INTERNATIONAL MONETARY FUND

IMF Country Report No. 17/69

BELGIUM

March 2017

2017 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; SUPPLEMENTARY INFORMATION

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2017 Article IV consultation with Belgium, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its March 13, 2017 consideration of the staff report that concluded the Article IV consultation with Belgium.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on March 13, 2017, following discussions that ended on December 12, 2016, with the officials of Belgium on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on February 23, 2017.
- An **Informational Annex** prepared by the IMF staff.
- **Supplementary Information** updating information on recent developments.

The following document has been or will be separately released.

- Selected Issues Paper.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

Copies of this report are available to the public from
International Monetary Fund • Publication Services
PO Box 92780 • Washington, D.C. 20090
Telephone: (202) 623-7430 • Fax: (202) 623-7201
E-mail: publications@imf.org Web: http://www.imf.org
Price: $18.00 per printed copy

International Monetary Fund
Washington, D.C.

© 2017 International Monetary Fund

Press Release No. 17/88
FOR IMMEDIATE RELEASE
March 17, 2017

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2017 Article IV Consultation with Belgium

On March 13, 2017, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Belgium.

After a slowdown in 2016, the recovery is expected strengthen modestly this year, with real GDP projected at 1.6 percent. The medium-term outlook remains constrained by structurally weak growth in advanced economies. Downside risks are significant, including those related to global and regional uncertainties that could affect trade and financial markets.

In its first year in office, the government enacted a range of important measures, including pension reforms, a suspension of wage indexation ("saut d'index"), and a "tax shift" reducing the labor tax wedge. The year 2016 proved more difficult, as fiscal consolidation stalled and the budget deficit exceeded its target by a significant margin. However, structural reform efforts continued, including through ongoing negotiations on reforming the wage setting process (the "1996 law on competitiveness") and the corporate income tax system.

Notwithstanding recent progress, major challenges continue to weigh on Belgium's economic prospects—including high public debt and severe labor market fragmentation. The fiscal gains made in previous decades have been undone by the crisis, and the public debt-to-GDP ratio has returned to triple digits. The pace of consolidation since 2010 has been much slower than in

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

other euro area countries, as public spending continued to grow faster than GDP until recently. Fiscal sustainability therefore remains tenuous and sensitive to potential shocks. And while private employment has been recovering, there is entrenched high unemployment and inactivity among certain groups, including the young, the low-skilled, and immigrants from outside the European Union.

Executive Board Assessment[2]

Executive Directors welcomed the reforms of the past two years, which should help strengthen competitiveness, support job creation, and address the cost of ageing. Directors noted that growth prospects are modest and risks are on the downside, in part due to a weak external environment. To address these issues and the high level of public debt, Directors recommended further efforts to strengthen public finances and raise the country's growth potential.

Directors agreed that fiscal consolidation should be underpinned by an ambitious and credible medium-term strategy that targets a balanced budget at all levels of government. The bulk of this fiscal consolidation should come from the spending side, based on efficiency-oriented reforms. Directors welcomed ongoing deliberations on further tax reform, while stressing that the overarching goal should be to make the tax system more supportive of jobs and growth while safeguarding revenues. In this context, Directors saw merit in lowering the relatively high corporate income tax rate as part of a broader reform of the business and investment income taxation. In light of the fiscal slippages in 2016, they emphasized the need for realistic revenue and expenditure targets, backed by high-quality measures.

Directors encouraged the authorities to adopt a comprehensive strategy for addressing labor market fragmentation and raising the employment rate among vulnerable groups to boost Belgium's growth potential. Such a strategy should preserve the gains from wage moderation by linking wage growth to broader labor market and economic conditions, reduce the labor tax wedge, improve education and on-the-job training, and reduce barriers to geographical mobility.

---

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

Directors stressed that additional reforms are needed to raise potential growth and employment. They underscored the need for a comprehensive and prioritized infrastructure strategy to reduce the backlog in public investment and alleviate transport bottlenecks. Directors also stressed the importance of fostering greater competition in services to help reduce prices paid by consumers and firms and boost productivity.

Directors observed that banks and insurers should continue to adapt to an environment of low growth and interest rates. To maintain their soundness and resilience, banks need to pursue further cost reduction and diversification of revenue sources. Directors encouraged regulators to closely monitor pockets of vulnerability in the mortgage market, and to stand ready to deploy further macro-prudential measures as appropriate.

Belgium: Selected Economic Indicators (2014–17)

	2014	2015	2016 Est.	2017 Proj.
Output (change in percent)				
Real GDP growth	1.7	1.5	1.2	1.6
Domestic demand	2.3	1.5	0.5	1.5
Foreign balance (contribution to GDP growth)	-0.5	0.0	0.8	0.2
Employment				
Employment (change in percent)	0.4	0.9	1.3	0.9
Unemployment (percent)	8.6	8.5	8.0	7.8
Prices (change in percent)				
Inflation	0.5	0.6	1.8	2.0
General government finances (percent of GDP)				
Revenue	52.0	51.3	51.0	51.0
Expenditure	55.1	53.9	53.7	53.1
Fiscal balance	-3.1	-2.5	-2.7	-2.1
Public debt	106.5	105.8	105.5	104.3
Money and credit				
Credit to the private sector (change in percent, excludes securitization)	5.3	6.5	7.0	...
3-month treasury bill interest rate (percent)	0.0	-0.2	-0.6	...
Balance of payments (percent of GDP)				
Current account	-0.7	0.4	1.0	0.9
Foreign Direct Investment	1.2	2.0	1.6	1.8
Exchange rate (change in percent)				
Real effective exchange rate	0.5	-8.7	3.7	...

Sources: Haver, Belgostat, and IMF staff projections.

INTERNATIONAL MONETARY FUND

BELGIUM

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION

February 23, 2017

KEY ISSUES

Following successful reforms during the government's initial year in office, the year 2016 proved to be more difficult. The terror attacks in Paris and Brussels had a significant, albeit temporary, effect on the economy. The fiscal strategy veered off track, with a sizeable overshoot of the deficit target. Growth prospects for 2017 and beyond are modest, as in other euro area countries. The Belgian labor market remains severely fragmented.

Given the high level of public debt and the uncertain external environment, it will be essential for the public sector to be both a source of stability and a contributor to stronger growth. Major efforts are therefore needed to make the public sector more efficient and to pursue reforms that would raise the country's growth potential. Staff recommends to:

- Implement a credible 2017 budget based on realistic revenue and spending assumptions, and supported by high quality measures.
- Rein in the growth of public spending through efficiency-oriented reforms at all levels of government.
- Agree on a coherent infrastructure investment strategy to remove transport bottlenecks.
- Pursue further tax reform to safeguard revenues while supporting investment and employment.
- Raise employment rates, especially among the young and non-EU immigrants.
- Strengthen competition in services to boost productivity and reduce prices paid by firms and consumers.
- Continue to encourage adaptation of banks and insurers to the profitability challenge from the low growth low rate environment, while monitoring housing market exposures and search for yield behavior, including in shadow banking.

Approved By
Mr. Decressin (EUR), Mr. Zeidane (SPR)

Discussions took place in Brussels, from November 30 to December 12, 2016. The staff team comprised C. Mumssen (head), J.J. Hallaert, P. Kongsamut (all EUR), G. Ho (RES) and was assisted at HQ by N. Batini, W. Gbohoui, D. Mason, and D. Santos (all EUR). R. de Mooij and S. Hebous (both FAD) and M. Hrdinkova (external expert) overlapped with the mission. A. de Lannoy and J. Clicq (OED) participated in the discussions. Staff met with central bank governor J. Smets, Ministers J. Van Overtveldt (Finance), K. Peeters (Economy and Labor), S. Wilmés (Budget), C. Lacroix (Minister of Budget, Public Service, and Administrative Simplification of Wallonia), senior officials from Flanders and the Brussels Capital Region, other senior government officials, representatives from the private sector, and trade unions.

CONTENTS

CONTEXT—A MORE DIFFICULT YEAR 4

A MODERATE REBOUND AHEAD BUT ALSO RISKS 7

DEEPENING AND BROADENING REFORMS 8

A. Consolidation Underpinned by Growth-Friendly Fiscal Reforms 9

B. Priorities for Boosting Potential Growth and Productivity 14

C. Profitability Challenge to The Financial Sector 19

STAFF APPRAISAL 22

BOXES

1. Growth-Friendly Corporate Income Tax Reform 13
2. Labor Market Reforms 16
3. Which Groups Are Most Vulnerable in Belgium's Fragmented Labor Market? 18

FIGURES

1. Macroeconomic and External Developments 6
2. Scenarios for Debt and the Deficit 10
3. Fiscal Context 12
4. Public Investment, Productivity, and Regulation in Services 15
5. Labor Market Fragmentation 17
6. Challenges to Banks 21

TABLES

1. Selected Economic Indicators, 2013–2022 25
2. Balance of Payments, 2013–2022 26
3. General Government Statement of Operations, 2013–2022 27
4. General Government Consolidated Balance Sheet, 2008–2015 28
5. Structure of the Financial System, 2010–2016 29
6. Financial Soundness Indicators of the Banking Sector, 2010–2016 30

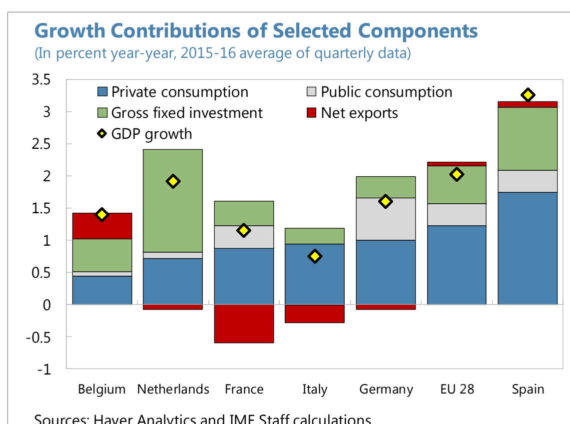
APPENDICES

I. Main Recommendations of the 2016 Article IV Consultation and Authorities' Response 31
II. External Sector Report 32
III. Risk Assessment Matrix 33
IV. The Impact of Low Growth and Rates on Bank Profitability 34
V. Debt Sustainability Analysis 40
VI. Labor Market and Pension Reform Measures 49

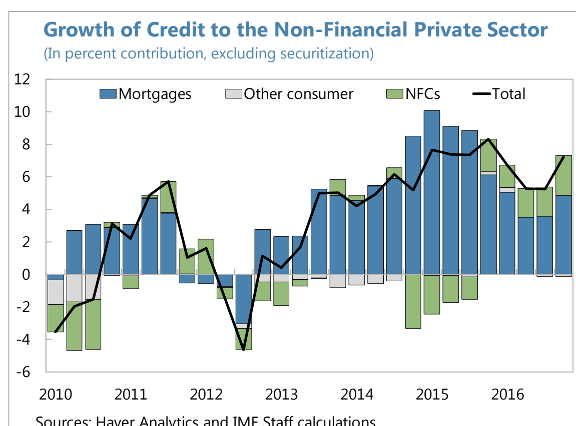
CONTEXT—A MORE DIFFICULT YEAR

1. **After a strong start, reform progress has slowed, particularly on fiscal policies.** The four-party right-leaning coalition government took big steps forward during its first year in office. The 2015 pension reform and the ongoing efforts to contain rising health care costs have been major advances toward addressing the cost of ageing. Wage moderation—including through the temporary suspension of indexation (*saut d'index*)—and the targeted cuts in the labor tax wedge under the "tax shift" have significantly reduced the labor cost gap with neighboring countries. Further labor market reforms to increase flexibility at the sector and firm levels, as well as a reform of the wage setting process to prevent wage competitiveness losses, are underway, although a comprehensive strategy for addressing the fragmentation of the labor market is still lacking. The government plans to reform the corporate income tax regime, but agreement has yet to be reached. Measures needed to achieve the government's ambitious fiscal consolidation objectives are largely lacking, particularly those to sustainably reduce the high level of government spending.

2. **Growth was held back by external factors and weak consumer spending.** Real GDP growth is estimated to have declined to 1.2 percent in 2016, partly reflecting the weakness of the euro area recovery, as well as the significant, though temporary, impact of the Paris and Brussels terrorist attacks. Moreover, private consumption contributed markedly less to growth than in peer countries. This likely reflected in part wage moderation combined with the tax shift, which raised certain consumption taxes to offset labor tax wedge cuts. As a result of these tax policies, inflation came closer to the ECB's target than in most other euro area countries (Figure 1). Unemployment, averaging 8 percent in 2016, has fallen closer to pre-crisis levels, supported by solid employment growth in the services sector.



3. **Credit conditions have remained supportive.** Corporate lending growth (in particular for manufacturing, real estate, and health services) has picked up alongside investment demand and interest rate reductions, while mortgage lending growth has slowed through 2016Q3 as reductions in tax deductibility of interest in certain regions and a higher VAT rate on renovations have become effective. Lending rates, particularly long term, have declined since the ECB's quantitative easing policies were put in place.



4. Low oil prices and solid export growth brought the current account back into surplus (Figure 1). Export growth, including in chemicals and transport equipment, may have benefited from wage moderation policies. Nominal unit labor costs have been broadly flat since 2013, closing the cost competitiveness gap with neighboring countries based on an hourly labor costs measure. Meanwhile, the primary income balance has turned negative, despite Belgium's strong net international investment position; the predominance of portfolio and other investment assets with low returns has been outweighing outgoing income flows. Nevertheless, the current account has moved back toward a moderate surplus and closer to its norm of 2.7 percent of GDP. Staff's preliminary assessment under the External Balance Assessment suggests that Belgium's external position is moderately weaker than medium-term fundamentals and desirable policies would suggest (see Appendix II), with a current account gap of -2¾ to -¾ percent and the real effective exchange rate overvalued by 2 to 7 percent.

5. Fiscal consolidation stalled in 2016, with a sizeable overshoot of the deficit target. Despite falling interest costs, the fiscal deficit widened to 2.7 percent of GDP, against an original budget target of 2.1 percent of GDP. Many factors have contributed, including higher expenditures from the impact of the terror attacks as well as revenue shortfalls reflecting some over-optimism on certain revenue yields and possible shifts in the tax base (such as from the withholding tax increase).[1] There was also delay in policy implementation, such as on certain new tax measures and savings in health spending. As a result, both the headline and structural primary balance appear to have worsened, rather than improving as envisaged in the April 2016 Stability Program.

Text Table. Budget and Projected Outturns[1]

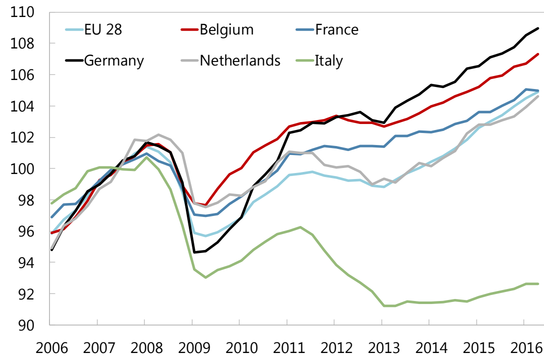
	2015 Outturn (1)	2016 DBP 15 (2)	2016 Stab prog (3)	2016 Est (4)
Revenues	51.3	51.3	50.8	51.0
Expenditures	53.9	53.4	53.4	53.7
o/w: Wages	12.5	12.3	12.3	12.4
Social benefits	25.3	25.3	25.1	25.3
Subsidies	3.4	3.4	3.3	3.5
Interest	3.0	2.7	2.7	2.7
Balance	-2.5	-2.1	-2.5	-2.7
Authorities' structural balance		-1.2	-1.7	
Staff's structural balance	-2.2			-2.4

Sources: Haver Analytics, Authorities, and IMF staff estimates.
[1] DBP = Draft Budgetary Plan, submitted to the European Commission in October preceding the budget year. Stab prog = April Stability program submission, consistent with revised budget submitted in May.

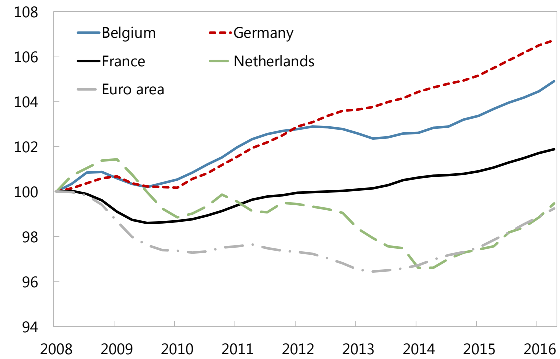
[1] Revenue shortfalls were partly offset by one-off collections such as from the excess profit tax, which was found illegal under European Union state aid rules.

Figure 1. Belgium: Macroeconomic and External Developments

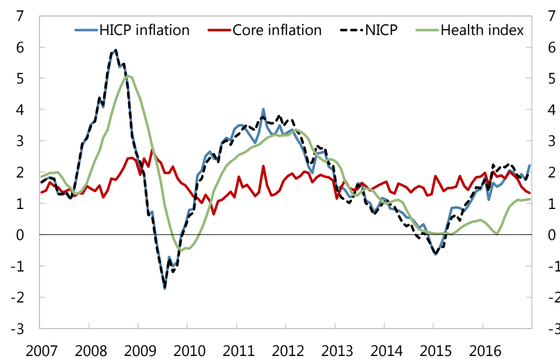
Growth is constrained by that in neighboring countries, which are also Belgium's largest trading partners.



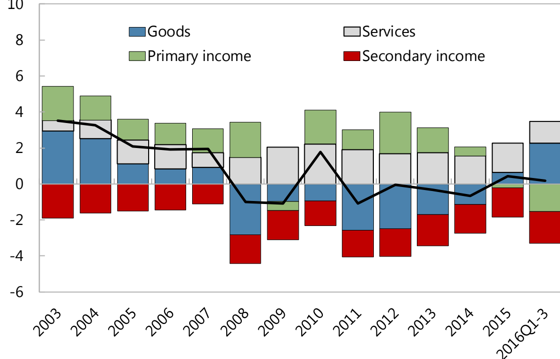
Employment growth has continued its steady pace.



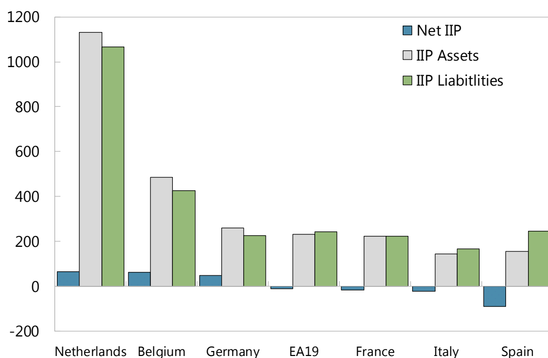
Headline inflation has risen as tax measures, including from the tax shift, have taken effect. Energy prices have also rebounded.



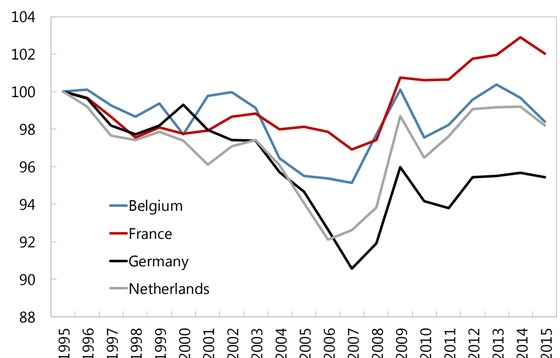
The goods balance surged in 2016, helping to keep the current account in surplus, despite negative primary income.



Belgium's net international investment position is highly positive, mainly from private balance sheet strength.



Unit labor costs have come down in the past few years, reflecting policy efforts to reduce the gap with neighbors.



Sources: Haver Analytics, Eurostat, National statistical authorities, and IMF staff calculations.

A MODERATE REBOUND AHEAD BUT ALSO RISKS

6. **Belgium's economy is projected to grow at a moderate pace of around 1½ percent for the foreseeable future.** Within the context of a lackluster euro area growth outlook, external demand is not expected to contribute significantly to growth in the medium term. Inflation should ease back as the impact of tax increases and recent energy price increases recede, but gradually increase over the medium term as the output gap closes. Potential output growth is estimated at around 1¼ percent, rising over the medium term as reforms already undertaken help raise participation rates, support continued employment growth, and reduce unemployment.

7. **A protracted period of low growth poses significant risks in the context of a highly uncertain external environment.** Given the economy's openness and dependence on Europe, risks arise from both global and regional factors. There are uncertainties relating to upcoming elections in neighboring countries, the United Kingdom's negotiations to exit the European Union, and the direction of U.S. policies, in particular on trade, corporate income taxes, and interest rates. Moreover, if domestic reform efforts and fiscal adjustment stall, within an environment of structurally low growth in advanced economies, Belgium faces the risk of persistent high public debt that could ultimately undermine confidence, especially if markets were to expect a gradual withdrawal of the exceptional monetary accommodation of the ECB. Under a "stagnation" scenario, with lower nominal GDP growth, public debt could turn explosive even if interest rates remain low, and there would be no room for fiscal maneuver (see below for a more detailed discussion on fiscal scenarios). This could become a source of macroeconomic instability and a deterrent to growth.

8. **Prolonged low growth and interest rates would also create financial sector vulnerabilities.** Banks' earnings would be constrained because of fixed rate long term assets with low yields, while life insurers and pension funds need to generate sufficient returns to meet long-term liabilities. Staff simulations suggest a significant negative impact on bank profitability of a low growth scenario (see Section C below and Appendix IV). Low profitability would reduce retained earnings and therefore internal capital generation, which could have an adverse impact on future credit supply, and expose banks to shocks. Such shocks could be external, through tighter and more volatile global or regional financial conditions, likely affecting Belgium indirectly, through effects on larger neighbors. Domestically, banks would also become more vulnerable to housing price shocks. Banks are currently relatively well protected (see below), but the rise in household indebtedness bears close watch. With mortgage loans on full recourse terms, in the event of a shock households would likely try to avoid default and instead cut consumption. An unemployment shock could depress private consumption sharply, slowing growth, which could raise default rates more generally and reduce banks' asset quality.

