

Belgian Prime News



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Special topic: Short-term viability versus long-term sustainability

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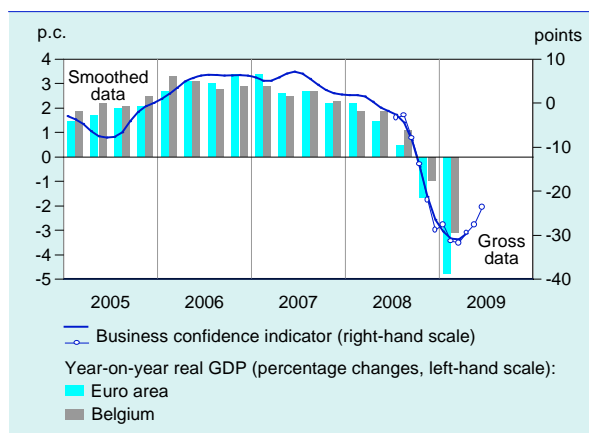
Consensus: Average of participants' forecasts

	2008		2009 p		2010 p	
	Belgium	Euro area	Belgium	Euro area	Belgium	Euro area
Real GDP ⁽¹⁾	1.0	0.6	-3.2 (-2.4)	-4.3 (-2.6)	0.8 (0.8)	0.6 (0.6)
Inflation (HICP) ⁽¹⁾	4.5	3.3	0.3 (0.7)	0.4 (0.6)	1.3 (1.4)	1.2 (1.4)
General government balance ⁽²⁾	-1.2	-1.9	-4.4 (-3.3)	n.	-5.1 (-3.9)	n.
Primary balance ⁽²⁾	2.5	1.1	-0.4 (0.4)	n.	-1.1 (0.1)	n.
Public debt ⁽²⁾	89.7	69.3	95.4 (92.8)	n.	99.0 (94.6)	n.

Numbers in parentheses refer to the previous consensus forecast of March 2009.
(1) Percentage changes. (2) EDP definition; percentages of GDP. n. Not available.

Macroeconomic developments

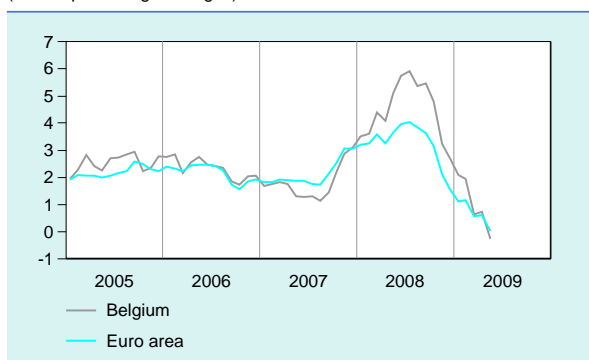
GDP GROWTH AND BUSINESS CYCLE INDICATOR



Sources: EC, NAI, NBB.

HARMONISED INDEX OF CONSUMER PRICES

(annual percentage changes)



Source: EC.

Economic activity continued to contract sharply in the first quarter of 2009. According to national accounts data, real GDP in Belgium was down by 1.7%, after having dropped to a similar extent in 2008Q4, which means the deepest recession since World War II. The downturn has been characterised by an unprecedented fall in industrial production and global trade. Developments in the euro area over the first quarter were even more depressed as, besides the industrial sector, the correction of housing markets, internal and external imbalances, have hit the euro area member states to various extents.

As the downturn over the first months of 2009 has again been sharper than anticipated, **primary dealers revised their forecast for GDP growth in 2009 downwards to -3.2%**. These estimates also take into account a growing number of tentative signals that the activity is likely to recover somewhat or at least that the decline will be at much less negative rates than in the recent past. Over the last months, business and consumer confidence indicators improved, albeit from very low levels, whereas tensions on financial markets ebbed away further. This growing optimism over the short term also explains why **the average of the participants' forecasts has not been downgraded and was left unchanged at 0.8% for 2010**. It should be pointed out that this figure is surrounded by a great deal of uncertainty, shown by the broad range of individual forecasts, varying from -0.2% to 1.7%. Nevertheless, the consensus implies that, although a recovery would start, economic growth would remain below trend, resulting in continued excess capacities, rising unemployment and further worsening fiscal deficits. If not properly tackled, these developments might jeopardise our growth perspectives also over a longer horizon and thus call for sensible policy actions as set out in the Special Topic.

