BELGIAN DEBT AGENCY

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

NationalBank OF BELGIUM
Eurosystem

Belgian Prime News

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No. 36 June 2007

Special topic : Potential output growth in Belgium

Cut-off date : 22 June 2007

Next issue: September 2007

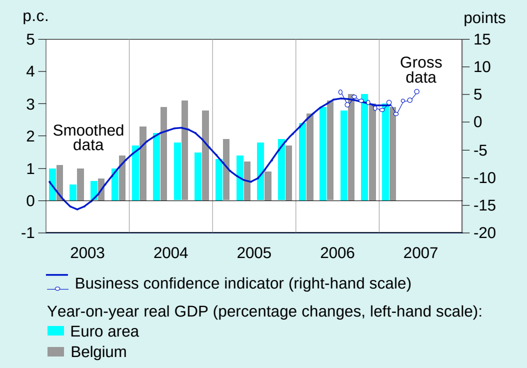
Consensus : Average of participants' forecasts

	2006		2007 p			2008 p		
	Belgium	Euro area	Belgium		Euro area[4]	Belgium		Euro area[4]
			Consensus	Previous consensus		Consensus	Previous consensus	
Real GDP[1]	3.0	2.7	2.6	2.3	2.6	2.2	2.2	2.5
Inflation (HICP)[1]	2.3	2.2	1.7	1.9	1.9	1.9	1.9	1.9
General government balance[2] [3]	0.2	-1.6	-0.1	-0.1	-1.0	-0.1	0.0	-0.8
Primary balance[2]	4.3	1.3	3.8	3.6	1.9	3.6	3.6	2.0
Public debt[2]	88.8	69.0	85.1	85.2	66.9	82.0	81.9	65.0

(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 (Spring forecast published in May 2007).

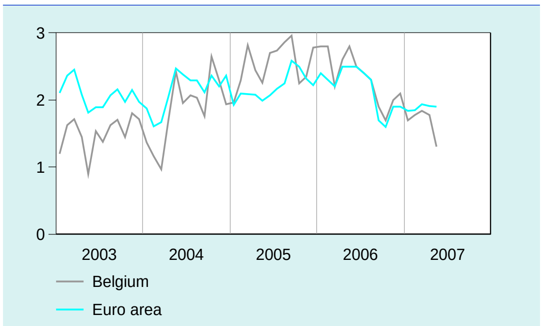
Macroeconomic developments

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 has moderated slightly since the peak of 3.3% in the third quarter of 2006, but it remained buoyant at 2.9% in the first quarter of 2007. The expansion in early 2007 was boosted by both foreign and domestic demand, the latter being supported by the improved labour market situation and strong investment. Moreover, the continued high level of both business and consumer confidence points to sustained growth in the second quarter of 2007 as well. In combination with the better than expected outcome for the first quarter and the improved economic outlook for Germany and the euro area as a whole, this **led the primary dealers to further upgrade their growth forecast for 2007, from 2.3% to 2.6%. For 2008, the average of the forecasts remains unchanged at 2.2%.** This moderation compared to 2007, reflecting the expected easing of domestic demand, would bring the rate of expansion back in line with potential output growth. The growth outlook for Belgium does not differ substantially from that for the euro area as a whole. The latter has also improved, as the rise in VAT in Germany scarcely seems to have weighed on growth, contrary to what had been feared some months ago, suggesting that the German economy should be able to consolidate the upturn of 2006. However, there are still downside risks to these growth outlooks, as the correction on the US housing market could become a larger drag on both the US and the world economy than is currently expected, and long-term interest rates could rise higher than anticipated.

Annual HICP inflation in Belgium slowed down in the first few months of 2007 to fall markedly to 1.3% in May. This drop can be explained by lower energy price inflation, which in turn resulted from lower oil prices, on the one hand, and from the liberalisation of the gas and electricity markets in Brussels and Wallonia, as well as the new method of recording these energy prices in the consumer price index, on the other hand. By contrast, the underlying trend in inflation has increased somewhat, as was also the case in other countries both in and outside the euro area, which fuelled expectations of some further monetary policy tightening. Overall, however, inflationary pressures should remain well contained. Following the subdued inflation outcome in early 2007, **the average of primary dealers' inflation forecasts for 2007 was revised downwards to 1.7%, but they still expect an inflation rate of 1.9% for 2008.**

Notwithstanding the supportive economic outlook, **the primary dealers on average expect the general government budget to show a slight deficit of 0.1% of GDP in both 2007 and 2008**, after the surplus of 0.2% in 2006. Attaining the goals set out in the latest stability programme of December 2006 (i.e. a surplus of 0.3% and 0.5% of GDP respectively in 2007 and 2008) will therefore most likely require additional measures.