DEEPENING AND BROADENING REFORMS

9. Belgium faces the risk of a high debt/low growth trap in the years ahead. Growth has recovered, but is expected to remain sub-par relative to pre-crisis. With a still weak recovery in the euro area, a slowdown in global trade, and political winds shifting against free trade, external demand may no longer serve as a strong engine of growth. Four broad structural challenges are weighing on economic prospects:

- Belgium's strong record of large primary fiscal surpluses was undone by the crisis, and progress in reducing high public debt has been slow since then, despite record low interest rates and the government's ambitious consolidation goals. High and rising expenditure has undermined revenue-based consolidation and precluded a return to the pre-crisis fiscal dynamics.

- There is still a long way to go in raising labor market participation rates, and addressing structurally high unemployment among certain vulnerable groups and in the Brussels and Wallonia regions.

- There has also been little movement in product market reforms, while the business environment is affected by further devolution of regulatory power to the regional level under the sixth reform of the state.

- At the same time, the financial sector is being challenged by the low growth/low interest rate environment, while also having to adapt to technological changes.

10. Addressing these challenges is all the more difficult in Belgium's unique political economy and governance system. Besides the federal government, the system also comprises three regional authorities with significant autonomy, while at the same time recognizing three language communities (cutting across the regions), with separate competencies (e.g., in education). Authority to tax and spend is thus spread across different levels of government, with complicated sharing arrangements and sometimes overlapping responsibilities. This complex political and institutional setting means that a consensus on economic issues is difficult to achieve. In this context, the European fiscal governance framework has provided a welcome anchor to forge agreement on difficult decisions, which has allowed Belgium to exit the Excessive Deficit Procedure in 2014. However, it also means that fiscal policy needs to be negotiated across many different dimensions, and that deeper reforms, both fiscal and structural, can be challenging to adopt.

11. Policy discussions focused on how a broad and well-coordinated reform strategy could raise the country's growth potential and bring down public debt sustainably. A central task is to balance the budget across all levels of government, with consolidation based on an ambitious and credible medium-term strategy—agreed between all levels of government—that delivers a gradual reduction in spending while safeguarding fiscal revenues. However, fiscal adjustment alone, especially if it is of low quality (e.g. based on across-the board containment), could hurt growth, thus yielding only limited benefits for fiscal sustainability. Given the potential impact on domestic

demand, consolidation should thus be underpinned by high quality fiscal measures accompanied by reforms to raise Belgium's growth potential, including by raising the low rates of employment among certain groups, pursuing a coherent infrastructure investment strategy, and strengthening competition in services. Flexibility in the sequencing of specific measures will be important, given Belgium's governance context. The majority of such reforms (see below) should have a positive impact on growth, even in the short run. Fiscal and product market reforms should also generally help improve the budget position, while certain labor market reforms (such as more flexible wage setting, a youth minimum wage, improved education, training) could have a negative fiscal impact while still being positive for employment and growth. Combining the three reform areas is thus the approach that is most likely to be a net positive for growth, employment, and fiscal sustainability.

A. Consolidation Underpinned by Growth-Friendly Fiscal Reforms

12. Staff expressed concern about fiscal slippages, especially given the high level of debt and the uncertain outlook. After the sizeable budget deficit overshoot in 2016, the authorities have targeted a structural adjustment of around 1 percent of GDP for 2017, to be achieved via both revenue (e.g. raising withholding taxes further) and expenditure measures (mainly on health spending), supported by a further decline in the interest bill as well as continued savings from earlier reforms on wages and social benefits. In staff's view, this ambitious target is hard to achieve without additional measures. As missing budget targets by significant margins two years in a row could harm credibility, staff emphasized the importance of implementing a budget that is based on a credible deficit target, backed by realistic revenue and spending assumptions, and supported by high quality measures.

13. A broad-based fiscal strategy would yield better growth and debt reduction outcomes. Under baseline projections with largely unchanged policies, public debt declines only modestly over the next ten years. In the event of a "stagnation" scenario in which nominal GDP growth is lower by 0.6 percentage points per year, the debt ratio becomes explosive (see Figure 2, and Debt Sustainability Analysis in Appendix V). This illustrates how sensitive Belgium's debt is to the macroeconomic environment (including interest rates) and how little fiscal space Belgium has to address shocks, especially if outside the context of a coordinated European response.

- With a view to gradually rebuilding fiscal buffers, staff recommended efficiency-oriented spending reforms (see below), anchoring primary spending growth to stay broadly flat in real terms over the medium run, together with revenue neutral but growth-oriented tax rebalancing and a package of labor and product market reforms. This could bring the structural fiscal position to near balance by 2021.

- Such an approach (see scenario "high quality with reform" below) would have much stronger growth and debt reduction pay offs compared to a "low quality" adjustment scenario of across-the-board spending containment. A well-designed consistent policy package would prevent output losses while bringing the debt-GDP ratio almost 20 percentage points below the baseline

over ten years (and 10 percentage points below a low-quality adjustment scenario without reforms).

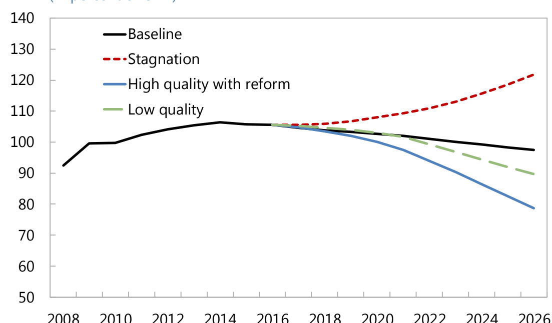
- As for near-term budget policies, staff strongly cautioned against overoptimistic adjustment assumptions that are not backed by quality measures. On balance, additional measures to achieve around ½ percentage point of GDP of structural primary fiscal adjustment per year would appear appropriate. Since high quality structural measures take time to put in place and yield results, a decisive start on such measures would be important, including already from 2017, in the context of a revised budget if deemed necessary.

Figure 2. Scenarios for Debt and the Deficit

A broad-based fiscal strategy with efficiency-oriented spending reforms and growth-oriented tax rebalancing, combined with labor and product market reforms, would yield better growth and debt reduction outcomes.

Public Debt Ratio Under Various Scenarios

(In percent of GDP)



Sources: Haver Analytics and IMF Staff calculations.

Belgium: Illustrating Debt and Deficits Under Different Scenarios

		2016	2021	2026
Nominal GDP (index)	Baseline	100	117.5	139.6
	Stagnation	100	114.2	130.5
	Low quality	100	112.8	134.0
	High quality with reform	100	114.7	138.1
	(in percent of GDP)			
Deficit	Baseline	-2.7	-2.6	-2.4
	Stagnation	-2.7	-4.1	-6.4
	Low quality	-2.7	-1.1	-0.8
	High quality with reform*	-2.7	-0.2	0.9
Debt	Baseline	105.6	102.0	97.5
	Stagnation	105.6	109.3	121.8
	Low quality	105.6	101.7	89.6
	High quality with reform*	105.6	97.5	78.7

Source: Staff estimates. *= staff recommended scenario

Stagnation: nominal GDP growth on average 0.6 percentage point lower than baseline.

Low quality: flat real spending growth, multiplier of 1.15, no other reforms.

High quality: flat real spending growth, multiplier of .85, product and labor market reforms.

Multipliers informed by Kilponen et al, "Comparing fiscal multipliers across models and countries in Europe", National Bank of Belgium Working Paper No. 278, 2015.

14. A sustainable strategy for growth-friendly medium-term consolidation would require broad reforms that are coordinated across levels of government. With further tax cuts scheduled for 2018–20 under the tax shift, staff projects that additional measures of about 2–2½ percent of GDP would be needed to achieve the goal of a balanced budget over the medium term. For high-quality adjustment, this should rely primarily on measures to improve spending efficiency. As shown in the text table, spending levels exceed those of peers in a number of areas, and significant savings could be achieved. Revenue-neutral tax reforms could help in promoting employment and growth. Agreement and implementation of such measures would require cooperation and participation across all levels of government. Current coordination mechanisms could be strengthened by binding commitments to meet agreed deficit targets, backed up by stronger budget processes, including centralized intra-year monitoring of outcomes across all levels of government.

Options for Fiscal Reforms
(In percent of GDP)

	Medium to Long Term
Expenditure[1]	
Reduce wage bill[2]	1.8
Reduce subsidies[3]	2.1
Increase social benefits efficiency[4]	2.0
Increase in public investment	-1.2
Revenue	
Reform of business and investment income taxation (revenue neutral)	0.0
Environmental tax[5]	0.3
Other (Tax expenditures, labor taxation...)	...
Total	5.0 - 6.0

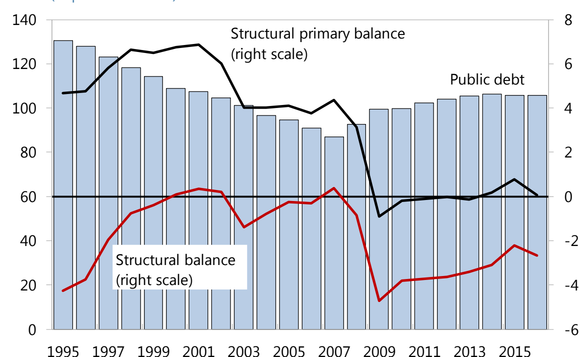
Sources: Eurostat, and IMF staff calculations.
[1]Effect estimated as a convergence to EU average.
[2]Through attrition.
[3]Subsidies are about 2.1 percent of GDP higher than the EU average and 2.0 percent of GDP higher than the three neighboring countries' average (France, Germany, Netherlands). Reforms should focus on business subsidies that are high by European standards (see Hallaert and Nowak, 2015, Country Report 15/71, and the NBB's Economic Review, September 2016).
[4]Assuming that the redistributive power of social benefits is increased to the EU average, Belgium could achieve the same reduction in income inequality at a fiscal cost lower by 3¼ points of GDP. This number is reduced by the planned reforms of social security of 1.2 percent of GDP over 2015-18. Measures could include (1) tightening the eligibility rules of sickness and disabilities schemes and unemployment to avoid their use as early retirement scheme and (2) increasing the use of means testing. For details (See Hallaert, 2016, Country report 16/78).
[5]Convergence to Euro area average.

15. Expenditure is at the heart of the consolidation challenge. After years of rapid growth, public expenditure amounted to nearly 54 percent of GDP in 2015, which does not necessarily translate into better services or social outcomes. There is significant scope to make spending more efficient, in particular by (i) reducing the high level of subsidies, (ii) making the division of labor between levels of government more efficient, (iii) accelerating ongoing reductions in public employment, (iv) enhancing means-testing and stronger control of social benefits, with a view to better targeting the most vulnerable.[2] Greater efficiencies in spending would also make room for much-needed public investment spending (see below).

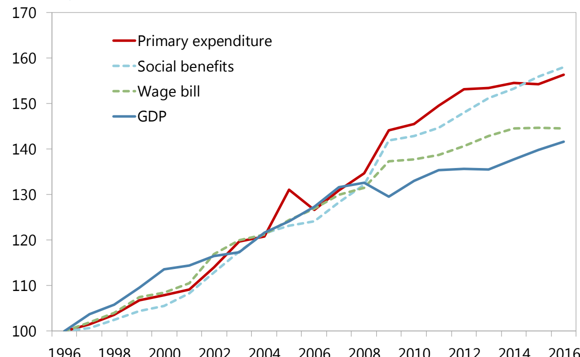
[2] See Hallaert, J.J. (2016), *Belgium—Making Public Expenditure More Efficient*, Washington, D.C.: IMF, Country Report 16/78.

Figure 3. Belgium: Fiscal Context

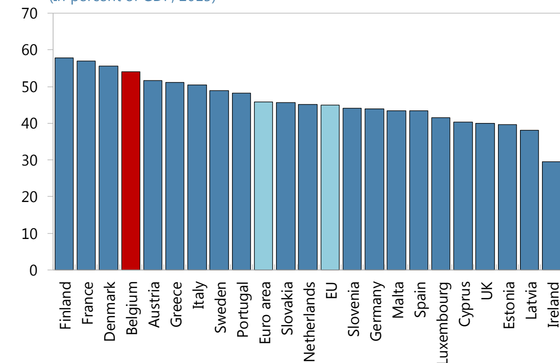
Belgium's strong record of large primary surpluses and debt reduction was undone by the crisis, with only limited progress in structural adjustment thereafter.



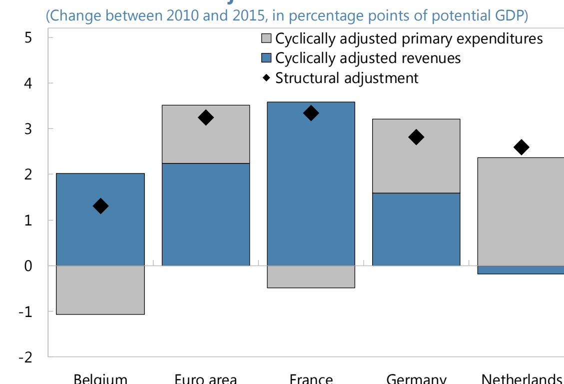
Since the crisis, expenditures have grown faster than GDP, driven by social benefits and the wage bill.



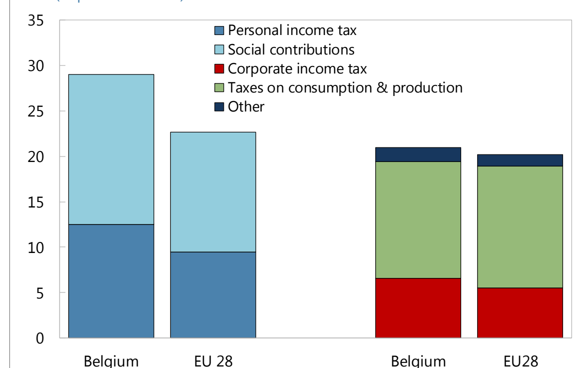
Public spending is among the highest in Europe,



reflecting the relatively low post-crisis adjustment compared to peers.



Sources: Haver Analytics, NBB, IMF *World Economic Outlook*, and IMF staff calculations.



16. Further tax reform could support growth while safeguarding revenues. The targeted personal income tax and social security contribution cuts planned for 2018–20 will appropriately further reduce the still high tax burden on labor. Staff suggested that well-targeted offsetting measures could help ensure revenue neutrality, including by strengthening environmental taxation, and eliminating deductions and exemptions, including on VAT and for company cars. The authorities' plan to lower the relatively high corporate income tax (CIT) rate has clear merits. However, as discussed with IMF tax policy experts, this should be part of a broader and revenue-neutral reform of business and

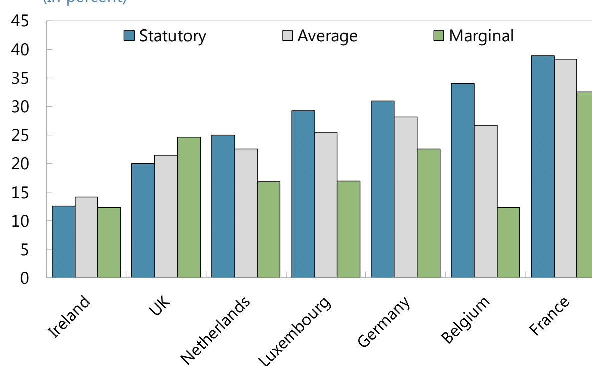
investment income taxation in order to maximize the growth impact without jeopardizing the consolidation strategy (Box 1).[3] A key principle would be to create a more level playing field across business and investment activities, including through a review of profit tax deductions, rules against tax avoidance, capital gains taxation, taxes on interest and dividends, tax treatment of rental income and real estate, and tax preferences on savings accounts.

Box 1. Growth-Friendly Corporate Income Tax Reform

CIT reform is currently under consideration by Belgium's coalition government. The relatively high CIT rate of 34 percent makes the tax base vulnerable to outbound profit shifting and can deter foreign investors, especially in a global environment of potentially intensifying tax competition. Belgium has historically attracted mobile businesses through targeted tax incentives, such as for intangible assets and financial services. Some of these are being revised to align Belgium's tax system with EU state-aid rules, the new European Anti-Tax Avoidance Directive, and new standards under the Base Erosion and Profit Shifting project of the G20/OECD.

Belgium's fiscal constraints limit the scope for lowering overall revenue from business and investment income taxation, especially as the labor tax wedge is still high. However, there should be room for reducing the statutory CIT rate since it is significantly higher than the average effective rate (see Figure), reflecting tax provisions such as for depreciation allowances, the tax credit for research and development, the innovation box, and the notional interest deduction. While Belgium's average effective rate is similar to peer countries, the marginal effective tax rate is comparatively low, suggesting that the tax disincentive to additional investment by Belgian firms is more limited than in other countries.

Statutory and Effective Tax Rates, 2015
(In percent)



Source: Zentrum für Europäische Wirtschaftsforschung (2016).

CIT reform could be an opportunity to improve the broader business and investment income tax regime by reducing distortions and thus better balancing growth and revenue objectives. Areas for potential efficiency gains include the preferential rate for small businesses, the patent box, measures against international tax avoidance, and some specific deductions and exemptions. Some other forms of base broadening, however, could hurt rather than support economic growth, such as limiting R&D incentives or loss carry forward. Another reform element could be Belgium's notional interest deduction (NID). The NID plays an important role in reducing the corporate debt bias by encouraging equity funding (IMF 2016), as it lowers the cost of capital and supports investment. Yet, it has also been used for tax planning via special-purpose vehicles of multinational companies, which could be addressed through strengthened anti-avoidance rules.

Finally, to ensure a level playing field across business and investment activities, the reform could usefully be broadened to include capital gains and dividend taxation, with a view to maintaining neutrality between different business forms and limiting tax arbitrage.

[3] Contributors: R. De Mooij and S. Hebous.

Authorities' views

17. The authorities emphasized the critical importance of sticking to the coalition agreement, reiterating their determination and commitment to reach structural budget balance in the near term. They agreed that most of the consolidation effort should come from expenditures, and acknowledged that further measures could be required in this area. They agreed that budget credibility is critical, and are assessing the reasons for the deficit overshoot in 2016. In this context, they noted that some revenue measures under the tax shift had taken more time to implement, such as the tax on real estate investment vehicles, and an agreement with the regions on regularization, and hence the effects will only be fully felt from 2017. The authorities appreciated the broader perspective that Fund staff brought on corporate income tax reform, without detracting from the urgency of such reform.

B. Priorities for Boosting Potential Growth and Productivity

18. Public investment in infrastructure will be critical to support economic activity following years of erosion of the public capital stock. At 2.3 percent of GDP in 2015, public investment is well below EU average (3.9 percent). With new investment barely keeping up with the depreciation of fixed assets since the late 1980s, the capital stock has been declining relative to GDP, and is now one of the lowest in Europe (Figure 4). There is also scope for redirecting public investment to more productive investment projects such as transport infrastructure. Transport infrastructure, both rail and road, is perceived to be of lower quality than in the three neighboring countries and has declined in recent years, with traffic congestion an increasingly serious problem. Since network density is already high, the priority appears to be maintenance and efficiency improvements. To ensure efficiency, it will be critical to develop a comprehensive and prioritized infrastructure strategy that is agreed between all levels of government, and reflected in medium-term budget plans.

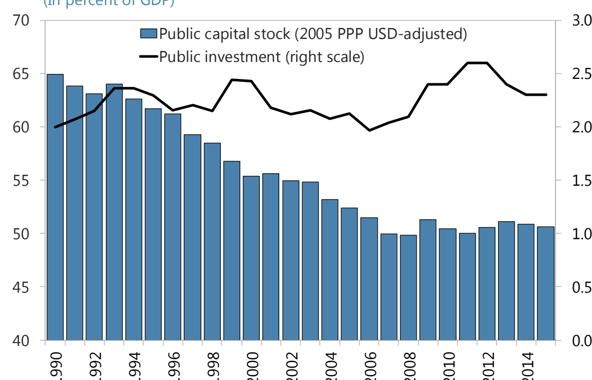
19. Greater competition in services would enhance productivity, while helping to reduce prices paid by consumers and firms. Competition could be increased in sectors such as telecommunications, retail, and the legal, architectural, and accounting professions. Protection of incumbents, including through the action of self-regulatory bodies that have, by law, regulatory power, and complex and lengthy bankruptcy procedures, contribute to a low rate of entry and exit in many services sectors. As a result, the services sector's productivity growth is substantially weaker than in neighboring countries and services' prices are comparatively high and dynamic, affecting the competitiveness of the tradable sector for which services are a crucial input (Figure 4). Some studies suggest that, if Belgium were to reduce the regulatory burden affecting services to the level of best practice observed in the OECD, TFP could grow by 1¼ percentage point more per year during five years.[4] Most of the gains would come from reform of professional services and retail trade.

[4] See B. Renaud, G. Cette, J. Lopez, J. Mairesse, and G. Nicoletti (2010b), *The Impact on Growth of Easing Regulation in Upstream Sectors*, CESifo DICE Report, vol. 8(3), pp. 8–12.

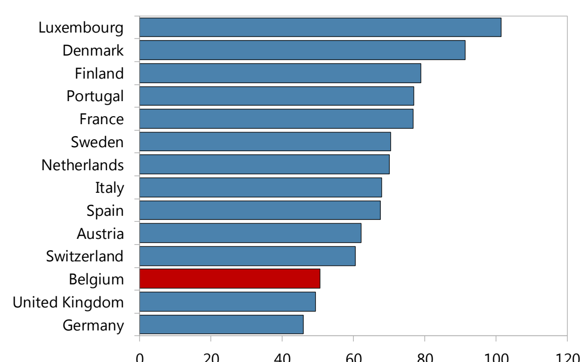
Figure 4. Public Investment, Productivity, and Regulation in Services

Low public investment has led to a decline in capital stock, which is now one of the lowest in Europe.

Belgium: Public Investment and Capital Stock
(In percent of GDP)

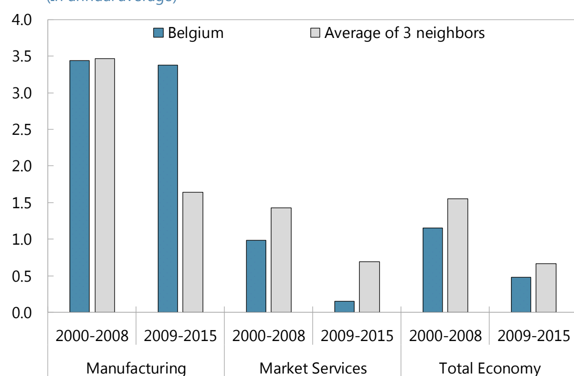


Public Capital Stock, 2015
(In percent of GDP)



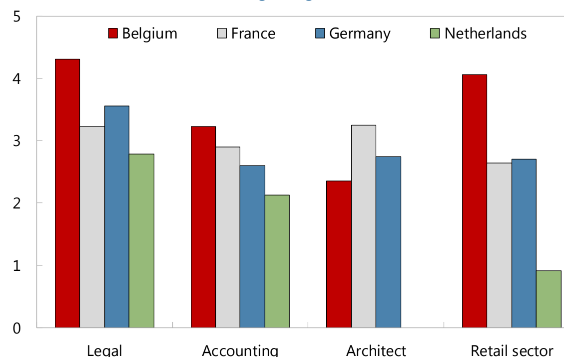
Labor productivity growth lags behind neighbors, particularly in the services sector.

