with that of the euro area. Acknowledging that this movement should continue, two major rating agencies have recently improved the outlook or the actual rating for the long-term Belgian government bonds (see the Treasury Highlights section).**

HARMONISED INDEX OF CONSUMER PRICES

(annual percentage changes)



Source: EC.

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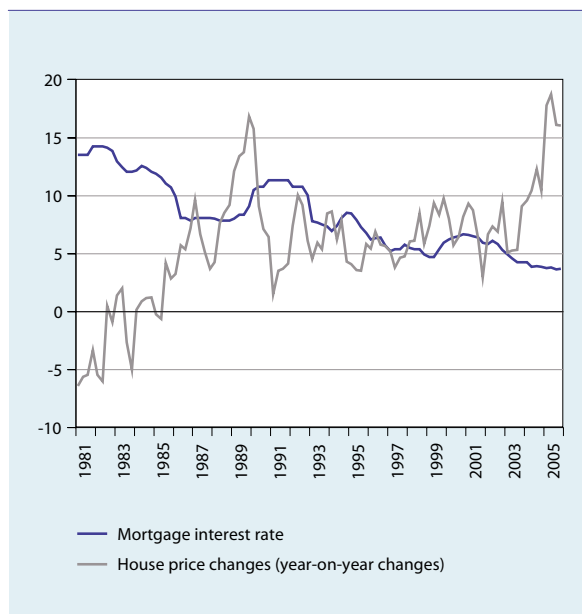
According to recently released statistics house prices in Belgium have increased continuously from 1985, nearly tripling in real terms over the last 20 years. In particular, it accelerated sharply the past two years, with a 8% growth rate in 2004 and 14% last year. As documented in the NBB's Financial Stability Review 2006, prices of apartments and building plots also increased vigorously, stepping up the average amount of new mortgage contracts for housing purchase purposes.

Apparently, the increase in house prices in 2005 is the highest among euro area countries, putting Belgium into the group of countries where the average annual rate of house price inflation over the last five years has been close to or beyond a double-digit figure. However, it has been larger in some other countries, namely in Spain, Ireland, France and Italy.

The bulk of the highly synchronised house price increases across the world can be explained by common factors, primarily the fall in both nominal and real terms interest rates, as demonstrated by a recent IMF study¹. This development has also been a crucial factor behind house price increases in Belgium, as reflected in the opposite chart. Other factors influencing house prices in Belgium include those affecting demand (real disposable income, demography, ...), supply (scarcity of building plots, ...) or the credit conditions.

House price increases seem to have decelerated somewhat in the course of 2005, and anecdotal evidence points towards a continuation of that trend in early 2006, in a context of interest rate increases. A further moderation in house prices cannot be excluded, in particular if mortgage interest rates continue rising.

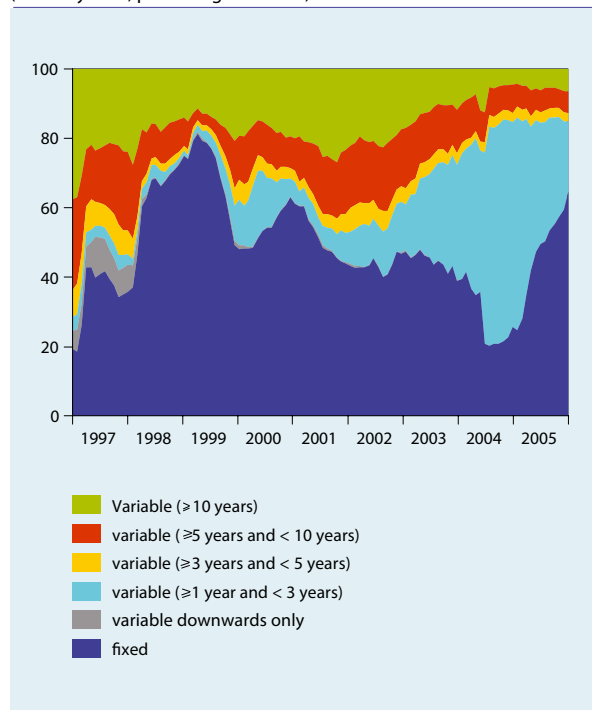
HOUSE PRICES AND INTEREST RATE



Sources: Stadim, NBB.

