INTERNATIONAL MONETARY FUND

IMF Country Report No. 23/98

BELGIUM

March 2023

2022 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR BELGIUM

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 2022 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 February 27, 2023, 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 February 27, 2023, following discussions that ended on December 21, 2022, 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 9, 2023.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Belgium.

The documents listed below have been or will be separately released.

Selected Issues

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.

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International Monetary Fund
Washington, D.C.

IMF Executive Board Concludes 2022 Article IV Consultation with Belgium

FOR IMMEDIATE RELEASE

WASHINGTON, DC – March 2, 2023:

On February 27, 2023, the Executive Board of the International Monetary Fund (IMF) concluded the 2022 Article IV Consultation[1] with Belgium.

Belgium's post-pandemic recovery has slowed with spillovers from Russia's war in Ukraine, high inflation, tighter financial conditions, and elevated uncertainty. In response to the spike of energy prices, the federal and regional authorities provided timely and substantial support to households and firms. Along with automatic indexation of wages and benefits, energy support helped cushion impacts, although at significant cost, increasing the fiscal deficit in 2022 and 2023. The labor market has remained tight, with record-high job creation and low unemployment. The external current account swung to a large deficit in 2022, due largely to higher energy imports and lower vaccine exports. A resilient financial sector is facing challenges from the weaker macro-financial environment. Some important structural reforms took place in 2022.

Growth is expected to slow from 3.0 percent in 2022 to 0.2 percent in 2023, before returning to potential of 1.2 percent over the medium term. Inflation should decelerate from 10.3 percent in 2022 to 5.5 percent in 2023, as energy prices ease. Indexation has opened a wage gap with key trading partners, posing challenges for competitiveness. With aging and social-benefit pressures and in the absence of adjustment measures, the structural fiscal deficit is expected to remain elevated over the medium term at 5½ percent of GDP and high public debt will also rise to about 120 percent of GDP in 2028, increasing vulnerabilities. Risks are tilted to the downside, related to escalation of the war in Ukraine and a sharper-than-expected tightening of financial conditions. Lower energy prices would reduce fiscal pressures, and with progress on structural reforms before elections in 2024, boost confidence.

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[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.

Executive Board Assessment[2]

Executive Directors broadly agreed with the thrust of the staff appraisal. They welcomed the authorities' timely policy response, which helped cushion the impact of the energy crisis on household and firms and strengthened energy security, but also led to fiscal deterioration and an erosion of competitiveness. Noting the economic slowdown this year and elevated uncertainty and downside risks, Directors called for prudent policies to preserve fiscal sustainability and financial stability and for structural reforms to boost competitiveness and reinvigorate growth.

Directors recommended a credible and ambitious multi-year, expenditure-led fiscal adjustment, drawing on spending reviews, to put debt on a declining path, replenish buffers, and complement monetary policy in curbing inflation. They encouraged the authorities to rationalize current spending while increasing productive public investment. Directors emphasized that energy support measures should remain limited and temporary, be better targeted, and maintain price signals. They also encouraged improved coordination of spending across government levels and welcomed efforts to initiate tax reforms and enhance public investment management.

Directors concurred that financial sector policies should continue to balance ensuring adequate credit provision, preserving resilience, and facilitating deployment of buffers to absorb losses when needed. Given rising interest rates and the slowing economy and housing market, they called for close monitoring of financial stability risks. While most Directors supported the authorities' near-term hold on additional macroprudential policy tightening, some Directors considered that further tightening could be desirable to continue strengthening resilience, as long as macro-financial conditions allow. Directors welcomed recent steps to further strengthen the AML/CFT framework and looked forward to the conclusions of the ongoing FSAP.

Directors emphasized that further labor and product market reforms are key to improve productivity and competitiveness and reinvigorate growth. They recommended additional measures to facilitate labor reallocation, including enhancing labor market flexibility and incentive setting in the social security and pension systems. Directors noted that pension reforms are critical for Belgium to receive the Next Generation EU funds. They also encouraged the authorities to consider revising the wage indexation framework once inflationary pressures subside. They welcomed efforts to improve the business environment, including reforms to the restructuring and insolvency frameworks and actions to strengthen cyber risk monitoring and preparedness.

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[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 agreed that reaching ambitious climate goals require a wider set of initiatives and greater focus on coordination and execution, including aligning national climate policies with more ambitious EU targets and considering raising carbon pricing. They welcomed the significant new investments in renewables to enhance energy security.

It is expected that the next Article IV consultation with Belgium will be held on the standard 12-month cycle.

Table 1. Belgium: Selected Economic Indicators, 2021-23

	2021	2022	2023
		Proj.	
Real economy			
Real GDP	6.1	3.0	0.2
Domestic demand	5.6	2.8	0.9
Foreign balance[1/]	0.6	0.3	-0.6
Exports, goods and services	11.3	4.7	1.1
Imports, goods and services	10.7	4.4	1.9
Potential output growth	3.9	1.8	1.2
Output gap (in percent)	-0.5	0.7	-0.2
Employment			
Unemployment rate (in percent)	6.3	5.5	6.0
Employment growth	1.8	1.8	0.2
Prices			
Consumer prices	3.2	10.3	5.5
GDP deflator	2.9	5.7	5.0
Public finance			
Revenue	49.9	49.4	50.8
Expenditure	55.5	54.2	56.3
General government balance	-5.6	-4.8	-5.5
Structural balance	-5.1	-5.1	-5.3
Primary balance	-3.9	-3.3	-3.8
General government debt	109.2	106.8	108.1
Balance of payments			
Goods and services balance	1.1	-3.8	-3.3
Current account	0.4	-4.0	-3.5
Exchange rates			
Euro per U.S. dollar, period average	0.8	0.9	…
NEER, ULC-styled (2005=100)	98.0	96.3	…
REER, ULC-based (2005=100)	97.3	98.7	…
Memorandum items			
Nominal GDP (in billions of euros)	502.3	547.0	575.9
Population (in millions)	11.6	11.7	11.7

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

1/ Contribution to GDP growth.

INTERNATIONAL MONETARY FUND

BELGIUM

STAFF REPORT FOR THE 2022 ARTICLE IV CONSULTATION

February 9, 2023

KEY ISSUES

Context: Post-pandemic recovery slowed with spillovers from Russia's war in Ukraine and high inflation, financial conditions tightening, and elevated uncertainty. In response to the spike of energy prices, the federal and regional authorities provided timely and substantial support to households and firms. Along with automatic indexation of wages and benefits, energy support helped cushion impacts, although at significant cost, increasing the fiscal deficit in 2022 and 2023. The labor market has remained tight, with record-high job creation and low unemployment. The external current account swung to a large deficit in 2022, due largely to higher energy imports and lower vaccine exports. Energy consumption is being cut, and gas imports reoriented. A resilient financial sector is facing challenges from the weaker macro-financial environment.

Outlook/risks: Growth is expected to slow from 3.0 percent in 2022 to 0.2 percent in 2023, returning to 1.2 percent (potential) over the medium term. Inflation should decelerate from 10.3 percent in 2022 to 5.5 percent in 2023, as energy prices ease. Indexation has opened a wage gap with key trading partners, posing challenges for competitiveness. Without measures, the already-high fiscal deficit—4.8 pct of GDP in 2022—will increase further with aging costs adding 0.2-0.3 ppt. per year; high public debt (106.8 percent of GDP) will also rise, increasing vulnerabilities. Risks are tilted to the downside, related to escalation of the war in Ukraine and a sharper-than-expected tightening of financial conditions. Lower energy prices would reduce fiscal pressures, and with progress on structural reforms before elections in 2024, boost confidence.

Policies: The authorities should pursue multi-year, expenditure-led fiscal consolidation from 2023 to support efforts to reduce inflation, ease financing pressures and vulnerabilities, rebuild buffers, make room for increased public investment, and put debt on a declining path. They should improve targeting of energy support and advance reforms in social benefits, pensions, and health in the window before elections. Efforts to initiate tax reforms are welcome, along with growth-enhancing measures (labor and product markets, business environment) to help meet ambitious employment goals. More progress is needed. Financial sector policies should balance ensuring the adequate provision of credit, preserving resilience, and facilitating deployment of buffers to absorb losses when needed. Climate actions should be advanced to meet new, more ambitious emissions-reduction targets. In all these areas, better alignment of federal and regional planning and policies will be helpful. While the financial sector has performed well, risks are rising, and vigilance is warranted.

Approved by:
Laura Papi (EUR) and Maria Gonzalez (SPR)

Discussions took place in Brussels during December 7–21, 2022. The team comprised Mark Horton (head), Yu Ching Wong, André Geis (all EUR) and Nate Vernon (FAD), and was assisted at IMF HQ by Paola Castillo and Karen Cerrato. Luc Dresse and Stijn Verhelst (OED) participated in the mission. The team met with Prime Minister De Croo, National Bank of Belgium (NBB) Governor Wunsch, Deputy Prime Minister Van Peteghem (Finance), Deputy Prime Minister Clarinval (Self-Employed, SMEs and Agriculture, Institutional Reforms and Democratic Renewal), the cabinets of Deputy Prime Ministers De Sutter (Public Administration, Public Enterprises, Telecommunications, and Postal Services), Dermagne (Economy and Employment), Van Quickenborne (Justice) and Vandenbroucke (Social Affairs and Public Health), the cabinets of Ministers Khattabi (Climate, the Environment, Sustainable Development, and Green Deal), Lalieux (Pensions and Social Integration), and Van der Straeten (Energy), and State Secretaries Bertrand (Budget), De Moor (Asylum and Migration), Dermine (Economic Recovery and Strategic Investments), and Schlitz (Diversity, Opportunities and Inclusion). The mission also met with the finance ministers of Brussels, Flanders, and Wallonia, other senior officials, and representatives of the private sector, academia, and labor unions.

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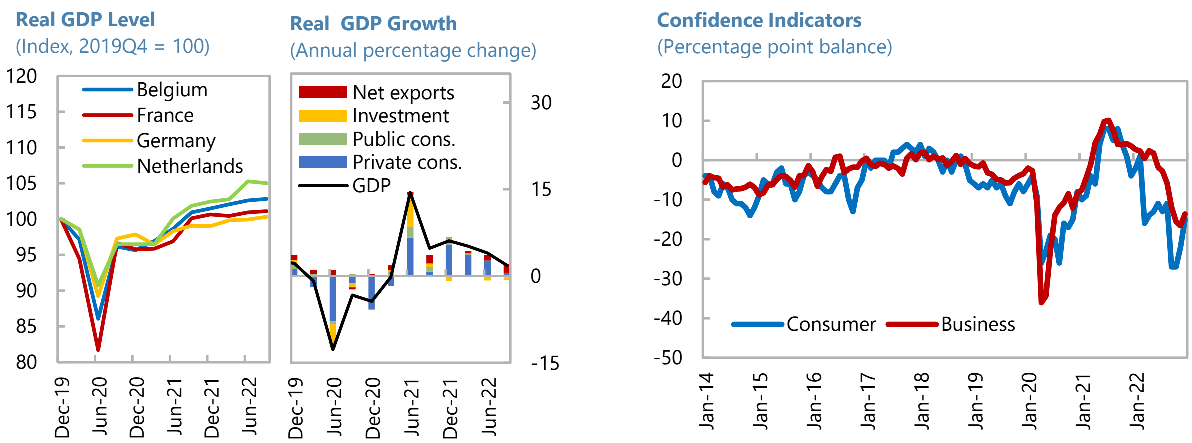
TABLES

ANNEXES

CONTEXT

1. **Spillovers from Russia's war in Ukraine have weakened a strong, private consumption-led, post-pandemic recovery.** Direct exposures to Russia and Ukraine via trade, energy, and financial channels are limited, but growth has slowed due to elevated uncertainty and spillovers from key trading partners more directly affected by the conflict. Price pressures and tighter financial conditions have also weighed on households and firms, undermining confidence and activity. Widespread indexation of wages and social benefits and substantial and timely fiscal support for higher energy bills have shielded household incomes; easing supply bottlenecks have supported output.[1]

Economic Developments



Sources: Eurostat, NBB and IMF staff calculations.

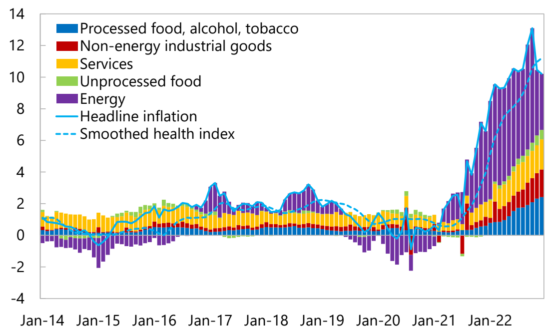
Source: NBB.

2. **Inflation has risen sharply, with pressures broadening from energy to core categories.** Energy has accounted for two-fifths of inflation, 10.2 percent y/y in December, down from a peak of 12.3 percent in October. Core inflation (5.5 percent y/y, close to the euro-area average) has accelerated as price pressures have spilled into services and non-energy industrial goods, reflecting robust post-pandemic demand and the ability of firms so far to pass on higher wages and energy cost pressures to consumers. Nearly nine-tenths of household consumption items are registering inflation above 2 percent.

[1] See Annex I for a review of implementation of past recommendations.

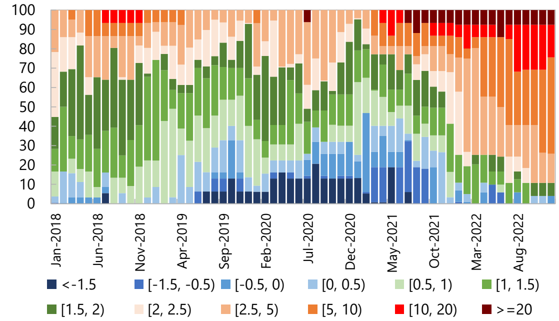
Inflation Developments

HICP Inflation
(Annual percentage changes, percentage point contributions)



Sources: StatBel and IMF staff calculations

Inflation Dispersion 1/
(Percent)

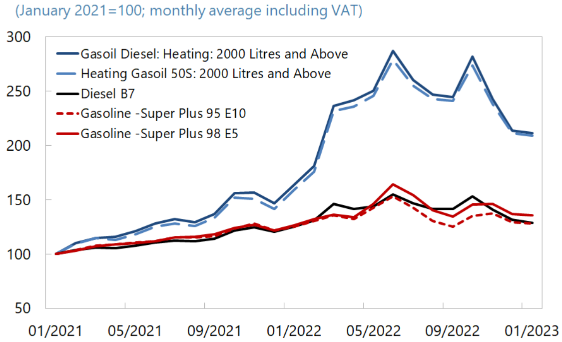


1/ Share of consumption basket within each inflation band.
Sources: StatBel and IMF staff calculations.