Labor Productivity Growth
(In annual average)



Regulation is particularly strong in the legal and accounting services, and in the retail sector.

Service Sector Regulation
(In index, 0 to 6; 6 indicates strongest regulation)



Source: Eurostat, WEO and Public Investment Management Assessment (PIMA) databases, OECD, Federal Planning Bureau, and IMF staff calculations.

20. Labor market reforms could provide a major boost to Belgium's growth potential. Building on the reforms of unemployment benefits and pensions implemented since in 2012 (See Appendix VI) the government is undertaking several labor market reforms that should help keep Belgium's labor costs in line with its neighbors, while increasing flexibility at the sector and firm level (Box 2). In particular, the reform of the wage setting mechanism (the so-called "1996 law") aims to preserve the recent gains from wage moderation by linking wage growth to broader labor market and economic conditions. In this context, in setting the ceiling for wage growth, it would be important to consider not only wage developments in neighboring countries but also the differences in labor productivity growth. Moreover, while wage moderation has been successful in improving Belgium's competitiveness, it has weighed on private consumption and growth performance. Going forward, it will be important to also focus on non-cost competitiveness by fostering innovation, improving education and training, and labor market performance.

Box 2. Labor Market Reforms

The government has proposed several labor market reforms to Parliament. The main elements focus on:

Adjusting the wage setting mechanism. The 1996 law on competitiveness establishes, every two years, a "wage norm" to keep wage developments aligned with those of the three main partner countries.[1] Recent wage moderation has closed the wage gap accumulated since 1996 and the government is reforming the calculation of the wage norm to avoid that rapid wage increases erode the effects of the temporary de-indexation and to close the wage gap accumulated before 1996 (the "historical handicap" that remains to be quantified by the *Conseil Central de l'Economie*). Specifically, the reform would (i) build in the calculation of the wage norm a "security margin" to avoid that, as in the past, forecast errors contribute to a wage gap (if not used, the margin would allow faster wage increase in the subsequent wage norm), (ii) require social partners to correct past slippages when establishing a new norm, and (iii) increase the fine for firms and sectors that do not respect the norm. The cut in employers' social contributions implemented under the tax shift would be used to reduce the historical handicap and not to allow a faster increase in wages. To better take into account economic conditions, the calculation of the wage norm could take into account deviations in labor productivity growth between Belgium and its partner countries. The 2017–18 wage norm has been agreed in the context of the new mechanism.

Re-instating a minimum wage for the young. To tackle youth unemployment, a lower minimum wage for employees younger than 21 (eliminated in 2015) will be re-introduced. The minimum wage would be reduced by 6 points per year below 21 (6 percent reduction for a 20-year-old, up to a 30 percent reduction for a 16-year-old). The young would receive compensation from the government so as not to receive lower pay. The authorities[2] estimate that between 13,300 and 17,660 wage earners could be concerned and the measure would have a direct fiscal cost of about €40.5 million (0.01 percent of GDP).

Increasing flexibility in work time. Legal work time would continue to be set at 38 hours per week on average, but the average would now be calculated on an annual basis rather than a quarterly basis. This increased flexibility would remain constrained by a maximum working time of 9 hours per day and 45 hours per week (with wage premium starting at 44 hours). However, a branch agreement could increase the limits to 11 hours per day and 50 hours per week. In sectors facing international competition (industry and services), it will be possible to calculate the 38-hour week average over a period of up to 6 years. This system already exists for some sectors such as the automobile industry. Possibility for night work would be extended to the E-commerce. Moreover, the administrative regulation of part time jobs will be simplified.

Changing training requirements. The legal requirement would shift from dedicating 1.9 percent of the wage bill to training to providing at least 5 days of training by equivalent full time employee.

---

[1] Wages are indexed to inflation, but the wage norm sets a ceiling on real wage negotiations based on expected wage developments in Germany, France, and the Netherlands. The national wage norm then guides sectoral wage negotiations.

[2] Masure, L., M. López-Novella, M. Saintrain, and P. Stockman, *Herinvoering van de degressiviteit van de mininumlonen van min-21-Jaringen*, Federal Planning Bureau, Rapport 11337, October 2016.

21. Raising the low employment rates among certain groups would help reduce the severe fragmentation of the labor market. While employment growth has been solid, the labor market remains severely fragmented across regions and skill levels (Figure 5). Many younger and older persons are not working, and non-EU immigrants are less integrated in the labor market than in other European countries (Box 3). Only about half of non-EU immigrants aged 25–55 are employed, compared to over 80 percent for Belgian-born residents. The reform of the minimum wage and of

training are first steps that will need to be complemented by improvements in education and on-the-job training, in particular given the need for competency in multiple languages and unmet demand for certain technical skills.

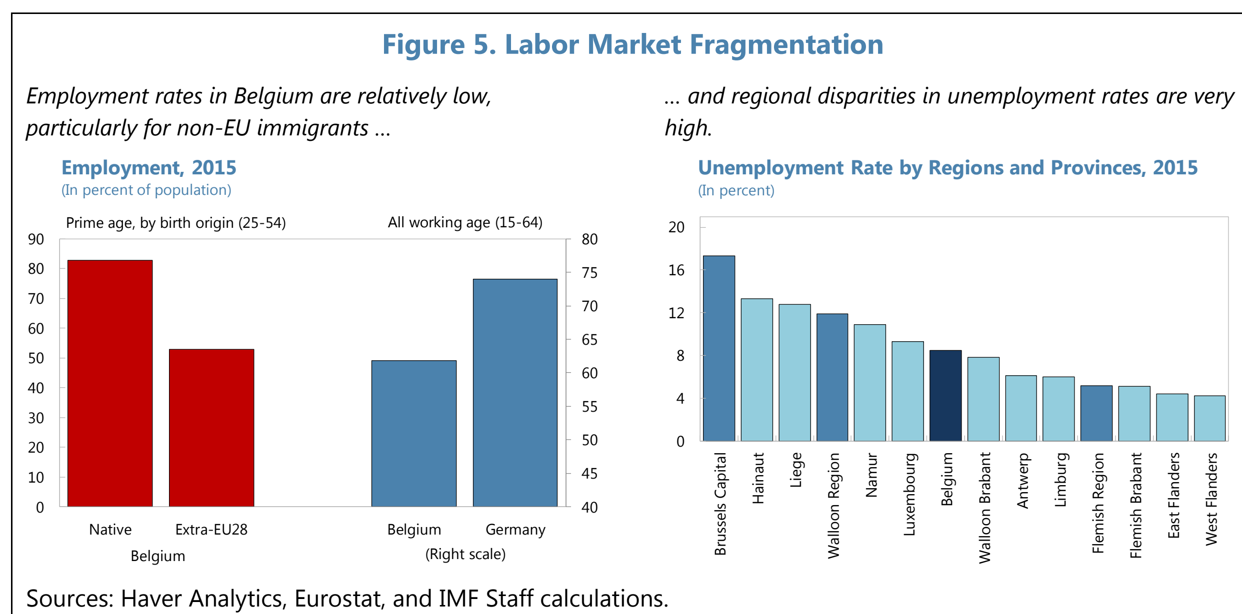


Figure 5. Labor Market Fragmentation

Sources: Haver Analytics, Eurostat, and IMF Staff calculations.

Authorities' views

22. The authorities concur that there is a need to boost quality public investment, which adds to the fiscal consolidation challenge. Since transport projects such as the completion of the Antwerp ring or the 10-year plan for the public transport system in Brussels are typically large and occur at irregular intervals, the authorities argue that more flexibility in European fiscal rules is needed to avoid deterring such investment, in addition to the welcome recent clarification by Eurostat of the treatment of Public Private Partnerships. Moreover, the Prime Minister has announced that an investment plan for Belgium will be elaborated in consultation with sub-federal levels of government, which undertake most public investment. The government has also initiated plans to speed up the integration of immigrants who come from outside the EU. The Minister of Economy has commissioned a study to analyze the reasons of stronger services inflation than in neighboring countries, which could provide guidance on where greater competition may be needed. While emphasizing the importance to gains from wage moderation, the authorities agreed on the need to foster also non-cost competitiveness.

Box 3. Which Groups Are Most Vulnerable in Belgium's Fragmented Labor Market?

Belgium suffers from low labor market participation and high (un)employment disparities across regions and population subgroups. To better gauge the factors underlying labor market fragmentation, the relative likelihood of being out of or in a job conditional on belonging to a certain socioeconomic group was explored using a standard probit regression model estimated on microeconomic data for Belgium and various other countries from the European Union Labor Force Survey (EU LFS). This allows controlling for overlap between vulnerable sub-groups (e.g., low-skilled young workers living in Brussels) to assess which individual characteristics appear to be most important for determining the probability of employment or unemployment.

At the aggregate level, the results confirm significant group "penalties" for conditional unemployment probabilities affecting the young, the low-skilled, and non-EU immigrants. But while the youth and skill penalties are broadly in line with comparator countries (a bit higher than in stronger labor markets and a bit lower than in weaker labor markets), the unemployment probability penalty for immigrants from outside the EU is considerably higher than in most other countries. Moreover, the vulnerability of this group decreases more slowly with years of residency than in other countries.

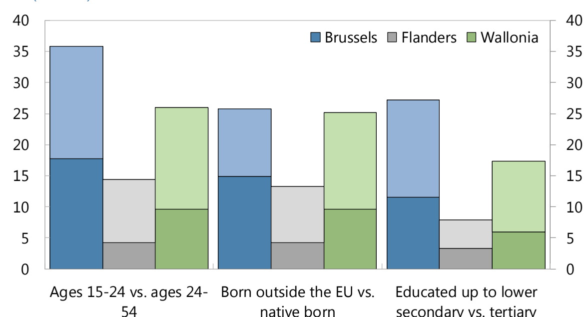
Probability[1] of being Unemployed	Belgium		Crisis-Impacted Comparators[2]		Crisis-Resilient Comparators[3]	
	2006	2014	2006	2014	2006	2014
Age						
25-54 years (base)	0.075	0.080	0.062	0.150	0.049	0.064
15-24 years	0.127	0.138	0.082	0.190	0.070	0.074
Country of birth						
Reference country (base)	0.075	0.074	0.064	0.147	0.052	0.067
Non-EU born	0.113	0.109	0.034	0.061	0.066	0.063
Country of birth and years of residency						
Non-EU born, years of residency 1 or less (base)	0.347	0.285	0.195	0.335	0.306	0.308
Non-EU born, years of residency 4 or more	-0.166	-0.109	-0.098	-0.130	-0.189	-0.180
Highest level of education successfully completed						
Lower secondary (base)	0.131	0.139	0.084	0.211	0.087	0.115
Headline unemployment rate (percent)	**8.3**	**8.6**	**7.2**	**15.6**	**6.1**	**7.4**

[1] Coefficients represent the change in the probability of being unemployed compared to the base category unless otherwise noted. Base categories are shown in actual probabilities. All probabilities are conditional on the factors above and the following: sex, household composition, and years of residency.
[2] Countries with significant labor market impact following the 2008 crisis: Italy, Ireland, Portugal, and Spain.
[3] Countries with mild labor market impact following the 2008 crisis: France, Netherlands, the U.K., and Austria.

Comparing pre- and post-crisis probabilities indicates that the crisis has not exacerbated these penalties tangibly, which contrasts with EU countries whose labor markets were hit harder by the crisis. Estimates reaffirm strong regional disparities in labor market performance among different socio-economic groups, with Flanders' residents of any socioeconomic group largely outperforming comparable groups in Brussels and in Wallonia. These results are broadly confirmed when looking at conditional employment probabilities, although immigrants seem equally placed to find a job across Belgium in the very first year upon arrival.

Mismatches in labor supply and demand and low geographical mobility have been advanced as factors explaining persistent underperformance of labor outcomes for young, immigrant and low-skilled workers in the non-Flanders regions (High Council of Employment, 2013). This suggests the need for a comprehensive strategy involving traditionally advocated measures on labor market flexibility, complemented by activation policies, migrant integration, and steps to increase labor mobility in order to help reduce fragmentation and unlock Belgium's large untapped employment potential.

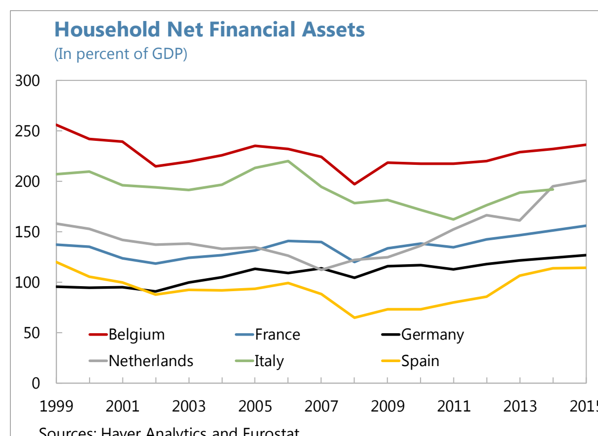
Probability of Being Unemployed and Marginal Penalties
(Percent)



Note: Marginal probability of the first category (lighter) over the second category (darker). The total reflects the probability of the first category.

C. Profitability Challenge to The Financial Sector

23. Private balance sheets appear solid in aggregate, although there may be pockets of vulnerability in households. Compared to other countries, Belgian households hold very high levels of financial assets, with net financial wealth reaching 238 percent of GDP in 2016H1. Much of this is held abroad, as reflected in the strong net international investment position.



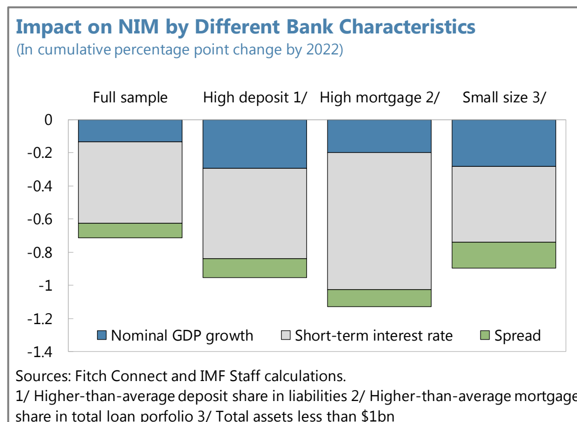
- Household debt has increased steadily since the mid-2000s, reaching 60 percent of GDP in 2016H1 and now above the average for the euro area. The debt service ratio remains contained at 7½ percent of gross disposable income. However, around 14 percent of indebted households had debt to income ratios above 3, and, in aggregate, debt to disposable income has increased to over 100 percent.
- Corporate debt on a consolidated basis reached 119 percent of GDP in 2016H1, up from 106 percent of GDP in 2014, although this headline figure captures intragroup funding for multinationals locating treasury centers in Belgium via special purpose vehicles, including for tax reasons. Excluding these operations reduces this ratio by around half. Interest coverage ratios look solid, with the median firm earning (before interest, taxes, and depreciation) more than seven times the interest paid on financial debt in 2014, and the 25th percentile earning more than double.

24. The banking sector faces the challenge of a low growth/low interest rate environment. The banking system has restructured post crisis and built more comfortable capital buffers, with the Tier 1 capital ratio reaching 15½ percent, and NPLs remain low at 3.5 percent (Figure 6). Banks have become more focused on the domestic market, with legacy issues from *Dexia* waning as the bank is wound down. The system's customer deposits comfortably exceed its loans, unlike many peers in neighboring countries. However, the low rate low growth environment has brought new challenges:

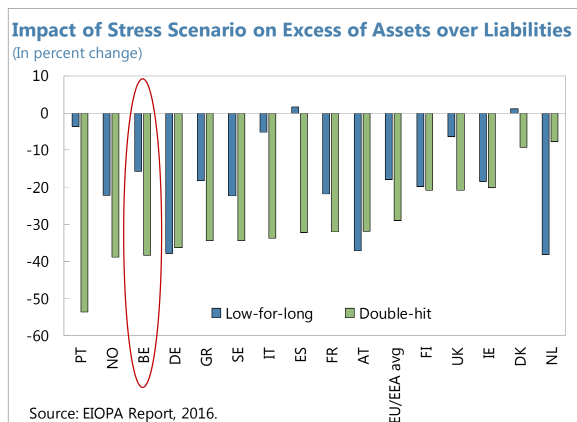
- While the overall net interest margin has been broadly resilient in the face of negative/low interest rates (Appendix IV), margins on mortgage loans have been declining, and the prevalence of fixed rate loans and strong refinancing trends imply lower future returns for the banks through loan repricing. Moreover, the term premium on outstanding mortgage loans has come down close to zero. The resulting squeeze on profitability and internal capital generation could constrain future credit supply, potentially affecting growth. However, banks could also loosen lending standards to increase interest income by boosting volumes, increasing household and corporate leverage. At the same time, banks face challenges from digitalization and competition from non-banks, as well as cyber-security expenses, requiring nimble adaptation to remain competitive.

- This environment raises the risk of search-for-yield behavior, as investors move funds away from low-yielding bank accounts and into real estate, asset management or other financial vehicles. These risks would stretch beyond the banking system and bear close watching and strong monitoring mechanisms.
- In such a context, banks will need to shift to other sources of income and cut costs further to boost profitability and internal capital generation, to help them withstand the expected long period of low returns on loans. Indeed, the sector has been consolidating; the number of domestic banks has fallen, and some Belgian banks have reduced their workforce and closed branches with a view to cutting expenses.

25. Staff's empirical analysis suggests that a low interest rate environment is harmful to bank profitability even after controlling for general macroeconomic conditions (Appendix IV). Based on a sample of more than 3,000 European banks, the analysis indicates that low nominal GDP growth and low interest rates tend to squeeze various measures of profitability. Drawing on the econometric estimates, a "stagnation" scenario (with a growth slowdown of 0.6 percent per year on average, as discussed above) accompanied by low rates and spreads through 2022, would result in a cumulative decline of ¾ percentage points in banks' net interest margins, and sharply lower returns on equity. Moreover, given Belgian banks' greater reliance on fixed-rate mortgage lending and retail deposit funding, the effects could be more pronounced than for the typical European bank.



26. Insurance companies are also vulnerable to the low growth/low interest rate environment. The sector's profitability has been deteriorating, squeezed by legacy policies offering guaranteed high interest rates and declining yields on assets. And while most Belgian insurance companies comfortably meet the solvency capital requirement, the European insurance regulator's 2016 stress test found that they would be vulnerable to a prolonged period of low interest rates. Belgian insurers would seem less hurt by a "low-for-long" scenario than many other European insurers, but would be among the more strongly affected by the "double-hit" scenario which combines a low yield environment with a sudden increase in risk premia. The average guaranteed interest rate is declining only slowly, falling to 2.82 percent at end-2015, and past-concluded contracts offering a guaranteed returns greater than 4.5 percent still accounted for 15 percent of inventory reserves. The authorities have taken policy actions to ensure the sector's adjustment, including setting up action plans for capital strengthening of some smaller

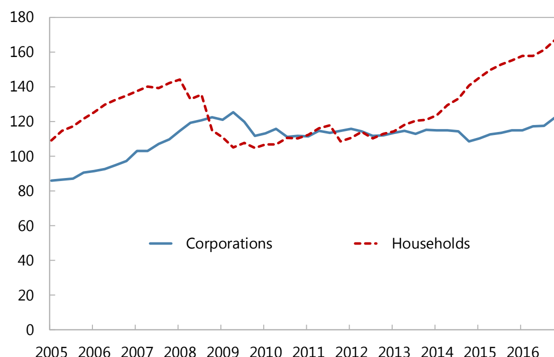


firms. More broadly, a new mechanism has been put in place for the annual setting of maximum interest rates on individual long-term life insurance contracts to better reflect current market conditions. A royal decree is expected to be issued soon granting the NBB greater powers to supervise the distribution of profit sharing or dividends by insurance companies.

Figure 6. Belgium: Challenges to Banks

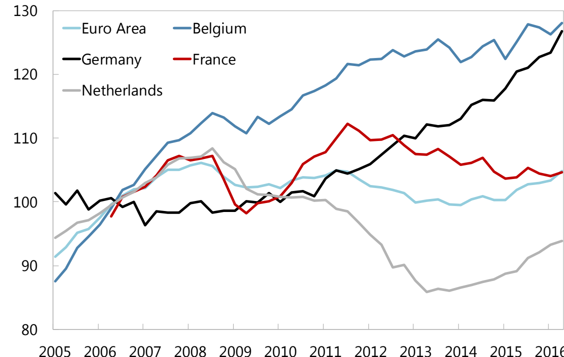
Banks have relied heavily on mortgage lending recently...

Loans to Households and Corporations
(In billions of euro, excluding securitization)



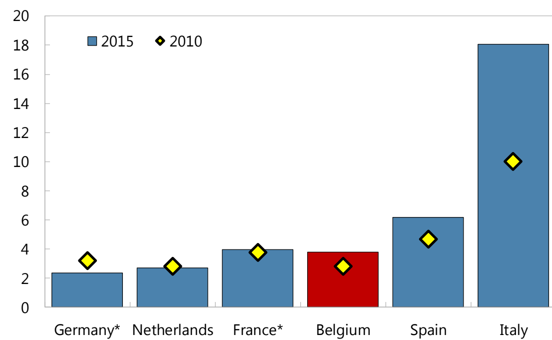
...while housing prices continue to rise.

International Comparison of House Price Evolutions
(Index, 2006=100)



NPLs remain low (consolidated basis).

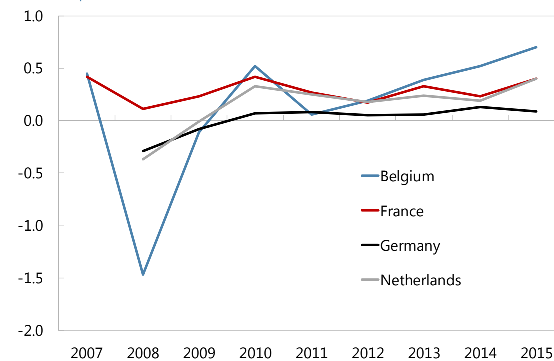
Non-Performing Loans to Gross Total Loans
(In percent)



Note: Data for France and Germany are 2014.

