BELGIAN DEBT AGENCY

Participating Primary and Recognised Dealers: Barclays Capital, BNP Paribas Fortis, Citigroup, Commerzbank, Dexia Bank, ING, KBC Bank, Royal Bank of Scotland, Société Générale Corporate & Investment Banking, UBS Limited

NationalBank OF BELGIUM
Eurosystem

# Belgian Prime News

QUARTERLY PUBLICATION

**No. 48** June 2010

**Last update:** 23 June 2010

Next issue: September 2010

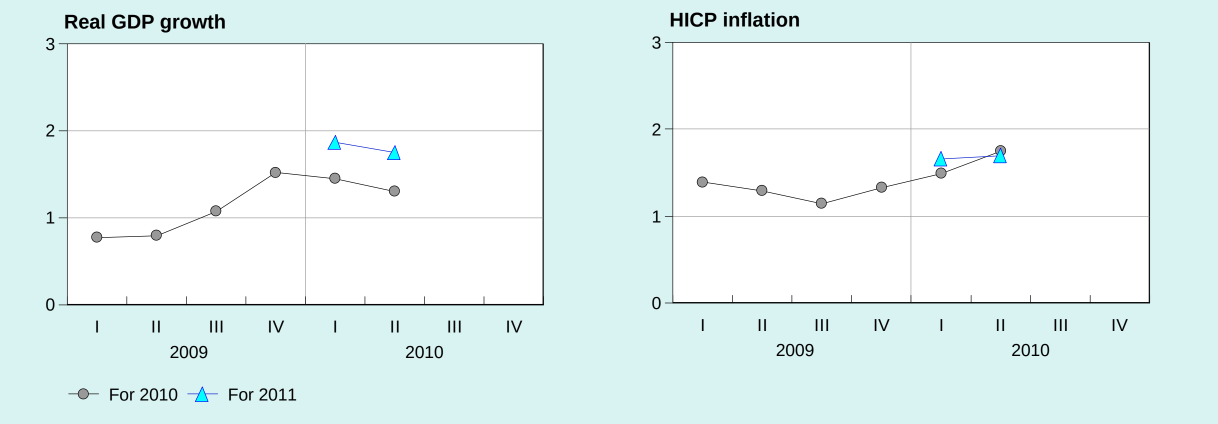
- The economic recovery, which started in the third quarter of last year, is expected to continue at a moderate pace, in a context of renewed financial tension. In Belgium, real GDP growth should reach 1.3% in 2010 and 1.8% in 2011.
- Fuelled by higher energy prices and a weaker euro, inflation is expected to rise to 1.8% in 2010 and 1.7% in 2011.
- Although the economic and financial operating environment remains challenging, recent developments in the Belgian financial sector's profitability and solvency show clear improvements. The Belgian banks are undertaking a major structural reform process, seeking to develop profitable but less risky activities.

## Consensus: Average of participants' forecasts

| | 2009 | | 2010 p | | | | 2011 p | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Belgium | Euro area | Belgium | | Euro area | | Belgium | | Euro area | |
| Real GDP(1) | -3.0 | -4.1 | 1.3 | (1.5) | 1.2 | (1.2) | 1.8 | (1.9) | 1.5 | (1.6) |
| Inflation (HICP)(1) | 0.0 | 0.3 | 1.8 | (1.5) | 1.5 | (1.3) | 1.7 | (1.7) | 1.5 | (1.4) |
| General government balance(2) | -6.0 | -6.2 | -5.0 | (-5.4) | -6.4 | (-6.8) | -4.6 | (-4.7) | -5.2 | (-5.8) |
| Primary balance(2) | -2.3 | -3.4 | -1.0 | (-1.2) | n. | | -0.6 | (-0.3) | n. | |
| Public debt(2) | 96.8 | 78.8 | 100.4 | (100.8) | 84.2 | (84.5) | 101.2 | (102.5) | 87.1 | (87.8) |

Numbers in parentheses refer to the previous consensus forecast of March 2010.
(1) Percentage changes.
(2) EDP definition; percentages of GDP.
n. Not available.

