BELGIAN PRIME NEWS
Quarterly publication
BELGIAN DEBT AGENCY
NationalBank OF BELGIUM
Eurosystem

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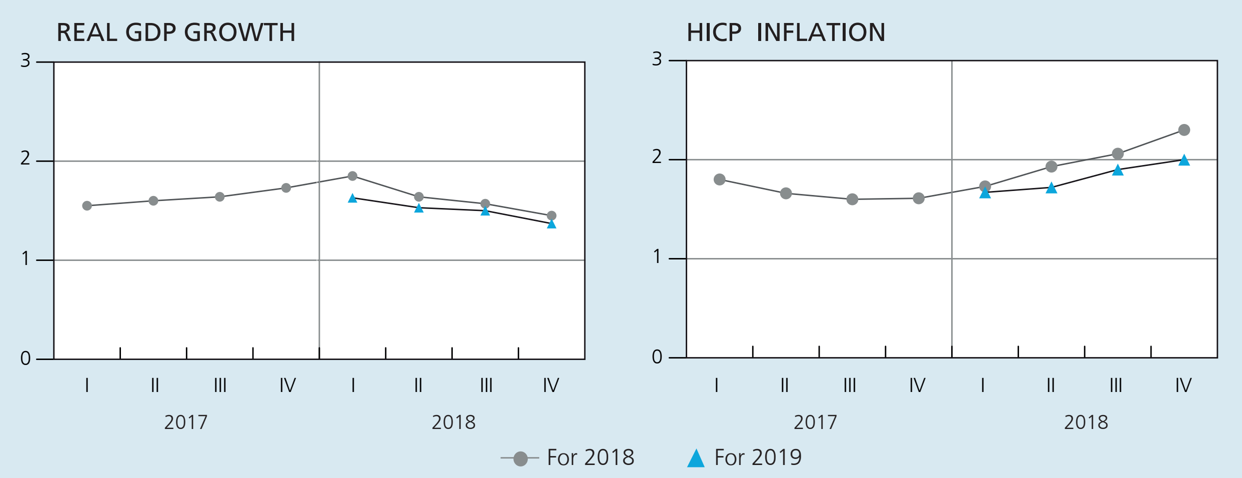
- SPECIAL TOPIC: Labour-intensive growth in Belgium brings mounting labour market tensions
- FINANCIAL MARKETS AND INTEREST RATES: Heightened financial markets volatility and flattening of the US sovereign yield curve
- TREASURY HIGHLIGHTS: 2018 funding targets were reached and the funding plan for 2019 is introduced

CONSENSUS Average of participants' forecasts

	Belgium			Euro area		
	2017	2018p	2019p	2017	2018p	2019p
Real GDP(1)	1.7	1.5	1.4	2.4	1.9	1.6
Inflation (HICP)(1)	2.2	2.3	2.0	1.5	1.7	1.6
General government balance(2)	–0.9	–1.1	–1.4	–1.0	–0.7	–0.9
Public debt(2)	103.4	101.7	100.4	88.9	86.2	84.6

(1) Percentage changes.
(2) EDP definition; percentages of GDP.

SUCCESSIVE FORECASTS FOR BELGIUM



Source: Belgian Prime News.

MACROECONOMIC DEVELOPMENTS **Global growth desynchronizes**

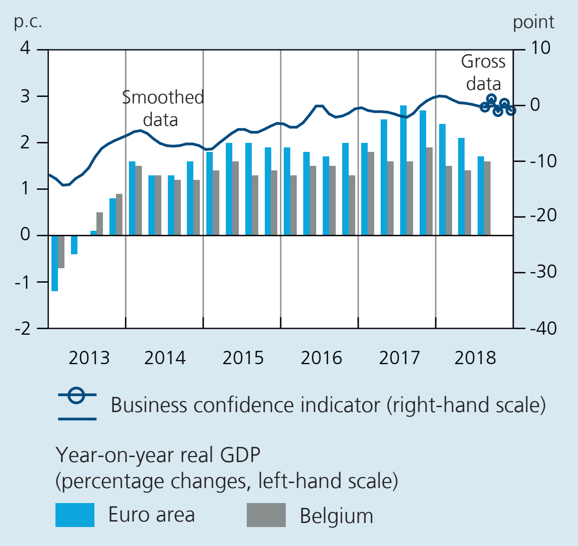
Global activity slowed somewhat in 2018 and is displaying signs of desynchronization. While the United States, boosted by fiscal stimulus, registered strong growth rates throughout most of the year, growth in certain (advanced) countries even dipped into negative territory. Meanwhile, there were also signs of global trade slowing down, against the background of rising trade tensions. If the latter were to escalate further, they are likely to become an even more important drag on global growth.