Special topic : Potential output growth in Belgium

Potential output refers to the level of output that can be supplied sustainably over time, i.e. without generating imbalances on the product and labour markets, as determined by the available amounts of labour and capital in the economy and by the efficiency with which these production factors are used. Since an economy's potential output cannot be measured directly, it has to be estimated. Having a reliable estimate of potential output growth is important for several reasons. First, an economy's growth potential is a crucial determinant of the prosperity of its population. Second, the concept is also used to assess the cyclical position of economic activity and the associated inflationary pressures, which is important for the conduct of monetary policy. Finally, an economy's growth potential also arises in connection with the management of public finances.

The potential growth estimates that are published by international institutions, like the EC, the IMF and the OECD, are generally quite comparable, although they rely on different procedures. They all suggest that the growth potential of the Belgian economy has been somewhat above 2% on average over the past ten years. A similar outcome is found for the euro area as a whole, but the growth potential of the US economy is estimated to have been clearly higher over the same period. Differences in potential output growth between countries reflect different developments in the labour force and/or in apparent labour productivity. The better growth performance of the United States over the past ten years almost exclusively derives from stronger labour productivity growth. Numerous studies have highlighted that this was largely attributable to the role played by information and communication technologies (ICT). First, the manufacturing sector producing ICT is relatively large and these branches are noted for rapid technological progress. Second, investment in ICT increased, as the combination of improved performance of these products and a fall in their price caused labour to be replaced by less expensive capital, raising the capital intensity in ICT. Third, the diffusion of ICT throughout the US economy also led to a rise in productivity growth in all ICT-using branches. The growth rates of the labour force in both Belgium and the United States were broadly the same on average over the past ten years. However, it is worth noting that, in terms of levels, the number of hours worked per capita in Belgium is still about 30% lower than in the United States. This is the main factor accounting for the lower GDP per capita.

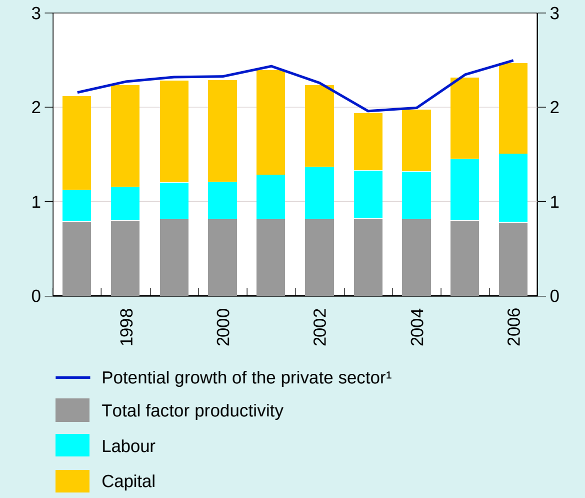
ESTIMATES OF POTENTIAL GROWTH OF TOTAL ECONOMY
(percentage changes, averages over the period 1997-2006, unless otherwise stated)

	Belgium	Euro area	United States
EC	2.1	2.1	n.a.
IMF	2.2	2.1	3.4
OECD	2.1	2.1	3.0
p.m. GDP per capita[1]	*77.6*	*70.2*	*100.0*
p.m. Hours worked per capita[1]	*71.1*	*81.1*	*100.0*

Sources: EC, IMF, OECD.
[1] Data refer to 2005, indices (United States = 100), GDP data are based on current purchasing power parities.

Looking at long-term averages of the growth potential of an economy masks its variation over time, which could give an indication in real time of the impact of structural reforms, or structural change more generally, on the potential growth rate. The time profile of the growth potential of the Belgian economy over the past ten years is analysed in a standard growth accounting framework, considering three main components, namely labour, capital and total factor productivity (TFP) as described in Rigo (2005)[1]. Although the variations in the potential growth rate of the private sector have generally been limited, the volatility has been somewhat higher in recent years. After falling by 0.5 percentage point between 2001 and 2003, the estimated growth potential accelerated from 2005 onwards and reached 2.5% in 2006. Looking at the breakdown, it becomes clear that the estimated potential growth rate does contain a cyclical component which can be attributed to the contribution of the capital stock. As firms cut back their investment in 2002 and 2003, the contribution of the capital stock dropped by 0.5 percentage point. Since then, it has almost fully recovered as a result of the investment revival. By contrast, the contribution of labour has almost constantly increased, from 0.3 percentage point at the start of the analysis period to 0.7 percentage point in 2006, due to the faster growth of the working age population, which in turn reflected an increase in net immigration. Finally, the contribution of TFP has remained broadly stable at 0.8 percentage point over the past ten years. By construction, this TFP reflects the influence on output of all the factors which are not captured by the respective measurements of labour and capital, such as the skills of the labour force or the degree of technology intensity of the machinery. It should not be seen as a good measure of technological progress, since variations in TFP could, for instance, also be induced by changes in the distribution of skills or by shifts among productive sectors with different TFP. Identifying the impact of technological progress more accurately would require supplementing the results based on aggregate data with findings based on industry-level data.