**SUCCESSIVE FORECASTS FOR BELGIUM**

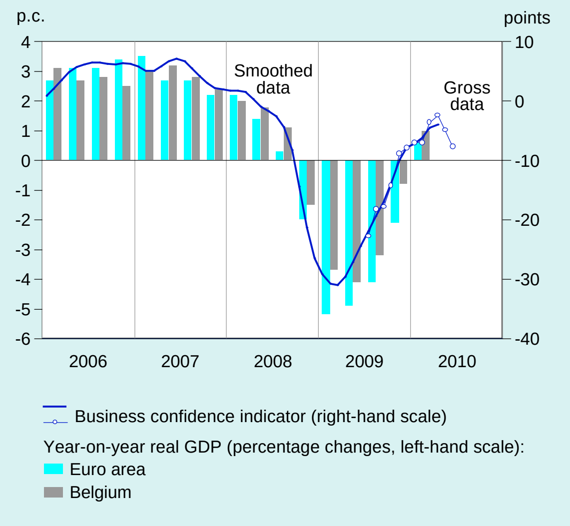



Source: Belgian Prime News.

# Macroeconomic developments

Together with the improvement in the business confidence indicator to a level above its long-term average, the Belgian economy continues on the recovery path that started in the middle of last year. After the initial upturn in real GDP of 0.7% in the third quarter of 2009, the rate of expansion has moderated though, slipping back to 0.3% in the last quarter and 0.1% in the first quarter of 2010. This latter result, however, has been negatively influenced by the bad weather conditions for the construction sector. As regards the short-term outlook, recent developments in both business and consumer confidence suggest that growth will remain subdued. In line with this trend, **the primary and recognised dealers expect Belgian real GDP growth to increase from -3% in 2009 to on average 1.3% in 2010 and 1.8% in 2011**, which implies a small downward revision compared to last quarter. The same applies to the outlook for the euro area as a whole, where the economy is now expected to grow by 1.2% in 2010 and 1.5% in 2011. On the one hand, real GDP growth is benefiting from the positive developments in the international environment. On the other hand, the outlook for domestic demand in the euro area remains weak, as it will be curbed by the expected wave of fiscal consolidation, for instance.

**GDP GROWTH AND BUSINESS CYCLE INDICATOR**

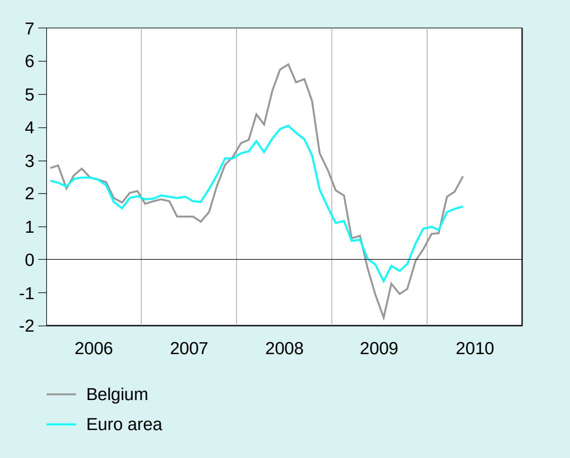



Sources: EC, NAI, NBB.

Up until now, the drop in employment and the concomitant rise in unemployment have been very limited in Belgium, compared to the fall in output. This relates mainly to labour hoarding via the extensive use that firms have made of methods to reduce working hours. Against that background, the subdued recovery will most likely not be strong enough for firms to start hiring extra staff, as they will first try to restore the productivity of their existing workforce.

After the steep fall in annual HICP inflation in Belgium - from a peak of 5.9% in July 2008 to a trough of -1.7% one year later - the inflation rate picked up strongly to reach 2.5% in May 2010. This increase reflected mainly developments in the volatile HICP components, such as energy and unprocessed food. The underlying trend in inflation continued its downward trend until April, before rising to 1.2% in May. The primary and recognised dealers have raised their inflation forecast for 2010 for the third quarter in a row, mainly reflecting their expectations of a larger depreciation of the euro. **They now forecast Belgian headline inflation to be 1.8% in 2010 and 1.7% in 2011.** For the euro area, inflation is expected to reach only 1.5% in both 2010 and 2011. This discrepancy is largely due to the fact that Belgian inflation reacts more strongly to movements in energy prices.

