Participating Primary Dealers: Barclays Capital, Citigroup, Dexia Bank, Fortis Bank, ING, KBC Bank, Société Générale, UBS Limited

Belgian Prime News

QUARTERLY PUBLICATION

No. 35 March 2007

Special topic: Notional interest and financial choices for firms

Cut-off date: 27 March 2007

Next issue: June 2007

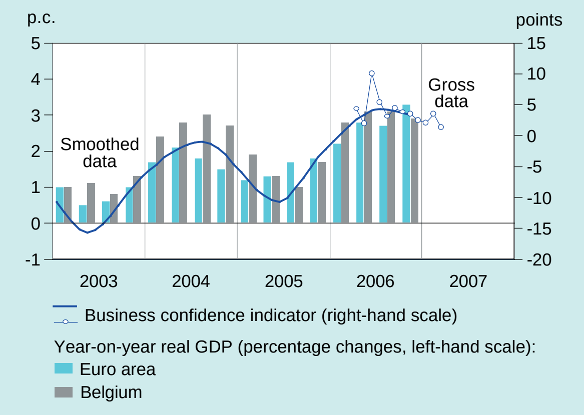
Consensus: Average of participants' forecasts

	2006		2007 p			2008 p	
			Belgium			Belgium	
	Belgium	Euro area	Consensus	Previous consensus	Euro area[4]	Consensus	Euro area[4]
Real GDP[1]	3.0	2.7	2.3	2.1	2.1	2.2	2.2
Inflation (HICP)[1]	2.3	2.2	1.9	1.9	2.1	1.9	1.9
General government balance[2] [3]	0.1	-2.0	-0.1	-0.1	-1.5	0.0	-1.3
Primary balance[2] [3]	4.2	0.9	3.6	3.7	1.4	3.6	1.5
Public debt[2] [3]	89.1	69.5	85.2	86.7	68.0	81.9	66.9

(1) P.c. change.
(2) In p.c. of GDP.
(3) EDP definition. Taking account of Eurostat's decision that the Railway Infrastructure Fund is part of the general government sector.
(4) European Commission (forecast available since November 2006).

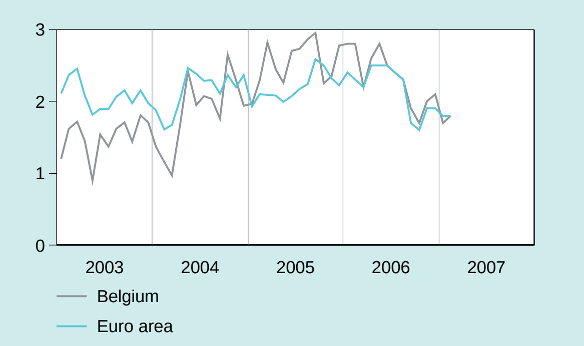
Macroeconomic developments

GDP GROWTH AND BUSINESS CYCLE INDICATOR



Sources: EC, NAI, NBB.

HARMONISED INDEX OF CONSUMER PRICES
(annual percentage changes)



Source: EC.

In Belgium, annual GDP growth increased from 1.5% in 2005 to 3% in 2006. Although quarter-on-quarter growth moderated somewhat in the course of 2006, it still amounted to 0.6% in the last quarter, according to the NAI's flash estimate. The recent developments in the NBB business survey indicator point to sustained growth in the first part of 2007 as well. The moderation in the smoothed synthetic curve since its historical peak of July 2006 has been smaller than during similar periods since the start of the 1990s. In combination with the better than projected outcome for the second half of 2006 and the improved economic outlook for Germany and the euro area as a whole, this **led the primary dealers to upgrade their growth forecast for 2007, from 2.1% to 2.3%. For 2008, the average of the forecasts is 2.2%.** Economic growth is therefore expected to be more in line with potential. The main downward risks to this outlook relate to the growth outlook in the United States and the persisting global imbalances.

