5. Financial developments

5.1 So far, businesses have managed to overcome the shock of the COVID-19 crisis

Imposed in March 2020 to contain the spread of coronavirus, the first business closures had triggered fears of a wave of bankruptcies and numerous job losses in the hardest-hit sectors. The main concern was not so much the resulting loss of turnover but rather the cash reserves that firms held at that point, which might be insufficient to cope with a prolonged absence of income streams. In fact, many firms still had to cover a range of expenses such as paying rent and suppliers' invoices, employees' remuneration, insurance premiums or the servicing of loans previously obtained from banks.

In a study already mentioned in its Report on the year 2020[1], the Bank estimated that around one in four Belgian firms could face a cash shortage at some point during the first wave of the pandemic, albeit to varying degrees. In practice, this means that those firms had to either obtain additional funds or negotiate payment deferrals with their suppliers or other creditors, in order to avoid a cash deficit which would have prevented them from meeting their short-term commitments.

More than a year after the coronavirus appeared in Belgium, and after the year 2021 had begun with a number of sectors of activity still closed down, the extensive government measures have thus far substantially limited firms' losses and cash flow problems, so that bankruptcies recorded in 2020 and 2021 actually dropped to historically low levels. Although corporate debt levels have not risen significantly overall, a number of firms – particularly those operating in the sectors most affected by the lockdowns – have seen their financial health deteriorate since the start of the COVID-19 crisis. The federal and regional authorities therefore set up various schemes to strengthen their balance sheets.

1 See Tielens J., Ch. Piette and O. De Jonghe (2021), "Belgian corporate sector liquidity and solvency in the COVID-19 crisis: a post-first-wave assessment", NBB, *Economic Review*, June.

The support measures continued to play a key role in 2021

Public authorities were very quick to realise the problems that the lack of cash could cause, and hence the threat facing a broad swathe of the economy. They therefore speedily introduced various support measures to enable firms to stay afloat.

As well as facilitating furlough arrangements for staff, some of these measures consisted in the grant of flat-rate allowances for firms suffering a substantial reduction in their turnover as a result of the lockdowns. Paid by the regional authorities, these allowances were granted tax exemption by the federal government. Other federal and regional aid, similarly in the form of allowances or tax exemptions, was targeted more at the sectors most affected by the lockdowns. For example, restaurateurs were granted a temporarily reduced rate of 6% VAT on their purchases of food supplies, exemption from social security contributions, and corporation tax reductions. In addition, a number of general tax exemptions were introduced at federal level, such as the deduction of anticipated losses for 2020 from corporation tax, the investment deduction (to remain active until 2022), and tax concessions for landlords waiving their rent.

The financial sector also helped to attenuate the risks of cessation of payment due to the closure of some economic activities. In particular, it put in place a moratorium on the repayment of loans granted for an initial term of six months, which was extended several times before finally coming to an end on

30 June 2021. Apart from this moratorium, which was widely used by firms, the banks also provided businesses with liquidity simply by fulfilling their traditional role, either via credit facilities that already existed before the start of the pandemic or by granting new loans. Some of the latter were covered by two guarantee schemes set up by the federal government. The first automatically covered loans with a maximum term of twelve months, granted to viable businesses between March and December 2020. The second, activated in July 2020 and remaining in operation until 31 December 2021, concerned loans for a term of between 12 and 36 months (and up to five years with effect from January 2021). Under the second scheme, in contrast to the first, it was for the banks to decide whether to back the loan with a State guarantee. However, little use was made of these two guarantee schemes, probably because the cash flow problems of firms likely to use them had already been resolved in other ways. The banks also demonstrated some flexibility in relation to their debtors by allowing the rescheduling of repayment dates for a number of credit agreements.

While the repayment moratoria and State guarantees were conditional upon certain viability criteria, that was not the case for all the support measures. As already stated, the lump-sum allowances were essentially allocated to firms on the basis of the reduction in their turnover and/or the fact that they belonged to a branch of activity particularly badly affected by the lockdowns. Various reasons justify this government strategy, such as the prevention of escalating defaults on bank loans and excessive numbers of job losses, with the latter's potential implications for demand. However, it does have two drawbacks. First, it may create windfall effects, in that public funds may have been allocated to firms that did not need them to survive a temporary halt in their activities. That is the case, for example, if they could easily adjust their costs in line with the fall in sales, or if their business model enabled them to continue their business activity during the lockdowns. Also, it could hamper the "creative destruction" process by facilitating the survival of failing businesses. In the study mentioned above, it had been considered that, at the end of the first wave of the pandemic, 2 % of non-financial corporations were not viable before the pandemic erupted but had managed to make a profit at the end of the first wave thanks to the support measures (at least those for which the impact could be quantified). The annual accounts for 2020 which are now available seem to bear this out, because – as shown in box 1 – the impact of the COVID-19 crisis on firms' results and balance sheets was ultimately limited in that year. But the impact was greater on some businesses, notably those operating in the sectors most affected by the lockdowns.

BOX 4

The impact of the COVID-19 crisis on the financial health of firms: an initial assessment

While the COVID-19 pandemic had a substantial impact on the turnover and gross operating surplus of many firms, its effect on the balance sheets of non-financial corporations still seems to be relatively modest overall. That is one of the lessons to be derived from an analysis of the corporate accounts drawn up for the year 2020.

Although many firms saw their profits shrink as a result of the interruption in their activities during the lockdowns, or in some cases owing to supply problems, the percentage that actually ended the year 2020 with a loss was not noticeably different from the figure for previous years. Estimated at 29 %, that proportion was actually slightly lower than in 2019. Moreover, as more firms were able to carry forward gains in their equity, that also had the effect of boosting their solvency. The proportion of firms whose debts exceed the value of their assets therefore also declined from 14 % in 2019 to 13 % in 2020.

The COVID-19 crisis did not cause any serious damage to firms' profitability and solvency

Source: NBB.
1 Provisional figures based on around 374 000 sets of annual accounts filed by non-financial corporations. For 2019, the population covered totals 431 000 companies.
2 Hospitality, personal services, transport, travel agencies, miscellaneous creative, cultural and sporting activities.

This situation, which may appear paradoxical in a crisis context, is probably due in part to the allowances and tax exemptions that businesses received in 2020, since the compensation paid in respect of the loss of turnover was recorded as operating revenue. Yet, it conceals wide disparities, particularly between branches of activity. Taken separately, the results of firms operating in the sectors hit hardest by the lockdowns definitely deteriorated in 2020: 45 % of them ended the year with a loss, compared to 40 % in 2019. However, the proportion of firms facing a solvency problem remained stable.

As shown by Dhyne and Duprez (2021)[1], the impact of the COVID-19 crisis on firms' results not only varied from one sector to another but was also, and above all, heterogeneous between firms, even within a given branch of activity. While some firms saw their turnover fall dramatically in 2020, others recorded a much more moderate decline. There are also firms which saw their revenue increase, probably because their business model – e.g. specialising in online sales or in a specific category of products – enabled them to prosper. Another factor explaining the disparate impact of the crisis is that, despite easier recourse to furlough, the firms suffering a loss of turnover were not all able to reduce their consumption of intermediate goods and services proportionately.

1 See Dhyne E. and C. Duprez (2021), "Belgian firms and the COVID-19 crisis", NBB, Economic Review, September.

The combined impact of the various support measures on firms' cash flow and profitability was therefore also reflected in the number of bankruptcies recorded in Belgium. Compared to the average figures over the past ten years, there have been very few bankruptcies since the start of the COVID-19 crisis. Apart from the level of support – most of which continued to be granted during the third wave of the pandemic, i.e. in the first half of 2021 – that is also due largely to the moratorium on bankruptcies which was first introduced in April 2020 for a period up to 17 June in that year, and was then reinstated in November 2020 until January 2021. After that date, the tax authorities and the NSSO applied *de facto* moratoria on the payment of taxes and social contributions due. The NSSO waited until the autumn before again starting insolvency proceedings in the case of firms which failed to meet their obligations in that regard.

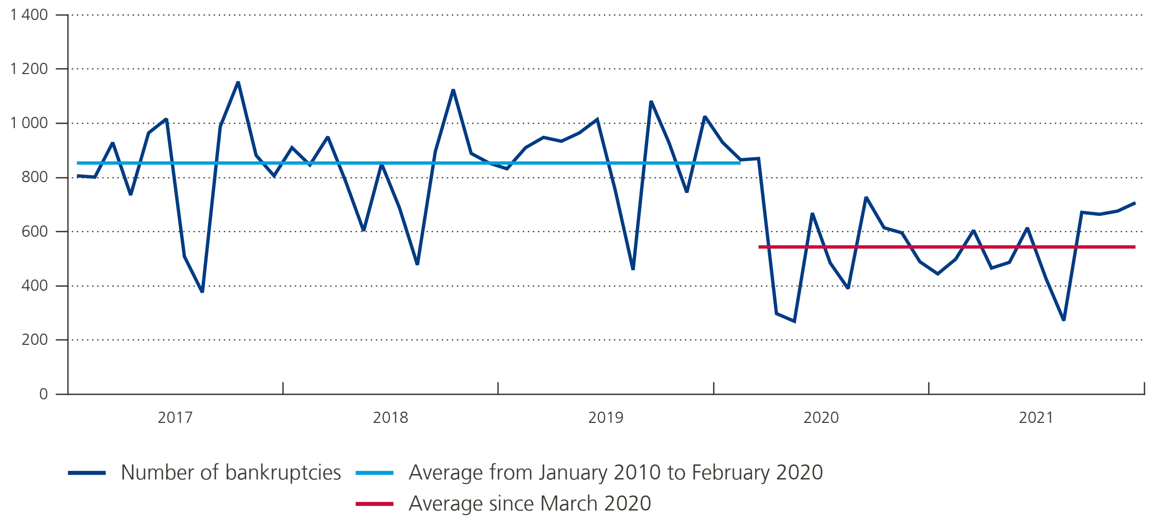
There have been very few bankruptcies since the start of the COVID-19 crisis

