Foreword

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Five years after the crisis began, the effects on the real economy are still apparent in the advanced economies. The adjustments are taking place very gradually, with large divergences between the various regions. In 2013, global economic growth remained moderate at 3 %. While growth lost momentum in the emerging countries, it gathered pace in the advanced economies. That applied particularly in the United States, prompting the Federal Reserve to start cautiously tapering its large-scale asset purchases from the beginning of 2014. However, at the same time, it announced that the key interest rate was likely to remain at its current low level for a considerable time. It is possible that the normalisation of the monetary policy stance may be accompanied by increased financial market volatility, as was already the case in 2013. In this context, it is crucial to calibrate the timing and pace of the exit accurately, and to communicate the chosen strategy in an appropriate way.

In the euro area, economic activity was down by a further 0.4 % year-on-year, but a turnaround was apparent from the second quarter, primarily in the peripheral countries, which was accompanied by a restoration of confidence. However, the reduction of the high debt ratios in the private and public sectors, high unemployment and the tight financing conditions that persisted in some Member States continued to dampen domestic demand. Nonetheless, considerable progress was made with fiscal consolidation and in correcting the current account deficits, though further efforts are needed to lay the foundations for a return to sustainable growth.

Throughout this adjustment process, the Eurosystem ensures stability. In the summer of 2012, the programme of outright monetary transactions (OMTs) was announced with the aim of quelling the doubts that had arisen over the irreversibility of the euro. Together with the macroeconomic rebalancing efforts and progress towards the banking union, that programme turned the financial markets around. Moreover, the ECB's key interest rate was cut in May and November 2013, bringing it down to 0.25 %, and forward guidance on interest rates was provided from July onwards. The ECB Governing Council will do everything possible to prevent a persistent fall in inflation – let alone deflation – from hampering the economic recovery. It aims to maintain inflation not just below 2 %, but close to that figure in the medium term.

The accommodative monetary policy is making a fundamental contribution towards the economic recovery and thus ensuring positive feedback effects on financial stability. Nevertheless, a long period of very low interest rates also implies specific risks for financial stability. From a medium-term perspective, monetary policy must also be wary of such risks, even though undesirable side effects of low interest rates must also be contained by prudential policy.

In the euro area, the continuing differences between national markets can thus be taken into account, while the interest rate policy can only be calibrated at monetary union level. Macroprudential policy therefore accords a particular role to a national component. In Belgium, a draft law on macroprudential policy entrusts that task to the Bank, in view of the latter's expertise in analysing systemic risks.

2013 was above all the year in which further crucial steps were taken towards developing the banking union. With the establishment of the single supervisory mechanism (SSM), the ECB will exercise direct supervision over the 130 or so largest banking groups in the euro area from November 2014.

Since the SSM must be credible from the start, the large banks are undergoing an in-depth assessment. If that reveals structural weaknesses or inadequate capital, then action must be taken, in the first place by the private sector but if necessary also via direct government support. This opportunity must be seized to restore confidence in the European banks so that the currently still disrupted lending process begins functioning properly again and can thus support the economic recovery.

The financial crisis management mechanisms must be integrated at a comparable pace. To that end, in December 2013, the EU Council approved a proposal for a Regulation establishing a single resolution mechanism, intended to bring together the national resolution authorities at euro area level. The Council also approved the principle of a single resolution fund, financed by contributions from the banking sector and gradual pooling of the national compartments.

In exercising its supervision over Belgian financial institutions, the Bank has paid particular attention to the risks associated with the changing business models, keener competition between banks, and the low interest rate environment. Low interest rates may in fact prompt financial institutions to seek riskier assets and, in the case of credit institutions, extend the maturity transformations. Checks were also done to see whether life insurance companies are adjusting guaranteed yields regularly in line with market conditions.

In addition, the risks associated with the banks' loan portfolios were examined, thus anticipating the general process of assessment by the ECB. This brought to light occasionally significant divergences in the way in which the various banks weigh up the same risk, and the capital buffers for housing loans proved to be smaller than in most other European countries. The Bank consequently decided to increase the weighting coefficients for the risks in the internal models used for mortgage loans. That will make the banks more resilient to potential property market shocks.

During the period of transition to the SSM, the Bank will need to deploy considerable resources, and will retain important functions even after prudential supervision is transferred to the ECB, as the authorities in the home and host countries of the principal subsidiaries of the large banking groups will play a key role in the multinational supervision teams. The national supervisors will thus enhance the system with their long-standing knowledge of individual institutions and familiarity with the local markets. In addition, the Bank will retain primary responsibility for supervising small credit institutions. Overall supervision of insurance companies and front-line supervision of the large payment and settlement infrastructures based in Belgium will also remain the responsibility of the Belgian authorities.

In 2013, agreement was also reached on a new banking law in Belgium. It provides for a structural reform designed to contain risk-taking by the banks. On the one hand, additional capital requirements will apply if a bank's trading activities exceed a certain threshold. Also, trading for own account is prohibited in principle, except for a small margin to take account of the fact that certain positions are actually inherent in risk management or the bank's intermediation role in support of economic activity.