The sharp deceleration of annual HICP inflation continued in Belgium and the euro area. In May, inflation in Belgium even turned negative and stood at -0.2%, compared to 5.1% one year earlier and 0% for the euro area. This situation of negative inflation is due to strong base effects from the substantial past fall in oil prices and should only last for a few months. Continued positive underlying inflation figures indicate that inflation would revert to positive figures once these base effects die out.

■ Macroeconomic developments (continued)

All in all, **primary dealers expect inflation to pick up from 0.3% in 2009 to 1.3% in 2010**, which is comparable to developments in the euro area. The estimates were revised downwards compared to the March consensus and remain rather low due to the subpar economic activity outlook, the downward pressures of which still dominate upward risks related to the recent pickup in commodity prices.

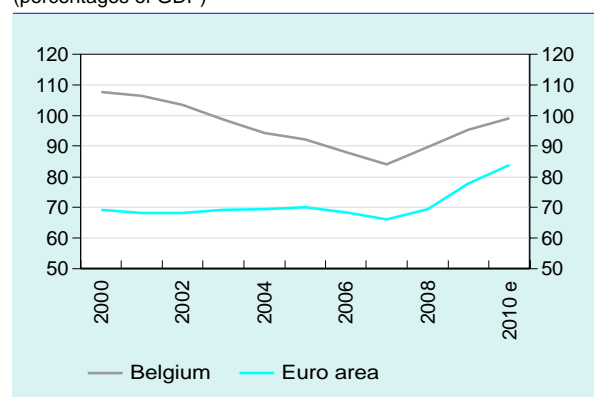
Within this bleak context, **primary dealers expect the general government balance to go on worsening from -1.2% in 2008 to -4.4% and -5.1% of GDP in 2009 and 2010**. The sharp deterioration in 2009 mainly results from the operation of automatic stabilisers, as well as, to a lesser extent, the recovery plan. As a consequence, the **public debt-to-GDP ratio is expected to increase to 99% in 2010**, which is almost 10 percentage points higher than in 2008. Since some participants anticipate possible measures of fiscal consolidation in their forecasts, these deteriorations are clearly worrisome. An ambitious and challenging effort will be required to safeguard financial sustainability and to maintain our long-term growth perspectives.

■ Special topic : Short-term viability versus long-term sustainability

Around the turn of the year, the global economic downturn proved to be faster, deeper and more widespread than anticipated. In Belgium, GDP showed the largest consecutive quarterly falls in 2008Q4 and 2009Q1 in post-war history. The recession has been characterised by a worldwide synchronicity and an accompanied unprecedented fall in world trade and industrial production.

In view of this abrupt fall in economic activity, considerable policy measures were taken to stimulate aggregate demand and to alleviate the pressures in the financial sector underlying the downturn. Central banks significantly eased monetary conditions, by lowering policy rates considerably and by modifying their operational monetary framework allowing for unconventional liquidity-providing measures. At the same time, governments contributed to stabilise financial markets through capital injections into financial institutions and an extension of guarantee schemes and provided significant budgetary support to the real economy by allowing the conventional automatic stabilisers to operate or, in most cases, by deciding on substantial fiscal policy packages.

CONSOLIDATED GROSS DEBT
(percentages of GDP)



Sources: EC, Belgian Prime News.

Meanwhile, a growing number of indicators have lifted the hope that a rebound in activity might well be under way or at least that the speed of the downturn decelerated. This building optimism emerged as conditions on financial markets improved. Spreads on the interbank and bond markets came down considerably compared to the acute situation in the autumn of 2008, while stock markets recovered somewhat. Furthermore, both business and consumer confidence indicators picked up, although they remained at low levels. Apart from these forward-looking indicators, a short-term improvement in activity might well take place as a process of destocking seems to have pushed down production below actual final demand developments.

Although the economy might recover in the short run, there is a general consensus that the economic crisis might cast its shadow for a long time, retrenching the size of the recovery and possibly also longer-term growth prospects. The crisis has given rise to a substantial negative output gap, unlikely to be closed in the coming years. Furthermore, unemployment started to increase and wide fiscal deficits emerged.