BREAKDOWN OF NEW MORTGAGE CONTRACTS BY TYPE OF RATE

(monthly data, percentages of total)



Source: UPC.

However, the impact of an interest rate increase on the mortgage debt service burden and income of households is mitigated in Belgium by two factors. Firstly, in contrast to the euro area where variable rate mortgages remained the most frequent form of contract, Belgian households reverted to the historically predominant fixed rate formula. In the case of new mortgage loans, the share of fixed rate contracts, which had fallen to around 20% in the course of 2004, climbed back during 2005, reaching almost 65% by December (see opposite chart). Furthermore, the available evidence suggests that mortgages with rates subject to review in the next 5 years still represent a very small share of the total stock of mortgage loans outstanding (below 5%). Secondly, the frequency and the extent of revisions under variable-rate contracts are limited both by legal provisions and by the increasing use of rate caps and accordion loans.

Also, the macroeconomic impact of a house price decline is likely to be limited. According to economic theory, there are three main ways in which a decline in house prices may depress aggregate demand and activity: it reduces demand for new housing, as it is relatively cheaper to buy an existing house ("Tobin's q"); it exerts negative wealth effects on consumption; it decreases the value of the guarantees that individuals are able to provide for lenders, making access to credit more difficult ("financial decelerator").

In practice, the effect of a decline in house prices is expected to be limited in Belgium since, as is the case in some other euro area countries including² Germany, France and Italy, econometric research on consumption has revealed no evidence of wealth effects³. One reason for this may be that the use of housing equity withdrawal (HEW) is limited. No HEW was apparent in Belgium over the period 1995-2005. This also applies to Germany, France and Italy, "countries where the deregulation of the mortgage market has been less extensive"⁴. As a matter of fact, private consumption grew in Belgium by a moderate 1.3% in both 2004 and 2005 at the time of the sharpest increases in house prices. Furthermore, the correlation between housing investment and house price changes appears to be quite low.

1 Terrones M. (2004), The global house price boom, in IMF (2004), World Economic Outlook.
 2 OECD (2005), Recent house price developments: the role of fundamentals, OECD Economic outlook, December.
 3 Eugène B., Ph. Jeanfils et B. Robert (2003), La consommation privée en Belgique, Working paper n°39, National Bank of Belgium.
 4 Blondal S. et N. Girouard (2001), House prices and economic activity, OECD Economics Department Working Papers, n°279.

Treasury highlights

1. The Treasury held its first OLO auction of 2006 on 27 March, accepting bids amounting to €2.305 billion for OLO 3.25% 09/2016 (OLO 47) and €0.950 for OLO 5.00% 09/2035 (OLO 44), totalling €3.255 billion. The bid-to-cover rate of the auction was 2.07.
2. On 17 May, the Treasury issued €4.0 billion of OLO 4.00% 03/2022 (OLO 48) through a syndicate led by Calyon, Citigroup, Fortis and Goldman Sachs. The transaction priced at 4 bp. over the OAT April 2021. This equates to a pricing less than 2 bp. over the OAT curve, equivalent to mid swaps less 16.5 bp. In terms of geographical allocation, French (36%) and UK-based (25%) investors stood out. Banks (35%) and Asset Managers (34%) took up the largest part. With this 15-year benchmark, Belgium now has on the run benchmarks at 10, 15 and 30 years.
3. On 2 May, FitchRatings increased its long-term rating for Belgian Government Bonds from AA to AA+, on the basis of the subsequent balanced government budgets and of the government's intention to further reduce debt. Earlier this year, on 28 March, Moody's Investors Service had changed its outlook for its long-term rating of Belgian Government Debt (Aa1) from stable to positive.