3. **Fiscal support to households and firms during the pandemic and the energy price shock have helped mitigate impacts, but eroded buffers.** The 2022 overall deficit remained high—4.8 percent of GDP versus 5.6 percent in 2021—and widened by 0.4 ppt. compared with pre-war forecasts. This reflected energy-price measures (1.0 percent) and refugee support (0.2 percent), partly offset by higher revenues. Energy support measures include expanded social tariffs and gas and electricity vouchers for lower- and middle-income households in the winter months. Some measures, such as reduction of the VAT rate on gas and electricity from 21 to 6 percent and lowering of excise duties for petrol and diesel, were not targeted and did not maintain price signals to reduce consumption. Measures are subject to quarter-by-quarter review; most are now set to expire at end-Q1:2023. This coincides well with the recent decline in natural gas prices.

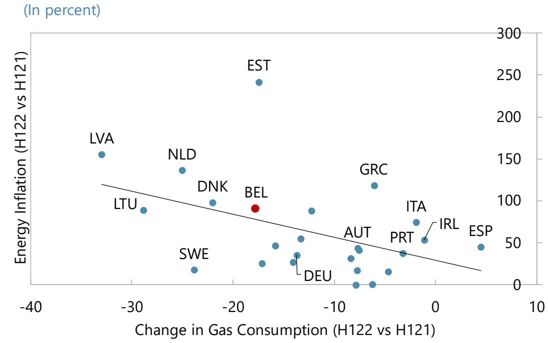
Energy Prices Developments[1/]

Fuel Prices
(January 2021=100; monthly average including VAT)



Sources: CEIC and IMF staff calculations.

Energy Retail Prices and Gas Consumption
(In percent)



Sources: Eurostat and IMF staff calculations.
Note: Energy inflation is a simple average of retail electricity and gas.

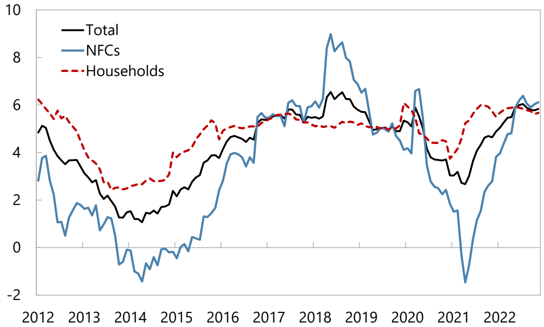
1/ Natural gas price (Dutch TTF) in January has fallen back to the level before the surge in the summer of 2021 but still about three times above the pre-energy crisis level.

4. **Despite the elevated deficit, high inflation helped ease the debt ratio in 2022 (from 109.2 percent to 106.8 percent of GDP), but debt remains well above pre-pandemic levels (97.6 percent of GDP in 2019).** The authorities used the long period of low interest rates to extend maturities and reduce debt-service costs. With financial tightening, government bond yields have

picked up to levels prevailing before the ECB's launch of public-sector bond-purchase programs in 2014, although spreads have so far remained contained.

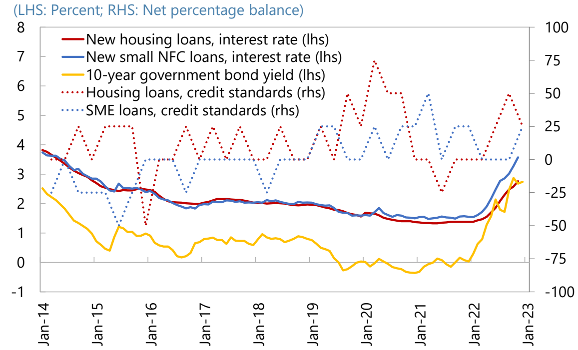
Credit Developments

Private Sector Lending
(Annual percent change)



Sources: NBB and IMF staff calculations.

Private and Public Sector Credit Conditions
(LHS: Percent; RHS: Net percentage balance)



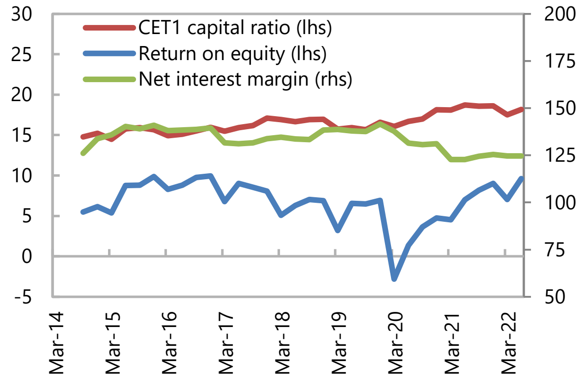
Sources: NBB and ECB.

5. **Credit has continued to grow at a robust pace, although tightening financial conditions are heralding a slowdown.** Mortgage lending (+5.7 percent y/y in November) has stabilized at an elevated level, supported by ongoing, albeit flagging, strength in house prices. Borrowing by non-financial corporations (NFCs) continued its rebound (+6.1 percent y/y). However, the latest available bank lending surveys indicate a slowing of housing and corporate credit demand, as interest rates have markedly risen from historic lows, and banks have tightened credit standards, reflecting growing concerns about the outlook and risk.

6. **The financial sector has emerged resilient from the pandemic, although systemic risks are rising due to tightening financial conditions and the worsening economic environment.** Profitability has returned to pre-pandemic levels, as pandemic-related NPLs and bankruptcies did not materialize, further bolstering elevated capital ratios. Still, Russia's war in Ukraine and the energy crisis have raised sectoral credit and cyber risk concerns, prompting banks to strengthen loan-loss provisioning. House prices did not rise as markedly as in other euro-area (EA) countries but there are signs of overvaluation and the market has started to cool. Commercial properties remain supported by a stable tenant structure in the dominant Brussels office segment and by sustained demand in logistics. Non-bank financial institutions have shown little sign of stress. Occupational pension funds account for a relatively small part of financial-sector assets, and liquidity pressures from derivatives exposures appear contained. With a sizeable part of the insurance sector being part of larger financial groups, the hedging of interest-rate risk is often with the group's banking arm, limiting spillover risks; investment funds appear little leveraged.

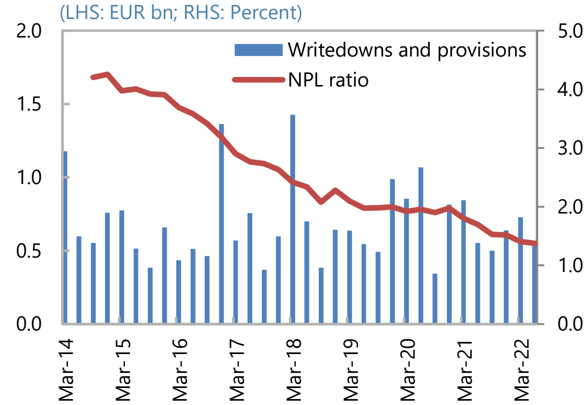
Financial Sector Developments

Bank Profitability and Capital Adequacy
(LHS: Percent; RHS: basis points)



Source: EBA.

Bank Asset Quality
(LHS: EUR bn; RHS: Percent)

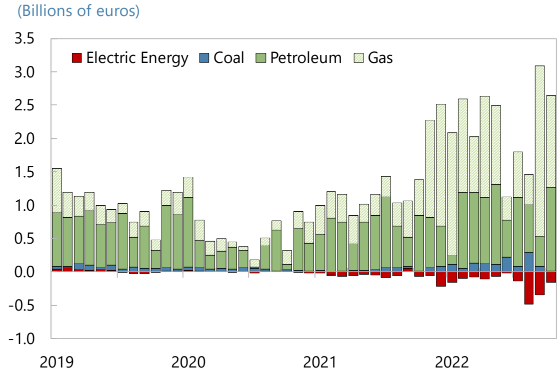


Sources: NBB and EBA.

7. **On preliminary estimates, the 2022 external position was substantially weaker than implied by medium-term fundamentals and desirable policies** (Annex II). In Q1-Q3:2022, the current account (CA) balance swung to a deficit of 2.9 percent of GDP from a surplus of 0.4 percent in 2021, driven by higher energy net imports (3.1 percent of GDP) and lower vaccine net exports (1.6 percent of GDP). The CA deficit is expected to have reached 4.0 percent of GDP in 2022. Staff's preliminary assessment suggested that the CA gap was -5.6 percent of GDP, and the REER overvalued by 7.6 percent.

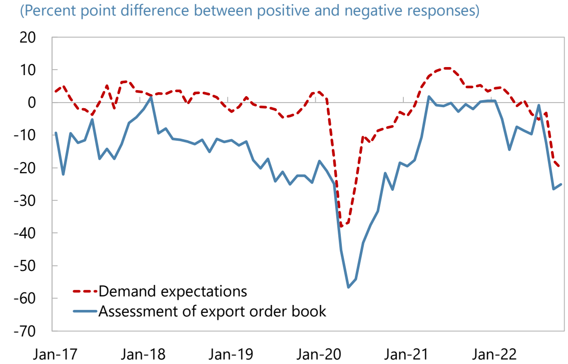
External Sector Developments

Net Imports of Fuels
(Billions of euros)



Sources: Haver Analytics and IMF staff calculations.

Export Orders in Manufacturing
(Percent point difference between positive and negative responses)



Source: NBB.

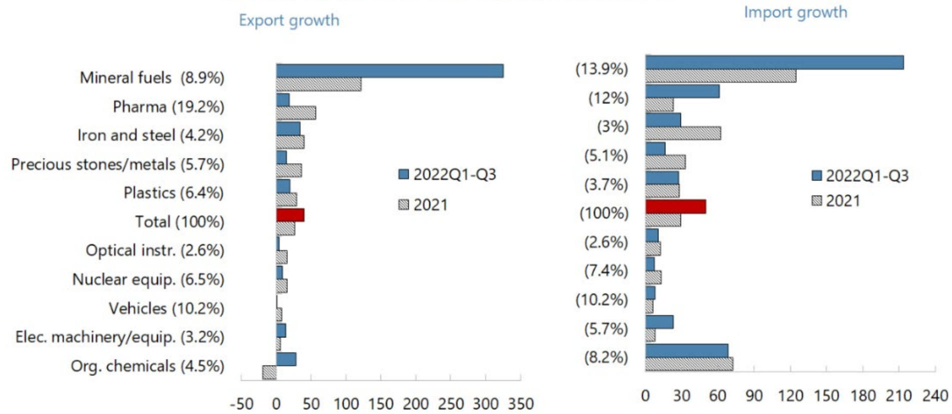
8. **Automatic indexation has protected households, but is yielding labor-cost increases above major trading partners, weighing on competitiveness**. Wage growth through Q3:2022 surpassed neighboring countries, and the authorities anticipate the emergence of a sizeable wage gap with key competitors in the coming years. Indexation for employees who receive adjustment once per year took place in January 2023; this more-than-10-percent rise in labor costs for two-fifths

of private-sector workers will place further pressures on competitiveness (Box 1).[2] Robust corporate profit margins offer some scope to absorb higher labor costs, but sustained price pressures, together with elevated inflation expectations, are sharpening risks of a wage-price spiral. Vacancies are high, and unemployment remains low overall, especially in Flanders and among skilled workers. Unemployment is higher in Wallonia and Brussels and among low-skilled and younger workers; geographic mobility is limited. Temporary unemployment has picked up recently, as some firms paused production due to high energy prices.

External Sector Developments II

Belgium: Exports and Imports of Top 10 Products in 2021-2022

(Percent change, y/y; share of 2021 total in percent in brackets)

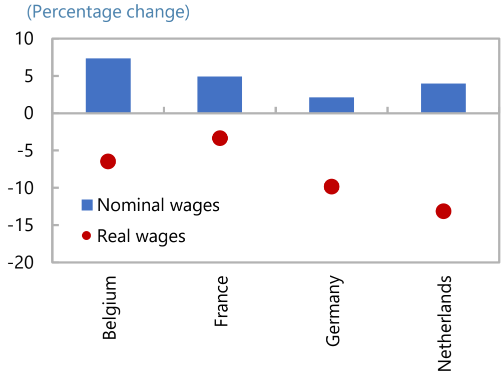


Sources: NBB; and IMF staff calculations.

Wage Developments and Price Expectations

Private Sector Wage Developments, 2021Q1-2022Q3

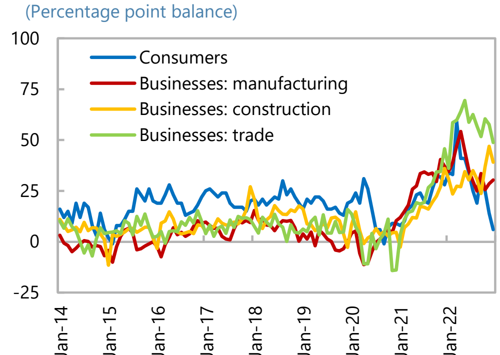
(Percentage change)



Source: Eurostat.

Price Expectations

(Percentage point balance)



Source: NBB.

9. **Spillovers from the war in Ukraine and the spike of energy prices have kept the seven-party coalition government focused on crisis management.** The government was formed in October 2020, 1½ years after 2019 elections, from the liberals, greens, socialists, and Christian Democrats, but without either of the two largest parties in Flanders. While the government has

[2] For further details, see the accompanying Selected Issue Paper: "Wage Indexation and International Competitiveness in Belgium: An Uneasy Coexistence".

capably navigated the pandemic and energy-price shock, headwinds and differences on fiscal, labor-market, pension, and structural policies may limit the scope for a break-through on reforms before elections in 2024.[3]

Box 1. Belgium: Characteristics and Challenges of Belgium's Wage Indexation Framework

Wage formation is characterized by the desire to shield households from purchasing-power losses while protecting the competitiveness of a highly open economy. The wage-setting process was codified into a Wage Law in 1996, obliging employers and trade unions to negotiate salary increases for the coming two years within the bounds of a ceiling determined by *projected* hourly wage developments in key export markets and a floor determined by *projected* inflation in Belgium. Wages are indexed to *actual* inflation by means of a "health index", a basket of prices excluding alcohol, tobacco, and petrol. Wage indexation is triggered once the health index passes a 2-percent threshold, immediately for about half of private sector employees and, with a two-month delay, for all public sector workers. For the remainder, wage indexation takes effect at intervals of up to 12 months, reflecting historical patterns of sales price indexation by firms that are generally no longer in force. If *actual* inflation in Belgium, and, by extension, wage indexation, surpasses *projected* inflation and *projected* wage growth in key competitors, a positive wage gap emerges. In such an event, the Wage Law stipulates its reduction over time, possibly necessitating a long period of real wage restraint, politically sensitive and potentially weakening labor market efficiency.