These developments might seriously threaten our long-term growth perspectives through a number of mechanisms which affect the supply side of the economy. Due to the capacity underutilisation or even scrapping of fixed capital resources, the capital stock growth and its efficiency are likely to be lowered. Furthermore, as past episodes illustrate, labour input might be permanently affected, as the higher unemployment level proves to be structural in the light of inflexible labour markets. Finally, the severity of the current recession and its negative interaction with the financial sector, faces the economy with sizeable adjustments on both product, capital and labour markets which, in the short run, might exacerbate the above-mentioned effects and furthermore affect overall productivity developments adversely. Recent estimates by several institutions confirm these possibilities, as they point to an imminent slowdown of the potential growth rate of the economy.

With a view to limiting these negative effects, further policy action at all levels is necessary and should primarily focus on improving potential output and ensuring fiscal sustainability in order to guarantee sound long-term growth perspectives, taking into account complementarities between different policies, international coordination and time consistency.

Regarding fiscal policy, while measures so far rightly have been aimed at stopping the collapse in demand in the short run, these same measures might jeopardise long-term growth and the sustainability of public finances, as shown by the wide fiscal deficits and the pickup in government debt levels. Therefore it is necessary to consider appropriate exit strategies, unwinding in a timely way the supporting measures, as the recovery gathers momentum, in order to prevent lower long-term growth prospects sparked by increases in long-term interest rates and households' savings related to increasing doubts on the sustainability of public finances.

The constraints of fiscal policy action reinforce the importance and the urgency of structural reforms aimed at increasing productivity and achieving efficient, flexible product and labour markets, so as to be able to respond swiftly to the negative consequences of the crisis and the in-depth restructuring facing certain branches of activity and financial markets. These reforms might act as a lever to attain a more sustainable growth in the future and to prevent negative effects of the crisis on potential growth.

Such a stable framework will be of the utmost importance in order to cope with new difficulties which might emerge as financial markets initially will remain fragile and to tackle the major challenge of restoring sound public finances without hampering a recovery.

POTENTIAL OUTPUT GROWTH ESTIMATES
(annual percentage changes, unless otherwise stated)

	Average 2006-2008	2009	2010
EC	1.8	1.0	1.0
Federal Planning Bureau	1.8	1.2	1.2
NBB	1.6	1.3	1.1
<i>p.m. contributions¹</i>			
Labour	0.4	0.0	0.0
Capital	0.9	1.0	0.7
TFP	0.4	0.4	0.4

Sources: EC, Federal Planning Bureau, NBB.

¹ In percentage points, NBB estimate. Potential output can be decomposed into three components: labour, capital and total factor productivity (TFP).

Treasury highlights

1. By the end of May 2009, the Treasury had already issued €21.66 billion of OLOs, corresponding to 71% of the target issuance for 2009 (€30.5 billion).
2. Following the traditional new 10-year OLO in January and the OLO auctions in January and February, a **second new OLO benchmark** was launched by syndication on 17 March. OLO56 3.5% 28 March 2015 is a long 5-year with an initial size of €5 billion. In less than a day, the order book totalled €8 billion and contained orders from 191 different investors across a range of geographies and investor types, enabling a pricing of mid swaps + 72 bp.
3. The Treasury also held regular OLO auctions in April (€3.619 billion including non-competitive subscriptions) and in May (€2.460 billion), with most of the bid-to-cover ratios exceeding 2.0.
4. Finally, on June 23, the Treasury launched its **third new OLO benchmark**. The Treasury opted for a 3-year maturity. OLO57 2% 28 March 2012 was issued for an amount of €5 billion by syndication at mid swaps – 6 bp.
5. On June 15, the Treasury published an updated funding plan that took into account new projections for the federal government cash deficit in 2009 (€12.2 billion) as well as the reimbursement of €4.83 billion from the Federal Participation and Investment Company, resulting from the shareholder's approval of the sale of 75% of Fortis Bank to BNP Paribas. The Kingdom's overall 2009 borrowing requirements increased only marginally and the targeted issuance of OLOs and EMTN paper was confirmed at €30.5 billion and €3 billion respectively.