Although the various forms of government intervention undeniably enabled many businesses to survive the successive lockdowns, the amounts of the various allowances and tax exemptions were not always sufficient to cover the cash deficits in the case of some firms. They therefore needed to be able to rely on recapitalisation or medium- or long-term loans, to give them time to restore normal profitability and generate sufficient financial revenues to pay off their borrowings, while still having the resources needed to continue growing their business. To meet these needs, the government took steps to increase the supply of long-term finance. In 2020, the regional investment companies set up subordinated loan systems within the limits authorised by the temporary framework adopted by the EU. One of the latter's requirements is that certain viability criteria must be taken into account when granting funds to businesses affected by the crisis. Subordinated loans will also be granted by the Belgian Recovery Fund, the establishment of which was announced by the federal government in September 2021. That fund is co-financed by the Federal Holding and Investment Company and by institutional investors. The federal government also introduced tax incentives to encourage strengthening of the

Chart 5.1

The number of bankruptcies is still below the pre-pandemic levels

(monthly bankruptcy declarations [1])



Source: Statbel.

1 The data cover declarations of bankruptcy for individuals pursuing an occupation on a self-employed basis, legal persons, and organisations without legal personality.

capital of firms hit by the crisis. These include a tax exemption equivalent to the losses incurred in 2020 on revenues generated between 2021 and 2023 if they are allocated to the reserve. In addition, a "tax shelter" type of personal income tax reduction was granted for investment in share capital in firms suffering a loss of at least 30 % of their turnover between mid-March and the end of April 2020. In view of the persistence of the pandemic, the federal government decided to extend this last measure adopted in April 2020, widening its scope to include firms whose turnover contracted by 30 % or more between mid-March 2020 and the end of August 2021.

Nevertheless, whether granted by the financial sector or by public investment companies, long-term loans are not accessible to all businesses. That is the case, for example, if firms do not meet certain viability criteria, as that could cast doubt on their ability to service a new loan. It is also possible that such a loan might push their debt to a level detrimental to their solvency, for example if they do not have sufficient assets to pledge as security for potential lenders. In such cases, financing needs have to be resolved via funds contributed in the form of current account advances by the directors, partners or shareholders of the undertakings concerned.

Long-term loans are not accessible to all businesses

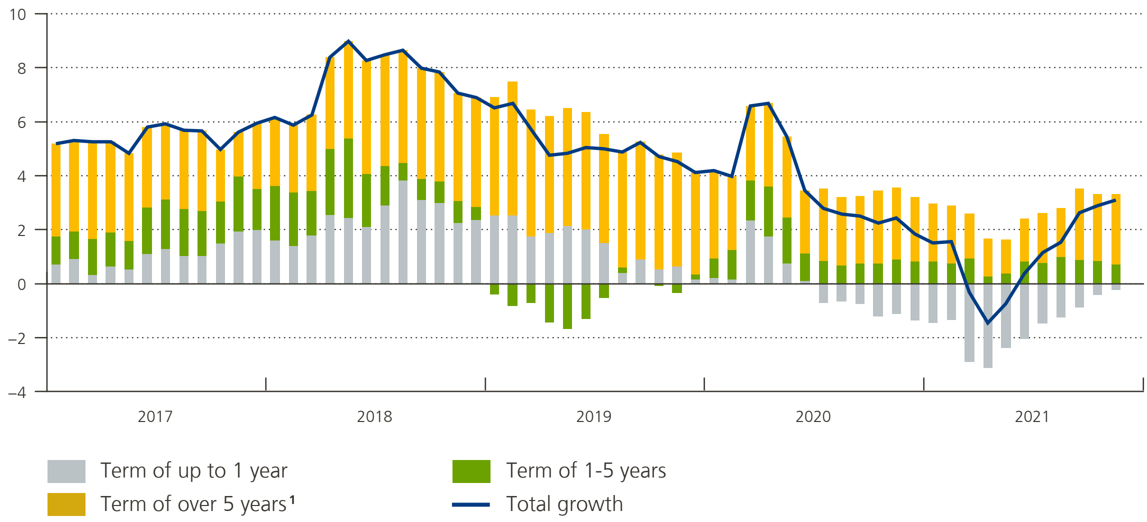
The growth of bank lending picked up at the end of the year

Lending to businesses continued to decline during the initial months of 2021, maintaining the trend which had emerged at the beginning of the summer in 2020. According to the results of the bank lending survey (BLS) covering the four largest banks active in Belgium, that trend was due partly to the decline in investment and, to a lesser extent, to a reduction in working capital requirements. The latter also meant that loans of up to one year made a negative contribution to the total growth of bank lending. Another factor which may have affected lending to businesses concerns loan criteria, which have become progressively stricter since the start

Chart 5.2

The growth of business loans picked up in the second half of 2021

(growth of loans by resident banks to non-financial corporations, annual percentage change and contributions)



Sources: ECB, NBB.
1 Including loans securitised or otherwise transferred.

of the COVID-19 crisis, owing to the increase in credit risks and lower credit risk[1]. In addition, credit growth fell to a low point between March and April 2021, owing to a base effect. This concerns the distorting effect of the peak which had occurred in the corresponding period of 2020, as credit growth rates are usually expressed in year-on-year terms. That growth peak was due to the temporary use of credit lines by a small number of large companies which were trying to boost their liquidity position at that time.

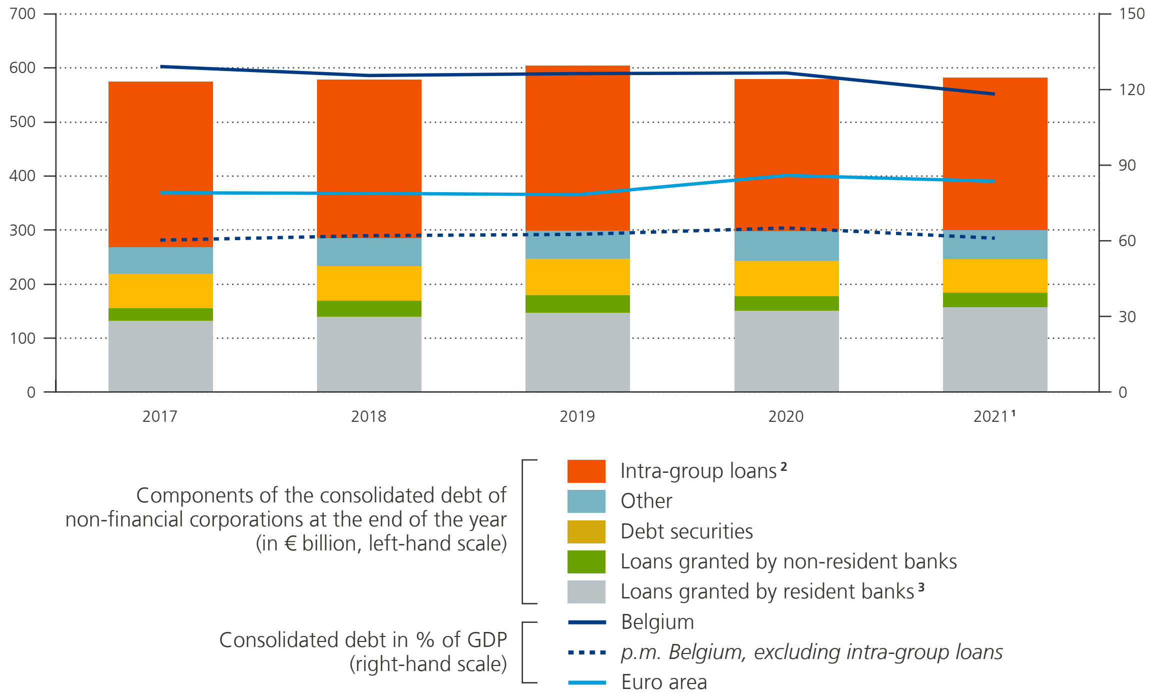
The growth of lending to businesses became positive again from June 2021. In November, it came to 3.1 % year-on-year. This can be viewed in the context of the revival in activity during the year which, according to the BLS findings, gave rise to additional demand for loans to finance new investment, stocks and working capital needs. Nonetheless, the credit growth recorded at the end of 2021 falls short of what was seen in the two years preceding the outbreak of the COVID-19 pandemic.

Overall, according to the financial accounts data, the debt of Belgian non-financial corporations to resident banks increased by € 6.7 billion in the first nine months of 2021, to reach € 157.9 billion at the end of September (including securitised loans). The outstanding amount of loans obtained from non-resident banks expanded by € 160 million over the same period. This year, the amount of debt securities repaid at maturity far exceeded the level of new issues, so that the outstanding amount was down by € 4 billion. Intra-group financing obtained from non-resident entities or non-institutional lenders expanded by € 744 million. If loans by other financial intermediaries and the government are included, the total consolidated debt of Belgian non-financial corporations came to € 582.1 billion at the end of the third quarter of 2021, or 118.2 % of GDP, compared to € 578.5 billion (126,6 % of GDP) at the end of 2020. Taking account of the level of intra-group financing in Belgium, that is still well above the figure for the euro area as a whole. If that component is excluded, the consolidated debt came to 61.1 % of GDP at the end of September 2021.