Despite successfully maintaining wage competitiveness in recent years, the current run-up in inflation may put the wage setting framework under considerable strain. While wage indexation largely protects the purchasing power of households, it redistributes the economic costs of a terms-of-trade shock like the current climb in commodity prices to firms and the government, thereby burdening public finances and corporate profitability or competitiveness. With the rapid acceleration of *actual* inflation, multiple rounds of wage indexation have taken place, far surpassing the *projected* domestic inflation and *projected* wage developments in key export markets that underpinned the last wage negotiation round in early 2021. Consequently, latest estimates by the authorities indicate the opening of a 2.9 percent wage gap at the end of 2022. As a result, space for real wage growth for the period 2022-24 is non-existent, as the Wage Law mandates real wage restraint until the wage gap is closed. To secure a deal between employers and trade unions, government intervention involving fiscal incentives was required, a common feature in recent wage negotiations rounds.

Absent abolition of wage indexation, several avenues of reform could improve the performance and viability of the current wage setting framework. In particular, the basis for indexation, the health index, should be reviewed. Specifically, the scope for excluding price increases in highly volatile components of the consumption basket, like energy or food, should be explored to prevent their quick pass-through to wages that will need to be offset by prolonged periods of real wage restraint if they do not get incorporated in equal measure into the wages of key export markets. Moreover, options to at least temporarily widen the flexibility of the indexation regime should be contemplated to alleviate the burden of firms at times of large and multiple shocks, thereby also preserving investment and employment. Finally, productivity trends should also be accounted for to capture deviations of labor costs between Belgium and its key export markets, rather than merely nominal wage costs.

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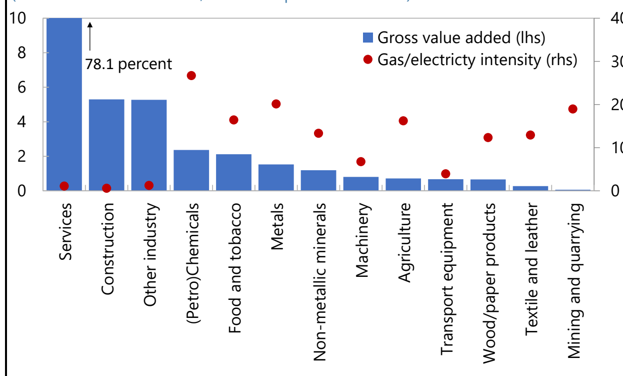
[3] Belgium has adhered to the IMF's Special Data Dissemination Standard (SDDS) Plus, the highest tier of the IMF's Data Standards Initiatives, as of January 26, 2023 (see Press Release).

OUTLOOK AND RISKS

10. **Inflationary pressures, elevated uncertainty, and tighter financial conditions are weighing on confidence and activity.** This is expected to lead to a shallow recession during winter 2022-23. A mild recovery is anticipated over the rest of 2023, yielding annual growth of 0.2 percent, mainly reflecting gains in household purchasing power from wage indexation and a pick-up of external demand. Inflation (core) is expected to reach 5.5 (6.3) percent in 2023, compared with 10.3 (4.0) percent in 2022. Growth should return to potential of 1.2 percent over the medium term, with a modest negative output gap (-0.2 percent in 2023) closing by 2026. With aging and social-benefit pressures, the structural fiscal deficit is expected to remain elevated over the medium term at 5½ percent of GDP, well above pre-pandemic (1.9 percent in 2019) and debt-stabilizing levels (2.3 percent). The external CA deficit is expected to gradually return to near balance over the medium term, as energy-price pressures ease and external demand recovers.

11. **The growth outlook is subject to significant uncertainty and downside risks, with upside risks for inflation** (Annex III). Key risks stem from a prolonged war in Ukraine and an escalation of sanctions on Russia, with negative implications for growth and upward pressures on inflation.[4] Given Belgium's high share of energy-intensive industries (e.g., chemicals, metals), intensified energy-supply disruptions could depress output. Further energy price shocks could feed a wage-price spiral, and de-anchor inflation expectations. Tightening financial conditions could pressure private and public sector funding or lead to a sharper correction in real estate markets. An alternative risk to growth is from a global slowdown, for example, triggered by recession in the U.S. In either case, spillovers from affected trading partners would place an additional drag on growth in Belgium, even if a global slowdown might dampen inflationary pressures. Also, the energy crisis and the electoral calendar may impede progress on politically-sensitive fiscal consolidation and reforms. By contrast, lower energy prices could reduce fiscal pressures, and together with progress on structural reforms, boost confidence.

Gross Value Added and Gas/Electricity Intensity
(LHS: Percent of total GVA; RHS: Ktoe per EUR mn GVA)



Sources: Eurostat, NBB and IMF staff calculations.

Authorities' Views

12. **The authorities agreed broadly on the outlook and balance of risks.** In the near-term, they see a shorter, mild downturn, followed by a stronger recovery, driven by private consumption

[4] *The list of EU sanctions adopted following Russia's invasion of Ukraine is available here.* An analysis of the global spillovers of sanctions can be found in the April 2022 IMF World Economic Outlook. In line with the recently revised IMF's Institutional View on the liberalization and management of capital flows, some of the sanctions imposed on Russia can be considered as capital flow management measures (CFMs) imposed for national and international security reasons.

and investment, as wage indexation gains in purchasing power combine with expectations of a more rapid inflation deceleration and a boost by firms of spending on automation and greening of production processes. The authorities anticipate faster easing of price pressures, with the capability of firms to maintain profit margins and pass on cost increases as a key factor determining the inflation outlook. However, the authorities are also concerned that higher wage costs and persistently-higher energy prices could lead to a worsening of competitiveness for Belgian exporters, particularly vis-à-vis non-EU competitors that do not face as strong energy price pressures. Cost-conscious diversion of FDI away from Belgium is a concern, although they noted that Belgium remains an innovation hub. Finally, while the authorities see limited risk of financial market pressures, they agreed that these could originate elsewhere.

POLICY DISCUSSIONS

A. Strengthening Fiscal Sustainability

13. A tighter fiscal stance is needed in 2023 to support inflation reduction, diminish risks and vulnerabilities, and initiate rebuilding of buffers. The 2023-24 budgetary plan envisages a higher deficit in 2023, including due to energy support. Notwithstanding continuing high energy prices and slower growth, commencing adjustment this year and committing to a credible, multi-year adjustment path anchored by both cyclical and sustainability considerations would ease inflation pressures and have positive impacts on confidence, risk premia, and fiscal space. This calls for adjustment of 0.6 percent of GDP (or more) for 2023 and 0.8 percent of GDP per year (or more) for 2024-30. The overall deficit in 2023 should not increase, and ideally, should be reduced. [5] Energy support should remain within the budgeted allocation of 0.9 percent of GDP (or lower); measures set to expire at end-Q1:2023 should not be extended without offsetting measures.[6] If downside risks materialize with entrenched stagflation, automatic stabilizers should operate, but be offset elsewhere, so that the overall deficit does not increase; additional discretionary support, if any, should be well-targeted and offset. This would enhance policy credibility, sustainability, and consistency with monetary policy. Tighter financing conditions would call for a more sizable adjustment. If global growth slows with less inflationary pressure, stabilizers might operate without full offset, although some offset may be desirable or necessary given risks from the high deficit and debt. If upside risks materialize, revenue overperformance should be saved and energy support phased out faster to speed up the needed adjustment.

[5] Staff's baseline projections for 2023 assume that higher revenue collections more than offset higher expenditures compared to the budgetary plan; include VAT cuts on energy products for the whole year (0.3 percent of GDP beyond Q1:2023); and do not incorporate possible new excise taxes.

[6] The net cost of energy measures budgeted for 2023 covering Q1:2023 amounted to 0.9 percent of GDP (compared to 1 percent of GDP for 2022) as they include basic energy package for low-middle income households (0.3 percent of GDP) and new regional governments' measures largely for businesses (0.2 percent of GDP).

Fiscal Overview

Overview of Fiscal Positions 1/
(Percent of GDP)

	Budgetary Plan 2023		Baseline		
	2022	2023	2022	2023	2024
Revenue	48.4	49.9	49.4	50.8	51.3
Expenditure	53.6	55.7	54.2	56.3	56.6
o/w Interest	1.5	1.7	1.6	1.7	2.1
Net lending/borrowing	-5.2	-5.8	-4.8	-5.5	-5.4
Primary balance	-3.8	-4.2	-3.3	-3.8	-3.2
Structural balance	**-4.9**	**-4.9**	**-5.1**	**-5.3**	**-5.2**
(excl. Covid-19 measures)	...	...	-4.0	-4.7	-4.9
Structural primary balance	-3.4	-3.2	-3.6	-3.6	-3.1
Gross Debt	105.3	108.2	106.8	108.1	109.8

Sources: 2023 Budgetary Plan; and IMF staff projections.
1/ 2022: estimated outturn; 2023-24 updated projections based on Budgetary Plan 2023.

Additional Measures from the Budgetary Plan 2023

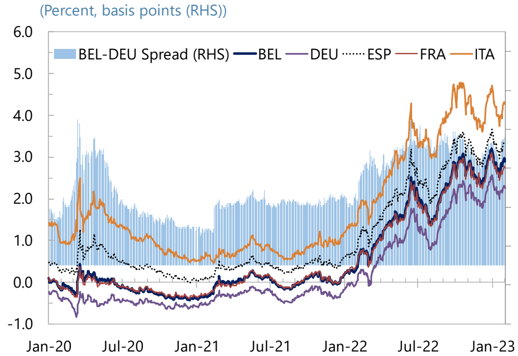
	2022	2023	2022	2023
	Bil €		Percent of GDP	
New Measures	11.7	7.7	2.1	1.3
Floods 2021	0.8	0.2	0.1	0.0
COVID-19	4.2	0.8	0.8	0.1
Refugees from Ukraine	1.3	0.6	0.2	0.1
Energy measures	5.5	5.2	1.0	0.9
Competitiveness 1/	0.0	0.9	0.0	0.2

Sources: 2023 Budgetary Plan; FPS BOSA; and Federal Planning Bureau
1/To mitigate the impact of rising wage costs, the employer's social security contributions will be reduced by 7.07 percent in 2023Q1-Q2. Companies can request an automatic deferral of payment of 7.07 percent of the contributions in 2023Q3-Q4, to be collected in four equal instalments in 2025

14. Fiscal adjustment should continue over the medium term. With deficits projected to remain high due to aging-related expenditures, higher defense outlays, and increasing debt service costs, the debt ratio will rise, along with vulnerabilities to adverse changes in market sentiment. These could emanate elsewhere, with Belgium as a bystander. High deficits and debt limit space to respond to new shocks and constrain increases in capital investment needed to support growth and green transition. Further annual adjustments of 0.8 percent of GDP (or more) from next year would ensure that the debt-stabilizing deficit level is reached in 2026 and structural balance attained in 2030 (Annex IV).[7,8] Fiscal consolidation, together with structural reforms, would also help strengthen Belgium's external position, helping bring it in line with fundamentals and desirable policies.

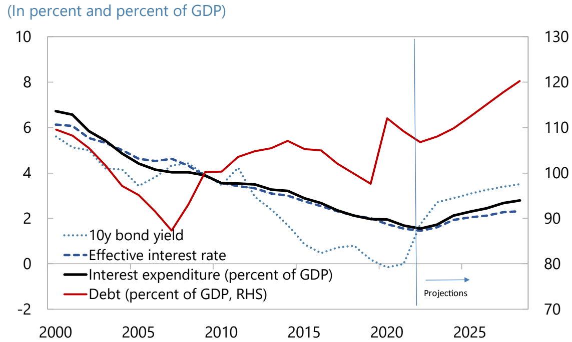
Borrowing Costs

Government Bond Yields (10-year) and Spread
(Percent, basis points (RHS))



Sources: Haver Analytics and IMF staff calculations.

Interest Burden and Debt
(In percent and percent of GDP)



Sources: NBB and IMF Staff calculations.

15. Fiscal adjustment should focus on spending, while preserving and increasing investment outlays to mitigate near-term growth impacts and support medium-term growth. General government spending is elevated at 56 percent of GDP in 2023, particularly social outlays

[7] The structural balance includes some Covid-19, energy, and Ukraine crisis measures not considered one-offs (e.g., health spending increases on wages and other qualitative improvements in health-sector working conditions).

[8] See Annex V for a discussion of debt sustainability.

(27 percent of GDP), the wage bill (13 percent of GDP), and subsidies (4 percent of GDP), with substantial scope for efficiency gains. Tax rates are high, affecting compliance and growth.

- *Rationalization*. Adjustment should draw on recent spending reviews[9], with focus on enhancing efficiencies, especially in energy-support measures, goods and services, and subsidies, along with reducing federal-regional duplication. Beyond 2023, further efforts will be needed in these areas, along with measures to contain wage-bill, social-benefit, and aging (pensions, health) costs. Social benefits should be better targeted (especially unemployment, disability), with a focus on improving incentives for job search. The authorities have identified targets for health-system savings in 2023 and 2024 and intend to reduce real health spending growth from 2.5 to 2.0 percent in 2024.
- *Investment*. Public investment has increased in recent years, but remains relatively low, constraining productivity and growth (e.g., mobility bottlenecks). The authorities rightly aim to increase investment outlays from 2.7 percent of GDP to 4 percent of GDP by 2030, initially via Next Generation EU (NGEU) grants. There is scope to improve the public investment management framework at the federal and regional levels, with support from an IMF diagnostic assessment (PIMA).[10]

16. Energy support should be better targeted and remain temporary and limited. Support is relatively large among EU countries, especially given wage and benefit indexation in Belgium, and there are risks of measures becoming protracted if high prices continue (Annex VI). The authorities should communicate that support will not exceed the budgeted amount of 0.9 percent of GDP in 2023, and will be scaled back from 2024 (or earlier, if possible). Social tariffs with enhanced targeting are expected to remain. Support has been somewhat targeted, including a claw-back mechanism for higher-income earners. However, design should be enhanced by better targeting to account for purchasing-power protection via indexation and for energy exposure, in addition to income. Support should be provided in cash transfers to incentivize energy savings, and social tariff benefits should not involve employment disincentives via full phase-out with changes of job status, but instead a tapering mechanism that allows for some increase of income above eligibility thresholds. The reduction of the VAT rate on gas and electricity for households from 21 to 6 percent is expected to become permanent, with a shift to specific excises that will incorporate progressivity elements and be adjusted for sharp changes in prices. Excise rates are expected to be set to promote a shift from fossil fuels to clean electricity. The excises should also be indexed and incorporate an upward path that promotes emissions reduction. Part of the costs of energy support is expected to be defrayed by windfall taxes on energy companies and oil sector solidarity contributions. While these have been

[9] The federal government implemented three pilot spending reviews in each 2021 and 2022: withholding-tax transfer exemptions, health care effectiveness, teleworking, income-tax collection cooperation, nuclear decommissioning, and federal scientific-institution management. Additional reviews are planned in 2023. The regional governments are also conducting spending reviews.