The OLO auction dates for 2006 are the following:

OLO AUCTIONS AND SYNDICATIONS

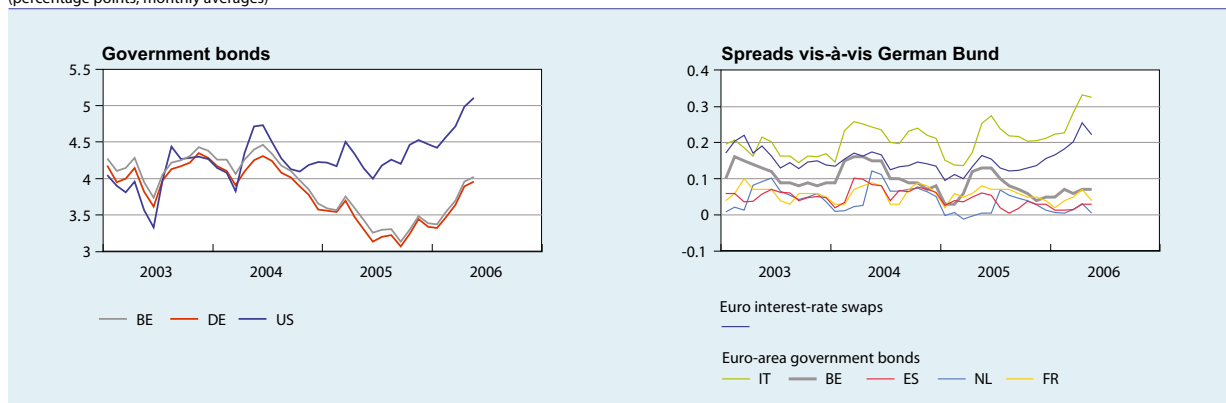
Month	Date	Settlement
July (Auction)	31	3 August
September (Auction)	25	28
November (Auction)	27	30

Please note that this schedule may be modified and that a syndicated new issue may replace an auction.

Government securities market

10-YEAR INTEREST RATES

(percentage points, monthly averages)



Sources: BIS, Datastream.

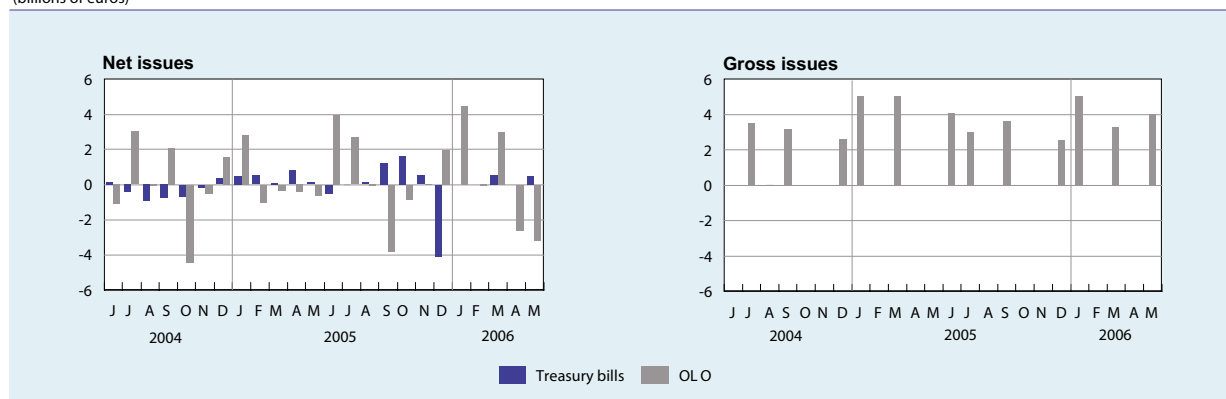
The upward trend in 10-year interest rates on government bonds, which started around mid 2005, continued in the first months of 2006. This development can be attributed to an increase in real interest rates, and to a slightly smaller increase in break-even inflation.

Government bond spreads vis-à-vis the German bund increased somewhat during the first four months of 2006 in most countries, and stabilized in May. The notable exception, however, is Italy, where the spread sharply increased. In France and the Netherlands, spreads declined in May.

The spread on Euro interest-rate swaps continued rising between January and April 2006, thus maintaining the gradual upward trend seen at the end of 2005. This upward movement ended in May 2006, when this spread declined.