1 The tightening of conditions for accessing bank lending since the beginning of 2020 is also confirmed by the Bank's quarterly survey of firms' assessment of credit conditions.

Chart 5.3

The total debt of non-financial corporations remained relatively stable



Sources: ECB, NBB.

1 Data relating to the situation on 30 September 2021.

2 Intra-group loans are defined as loans granted by captive money lenders and by the foreign non-financial sector. The debts of resident non-financial corporations to other resident non-financial corporations are disregarded.

3 Including loans recorded as assets on the balance sheet of securitisation vehicles.

5.2 The situation of households is mixed, with some facing greater insecurity while others have to decide between financial investment or investment in property

While the crisis took a heavy toll on some groups of households (which suffered loss of income combined with the erosion of their savings), others – having less opportunities for consumption – were able to build up their assets and invest in the financial markets and property. Staging a strong recovery, the Belgian property market, like that in other European countries, experienced a boom in prices which made housing less affordable. At the same time, household debt – though still rising – seems to be under control (improvement in loan quality and low default rates).

The vulnerability of some groups has increased …

The public health crisis has varied in its repercussions from one household category to another. Not all households have emerged in a stronger financial position after the months of lockdown or restrictions. The aggregate data obtained from the financial accounts mask that reality. The use of data from surveys, such as the Bank's monthly consumer survey, which was supplemented by questions designed to measure the impact of the COVID-19 crisis on households' financial situation, can therefore shed light on questions concerning the differing real-life situations [1].

While a large proportion of households experienced little (less than 10 %) or no loss of income as a result of the crisis, a certain section of the population did suffer in that way, though the number has fallen as the months go by (for more details, see chapter 3). In particular, the survey data (variables available only since the start of the crisis) reveal that, for those households, opportunities for saving steadily disappeared and their savings buffer collapsed. Thus, since April 2021, a stable proportion of one in twenty households (compared to one in ten at the start of the pandemic) stated that they still had to contend with a loss of income in excess of 10 % and only had enough savings to cover current expenses for a maximum of three months. The gradual exhaustion of their savings has therefore made these households particularly vulnerable and increased their risk of hardship.

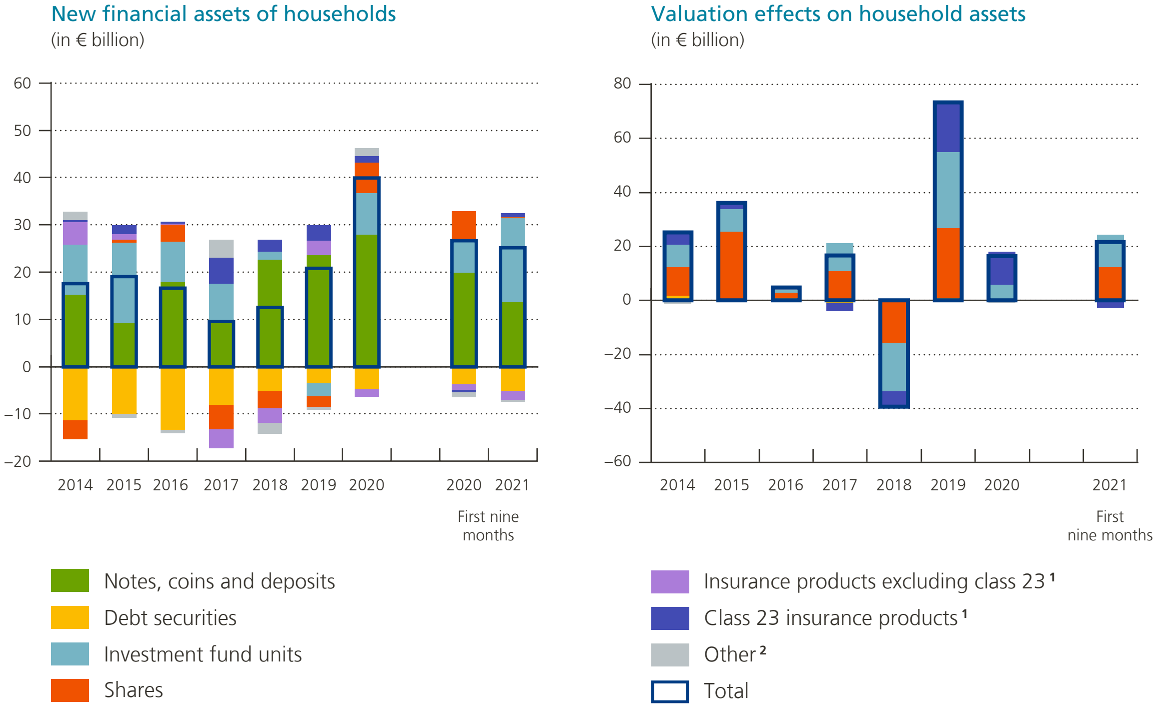
… although the financial position is better overall

However, in overall terms, after the health crisis had been going on some for months, the financial position of Belgians was better than before. The lack of opportunities for spending during the lockdowns or in periods of travel restrictions due to the COVID-19 pandemic led to a substantial rise in financial assets in 2020. That trend continued during the first nine months of 2021, with new financial investment during that period practically matching the volume increase recorded in the first three quarters of 2020.

1 For more details, see Statistical Focus (2021), "Impact of the COVID-19 crisis on household incomes and savings: results after one year in the light of the consumer survey", NBB, April.

Chart 5.4

Households continued to display an interest in medium-risk investments, which also went up in value in 2021



Source: NBB.
1 This item includes the net claims of households on technical insurance reserves, pension funds and standard guarantee reserves.
2 In the left-hand section of the chart, this item comprises, in so far as they have been recorded, trade credit as well as miscellaneous assets of general government and financial institutions. In the right-hand section of the chart, this item also covers notes, coins and deposits and insurance products not ranked under class 23.

Households also put part of their savings into riskier financial assets, to a greater extent than in the previous year: while money was still placed in accounts and deposits, Belgians also favoured investment funds in 2021, in contrast to debt securities and insurance products without a capital guarantee (class 23). The continuing deep-seated preference for liquid assets may also reflect a propensity for precautionary savings in the context of escalating prices of consumer goods, particularly energy.

Some household savings went into riskier financial products

Apart from new investment, existing financial assets benefited from positive valuation effects in the first nine months of 2021 as a result of rising prices on the financial markets. Households owning equities and investment funds thus made an extra € 22 billion approximately.

Taking account of transactions and valuations, the financial assets (excluding debts) of households in Belgium therefore rose by almost € 46 billion between January and September 2021, climbing to € 1 507 billion (+3.1 %), which is more or less stable in real terms. Apart from the financial component, household wealth also includes property assets which, according to the available data, reached almost € 1 800 billion at the end of the third quarter of 2021. Over the first three quarters of 2021, that represents a rise of 8.5 % compared to the corresponding period of the previous year. The escalating value of property assets is due to both the new investment made by individuals and the rapid rise in house prices.

House prices rose steeply

In 2021, the housing market saw a strong revival in activity after the number of transactions had fallen sharply at the beginning of 2020 owing to the COVID-19 pandemic, but also the abolition of the housing bonus in the Flemish Region on 1 January in that year. The growth of real estate activity which began in the second quarter of 2020 continued overall during the first three quarters of 2021, with a bounce of 36.2 % compared to the corresponding period of the previous year. In addition, in the third quarter of 2021, the number of transactions was 8.6 % higher than the level of activity recorded two years previously, i.e. before the COVID-19 pandemic and the impact of the aforesaid tax reform.

Price growth accelerated again in 2021, reaching 8.5 % over the first three quarters compared to the corresponding period of the previous year. The price rise therefore exceeds that seen in 2020 (5.8 %) but is also above the average for the three previous years (3.7 %). This is in fact the strongest rise since 2007. Taking account of inflation, the real rise in house prices is still significant, with a year-on-year increase of 7.1 % over the first three quarters of 2021.

This rise in house prices was general, in that it was evident in all three Regions of the country on a similar scale: over the first three quarters of 2021, the year-on-year increase came to 8.6 % in the Flemish Region, 8.7 % in the Walloon Region and 6.6 % in the Brussels-Capital Region. It also concerned all types of housing, with prices of ordinary homes rising by 8.9 % over the same period, while villas and apartments went up by 9.1 % and 7.4 % respectively.

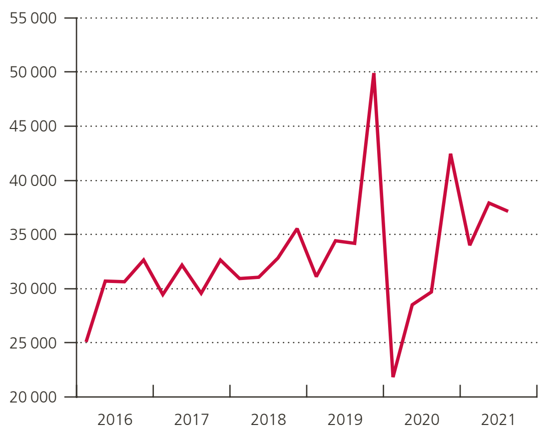
Except in a few countries, particularly Spain and Italy, property prices also displayed a marked rise in the euro area. On average, they increased by 6.3 % during the first three quarters of 2021, exceeding the rise in previous years. Although prices in Belgium went up by more than the euro area average, the rise was still smaller than that recorded in many European countries over the same period, such as Germany (9.9 %), Austria (10.8 %), the Netherlands (12.2 %) and Luxembourg (15.3 %).