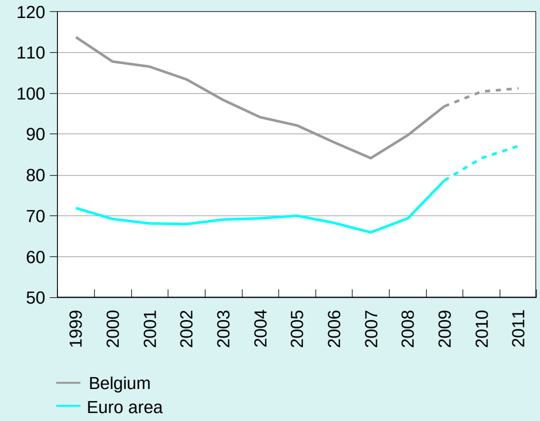
**HARMONISED INDEX OF CONSUMER PRICES**
(annual percentage changes)




Source: EC.

Finally, as regards public finances, **the primary and recognised dealers expect the Belgian general government deficit to moderate from 6% of GDP in 2009 to an average of 5% in 2010 and further to 4.6% in 2011.** Those expectations implicitly include additional measures that have not yet been decided - in contrast to a technical hypothesis of unchanged policy. Some participants feel that the growing awareness of the need for fiscal consolidation to secure long-term public debt sustainability and, more broadly speaking, the economy's growth potential, as well as the extra pressure from financial markets and the European context of fiscal consolidation, have all heightened the probability of reaching the targets set in the government's latest stability programme. In line with the large deficits, **the government debt ratio is projected to increase from 96.8% of GDP in 2009 to 100.4% in 2010 and 101.2% in 2011.** As for the euro area's public finances, the primary and recognised dealers are even more pessimistic. The general government deficit for the euro area as a whole is expected to stand at 6.4% of GDP in 2010 and 5.2% in 2011. As a consequence, the discrepancy between the Belgian and the euro area government debt ratio will shrink, from 18.1 percentage points of GDP in 2009 to 14.1 points by 2011.

**CONSOLIDATED GROSS DEBT OF GENERAL GOVERNMENT**
(percentages of GDP)



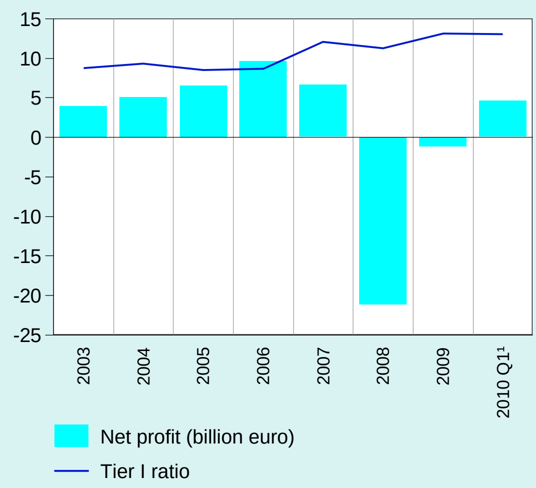

Sources: EC, NBB, Belgian Prime News.

# Special topic: Recent developments in the Belgian financial sector

The period of extreme financial tension following the failure of Lehman Brothers in September 2008 put severe pressure on the profitability and liquidity position of credit institutions and insurance companies in advanced economies, including Belgium. At the time, swift and massive actions by governments and central banks were necessary to restore the normal functioning of the financial sector. As explained in the Financial Stability Review 2010(*) published by the NBB on 17 June, the Belgian banks have responded to their revealed vulnerabilities by undertaking a major structural reform process, paving the way for a return to adequate and sustainable profitabililty. Although the economic and financial operating environment remains challenging for financial institutions, recent developments in the Belgian banks' profitability and solvency show clear signs of improvement.

With a net bottom-line profit of €1.2 billion in the first quarter of 2010 (€4.8 billion annualised), the **Belgian banking sector** consolidated the return to profitability that took hold in the second half of 2009. Improvements in various income sources, cost control and a significantly lower level of impairments contributed to this positive result in the first months of the year. In 2008 and the first half of 2009, the Belgian banking sector's income statement had been dominated by large exceptional crisis-related losses and one-off risk charges, sometimes related to restructuring and de-risking strategies undertaken by the main bancassurance groups. To the extent that these losses and de-risking measures relieved the banks of potential future losses and of business activities and legacy exposures out of line with their new business strategy, they helped the observed return to profitability in the second half of 2009 and the first months of 2010.

**PROFITABILITY AND SOLVENCY**
(consolidated data, percentages, unless otherwise stated)




Sources: CBFA, NBB.
¹ Annualised figure.