HICP inflation moderated from 2.5% on average in 2005 to 2.3% in 2006, primarily because of the lower energy price inflation. The developments in energy prices were also the main factor behind the rather volatile inflation movements in recent months. HICP inflation peaked at 2.1% in December 2006, before slowing down markedly to 1.7% in January. The subsequent increase in HICP inflation to 1.8% in February, however, was also driven by a small rise in the underlying trend of inflation, as the prices of services and processed food accelerated somewhat. Overall, inflationary pressures are expected to remain well contained: **the average of primary dealers' inflation forecasts for 2007 stood unchanged at 1.9%, a level they on average expected for 2008 as well.**

According to the NBB's Annual Report estimate, the general government budget recorded a small surplus in 2006. **For 2007 and 2008, the primary dealers on average expect a minor deficit of 0.1% of GDP and a balanced budget respectively.** It should be stressed, however, that only some of the participants' forecasts already include the effect of additional measures which may be taken by the government. **The debt ratio should continue to decline and reach 85.2% of GDP at the end of 2007 and 81.9% at the end of 2008.**

Special topic: Notional interest and financial choices for firms

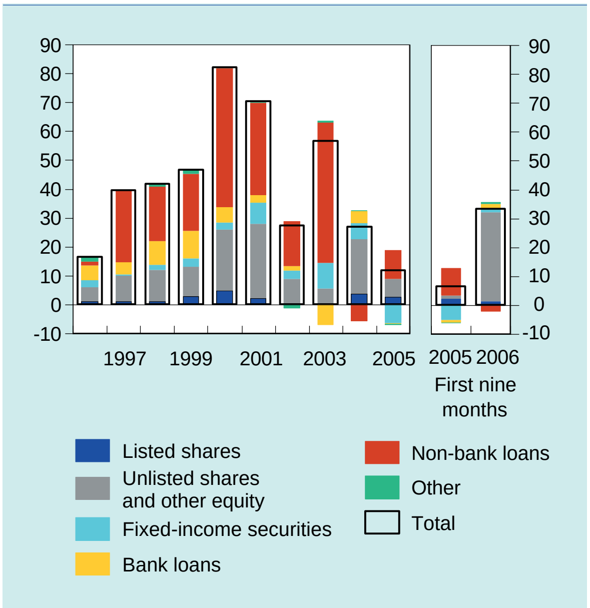
Introduced by the law of 22 June 2005 and entering into force on 1 January 2006, the notional interest deduction (NID) allows to lower the tax base by a part of the equity capital, calculated by multiplying the equity - after adjustment for certain factors - by a notional rate of remuneration on the capital. This notional rate is the average annual yield on ten-year linear bonds. Because of their riskier profile and more difficult access to the financial markets, SMEs are allowed a 0.5 percentage point increase in their reduction rate. It is also worth mentioning that the introduction of the NID was accompanied by the abolition of the 0.5 p.c. registration fee for capital contributions.

Intended to reduce the present discrimination between debt financing and equity financing, the NID should also enhance the country's fiscal attractions for both Belgian and foreign investors by reducing the tax burden for all firms established in Belgium. Moreover, since it is by definition more attractive for the most heavily capitalised companies, it offers a viable alternative to the planned dismantling of the coordination centre regime.

The NID will probably have a structural influence on the financial behaviour of economic agents in Belgium. Already in the first nine months of 2006, share issues totalled 32.1 billion euro, a huge increase on the previous year (3.2 billion). The NID may influence the financing choices of companies already established in Belgium. That influence may vary according to the type of investor: individual or corporate, resident or non-resident.

To gain an understanding of the impact of the NID on corporate financing choices, two "fictitious" companies with different financing methods are considered in the table below: the first (company A) is financed exclusively by debt, while the second (company B) is financed exclusively via its own resources. Before the introduction of the NID, debt financing is clearly the first preference for individual investors, followed by equity financing without payment of dividends and finally equity financing with payment of dividends. By financing through another company within the same group, debt financing gives the same outcome as a shareholding with retained earnings, where a shareholding with regular dividend payments attracts very slightly less favourable tax treatment.

NEW FINANCIAL LIABILITIES OF NON-FINANCIAL CORPORATIONS
(billions of euro)



Source: NBB.