Apart from the fall in mortgage interest rates which, all other things being equal, boosts demand for housing, the persistence of the general low yield environment and the associated search for yield also bolstered the property market in 2021

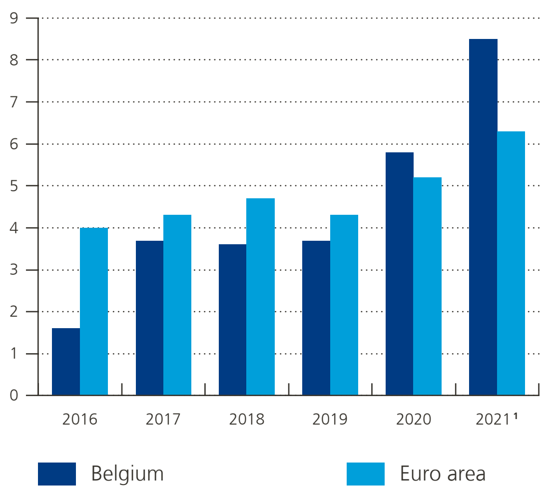
Chart 5.5

In 2021, the growth of real estate activity and house prices continued

Number of transactions on the secondary market



Residential property prices
(percentage annual change)



Sources: Statbel, NBB.
1 First three quarters.

and contributed to the rise in property prices, especially as the tax rules on securities accounts were amended in Belgium, reducing the attractiveness of that type of investment. More specifically in the case of the primary market, the price of new builds was propelled higher by the rising cost of building materials, with the ABEX index up by 4.6 % in 2021, the biggest rise in 13 years and more than one percentage point higher than the average for the three preceding years.

However, the 2021 rise in property prices cannot be explained entirely by the main market determinants, namely average household disposable income, mortgage interest rates, demographics and changes in property taxes. In 2021, the degree to which market prices deviated from their reference value – i.e. the value determined by the said factors – rose to an average of 20.8 % during the first three quarters. It is also worth noting that the house price boom is not attributable to a change in the composition of the transactions since the COVID-19 pandemic, as the share represented by detached houses and the average size of gardens, the average habitable area and the average energy efficiency of the buildings have expanded very little since the revival of real estate activity in the third quarter of 2020, and that is in line with a pre-existing trend.

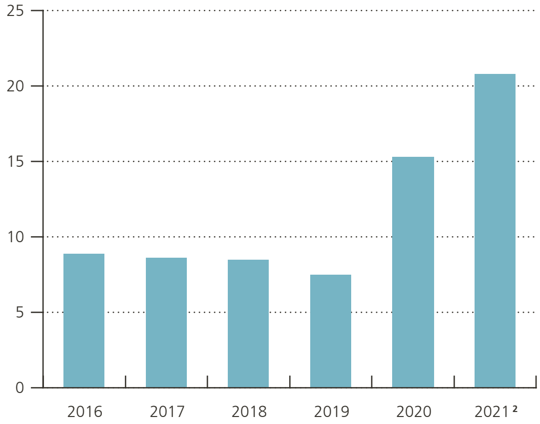
Growth of property prices accelerated again in 2021

On the supply side, all the statistics point to a further expansion of the housing stock in 2021, as residential investment and value added in the construction industry recorded a marked rise. In fact, conditions have generally been favourable to investment in property and the construction of new housing : mortgage interest rates have remained at historically low levels, keeping down the cost of financing such investment, and – as property prices

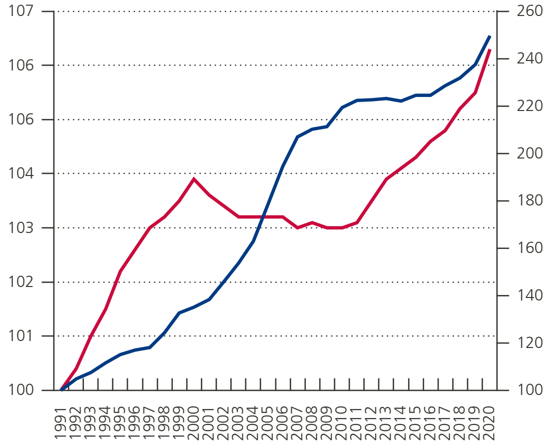
Chart 5.6

The rise in property prices cannot be attributed entirely to the main market determinants

Deviation of property prices from the prices estimated according to the Bank's model [1]
(in %)



Housing stock and property prices
(indices 1991 = 100)



Sources: Statbel, NBB and own calculations.

1 See Warisse Ch. (2017), "Analysis of the developments in residential property prices: is the Belgian market overvalued?", NBB, *Economic Review*, June, 61-77.

2 Average of the first three quarters.

3 Deflated by the private consumption deflator.

have outpaced the rise in construction costs – the apparent profitability of investing in new housing has again improved.

While the expansion of the housing stock is a factor that may moderate the rise in property prices, particularly if it outstrips the increase in the number of households as was the case at the beginning of this century, the recent increase in supply has instead been accompanied by a marked rise in house prices, suggesting that it is mainly demand factors that are driving the property price boom.

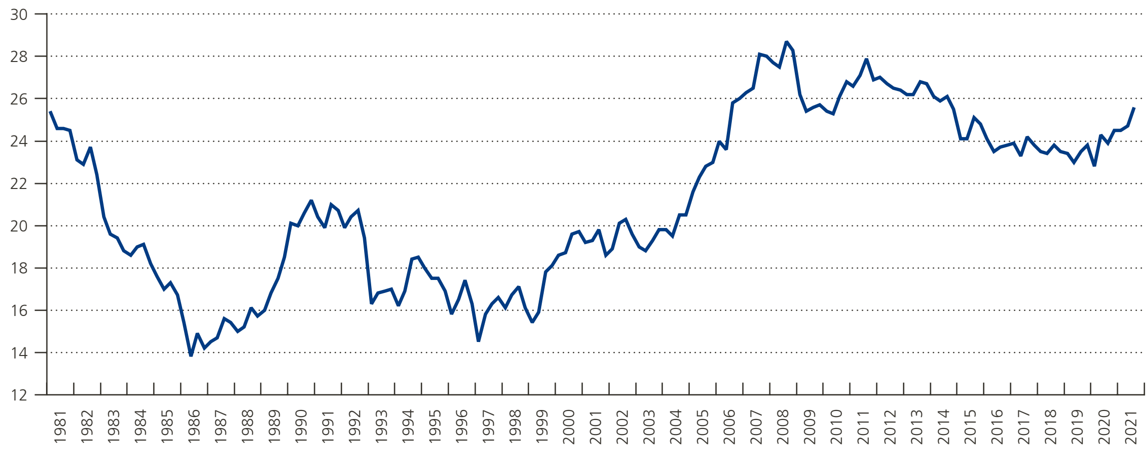
The affordability of property has diminished somewhat

The surge in property prices has also made property somewhat less affordable. The estimated share of households' net disposable income that has to be spent on repaying a new mortgage loan – with a loan-to-value ratio of 80 % and a term of 20 years – amounted on average to 24.9 % during the first three quarters of 2021. Although that is higher than the peak reached in 2020 (23.9 %), it is still below the peak of 28.7 % recorded in the third quarter of 2008, just before the eruption of the global financial crisis. The recent increase in house prices has therefore had a greater impact on households' ability to repay a mortgage loan than the rise in incomes and the maintenance of low interest rates.

Chart 5.7

The rise in house prices has reduced affordability to some extent

(share of households' net disposable income spent on repaying a new mortgage loan[1], in %)



Source: NBB.

1 This indicator is based on the assumptions that a mortgage loan has an average term of 20 years and that it is granted to finance 80 % of the value of the property purchased. Repayment is assumed to take the form of annual instalments and takes no account of any tax deductibility of the loan.

Debt levels have increased but remain under control

The growth rate of household lending has continued to rise, and that trend has been accentuated as the months go by, propelled by home loans. These developments were facilitated by the accumulation of capital during the health crisis, which also permitted investment expenditure financed by borrowing. In addition, reflecting the surge in property prices, the average amount borrowed for the purchase of a home increased significantly, and at a faster pace than in previous years, rising from € 135 100 at the end of 2020 to € 144 300 in November 2021. Overall, taking new investment and price rises together, the annual rate of change in home loans, which came to 4.4 % at the end of 2020, peaked at 6.4 % in September 2021, before subsiding slightly to 6.1 % in November. Between January and November, new loans had been issued for a net total of € 12.5 billion.

The historically low interest rates – rates on ten-year mortgage loans remained below 1.40 % throughout the year – undoubtedly helped to stimulate demand, as stated by the banks in the BLS, while considering that other factors probably also played a role, such as the outlook for the property market and consumer confidence.

Credit conditions remaining relatively strict contributed to the improvement in the overall quality of mortgage loans

At the same time, defaults on both mortgage loans and consumer loans have remained low. Default rates on home loans which benefited from the moratorium introduced by the banks on account of the COVID-19 pandemic up to the end of June 2021 continued falling until then before stabilising at 0.7 % in the ensuing months. Default rates were similarly restrained in the case of other types of loans to households.

The rise in amounts borrowed by households coinciding with the decline in default rates may reflect preventive behaviour on the part of banks, more willing to lend to households with better collateral and borrowing capacity. That trend had already been apparent in 2020.