In the first half of 2018, the euro area economy posted stable performance with an average quarterly growth rate of 0.4 %. Still, this represents a marked slowdown compared to the average rhythm recorded in 2017. In the third quarter quarterly growth softened to 0.2 %, which may be partially due to temporary factors. New emission testing procedures as of September led to production delays in the car manufacturing industry, mostly in Germany, and are likely to have weighed somewhat on growth. Nonetheless, high-frequency indicators, such as the Purchasing Managers' Index (PMI), have proved to be disappointing lately and are not showing any signs of a clear pick-up for Germany, nor for the euro area. The latest news has induced BPN participants to revise downward their expectations by 0.3 pp in cumulative terms compared to the September estimate: **they currently see GDP growing by 1.9 % in 2018 and 1.6 % in 2019. Euro area inflation is expected to reach 1.7 % and 1.6 % respectively.**

In Belgium, GDP growth came in at 0.3 % in the third quarter of 2018. Economic activity was, to a large extent, supported by net exports, while private consumption contracted. Even though business and consumer confidence indicators are no longer at the record highs that were observed in late 2017, they remain quite resilient, to a larger extent than observed for the euro area on average. Nonetheless, global and euro area uncertainties have also weighed on the participants' outlook for Belgium and have caused them to lower their growth expectations for this year and the next, by 0.1 pp each, compared to the September estimate. **On average, BPN participants currently expect growth in Belgium to reach 1.5 % in 2018 and 1.4 % in 2019.**

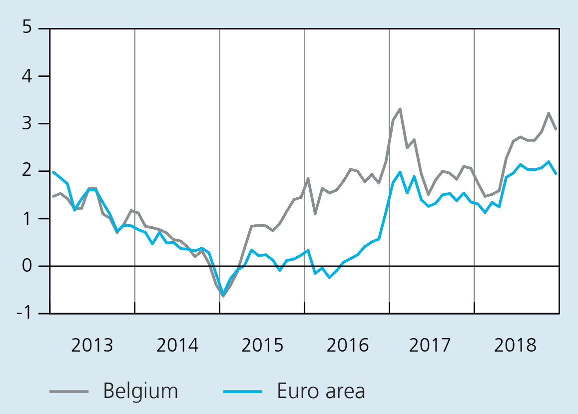
The Belgian labour market has continued to perform very well throughout the first nine months of 2018, with a harmonised unemployment rate of 5.8 % in the third quarter according to the EU labour force survey. Meanwhile, on the nominal side, HICP inflation in Belgium reached 2.9 % in November. Although oil prices have recently moderated, headline inflation remains elevated, with double-digit inflation rates for all energy products, partly due to supply tensions on the domestic electricity market. **According to the consensus forecast, inflation in Belgium should amount to 2.3 % on average in 2018 and 2.0 % in 2019.**

GDP GROWTH AND BUSINESS CYCLE INDICATOR



Sources: EC, NAI, NBB.

INFLATION (HICP)
(annual percentage changes)



Source: EC.