(*) http://www.nbb.be/doc/ts/Publications/FSR/FSR_2010_EN.pdf

The Tier I capital ratio remained at a high level in 2008 and 2009, despite the large cumulative income statement loss (€22.4 billion) recorded during this period, reflecting several developments, including government-led recapitalisations through Tier I capital instruments, the composition of the income statement losses in 2008 and 2009, and the complete transition in 2008 to the Basel II framework for calculating risk-weighted assets. With a drop of no less than 30% between the end of 2007 and the end of 2009, changes in the amount of risk-weighted assets were a main driver of recent developments in the Tier I capital ratio. This decline in risk-weighted assets resulted both from decreases in the balance sheet total (leverage effect) and changes in the average risk weight applied to these assets (risk effect). As regards the latter effect, risk factors leading to higher risk weights were in fact counterbalanced by the benefits of State guarantees on impaired assets, as well as other asset relief measures.

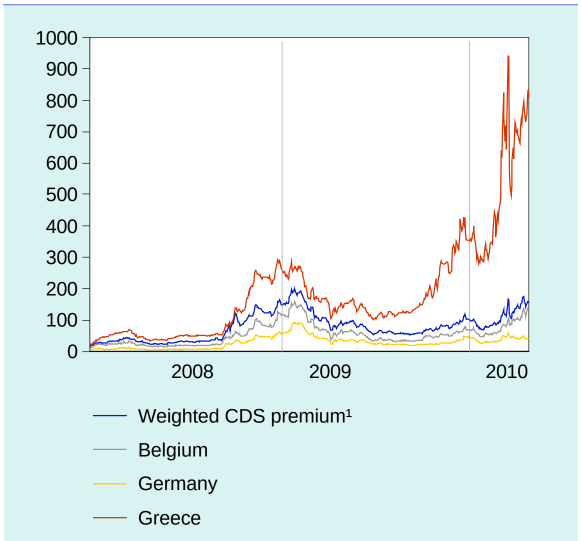
An important factor shaping developments in the profitability, solvency and balance sheets of the main Belgian bancassurance groups was the implementation and execution of restructuring plans, aimed at addressing the vulnerabilities uncovered by the global financial crisis. These vulnerabilities had required government interventions in bancassurance groups Fortis, Dexia and KBC in the last quarter of 2008 and the first half of 2009 (see Financial Stability Review 2009(**), pp. 28-34, for more details), which have been instrumental in stabilising market confidence vis-à-vis systemically important banking and insurance companies in the Belgian financial system, while providing time and resources for the financial institutions to undertake restructuring plans and refocus their activities on core businesses. Some elements of these ongoing restructuring processes form part of the agreements reached with the European Commission on the remedial measures to be taken in return for the state aid received.

The refocusing of the Belgian banks' business models on their domestic and some foreign core clients, together with the fundamental reassessment of capital market activities and expansion into non-core markets, has led to the placing into run-off of certain activities and portfolios, with a consequent decline in balance sheet totals. The strong deleveraging process was started in the last quarter of 2008 with the deconsolidation of Fortis Bank Nederland out of Fortis Bank and continued last year with a reduction in total assets from €1,422.1 billion at the end of 2008 to €1,190.5 billion at the end of 2009. The category most affected by the reduction in the total balance sheet were the interbank assets and liabilities.

Interbank debts declined by €142.3 billion in 2009, contributing to a significant rebalancing of the funding structure of the Belgian banking system as compared to the situation at the end of June 2008. The share of retail deposits and customer savings certificates in the total amount of deposits collected and securities issued has increased from 24.5% to 35.6%, while the relative share of interbank deposits fell to 18.5%, from 34.4% at the end of June 2008.

On the assets side of the balance sheet, the €57.1 billion decline in loans to credit institutions was responsible for three-quarters of the decline in total loans and advances between the end of 2008 and 2009. Over this same period, loans to customers dropped from €555.5 billion to €536.5 billion, as a result of developments in the so-called non-core markets where exposures have been put into run-off in line with the restructuring plans. The amounts of claims on counterparties located in Belgium and other core markets continued to increase though. The change of focus away from trading activities towards more traditional banking activities also led to a decline in debt securities portfolios. Debt securities issued by central governments accounted for 13.1% of the Belgian banking sector's total assets at the end of 2009. These holdings of government bonds are concentrated in the countries with lower CDS premiums, such as Germany and Belgium.