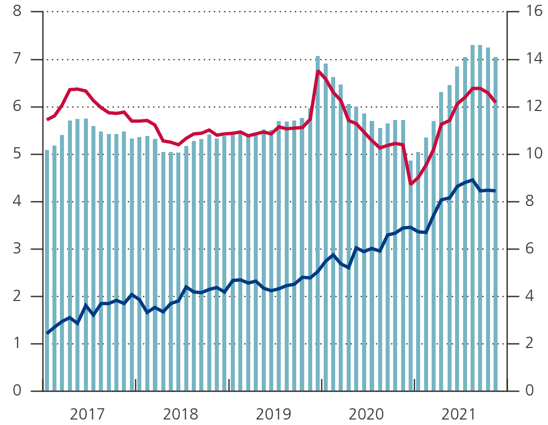
On the credit supply side, at the beginning of the year, the banks polled in the BLS reported a slight easing of their mortgage loan conditions, owing to a downward revision of the risk perception. That essentially took the form of a reduction in the margins

Chart 5.8

Household debt increased, driven up by mortgage borrowing

Growth rate of mortgage loans

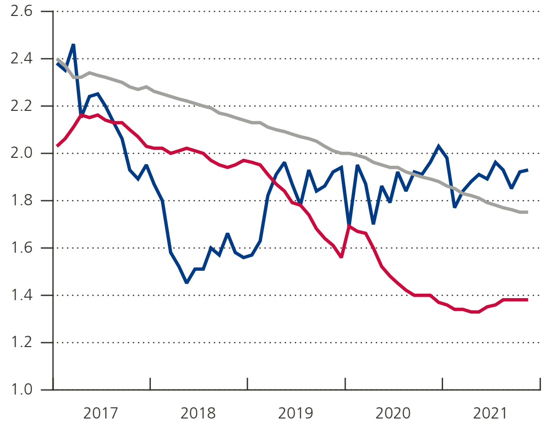
(in %, unless otherwise stated)



- Cumulative net monthly flows over 12 months (in € billion) (right-hand scale)
- Annual growth rate – Belgium
- Annual growth rate – euro area

Interest rate on mortgage loans

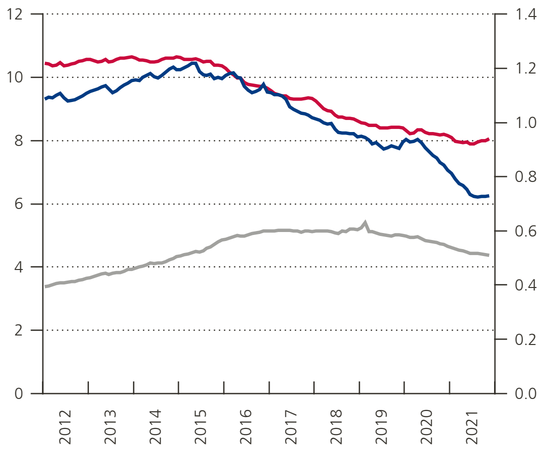
(in %)



- Variable rate, initial rate fixed for less than 1 year
- Initial rate fixed for longer than 10 years
- Average interest rate on current loans with a residual term of more than 5 years

Default rate on household loans

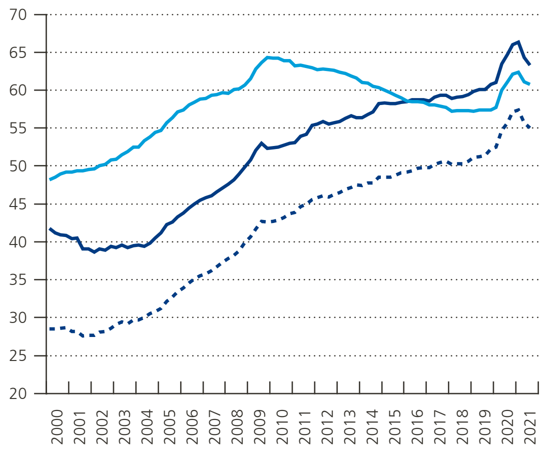
(in %)



- Instalment plans
- Credit lines
- Mortgage loans (right-hand scale)

Household debt

(in % of GDP)



- Belgium
- Of which: mortgage debt
- Euro area

Sources: ECB, NBB.

on standard loans while the other credit conditions (maturity, collateral, loan volume and charges other than interest) remained unchanged. After that, lending conditions remained unchanged during the following three quarters. Over the year as a whole, they were therefore still relatively strict, taking account of the repeated tightening in 2019 and 2020. In practical terms, the result was an improvement in the loan-to-value (LTV) ratio which relates the amount borrowed to the value of the property purchased.

The banks' tightening of credit conditions relating to the LTV ratio of new mortgage loans is due to the prudential expectations announced by the Bank at the end of 2019 (see also box 5). In comparison with previous years, far fewer loans with a high LTV ratio were therefore concluded in 2020 and in the first half of 2021. In introducing these measures, the Bank aims to protect new borrowers from excessive debt and to ensure that the risks in the mortgage loan portfolios of financial institutions do not continue to rise.

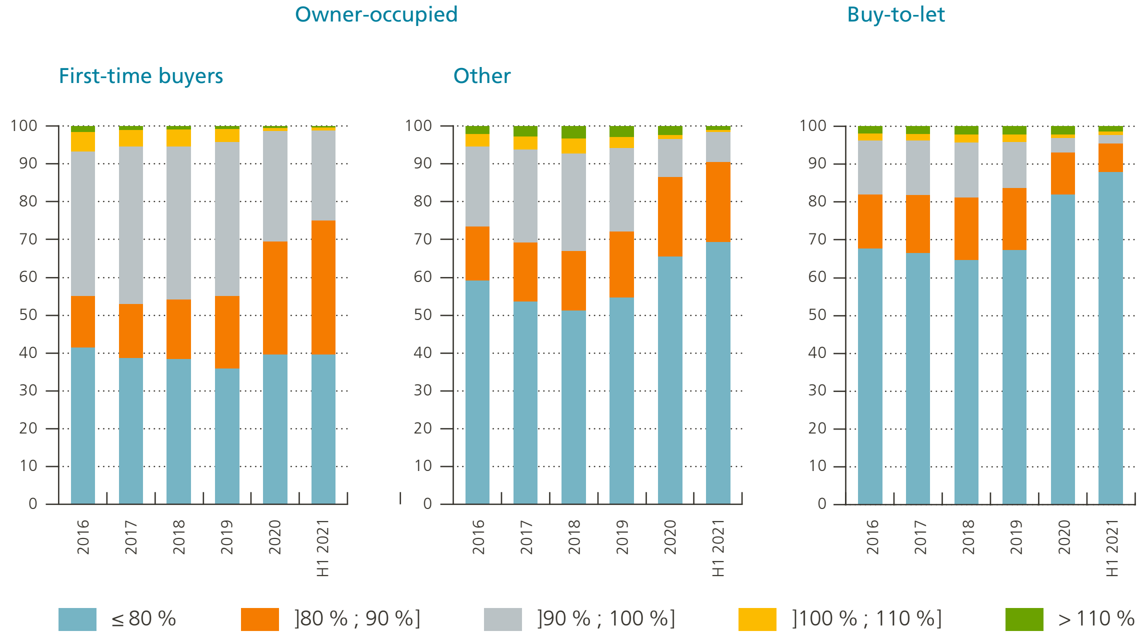
The Bank's recommendations distinguish between loans granted for the purchase of an owner-occupied property and those for the purchase of a buy-to-let property. In the latter – riskiest – category, only 12 % of new loans concluded in the first half of 2021 still had an LTV ratio of more than 80 % (the reference value applied by the Bank for this type of loan). In 2018, that proportion had still amounted to 35 %. In the case of new owner-occupied loans (except to first-time buyers), only 9 % still had an LTV ratio of more than 90 % (reference value), compared to 33 % in 2018. In the case of first-time buyers, the proportion of loans with an LTV ratio of more than 90 % dropped from 46 % in 2018 to 25 % in the first half of 2021. According to the Bank's recommendations, which are less strict for first-time buyers, 35 % of these loans can exceed the LTV limit of 90 %. The fact that institutions did not make full use of the available tolerance margins for granting loans with a high LTV ratio also indicates that demand for such loans has fallen since the measures were introduced. Also, the Central Individual Credit Register figures show that the proportion of young borrowers (under the age of 35 years) has been stable at around 35 % in recent years. These findings together with the loan dynamics therefore show that the Bank's prudential expectations are sufficiently flexible for the mortgage market to remain accessible to first-time buyers.

While household debt does not show any particular signs of fragility overall, it peaked at € 326.6 billion

Chart 5.9

Fewer loans with a high LTV ratio in 2020 and in the first half of 2021 than in previous years

(breakdown of new mortgage loans according to the LTV ratio, in % of the total)



Source: NBB.

in September 2021, representing a 3.5 % increase against the end of 2020. Mortgage debt made up the bulk of lending to individuals (86.9 %). Although debt levels declined in relative terms as a result of the recovery of GDP in the first two quarters of 2021, they nevertheless remained above the euro area average. Thus, household debt in Belgium fell from 66.0 % of GDP at the end of 2020 to 63.3 % at the end of September 2021, while in the euro area it averaged 60.8 % of GDP at that time. In Belgium, debt also remained at a level well above the plateau reached in 2018 and 2019 (average of 59.7 % of GDP).

BOX 5

Macroprudential measures

In March 2020, in its capacity as macroprudential authority, the Bank decided to release the countercyclical capital buffer. That buffer is built up in times of dynamic lending to give banks sufficient room for manoeuvre when economic conditions deteriorate. The macroprudential policy stance thus switched from a phase of preventive build-up of capital buffers to crisis mode in which some buffers were released. Since the outbreak of the COVID-19 crisis, it has been important for the supervisory authorities to safeguard the resilience of the banking sector and to ensure that the banks can continue to perform their role of lending to businesses and households. In addition, to make sure that the available bank buffers are used primarily to support the economy, the importance of a prudent dividend distribution policy was emphasised from the macroprudential perspective, in addition to the microprudential recommendations on that subject.