Belgian Prime News participants expect the public sector deficit to worsen slightly from, on average, 1.1 % in 2018 to 1.4 % in 2019. The deficit for 2018 could turn out better than expected, as the most recent developments point to strong revenues. Indeed, the 2018 budget was affected favourably by a strong increase in advance payments on corporation tax, and the increased labour intensity of growth. The former is the result of an increase of the corporate income tax surcharge in case of insufficient advance payments, which implies an important incentive to frontload tax payments. However, this shift in timing is considered to have only a temporary effect. In any case, additional fiscal consolidation efforts would still be required to achieve the medium-term objective of a balanced budget in structural terms. On the basis of their own macro and budgetary forecasts, **the BPN participants anticipate a further slow reduction in the Belgian public sector debt, from 103.4 % of GDP at the end of 2017 to 101.7 % in 2018 and 100.4 % in 2019.**

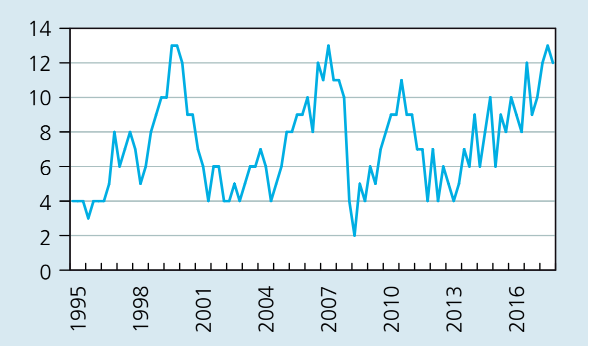
SPECIAL TOPIC **Labour-intensive growth in Belgium brings mounting labour market tensions**

The labour market in Belgium continued to perform very well throughout 2018, for the fourth consecutive year, resulting in the net creation of over 220 000 jobs since early 2015. The employment growth of, on average, 1.2 % over the recent years is not that exceptional, but it can be considered as very strong relative to the rather moderate output growth. Indeed, the elasticity of employment with respect to output has been quite elevated over the past couple of years. More specifically, over the past four years, one percentage point of economic growth has resulted in 0.7 % employment growth, which is clearly higher than the estimated long-term elasticity. At the same time, employment intensity in Belgium has been higher than in the euro area on average. However, the strong job intensity was not specific to Belgium and should be considered against the backdrop of measures to curb labour cost growth.

As a result of this strong job creation, the unemployment rate in Belgium has come down to a historical low. In 2018, the unemployment rate is estimated to have reached 6.3 %, which was generally considered to be well below the structural rate (NAIRU). While that decline was enhanced by the favourable macroeconomic environment, it was most likely also the result of the structural reforms that have been carried out in recent years with a view to expanding both labour demand and supply. The drop in unemployment was generally broad-based and occurred across all regions, although differences remain. The Belgian unemployment rate remains well below the euro area's rate, even though it started its decline at a later point in time.

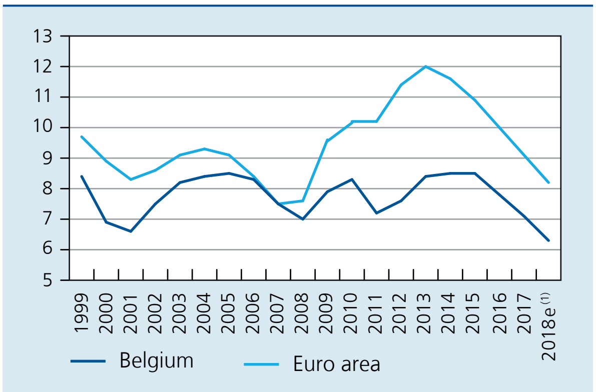
With unemployment dropping, a rising number of businesses are having difficulties finding staff with the right qualifications for the job. In the most recent response to the NBB's quarterly survey on production capacity, about 12 % of manufacturing firms indicated that the lack of sufficiently skilled staff is hampering production. This percentage is comparable to the figure reached in early 2008, just before the great recession, and at the end of 2000.

MANUFACTURING INDUSTRY: PRODUCTION CONTRAINTS FROM LACK OF SKILLED STAFF
(gross data)



Source: NBB.