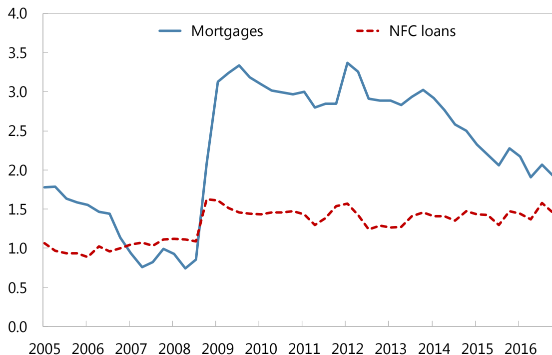
Belgian banks' profitability compares well with peers...

Return on Assets
(In percent)

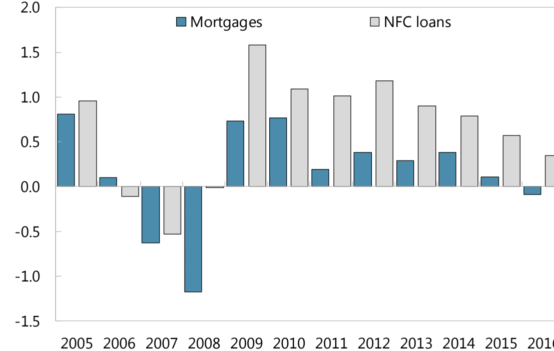


... but margins for mortgage lending are coming down, and their term premium is virtually zero, even as margins for corporate lending have remained stable while the term premium has come down by less.

MFI Lending Margins
(In percentage points)



Term Premia on Outstanding Mortgage and NFC Loans
(Difference between interest rates on loans > 5 years and those < 1 year)



Sources: Haver Analytics, IMF *Financial Soundness Indicators*, and IMF Staff calculations.

27. Further macro-prudential actions may be needed to address pockets of vulnerability in the housing market. Concerns relate to the continued growth in house prices, combined with rising household indebtedness and significant shares of risky mortgage lending practices[5], as well as strong expansion in mortgage credit. Various overvaluation estimates are in the range of 0–20 percent. Policy actions could address these issues from various angles:

- *Direct remedies*. In addition to the existing 5-percentage-point add-on to certain domestic mortgage risk weights, the NBB plans to impose additional capital buffers targeted at riskier loans, i.e. mortgage loans with loan-to-value (LTV) ratio higher than 80 percent, effective May 2017 (pending approval from the European authorities). Staff welcomed these measures and called for continued close monitoring of real estate market developments, including possible search-for-yield behavior in the housing market, and discussed possible further measures such as LTV or debt service to income (DSTI) limits to more directly target vulnerable borrowers.

- *Other buffers.* An additional capital cushion, the capital conservation buffer, will also be raised by 2019 by eight banks deemed domestically systemically important, among which are the large mortgage lenders. Another buffer that could be deployed should strong credit growth persist is the counter-cyclical capital buffer, which is currently set to zero. On balance, staff considers this appropriate, in view of the various estimates of the credit gap of near zero[6]. Close monitoring is nevertheless warranted.

Authorities' views

28. The authorities broadly agreed with staff's assessment. On the banking sector's challenges in a low-rate environment, they noted that there is scope for higher commercial margins on mortgage loans, but banks have also diversified to other sources of income (e.g., fees and commissions) and there is room for further adaptation of the cost structure. Regarding life insurance, they noted that the sector is restructuring, with some firms exiting and others no longer offering guaranteed products. In addition, NBB is developing several macroprudential tools, including a national stress test framework, to monitor risks in the life insurance market. On potential further macroprudential measures (such as LTV and DSTI) to more directly address housing market risks, the authorities noted that they plan to wait and see how effective current and upcoming measures are before considering these alternatives.

STAFF APPRAISAL

29. The government continues to make progress on its reform agenda, albeit with less success on the fiscal strategy. Major strides taken during the government's first year, building on previous efforts, include the *saut d'index*, the tax shift, and pension reforms. These should contribute

[5] In 2015, 30 percent of new loans had loan-to-value ratios of over 90 percent, and a fifth had debt-service-to-income ratios of over 50 percent.

[6] Estimates by staff, NBB, and European Systemic Risk Board, the latter after removing the effects of debt issuance of a large Belgian non-financial corporation in the context of a takeover of a large foreign company in 2016Q1.

to reducing the cost competitiveness gap with neighboring countries, support job creation, and reduce the long-term increase in the cost of aging. Additional labor market reforms are under way, notably a revision to the wage setting mechanism.

30. Deeper reforms would reduce the risk of a low growth/high debt trap. Complementary efforts to increase the efficiency of public expenditure, make the tax system more growth friendly, raise low rates of employment among certain groups, implement a coherent infrastructure investment strategy, and strengthen competition in services, would help raise the headroom for growth through faster job creation and productivity growth, and contribute to faster debt reduction. This will be particularly important in the context of increased global and regional uncertainties and structurally weak growth in key trading partners.

31. Given the high level of public debt, it will be essential for the public sector to be both a source of stability and a contributor to stronger growth. The sizeable fiscal slippage in 2016 has halted the nascent trend in public debt reduction. It will now be critical to implement a credible 2017 budget, backed by realistic revenue and spending assumptions, and supported by high quality measures. Beyond 2017, the main task is to balance the budget across all levels of government, which will require substantial additional measures. It should be underpinned by an ambitious and credible medium-term strategy—agreed and committed to by all levels of government.

32. The bulk of fiscal consolidation must come from the spending side. There is significant scope to make spending more efficient, through measures to reduce subsidies and public employment, reform social benefits to better target to most vulnerable, streamline the division of labor between levels of government, and improve the budget process across all levels of government.

33. Further tax reform should safeguard revenues while making the system more supportive of jobs and growth. The targeted personal income tax and social security contribution cuts planned for 2018–20 will further reduce the high tax burden on labor, and there is a need to ensure revenue neutrality through additional measures, as outlined in paragraph 16. In this context, there would be merit in lowering the corporate income tax rate if it is part of a broader and revenue-neutral reform of business and investment income taxation that is designed to support jobs, growth, and innovation.

34. A comprehensive plan to raise the low employment rates among vulnerable groups would provide a major boost to Belgium's growth potential. While employment growth has been solid, the labor market remains severely fragmented across regions and population groups. Four broad priorities stand out: (i) preserving the gains from wage moderation by linking wage growth to broader labor market and economic conditions (supported by the reform of the 1996 law on employment and competitiveness); (ii) further reducing the labor tax wedge; (iii) improving education and on-the-job training, in particular given the need for competency in multiple languages and unmet demand for certain technical skills, while also promoting the integration of non-EU immigrants; and (iv) addressing barriers to geographical mobility, including traffic congestion and gaps in the public transport network.

35. Upgrading public infrastructure and strengthening competition in services would raise productivity growth and competitiveness. The backlog in public investment is weighing on economic prospects, with bottlenecks particularly severe in transport infrastructure. To ensure the efficiency of investment, it will be critical to develop a comprehensive and prioritized infrastructure strategy that is agreed between all levels of government, and reflected in medium-term budget plans. In addition, greater competition in services should be fostered—including in telecommunications, retail, and the legal, architectural, and accounting professions—which should help reduce prices paid by consumers and firms, while boosting productivity.

36. The financial sector will have to continue adapting to the low interest rate environment, and regulators should continue to closely monitor pockets of vulnerability in the mortgage market. The possibility of a prolonged period of very low growth and interest rates could put pressure on banks' profit margins, especially given the high reliance on deposit taking and mortgage lending. To maintain the sector's soundness and resilience, banks will need to pursue further cost reduction and diversification of revenue sources. The measures undertaken by the authorities and the continued restructuring efforts by both banking and insurance sectors to adapt to these challenges have been appropriate. It will also be important to monitor and address potential risks in the mortgage, life insurance, and shadow bank markets, and stand ready to deploy further macro-prudential measures when appropriate.

37. It is proposed that the next Article IV consultation take place on the standard 12-month cycle.

Table 1. Belgium: Selected Economic Indicators, 2013–2022

				Est.	Projections					
	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
	(percentage change from previous period; unless otherwise indicated)									
Real economy										
Real GDP	-0.1	1.7	1.5	1.2	1.5	1.5	1.5	1.5	1.5	1.5
Domestic demand	-0.5	2.3	1.5	0.4	1.5	1.5	1.5	1.6	1.5	1.5
Private consumption	0.7	0.6	1.1	0.8	1.5	1.4	1.4	1.4	1.4	1.3
Public consumption	0.1	1.4	0.5	0.1	0.4	0.4	0.7	0.7	0.8	0.9
Gross fixed investment	-1.5	5.1	2.4	2.2	2.7	3.0	2.5	2.9	2.5	2.6
Stockbuilding[1]	-0.6	0.4	0.3	-0.5	0.0	0.0	0.0	0.0	0.0	0.0
Foreign balance[1]	0.4	-0.5	0.0	0.8	0.1	0.0	0.0	0.0	0.0	0.0
Exports, goods and services	0.8	5.1	4.3	5.7	3.9	4.0	3.9	4.0	3.8	3.9
Imports, goods and services	0.3	5.9	4.3	4.8	3.9	4.1	4.0	4.1	3.8	3.9
Household saving ratio	12.3	12.1	11.7	12.6	12.6	12.7	12.9	13.0	13.2	13.3
Potential output growth	1.0	1.1	1.1	1.2	1.3	1.4	1.4	1.4	1.4	1.5
Potential output growth per working age person	0.8	1.0	0.9	0.9	1.0	1.2	1.5	1.5	1.5	1.5
Output gap (in percent)	-1.5	-1.0	-0.6	-0.6	-0.4	-0.2	-0.1	0.0	0.1	0.1
Employment										
Unemployment rate	8.5	8.6	8.5	8.0	7.8	7.7	7.6	7.5	7.4	7.3
Employment	-0.3	0.4	0.9	1.2	0.8	0.8	0.6	0.5	0.4	0.5
Prices										
Consumer prices	1.2	0.5	0.6	1.8	1.9	1.7	1.8	1.9	2.0	2.0
GDP deflator	1.2	0.7	0.9	1.5	1.6	1.6	1.7	1.8	2.0	2.0
	(Percent of GDP; unless otherwise indicated)									
Public finance										
Revenue	52.7	52.0	51.3	51.0	51.0	50.7	50.4	50.2	50.2	50.2
Expenditure	55.7	55.1	53.9	53.7	53.1	53.0	52.7	52.7	52.7	52.7
General government balance	-3.0	-3.1	-2.5	-2.7	-2.1	-2.3	-2.3	-2.5	-2.5	-2.5
Structural balance	-2.9	-2.8	-2.2	-2.4	-1.9	-2.2	-2.3	-2.5	-2.6	-2.6
Structural primary balance	0.4	0.4	0.8	0.3	0.5	0.1	0.0	-0.1	-0.1	-0.1
Primary balance	0.3	0.2	0.5	0.0	0.4	0.0	0.0	-0.1	0.0	0.0
General government debt	105.4	106.5	105.8	105.6	104.5	103.6	102.7	101.9	100.9	100.0
Balance of payments										
Goods and services balance	0.1	0.4	2.3	3.0	2.1	1.7	1.7	1.5	1.5	1.7
Current account	-0.3	-0.7	0.4	1.1	0.7	0.8	1.0	1.1	1.4	1.7
Exchange rates										
Euro per U.S. dollar, period average	0.8	0.8	0.9	0.9	...	...	...	...	...	...
NEER, ULC-styled (2005=100)	102.2	102.1	97.9	98.9	...	...	...	...	...	...
REER, ULC-based (2005=100)	104.1	103.8	99.7	101.2	...	...	...	...	...	...
Memorandum items										
Nominal GDP (in billions of euros)	391.7	400.8	410.4	421.7	434.9	448.7	463.3	478.7	495.7	513.4
Population (in millions)	11.2	11.2	11.2	11.3	11.3	11.4	11.4	11.5	11.6	11.6

Sources: Haver Analytics, Belgian authorities, and IMF staff projections.

[1] Contribution to GDP growth.

Table 2. Belgium: Balance of Payments, 2013–2022

	2013	2014	2015	Est. 2016	Projections 2017	2018	2019	2020	2021	2022
					(in percent of GDP)					
Balance on current account	-0.3	-0.7	0.4	1.1	0.7	0.8	1.0	1.1	1.4	1.7
Balance on goods and services	0.1	0.4	2.3	3.0	2.1	1.7	1.7	1.5	1.5	1.7
Balance of trade (f.o.b., c.i.f.)	121.9	119.3	111.3	114.5	120.8	123.7	125.9	128.1	130.9	133.2
Exports of goods and services	81.9	82.6	80.8	83.5	87.5	89.4	91.0	92.5	94.4	96.2
Exports of goods	60.1	59.1	56.0	57.8	60.6	61.9	63.0	64.1	65.4	66.6
Exports of services	21.8	23.5	24.8	25.7	26.9	27.5	28.0	28.4	29.0	29.6
Imports of goods and services	-81.8	-82.2	-78.5	-80.5	-85.4	-87.7	-89.3	-90.9	-93.0	-94.5
Imports of goods (f.o.b.)	-61.8	-60.2	-55.3	-56.7	-60.2	-61.8	-62.9	-64.1	-65.5	-66.6
Imports of services	-20.0	-22.0	-23.2	-23.8	-25.2	-25.9	-26.4	-26.9	-27.5	-27.9
Income, net	1.4	0.5	-0.2	-0.2	0.3	0.7	0.9	1.2	1.5	1.6
Current transfers, net	-1.8	-1.6	-1.6	-1.6	-1.7	-1.6	-1.6	-1.6	-1.6	-1.6
Balance on capital account	-0.1	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Balance on financial account	0.0	-0.8	0.7	1.1	0.8	0.8	1.1	1.2	1.4	1.7
Direct investment, net	0.8	1.2	2.0	1.6	1.8	2.0	2.2	2.4	2.6	2.8
Portfolio investment, net	-7.8	-1.9	-4.8	0.0	-0.9	-1.2	-1.4	-1.8	-1.9	-2.0
Financial derivatives, net	-0.5	0.8	-0.1	0.0	0.0	-0.1	0.0	0.1	0.0	0.0
Other investment, net	7.5	-0.6	3.8	-0.2	0.0	0.2	0.4	0.6	0.8	1.1
Reserve assets	-0.1	-0.3	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Errors and omissions, net	0.4	0.1	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Sources: Haver Analytics, Belgian authorities, and IMF staff projections.

Table 3. Belgium: General Government Statement of Operations, 2013–2022

(In percent of GDP)

				Est.			Projections			
	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	52.7	52.0	51.3	51.0	51.0	50.7	50.4	50.2	50.2	50.2
Taxes	30.8	30.7	30.3	30.0	30.2	30.0	29.7	29.7	29.7	29.7
Personal income tax	13.3	13.2	12.9	12.4	12.4	12.1	11.8	11.8	11.8	11.8
Corporate income tax	3.2	3.3	3.4	3.7	3.7	3.7	3.7	3.7	3.7	3.7
Taxes on property	2.3	2.2	2.1	2.2	2.2	2.2	2.2	2.2	2.2	2.2
VAT	7.0	6.9	6.7	6.5	6.6	6.6	6.6	6.6	6.6	6.6
Excise	2.1	2.1	2.1	2.2	2.3	2.4	2.5	2.5	2.5	2.5
Other taxes	3.0	3.1	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Social contributions	16.8	16.7	16.5	16.1	15.9	15.7	15.7	15.5	15.5	15.5
Actual social contributions	14.4	14.3	14.3	13.8	13.6	13.5	13.4	13.2	13.2	13.2
Imputed social contributions	2.4	2.4	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3
Other revenue (incl. grants)	5.0	4.7	4.5	4.9	5.0	5.0	5.0	5.0	5.0	5.0
Expenditure	55.7	55.1	53.9	53.7	53.1	53.0	52.7	52.7	52.7	52.7
Expense	51.4	50.9	50.3	50.1	49.5	49.3	49.1	49.0	49.1	49.1
Compensation of employees	12.8	12.7	12.5	12.4	12.3	12.2	12.1	12.0	12.0	12.0
Use of goods and services	4.3	4.2	4.1	4.1	4.1	4.1	4.1	4.1	4.1	4.1
Interest	3.3	3.3	3.0	2.7	2.5	2.3	2.3	2.4	2.5	2.5
Subsidies	3.5	3.4	3.4	3.5	3.5	3.5	3.5	3.5	3.5	3.5
Grants	1.3	1.2	1.2	1.3	1.2	1.2	1.2	1.2	1.2	1.2
Social benefits	25.4	25.3	25.3	25.3	25.1	25.2	25.1	25.1	25.0	25.0
Other expense	0.8	0.9	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8
Net acquisition of nonfinancial assets	4.3	4.2	3.6	3.6	3.6	3.8	3.6	3.6	3.6	3.6
Gross operating balance	1.3	1.1	1.1	0.9	1.5	1.5	1.2	1.1	1.1	1.1
Net lending/borrowing	-3.0	-3.1	-2.5	-2.7	-2.1	-2.3	-2.3	-2.5	-2.5	-2.5
Net financial transactions	-3.0	-3.1	-2.5	...	...	...	...	...	...	...
Net acquisition of financial assets	-0.2	-0.2	-0.1	...	...	...	...	...	...	...
Currency and deposits	-0.1	-0.1	-0.1	...	...	...	...	...	...	...
Securities other than shares	-0.2	-0.2	-0.1	...	...	...	...	...	...	...
Loans	1.2	1.1	1.0	...	...	...	...	...	...	...
Shares and other equity	-1.1	-1.1	-0.9	...	...	...	...	...	...	...
Other financial assets	0.0	0.0	0.0	...	...	...	...	...	...	...
Net incurrence of liabilities	2.9	2.9	2.4	...	...	...	...	...	...	...
Currency and deposits	0.0	0.0	0.0	...	...	...	...	...	...	...
Securities other than shares	1.5	1.5	1.2	...	...	...	...	...	...	...
Loans	1.6	1.6	1.3	...	...	...	...	...	...	...
Other liabilities	-0.1	-0.1	-0.1	...	...	...	...	...	...	...
Memorandum items										
Primary balance	0.3	0.2	0.5	0.0	0.4	0.0	0.0	-0.1	0.0	0.0
Structural fiscal adjustment	0.8	0.0	0.6	-0.2	0.5	-0.3	-0.1	-0.2	-0.1	0.0
Structural fiscal primary adjustment	0.4	0.0	0.4	-0.5	0.3	-0.4	-0.1	-0.1	0.0	0.0
Gross government debt	105.4	106.5	105.8	105.6	104.5	103.6	102.7	101.9	100.9	100.0
Real growth of primary expenditure[1]	1.8	0.5	-0.4	1.5	0.8	1.6	0.9	1.3	1.4	1.5

Sources: Haver Analytics, Belgian authorities, and IMF staff projections.

[1] Excludes the 2012 Dexia recapitalization.

Table 4. Belgium: General Government Consolidated Balance Sheet, 2008–2015

	2008	2009	2010	2011	2012	2013	2014	2015
				(in percent of GDP)				
Net worth and its changes	…	…	…	…	…	…	…	…
Nonfinancial assets	…	…	…	…	…	…	…	…
Net financial worth	-76.6	-82.9	-81.6	-83.1	-91.9	-90.2	-100.1	-97.7
Financial assets	24.5	26.5	26.1	26.9	28.2	28.1	29.4	29.0
Currency and deposits	4.6	4.4	4.7	4.8	4.5	4.4	4.4	4.3
Securities other than shares	0.8	0.8	0.6	0.5	0.5	0.4	0.3	0.3
Loans	5.3	5.9	6.0	6.4	7.7	8.1	8.5	8.3
Shares and other equity	9.0	10.5	10.0	10.1	10.6	10.0	11.1	10.7
Insurance technical reserves	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial derivatives	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other accounts receivable	4.7	4.9	4.8	5.1	5.0	5.2	5.3	5.4
Liabilities	101.0	109.4	107.6	110.0	120.1	118.3	129.5	126.7
Special Drawing Rights	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits	0.3	0.4	0.4	0.4	0.4	0.4	0.3	0.3
Securities other than shares	84.0	90.6	88.5	89.7	98.7	96.2	105.4	103.1
Loans	13.4	14.5	15.1	16.2	17.1	18.0	20.2	19.4
Shares and other equity	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.2
Insurance technical reserves	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Financial derivatives	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other accounts payable	3.2	3.8	3.5	3.6	3.8	3.5	3.3	3.4

Sources: Haver Analytics and IMF staff calculations.

Table 5. Belgium: Structure of the Financial System, 2010–2016

	2010	2011	2012	2013	2014	2015	2016 3/
Banking sector							
Number of credit institutions	107	108	104	104	103	99	95
Domestic	48	47	42	39	37	37	35
Branches of foreign banks	59	61	62	65	66	62	60
Total assets (in billions of euros)[1]	1,151	1,147	1,049	961	996	970	1039
of which Four largest banks	1,003	968	857	775	816	803	858
of which claims on Belgian residents	478	500	527	488	476	478	486
Insurance sector							
Number of insurance companies	145	142	134	130	128	123	115
Life	28	26	24	23	23	23	20
Mixed	24	25	25	25	25	25	24
Non-life	91	89	83	80	78	73	69
Reinsurance	2	2	2	2	2	2	2
Total assets (in billions of euros)[2]	249	257	265	271	281	286	336
Net premiums written (in billions of euros)[2]							
Life	19	18	21	16	16	15	7
Non-life	10	10	11	11	12	13	6
Other financial intermediaries							
Stockbroking firms							
Number	23	22	20	20	20	20	20
Income (in billions of euros)	0.3	0.3	0.3	0.3	0.3	0.2	0.1
Total assets (in billions of euros)	2.4	2.0	2.2	2.3	3.2	2.1	2.7
Portfolio management companies							
Number	24	20	21	19	19	19	19
Income (in billions of euros)	0.0	0.0	0.1	0.1	0.1	0.1	0.0
Assets under management (in billions of euros)	62	3	4	3	4	5.2	6.3
Management companies of undertakings for collective investment							
Number	7	7	7	7	7	7	8
Income (in billions of euros)	0.9	0.8	0.8	1.0	1.1	1.3	0.6
Assets under management (in billions of euros)	194	178	178	175	201	217.6	221.6
Undertakings for collective investment distributed in Belgium							
Number of investment companies	460	484	509	521	578	638	635
Belgian law	148	142	144	130	128	130	129
Foreign law	312	342	365	391	450	508	506
Assets under management	139	115	118	132	164	204	n.a.
Pension funds							
Number	251	245	237	201	196	200	199
Total assets (in billions of euros)	16	16	19	20	23.4	24.7	n.a.