**CDS PREMIUMS ASSOCIATED WITH BELGIAN BANKS' EXPOSURES TO THE PUBLIC SECTOR**
(basis points)




Sources: CBFA, NBB, BIS.
[1] The weighted sovereign CDS premium takes into account the amount of the exposure of Belgian banks vis-à-vis public authorities in each country as of end-December 2009. Only the 15 largest exposures (with a minimum size of 1 billion euro) are taken into account in the calculation. Figures taken into account for Belgium only refer to exposures to the Belgian central government. Data are recorded on an ultimate risk basis, that is, taking into account effects of guarantees received and credit derivatives bought for protection purposes, except for exposures on the Belgian central government.

(**) http://www.nbb.be/doc/ts/Publications/FSR/FSR2009EN.pdf

**Belgian insurance companies** posted a net profit of €1.0 billion in 2009, as a result of a return to profitability in the life insurance segment, which had incurred substantial losses due to the sharp asset price falls that occured in the second half of 2008. The subsequent improvement of asset prices in 2009 not only restored profitability but also contributed to an improvement in the sector's regulatory solvency ratio, which reached a level of almost twice the minimum required level by the end of the year.

* *
*

Obviously, global market conditions are still uncertain, as illustrated by the renewed tensions on some segments of the sovereign bond markets. However, by focusing on their core markets, the Belgian banking institutions are tackling the vulnerabilities revealed by the global financial crisis. Together with the insurance companies, they are now on a stronger footing to develop profitable, but less risky, activities and thus further strengthen their balance sheet position.

## Treasury highlights

1. On 14 April 2010, the Treasury took advantage of a window to issue its long-awaited new 30-year benchmark OLO 4.25% 28/03/2041 (OLO60) for an amount of €4.00 billion.

   It was priced at m/s +58 bp, equivalent to the Jul-40 Bund +38.7 bp. There were 127 investors contributing orders, and it was the most internationally distributed OLO syndication of 2010, with only 5% placed in Belgium. UK investors took a major part with 35.8% of allocated orders, while in terms of investor type, insurance companies and hedge funds accounted for 25% of the deal.

2. The May OLO auction had been scheduled for 7 June 2010 because of holidays. The Treasury issued €3.167 billion, close to the top of the announced range of €2.2/3.2 billion, along the following lines:

   - OLO 2.00% 28/03/2012 (OLO57): €0.857 billion; average yield: 0.928%; bid-to-cover: 3.14

   - OLO 2.75% 28/03/2016 (OLO59): €0.950 billion; average yield: 2.835%; bid-to-cover: 1.43

   - OLO 3.75% 28/09/2020 (OLO58): €1.360 billion; average yield: 3.523%; bid-to-cover: 1.40

   As such, total OLO issuance amounts to €20.612 billion.

3. The Treasury also continued its EMTN programme with the issue of an extendable note 2030(2040) for an amount of €700 million, a CHF 100 million private placement, and a second tap of its March 2015 public USD note for an amount of $500 million.

   In total, the Treasury now has realised 61.6% of its 2010 funding plan.

4. Financial markets again came under stress in May 2010, and while this resulted in lower yields for Belgian government debt in May, yields suddenly moved higher in early June, following a general widening in peripheral spreads. Yet these OLO yields have still remained low in absolute terms, with the 10-year yield never exceeding 3.60%.

   On the other hand, liquidity on the secondary market was markedly lower, with bid-offer spreads attaining levels that had not been seen since the collapse of Lehman Brothers.

The OLO auction dates for the remainder of 2010 are the following:

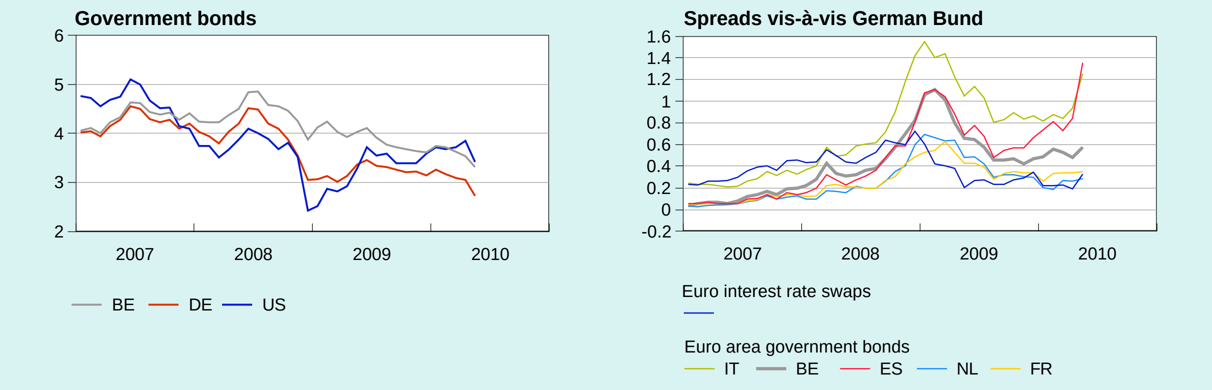
| Issuance date | Settlement date |
|---|---|
| 28 June | 1 July |
| 26 July | 29 July |
| 23 August | 26 August |