The OLO auction dates for the remainder of 2009 are the following:

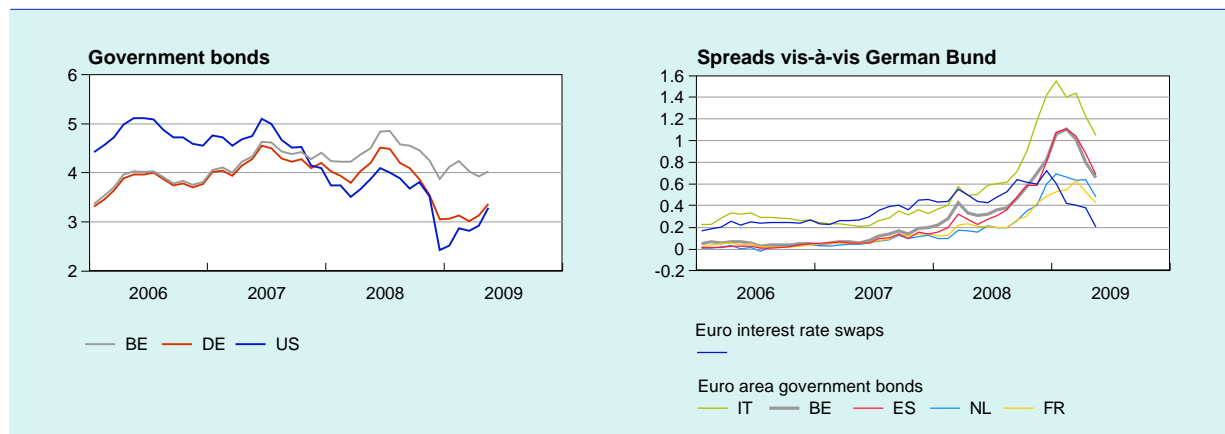
Issuance date	Settlement date
27 July	30 July
28 September	1 October
30 November	3 December

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

Government securities market

10-YEAR INTEREST RATES

(percentage points, monthly averages)



Sources: BIS, Datastream.

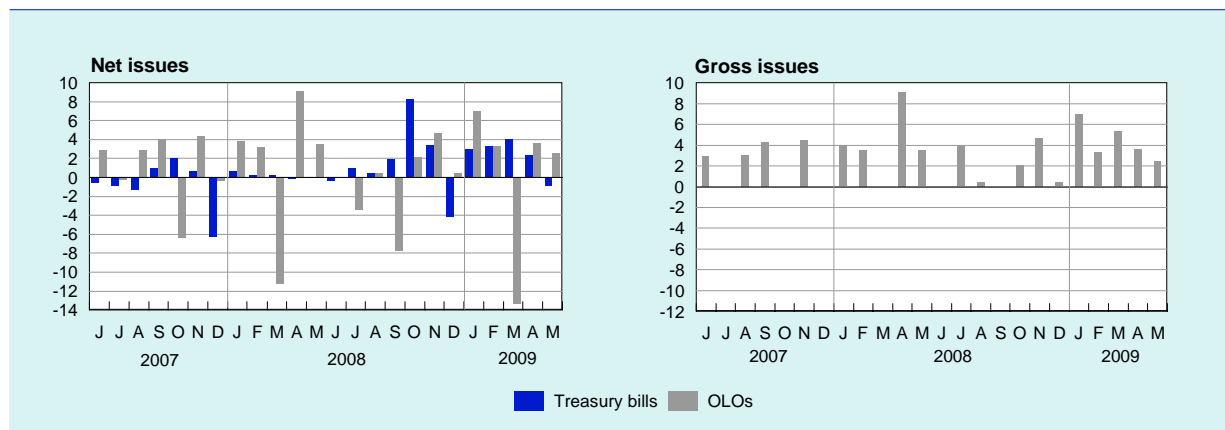
After some hesitation in March, the increase of the long-term interest rates on government bonds which started at the beginning of this year, resumed especially in the United States but also in Germany. In Belgium these rates stabilised at the level of early 2009.

The factor behind the increase of the long-term interest rates in those major economies is higher break-even inflation rates, as the real yields declined somewhat.

The spreads on government bonds and on interest rate swaps vis-à-vis the German Bund decreased sharply during the last months, indicating that investors might have been returning to riskier assets amid a general reduction of flight-to-safety flows.