[10] The authorities have made important use of IMF technical assistance advice, including in tax reform formulation and revenue administration (compliance enforcement, VAT gap analysis).

designed to apply to a prudent measure of extraordinary revenues, potential adverse impacts on investments in renewables should be closely monitored.

17. Further efforts to advance tax and benefit reforms are key to sustained rebuilding of buffers and higher growth. Efforts are focusing on reducing the tax burden on labor and on tax expenditures, strengthening revenue administration, reducing disincentives to work, and shoring up pension sustainability. There is scope to enhance fiscal-federalism arrangements—improving planning, coordination, incentives, and outcomes.

- *Tax reform*. A blueprint to modernize and simplify the tax system, while enhancing fairness and neutrality, was presented in July 2022, with commentary from the IMF. Implementation had been intended to start with the next legislature, but reforms may be launched in 2023. Measures would reduce the tax burden on labor, eliminate or reduce tax expenditures, and address work disincentives (via tax rates, brackets, and alignment with social benefits). Reforms should also make capital taxation more consistent across income sources. A second tax reform stream focuses on carbon pricing and emissions reduction. These are key reforms that should move forward. It will be important that robust compensating measures are secured, so that the reform is (at least) budget neutral.
- *Revenue administration.* The authorities are strengthening compliance and revenue mobilization through an anti-fraud plan that improves tools and coordination of tax, social security, employment, and law enforcement agencies. Greater access to third-party information would be helpful. The IMF will continue to provide support to estimating and closing the VAT collection gap, and the authorities have expressed interest in the IMF's Tax Administration Diagnostic Assessment Tool (TADAT).[11]
- *Pensions*. Reforms were agreed in July (effective 2024), including: (i) reintroduction of a three-year pension bonus for working after the statutory retirement age of 65 (or early retirement at 62); (ii) re-setting minimum working conditions to 20 years of effective employment for access to minimum pensions; and (iii) a pension supplement to reduce the gender gap for periods of part-time work due to child or family care. These reforms addressed important gaps, but increased costs by 0.1 – 0.3 percent of GDP by 2070. Further efforts are needed now to ensure budget-neutral reforms—a key condition for NGEU funding—and over the medium term to reduce aging-related spending pressures.
- *Other benefits.* Recent expansions of social spending (minimum pensions, COVID-19 and energy support) have added to fiscal pressures. More generally, real benefit increases have exceeded productivity and wage growth. Unemployment benefits are generous, with high replacement rates relative to other EU countries, unlimited duration, and low phase-out. Favorable eligibility and duration of disability benefits also add to costs. The tight job market offers an opportunity to advance social benefit reforms and reduce inactivity traps, along with efforts to improve job-matching, training, coaching, mobility, and flexibility.

[11] The VAT gap was estimated in 2022 at 8 percent of GDP (22 percent of potential). Policy gaps comprise 6 ppts, half due to the large public sector, while compliance gaps comprise 2 ppts.

- *Fiscal federalism*. Federalism arrangements in Belgium involve substantial decentralization of fiscal competencies to regions and communities. Within this framework, there is scope to improve planning, policy alignment, savings incentives, and outcomes. This is particularly important given the need for fiscal consolidation—regional and community deficits comprise a third of the general government deficit. Implementing existing cooperation arrangements, agreed in 2013, would help strengthen policy alignment across different levels of government. Further options include implementing medium-term budgetary frameworks and expenditure rules at all levels, fully integrating comprehensive spending reviews and cost-benefit assessments and improving integration of fiscal sustainability objectives and burden sharing.[12]

Authorities' Views

18. The authorities agreed that fiscal adjustment is needed but cautioned that consolidation in 2023 should be balanced with energy support needs and slowing growth. If energy prices remain high, continued support will require a political decision, including on adjustment of measures and on budget mitigation. They also pointed to limited market pressures to date and uncertainty on new EU fiscal rules. They noted that adjustment will be considered during a budget review planned for March. They reiterated that energy measures are temporary and are considering ways to further improve targeting and incentives. They stressed that the new excises will be progressive and provide price signals for energy savings and the green transition. They appreciated staff's recommendations for the adjustment to be shared with regions and communities, but noted challenges given assigned federal, regional, and community competencies, lack of federal-regional hierarchy, and a political landscape that limits consensus on coordination.

B. Safeguarding Financial Stability

19. Cooling of the housing market, which has been characterized by elevated prices, calls for heightened vigilance and release of buffers, if needed. Although valuations are not as stretched as elsewhere in Europe, model-based estimates point to some overvaluation.[13] Bank mortgage exposures are relatively high, and debt-service-to-income ratios are somewhat elevated. Risks are mitigated by prevalence of mortgages with full-recourse provisions that amortize fully over the maturity of the loan and by a high share of fixed-rate and longer-term (>15 years) loans. A sectoral systemic risk buffer (SSyRB) against housing-related exposures introduced in May 2022[14] and tighter LTV limits imposed by prudential guidelines since 2020 provide additional comfort. Moreover, aggregate liquid assets of households exceed mortgage debt (Figure 3), potentially

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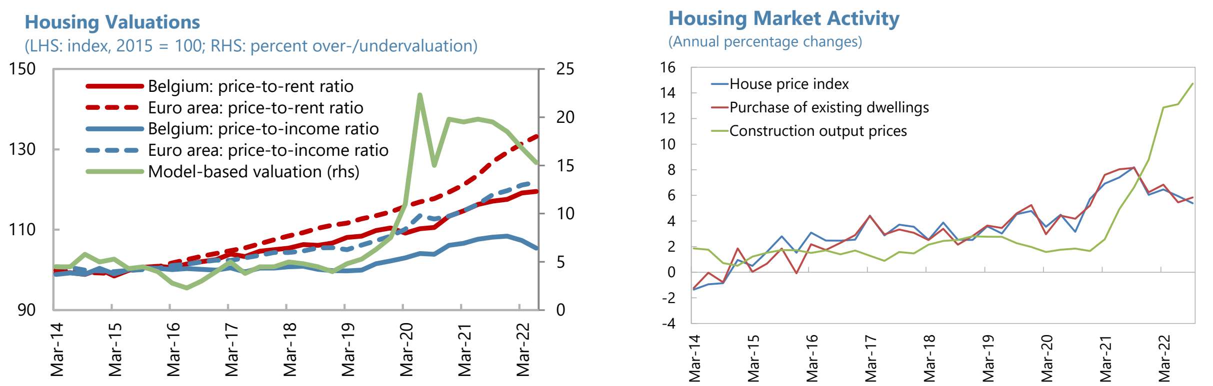
[12] See accompanying Selected Issues Paper: "Fiscal Federalism in Belgium: Challenges in Restoring Fiscal Sustainability."

[13] For details on the methodology to estimate RRE valuations, see ECB (2011): "Tools for Detecting a Possible Misalignment of Residential Property Prices from Fundamentals", Financial Stability Review, pp. 57-59, June, and ECB (2015): "A Model-Based Valuation Metric for Residential Property Markets", Financial Stability Review, pp. 45-47, November.

[14] With EU-wide harmonization of macroprudential instruments via introduction of CRDV, a 9 percent SSyRB affecting the largest lenders replaced mortgage risk-weight add-ons in place since 2013, keeping the level of additional capital preserved at approximately €2 billion.

cushioning the impact of deteriorating income prospects on debt servicing capacity. Still, the recent slowdown of house-price momentum, potentially heralding a sharper market turn, deserves careful monitoring and SSyRB deployment, if needed. Despite limited use, strict eligibility criteria, and adequate provisioning, reactivating mortgage moratoria for October 2022-March 2023 to cushion energy-crisis impacts was inappropriate, as it may delay timely bank-borrower engagement to address debt-servicing challenges. NBB efforts to gather housing stock energy efficiency information to allow for better assessment of collateral values and risks are welcome and should continue, particularly given emerging stratification of house prices based on sustainability considerations.[15]

Housing Market Valuation and Momentum



Sources: OECD and ECB.

Source: StatBel.

20. The war in Ukraine and energy crisis have rekindled sectoral credit and cyber risk concerns, calling for a near-term halt to macroprudential tightening and enhanced operational preparedness. Banks command considerable buffers, and corporate credit risk appears manageable.[16] NPLs have improved across most sectors since 2019, despite the pandemic. Still, cost pressures are affecting businesses that were most affected by the pandemic (hospitality, entertainment), and dampening the outlook for firms that account for a prominent share of lending (e.g., manufacturing, trade). Combined with a possible downturn in real estate, asset quality could deteriorate, requiring additional provisioning. In this context, maintaining the CCyB at its 0 percent neutral level until uncertainty on the outlook subsides is appropriate. Going forward, further weakening of the macro-financial environment may call for calibration of macroprudential policy towards supporting capacity of banks to absorb losses and safeguarding provision of credit. Challenges from digitalization have been put into sharper relief due to the war in Ukraine and increasing risk of cyberattacks. Gathering of information on cyber-preparedness is welcome, along with tailored stress-testing and policy intervention to mitigate risks. Heightened awareness of

[15] See Damen, S., Reusens, P. and F. Vastmans (2022): "The Impact of Changes in Dwelling Characteristics and Housing Preferences on House Price Indices", NBB Working Paper No. 406, May.

[16] For analysis of impacts of corporate energy/labor cost pressures, see Bijnens, G. and C. Duprez (2022): "Les Firmes et la Hausse des Prix Energétiques", NBB Studies, May.

weaknesses in AML/CFT measures of some financial institutions should be complemented by concrete actions to rectify deficiencies.

21. Higher and steeper yield curves should benefit financial intermediaries, but may also expose vulnerabilities, calling for intensified monitoring and determined policy action. Exiting the low-for-long interest-rate environment should improve interest margins and better balance assets of NBFIs, e.g., life insurers, against long-term liabilities. But a disorderly adjustment of yields, accompanied by market volatility or a downturn, could negate interest-rate normalization benefits. The big foreign bank presence adds to complexity, due to the interplay of home and host supervision. Efforts to better understand NBFI interlinkages and risks are welcome to detect vulnerabilities and contain spillovers at an early stage, as is the commitment by the authorities to advance the EU banking union. In addition, dedicated analysis and simulation of various interest-rate trajectories would help gauge potential financial-sector strains and inform the appropriateness of buffers and deployment of policy levers. Similar work should be conducted to assess possible implication of climate risks. The ongoing FSAP provides an opportunity for an in-depth review of financial sector vulnerabilities and resilience.[17]

Authorities' Views

22. The authorities shared staff's assessment of financial stability risks, demonstrating alertness to emerging challenges and readiness to take appropriate policy actions. They consider the near-term halt to macroprudential tightening to be a suitable stance in the current environment, while indicating willingness to contemplate further strengthening of buffers once greater clarity on the macro-financial outlook is attained. Overall, they were comfortable with the resilience of the financial sector and the housing market, yet agreed with staff's views on potential vulnerabilities, signaling readiness to release available buffers should risks materialize. They are working to improve their appraisal of NBFI-related risks and to strengthen AML/CFT measures of financial institutions. They also expressed strong commitment to fully leveraging opportunities presented by the IMF FSAP launched in November 2022 to enhance financial sector resilience.

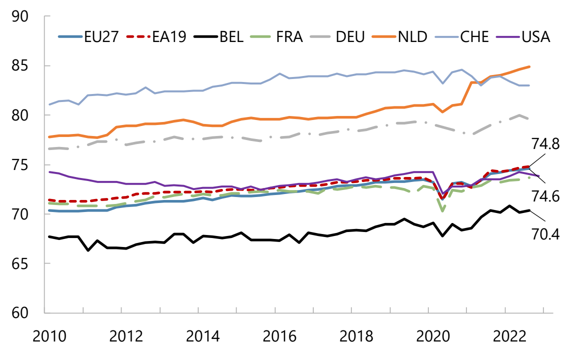
C. Building a Stronger and More Sustainable Economy

23. Recent labor market reforms have covered important gaps, but further measures are needed to facilitate reallocation and ambitious employment goals. A new federal labor package became effective in 2022 focusing on: (i) *flexibility* (e.g., easier e-commerce night-work, enhanced status for platform workers and remote working, recognition of compressed or varying schedules); (ii) *training* (increased individual training rights, employer obligations for annual training plans); and (iii) *mobility* (facilitating job switching and redeployment during notice periods). Also, for 2023, the federal government increased the allocation for minimum wages relative to unemployment benefits in the distribution of the "welfare envelope" to promote activation. The measures modernize aspects of employment law, but further efforts are needed to increase the employment rate from 72 percent

[17] See Annex VII for an update of implementation of recommendations from the 2017 FSAP.

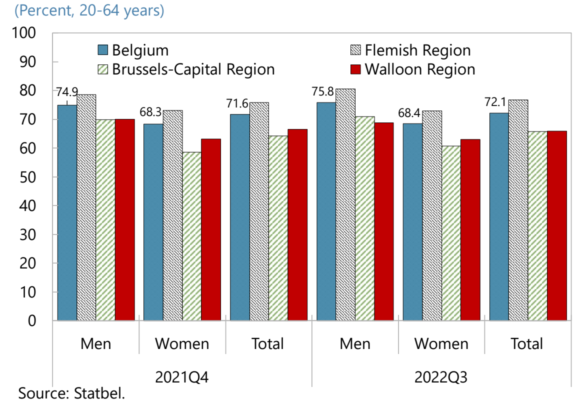
to the goal of 80 percent by 2030.[18] The tight labor market adds urgency. Efforts should target younger workers and job entrants, older workers, women, workers with an immigration background, and those receiving disability benefits and include more fundamental reforms of wage-setting, hiring and dismissal, employment protection, social benefits, and employer flexibility. Reducing and capping duration of unemployment benefits would provide greater incentives for job search, along with easing the reduction of social benefits when recipients take jobs. Enhancing and speeding accreditation of foreign education and professional qualifications is another area.

Labor Force Participation Rate
(Percent, 15-64 years, seasonally adjusted)



Source: Haver Analytics.

Employment Rate by Region and by Gender
(Percent, 20-64 years)

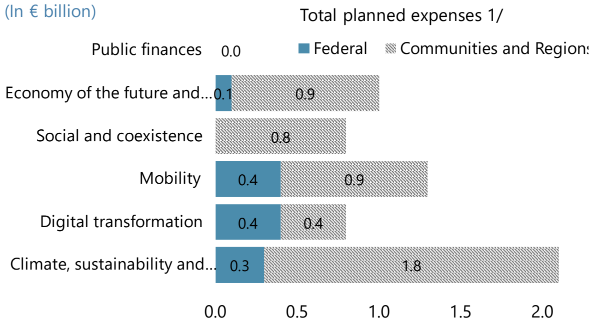


Source: Statbel.