| Issuance date | Settlement date |
|---|---|
| 27 September | 30 September |
| 25 October | 28 October |
| 29 November | 2 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)

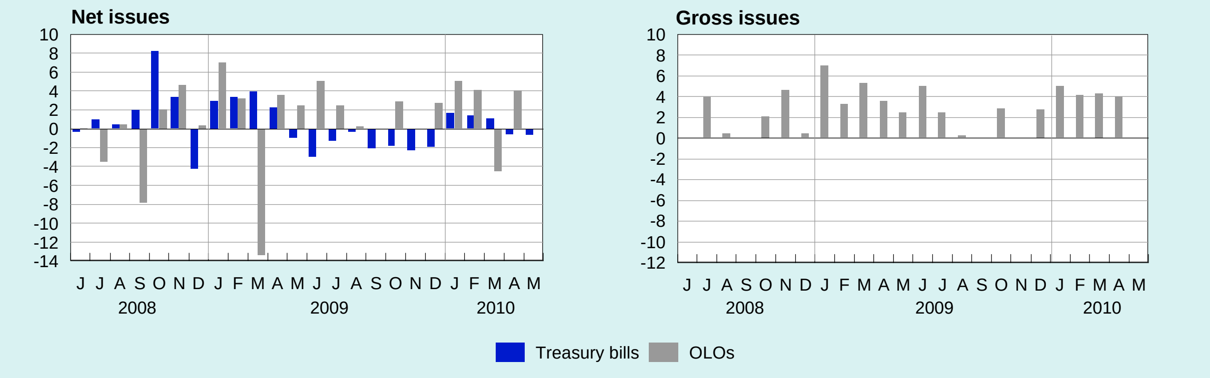



Sources: BIS, Datastream.

Developments in the long-term government bond markets over the last three months have primarily been driven by mounting financial market concerns about the sovereign debt of some euro area countries. In early May, tensions spread to financial markets more generally, triggering large-scale flight-to-safety behaviour by investors. As a result, long-term government bond yields declined markedly in the United States and in the core countries of the euro area. Long-term euro area break-even inflation rates have remained broadly unchanged in the last few months.

These increased market concerns about the sustainability of fiscal positions in some euro area countries induced a sharp increase in the spreads of some government bonds vis-à-vis the German Bund.

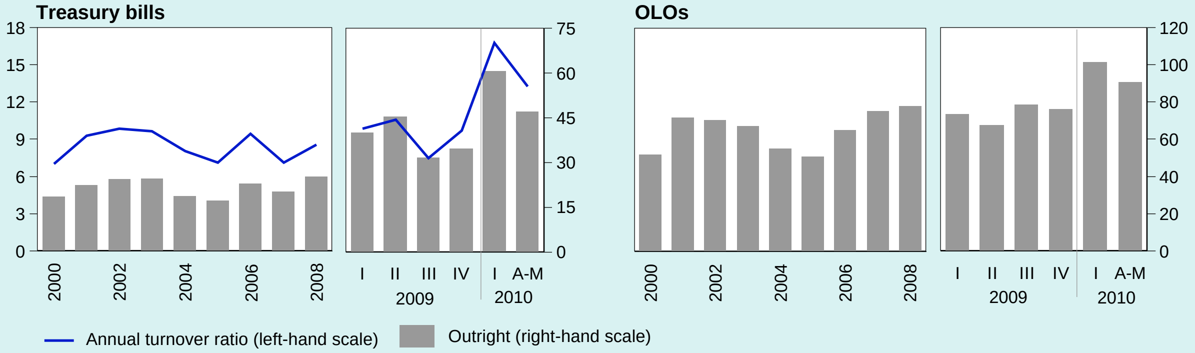
**PRIMARY MARKET**
(billions of euro)