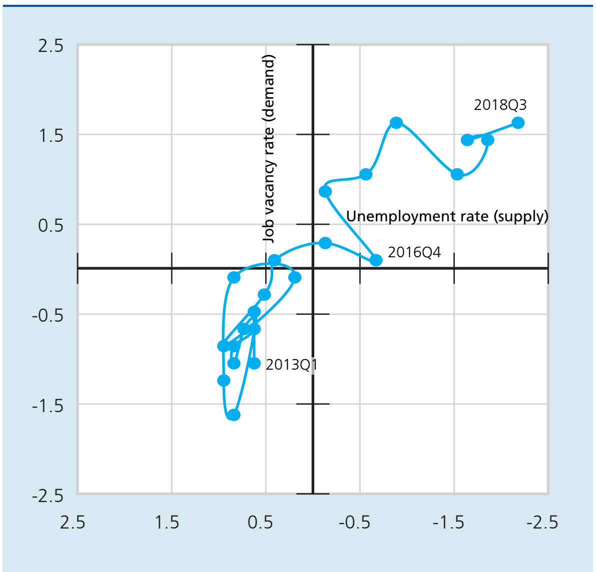
UNEMPLOYMENT RATE IN BELGIUM AND THE EURO AREA
(in % of the active population, annual data)



Sources: Eurostat, Eurosystem, NBB.
(1) The anticipated unemployment rate for Belgium and the euro area in 2018 are derived from the Autumn 2018 forecasts by the National Bank and the Eurosystem, respectively.

In order to visualise labour market tensions, Statistics Netherlands (CBS) has come up with a graphical representation, which shows standardised values for labour supply, represented by (minus) the unemployment rate, and labour demand, represented by the job vacancy rate that measures the total number of job vacancies divided by the average number of jobs. Since mid-2016, the combination of an above-average job vacancy rate and a below-average unemployment rate puts Belgium in the upper right quadrant, which is indicative of a tight labour market. In order to reduce tensions on the labour market, some structural issues need to be tackled in order to further expand the supply of labour. For a more detailed discussion on this, please refer to the article on full employment, mismatches and labour reserve in the [December 2018 NBB Economic Review.]

LABOUR MARKET TENSION METER
(standardised data using average and standard deviation since 2013, seasonally adjusted)



Sources: Eurostat, indicator based on Statistics Netherlands.

FINANCIAL MARKETS AND INTEREST RATES

Heightened financial markets volatility and flattening of the US sovereign yield curve

The last quarter of 2018 was marked by a stock market correction, triggering a further increase in volatility. The S&P 500 and the Euro Stoxx 600 fell by about 13 % over a period of three months. This indicates that the markets are still very responsive to specific announcements related to, for instance, monetary policy, trade disputes, political tensions (Brexit, Italy), and the publication of slightly disappointing macroeconomic data. At the beginning of October, the VIX and VSTOXX doubled to reach 25 and 21 %, respectively. Unlike the surge observed in February 2018, which turned out to be temporary, the most recent volatility spike seems to be more persistent. By the end of December, both the VIX and VSTOXX stood at about 25 %. It is therefore possible that the year 2018 could mark the transition from relatively calm to more turbulent stock markets. Overall, stock market valuations nevertheless are still relatively high compared to historical standards, especially in the US where the cyclically adjusted price/earnings ratio of the S&P 500 stood at about 29 in December 2018 according to Robert Shiller’s estimate.