24. Continued product-market reforms are also needed to improve productivity and competition and boost growth. Important business environment reforms are underway, including enhancing restructuring and insolvency frameworks, digitalizing the judiciary, and rolling out 5G networks. The federal and regional governments are strengthening cyber-risk monitoring and preparedness throughout the economy. Belgium's NGEU recovery and resilience plan (RRP) aims at contributing to growth and green-digital transition by focusing resources on mobility, innovation, and support to promising sectors. Belgium must meet 22 milestones before receiving the next NGEU RRP tranche (€847 million); most milestones have been met except budget-neutral pension reforms. Additional efforts should focus on easing entry barriers (particularly retail distribution/services), reducing red tape (particularly for startups), risk capital availability, and improved efficiency of R&D tax incentives.

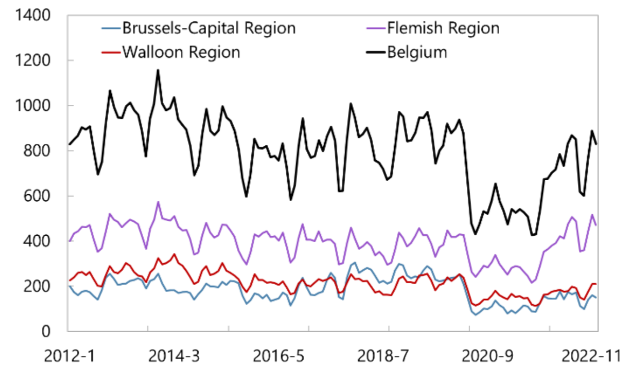
[18] Larger increases are needed in Brussels and Wallonia than in Flanders.

The Belgian Plan for Recovery and Resilience
(In € billion)



Sources: Belgian National Plan for Recovery and Resilience; and NBB.
1/ Based on initial distribution of €5.9 billion, with projections in climate/green transition (50 percent), digital transformation (27 percent), and economic/social resilience (23 percent). Revised down to €4.5 billion, the government plans to close the €1.4 billion gap from the budget.

Number of Bankruptcies are Returning to Pre-pandemic Levels
(3-month moving average)



Sources: Belgian Statistical Office; and IMF staff calculations.

25. Automatic wage indexation provides relatively timely protection of household purchasing power, but modifications should be considered. As indexation places much of the cost of adjustment to higher prices on employers, it should—in principle—involve less need for government intervention in the event of a price shock. However, indexation may weaken corporate profitability and balance sheets, investment, international competitiveness, and growth. While Belgium's Wage Law balances indexation with a corrective mechanism to preserve external competitiveness, this may necessitate prolonged periods of limited or no real wage increases following shocks. This may cement labor market rigidities by lessening room for real wage differentiation across sectors or firms according to productivity developments. In addition, government involvement in collective bargaining to facilitate agreement among social partners has been common, often accompanied by costly fiscal incentives. To preserve the benefits of indexation while enhancing long-term viability, the authorities and stakeholders should modify the framework once the present shock has passed. In particular, the health index could be adjusted to exclude additional items—beyond alcohol, tobacco, and motor fuels at present—that are subject to high price volatility from terms of trade shocks and global commodity price swings, with vulnerable groups compensated for purchasing-power losses by well-targeted fiscal support. Moreover, consideration should be given to incorporating productivity trends and a wider set of peer countries when assessing developments in competitiveness under the Wage Law.[19]

26. Reaching ambitious climate goals will require a wider set of initiatives and greater focus on coordination and execution, while taking energy-security challenges into account. Climate policies need to be aligned with more ambitious targets under the EU's recent Fit-for-55 initiative (47 percent domestic emissions reduction by 2030 for sectors not covered by the EU

[19] Other reform options include further exclusion of items from the health index, partial or smoothed indexation, indexation (partly or fully) linked to an inflation target, or differentiated indexation, or a lump-sum increase rather than a percentage rise.

emission trading system).[20] EU-identified gaps in the authorities' current plans—from 2019—include: high transport and building-related emissions; federal-regional differences on targets and policies; the need for more ambitious actions on renewables and energy efficiency; greater attention to subsidies; and limited quantified information on investment needs. Some of these issues have been addressed, including via planned NGEU-RRF investments for building renovation (0.2 percent of GDP), low-carbon energy projects (0.1 percent), and green mobility (0.2 percent). But more needs to be done in policy updates and implementation. Recent EU measures will help (e.g., new ETS sectors, carbon-border adjustment mechanism). Carbon pricing should be increased as international energy prices fall, especially for sectors outside the EU ETS (transportation, buildings, excluded industrial emissions), with revenue recycling to protect vulnerable households and viable trade-exposed firms.[21] Higher carbon pricing should be complemented by sectoral feebates and price floors/ceilings to provide abatement cost certainty needed for investments in low-carbon technology. Other measures include reducing subsidies (fuel cards, commercial diesel, heating oil), rationalizing electricity network fees and levies (to reduce disincentives to use electricity over fossil fuels) and providing targeted social protection with cash rather than energy-based support.
Real-time electricity metering and distance and congestion road charging should also be introduced. Complementary non-price reforms should include strengthening federal-regional coordination and burden-sharing and further bolstering climate-related public investment.

27. Belgium is a key energy hub in Western Europe, and the authorities took important steps in 2022 to enhance energy security.[22] This includes a decision in March to extend operations of two nuclear power stations for ten years and efforts to secure alternative gas supplies via pipelines and LNG deliveries, helping fill storage facilities in the region and increasing electricity generation while nuclear plants in neighboring countries were undergoing maintenance. Significant new investments are being made in offshore windfarms, hydrogen, and other renewable initiatives, including with support from the NGEU RRP. These efforts should continue.

Authorities' Views

28. The authorities agreed on the need to further implement decided labor and product market reforms to achieve their ambitious employment targets, improve productivity and competitiveness, and boost growth. They conceded that tight labor markets, especially in Flanders, could become a growth bottleneck and underscored that enhanced mobilization is a key objective. They acknowledged that the structure of social benefits may provide disincentives for job search, but stressed the importance of smoothing the phase-out of support, training, and coaching to promote employment, particularly among disability-benefit recipients and disadvantaged groups. They also noted the complex federal-regional division of competencies in the labor market area and for social benefits—training and activation policies are regional competencies; unemployment benefits are

[20] The current plan (2021-30) is based on 40 percent reduction by 2030.

[21] See accompanying Selected Issues Paper: "Fiscal Policy Options to Accelerate Emissions Reductions in Belgium."

[22] Belgium is an energy hub in that it is the location of a major LNG import terminal, a network of gas pipelines, including to the Netherlands, Norway, and the UK as well as France, Germany, and Luxembourg, and important gas storage facilities. Investments are underway to ensure compatibility with hydrogen and to build substantial additional offshore wind capacity.

federal. The authorities took note of targeted views on improving the indexation framework, also noting that building consensus on far-reaching changes would be difficult, especially amid historically-high inflation. They noted that possible prolonged real wage restraint and adverse effects due to Wage Law provisions may be mitigated by future wage hikes in France, Germany, and the Netherlands. The authorities were receptive on the need to advance climate reforms, although they pointed to challenges on carbon pricing and on federal-regional competencies/coordination.

STAFF APPRAISAL

29. Belgium's recovery from the pandemic has slowed with high inflation and tighter financial conditions, while the outlook is marked by significant uncertainty and downside risks. A strong, timely response to higher energy prices, along with indexation eased impacts, and the labor market and financial sector have shown resilience. However, along with slowing activity and high inflation, Belgium faces competitiveness challenges, elevated fiscal deficits and debt, and continuing risks and uncertainty, especially escalation of the war and further spillovers. By contrast, lower energy prices could ease fiscal pressures, and together with progress on reforms, boost confidence.

30. Fiscal policy should aim for a tighter stance to complement monetary policy in curbing inflation and to rebuild buffers through a credible medium-term adjustment path. The authorities should pursue multi-year, expenditure-led consolidation from 2023 to support efforts to reduce inflation, ease pressures and vulnerabilities, and begin rebuilding buffers. Adjustment should aim to avoid a larger overall deficit this year, and going forward, to reach the debt-stabilizing deficit level and overall balance. It should focus on rationalization of current spending, which is elevated and where there is room for efficiency gains. Expenditure rationalization should draw on federal and regional spending reviews and focus on energy-support measures, goods and services, and subsidies. Energy support should be better targeted while maintaining price signals; it should remain temporary and limited. Sustained efforts are needed to contain wage-bill, social-benefit, and aging costs (pensions, health) and to improve benefit targeting and incentives. Efficient and productive investment spending at the federal and regional levels should be preserved and increased to mitigate growth impacts and raise medium-term growth. Efforts to initiate tax reforms are welcome. In all these areas, alignment of federal and regional policies and improving coordination, incentives, and burden-sharing will be important. A credible, expenditure-led fiscal consolidation, together with structural reforms to strengthen competitiveness, would improve Belgium's external position, which on a preliminary assessment is substantially weaker than implied by medium-term fundamentals and desirable policies.

31. In a fluid environment, financial sector policies should continue to balance ensuring the adequate provision of credit, preserving resilience, and facilitating deployment of buffers to absorb losses when needed. While comfortable capital cushions are keeping systemic risks at bay, financial intermediaries are challenged by a weakening economy, a cooling housing market, and reemergence of sectoral credit concerns. Exit from long, low-yield environment heightens risks of a disorderly adjustment. In this context, placing a near-term hold on additional macroprudential policy tightening has been appropriate. The authorities should remain alert to emerging weaknesses, particularly in real estate given large exposures and among NBFIs, in view of more limited visibility on interlinkages and balance sheet vulnerabilities. Worsening of the macro-financial outlook may call for a further calibration of macroprudential policy towards release of available buffers. Ongoing efforts to gather information to enable more tailored stress testing and policy intervention regarding interest rate, cyber or climate risks are welcome and should continue.

32. Further advancing of structural reforms is critical, especially labor and product market actions to enhance flexibility, productivity, and competitiveness. Following important measures taken in 2022, further labor market reforms are needed to facilitate reallocation and meet ambitious employment goals. Efforts should target younger and older workers, women, workers with an immigration background, and those receiving disability benefits. This should include reforms of wage-setting, hiring and dismissal, employment protection, social benefits, and employer flexibility. Coaching and training will also help. Once inflationary pressures subside, options to revise the wage indexation framework should be explored with a review of the indexation basis a possible avenue of reform. Important business environment efforts are underway, including involving the restructuring and insolvency frameworks and investments in mobility and green transition. These should continue, along with actions to strengthen cyber risk monitoring and preparedness.

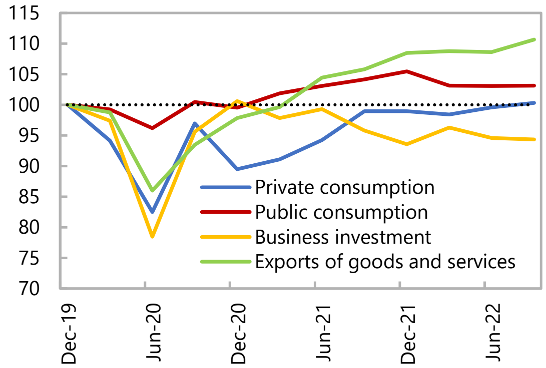
33. Reaching ambitious climate goals will require a wider set of initiatives and greater focus on execution and coordination. National climate policies need to be aligned with more ambitious EU targets, addressing gaps and shortcomings. Higher carbon pricing is needed, especially as international energy prices fall, along with reducing subsidies, introducing feebates, rationalizing electricity fees and levies, and providing social protection in cash rather than energy-based support. Real-time electricity metering and distance and congestion charging should be introduced. Stronger federal-regional coordination and burden-sharing are needed, along with stepped-up climate-related public investment. Belgium is an important energy hub in Western Europe, and important steps have been taken to enhance energy security. Significant new investments are being made in offshore windfarms, hydrogen, and other renewable initiatives. These important efforts should continue.

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

Figure 1. Belgium: Macroeconomic Developments

As the economy has recovered from the pandemic…

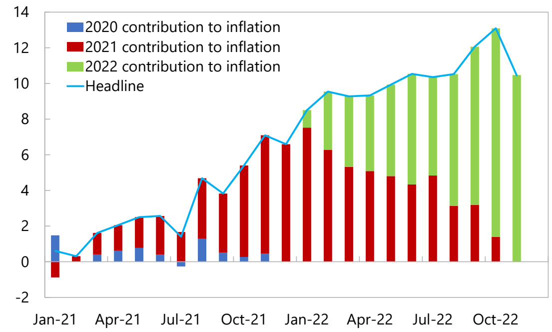
Level of Real GDP Components
(Index, 2019Q4 = 100)



Sources: Eurostat, NBB and IMF staff calculations.

…a succession of energy- and supply chain-related shocks has driven inflation to multi-decade highs.

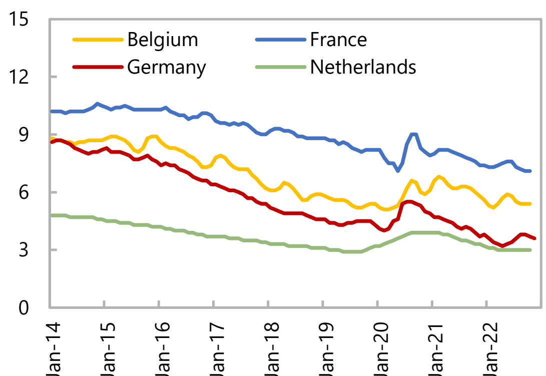
Contributions to Annual Headline Inflation
(Annual percentage change; percentage points)



Sources: StatBel and IMF staff calculations.

Despite labor markets tightening to historically-strong levels…

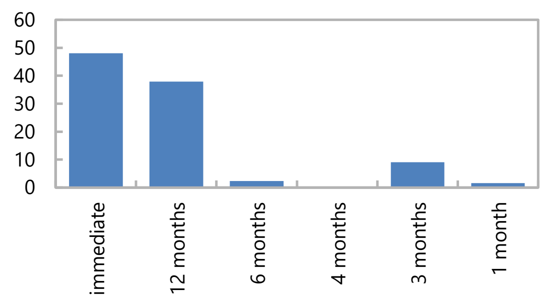
Unemployment Rate
(Percent)



Source: Eurostat.