Although the economic conditions improved during the year under review, the Bank has not yet decided to rebuild the countercyclical capital buffer. Furthermore, it has stated that it has no plans to do so before the second quarter of 2022, so long as there are no major deviations from the current expectations concerning loan losses and credit growth, in particular. The Bank is keeping a close watch on these developments.

The Bank also closely monitors developments on the housing market. For some years now, it has required the Belgian banking sector to maintain a specific macroprudential capital buffer for real estate risks, owing to the banks' substantial exposure to that market in the form of mortgage loans. In May 2021, that measure was extended for a further year. In the event of problems on the property market, banks can use the buffer – amounting to around € 2 billion for the sector as a whole – to absorb losses due to default and to be proactive in proposing sustainable solutions for borrowers facing payment difficulties. That reduces the risk of a housing market crisis erupting in the wake of a substantial rise in the number of defaults and evictions. So long as the vulnerabilities on the market persist and there is no sign of the risks materialising, e.g. via increasing payment difficulties, the Bank will maintain this buffer for real estate risks.

At the beginning of 2020, alongside this capital buffer, the Bank issued prudential expectations for institutions granting mortgage loans. Those recommendations were also maintained following the outbreak of the COVID-19 crisis. They aim to improve the average credit quality of new mortgage loans because, in recent years, the proportion of risky loans has risen significantly, and that may lead to substantial loan losses in the event of a negative shock. In 2021, for the first time, institutions had to report to the Bank on their compliance with the recommendations for any new mortgage loans granted in 2020. The sharp fall in the percentage of loans with a high LTV ratio (see chart 5.9) indicates that the recommendations were indeed complied with overall. At the same time, the persistent dynamism of mortgage lending and the fact that the available tolerance margins for granting loans with a high LTV ratio has not been fully used, show that these recommendations leave sufficient room for manoeuvre so that the mortgage market remains accessible to solvent borrowers, including young purchasers and first-time buyers (for whom the recommendations are the most flexible).

5.3 In 2021, the COVID-19 crisis had a more limited impact on the banking sector than initially expected

So far, the Belgian banking sector has stood up well to the challenges which it has faced following the eruption of the COVID-19 pandemic. At the start of the crisis, it was expected that the sector would have to contend with a wave of defaults, but up to now those fears have not been borne out. The reason lies mainly in the effectiveness of the various support measures and the improvement in economic conditions. In addition, the banking sector's robust financial situation has enabled it to provide support to the economy by lending to businesses and households and by granting payment deferrals or other forms of loan restructuring for borrowers encountering financial problems. The sector thus helped to absorb the shock and was not itself the source of the problems, as it had been at the time of the 2008-2009 financial crisis. However, the risks have not entirely gone away. New waves of the pandemic are creating uncertainty over the speed and strength of the economic recovery, so that credit risk remains a point of attention. Moreover, the banking sector still faces some pre-existing challenges, such as the low interest rate environment, business model sustainability, and digitalisation.

The Belgian banking sector was able to support the economy

During the first nine months of 2021, the outstanding volume of loans in the Belgian banking sector increased by € 7 billion in the case of businesses and € 15 billion for households [1]. Most of these are loans to Belgian counterparties, but they also include loans to borrowers on banks' main foreign markets. At the end of September 2021, the sector therefore recorded an outstanding total of € 333 billion in loans to households and € 265 billion in loans to businesses, representing 50 % of the total assets on its balance sheet.

This new credit growth in uncertain economic circumstances was possible thanks to the ample amount of buffers available in the Belgian banking sector. Those buffers, which were already high at the start of the COVID-19 crisis, have expanded further as a result of the measures introduced since then. The prudential measures, such as the restrictions on dividend distribution or the release of accumulated buffers, boosted the available capital buffers while the monetary policy measures – particularly the easing and expansion of the TLTRO programme – led to an increase in the banking sector's funding resources and liquidity buffers. In September 2021, the average core capital ratio (CET 1 ratio) in the banking sector came to 17.7 % and the liquidity coverage ratio (LCR) stood at 180 %, compared to 15.6 % and 141 % respectively at the end of 2019. The size of these buffers offers the banks greater room for manoeuvre, enabling them among other things to absorb loan losses and be proactive in proposing debt restructuring without having to make drastic cuts in their lending.

The banking sector was not only able to continue granting new loans but could also grant payment deferrals in the case of existing loans to borrowers facing (temporary) financial difficulties. Some of these deferrals came under the agreement concluded by the sector with the federal government which, after having been extended several times, came to an end in June 2021. The banks also offered specific payment deferrals on an individual basis and other types of debt restructuring. This largely avoided defaults

1 Excluding some one-off movements occurring in certain banks, such as those due to a change in one bank's prudential consolidation scope, and those resulting from the sale of a loan portfolio by another bank.

resulting from a temporary loss of income for businesses and households.

So far there have been fewer defaults than feared …

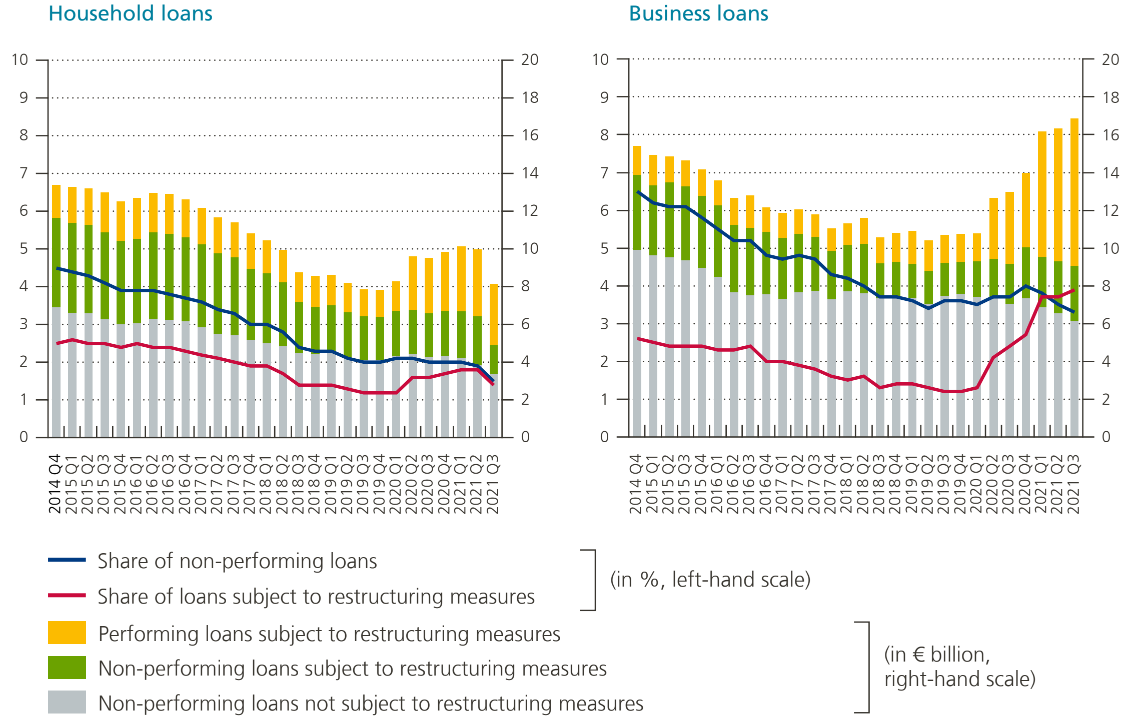
At the start of the crisis, the expectation was that banks would face a wave of defaults on their outstanding loans as a result of an increase in the number of bankruptcies and the unemployment rate. So far, those fears have not materialised. In the last quarter of 2020, it must be said that business loans presenting existing or expected payment arrears (known as non-performing loans) had risen to € 10.1 billion, or 4 % of total business loans. Nevertheless, that rise did not continue in the first nine months of the year under review, as non-performing loans subsided to € 9.1 billion (or 3.4 %) in September 2021. Households' non-performing loans remained relatively stable at around € 6.7 billion, or 2 % of all loans to households. Their sudden fall in September 2021 – to € 4.9 billion, or 1.5 % – is due to the sale of a (foreign) portfolio of non-performing loans by a Belgian bank.

Conversely, since the start of the COVID-19 crisis, the number of loans granted a specific repayment deferral on an individual basis or an extension of the term on account of the borrower's financial difficulties has risen sharply. These restructuring measures can be applied to (non-) performing loans if that is likely to help enable borrowers to honour their payment obligations (again). In September 2021, such measures were applicable to € 4.8 billion of

Chart 5.10

Fewer non-performing loans[1], but more loans subject to restructuring measures[2]

(in % of total outstanding loans on the left-hand scale ; in € billion on the right-hand scale)



Source : NBB.

1 Non-performing loans are loans which will probably not be repaid owing to the borrower's financial problems, or loans which are already in arrears of payment.