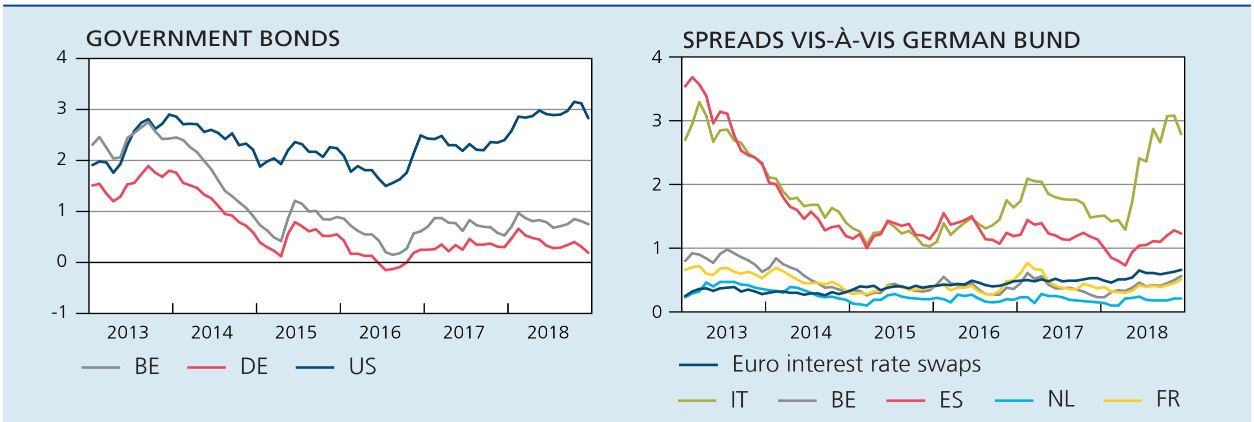
The last quarter of the year was also marked by the sovereign yield curve virtually flattening out in the US. This flat-lining can be considered as an early warning indicator of a looming recession(1). The slope of the US yield curve has essentially been declining since latest financial crisis and stood at about 14 basis points at the end of 2018 when comparing 10-year and 1-year sovereign yields. Over the most recent period, the flattening of the US yield curve mainly reflects the rise in short-term yields, in turn reflecting the monetary policy decisions of the Fed, which started to increase the target range for the federal funds rate in December 2015, and raised it again in December 2018 to 2.25 % – 2.50 %. In the euro area, the slope of the OIS curve has been hovering around 100 basis points over the past five years, reflecting the continued overall accommodative monetary policy stance of the ECB despite the termination of its asset purchase programme at the end of 2018.

In contrast to short-term yields, long-term sovereign yields remained relatively stable in the last quarter of 2018, although a slight drop was observed in the (virtually) risk-free yields. German and US 10-year sovereign yields fell by respectively 18 and 17 basis points to 0.19 and 2.83 %, against a backdrop of heightened geopolitical uncertainty, a perceived deterioration in the macroeconomic outlook and the US government shutdown.

Long-term sovereign spreads in the euro area vis-à-vis Germany have tended to widen slightly, reflecting repricing of risk in a more volatile financial markets environment. In some cases, however, the increases were more closely associated with specific domestic developments. In France for instance, the 10-year spread rose by 11 basis points against a background of internal protests against government policies that led President Macron to announce a higher-than-expected public deficit for 2019. In Belgium, the 10-year spread increased by 16 basis points as the Prime Minister handed in the government's resignation. In Italy, the 10-year sovereign spread was up by 20 basis points, reflecting continued uncertainty about the effects of announced economic policies. Nevertheless, the Italian spread dropped slightly in December 2018 after the government in Rome reached an agreement with the European Commission on the budget for 2019.

(1) The yield curve inverted about one year before each of the nine US recessions dated by the NBER since 1955. Only one false alarm was released in 1966 when the US GDP growth rate did not turn negative but dropped significantly.

10-YEAR INTEREST RATES
(percentage points, monthly averages)



Sources: BIS, Thomson Reuters.

TREASURY HIGHLIGHTS **2018 funding targets were reached and the funding plan for 2019 is introduced**

The last OLO auction of the year was held in November, and resulted in a total of **€3.515 billion** worth of funding. With this, the Belgian Debt Agency has reached its 2018 funding plan targets.

OLO AUCTIONS (€ 3.52 BILLION)

Date	OLO	NR	Issued (€ Billion)	Yield	Bid to cover
November 17	OLO 0.50 % 22/10/2024	OLO82	**0.700**	0.220 %	3.07
	OLO 0.80 % 28/06/2028	OLO85	**1.605**	0.804 %	1.40
	OLO 3.00 % 22/06/2034	OLO73	**0.485**	1.306 %	1.64
	OLO 2.25 % 22/06/2057	OLO83	**0.594**	2.021 %	1.75
Non-competitive tour			*0.131*		
Total November			3.515		

No EMTNs or Schuldscheine were issued in the fourth quarter of 2018.

In terms of portfolio structure, the average life of the portfolio remains high at 9.2 years (end of December). The implicit cost of the portfolio stabilized at 2.17 %.

Funding plan for 2019

The Belgian Debt Agency plans to issue €28.00 billion worth of OLOs in 2019, €5.94 billion less than the €33.94 billion issued in 2018. It expects to launch two new OLO fixed-rate benchmarks : a 10-year benchmark and a long-term benchmark with a minimum maturity of 15 years.