…and near-universal indexation of private sector wages…

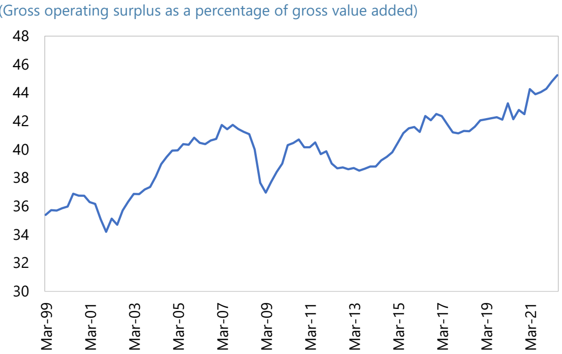
Mechanisms for private sector wage indexation, 2021
(Percentages)



Source: NBB.
Note: The chart shows the share of employees benefitting from wages indexation immediately after a 2 percent health index increase or at n month intervals.

… corporate profit margins have held up well so far.

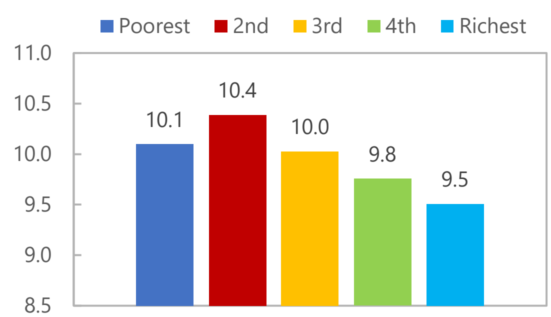
Corporate Profit Margins
(Gross operating surplus as a percentage of gross value added)



Sources: Eurostat and IMF staff calculations.

Low-income households have faced strong price pressures.

Inflation by Household Income Quintile
(Annual percentage change, November 2022)



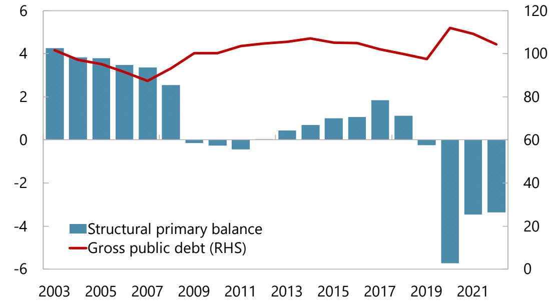
Sources: Eurostat, StatBel and IMF staff calculations.

Figure 2. Belgium: Fiscal Developments

Post-GFC rebuilding of buffers faded from 2018…

Structural Primary Balance and Gross Public Debt

(Percent of GDP) 1/

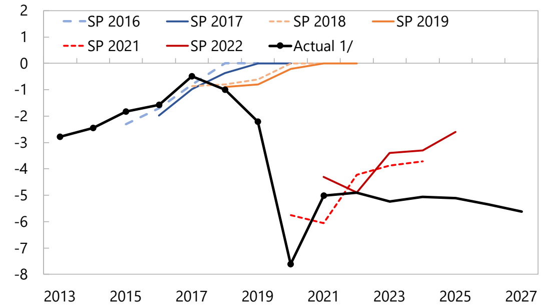


Sources: NBB and IMF staff calculations.
1/ 2022: proj.

…and were derailed by the pandemic and energy shocks.

Structural Deficit Projections in Stability Programs

(Percent of Potential GDP)

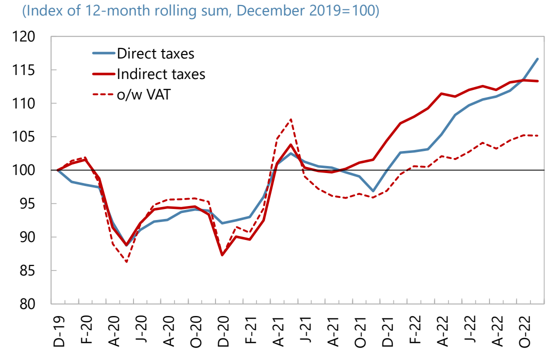


Sources: Belgian authorities; and IMF staff projections.
1/ Based on staff calculations. Data for 2022 and beyond are projections.

Tax collections recovered with output and high prices…

Treasury Tax Collection

(Index of 12-month rolling sum, December 2019=100)

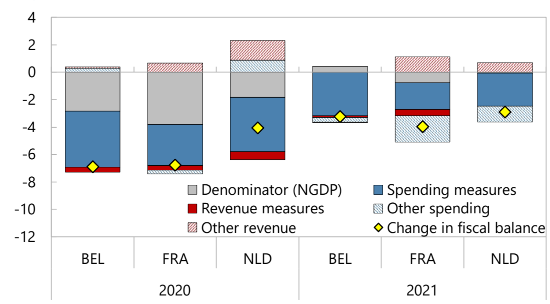


Sources: NBB and IMF Staff calculations.

…but spending continued to drive high deficits…

Deviation of Fiscal Balance from Pre-Pandemic Forecast 1/

(In percent of GDP, 2020-21)

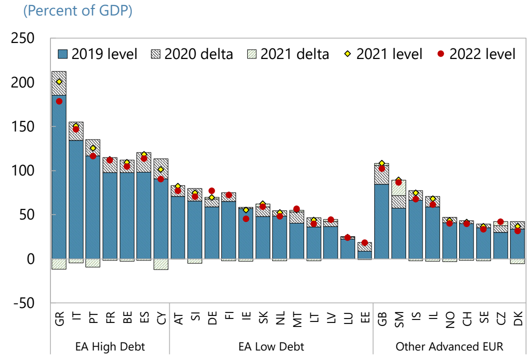


Sources: WEO and IMF staff calculations.
1/ Pre-pandemic forecast is January 2020 WEO Update.

…Belgium is among the most indebted EA countries.

Public Debt 2022

(Percent of GDP)

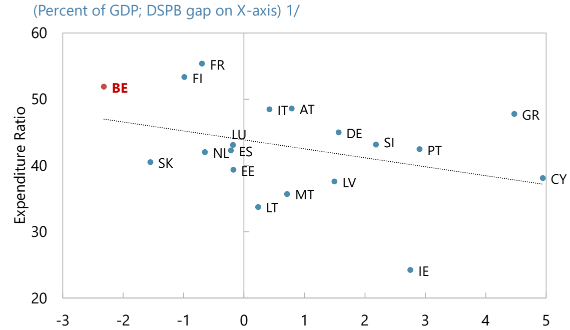


Sources: WEO and IMF staff calculations.

With spending among the highest in Europe, expenditure-led consolidation is needed.

Adjustment Needs and 2019 Expenditure Ratio

(Percent of GDP; DSPB gap on X-axis) 1/

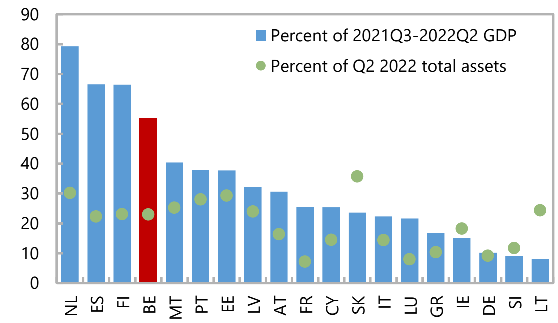


1/ Deviation of primary balance from its debt-stabilizing level in 2026.
Sources: IMF WEO and Staff calculations.

Figure 3. Belgium: Financial Sector Developments

Although bank exposures to residential mortgages are comparatively high…

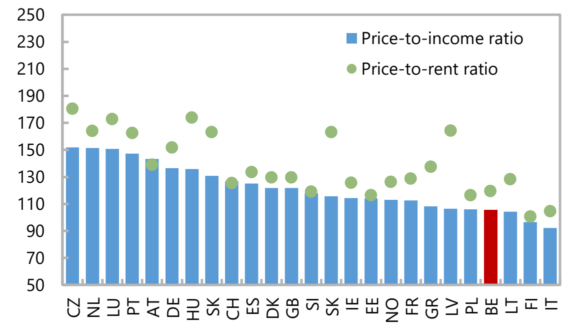
Residential Mortgage Loan Exposures of Banks, Q2 2022
(Percent)



Sources: EBA and IMF staff calculations.

…stretched housing valuations and affordability concerns appear less pronounced than in other European countries.

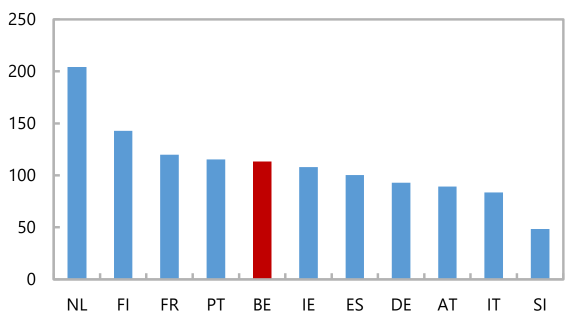
Housing Valuations, Q2 2022
(Index, 2015 = 100)



Source: OECD.

The aggregate household debt burden seems elevated…

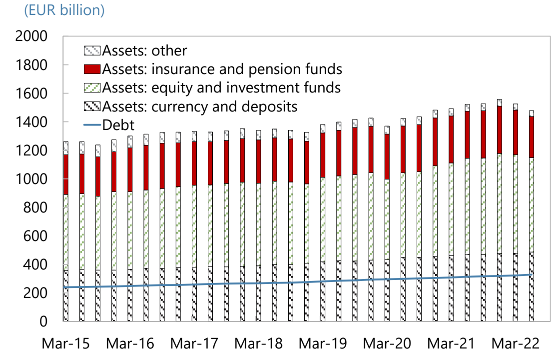
Household Debt to Gross Disposable Income, 2021
(Percent)



Sources: ECB; Eurostat; and IMF staff calculations.

…but substantial liquid financial assets provide comfort.

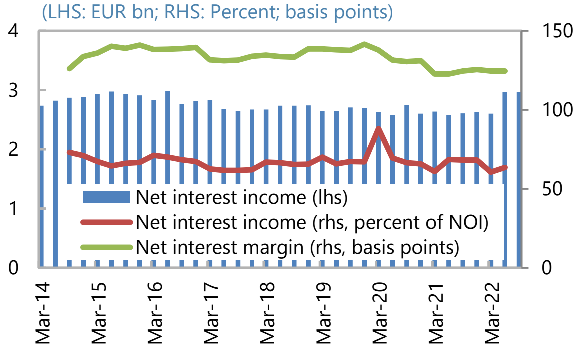
Household Debt and Financial Assets
(EUR billion)



Sources: BNB and ECB.

While the end of the low-for-long interest rate environment may halt the decline in interest margins…

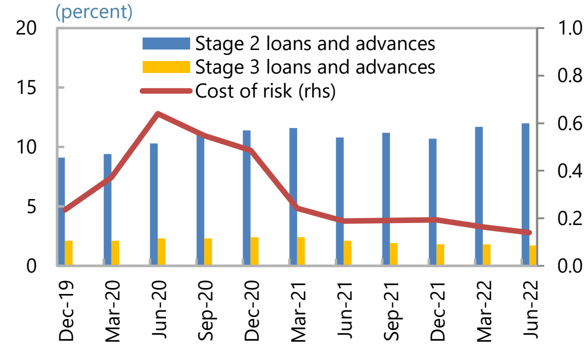
Bank Net Operating and Net Interest Income
(LHS: EUR bn; RHS: Percent; basis points)



Sources: NBB and EBA.

…a deteriorating economic outlook coupled with tighter financial conditions raises risks for bank loan portfolios.

Bank Loan Classification and Cost of Risk
(percent)

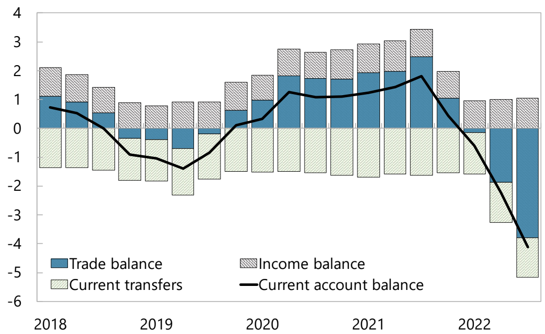


Sources: EBA.

Figure 4. Belgium: External Sector Developments

The energy price shock reversed recent CA balance gains...

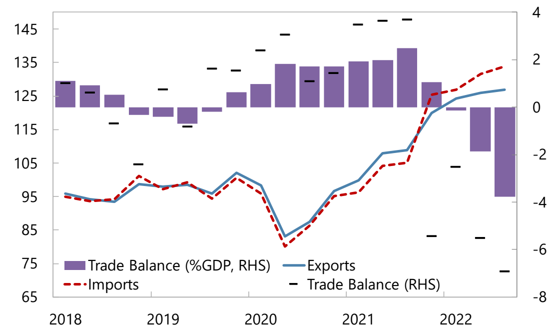
Current Account
(Moving 4Q sum, in percent of GDP)



Sources: Haver Analytics and IMF staff calculations.

...as imports led the trade deficit to widen sharply in 2022.

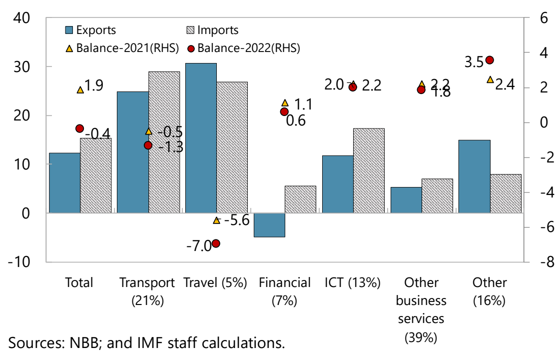
Trade Balance
(In billions of euros, rolling 4Q sum in percent of GDP)



Sources: NBB and IMF staff calculations.

The services balance deteriorated, as transport/travel returned to pre-pandemic trends...

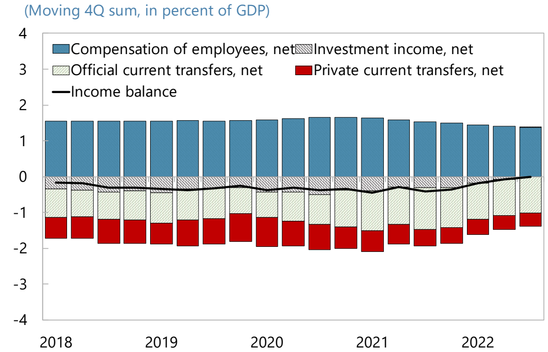
Services Exports and Imports in 2022Q1-Q3
(Percent change year-on-year and balance in billions of euros) 1/



Sources: NBB; and IMF staff calculations.
1/ Share in total services exports in 2021 in brackets.

...while net income improved slightly as net investment income outflows declined.