2 Loans subject to restructuring measures are loans for which the banks have granted concessions (e.g. in the form of repayment deferral or an extended term to maturity) to debtors facing financial difficulties. According to the EBA guidelines on payment moratoria, a general postponement of payment (moratorium) which meets the criteria is not regarded as a renegotiation or restructuring measure (EBA/GL/2020/02, amended by EBA/GL/2020/08 and EBA/GL/2020/15).

household loans (1.4 % of the total) and € 10.7 billion of business loans (4 %). Before the crisis broke out, they only applied, respectively, to € 3.7 billion (1.2 %) and € 3.1 billion (1.2 %) of these loans (at the end of 2019). The increase in restructured loans mainly concerned borrowings on which there were as yet no (long-term) arrears of payment. This shows that the banks were proactive in offering this type of solution to borrowers facing (temporary) financial problems in order to limit the losses and avoid defaults. Combined with the general deferral of payment (moratorium), these measures have so far helped to curb the expected steep rise in non-performing loans, so that loan losses should be lower than initially expected.

… but the possibility of credit risks materialising is still not ruled out

Nonetheless, some borrowers and sub-segments of outstanding loans still display vulnerabilities. Firms and workers in the sectors hardest hit by the measures to contain the pandemic or currently confronted by structural changes, such as accelerating e-commerce or the spread of remote working, present a greater risk of default. Moreover, new waves of the pandemic are causing some uncertainty over the speed and vigour of the economic recovery, so that the possibility of a future materialisation of credit risk for vulnerable borrowers cannot be ruled out.

The picture for each branch of activity shows that the hospitality sector and the events sector are where non-performing loans have risen the most. In hospitality, in particular, the proportion of loans with existing or expected arrears of payments remained high in September 2021 (8.9 %), after having risen more or less continuously since the end of 2019 (5.9 %). In the events sector, too, non-performing loans have increased from 4.1 % at the end of 2019 to 5.1 % in March 2021. Nevertheless, they have since subsided, dropping to 4.5 % in September 2021. In the Belgian banking sector, the outstanding total of loans to these two branches is admittedly fairly small. In September 2021, it stood at € 6.3 billion, or barely 2 % of all business loans.

The banking sector still has a substantial and growing exposure to the Belgian residential and commercial real estate markets. In September 2021, the banks' balance sheets showed € 243 billion in Belgian mortgage loans and € 48 billion in loans to Belgian businesses operating in the construction and real estate sectors, together representing no less than 25 % of their total assets. A shock to this market caused, for example, by a rise in unemployment or a fall in house prices or commercial property prices, could trigger substantial loan losses for the banks. That is why the Bank keeps a close eye on the property market situation (see also box 5).

Profitability restored …

Over the first nine months of the year, the Belgian banking sector made a net profit of € 5.3 billion, representing a return on equity of 9.2 %. In the previous year, profitability in the corresponding period had been considerably lower (a net profit of € 2.7 billion and a return on equity of 5.0 %), mainly because of the additional provisions that the banks had built up to cover the expected increase in loan losses in the aftermath of the COVID-19 crisis.

However, as payment defaults have so far been fewer than feared, the banks only recorded minor additional provisions over the first nine months of 2021. Some of them have actually already reversed part of their previously booked provisions, and that has had a favourable impact on the profit and loss account. The net volume of impairments and provisions therefore came to just € 0.2 billion, compared to € 2.5 billion in the corresponding period of the previous year. Consequently, the loan loss rate – which corresponds to the ratio between new loan loss provisions and the total volume of loans – fell sharply, dropping to 2.3 basis points. In 2020, this rate still came to 35 basis points.

The banks only recorded minor additional provisions and have even already begun to reverse part of the previously booked provisions

The gross operating result before impairments and provisions remained stable compared to 2020, at € 6.3 billion. However, there were several differences in its composition. The net result on fees and commissions came to € 4.8 billion, up sharply against the corresponding period of the previous year (€ 4.1 billion), thanks to the higher fees received by banks for their asset

Table 5.1

Income statement of Belgian credit institutions

(consolidated data, in € billion)

					First nine months[3]	
	2017	2018	2019	2020	2020	2021
Net interest income	14.1	14.4	14.6	14.2	10.7	10.8
Non-interest income	8.9	8.3	8.5	7.9	6.0	5.7
Net fee and commission income[1]	5.6	5.6	5.6	5.6	4.1	4.8
Net realised gains and losses on financial instruments	0.9	1.2	0.5	0.0	–0.2	0.5
Other non-interest income	2.5	1.5	2.4	2.3	2.1	0.4
Operating income	23.0	22.7	23.1	22.1	16.7	16.5
Operating expenses	–13.4	–13.9	–13.7	–13.5	–10.5	–10.1
Gross operating result (before impairments and provisions)	9.6	8.8	9.4	8.6	6.2	6.3
Impairments and provisions	–0.7	–0.8	–1.3	–3.1	–2.5	–0.2
Other components of the income statement[2]	–3.0	–2.3	–2.0	–1.2	–1.0	–0.9
Net profit or loss	5.9	5.6	6.1	4.3	2.7	5.3

Source: NBB.

1 Including commission paid to bank agents.

2 This item includes taxes, extraordinary results, negative goodwill recognised in profit or loss, and the share in the profit or loss of investment in subsidiaries and joint ventures.

3 For the data for the first nine months of 2020 and 2021, an adjustment in the reporting was taken into account, as a result of which there was a shift of certain costs between parts of the income statement at some banks. The figures for the full year 2020 have been adjusted to make them comparable with the years before.

management activities and payment services. In addition, the results on financial instruments made a positive contribution (€ 0.5 billion over the first nine months of 2021) owing to the improved conditions prevailing on the financial markets. In the previous year, that item still showed a loss (of € 0.2 billion). Various other movements such as the fall in other non-interest income, but also the decline in operating expenses, are attributable in part to a change in the prudential consolidation scope of one Belgian bank. Net interest income came to € 10.8 billion, comparable to the figure for the corresponding period of the previous year.

… but still under pressure in the longer term

As net interest income is their biggest source of revenue, the low interest rate environment remains one of the main challenges facing Belgian banks. The difference between the average interest that banks receive on loans and bonds and the interest that they have to pay on sight accounts and savings accounts (i.e. the net interest margin) has clearly narrowed in recent years. Nevertheless, net interest income has stood up relatively well, as banks have managed to offset the narrower margins by boosting the volume of lending. Interest income has also benefited slightly from the fall in (net) interest charges on derivatives, which could perhaps point to changes in the banks' hedging policies. In 2020 and during the first nine months of 2021, net interest income was also underpinned by, on the one hand, the generous conditions applied to substantial amounts of financing made available by the central bank, which the banks made use of under the TLTRO programme, and on the other hand by the application of a zero rate instead of a negative interest rate on part of the reserves that they hold at the central bank.

The banks are also increasingly trying to pass on, to the liabilities side of their balance sheet, the low or even negative interest rates recorded on the assets side. For instance, they have therefore begun to convert regulated savings accounts into non-regulated savings accounts (which are not subject to the statutory minimum interest rate of 11 basis points) and to apply negative interest rates on (large) deposits of other financial institutions, firms and non-profit organisations. The overall effect of these initiatives on the net interest income has been rather meagre so far, notably because the majority of (savings) deposits are held by households to which negative interest rates are not applied (except in certain cases concerning wealthy customers).

Some banks are also trying to further diversify their income sources, e.g. by increasing the fees on traditional banking activities (such as bank accounts and investment and insurance products) or by activating some of the savings deposits via asset management. They are also striving to increase cross-selling and customer loyalty, e.g. by offering non-financial services on their banking applications. The cost reduction programmes implemented in recent years should support profitability by reducing the banking sector's traditionally heavy costs, but despite everything the cost/income ratio remained high at 62 % during the first nine months of 2021. That can be ascribed in part to the IT investment necessary for pursuing the digitalisation of services and internal processes. Even if this investment should ultimately lead to better cost efficiency, digitalisation also implies additional risks, e.g. in regard to data security and vulnerability to cyber attacks.

The challenges relating to low interest rates, cost efficiency and the digital transformation are more acute for small and medium-sized banks whose business model is geared to retail activities. In comparison with the large universal banks, their income model is often less diversified, being centred on activities particularly affected by the impact of the low interest rate environment, and they cannot take advantage of economies of scale, for instance, by spreading over a broader asset base the cost of IT investment made in the course of their digital transition. Also, according to a recent analysis conducted by the Bank on FinTech and digitalisation (see the section on *Prudential regulation and supervision* in this Report, section D.1.5), it is evident that these small and medium-sized banks are often the least advanced in developing digital applications, implying the risk of their business model coming under pressure, because the bigger banks can often respond more appropriately to customers' wishes, setting the bar higher for all players in the sector.

Finally, some major challenges related to climate risk are in store for the banking sector in the near future, as climate change and the climate transition could accentuate a number of traditional risks in the banking sector. For instance, banks could experience an increased credit risk owing to their exposure to certain sectors, regions or markets which feel the direct impact of climate change or which are affected by the measures taken to bring about the transition to a more sustainable economy.

5.4 The insurance sector is in a sound and robust starting position to cope with the impact of the floods that the country suffered in July

During 2020, the insurance sector's solvency level remained relatively high, despite dipping slightly in the second quarter as a result of the double hit caused by the impact of the COVID-19 crisis on the financial markets. That shock had affected the value of both the assets and the liabilities on insurance companies' balance sheets (on that subject, see the Annual Report 2020).

At the end of December 2020, the solvency capital requirement (SCR) coverage rate had reverted to its pre-crisis level and stood at 202 %, or about double the level required by the regulations. The year 2021 therefore began with a strong solvency position. In the first quarter of 2021, the solvency level climbed higher, supported by the rise in risk-free rates which drove down the discounted market value of commitments to policy-holders and by the upturn on the financial markets, boosted by the predictions of economic recovery and the anti-coronavirus vaccination campaigns. The sector's solvency level then declined slightly in the second and third quarters of 2021, reaching 205 % at the end of September 2021.