Sources: National Bank of Belgium, Belgian Asset Managers Association, and Financial Services and Markets Authority.

[1] On consolidated basis.

[2] On company basis. Figure for insurance total assets in 2016 at market value.

[3] For the number of credit institutions, data refer to situation of 30 October. For the number of pensions funds, data refer to situation of 3 November. All other data refer to the end-June 2016 situation.

Table 6. Belgium: Financial Soundness Indicators of the Banking Sector, 2010–2016[1]

	2010	2011	2012	2013	2014	2015	2016H1
Earnings and profitability							
Return on assets	0.5	0.0	0.1	0.3	0.5	0.6	0.6
Return on equity	10.7	0.7	3.0	5.9	7.7	10.1	9.7
Net interest income to total income	68.3	71.2	71.6	62.6	70.2	67.7	67.5
Interest margin	1.2	1.2	1.3	1.2	1.6	1.8	1.8
Average yield on assets	2.8	2.9	2.9	2.6	2.7	2.6	2.5
Average cost of funding	1.6	1.7	1.7	1.4	1.1	0.8	0.7
Noninterest income to gross income	31.7	28.8	28.4	37.4	29.8	32.3	32.5
Of which: Net fee and commission income	25.6	26.8	28.3	27.7	25.8	26.7	25.6
(Un)realized capital gains booked in P&L	-0.2	-3.9	0.2	6.0	-0.3	5.3	4.3
Cost/income ratio	66.0	67.3	73.4	62.4	61.2	58.6	62.7
Structure assets							
Total assets (in percent of GDP)	323.2	310.2	278.7	251.0	249.0	236.5	250.1
Of which (in percent of total assets):							
Loans to credit institutions	17.0	15.2	12.4	12.3	9.1	8.5	10.8
Debt securities	20.1	18.5	18.4	18.9	19.6	18.0	17.4
Equity instruments	0.5	0.4	0.6	0.4	0.6	0.7	0.4
Derivatives	11.6	14.6	11.5	6.8	8.4	6.4	7.2
Loans to customers	44.0	44.4	48.1	53.9	54.1	56.4	53.5
Of which: Belgian residents (in percent of loans)	64	70	72.0	69.4	69.2	69.2	70.5
Other EMU residents (in percent of loans)	19	17	15.0	15.7	16.2	16.1	14.8
Rest of the world (in percent of loans)	17	13	13.0	14.9	14.5	14.7	14.7
Mortgage loans (only to households as of 2014, in billions euros)	179	184	188.3	190.8	202.4	216.1	220.5
Consumer loans (only to households as of 2014, in billions euros)	24	23	24.0	26.9	17.2	19.7	23.1
Term loans (in percent of loans)	42.3	40.0	39.3	40.8	n.a	n.a	n.a
Reverse repo operations (in percent of loans)	7.3	4.2	3.3	3.1	2.3	2.5	3
Funding and liquidity (in percent of total assets)							
Debts to credit institutions	15.4	11.2	11.0	10.7	9.1	8.5	8.9
Bank bonds and other debt securities (excludes saving cert. as of 2014)	10.9	8.8	10.6	10.1	9.3	9.1	9.1
Customer deposits	46.0	46.5	49.3	54.7	58.5	61.0	59.2
Of which: Sight deposits (at amortized cost)	13.7	12.6	15.1	18.1	24.2	28.4	28.1
Saving deposits (only households as of 2014)	16.2	16.0	18.9	21.0	19.9	20.8	22.5
Term deposits (at amortized cost)	8.5	9.6	9.2	9.6	8.9	8.1	6.7
Retail deposits (only households as of 2014)	26.1	26.5	30.6	34.8	33.5	35.1	34.7
Repo's	5.0	5.2	2.3	2.7	2.3	1.7	1.8
Liquid assets (unconsolidated data)	32.5	34.3	36.4	36.8	32.8	32.2	30.9
Asset quality							
Sectoral distribution of loans (in percent of total assets)							
Credit institutions	17.0	15.2	12.4	12.3	9.1	8.5	10.8
Corporate (until 2013) /Non financial corporations (as of 2014)	17.2	16.4	16.3	18.5	20.6	22.0	20.3
Retail (until 2013) / Households (as of 2014)	22.1	22.9	26.3	29.4	25.5	27.4	26.4
Central governments (until 2013) / General government (as of 2014)	1.0	0.8	0.8	1.0	4.4	4.3	4.1
Non-credit institutions (until 2013) / Other financial corporations (as of 2014)	3.8	4.3	4.7	5.0	3.5	2.7	2.5
Non-performing loans (NPL) as percent of gross loans (unconsolidated)	2.8	3.2	3.2	3.1	2.7	2.6	2.6
Provisions and write-offs as percent of NPL (unconsolidated)	53	49	53.0	54.1	57.1	54.3	56.9
Capital adequacy							
Regulatory capital to risk-weighted assets	19.3	18.5	18.1	18.7	17.3	18.7	18.1
Regulatory Tier 1 capital to risk-weighted assets	15.5	15.1	15.8	16.4	15.1	16	15.5
Capital to assets	5.0	4.6	5.8	6.4	6.6	6.5	6.7
NPL net of provisions as percent of Tier 1 capital (unconsolidated)	12.2	14.2	13.4	12.3	12.0	12.9	11.6
Net open position in foreign exchange to capital	3.3	1.4	2.1	2.1	3.4	2.6	2.2

Sources: National Bank of Belgium.

[1] Consolidated data. Data are based on the IAS/IFRS reporting scheme.

Appendix I. Main Recommendations of the 2016 Article IV Consultation and Authorities' Response

Fund Recommendations	Policy Actions
Fiscal Policy	
Fiscal consolidation should be primarily expenditure-based and underpinned by high quality structural measures	Expenditure measures are being implemented in various areas, such as health spending. However, overall consolidation fell short in 2016 (see para. 5).
Make public spending more efficient through well-targeted reductions in public employment, enhanced means-testing in social spending, and improved budgetary control across all levels of government.	Reductions in public employment are ongoing. Regions have reported improved monitoring and control of budgets. Means testing for certain benefits may be considered in some regions.
On revenues, more efficient taxation of wealth and real estate, and phasing out of generous tax exemptions	The multi-year tax shift is being implemented and a corporate income tax reform is under discussion, which may include closing of some exemptions.
Financial Sector Policy	
Vigilance and proactive supervision over mortgage lending, including consideration of targeted prudential measures to limit overexposures of vulnerable borrowers.	A further measure targeted at riskier loans with high loan-to-value ratios has been announced, to take effect in May 2017 (pending approval by the EU authorities).
Structural Reforms	
A comprehensive and inclusive jobs strategy	Several laws are under consideration for labor market reform (see Box 2)
Further efforts to reduce the labor tax wedge for the low-skilled, improve education and training, and strengthen incentives toward active labor market participation	The labor tax wedge will continue to be reduced under the tax shift. Efforts to improve education and training, and strengthening incentives to labor market participation are continuing.
Steps to remove barriers to geographic mobility, promote competition, and reduce the administrative burden on companies.	Efforts are ongoing to better coordinate between regions on transportation issues.

Source: IMF Staff

Appendix II. External Sector Report

	Belgium	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. The net international investment position (NIIP) remains strong, averaging 54 percent of GDP in 2016Q1–3, reflecting very healthy private balance sheets. Despite Belgium's decline as a financial center, gross foreign assets are large (averaging 495 percent of GDP). Gross foreign assets of the financial sector stood at 103 percent of GDP, down considerably from the pre-crisis peak. The external debt of the public sector was around 66 percent of GDP. **Assessment**. Belgium's large gross international asset and liability positions are bloated by the presence of corporate treasury units, without creating macro-relevant mismatches. The remaining risk exposures on the asset side mostly relate to financial sector claims. Risk exposures on the liability side are related to external public debt. Based on the projected current account and growth paths, the NIIP to GDP ratio is expected to increase gradually going forward. The strongly positive NIIP and its trajectory do not raise sustainability concerns.	**Overall Assessment**: *The external position in 2016 was moderately weaker than medium-term fundamentals and desirable policy settings would imply*. The positive trend compared to previous years as well as recent measures to improve competitiveness point towards some strengthening of the external position in 2017, conditional on the euro depreciation and policies not being reversed. The strong net international investment position mitigates vulnerabilities associated with the high external public debt. **Potential policy responses**: Planned steady fiscal consolidation, reductions in labor taxes and continued wage moderation will help towards making the external position fully consistent with fundamentals and policy settings. To protect against a reversal of the projected improvements, productivity enhancing structural reforms (in the product and labor markets, particularly to address the severe labor market fragmentation) would be useful.
Current account	**Background**. After declining since the early 2000s and reaching deficits of around 1 percent of GDP during the crisis, the CA has been close to balance during the past several years. 1/ This masks significant movements in the trade balance and investment income balance since 2014. The goods balance has turned back into a surplus for the first time since the crisis, while the primary income balance has turned negative, driven by a worsening in the net investment income balance. This appears to reflect relatively low returns on direct investment assets. The cyclically-adjusted CA balance was stable between 2015 and 2016. **Assessment**. The EBA model estimates a CA gap of -1.7 percent of GDP for 2016. The staff assessment is similar, estimating a CA gap in the range of -2¾ to -¾ percent of GDP. 2/ The projected CA evolution of returning to a moderate surplus is consistent with a fiscal consolidation and a recovery in the household saving rate, which are offset by a more gradual increase in both private and public investment.	
Real exchange rate	**Background**. Unit labor costs point to a gradual loss of competitiveness since 2005. Most of this loss has come from lower productivity growth, with a smaller contribution from wage growth exceeding that of trading partners. Real wage moderation since 2013 has reduced the ULC-based REER by 4 percent through 2015, with a small offset in 2016. The CPI-based REER has seen larger swings in recent years. **Assessment**. Estimates of the EBA model for 2016 point to a REER overvaluation of 4.7 percent and 6.5 percent according to the index and REER models, respectively. The staff assessment, consistent with the EBA REER regression model estimates and the CA assessment, is a 2016 REER gap in the range of 2 to 7 percent. 3/	
Capital and financial accounts: flows and policy measures	**Background**. Gross financial outflows and inflows were on an upward trend during the pre-crisis period along the expansion of banks' cross-border operations. Since 2007, alongside the bank deleveraging they have shrunk and have been more volatile. Short-term debt accounted for about 40 percent of the external liabilities and financing need in 2015. The capital account is open. **Assessment**. Belgium remains exposed to financial market risks but the structure of financial flows does not point to specific vulnerabilities. The strong NIIP reduces the vulnerabilities associated with the high public debt.	
FX intervention and reserves level	**Background**. The euro has the status of a global reserve currency. **Assessment**. Reserves held by the euro area are typically low relative to standard metrics, but the currency is free floating.	
Technical Background Notes	1/ The Belgian CA numbers have undergone major revisions in 2015 and 2016, complicating the comparison with previous ESR assessments. 2/ Belgium's status as a center of corporate treasury activities and its resulting large gross foreign asset and liability positions complicate the measurement of the current account, and thus are a source of uncertainty about the CA assessment. 3/ The REER gap assessment is consistent with the staff's CA gap assessment, considering the relatively high ratios of exports and imports to GDP, which tend to make the CA more responsive to the REER.	

Appendix III. Risk Assessment Matrix[1]

Source of Risk and likelihood	Impact if realized and transmission channel	Policy response
High Policy and geopolitical uncertainties, and retreat from cross-border integration. Uncertainty associated with negotiating post-Brexit arrangements, difficult to predict U.S. policy positions and upcoming major elections. A fraying consensus about the benefits of globalization could lead to protectionism, with negative consequences for trade, capital and labor flows, sentiment, and growth.	**High** Externally, protracted uncertainty on post-Brexit arrangements or on U.S. policy positions would likely transmit through postponed export-related investments and a loss of external demand. Domestically, this uncertainty could manifest through weak implementation of fiscal and structural reforms. Failure to keep up with competitiveness gains in the rest of the euro area would trigger adverse growth-fiscal dynamics	*A moderate pace of fiscal adjustment to bring down public debt gradually should be a driving policy objective. Pursue complementary reforms in product markets and reduce the regulatory burden.*
High Financial conditions: significant further strengthening of the U.S. dollar and/or higher rates as investors reassess policy fundamentals and as term premia decompress. Bank distress in one or more major European banks could lead to possible knock-on effects on the broader financial sector and for sovereign yields.	**Medium** Limited exposure of domestic banks to global risks. Sovereign-bank nexus is gradually being unwound. Effects would be mainly indirect, through spillovers from neighbors. However, lower U.S. corporate income tax rates and higher yields in the U.S. could lead to capital outflows and also constrain investment.	*Euro area monetary policy is first line of defense against liquidity stress, supported by activation of backstops and resolution mechanism.*
High Structurally weak growth in key advanced economies. Low productivity growth and a failure to fully address crisis legacies and undertake structural reforms, and persistently low inflation, undermine medium-term growth in advanced economies.	**High** Strong impact through trade channel and by implication investment. Protracted growth shortfall could in turn lower potential growth, raise structural unemployment and complicate further fiscal adjustment.	*Coordinated policy response at European level to which Belgium could contribute by slowing the pace of consolidation.*
Low Rapid and disruptive housing price correction.	**Medium** Overvaluation is expected to be resolved gradually. But private adjustment in the context of an unemployment shock could accelerate in some vulnerable households, cutting consumption. Banks are however relatively well protected given capital buffers, prudent lending standards, and full recourse loans.	*Additional macro-prudential measures may need to be adopted based on loan to value or debt service to income criteria, to protect vulnerable borrowers*

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term" and "medium term" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.

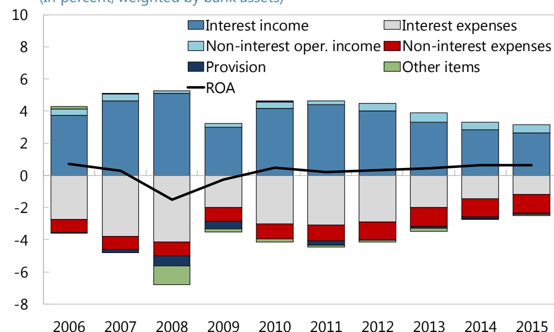
Appendix IV. The Impact of Low Growth and Rates on Bank Profitability[1]

This annex presents a stylized quantitative analysis of how a protracted period of low growth and interest rates might affect bank profitability in Belgium.

Belgium's banking sector has undergone significant deleveraging since the Global Financial Crisis, with shifts in asset and liability structures. The scaling down of bank balance sheets has been accompanied by a reorientation of their business activities towards domestic and other core markets and more traditional business lines (National Bank of Belgium, 2016). During this process, banks have expanded their deposit base from an already high level and increased exposure to domestic households through mortgage lending—outstanding mortgage credit in total loans to the private sector has risen from under 30 percent in early 2012 to 43 percent in September 2016.

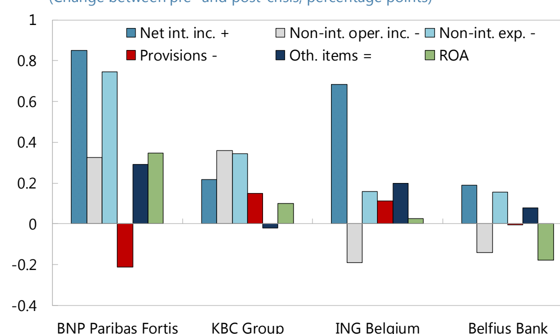
Bank profitability has held up well. Belgian banks' returns on assets and equity (ROA, ROE) suffered large declines during the crisis, but most of them have quickly recovered afterwards. Profits have recently been improving—surpassing performance in neighboring countries (France, Germany)—despite sluggish domestic activity and falling interest rates in the euro area. A decomposition of ROA for the average Belgian bank suggests that interest savings from lower funding costs are more than offsetting the compression in interest incomes as a result of low/negative interest rates, supporting net interest margins (NIMs). The resilience in interest incomes observed so far is partly due to the inclusion of one-off penalties associated with the large volumes of refinanced loans, attracted by historically low rates.[2] The picture looks similar for the four largest Belgian institutions; whose post-crisis (2013–15) net interest incomes stand higher compared to pre-crisis (2006–07) levels. Some banks have also managed to increase their non-interest revenues such as fees and commissions (BNP Paribas Fortis, KBC Group) or have benefitted from lower loan loss provisions post-crisis (BNP Paribas Fortis).

Belgium: Components of Bank ROA
(In percent, weighted by bank assets)



Sources: Fitch Connect and IMF Staff calculations.

Belgian Big-4: Components of ROA
(Change between pre- and post-crisis, percentage points)



Sources: Fitch Connect and IMF Staff calculations.

[1] Prepared by Giang Ho (RES).

[2] To refinance a loan, the customer has to pay a penalty equal to three months' interest payments on the outstanding amount. The majority of mortgages in Belgium have fixed-rate contracts.

However, a protracted period of low growth and interest rates could be costly for banks. While the lending-deposit margins on the corporate side have remained largely stable, margins on household loans and in particular mortgages have been shrinking as a result of falling market interest rates and the flat yield curve. Together with the tapering in refinancing volumes (and hence revenues from penalties), banks' NIMs are expected to decline going forward, especially if growth stays subdued. Recent consolidation efforts by Belgian banks have kept a lid on the cost-to-income ratio, which compares favorably with peer countries. But future profitability prospects will depend to a large extent on banks' ability and willingness to cut costs further and/or adjust their business models by diversifying into other income sources.

A Quantitative Perspective

The relationship between economic growth/interest rates and bank profits is usually positive. Weak growth is typically associated with sluggish credit demand and deteriorating asset quality for banks, which weigh on profits. In addition, a sustained period of low interest rates associated with a flat yield curve in the context of economic stagnation can reduce bank income from maturity transformation activities by compressing margins. First, there is a limit to banks' ability to pass on low (or even negative) interest rates to retail depositors, i.e. a downward stickiness in funding costs. Second, the flat yield curve associated with a "low for long" rate environment is detrimental to banks, who typically borrow funds in the short term and make longer-term loans and investments. In general, the degree to which fluctuations in interest rates impact banks' NIMs and profitability depends importantly on the maturity and repricing structure of banks' assets and liabilities, and the extent to which banks are able to shift their balance sheet and activities to adapt to interest rate changes. A growing empirical literature finds that low growth and interest rates weigh on banks' bottom lines.[3]

Following the literature, we adopt the following empirical specification:

$$y_{ijt} = \beta r_{jt} + \gamma s_{jt} + \delta' X_{jt} + \theta' Z_{i,t-1} + \alpha_i + \mu_t + \varepsilon_{ijt} \qquad (1)$$

Here, y_{ijt} denotes a measure of profitability (e.g., NIM, ROA, ROE) of bank i in country j in year t, r_{jt} the level of short-term (ST) interest rate (the 3-month interbank rate), s_{jt} the slope of the yield curve, or the spread between the ST rate and 10-year government bond yield, X_{jt} a vector of macroeconomic variables (e.g., nominal GDP growth, real house price growth), and $Z_{(i,t-1)}$ a vector of (lagged) bank-level controls (e.g., asset size, capital, asset and funding structures). The financial and macroeconomic variables are at the country level. A full set of bank and year fixed effects are included, the former to control for unobserved time-invariant bank heterogeneity and the latter to absorb any common shocks. Per the theoretical discussion above, we expect positive coefficients on the ST rate, the spread, and GDP growth.

---

[3] See e.g. Genay and Podjasek (2014) for US, Kok and others (2015) and Jobst and Lin (2016) for euro area, Busch and Memmel (2015) for Germany, Kongsamut and Tressel (2016) for France, Alessandri and Nelson (2012) for UK, and Deutsche Bank (2013) for Japan. On the other hand, Turk (2016) found that bank margins in Sweden and Denmark have been broadly stable despite negative policy interest rates as lower interest income was offset by reductions in wholesale funding costs and higher fee income.

We explore the hypothesis that growth and interest rates may have differential effects along several dimensions. Following Claessens and others (2016), we test for possible nonlinearities in the interest rate-profitability relationship (with respect to the level of interest rates) by classifying countries each year as being in a low-rate environment if the average 3-month interbank rate is below 1.25 percent. We expect the relationship to become stronger for banks in a low-rate environment, as has been found in previous empirical work. Further, we split the low-rate sample along several banks' characteristics: (i) asset size, (ii) share of deposits in total liabilities, and (iii) share of mortgages in total loans.[4]

The model is estimated using a rich cross-country bank level dataset. The bank level data—provided by Fitch Connect—come from annual financial statements containing detailed reported information on balance sheet components, incomes, and costs for each bank. We use data at the unconsolidated level to isolate the effect of a country's macroeconomic and financial conditions on only the bank's operations in that country.[5] The estimation sample consists of about 3,400 banks from 15 advanced European economies spanning the 2006−15 period.

Results indicate that both lower growth and low interest rates are associated with weaker bank profits, with a significantly stronger effects in a general low-rate environment (Table 1). Specifically:

- *Growth*. Using the full estimation sample, a one-percentage-point decline in nominal GDP growth is associated with a modest decline in bank NIMs of 2.4 bps, whereas the impact on overall profits (ROA, ROE) is not statistically significant. However, focusing on the low-rate period, the effect on NIMs increases slightly, and the estimates for ROA and ROE become much larger and highly significant.

- *ST interest rate*. In line with findings in the literature, there is a strong empirical association between ST interest rates and bank profits.[6] For example, a one-percentage-point decline in the ST rate is estimated to result in a 53 bps decline in NIMs in the low-rate environment compared with only 15 bps using the full sample, and the difference is statistically significant.[7] The corresponding estimates for ROE are 4.7 versus 1.6 percentage points.

---

[4] Smaller banks may be in a less advantaged position compared to larger banks, who can better cushion the effects of low interest rates on profits by shifting their business focus to activities generating fee and commission income. Also, banks relying more heavily on retail funding and/or mortgage lending may be expected to see relatively more compressed NIMs in a low-rate environment, given the downward stickiness of deposit funding costs.