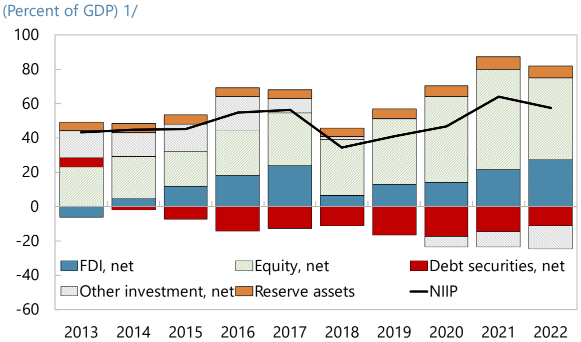
Primary and Secondary Income Balance
(Moving 4Q sum, in percent of GDP)



Sources: NBB and IMF staff calculations.

Belgium's comfortable net asset position continues.

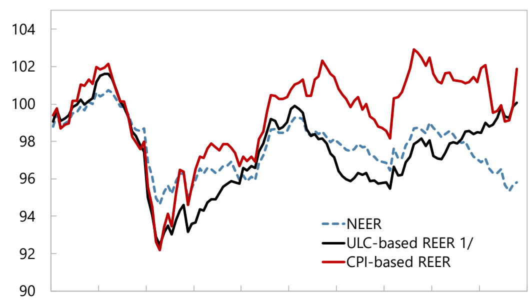
Net International Investment Position
(Percent of GDP) 1/



Sources: NBB and IMF staff calculations.
1/ 2022: as of September.

While the nominal ER depreciated, real ERs appreciated reflecting inflation and labor market effects.

Exchange Rates
(Index, 2010=100)



Source: IMF staff calculations.
1/ ULC-based REER calculated based on ULCs in manufacturing sector.

Table 1. Belgium: Selected Economic Indicators, 2019-28 1/

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
				Projections						
	(Percent change, unless otherwise indicated)									
Real economy										
Real GDP	2.2	-5.4	6.1	3.0	0.2	1.3	1.2	1.2	1.2	1.3
Domestic demand	1.9	-5.8	5.6	2.8	0.9	1.5	1.6	1.7	1.5	1.6
Private consumption	1.7	-8.3	5.5	4.0	1.3	1.6	1.8	1.6	1.6	1.6
Public consumption	2.2	0.0	4.8	1.0	0.0	1.0	1.0	1.7	1.5	1.2
Gross fixed investment	5.0	-5.1	4.9	-1.3	0.8	2.1	1.9	2.0	1.5	2.1
Stockbuilding 2/	-0.7	-0.3	0.4	0.8	0.1	0.0	0.0	0.0	0.0	0.0
Foreign balance 2/	0.4	0.5	0.6	0.3	-0.6	-0.2	-0.4	-0.4	-0.4	-0.3
Exports, goods and services	2.4	-5.0	11.3	4.7	1.1	3.0	3.6	3.5	3.4	3.3
Imports, goods and services	2.0	-5.6	10.7	4.4	1.9	3.3	4.1	4.0	3.7	3.6
Household saving ratio	12.4	20.6	17.1	14.7	14.2	13.7	13.7	13.8	13.7	13.7
Potential output growth	1.1	-2.7	3.9	1.8	1.2	1.2	1.2	1.2	1.2	1.3
Potential output growth per working age person	0.9	-2.9	3.6	1.2	0.8	1.4	1.2	1.1	1.1	1.3
Output gap (in percent)	0.1	-2.6	-0.5	0.7	-0.2	-0.1	-0.1	0.0	0.0	0.0
Employment										
Unemployment rate (in percent)	5.5	5.7	6.3	5.5	6.0	5.9	5.6	5.6	5.5	5.5
Employment growth	1.6	0.0	1.8	1.8	0.2	0.3	0.6	0.6	0.6	0.6
Prices										
Consumer prices	1.2	0.4	3.2	10.3	5.5	2.2	1.8	1.9	2.0	2.0
GDP deflator	1.8	1.5	2.9	5.7	5.0	2.7	1.8	1.8	1.9	1.8
	(Percent of GDP; unless otherwise indicated)									
Public finance										
Revenue	49.9	49.9	49.9	49.4	50.8	51.3	51.4	51.3	51.3	51.5
Expenditure	51.9	58.9	55.5	54.2	56.3	56.6	56.7	56.7	56.9	57.0
General government balance	-1.9	-9.0	-5.6	-4.8	-5.5	-5.4	-5.3	-5.4	-5.5	-5.5
Structural balance	-2.2	-7.6	-5.1	-5.1	-5.3	-5.2	-5.2	-5.4	-5.5	-5.5
Structural balance (excl. Covid measures)	-2.2	-3.2	-2.2	-4.0	-4.7	-4.9	-5.2	-5.4	-5.5	-5.5
Structural primary balance	-0.2	-5.9	-3.5	-3.6	-3.6	-3.1	-2.9	-3.0	-2.9	-2.7
Primary balance	0.0	-7.0	-3.9	-3.3	-3.8	-3.2	-3.0	-3.0	-2.8	-2.7
General government debt	97.6	112.0	109.2	106.8	108.1	109.8	112.4	115.1	117.8	120.3
External Sector										
Goods and services balance	0.6	1.7	1.1	-3.8	-3.3	-1.5	-1.3	-1.0	-0.9	-0.7
Current account	0.1	1.1	0.4	-4.0	-3.5	-1.6	-1.2	-0.7	-0.4	0.0
Net International Investment Position	40.9	46.7	63.9	54.9	...	...	...	...	...	...
Exchange rates										
Euro per U.S. dollar, period average	0.9	0.9	0.8	0.9	...	...	...	...	...	...
NEER, ULC-styled (2005=100)	97.5	97.9	98.0	96.3	...	...	...	...	...	...
REER, ULC-based (2005=100)	96.0	96.0	97.3	98.7	...	...	...	...	...	...
Memorandum items										
Gross national savings (in percent of GDP)	25.1	25.4	26.4	22.2	22.6	24.2	24.6	25.0	25.3	25.7
Gross national investment (in percent of GDP)	25.0	24.3	26.0	26.2	26.2	25.8	25.8	25.8	25.7	25.7
Nominal GDP (in billions of euros)	478.6	459.8	502.3	547.0	575.9	599.1	616.8	635.9	655.4	675.9
Population (in millions)	11.5	11.5	11.6	11.7	11.7	11.7	11.8	11.8	11.8	11.9

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

1/ Belgium has adhered to the IMF's Special Data Dissemination Standard (SDDS) Plus as of January 26, 2023 (see Press Release).

2/ Contribution to GDP growth.

Table 2. Belgium: Balance of Payments, 2019-28

				Projections						
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
	(In percent of GDP)									
Balance on current account	0.1	1.1	0.4	-4.0	-3.5	-1.6	-1.2	-0.7	-0.4	0.0
Trade balance on goods and services	0.6	1.7	1.1	-3.8	-3.3	-1.5	-1.3	-1.0	-0.9	-0.7
Trade balance on goods (f.o.b.)	0.8	1.3	0.8	-2.7	-2.4	-1.0	-0.9	-0.7	-0.6	-0.5
Exports of goods and services	82.4	79.4	86.9	95.0	90.8	91.9	95.7	99.8	104.7	110.5
Exports of goods	59.3	56.4	63.7	69.7	66.6	67.4	70.2	73.2	76.8	81.0
Exports of services	23.1	23.0	23.2	25.3	24.2	24.5	25.5	26.6	27.9	29.5
Imports of goods and services	-81.8	-77.7	-85.8	-98.8	-94.2	-93.3	-96.9	-100.9	-105.6	-111.2
Imports of goods (f.o.b.)	-58.5	-55.1	-62.9	-72.4	-69.0	-68.4	-71.0	-73.9	-77.4	-81.5
Imports of services	-23.2	-22.6	-22.9	-26.4	-25.2	-24.9	-25.9	-26.9	-28.2	-29.7
Income, net	1.0	1.0	0.9	1.2	1.2	1.3	1.5	1.7	1.9	2.1
Current transfers, net	-1.5	-1.6	-1.5	-1.4	-1.4	-1.4	-1.4	-1.4	-1.4	-1.4
Balance on capital account	0.1	-0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Balance on financial account	-0.6	0.6	0.9	-3.8	-3.4	-1.4	-1.0	-0.6	-0.2	0.2
Direct investment, net	-0.9	1.1	3.6	3.6	3.4	3.4	3.4	3.4	3.4	3.4
Portfolio investment, net	-1.3	4.2	1.8	-2.0	-1.4	0.4	0.7	0.9	1.1	1.2
Financial derivatives, net	0.2	0.0	-0.2	0.0	0.1	0.1	0.0	0.0	0.0	0.1
Other investment, net	1.4	-4.9	-5.9	-5.7	-5.5	-5.3	-5.1	-4.8	-4.6	-4.4
Reserve assets	0.0	0.2	1.6	0.3	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions, net	-0.8	-0.5	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items										
Net International Investment Position	40.9	46.7	63.9	54.9						
Direct investment	13.1	14.0	21.4	23.2						
Portfolio investment	21.4	32.9	43.8	38.3						
Financial derivatives	0.8	0.0	-0.1	-0.1						
Other investment	0.2	-6.1	-8.5	-13.5						
Reserve assets	5.4	5.9	7.4	7.1						

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

Table 3. Belgium: General Government Statement of Operations, 2019-28

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
				Projections						
			(In percent of GDP)							
Revenue	49.9	49.9	49.9	49.4	50.8	51.3	51.4	51.3	51.3	51.5
Taxes	29.7	29.4	30.0	29.5	30.4	30.5	30.6	30.5	30.5	30.4
Personal income tax	11.6	12.1	11.6	11.9	12.3	12.5	12.5	12.5	12.5	12.5
Corporate income tax	3.8	3.3	3.9	3.7	3.7	3.7	3.7	3.7	3.7	3.7
Taxes on property	1.9	2.0	2.0	1.9	1.9	1.9	1.9	1.9	1.9	1.9
VAT	6.7	6.5	6.9	6.6	6.7	6.7	6.7	6.7	6.7	6.7
Excise	2.6	2.5	2.5	2.3	2.4	2.6	2.8	2.8	2.9	2.9
Other taxes	3.1	3.0	3.1	3.2	3.3	3.1	3.0	2.9	2.8	2.6
Social contributions	15.4	15.9	15.2	15.2	15.7	16.0	16.0	16.1	16.3	16.5
Actual social contributions	13.2	13.5	13.0	13.0	13.4	13.6	13.6	13.6	13.8	14.0
Imputed social contributions	2.2	2.3	2.2	2.2	2.3	2.4	2.4	2.4	2.5	2.5
Other revenue (incl. grants)	4.9	4.7	4.7	4.7	4.7	4.8	4.8	4.7	4.6	4.6
Expenditure	51.9	58.9	55.5	54.2	56.3	56.6	56.7	56.7	56.9	57.0
Current expenditure	48.5	55.3	51.6	50.6	52.5	52.8	53.0	53.0	53.2	53.3
Compensation of employees	12.3	13.1	12.5	12.5	13.0	13.0	13.0	13.0	13.0	13.0
Use of goods and services	4.1	4.3	4.3	4.2	4.1	4.1	4.0	4.0	4.0	3.9
Interest	2.0	1.9	1.7	1.6	1.7	2.1	2.3	2.4	2.7	2.8
Subsidies	3.7	5.0	4.3	4.0	4.2	4.1	4.1	4.1	4.1	4.1
Grants	1.1	1.3	1.4	1.3	1.3	1.2	1.2	1.2	1.2	1.2
Social benefits	24.5	27.9	26.3	25.8	26.8	27.2	27.3	27.4	27.5	27.5
Pensions	10.4	11.3	10.7	10.7	11.4	11.6	11.6	11.7	11.7	11.7
Unemployment	1.0	2.8	1.8	1.0	1.0	1.0	1.0	0.9	0.9	0.9
Health care	6.7	6.9	7.0	6.8	7.1	7.3	7.4	7.5	7.5	7.5
Early retirement, sickness and disability	2.3	2.5	2.4	2.8	2.9	2.9	2.9	2.8	2.8	2.8
Family allowances	1.4	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.6	1.6
Other social benefits	2.6	2.9	2.9	2.9	2.9	3.0	3.0	3.0	3.0	3.0
Other expense	0.9	1.6	1.2	1.3	1.4	1.0	1.0	0.8	0.8	0.8
Capital expenditure	3.3	3.6	3.9	3.6	3.8	3.9	3.7	3.7	3.6	3.7
Gross Fixed Capital Formation	2.6	2.7	2.7	2.6	2.8	2.9	2.8	2.8	2.7	2.8
Gross operating balance	1.4	-5.4	-1.7	-1.2	-1.7	-1.5	-1.5	-1.7	-1.9	-1.8
Net lending/borrowing	-1.9	-9.0	-5.6	-4.8	-5.5	-5.4	-5.3	-5.4	-5.5	-5.5
Memorandum items										
Primary expenditure	49.9	57.0	53.8	52.7	54.6	54.5	54.4	54.3	54.2	54.2
Primary balance	0.0	-7.0	-3.9	-3.3	-3.8	-3.2	-3.0	-3.0	-2.8	-2.7
Structural balance	-2.2	-7.6	-5.1	-5.1	-5.3	-5.2	-5.2	-5.4	-5.5	-5.5
Structural balance (excl. Covid-19 measures)	-2.2	-3.2	-2.2	-4.0	-4.7	-4.9	-5.2	-5.4	-5.5	-5.5
Structural primary balance	-0.2	-5.7	-3.5	-3.6	-3.6	-3.1	-2.9	-3.0	-2.9	-2.7
Structural fiscal adjustment	-1.2	-5.4	2.5	0.0	-0.2	0.1	0.0	-0.2	-0.1	0.0
Structural fiscal primary adjustment	-1.4	-5.5	2.3	-0.1	0.0	0.5	0.2	0.0	0.1	0.2
Gross government debt	97.6	112.0	109.2	106.8	108.1	109.8	112.4	115.1	117.8	120.3
Real growth of primary expenditure	1.7	8.0	0.3	0.9	3.8	1.2	1.0	1.0	0.9	1.3

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

Table 4. Belgium: General Government Consolidated Balance Sheet, 2013-21

	2013	2014	2015	2016	2017	2018	2019	2020	2021
	(In percent of GDP)								
Net financial worth	-88.0	-95.7	-92.5	-90.8	-85.1	-83.9	-84.3	-100.6	-91.3
Financial assets	30.8	35.1	34.0	37.0	35.8	34.6	36.1	40.3	38.6
Currency and deposits	4.4	4.3	4.2	4.6	4.6	4.2	3.5	4.4	5.0
Securities other than shares	0.4	0.3	0.3	0.4	0.4	0.5	0.5	0.5	0.5
Loans	8.1	9.0	8.7	8.8	8.7	8.8	8.9	9.6	9.2
Shares and other equity	13.0	16.1	15.5	17.4	16.8	15.6	17.9	19.5	17.8
Insurance technical reserves	0.0	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	0.3	0.4	0.4	0.3
Other accounts receivable	4.9	5.3	5.3	5.7	5.3	5.2	4.9	5.8	5.7
Liabilities	118.8	130.8	126.5	127.8	120.9	118.5	120.5	140.8	129.9
Special Drawing Rights	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Securities other than shares	95.9	105.1	101.9	103.5	98.3	96.3	99.4	118.4	107.9
Loans	18.4	20.9	19.9	19.4	18.0	17.2	16.1	16.9	16.8
Shares and other equity	0.1	0.2	0.3	0.1	0.0	0.0	0.0	0.0	0.0
Insurance technical reserves	0.1	0.1	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	0.7	0.8	1.1	0.7
Other accounts payable	4.0	4.2	4.1	4.4	4.2	4.0	3.8	4.1	4.2

Sources: Haver Analytics; Belgian authorities; IMF International Financial Statistics; and IMF staff calculations.