PRIMARY MARKET

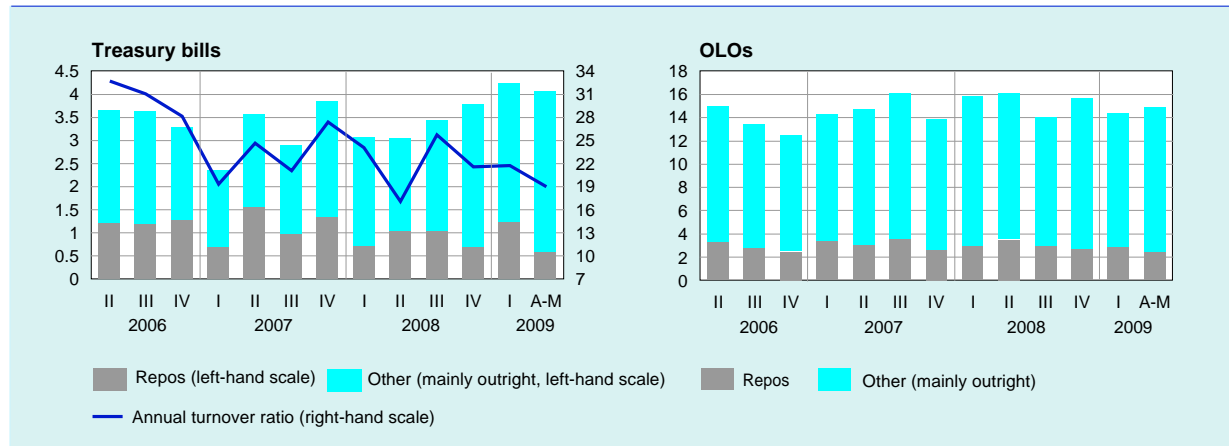
(billions of euros)



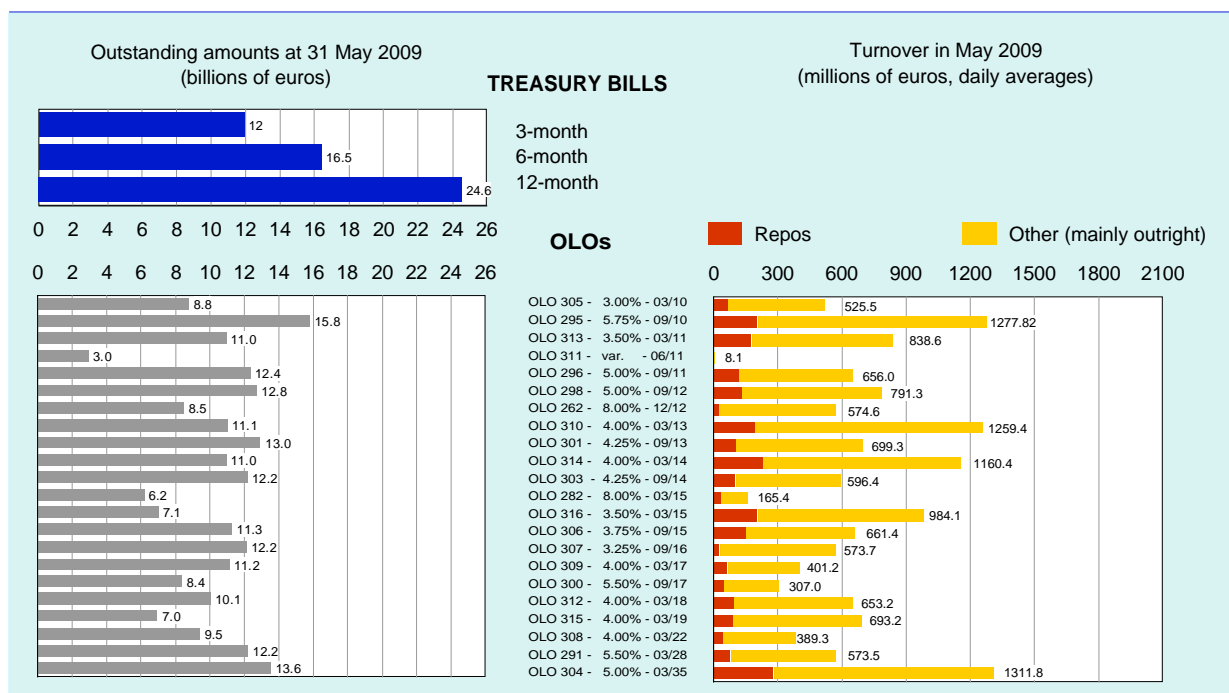
Government securities market (continued)

SECONDARY MARKET

(billions of euros unless otherwise stated, daily averages)



OUTSTANDING AMOUNTS AND TURNOVER



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