## SECONDARY MARKET TURNOVER

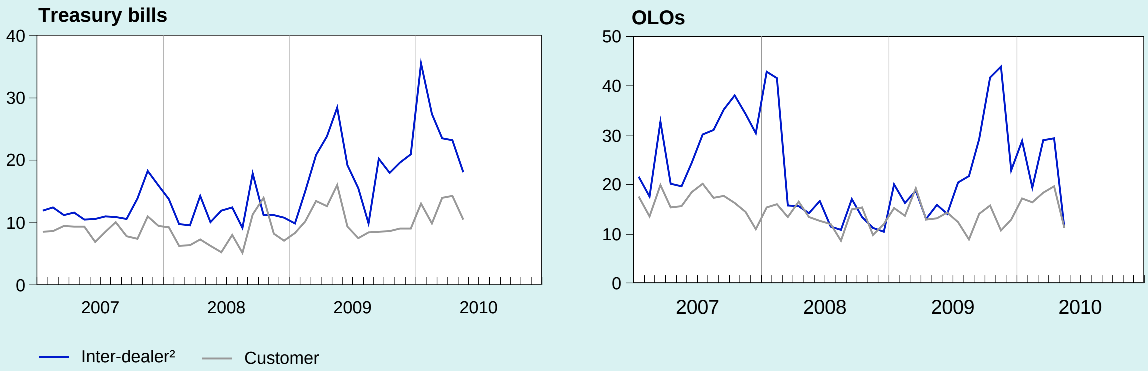
### As compiled by the Securities Regulation Fund[1]

(billions of euro unless otherwise stated, monthly averages)




### As reported to the Treasury by primary dealers and recognised dealers

(billions of euro)



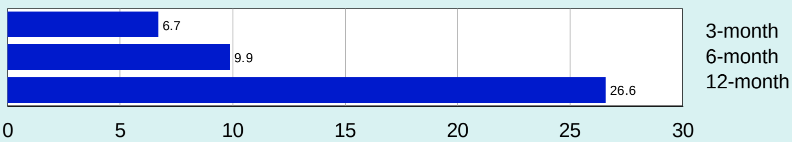

[1] As of January 2009, reporting information obtained via TREM is also included. The Securities Regulation Fund's turnover figures include sell/buy-back transactions which are in fact repurchase agreements.
[2] Please note that inter-dealer turnover is double-counted in these figures.

## OUTSTANDING AMOUNTS AND TURNOVER

(billions of euro)

### TREASURY BILLS

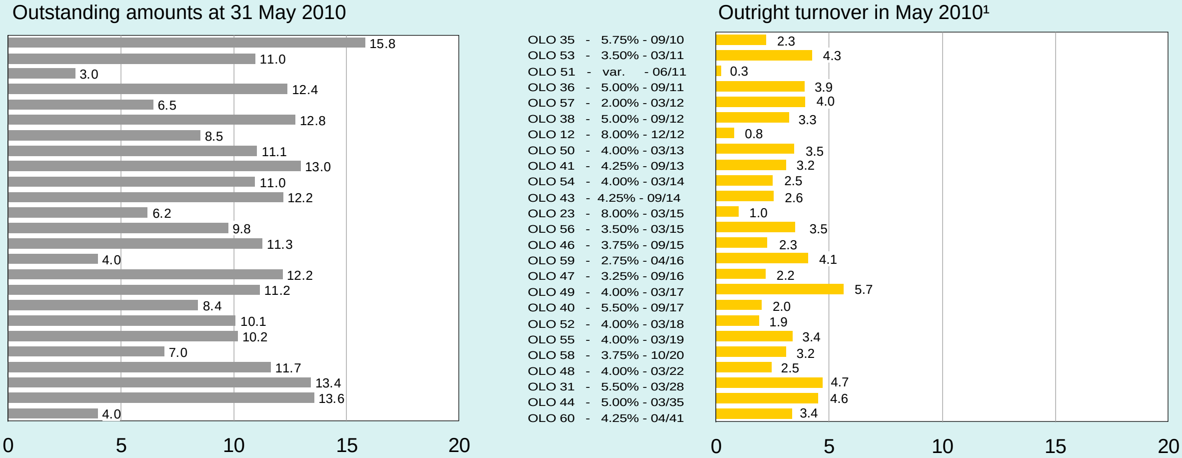
Nominal outstanding amounts at 31 May 2010