The new banking law also transposes into Belgian law the new European Directive on access to the activity of credit institutions and on supervision of credit institutions, and the European Regulation incorporating the new prudential requirements of the Basel Committee into Community law. It also anticipates certain aspects of the Directive on the recovery and resolution of credit institutions, and aims to strengthen bank governance.

Economic activity picked up in Belgium, too, from the second quarter of 2013. Owing to the negative carry-over effect of the contraction in the previous year, the economy grew by barely 0.2 % year-on-year. The recovery was still too weak to generate a revival in employment, which declined by a further 11 000 units, bringing the unemployment rate to 8.4 % at the end of the year.

Nevertheless, the Belgian economy withstood the crisis fairly well. Belgium is one of the few euro area countries where activity has already regained its pre-crisis level. All the same, the crisis has left its mark on production potential, employment and public finances. In addition, developments on the current account and competitiveness fronts and the low potential growth point to fragility in the creation of prosperity.

In the past two years, steps have been taken to turn the tide. In a zero-growth environment, the public deficit was cut from 3.7 % in 2011 to 2.7 % in 2013. Pension and labour market reforms have been launched, and measures have been taken to foster competition in the network industries and improve the competitiveness of firms. Nonetheless, major challenges remain and there is a need to continue preparing for the future in a context which, even without the crisis, would feature the challenges associated with increasing globalisation, climate change, and above all, the costs of population ageing. Moreover, those costs are particularly high in Belgium.

Without straying from the path mapped out by the Belgian government in the 2013 stability programme, the period 2014-2016 must be used for structural consolidation of public finances in a manner conducive to growth, before the costs of ageing become fully apparent. Additional measures are also needed to control those costs and safeguard solidarity between the generations, including a further extension of working life.

Since the government's primary expenditure has now risen to 51 % of GDP, public finances must first be consolidated by control over spending, which is less detrimental to growth. The sixth State reform must be seized as an opportunity for tailoring policy more closely to the specific needs of the different Communities and Regions. That could create new levers for increasing efficiency and providing stronger support for the economy's growth potential.

There is little scope for raising additional revenue. It would actually be advisable to reduce the particularly high levies on labour incomes. The Pact for Competitiveness and Employment already includes plans for three cuts in those levies in 2015, 2017 and 2019 respectively, each amounting to € 450 million. Apart from spending cuts, other revenue sources could be used to finance reductions in the burdens on labour, such as indirect taxes, environment taxes, or taxes on property incomes. There is a need here for tax reforms that promote growth and employment, and preferably also simplify the tax system.

The restoration of sound public finances requires the support of sufficiently vigorous economic development. So, there is an urgent need for reform in many other areas, aimed at boosting growth potential and employment and thus strengthening the basis of social protection. Furthermore, in a small open economy, prosperity is fundamentally dependent on the ability of firms to secure a place in the global value chains.

In regard to price and cost competitiveness, Belgium has proved vulnerable in various respects over recent years. Not only are exports highly energy-intensive, but a substantial competitiveness handicap has also developed in terms of labour costs in relation to the three neighbouring countries. That is due to a handicap in relation to Germany. Experience over recent years has shown that such a discrepancy is hard to eliminate. In addition, wage-setting is insufficiently geared to productivity, and needs to accord greater importance to increasing job opportunities for the unemployed. To keep wage costs more in line with productivity, safeguard competitiveness and promote employment it is necessary to reflect on wage-setting procedures.

In the longer term, integration into the global economy depends primarily on the ability to innovate; firms therefore bear a significant responsibility here. Investing in R&D is absolutely vital to create a dynamic economy. There is a need for more networks between producers and research centres, and entrepreneurship must be encouraged and supported by a modern, efficient public administration. Product market reforms must remove the factors hampering the establishment of businesses or market access, boost competition and lead to appropriate pricing.

A dynamic knowledge economy also needs an adequate supply of high-quality labour. Investing in training, support and activation for job seekers is therefore a priority, and a complement to the increased responsibility which was the aim of the unemployment benefit reform. The quality of education is another crucial factor. Lifelong learning must become the norm. Facilitating and encouraging labour mobility is another essential objective. Creating new businesses and jobs rather than protecting existing ones without potential is the driving force behind economic progress.

Overall, the aim must be to maximise returns in the medium term, rather than focusing on immediate results. The fact that structural measures take time to produce their full effects is no reason for failing to take them; on the contrary, it should be an incentive for launching them as soon as possible. Consistency between the various spheres of action and – in a federal country such as Belgium – between the various levels of power should be another crucial focus of attention.

The challenges facing policy-makers are considerable, but if they are tackled promptly and consistently, they are not insurmountable. The need is greater than ever for a large-scale societal project geared to the future, supported by all elements of society and all levels of power, otherwise the high standard of living and high degree of social protection will inevitably come under strain.