[5] For example, two of the largest Belgian institutions (BNP Paribas Fortis, ING Belgium) are subsidiaries of foreign Global Systemically Important Banks (G-SIBs), and KBC has extensive operations in Ireland and Eastern Europe, so that using consolidated bank accounts would introduce many confounding elements.

[6] Low short-term rates are typically associated not only with lower returns on assets but also lower funding costs, so the impact on profitability is *a priori* ambiguous. However, in a low-rate environment, margins tend to narrow as funding costs approach the zero lower bound. Accordingly, most studies find a strong correlation, with the short-term rate being a relatively good proxy for the interest rate conditions affecting bank margins.

[7] These impacts on NIMs are slightly larger than Claessens and others (2006)' findings for a larger set of countries.

- *Yield curve*. The slope of the yield curve is found to affect bank NIMs only when rates are low, with a flatter curve implying lower NIMs as expected. A one-percentage-point decline in spreads is estimated to reduce NIMs by a modest 8 bps. However, the spread doesn't appear to have a systematic impact on overall profits.

- Estimating the model on the sub-components of NIMs reveals that low interest rates tend to compress interest income more than they reduce interest expenses (consistent with the hypothesis of deposit rates being bounded below by zero). In addition, low growth/interest rates are associated with increased loan loss provisions but also higher non-interest income, the latter helping to mitigate the adverse impact on overall profits.[8]

- Our results are broadly maintained across a range of robustness tests.[9] [10]

Table 1. Impact on Bank Profits

	Full sample			**Low rate environment 1/**		
VARIABLE	NIM	ROA	ROE	NIM	ROA	ROE
Nominal GDP growth	0.024	0.006	0.129	0.027	0.022	0.198
	[0.005]***	[0.007]	[0.086]	[0.005]***	[0.009]**	[0.094]**
Short-term interest rate	0.150	0.020	1.563	0.528	0.389	4.669
	[0.023]***	[0.037]	[0.903]*	[0.057]***	[0.065]***	[1.098]***
Spread	-0.007	-0.047	-0.434	0.075	0.012	0.048
	[0.013]	[0.016]***	[0.268]	[0.013]***	[0.016]	[0.216]
Obs	23,260	23,582	23,575	14,836	15,077	15,072
R-squared	0.210	0.097	0.052	0.187	0.031	0.027
No. of banks	3,408	3,466	3,466	3,147	3,201	3,200

Sources: Fund staff estimates. 1/ ST rate below 1.25 percent. Notes: All specifications include bank-level controls (bank size, tangible common equity/tangible assets, deposit/liabilities, loans/assets) and bank and year fixed-effects.

[8] Results are not reported but available upon request.

[9] In particular, we (i) replace the 3-month interbank rate with the policy interest rate; (ii) include the VIX index instead of year fixed effects; (iii) use country fixed effects with errors clustered at the bank level instead of using bank fixed effects; (iv) correct for possible autocorrelation in the error structure by estimating the model using Generalized Least Squares; and (v) specify a dynamic model with the lag of NIMs as an explanatory variable. In all of these robustness tests, the coefficient on the short-term interest rate remains highly significant, with magnitude ranging from 0.03 to 0.29 (0.15 in the baseline). GDP growth and the yield curve also retain their explanatory power in most specifications, although the magnitude and precision of coefficients are relatively less consistent.

[10] Robustness tests on the low rate sample comprise model specifications that include the short-term interest rate, the long-term interest rate and the term spread separately, as well as those including the short-term rate in combination with either the long-term rate or the interest rate spread. We find that the coefficients on the interest rate variables remain highly significant throughout and relatively stable compared to the baseline NIM regression.

Table 2. Impact on NIMs by Bank Characteristics

VARIABLE	Full low-rate sample	Small banks 1/	High deposit 2/	High mortgage 3/
Nominal GDP growth	0.027	0.057	0.059	0.040
	[0.005]***	[0.008]***	[0.007]***	[0.013]***
Short-term interest rate	0.528	0.494	0.587	0.890
	[0.057]***	[0.062]***	[0.066]***	[0.094]***
Spread	0.075	0.129	0.097	0.084
	[0.013]***	[0.018]***	[0.022]***	[0.028]***
Obs	14,836	6,893	9,720	4,543
R-squared	0.187	0.239	0.188	0.277
No. of banks	3,147	1,635	2,253	1,088

Sources: Fund staff estimates. 1/ Total assets less than $1bn. 2/ Above-median share of deposits in total liabilities. 3/ Above-median share of mortgage lending in total loans. Notes: All specifications include bank-level controls (bank size, tangible common equity/tangible assets, deposit/liabilities, loans/assets) and bank and year fixed-effects.

The impact of a low-rate low-growth environment varies with bank size and asset and liability structure (Table 2). For example, we find that smaller banks' NIMs tend to be more sensitive to GDP growth and the yield curve compared to larger banks—consistent with findings by Genay and Podjasek (2014) for the US, whereas the response to ST market rate is broadly similar across bank size classes. There is also evidence that the NIMs of banks with greater reliance on deposit funding or mortgage lending are affected more by low growth or low interest rates. While not reported here, results for ROA and ROE show similar patterns.

Simulation of a Stagnation Scenario

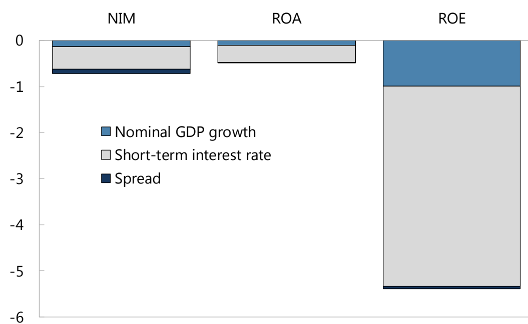
To gauge the impact of a potential protracted low-growth low-rate period on banks, we construct a downside scenario. In this stagnation scenario, nominal GDP growth would be lower than the baseline projection by an average of 0.6 percentage points per year between 2016 and 2022, and the ST interest rate (and spread) would remain low at roughly the current level until 2022.[11] This scenario emphasizes medium-term risks of economic stagnation as opposed to a near-term severe shock.

Banks would see their profitability squeezed under such a scenario, and the effect might be more pronounced in Belgium given high reliance on mortgages and deposit taking. Using coefficients from the estimated models (Table 1) and assuming other things stay constant (e.g., no change in bank business models), the scenario results in a cumulative ¾ percentage point decline in banks' NIMs by 2022, with about two-thirds of the effect coming from the ST rate and one-fifth from growth. The corresponding decline in ROE is larger (almost 5½ percentage points) whereas the decline in ROA is more muted. Simulations conducted on the relevant bank subsamples (i.e. using

[11] With long-term yields having risen lately, these assumptions represent more a severe scenario.

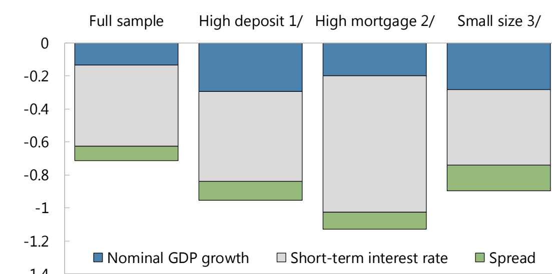
estimated effects from Table 2) suggests an even more pronounced impact of low rates and low growth on bank profits for smaller-sized banks, or banks which rely more heavily on retail funding or mortgage lending. Thus, notwithstanding the benefits of a stable funding base, the high-deposit, high-mortgage characteristics of Belgian banks may imply greater profitability challenges in a protracted low-growth, low-rate period, given the zero lower bound on deposit rates and compressed mortgage margins.

Illustrative Medium-Term Impact of Low Growth and Low Rates on Bank Profitability (In cumul. percentage point change by 2022)



Sources: Fitch Connect and IMF Staff calculations.

Impact on NIM by Different Bank Characteristics
(In cumulative percentage point change by 2022)



Sources: Fitch Connect and IMF Staff calculations.
1/ Higher-than-average deposit share in liabilities 2/ Higher-than-average mortgage share in total loan porfolio 3/ Total assets less than $1bn

Appendix V. Debt Sustainability Analysis

Public debt sustainability risks remain high. Under the baseline scenario, the public debt-to-GDP ratio is projected to have peaked at 106.5 percent in 2014 and to decline to 100.9 percent by 2021 under broadly unchanged policies while economic recovery gains traction in line with neighboring countries. Gross financing needs are estimated at 18 percent of GDP in 2016 and are expected to decline to 16–17 percent in the medium term. The projected decline in public debt is relatively sensitive to macroeconomic shocks, particularly involving combined shocks.

Baseline and Realism of Projections

Under the baseline, economic recovery and broadly unchanged policies result in a small decline in the gross financing need and the public debt ratio over the medium term, broadly unchanged relative to the DSA from the 2016 Article IV consultation.

- **Macroeconomic assumptions.** Growth is estimated at 1.2 percent in 2016 and rising to 1½ percent in 2017 on the back of stronger domestic demand. The output gap narrows over the medium term and is projected to close by 2020. Inflation is projected to reach 2 percent by the end of the projection period, reflecting the closure of the output gap.

- **Fiscal outlook.** In staff's baseline projections, the general government deficit comes down from 2.7 percent of GDP in 2016 to 2.3 percent in 2019, before rising again in the medium-term due mainly to unfinanced revenue losses from tax shift. The primary balance is projected to remain in small deficit throughout the projection period. The projected fiscal path results in a structural deficit of 2½ percent of GDP in 2021. This reflects staff's assessment of the authorities' plans over the medium-term, in which some measures remain to be identified.

- **Debt levels and gross financing needs.** Belgium's high level of government debt and gross financing requirement calls for using the higher scrutiny framework.[1] Government gross debt has increased significantly since 2007, reflecting sizable fiscal stimulus, declining real and nominal growth, and a large recapitalization of (and financial support to) the banking sector. Public debt is estimated to have reached 105.8 percent of GDP in 2015 (helped by early repayment of bank recapitalization funds) and is projected to stay above 100 percent through the medium term. Gross financing needs are estimated at 17.9 percent of GDP in 2017 and are expected to remain around 16–17 percent of GDP in the medium term.

- **Realism of baseline assumptions.** The median forecast error for real GDP growth during 2007–15 is 0.11 percent, while that for inflation (GDP deflator) is -0.3 percent, both of

[1] For advanced economies that (i) have a current or projected debt-to-GDP ratio above 60 percent; or (ii) have current or projected gross financing needs-to-GDP ratio above 20 percent; or (iii) have or are seeking exceptional access to Fund resources; teams are required to use an extended set of tools to identify and assess specific risks to debt sustainability. For these "higher scrutiny" cases, teams are also required to produce a standardized summary of risks in a heat map and prepare a write-up to discuss risks, including any country-specific considerations.

which are relatively small. The median forecast error for primary balance suggests that staff projections have been optimistic (a forecast bias of -1.1 percent of GDP).

- **Cross-country experience suggests the projected fiscal adjustment is feasible.** The adjustment in the cyclically-adjusted primary balance (CAPB) over the projection period is small, reflecting broadly unchanged policies. Stronger and more sustained adjustment would be feasible if the authorities implemented significant quality structural measures (see discussion in the text).

- **Heat map.** Risks from the debt level are deemed high given that the relevant threshold to which Belgium's values are compared is 85 percent and this threshold is breached under baseline and all stress test scenarios. Belgium's gross financing needs are just below the benchmark of 20 percent of GDP in 2014-15 and decline over the medium-term. Belgium also faces risks relating to its external financing requirement and a large share of public debt held by foreigners. At 99 percent of GDP, the external financing requirement is significantly above the upper threshold of early warning benchmarks and the share of debt held by foreigners is relatively high at 54 percent of total.

Shocks and Stress Tests

The DSA framework shows Belgium's sensitivity to GDP growth and real interest rate shocks, and a combined macroeconomic-fiscal shock. They illustrate how difficult reducing public debt could be as the effect of these shocks, based on Belgium's own historical record, play out. In some cases debt ends the projection period on a rising trajectory.

- **Growth shock.** Under this scenario, real output growth rates are lower by one standard deviation starting in 2017–18, i.e. 1.6 percentage points relative to the baseline scenario. The assumed decline in growth leads to lower inflation (0.25 percentage points per 1 percentage point decrease in GDP growth). Under this scenario, the debt-to-GDP ratio increases to 111 percent of GDP in 2018 and declines thereafter.

- **High interest rate scenario.** This scenario examines the implications for debt sustainability of an increase in spreads by 470 basis points (a historical high observed in 1995) starting in 2018. The deterioration of public debt and gross financing needs are back-loaded as old debt gradually matures and new higher interest rate debt is contracted. In 2021, the impact on financing needs is 2.9 percent of GDP. Debt dynamics are reversed as the debt ratio no longer follows a downward trajectory.

- **Real exchange rate shock.** This scenario assumes 10 percent depreciation in the real exchange rate in 2017. This shock results in small effects relative to the baseline.

- **Primary balance shock.** This scenario examines the implications of a revenue shock and a rise in interest rates leading to a cumulative 2 percentage points of GDP deterioration in the primary balance (one standard deviation shock) in 2017–18. This scenario illustrates risks of delayed fiscal adjustment, due to insufficient adjustment measures. This shock leads to a deterioration in the

debt ratio of 0.8 percentage points relative to the baseline in 2021 and slightly higher gross financing needs.

- **Combined macro-fiscal scenario.** This scenario aggregates shocks to real growth, the interest rate, the exchange rate, and the primary balance while taking care not to double-count the effects of individual shocks. Under this scenario, debt would reach 112.6 percent of GDP in 2018 and remain elevated through 2021. The impact on financing needs would be significant, keeping financing needs high through 2018 and remaining close to 20 percent of GDP through 2021. The higher gross financing need in 2021 reflects maturing debt.

- **Persistent fiscal deficits shock.** This scenario a primary balance close to 1 percent of GDP through 2021. This results in the debt ratio hovering at current rates over the medium-term.

The authorities agreed with the conclusion of the analysis, and noted that foreign holdership of public debt can be a source of risk as well as a sign of confidence by investors in Belgium's public finances. They also observed that the methodology did not take into account projections for the cost of aging, given its relatively short time frame.

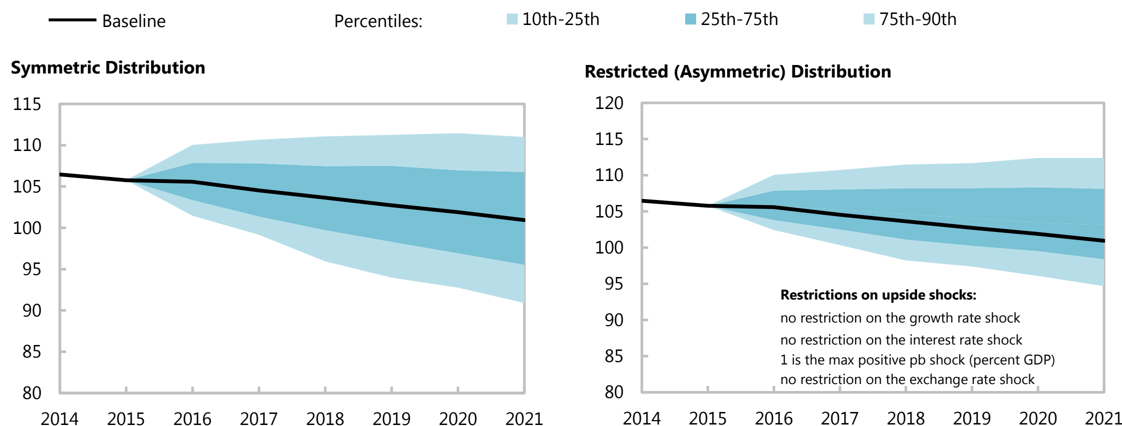
Belgium: Public DSA Risk Assessment

Heat Map

Debt level [1]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs [2]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile [3]	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

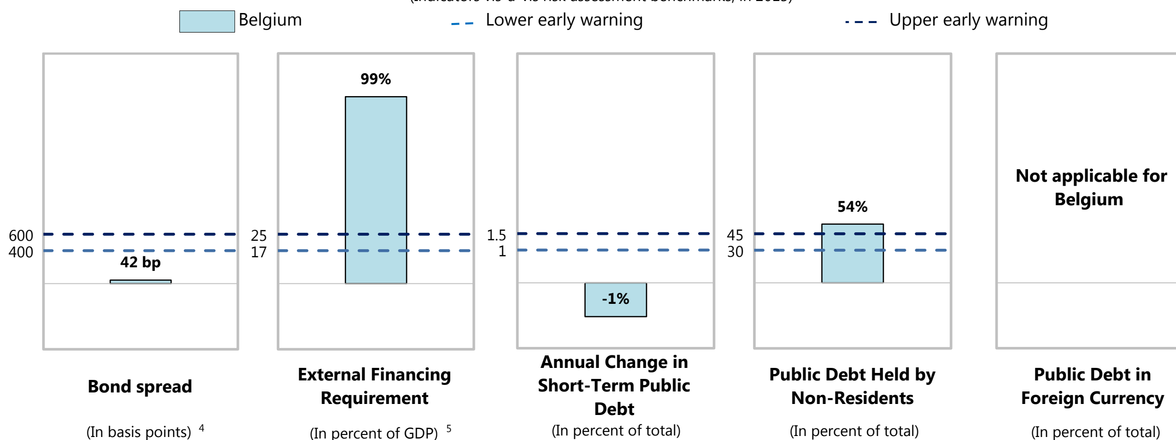
Evolution of Predictive Densities of Gross Nominal Public Debt

(In percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2015)



Source: IMF staff.

[1] The cell is highlighted in green if debt burden benchmark of 85% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

[2] The cell is highlighted in green if gross financing needs benchmark of 20% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

[3] The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are:

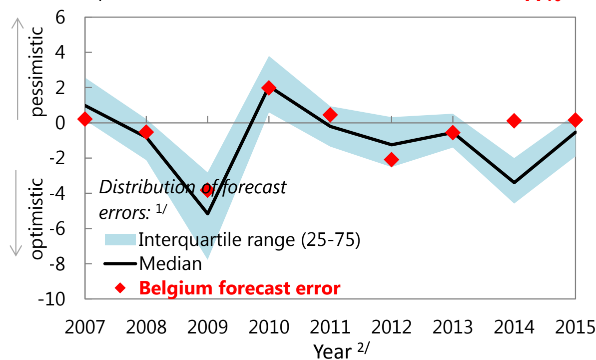
400 and 600 basis points for bond spreads; 17 and 25 percent of GDP for external financing requirement; 1 and 1.5 percent for change in the share of short-term debt; 30 and 45 percent for the public debt held by non-residents.

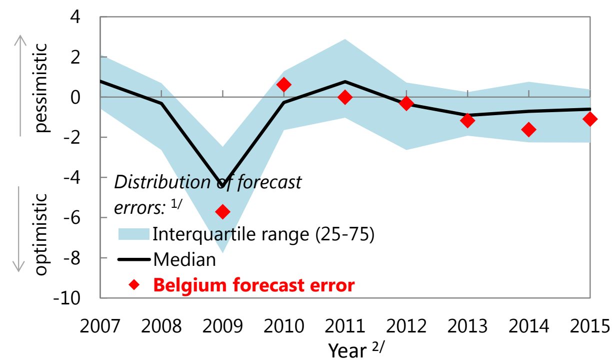
[4] Long-term bond spread over German bonds, an average over the last 3 months.

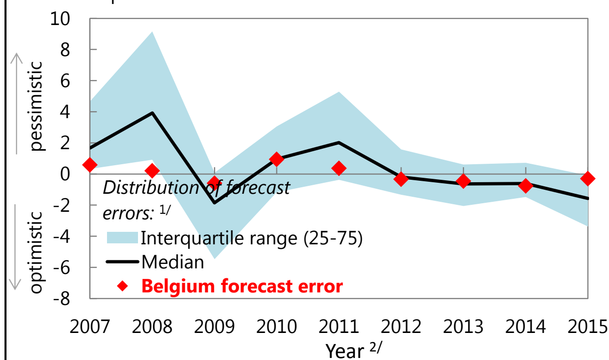
[5] External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Belgium: Public DSA – Realism of Baseline Assumptions

Forecast Track Record, versus surveillance countries





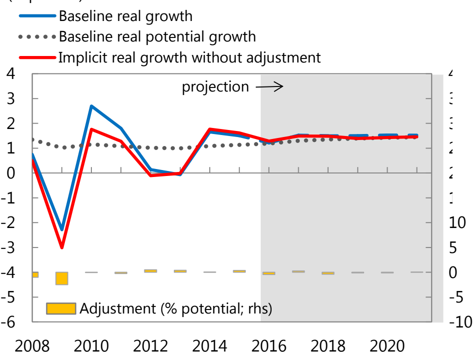


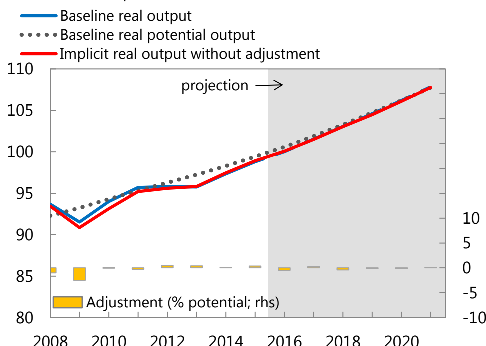
Source : IMF staff.
1/ Plotted distribution includes surveillance countries, percentile rank refers to all countries
2/ Projections made in the spring WEO vintage of the preceding year
3/ Belgium has had a cumulative increase in private sector credit of 36 percent of GDP, 2012-2015. For Belgium, t corresponds to 2016; for the distribution, t corresponds to the first year of the crisis.

Belgium: Public DSA – Realism of Baseline Assumptions (continued)

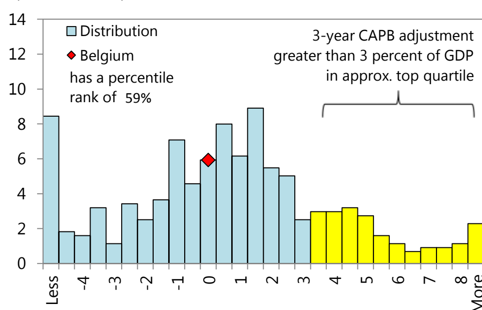
Growth and Level of Output in Absence of Fiscal Adjustment

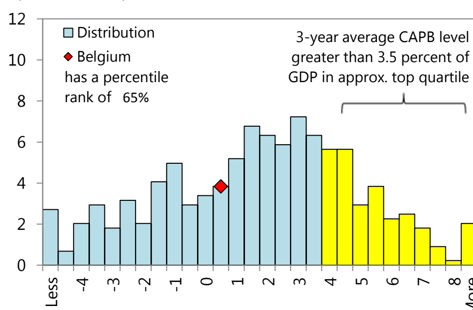
Assumed multiplier of 0.3, persistence of 0.5





Assessing the Realism of Projected Fiscal Adjustment





Source : IMF staff.