The Debt Agency also expects to issue €2.00 billion via its EMTN programme or other alternative funding instruments such as Schuldscheine. State Note issuance for private investors is expected to bring in just €0.25 billion of funding, given the low interest rate environment.

As for short-term funding, net short-term debt is projected to fall by €0.14 billion in 2019. The volume of Treasury Certificates, forecast to reach €24.7 billion at year-end 2018, is not expected to change over the year 2019. Some changes are being made to the Treasury Certificate programme in this area, but the issuance schedule remains unchanged, with two auctions per month. But the number of maturities will be reduced from twelve to six per year. Exceptionally, the Treasury will offer a supplementary line.

2019 Debt Management Strategy

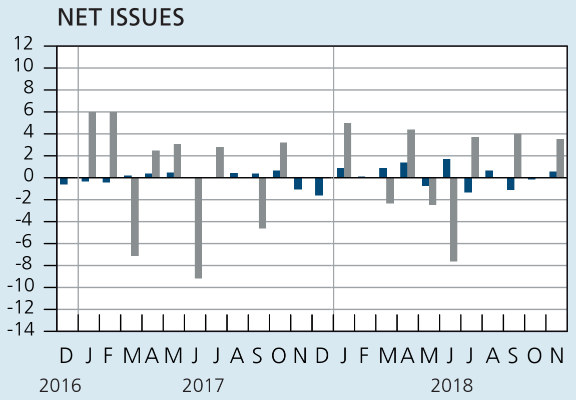
In 2019, both the maximum for the 12-month refinancing and the refixing risk will remain unchanged at 17.50 %. The maximum for the 60-month refinancing and refixing risk will also stay at 42.50 %.

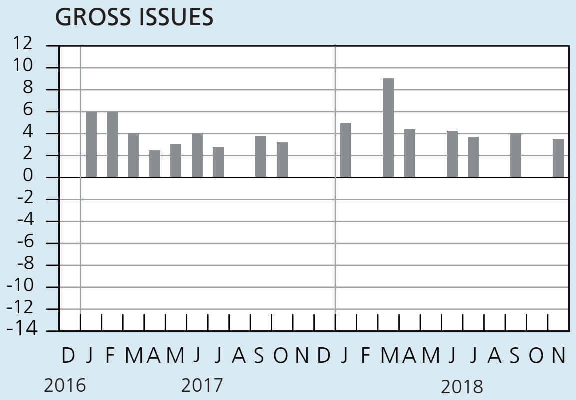
The average life of the debt portfolio is again required to be higher than 9.00 years.

The details of the 2019 Funding Plan are available on the Belgian Debt Agency's website : www.debtagency.be.

GOVERNMENT SECURITIES STATISTICS

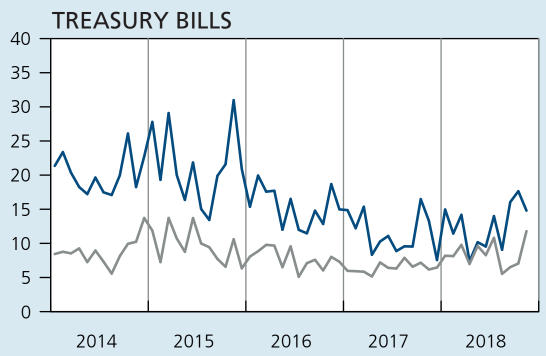
PRIMARY MARKET
(billions of euros)

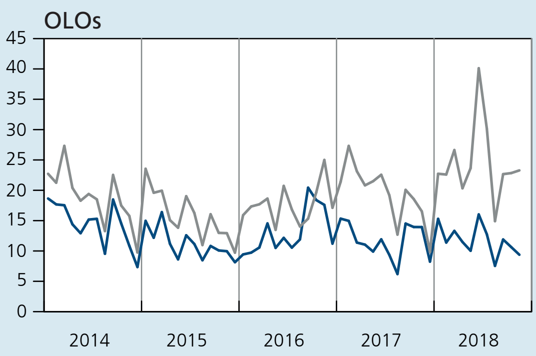




Source: Belgian Debt Agency.