PRIMARY MARKET

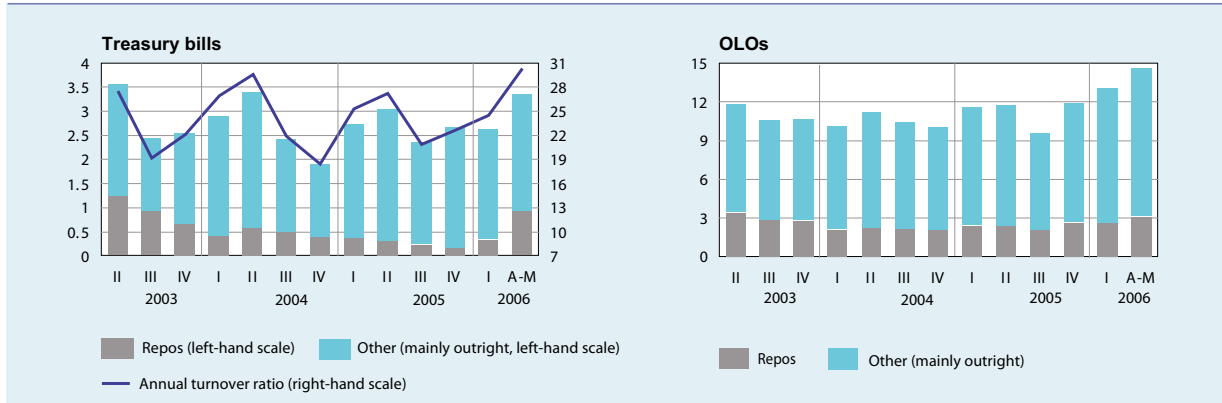
(billions of euros)



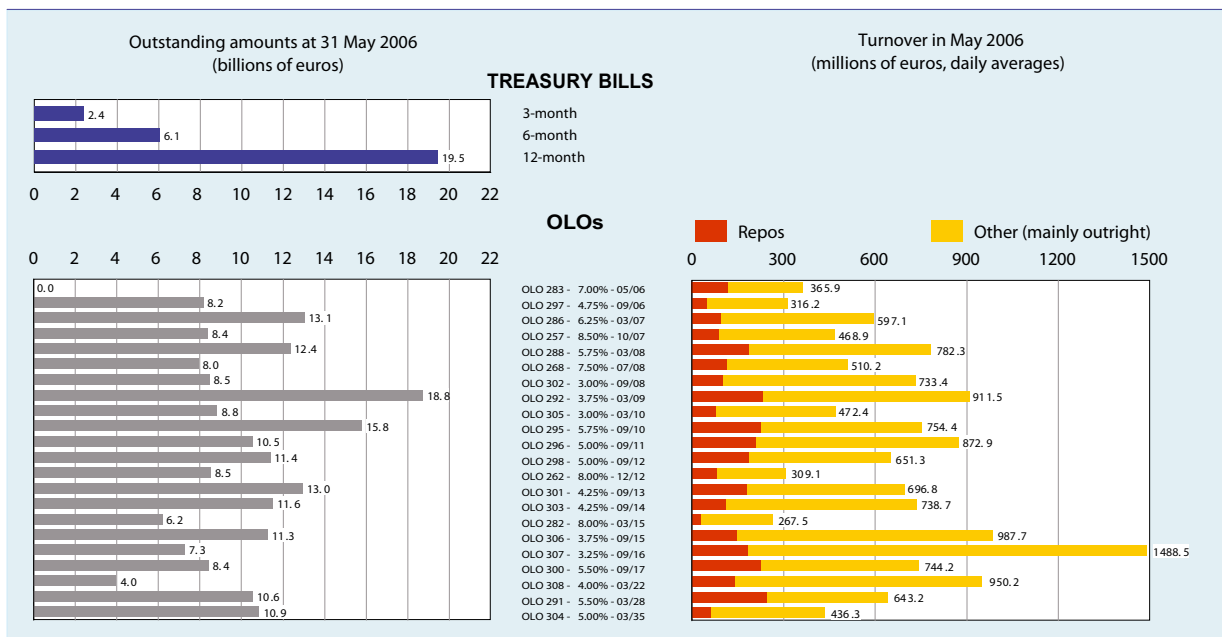
Government securities market (continued)

SECONDARY MARKET

(billions of euros unless otherwise mentioned, daily averages)



OUTSTANDING AMOUNT AND TURNOVER



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Fortis Bank

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UBS Limited

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Published by: National Bank of Belgium (NBB)

Sources: NBB, unless otherwise stated.

This publication is also available on the internet site www.nbb.be.

Information on the Belgian government debt can be found on the Treasury website: www.debtagency.be.

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