After the introduction of the NID and maximum use of its benefits by company B, the net position of an individual investor is better in the case of an investment in equities with capital gains than in the case of a bond investment. However bond investments are still more attractive than equity investments with dividend payments, although the yield differential between these two alternatives is considerably reduced in favour of equity investments. In the example with the financing between entities within the same group, the group's net position will now be decidedly better in the case of equity financing and debt financing will be relegated to the last position.

To conclude, before the introduction of the NID, there was tax discrimination between debt and equity, primarily at the level of the taxation of the individual investor's income, but there was virtually no discrimination if the finance was arranged within the group. The introduction of the NID effectively enhances the attractions of equity and, by reducing the tax burden, enables companies to pay their shareholders a better return.

Choice of financing before and after introduction of the notional interest deduction (NID)

	Before the NID			**After the NID**		
	Company A	Company B		Company A	Company B	
	Loan with interests	***Shareholding with dividends***	***Shareholding with capital gains***	***Loan with interests***	***Shareholding with dividends***	***Shareholding with capital gains***
Profit before taxes and financial expenses	100	100	100	100	100	100
Interest charges	100	-	-	100	-	-
Notional interest	-	-	-	-	100	100
Profit after taxes and interest charges	0	66	66	0	100	100
Investor's income	Creditor	Shareholder		Creditor	Shareholder	
1. Belgian individual	**85.0** (withholding tax of 15 p.c. on interest received)	49.5 (withholding tax of 25 p.c. on dividends received)	66.0 (no tax on capital gains)	85.0 (withholding tax of 15 p.c. on interest received)	75.0 (withholding tax of 25 p.c. on dividends received)	**100.0** (no tax on capital gains)
2. Belgian parent company	**66.0** (all interest received taxed at corporate tax rate)	64.9 (5 p.c. of dividends received taxed at corporate tax rate)	**66.0** (no tax on capital gains)	66.0 (all interest received taxed at corporate tax rate)	98.3 (5 p.c. of dividends received taxed at corporate tax rate)	**100.0** (no tax on capital gains)

Treasury highlights

1. In keeping with tradition, the Treasury opened its annual borrowing programme with a new 10-year benchmark bond. On January 16, €5,000,000,000 of OLO49 4.00% 03/2017 was issued through a syndicate led by ABN AMRO, Deutsche Bank, HSBC and KBC.
   The transaction was a remarkable success. Books were closed after one day of book building – they were arguably left open overnight for Asian investors in order to give them a last chance to participate - resulting in a final orderbook of over €16 billion coming from 215 accounts. Pricing, at DBR 3.75% Jan 2017 + 6bp, was at the tight end of the initial guidance.
   The distribution was as follows:

By region			
Belgium	19.5%	Other Eurozone	6.1%
Germany	8.3%	Scandinavia (non-euro)	4.0%
France	18.4%	Asia	7.5%
Italy	6.8%	US, CH, new EU	5.2%
Netherlands	3.5%	UK	20.6%

By type of investors			
Fund Managers	25.4%	Insurance	5.0%
ALM/Bank Customers	28.5%	Corporate	1.9%
Banks	13.4%	Pension Funds	3.2%
Hedge Funds	11.4%	Retail	0.6%
Central Banks	10.5%	Other	0.2%

2. In the framework of its policy of early redemption of OLOs with a short remaining life to maturity, the Treasury organised a reverse auction on February 12, 2007 for all OLOs maturing in 2008. In total, an amount of € 2,648,000,000 has been bought back.

OLO	Amount bought back
OLO 5.75% 28/03/2008 (OLO28)	€ 1,015,000,000
OLO 7.50% 29/07/2008 (OLO16)	€ 918,000,000
OLO 3.00% 28/09/2008 (OLO42)	€ 715,000,000

The OLO auction dates for the remaining of 2007 are the following:

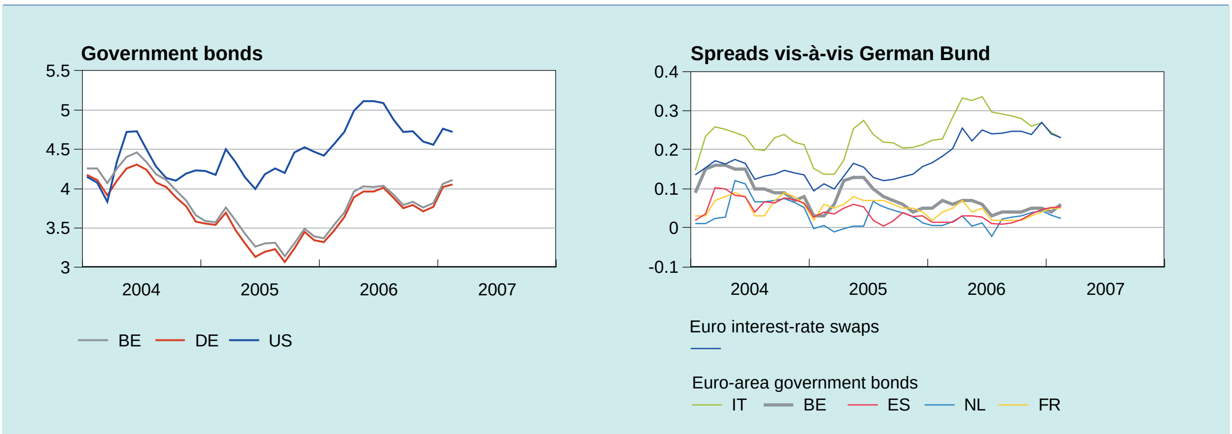
Issuance date	Settlement date
21 May	24 May
30 July	02 August

Issuance date	Settlement date
24 September	27 September
26 November	29 November

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)

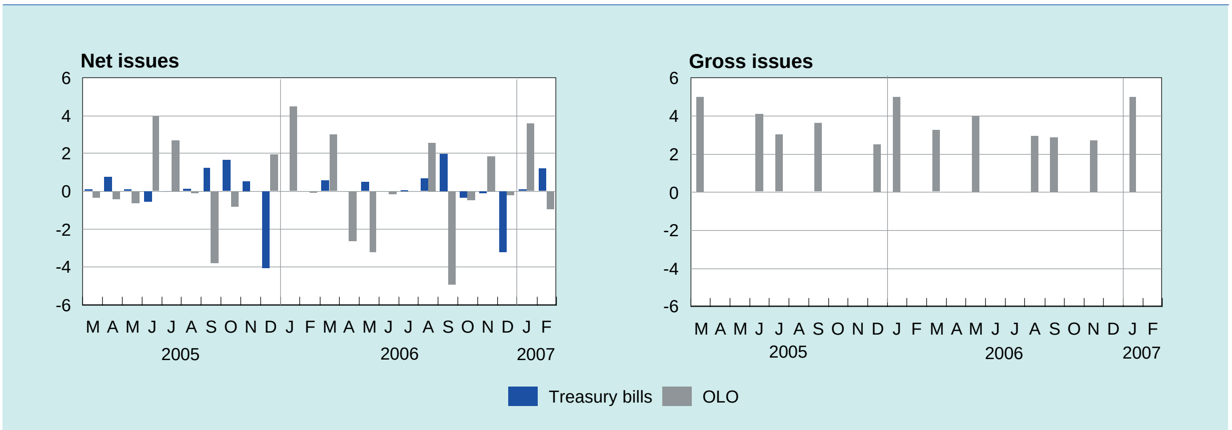


Sources: BIS, Datastream.

The decline in the 10-year interest rates on government bonds, which started this summer, came to an end in December. The subsequent rise was more pronounced in the euro area where it was due to higher real yields, while the more modest increase in the United States was also caused by a small rise of the break-even inflation rate.