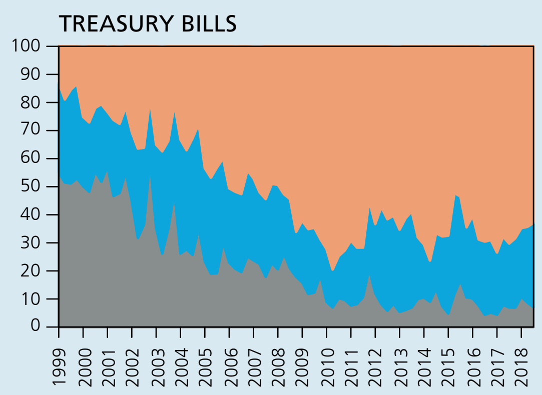
SECONDARY MARKET TURNOVER
(as reported by primary and recognised dealers to the Treasury, billions of euros)

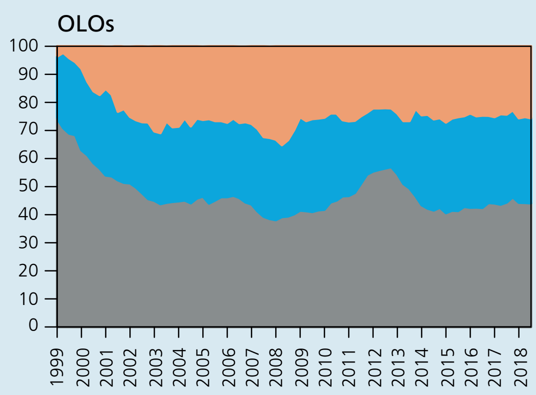




Source: Belgian Debt Agency.

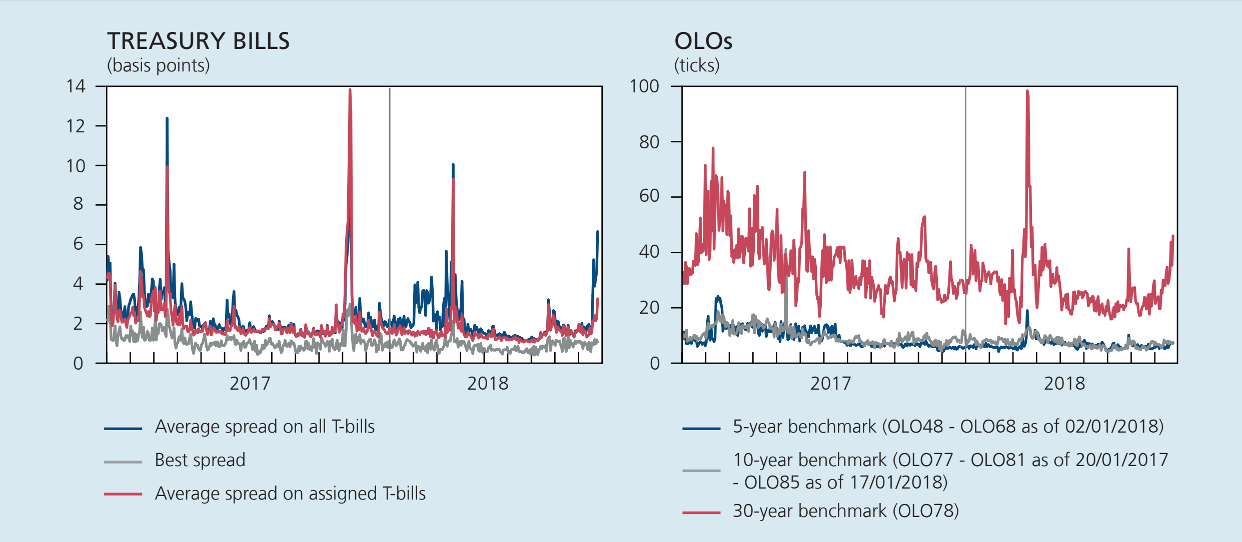
HOLDERSHIP BELGIAN SECURITIES
(in %)