4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Belgium: Public Sector Debt Sustainability Analysis (DSA) - Baseline Scenario

(In percentage of GDP unless otherwise indicated)

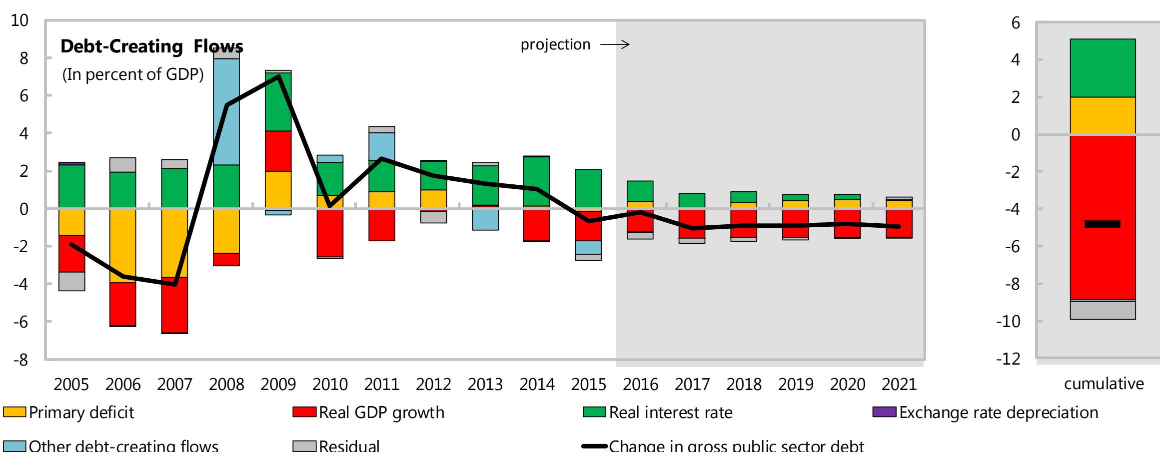
Debt, Economic and Market Indicators[1]

	Actual			Projections					
	2005-2013 [2]	2014	2015	2016	2017	2018	2019	2020	2021
Nominal gross public debt	97.4	106.5	105.8	105.6	104.5	103.6	102.7	101.9	100.9
Public gross financing needs	21.8	19.3	19.9	18.0	17.9	17.0	16.3	15.7	17.0
Real GDP growth (in percent)	1.2	1.7	1.5	1.2	1.5	1.5	1.5	1.5	1.5
Inflation (GDP deflator, in percent)	1.8	0.7	0.9	1.5	1.6	1.6	1.7	1.8	2.0
Nominal GDP growth (in percent)	3.1	2.3	2.4	2.8	3.1	3.2	3.3	3.3	3.6
Effective interest rate (in percent) [4]	4.1	3.2	2.9	2.6	2.4	2.2	2.1	2.1	2.1

As of January 31, 2017		
Sovereign Spreads		
Over German bonds[3]		40
5Y CDS (bp)		32
Ratings	Foreign	Local
Moody's	Aa3	Aa3
S&Ps	AA	AA
Fitch	AA-	AA-

Contribution to Changes in Public Debt

	Actual			Projections							
	2005-2013	2014	2015	2016	2017	2018	2019	2020	2021	cumulative	debt-stabilizing primary balance[9]
Change in gross public sector debt	1.0	1.0	-0.7	-0.2	-1.1	-0.9	-0.9	-0.8	-0.9	-4.8	
Identified debt-creating flows	0.9	1.1	-0.4	0.2	-0.8	-0.7	-0.8	-0.8	-1.1	-3.9	
Primary deficit	-0.7	0.2	-0.1	0.4	0.0	0.3	0.4	0.5	0.4	2.0	-1.5
Primary (noninterest) revenue and grants	49.4	51.7	51.0	50.6	50.7	50.3	50.0	49.8	49.8	301.3	
Primary (noninterest) expenditure	48.6	51.8	50.9	51.0	50.7	50.7	50.4	50.3	50.2	303.2	
Automatic debt dynamics [5]	1.0	0.9	0.5	-0.2	-0.8	-1.0	-1.2	-1.2	-1.4	-5.8	
Interest rate/growth differential [6]	1.0	0.9	0.5	-0.2	-0.8	-1.0	-1.2	-1.2	-1.4	-5.8	
Of which: real interest rate	2.1	2.6	2.1	1.1	0.8	0.5	0.4	0.3	0.1	3.1	
Of which: real GDP growth	-1.1	-1.7	-1.6	-1.2	-1.6	-1.5	-1.5	-1.5	-1.5	-8.9	
Exchange rate depreciation [7]	0.0	0.0	0.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.7	0.0	-0.7	0.0	0.0	0.0	0.0	0.0	0.0	-0.1	
Net privatization proceeds (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other debt flows (incl. ESM and euro area loans)	0.7	0.0	-0.7	0.0	0.0	0.0	0.0	0.0	0.0	-0.1	
Residual, including asset changes [8]	0.1	0.0	-0.3	-0.4	-0.3	-0.2	-0.1	0.0	0.1	-0.9	



Source: IMF staff

[1] Public sector is defined as General government. Medium-term projections for debt differ somewhat from the baseline due to differing methodologies.

[2] Based on available data.

[3] Long-term bond spread over German bonds.

[4] Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

[5] Derived as $[(r - \pi(1+g) - g + ae(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

[6] The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi(1+g)$ and the real growth contribution as -g.

[7] The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+r)$.

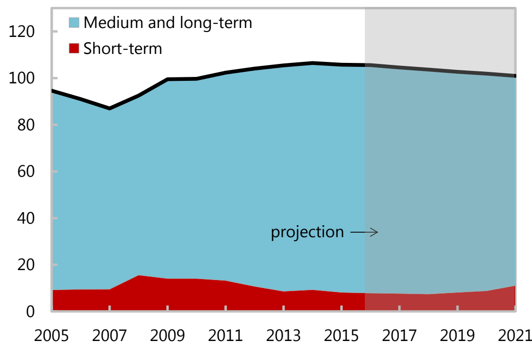
[8] Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

[9] Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

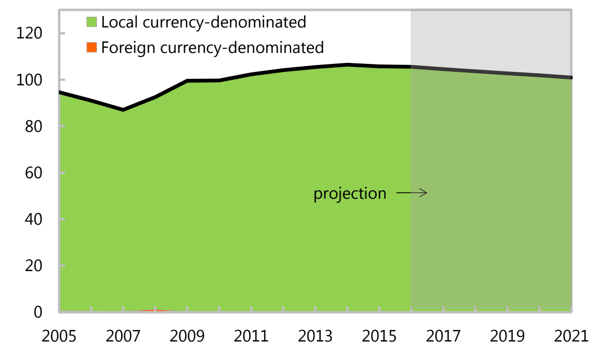
Belgium: Public DSA - Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(In percent of GDP)



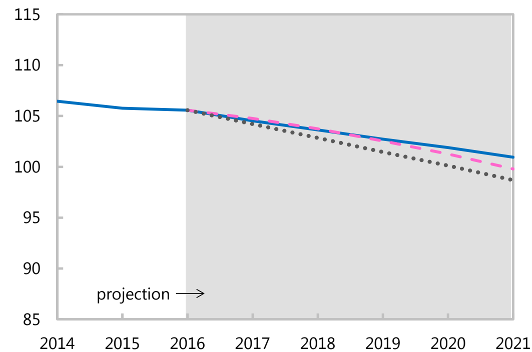
By Currency
(In percent of GDP)



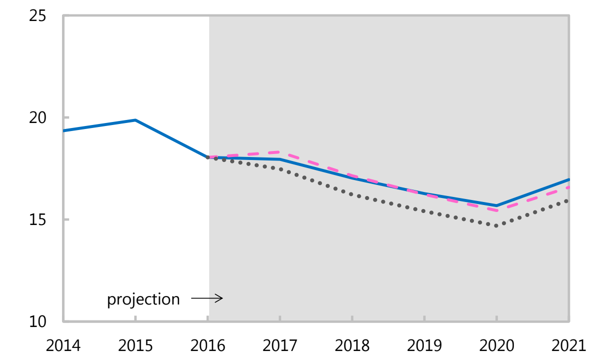
Alternative Scenarios

Baseline — Historical — Constant Primary Balance

Gross Nominal Public Debt
(In percent of GDP)



Public Gross Financing Needs
(In percent of GDP)



Underlying Assumptions
(In percent)

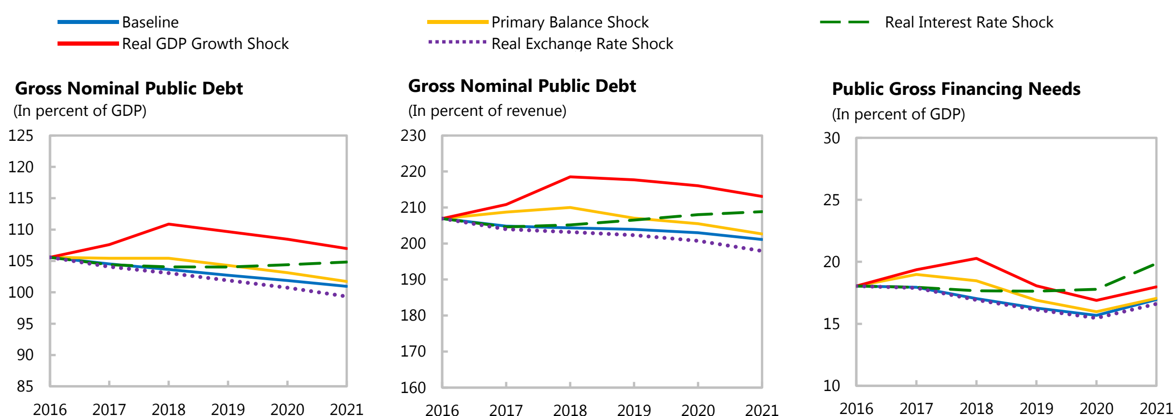
Baseline Scenario	2016	2017	2018	2019	2020	2021
Real GDP growth	1.2	1.5	1.5	1.5	1.5	1.5
Inflation	1.5	1.6	1.6	1.7	1.8	2.0
Primary Balance	-0.4	0.0	-0.3	-0.4	-0.5	-0.4
Effective interest rate	2.6	2.4	2.2	2.1	2.1	2.1
Constant Primary Balance Scenario						
Real GDP growth	1.2	1.5	1.5	1.5	1.5	1.5
Inflation	1.5	1.6	1.6	1.7	1.8	2.0
Primary Balance	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4
Effective interest rate	2.6	2.4	2.2	2.1	2.1	2.1

Historical Scenario	2016	2017	2018	2019	2020	2021
Real GDP growth	1.2	1.2	1.2	1.2	1.2	1.2
Inflation	1.5	1.6	1.6	1.7	1.8	2.0
Primary Balance	-0.4	0.5	0.5	0.5	0.5	0.5
Effective interest rate	2.6	2.4	2.4	2.5	2.6	2.7

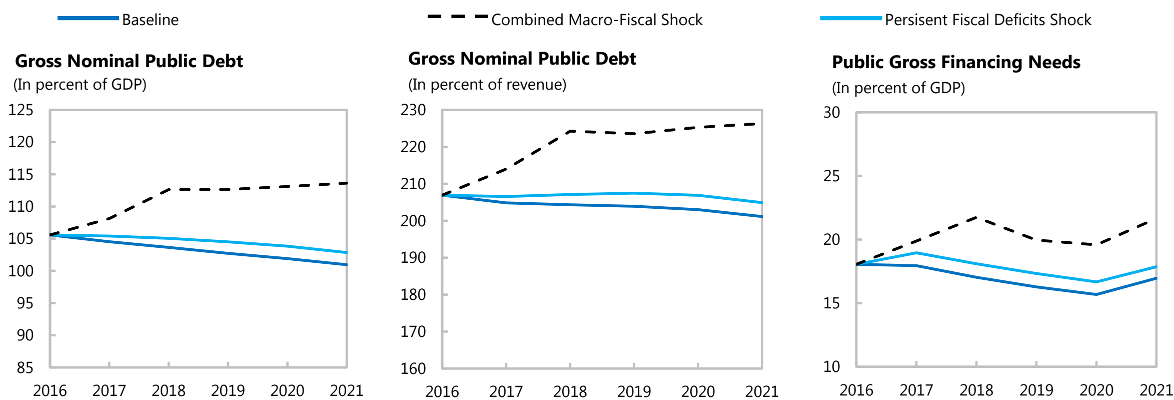
Source: IMF staff

Belgium: Public DSA - Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(In percent)

	2016	2017	2018	2019	2020	2021
Primary Balance Shock						
Real GDP growth	1.2	1.5	1.5	1.5	1.5	1.5
Inflation	1.5	1.6	1.6	1.7	1.8	2.0
Primary balance	-0.4	-1.0	-1.4	-0.4	-0.5	-0.4
Effective interest rate	2.6	2.4	2.2	2.1	2.1	2.1
Real Interest Rate Shock						
Real GDP growth	1.2	1.5	1.5	1.5	1.5	1.5
Inflation	1.5	1.6	1.6	1.7	1.8	2.0
Primary balance	-0.4	0.0	-0.3	-0.4	-0.5	-0.4
Effective interest rate	2.6	2.4	2.9	3.2	3.6	4.0
Combined Shock						
Real GDP growth	1.2	-0.1	-0.1	1.5	1.5	1.5
Inflation	1.5	1.2	1.2	1.7	1.8	2.0
Primary balance	-0.4	-1.6	-3.0	-0.4	-0.5	-0.4
Effective interest rate	2.6	2.4	2.9	3.3	3.7	4.0

	2016	2017	2018	2019	2020	2021
Real GDP Growth Shock						
Real GDP growth	1.2	-0.1	-0.1	1.5	1.5	1.5
Inflation	1.5	1.2	1.2	1.7	1.8	2.0
Primary balance	-0.4	-1.0	-2.5	-0.4	-0.5	-0.4
Effective interest rate	2.6	2.4	2.2	2.2	2.1	2.1
Real Exchange Rate Shock						
Real GDP growth	1.2	1.5	1.5	1.5	1.5	1.5
Inflation	1.5	1.9	1.6	1.7	1.8	2.0
Primary balance	-0.4	0.0	-0.3	-0.4	-0.5	-0.4
Effective interest rate	2.6	2.4	2.2	2.1	2.1	2.1
Persisent Fiscal Deficits Shock						
Real GDP growth	1.2	1.5	1.5	1.5	1.5	1.5
Inflation	1.5	1.6	1.6	1.7	1.8	2.0
Primary balance	-0.4	-0.9	-1.0	-1.1	-1.0	-0.9
Effective interest rate	2.6	2.5	2.2	2.1	2.1	2.1

Source: IMF staff

Appendix VI. Labor Market and Pension Reform Measures

2011	2012/2016 and 2017–2020	Status
UNEMPLOYMENT BENEFITS AND LABOR MARKET POLICIES		
Search requirements		
Suitable job is 25 km away or less	Suitable job is 60 km away or less	Implemented
Restrict rights to search for the same kind of job to six months	Restrict right to search for the same kind of job to three months (young unemployed) and five months (other unemployed)	Implemented
Monitor search efforts for 18–21 months after unemployment, with an annual follow-up	Monitor search efforts nine months (<26 years old) or 12 months (26 or older) after start of unemployment, with follow-ups every nine months	Implemented
Search requirement until 60	Search requirements applicable until 60 and according to concept of "adequate availability" between 60 and 65. Exemptions are still possible according to the length of the career.	Implemented
Exemption of search requirements for familial and social reasons	Use of the exemption is restricted (exemption for caregivers with more restrictive access conditions).	Implemented
To obtain unemployment benefits, unemployed have to be registered as job seekers within 2 weeks from the day they are laid off	Registration as job seeker has to be done within 4 weeks following the notice of lay-off	Postponed at request of the social partners
Control of search efforts at the Federal level (for the attribution of the unemployment benefit) and at the Regional level (for counseling and training)	The control and the application of sanctions is transferred to the Regions	Implemented in Flanders and Wallonia; Will be implemented in Brussels in 2017.
Unemployment benefit levels		
Initial unemployment benefits are 60 percent of last wage, falling after one year to 55 percent for people living alone and 40 percent for people living in a family with another income	Initial unemployment benefits are 65 percent of last wage for three months, then 60 percent for the following nine months. After 13 months there is a reduction to 55 percent for people living alone and 40 percent for people living in a family with another income. Between 15 and 24 months of unemployment, depending on career length before unemployment, a stepwise reduction to arrive after maximum 48 months at a level just above social assistance	Implemented
No degressivity of unemployment benefits for unemployed proving long periods of work	Required career length did raise from 20 years in 2012, to 23 years in 2015, and will become 25 years from November 2016 on.	Implemented
Higher unemployment benefits for unemployed above 50 (Seniority complement)	Eliminated for new entrants, except in specific cases related to collective dismissals or heavy jobs	Implemented

Unemployment benefit based on the wage of the last work period of at least 4 weeks	Unemployment benefit based on the average wage of the last 12 months	Administratively complicated – An alternative is implemented: verification of wage evolution in the 12 months before unemployment
Involuntary part time workers can obtain an allowance for income support so that their net income is higher than the unemployment benefit in case of full unemployment	Allowance for income support in case of part time job (AGR) is divided by 2 after two years of work	Planned by the government for 2018
	Calculation of the allowance for income support (AGR) will be reviewed based on the calculation that was made before 2008	Adapted calculation: implemented.
Access to unemployment benefits based on employment periods completed abroad	Access is restricted (limited list of foreign countries and obligation to have worked 3 months in Belgium instead of 1 day previously)	Implemented
Unemployment benefits for the young entering the labor force		
Available after nine months of unemployment	Available after 12 months of unemployment	Implemented
Evaluation of search efforts before opening the right on unemployment benefits for young people leaving school	Two evaluations of search efforts 7 and 11 months after registering as jobseeker. Opening of right on unemployment benefits only after two positive evaluations	Implemented for all youngsters that have left school after June 1, 2013
Search effort requirement every 12 or 16 months when on unemployment benefits based on studies (insertion benefits, the earlier waiting allowances)	Evaluation of search requirements every six months. In case of negative evaluation: no UB until the next evaluation, and no earlier than after 6 months	Implemented
Unlimited	Limited to three years (five years for worker on the margin of the labor market) for unemployed living with family with other income, or until the age of 33 in other family situations. Period of three years could be extended by six months if at least worked six months in the last 24 months.	Implemented - first application started in January 2015
Young school leavers can apply for unemployment benefit if they have participated in the secondary education final exam	Until 21, young school leavers can apply for unemployment benefit if they have obtained a secondary education degree or another degree opening good prospects on the labor market	Implemented
For school leavers, the maximum age to introduce a demand for unemployment benefits is 30	Maximum age reduced to 25	Implemented

Easing the transition to the labor market for low-skilled youth		
At sectoral level social partners have to conclude collective agreements addressing the employment needs of groups at risk for the equivalent of at least 0,10 % of gross wage cost of the whole sector.	2013: at least one quarter (0.025%)of the money spend has to go to unemployed youngsters < 26 years 2015: sectors are invited to raise the effort for youngsters: at least 0.05 % has to go into actions for youngsters	Implemented
Supplementary efforts at sectorial level for so called "ingrown" jobs for youngsters < 26 years without work-experience	Sectorial plans to offer supplementary job experience for youngsters in ingrown-jobs (total budget of €12 million), only accessible for sectors that have foreseen an effort of at least 0.05 % (see previous line)	13 plans approved – implementation in 2016–2017
Reduced social contribution for job students benefit from reduced social limited to 50 days worked (equivalent to 400 hours)	Ceiling will be calculated in hours raised to 475 hours	Planned (approved by the Council of Ministers)
Minimum wage for the Young	2015: Eliminated 2017: Re-introduced. The minimum wage would be reduced by 6 points by year below 21 (6 percent reduction for a 20-year-old up to a 30 percent reduction for a 16-year-old).	Planned for 2017 (approved by the Council of Ministers)
Government subsidy for temporary unemployment		
Without employer penalty	Employers will pay a penalty if there is excess use of the system	Implemented and strengthened from 2016 on
Allowance for temporary unemployment is 70 percent of last salary	Reduced to 65 percent of salary	Implemented
No limits on the use by employers of temporary unemployment	The right to temporary unemployment benefits is opened only after a working period of at least one year.	Implemented
Government subsidy for time-credit and career break system		
Five-year duration before the age of 50	2013: One-year duration (two to five years if part-time), with supplementary credit of maximum 36 months for specific motivated breaks, such as childcare or studies (maximum 48 months for specific cases such as taking care of a handicapped child less than 21-year-old)	Implemented
	2015: Elimination of the rights to benefits for one-year non-motivated break. For childcare, one supplementary year of break with benefits	Implemented

Unlimited duration above the age of 50 (time reduction)	2013: Unlimited duration above the age of 55 (time reduction)	Implemented
	2015: Unlimited duration (time reduction) above the age of 60 and 25 years of seniority (with transitional measures and possible derogations till 2019)	Implemented with some exceptions (age limit 55) for long periods of night- and shiftwork
72-month duration in public sector	60-month duration in public sector	Implemented
More favorable rights on career breaks in the public sector	Progressive harmonization of career break in the public sector with time credit in the private sector (full harmonization by 2020)	In progress
Work time		
Legal work time is set at 38 hours per week calculated on a quarterly basis	Legal work time remains set at 38 hours per week on average but is calculated on an annual basis	Planned for 2017 (approved by the Council of Ministers)
PENSION BENEFITS		
Pre-pension benefits (renamed to "Unemployment benefits with employer top-up")		
Minimum age and career length: 60/30 (men) 60/26 (women)	2012/13: Minimum age and career length 60/40 for new collective agreements (60 years in 2015 for existing agreements with 40 years' career in 2015 for men and in 2024 for women)	Implemented
Or: 58/37 (men) and 58/33 (women) for long careers	2012/13: 60/40 for men, 35 for women (40 in 2015) for new collective agreements. For existing agreements: 60 in 2015 for men and 38 for women (40 in 2017)	Implemented
Or: 58/35 for arduous jobs	58/35 for heavy jobs 2015: Minimum age 62 for new entrants No more "long career" scheme Minimum age 58 for new entrants in case of hardship jobs (60 on a date to be fixed by the National Labour Council) Special schemes 56/33 become 58/33 (60 on a date to be fixed by the National Labour Council)	Implemented – transitional period 2015–2017 with possibility to maintain 60 instead of 62.
Pre-pension years count fully towards pension rights at the last wage level	Pre-pension years below the age of 60 do not count towards pension rights at last wage level but on a lower fictive level	Implemented
	All pre-pension years will count toward pension rights at a lower fictive level instead of at last wage level except for pre-pensions in case of restructuration, firms in difficulties, or aduous jobs	Planned for 2017
Reduced social security contributions on employer's top-up payment	Employer social security contributions will be higher and linked to age of worker entering pre-pension	Implemented