POTENTIAL GROWTH OF THE PRIVATE SECTOR AND DETERMINANTS
(contributions to the yearly growth rate of the potential value added of the private sector, unless otherwise stated)



Source: NBB.
[1] Percentage change compared to the previous year.

All in all, the recovery in potential output growth in recent years was mainly driven by the booming investment of the private sector, which should be seen against the background of very weak investment in the period 2002-2003 and of robust demand prospects and favourable financing conditions in recent years. To the extent that the impact of these factors is expected to moderate in the years to come, the recent upturn in the Belgian economy's growth potential is no cause for complacency. This is all the more true since the adverse trend in the working age population that is forecast for the not too distant future should start to weigh on potential output growth. Although Belgium will most likely be affected less than the South European countries and Germany, it is necessary to reinforce measures to support the growth potential of the Belgian economy. On the one hand, efforts should be directed towards increasing the rate of expansion of the labour force. This would, for instance, involve raising the participation rate of the population aged 15 to 64 or efficiently integrating immigrants into the labour market. On the other hand, the slower growth of the working age population could be offset by higher productivity gains. To this end, measures could be taken which aim at upgrading the skills of the labour force, promoting two-way knowledge transfers between enterprises and researchers or at fostering innovation. The services sector seems to be a particularly suitable target for increasing productivity gains. Not only have recent studies shown that this sector has been lagging behind in terms of productivity growth in recent years, but it also accounts for a large share of the total economy.

[1] Rigo, C. (2005), "The potential growth of the Belgian economy and its determinants", NBB Economic Review, 3, pp.45-64.

Treasury highlights

1. On 26 March, the Treasury organised the first OLO auction of 2007, issuing €2.965 billion, distributed among the following lines:

OLO 5.00% 09/2012 (OLO39): €0.320 billion	OLO 4.00% 03/2017 (OLO49): €1.215 billion	OLO 4.00% 03/2022 (OLO48): €1.430 billion
Weighted average yield: 3.986%	Weighted average yield: 4.074%	Weighted average yield: 4.189%

   The auction had a bid-to-cover ratio of 2.64.

2. The Treasury issued its second new benchmark of 2007 on 24 April. The 4.00% €5 billion OLO50, maturing 28 March 2013 has been launched through a syndicate led by Barclays Capital, Dexia Capital Markets, JP Morgan and Société Générale Corporate & Investment Banking.

   In choosing between a new 5-year or a new 30-year maturity, the 5-year tenor was viewed as the most responsive to the then prevailing bearish market conditions.

   The issue experienced an extremely fast book-building process, with an order book closed by close of business on the first day of book building. The order book totalled €16.3 billion, allowing a pricing of 3bp over the Bund.

   The distribution by type of investor and by geographic region was as follows:

By region				By type of investors			
Belgium	15%	UK	24%	Asset Managers	28%	Hedge Funds	11%
France	14%	US	8%	Bank ALM	19%	Insurance Comp.	5%
Other euro area	21%	Asia	8%	Banks	18%	Pension Funds	5%
Europe non-euro	8%	Africa	2%	Central Banks	14%		