Claims resulting from climate events have increased in recent years

As far as profitability is concerned, the insurance sector posted a net profit of € 2.6 billion at the end of 2020. Despite the pandemic-induced crisis, that surpassed the figure recorded at the end of 2019, which was in the region of € 2.3 billion. Two factors account for this: first, the net result of the non-life insurance segment improved as a result of the lockdowns, which in general led to a decline in claims, whereas the level of premium income remained stable. Second, the non-technical result, a volatile component of the net result, exceeded the 2019 figure.

Although the information on the sector's profitability in 2021 is not yet available, a negative impact will certainly be apparent as a result of the floods that the country suffered last July. The claims burden due to those floods is borne by various public and private players, including insurance companies. On the basis of the latest data collected, the material damage caused by those floods comes to around € 2.1 billion. However, those estimates could change as the claims for compensation are processed.

However, the effect of the flooding is already apparent in the higher level of claims recorded in the third quarter of 2021. The combined ratio of the non-life segment, which expresses the relationship between outgoing and incoming payments, began rising in September 2021, reaching 96 %.

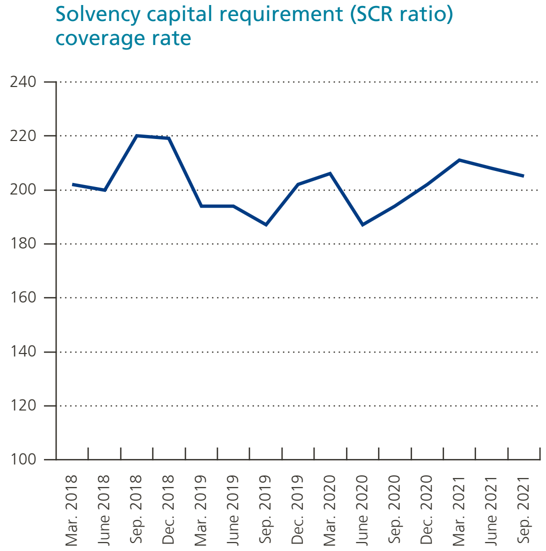
But, according to simulations conducted by the Bank, the negative impact of the flood-related claims on the sector's solvency should remain relatively limited.

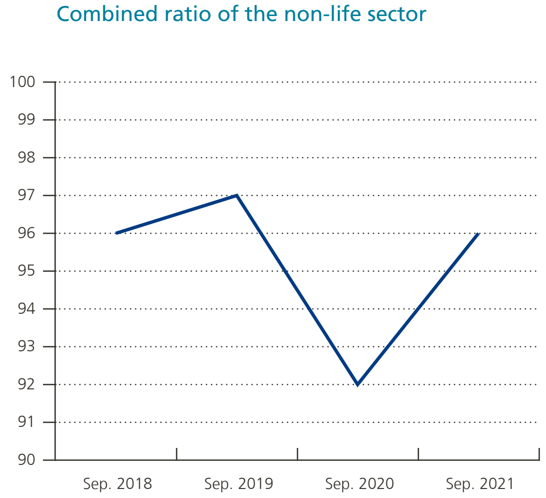
In general, it must be borne in mind that claims caused by climate events have increased in recent years and that they could become even more frequent and serious in the future. That is likely to put pressure on pricing in some branches of the non-life insurance segment.

Chart 5.11

The sector's solvency remained relatively good in 2021 while the impact of the flooding drove up the combined ratio of the non-life segment

(in %)





Source: NBB.

Investment portfolio: the search for yield continued in 2021 in the context of low interest rates

The low interest rate environment is a particular problem for life insurers offering cover at guaranteed rates (class 21). They have to make sufficient margins to honour contracts concluded in the past which sometimes guaranteed high yields which have become difficult to sustain in the low interest rate context which has prevailed for a number of years.

Nonetheless, these insurance companies continue to demonstrate their ability to adapt: on the one hand, they are continuing to reduce the average guaranteed rate on their stock of existing contracts (notably by steering customers towards class 23 with no guaranteed rates) while they are also securing returns by redirecting their investments towards more lucrative – but riskier and less liquid – assets.

Between 2019 and 2020, the returns on assets held to cover class 21 contracts remained relatively stable at around 3.12 %, while the average guaranteed rate on the stock of life contracts dropped from 2.16 % to 2.00 %.

Up to now, the return generated by these assets therefore seems to have suffered little from the impact of the health crisis. That is probably due to two factors. First, the support measures for the economy and households performed their role as stabilisers, and in particular averted a spate of immediate bankruptcies. Also, insurance companies' investment proved to have little exposure to the sectors most affected by the impact of the health crisis.

With the low interest rate environment persisting in 2021, the search for yield continued, as can be seen from the expanding investment in funds (particularly equity and real estate funds) and in the residential and commercial real estate sector. In that regard, the insurance sector's direct and indirect exposures to the residential and commercial real estate sector respectively represented 6 % and 10.9 % of the investment portfolio at the end of September 2021 (or € 16.5 and € 31.6 billion).

This shift in investment is at the expense of assets offering lower returns in the low interest rate environment, such as government and corporate bonds. Although these still account for a considerable share of the investment portfolio of the sector taken as a whole, exposures to these financial securities have maintained their downward trend, dropping from 72.9 % in September 2016 to 64.8 % in the corresponding period of 2021 (or € 188.5 billion).

Climate risk remains significant, while the pandemic has highlighted the growing cyber risk

The financial risks resulting from both physical climate change and the climate transition are considerable for insurance companies. While the level of claims due to damage caused by climate change is rising, the insurance companies' investment portfolio is itself exposed to climate risk via its constituent assets.

According to the recent mapping carried out by the Bank, around 48 % of the corporate bond portfolio, 54 % of the equities portfolio and 36 % of the commercial loans portfolio held by the insurance sector are exposed to industries likely to suffer from the risks associated with the transition to a low-carbon economy. Some of the sectors that issue securities are in fact more sensitive to a sudden, unexpected transition to a greener, more sustainable economy. At individual level, climate risk exposures vary widely and may sometimes be at a high level in some insurance companies.

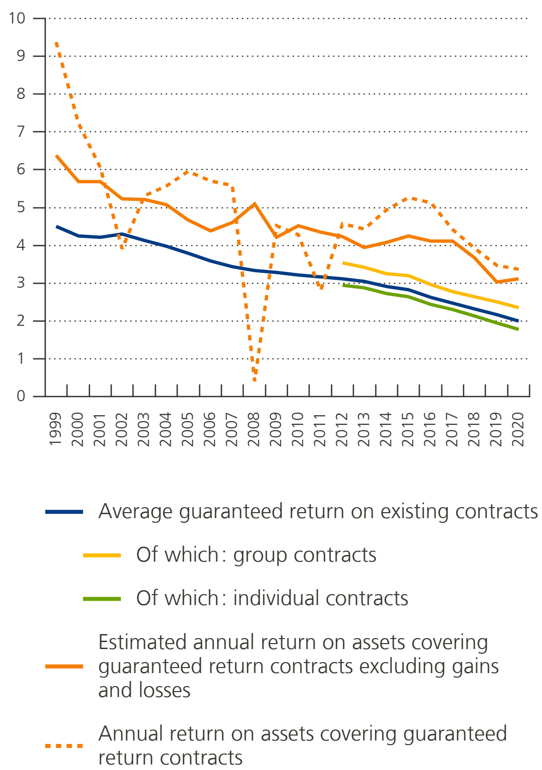
The COVID-19 crisis also highlighted the growing cyber risk. With the widespread recourse to remote working and the increasing digitalisation

Chart 5.12

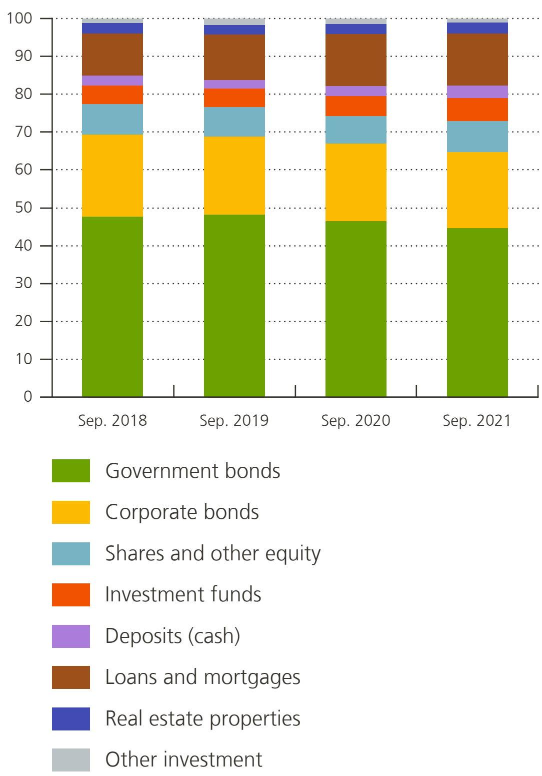
Returns on assets held to cover class 21 contracts still exceed the average guaranteed rate, thanks in particular to the reallocation of the investment portfolio

(in %)

Average guaranteed returns on class 21 contracts and returns on assets held to cover them



The sector's investment portfolio (excluding class 23), by asset type



Source: NBB.

accompanying online consumption habits, the frequency and scale of cyber attacks have escalated, particularly in the financial sector.

In regard to the insurance sector, the Bank took a number of measures on this subject, aiming in particular to encourage companies to take better account of cyber risk, not only from an operational angle but also in their insurance policies (silent cyber risk). The Prudential regulation and supervision section of this Report gives a detailed overview of those measures.