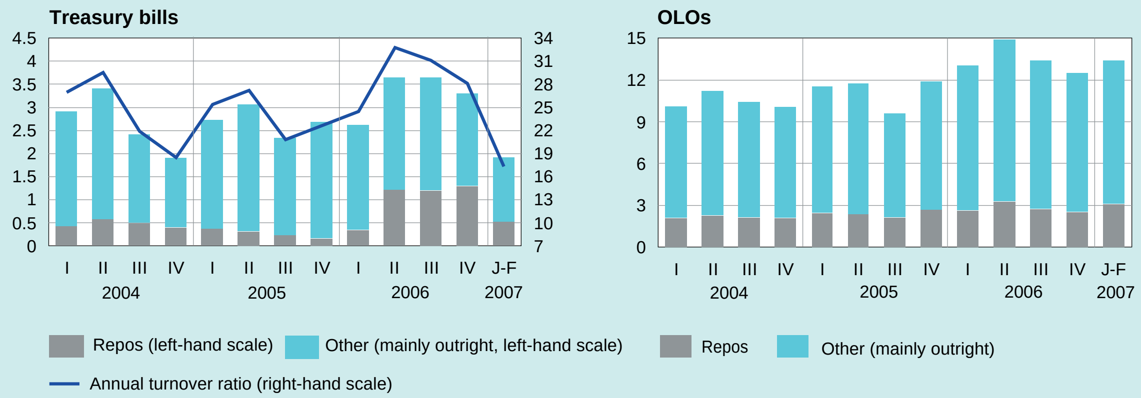
Most government bond spreads vis-à-vis the German Bund fluctuated between very small margins. The Italian government bond spread and the spread on euro interest rate swaps narrowed somewhat.

PRIMARY MARKET
(billions of euros)

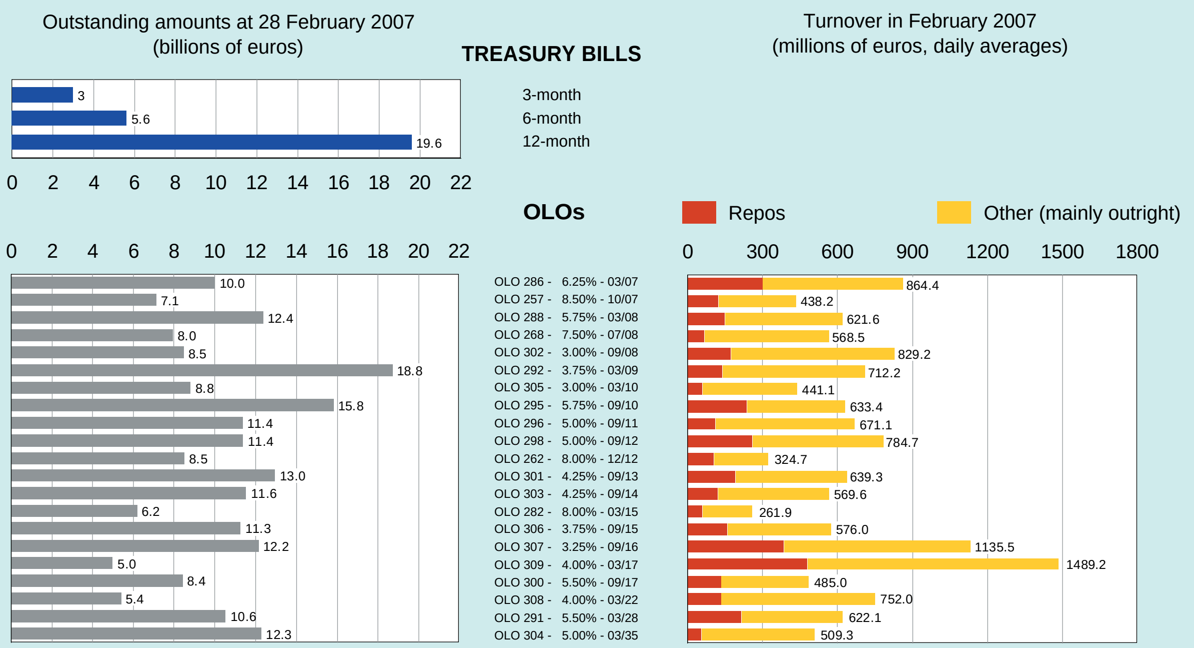


Government securities market (continued)

SECONDARY MARKET
(billions of euros unless otherwise mentioned, daily averages)



OUTSTANDING AMOUNTS AND TURNOVER



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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.