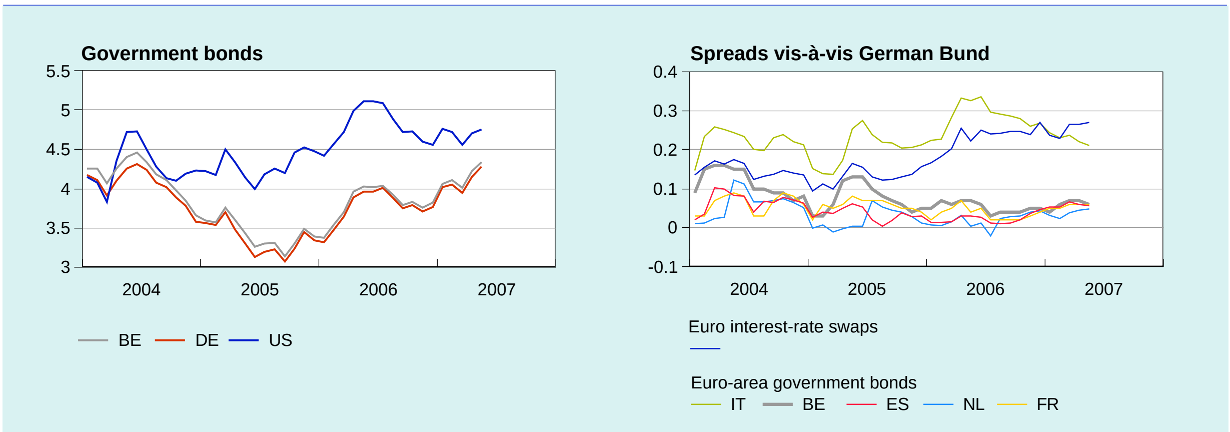
The OLO auction dates for the rest of 2007 are the following:

Issuance date	Settlement date
30 July	02 August
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)



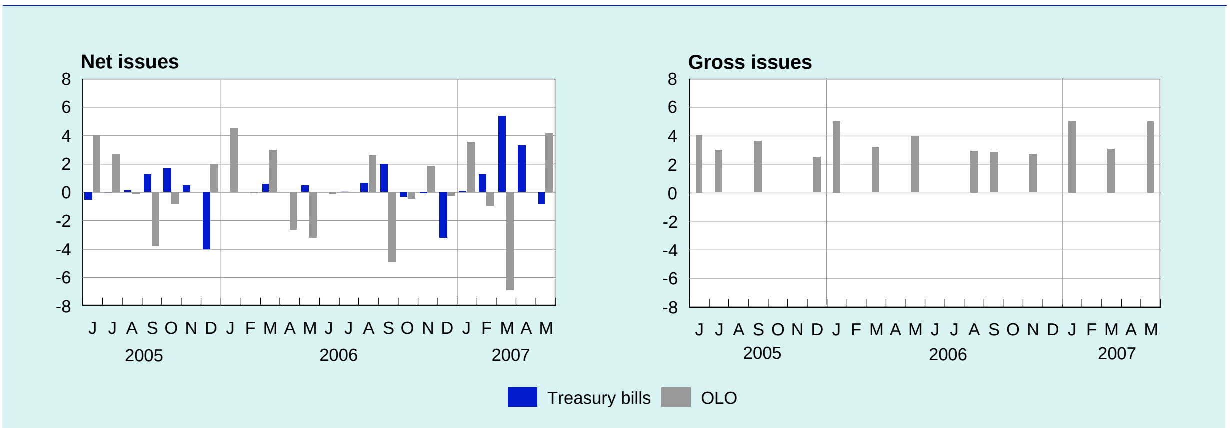
Sources: BIS, Datastream.

In the euro area, the rise of the 10-year interest rate continued since the beginning of the year, mainly due to higher real yields.

In the United States, the long-term interest rate fluctuated around the level of the end of 2006 with a clear narrowing of the 10-year spread between the euro area and the US as a result.

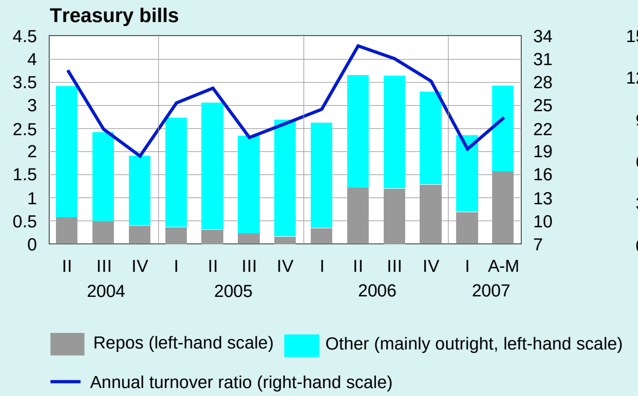
Most government bond spreads vis-à-vis the German Bund, as well as the spread on euro interest-rate swaps, fluctuated between very narrow margins, while the Italian bond spread was further reduced, continuing a trend that started in mid-2006.