The age limit in restructuring companies and loss-making companies is between 50 and 55	2015: The age limit is 55 in 2015 and rises every year with one year to arrive at the minimum age of 60 in 2020 for companies in difficulty. For companies undergoing restructuring, the age limit will be 60 in 2020.	Implemented
Top-up from the employer is submitted to taxation	No taxation during periods of work by another employer	Implemented
Part-time pre-pension system		
Part-time pre-pension system	No new entries from 2012	Implemented
Government subsidy for working time reduction to part time (time-credit with unlimited duration)		
Minimum age 50	2013: Minimum age 55 (with exceptions for physically demanding jobs)	Implemented
	2015: Minimum age 60 (with exceptions for physically demanding jobs) -	Planned by the new government
Statutory early retirement benefit		
2012 and before: Minimum age 60, full career length 35 years (5 years for civil servants)	2013: Minimum age increased by six months every year to 62 by 2016, career length increased by one year every year to 40 years by 2016 Exceptions for long career: 61/41 or 60/41 in 2016	Implemented
	2015: Minimum age will increase by six months in 2017 and 2018 to 63 on condition of a full career length that will increase by one year to 41 in 2017 and to 42 in 2019 Exceptions for long career will be stricter: required career length to retire at 60 will increase from 42 years in 2016 to 43 years in 2017 and 44 in 2019 (and for an early retirement at the age of 61 career length rises from 41 in 2016 to 42 in 2017 and 43 in 2019)	Implemented
Pension bonus for workers and self-employed persons: €2.2974 for every day worked extra if 62 or a career of 44 years Pension complement for statutory government employees: percentage increase for every month worked after 60 years of age.	Unified pension bonus for workers, self-employed persons and statutory government employees: progressively increasing lump sum amount (from €1.5 to €2.0) for every day worked extra. Bonus starts not earlier than 12 months after earliest possible date for early retirement. Bonus continued after 65 years of age. Only real working days create bonus rights.	Implemented
	Pension bonus is phased out. Only people who met conditions for early retirement by December 1, 2014 or were 65 years old and had a career of 40 before December 1, 2014 were still eligible to a pension bonus.	Implemented

Diploma bonus: Years spent to get a bachelor or a master degree required to become civil servants are accounted for in the calculation of the career condition for early retirement	Diploma bonus will be phased out (6 months each year) starting 2016	Implemented
Employer obligations towards older workers		
None	Draw up a plan to retain older workers	Implemented by collective agreement n° 104
Social security contributions and wage subsidies		
Reduced for hiring of older long-term unemployed	Before 2013: reduced for hiring of older long term unemployed and pre-pensioners	Implemented/transferred to Regions in 2015
	2013: stronger reduction, but starting at 54 years instead of 50 years and only for those with gross wage under 4.453/month	Implemented
Reduced for older workers from 50 years on	2015: reductions to social security contributions for "target" groups become a competence of the Regions (sixth state reform)	Implemented
	2015: Higher reductions for the first 3 employees in small SME's	Subject to advice of National Labour Council
	2014: First hiring in SMEs extended to 4 and 5	Implemented
	2016: First hirings exempted of SSC, reduction for 2–6th hirings	Implemented
	2014: SSC cuts for the catering sector combined with anti-fraud measures	In preparation
Reduction for small SME's	2016–2020 tax shift package: Two-stage overhaul of the SSC reductions in the profit sector: lower headline SSC rates (down to 30% in 2016 and 25% in 2018), strengthening the low-wage measure (2016–2020), removing high-wage measure (2018) and removing across-the-board cut per employee (2018)	Implemented
	2020 tax shift package: SSC cuts mainly for construction	Law and Royal Decree in preparation
	2016 tax shift package: Night and shift work wage subsidies (from 15.6% in 2015 to 22.8% in 2016)	Implemented
	2014: Strengthening shift work wage subsidies for around-the-clock activities	Law and Royal Decree in preparation
	2016: tax shift package: Strengthening around-the-clock shift work wage subsidies in high-tech sectors	Implemented

	2014: Increase general wage subsidy rate for SMEs (from 1% to 1.12%)	Implemented
	2015 tax shift package: Strengthening general wage subsidy in micro start-ups from 1.12% to 10% or 20% (2015)	Implemented
	2016 tax shift package: Strengthening overtime wage subsidies in construction and catering (2016)	Implemented
	2016–2020 tax shift package: Labor cost reducing package for non-profit sector (50% non-profit wage subsidy, 45% SSC cuts for low wages, 5% hospitals)	Implemented
	Tax shift package: Removing 1% general wage subsidy (2016)	Implemented
	Employees' SSC cuts for low-wage earners: compensation for non-indexation wages (2015)	In preparation
	Tax shift package: employees' SSC cuts for low-wage earners (2016-2020)	Implemented
Encourage longer employment via pension system reforms		
Encourage longer employment	For pensioners aged 65 or more, abolish ceiling on permitted earned incomes for those with careers spanning more than 42 years	Implemented
	No limits to income for pensioners who are 65-year-old or have a career of 45 years	Implemented
Full valorization of assimilated periods in pension calculation at last wage earned: unemployment, unemployment with company top-up and time credit	Limited valorization of assimilated periods in pension calculation: • 3rd period unemployment, unemployment with company top-up before 60 and end of career time credit before 60 at pension minimum wage • unmotivated time credit limited to 1-year assimilation	Implemented
	Unmotivated time credit is still possible but gives no right to any benefit since 2015	Implemented
Survivors' pension for widow(er)s: always for survivors of 45 years and older, under certain conditions in case of survivors younger than 45	For widow(er)s younger than 45 survivors' pension replaced by transition allowance (12 months if no children, 24 months if children) that can be combined without limitation with work income, followed by automatic access to unemployment benefit if no gainful occupation and entitled to appropriate and early guidance.	Implemented

	Eligibility age of 45 increased gradually to 50 by 2025 As for 2025, the eligibility age of 50 will increase gradually by one year each year to reach 55 in 2030	Planned by the new government
In workers' and self-employed persons' pension schemes the months of professional activity in the year of retirement are not taken into account for pension calculation.	In workers' and self-employed persons' pension schemes the months of professional activity in the year of retirement are taken into calculation.	Implemented
Principle of the limitation to the career unity in pension calculation in pension schemes of workers, self-employed persons and statutory government employees: career fraction or sum of career fractions cannot exceed 1 (45/45)	Notion career no longer expressed in years (45), but in full time equivalent days (14,040)	Implemented
Increased taxation of the second pillar system in case of early retirement	From July 1, 2013, 20 percent instead of 16.5 percent if leaving at 60 and if leaving at 61 without legal pension 18 percent instead of 16.5 percent	Implemented
Legal age for full pension is 65	Increased to 66 in 2025 and 67 in 2030	Implemented
	The legal framework for the second pillar system adapted such that the access is more in line with the statutory (early) retirement age	Implemented
Decrease pension expenditure		
Pension complement for frontier or seasonal workers in workers' pension scheme: frontier or seasonal workers residing in Belgium granted pension complement to increase foreign pension to level of pension they would have received if they had worked in Belgium	As of 2015, pension complement for frontier or seasonal workers takes into account the 2nd pillar pension and is only payable when the foreign pension is paid. Pension complement for frontier or seasonal workers is accessible only to those who woked as frontier or seasonal workers before 2015 The new system is not applicable to those who are before December 1, 2015: • 65 years old, or • Fulfill the conditions for early retirement	Implemented
Minimum pension: Career condition to benefit from 1/45th of the minimum pension is 30 years of 208 days	From 2015, at least 52 days in a year are required to obtain 1/45th of the minimum pension.	Implemented
Structural reform of the pension scheme		Planned by the new government

Sources: Belgian Federal Public Service Employment, Labor and Social Dialogue, National Bank of Belgium, National Employment Office, Federal Planning Bureau, Ministry of Pensions, and Belgian Stability Program 2012–15.

INTERNATIONAL MONETARY FUND

BELGIUM

February 23, 2017

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By | European Department

CONTENTS

FUND RELATIONS 2

STATISTICAL ISSUES 5

FUND RELATIONS

(As of December 31, 2016)

Membership Status: Joined December 27, 1945; Article VIII.

General Resources Account:

	SDR Million	Percent of Quota
Quota	6,410.70	100.00
IMF's Holdings of Currency (Holdings Rate)	6,170.83	96.26
Reserve Tranche Position	239.91	3.74
Lending to the Fund		
New Arrangements to Borrow	578.90	

SDR Department:

	SDR Million	Percent of Allocation
Net Cumulative Allocation	4,323.34	100.00
Holdings	3,842.00	88.87

Outstanding Purchases and Loans: None

Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-By	Jun 19, 1952	Jun 18, 1957	50.00	50.00

Overdue Obligations and Projected Payments to Fund [1/]

(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2017	2018	2019	2020	2021
Principal					
Charges/Interest	1.29	1.31	1.31	1.31	1.31
Total	1.29	1.31	1.31	1.31	1.31

[1/] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

Implementation of HIPC Initiative: Not applicable

Safeguards Assessments: Not applicable

Exchange Rate Assessments:

- Belgium's currency is the euro, which floats freely and independently against other currencies.
- Belgium has accepted the obligations under Article VIII, Section 2(a) and 3, and maintains an exchange system free of restrictions on payment and transfers for current international transactions except for restrictions maintained solely for security reasons, which have been notified to the Fund pursuant to Executive Board Decision No. 144-(52/51).

Last Article IV Consultation:

The last Article IV consultation was concluded on March 2, 2016. The associated Executive Board assessment is available at https://www.imf.org/external/np/sec/pr/2016/pr1693.htm and the staff report (IMF Country Report No. 16/77) at http://www.imf.org/external/pubs/ft/scr/2016/cr1677.pdf. Belgium is on the standard 12-month consultation cycle.

FSAP Participation and ROSC:

- **Belgium: Financial System Stability Assessment, including Reports on the Observance of Standards and Codes on the following topics: Banking Supervision and Regulation, and Insurance Supervision and Regulation** — IMF Country Report No. 13/124

Summary: During the 2013 FSAP Update, staff assessed progress with the implementation of the 2006 FSAP recommendations. The report outlines that the authorities have made progress in addressing the recommendations of the 2006 FSAP but many recommendations in the area of conglomerate supervision and governance remain relevant. The new institutional model is a work in progress and better communication and coordination between supervisory institutions is needed. Improvements are evident in the intensity of banking supervision and the adoption of analytical tools to support system-wide monitoring, including the introduction of an intensive process for determining Pillar II capital requirements, liquidity stress testing for the banking sector, and introduction of macrofinancial risk dashboard to monitor systemic and emerging risk. Funding and risk management standards are being improved. Supervisory tools for monitoring group-wide risks need to be upgraded. The crisis management framework, while updated for handling systemic firms, is in need of a further upgrade owing in part to EU-wide developments.

Insurance supervision has been significantly strengthened although further work is needed, particularly, in strengthening the solvency framework. Both bank and insurance supervisory frameworks integrate vertical analyses of individual insurers with horizontal review of the sector. The adoption of the new institutional architecture has allowed the FSMA to focus solely on market and business conduct and the adoption of EU directives in the interim has addressed many of the recommendations for the securities sector. The FSMA's plan to adopt a risk-based approach to conduct supervision must be adequately resourced. Pension regulation and supervision has been strengthened. While pension funds remain the remit of the FSMA, there is currently a debate as to whether this should be the responsibility of the NBB.

- **Belgium: Report on Observance of Standards and Codes—Fiscal Transparency Module** IMF Country Report No. 08/116

Summary: In many areas Belgium meets, and in some cases exceeds, the requirements of the fiscal transparency code. The basic government finance processes are supported by a sound institutional and legal framework. Roles and responsibilities in the budget process are clear, with a well-defined separation of powers between the executive and legislature. Fiscal information is provided through regular publications and extensive use of the internet. Budget formulation is appropriately supported by medium-term macroeconomic forecasts and clearly formulated medium-term fiscal policy goals, and fiscal policy is presented clearly, and in a medium-term context. Finally, audit processes are extensive and help improve budget management decisions, practices and standards, with government financial decisions evaluated ex ante and ex post by various institutions.

There is room to improve the quality and openness of budget processes: (i) there is limited insight about the objectives and targets of government expenditure; (ii) the medium-term budget estimates need to make budgetary decision-making more oriented to the medium-term; (iii) the presentation of new policy measures and their medium-term costs could be clarified; (iv) and budget implementation by departments and agencies could be streamlined. Information available to the public on the following topics could be increased: (i) fiscal risk and tax expenditures in budget documents; (ii) in-year budgetary data on local government and agencies; (iii) the content of the final government accounts; and (iv) the governance of state-owned equity holdings.

Institutional arrangements for fiscal policy coordination could be strengthened by (i) reinforcing and expanding the role of the High Council of Finance, including by providing additional institutional safeguards as to its continuity and independence, and having the Council cover all important issues bearing on fiscal policy; and (ii) converting the budget agreements between the federal government, regions, and communities into published agreements which specify the targeted balance for each partner and identify the measures needed to achieve this target.

Finally, internal audit processes could be better coordinated and simplified by reducing the number of internal control and audit layers. This makes the Court of Audit's recent Single Audit initiative to minimize overlap, coordinate work programs, and to share common data and analysis, timely.

Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT):

Belgium's AML/CFT framework was last assessed in July 2014. The assessment was conducted by the Financial Action Task Force (FATF) against the 2012 FATF standard using the 2013 assessment methodology, both of which place greater emphasis on the effectiveness of AML/CFT measures in mitigating the money laundering and terrorist financing risks. The evaluation report was adopted during the FATF February 2015 plenary meeting and found that the core elements of a sound AML/CFT regime were present, although some elements remained to be brought in line with the 2012 FATF standard.

STATISTICAL ISSUES

Belgium's economic and financial statistics are adequate for surveillance purposes. The National Bank of Belgium (NBB) regularly publishes a full range of economic and financial data and provides calendar dates of main statistical releases. On-line access to these comprehensive databases is facilitated by the NBB's data search engine, Belgostat. Belgium is a SDDS subscriber. Statistics for International Financial Statistics on banking institutions and monetary aggregates are prepared on a monthly basis and are timely.

Belgium adopted the European System of Integrated Economic Accounts 2010 (ESA 2010) in 2014. Revisions of national accounts were released in September, 2014, to comply with EUROSTAT requirements to provide national accounts statistics in ESA 2010. Unlike in other countries, the central bank is responsible for compiling national accounts statistics. Quarterly accounts are published within a lag of three months. Both annual and quarterly accounts data are of good quality, with shortcomings mainly related to export and import deflators, which are based on unit values, rather than prices collected directly from exporters and importers.

Belgium compiles and publishes a complete set of general government accounts on an accrual basis (ESA 2010). The NBB publishes annual and quarterly data on general government revenue, expenditure, and net lending/ borrowing; transactions in financial assets and liabilities and a financial balance sheet data; and details on the consolidated gross debt.

The overall quality and availability of financial indicators are good. The authorities are providing quarterly updates of financial sector indicators (FSIs) in a timely manner.

Key publicly accessible websites for macroeconomic data and analysis are:

National Statistical Portal, http://stat.nbb.be/?lang=en

National Statistics Institute, www.statbel.fgov.be

National Bank of Belgium, www.nbb.be

Federal Planning Bureau, www.plan.be

High Council of Finance, www.docufin.be

Central Economic Council, www.ccecrb.fgov.be

Belgium: Common Indicators Required for Surveillance

(As of January 2017)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]
Exchange Rates	12/16	1/17	M	M	M
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	12/16	1/17	M	M	M
International Investment Position	2016:Q3	12/16	Q	Q	Q
Reserve/Base Money	11/16	12/16	M	M	M
Broad Money	11/16	12/16	M	M	M
Central Bank Balance Sheet	12/16	1/17	M	M	M
Consolidated Balance Sheet of the Banking System	12/16	1/17	M	M	M
Interest Rates[2]	12/16	1/17	M	M	M
Consumer Price Index	12/16	1/17	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]—General Government[4]	2016:Q3	12/17	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing[3]—Central Government[5]	11/16	12/16	M	M	M
Stock of Central Government Debt	11/16	12/16	M	M	M
External Current Account Balance	9/16	12/16	M	M	M
Exports and Imports of Goods and Services	9/16	12/16	M	M	M
GDP/GNP	2016:Q3	11/16	Q	Q	Q
Gross External Debt	2016:Q3	12/16	Q	Q	Q

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

[2] Both market-based and officially-determined, including discount rates, money market rates, and rates on treasury bills, notes and bonds.

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds), and state and local governments.

[5] This information is provided on a budget-accounting basis (not on a national accounts basis).

[6] Daily (D), weekly (W), monthly (M), quarterly (Q), annually (A), irregular (I), and not available (NA)

INTERNATIONAL MONETARY FUND

BELGIUM

March 9, 2017

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION—SUPPLEMENTARY INFORMATION

Prepared By European Department

This supplement provides information that has become available since the issuance of the staff report on February 23, 2017. The thrust of the staff appraisal is unchanged.

Staff has updated the macroeconomic framework to reflect the release of 2016 data and revised global assumptions. The headline 2016 real GDP growth figure was in line with the estimate in the staff report, although with somewhat weaker consumption growth and stronger (gross) investment growth. The contribution to growth from net exports was in line with earlier projections, though both exports and imports grew more strongly than expected. Staff's revised medium-term projections (Table 1) are very similar to those reported in the staff report.

Table 1. Belgium: Selected Economic Indicators, 2013–2022

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
					Projections					
(percentage change from previous period; unless otherwise indicated)										
Real economy										
Real GDP	-0.1	1.7	1.5	1.2	1.6	1.5	1.5	1.5	1.5	1.5
Domestic demand	-0.5	2.3	1.5	0.5	1.5	1.6	1.5	1.6	1.5	1.5
Private consumption	0.7	0.6	1.1	0.7	1.4	1.5	1.4	1.4	1.4	1.4
Public consumption	0.1	1.4	0.5	0.2	0.4	0.4	0.7	0.7	0.8	0.8
Gross fixed investment	-1.5	5.1	2.4	2.1	2.6	2.9	2.4	2.8	2.4	2.6
Stockbuilding[1]	-0.6	0.4	0.3	-0.4	0.0	0.0	0.0	0.0	0.0	0.0
Foreign balance[1]	0.4	-0.5	0.0	0.8	0.2	0.0	0.0	0.0	0.0	0.0
Exports, goods and services	0.8	5.1	4.3	6.1	4.8	3.9	4.1	4.0	4.0	4.0
Imports, goods and services	0.3	5.9	4.3	5.3	4.7	4.0	4.1	4.0	4.0	4.1
Household saving ratio	12.3	12.1	11.7	12.6	12.9	13.0	13.2	13.3	13.3	13.4
Potential output growth	1.0	1.1	1.1	1.2	1.3	1.4	1.4	1.5	1.5	1.5
Potential output growth per working age person	0.8	1.0	0.9	0.9	1.0	1.2	1.5	1.5	1.6	1.5
Output gap (in percent)	-1.6	-1.0	-0.6	-0.6	-0.2	-0.1	0.0	0.1	0.1	0.1
Employment										
Unemployment rate	8.5	8.6	8.5	8.0	7.8	7.6	7.4	7.4	7.3	7.3
Employment	-0.3	0.4	0.9	1.3	0.9	0.8	0.6	0.4	0.5	0.5
Prices										
Consumer prices	1.2	0.5	0.6	1.8	2.0	1.7	1.7	1.8	2.0	2.0
GDP deflator	1.2	0.7	0.9	1.6	1.6	1.7	1.7	1.8	2.0	2.0
(Percent of GDP; unless otherwise indicated)										
Public finance										
Revenue	52.7	52.0	51.3	51.0	51.0	50.7	50.4	50.2	50.2	50.2
Expenditure	55.7	55.1	53.9	53.7	53.1	53.0	52.6	52.6	52.6	52.7
General government balance	-3.0	-3.1	-2.5	-2.7	-2.1	-2.2	-2.3	-2.4	-2.4	-2.5
Structural balance	-2.8	-2.8	-2.2	-2.4	-1.9	-2.2	-2.3	-2.4	-2.5	-2.5
Structural primary balance	0.4	0.4	0.8	0.3	0.5	0.1	0.0	-0.1	0.0	-0.1
Primary balance	0.3	0.2	0.5	0.0	0.4	0.1	0.0	-0.1	0.0	0.0
General government debt	105.4	106.5	105.8	105.5	104.3	103.3	102.3	101.4	100.3	99.4
Balance of payments										
Goods and services balance	0.1	0.4	2.3	3.6	2.9	2.5	2.6	2.4	2.4	2.5
Current account	-0.3	-0.7	0.4	1.0	0.9	1.0	1.4	1.5	1.8	1.9
Exchange rates										
Euro per U.S. dollar, period average	0.8	0.8	0.9	0.9	...	...	...	...	...	...
NEER, ULC-styled (2005=100)	102.2	102.1	97.9	98.9	...	...	...	...	...	...
REER, ULC-based (2005=100)	104.2	104.0	98.3	101.4	...	...	...	...	...	...
Memorandum items										
Nominal GDP (in billions of euros)	391.7	400.8	410.4	422.0	435.6	449.6	464.2	479.8	496.9	514.6
Population (in millions)	11.2	11.2	11.2	11.3	11.4	11.4	11.5	11.5	11.6	11.7

Sources: Haver Analytics, Belgian authorities, and IMF staff projections.

[1] Contribution to GDP growth.