### OLOs

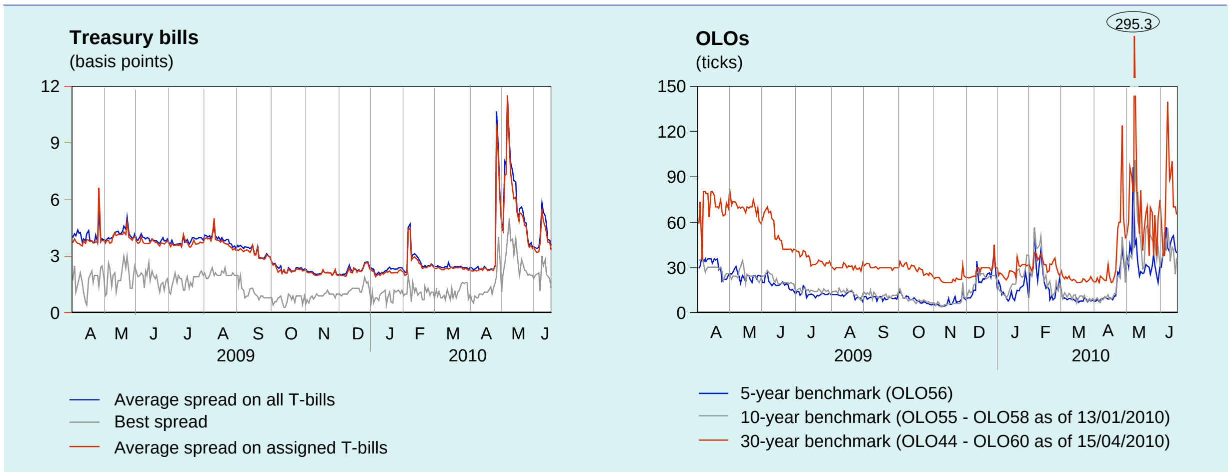
Outstanding amounts at 31 May 2010

Outright turnover in May 2010[1]



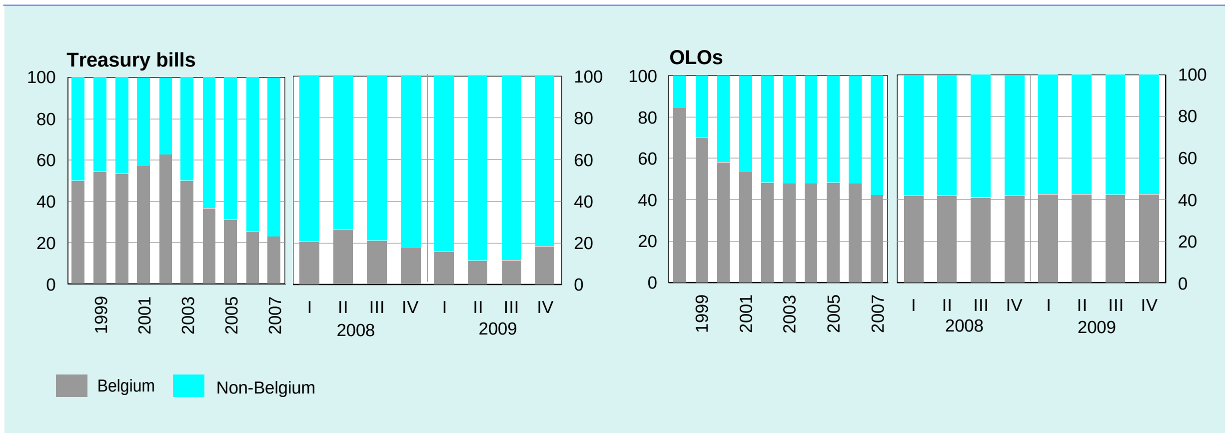

Source: Securities Regulation Fund.
[1] The turnover figures include sell/buy-back transactions which are in fact repurchase agreements.

**BEST BID/OFFER SPREADS[1]**




Source: Treasury.
[1] As reported by three electronic platforms (MTS, BrokerTec and BGC eSpeed). For the period October-December 2009, this is the best average over 6 hours; since January 2010, it is the best average over 5 hours.

**LOCATION OF HOLDERS**
(percentages of total)

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**Published by:** National Bank of Belgium (NBB).

**Sources:** NBB, unless otherwise stated.

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