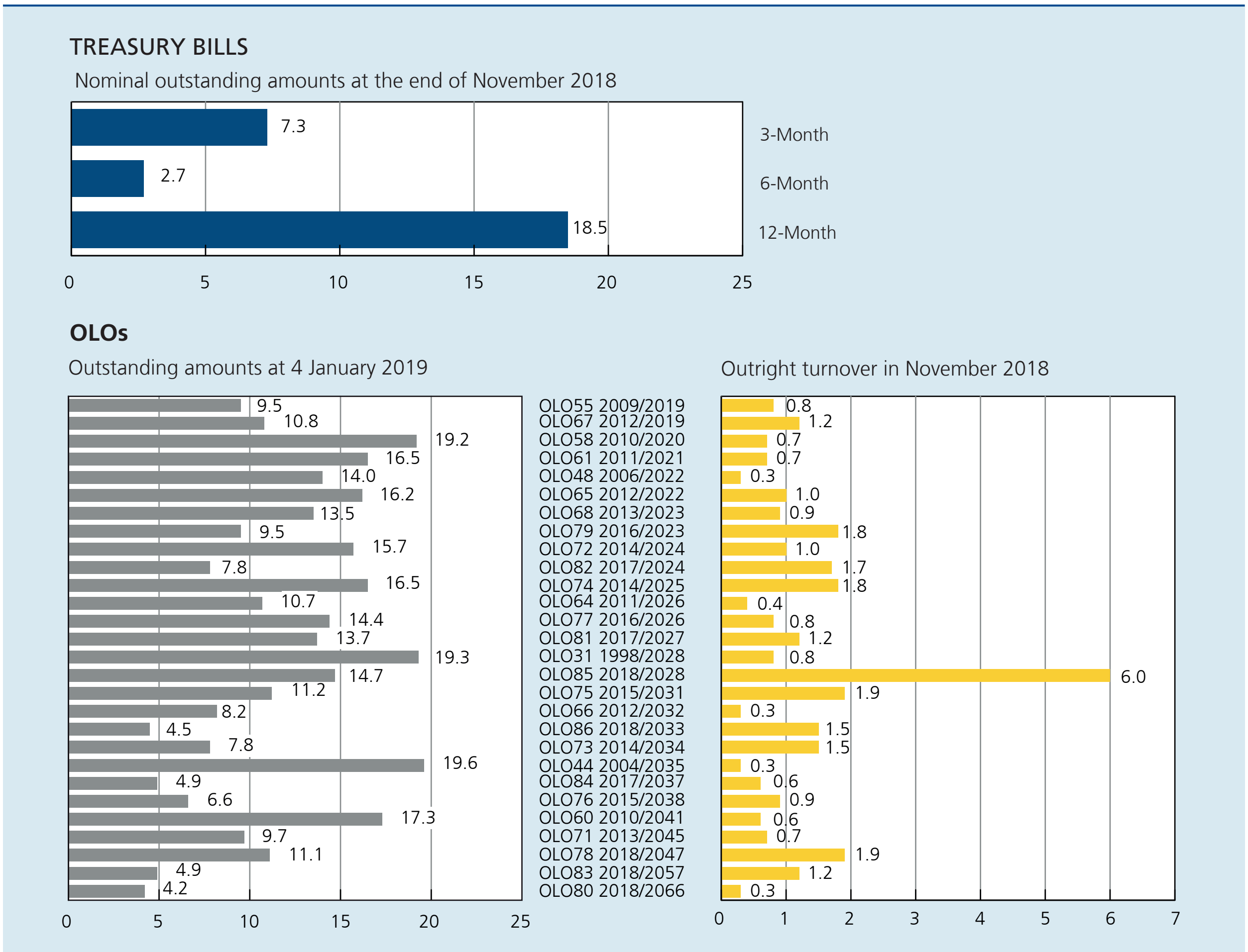
Source: NBB.

BEST BID/OFFER SPREADS [1]



Source : Treasury.
(1) As reported by three electronic platforms (MTS, Broker Tec and BGC eSpeed).

OUTSTANDING AMOUNTS AND TURNOVER
(billions of euros)



Source : Belgian Debt Agency.

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