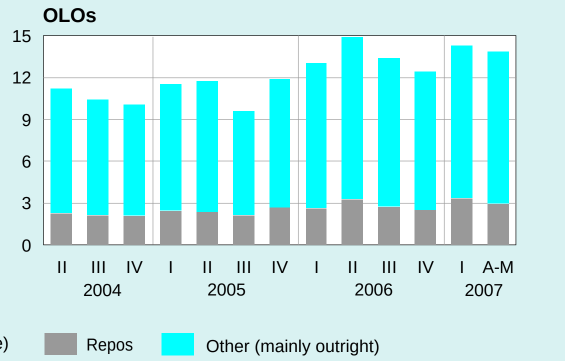
PRIMARY MARKET
(billions of euros)



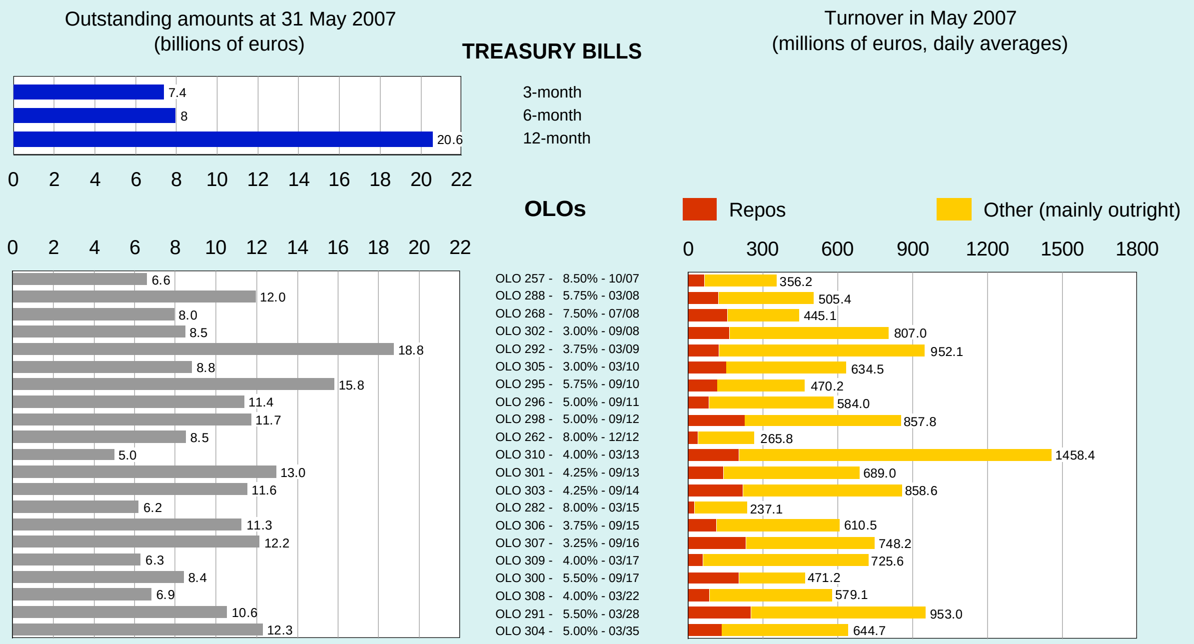
Government securities market (continued)

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





OUTSTANDING AMOUNTS AND TURNOVER



List of contacts

PARTICIPATING INSTITUTIONS	TECHNICAL EDITORS	TELEPHONE	FAX
Federal Public Service Finance	Mr Jean Deboutte	+ 32 2 233 72 79	+ 32 2 233 71 48
Barclays Capital	Ms Laurence Boone	+ 33 1 44 58 32 36	+ 33 1 44 58 32 92
Citigroup	Mr Jean Mercier	+ 44 20 7986 3292	+ 44 20 7986 3280
Dexia Bank	Mr Jacques de Pover	+ 32 2 222 44 71	+ 32 2 222 33 76
Fortis Bank	Mr Filiep Wyseur	+ 32 2 565 86 49	+ 32 2 565 62 36
	Mr Wim Bosman	+ 32 2 565 31 84	+ 32 2 565 24 18
ING	Mr Peter Vanden Houte	+ 32 2 547 80 09	+ 32 2 547 80 63
	Mr Ivan Van de Cloot	+ 32 2 547 31 61	+ 32 2 547 31 63
KBC Bank	Mr Bart Van Craeynest	+ 32 2 429 59 91	+ 32 2 429 42 57
Société Générale Corp. & Inv. Banking	Ms Véronique Riches-Flores	+ 33 1 42 13 84 04	+ 33 1 42 13 71 33
UBS Limited	Mr Stephane Deo	+ 33 1 48 88 30 36	+ 33 1 47 63 48 08
GENERAL INFORMATION			
National Bank of Belgium	Mr Luc Dresse	+ 32 2 221 20 39	+ 32 2 221 31 62

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