Table 5. Belgium: Financial Soundness Indicators for the Banking Sector, 2012-22Q2 1/

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022Q2
(In percent unless otherwise indicated)											
Earnings and profitability											
Return on assets	0.1	0.3	0.5	0.6	0.6	0.6	0.5	0.6	0.4	0.7	0.6
Return on equity	3.0	5.9	7.7	10.1	9.1	8.7	8.0	8.7	5.9	10.2	9.1
Net interest income to total income	71.6	62.6	70.2	67.7	66.0	61.2	63.5	63.3	63.4	65.3	62.8
Interest margin	1.3	1.2	1.6	1.8	1.8	1.6	1.6	1.6	1.5	1.4	1.5
Average yield on assets	2.9	2.6	2.7	2.6	2.4	2.1	2.1	2.1	1.8	1.5	1.7
Average cost of funding	1.7	1.4	1.1	0.8	0.6	0.5	0.5	0.5	0.3	0.1	0.2
Noninterest income to gross income	28.4	37.4	29.8	32.3	34.0	38.8	36.5	36.7	36.6	34.7	37.2
Of which: Net fee and commission income	28.3	27.7	25.8	26.7	25.1	24.3	24.6	24.1	25.0	29.3	28.6
(Un)realized capital gains booked in P&L	0.2	6.0	-0.3	5.3	6.7	3.7	5.4	2.3	0.0	2.5	6.9
Cost/income ratio	73.4	62.4	61.2	58.6	58.4	58.2	61.3	59.5	61.7	60.4	66.8
Structure assets											
Total assets (in percent of GDP)	278.7	251.0	249.0	236.5	266.1	227.3	215.7	220.0	250.9	227.4	226.4
Of which (in percent of total assets):											
Loans to credit institutions	12.4	12.3	9.1	8.5	7.5	6.8	6.7	7.9	4.3	3.3	3.1
Debt securities	18.4	18.9	19.6	18.0	16.4	14.4	13.3	12.3	12.1	10.9	10.3
Equity instruments	0.6	0.4	0.6	0.7	0.4	0.4	0.4	0.4	0.2	0.2	0.2
Derivatives	11.5	6.8	8.4	6.4	5.8	4.4	3.5	3.8	3.8	2.8	3.5
Loans to customers	48.1	53.9	54.1	56.4	55.4	59.4	62.3	61.9	57.2	59.0	58.6
Of which: Belgian residents (in percent of loans)	72.0	69.4	69.2	69.2	71.0	70.7	71.6	71.2	72.5	72.4	71.7
Other EMU residents (in percent of loans)	15.0	15.7	16.2	16.1	15.1	15.0	15.1	14.9	15.4	15.6	16.0
Rest of the world (in percent of loans)	13.0	14.9	14.5	14.7	13.9	14.2	13.3	13.9	11.9	12.0	12.3
Mortgage loans (in billions euros) 2/	188.3	190.8	202.4	216.1	229.7	227.4	243.3	261.4	274.1	289.0	304.2
Consumer loans (in billions euros) 2/	24.0	26.9	17.2	19.7	24.8	26.2	25.3	28.0	27.8	26.7	27.6
Term loans (in percent of loans)	39.3	40.8	n.a	n.a	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Reverse repo operations (in percent of loans)	3.3	3.1	1.7	1.5	1.0	1.1	0.5	0.5	0.3	0.3	0.3
Funding and liquidity (in percent of total assets)											
Debts to credit institutions	11.0	10.7	9.1	8.5	10.3	9.0	8.6	9.0	6.2	6.0	7.4
Bank bonds and other debt securities 3/	10.6	10.1	9.3	9.1	9.3	9.6	8.9	7.7	6.5	5.9	5.9
Customer deposits	49.3	54.7	58.5	61.0	58.4	62.2	63.9	64.6	64.3	65.9	65.7
Of which: Sight deposits 4/	15.1	18.1	24.2	28.4	26.4	30.3	31.1	31.7	33.6	36.3	36.0
Saving deposits 5/	18.9	21.0	19.9	23.0	22.8	23.5	24.7	25.1	24.7	24.9	23.8
Term deposits 4/	9.2	9.6	8.9	8.1	6.2	5.7	5.7	5.1	3.6	3.1	3.3
Retail deposits 5/	30.6	34.8	33.5	35.1	35.6	37.7	39.2	39.6	39.1	40.0	39.3
Repo's	2.3	2.7	2.3	1.7	0.2	0.1	0.0	0.0	0.0	0.1	0.7
Liquid assets 6/	36.4	36.8	32.8	32.2	32.5	31.7	29.2	26.8	35.0	35.4	38.9
Asset quality											
Sectoral distribution of loans (in percent of total assets)											
Credit institutions	12.4	12.3	9.1	8.5	6.1	6.8	6.5	7.7	4.2	3.2	2.9
Corporate (until 2013) /Non financial corporations (as of 2014)	16.3	18.5	20.6	22.0	21.4	22.7	24.8	24.2	21.5	23.6	23.5
Retail (until 2013) / Households (as of 2014)	26.3	29.4	25.5	27.4	27.5	29.6	29.9	30.4	29.1	29.3	28.8
Central governments (until 2013)/ General government (as of 2014)	0.8	1.0	4.4	4.3	4.1	4.3	4.4	4.0	3.6	3.5	3.6
Non-credit institutions (until 2013) / Other financial corporations (as of 20	4.7	5.0	3.5	2.7	2.4	2.9	2.9	3.1	2.9	2.4	2.4
Non-performing loans (NPL) as percent of gross loans 6/	3.2	3.1	2.7	2.6	2.4	2.1	1.9	1.9	2.1	1.9	1.7
Provisions and write-offs as percent of NPL 6/	53.0	54.1	57.1	54.3	55.7	57.2	61.6	60.4	60.6	62.0	62.1
Capital adequacy											
Regulatory capital to risk-weighted assets	18.1	18.7	17.3	18.7	18.8	19.0	18.8	18.8	20.3	20.5	20.0
Regulatory Tier 1 capital to risk-weighted assets	15.8	16.4	15.1	16.0	16.2	17.0	16.5	16.7	18.2	18.9	18.4
Capital to assets	5.8	6.4	6.6	6.5	7.1	7.1	7.2	7.0	7.0	6.7	6.2
NPL net of provisions as percent of Tier 1 capital 6/	13.4	12.3	12.0	12.9	10.7	7.9	6.5	6.3	6.3	5.7	5.8
Net open position in foreign exchange to capital	2.1	2.1	3.4	2.6	2.1	1.6	1.9	2.1	2.0	1.7	1.7

Sources: National Bank of Belgium.

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

2/ Only loans to households as of 2014

3/ Excluding saving certificates as of 2014

4/ Deposits booked at amortized cost only.

5/ Only household deposits as of 2014

6/ Unconsolidated data.

Annex I. 2021 Article IV Recommendations

2021 Article IV Recommendations	Policy Actions
Fiscal Policy	
Maintain fiscal support until recovery firms, targeted and focused on solvency needs and hard-hit households. Leverage private sector resources and expertise, coordinate measures across governments, and taper as risks abate. (ST)	Fiscal support was maintained. Tapering started in late 2021/early 2022, but events were overtaken by spillovers from Russia's invasion of Ukraine and the provision of energy bill support to households. Coordination mechanisms continue to need improvement.
Address recent expansions of social spending through reforms or offsetting adjustments. Consider fundamental reforms of unemployment, pension, and other social benefits, including to contain drift from indexation and real benefit increases. (ST/MT)	Events were overtaken by spillovers from Russia's invasion of Ukraine and the provision of energy bill to households. Reforms to pension benefits have so far focused on gaps (flexible workers, periods of childcare) and not reducing costs.
Rebuild fiscal space once recovery is secured, with ambitious, well-defined, upfront commitments to boast credibility and place debt on a downward trajectory from 2024. (ST/MT)	Events were overtaken by spillovers from Russia's invasion of Ukraine and the provision of energy bill support to households. Fiscal adjustment not yet in place.
Extend tax reforms: reduce consumption tax expenditures; update real estate taxation; address climate objectives; ensure additional revenue administration resources; put in place risk mitigation strategies (incl. for high-wealth individuals); improve access to third-party data. (ST/MT)	Tax reform blueprint issued in July 2022, focusing on personal income tax reforms. Proposals on carbon/climate taxation are under preparation/consideration. VAT GAP analysis recently completed with IMF FAD TA support.
Financial and Macroprudential Policies	
Ensure policy flexibility to address near-term vulnerabilities and risks; avoid premature policy tightening by allowing use of existing buffers. (ST)	Events were affected by spillovers from Russia's invasion of Ukraine and higher inflation and interest rates. Authorities have not adjusted macroprudential policy settings (as earlier considered) to allow flexibility and use of existing buffers.
Mitigate stability risks through supervisory vigilance and possible use of macroprudential policies (e.g., tightening to constrain lending to highly leveraged borrowers, strengthen buffers). (ST)	Supervisors closely monitoring vulnerabilities and risks.
Implement FSAP recommendations; continue reinforcement of the AML/CFT framework. (ST/MT)	See FSAP Annex VII.
Structural Reforms	
As recovery strengthens, pivot from protecting jobs to facilitating reallocation (e.g., hiring subsidies, increased focus on retraining). Broad support should be replaced by targeted measures. (ST)	Pivot undertaken. Job-retention support phased out and new jobs deal put in place in 2022 with focus on training. More far-reaching reforms to facilitate reallocation are under consideration.
More fundamental reforms of benefits, wage-setting, and employment-projection should be considered, including increasing UIB degressivity, revisiting the mechanism governing real benefit increases, allowing greater flexibility to align wages and productivity and reforming collective dismissals. (MT).	Not yet taken.
Firm up plans to reduce red tape and ease entry barriers, especially in retail distribution and services. Reverse decline in productivity, by improving risk-capital availability and R&D incentive efficiency, increase infrastructure investment. (ST/MT).	Some measures were taken in the Federal Action Plan for administrative simplification (the Kafka Plan) and the 2022 jobs deal, including support for night and weekend work. Also, NGEU RRP is supporting increased infrastructure investment. More far-reaching measures are under consideration.
Insolvency: accelerate strengthening of early warning mechanisms; introduce special SME out-of-court procedures; boost resources, allow creditors to initiate procedures; incentivize restructuring through tax relief/haircuts on government claims. (ST/MT)	Reforms ongoing in this area. Insolvency cases did not spike as anticipated during pandemic.
Additional efforts/focus on federal-regional policy coordination and execution to meet ambitious climate targets (eliminate fuel subsidies and put in place a credible long-term carbon pricing framework. (ST/MT)	Events were affected by spillovers from Russia's invasion of Ukraine and higher energy prices. Proposals on carbon/climate taxation are under consideration. Limited progress on policy coordination.

Source: IMF staff; see IMF Country Report 21/209.

Annex II. External Sector Assessment

Overall Assessment: *On a preliminary basis, the external position in 2022 was* ***substantially weaker*** *than the level implied by medium-term fundamentals and desirable policies.* The current account (CA) balance is expected to deteriorate to -4.0 percent of GDP, driven by a swing to deficit in the goods balance due largely to higher fuel imports reflecting price surges and lower vaccine exports. The outlook is highly uncertain, with the CA deficit remaining elevated in the near term due to higher energy prices, before returning to a small deficit in the medium term with easing of price pressures.

Potential Policy Responses: In the near term, outlays on energy bill support and other expenses related to spillovers from Russia's war in Ukraine have delayed fiscal adjustment, which is much needed, given elevated fiscal deficit/debt levels and aging-related spending pressures. Narrowing policy space requires fiscal support measures to be limited, targeted and time-bound, balancing the protection of vulnerable households and viable firms with facilitating resource reallocation to mitigate scarring and with increasing energy efficiency. Policies in the near and medium terms should focus on rebuilding fiscal buffers through a credible, expenditure-led consolidation that also creates space to support green-digital transformation through higher investment. Policies should also focus on strengthening competitiveness by addressing structural challenges, including indexed wage increases, social benefit, labor, and product market reforms and actions to foster green, digital, and inclusive growth. These steps are expected to bring the external position closer in line with medium-term fundamentals and desirable policy settings.

<table>
<tr><td>Foreign Asset and Liability Position and Trajectory</td><td colspan="7">Background. The net international investment position (NIIP) decreased to 58 percent of GDP in 2022Q3 from 64 percent at the end of 2021. The decline was driven by a larger reduction in gross foreign assets in 2022Q3 (down 37 ppt of GDP from 2021) than the decline in gross foreign liabilities (down 31 ppt of GDP). Net portfolio investment, the main component of the positive NIIP, declined to 37 percent of GDP (down 7 ppt of GDP from 2021) reflecting largely valuation changes. Net other investment liabilities rose to a high of 14 percent of GDP in 2022Q3, as cessation of payouts to the Bank of Russia due to sanctions remain as interbank debt. Belgium's large creditor position is also underpinned by sizable net household financial wealth. Gross foreign assets of the banking sector amounted to 76 percent of GDP at end-2022Q3, well below the pre–GFC peak of more than 200 percent following a decade of consolidation and deleveraging. External public debt—mainly denominated in euros—continued to decline to 55 percent of GDP in 2022Q3 from 68 percent of GDP in 2021, a reversal following a sharp increase in financing needs in 2020 due to the fiscal response to the pandemic and a decline of nominal GDP.

Assessment. Based on the projected CA deficit and growth paths, the NIIP-to-GDP ratio is expected to decline. The large and positive NIIP and its trajectory do not raise sustainability concerns. Belgium's large gross international asset and liability positions are elevated by the presence of corporate treasury units, which do not appear to create macro-relevant mismatches.</td></tr>
<tr><td>2022 (% GDP)</td><td colspan="2">NIIP: 55</td><td colspan="2">Gross Assets: 435</td><td>Debt Assets: 147</td><td>Gross Liab.: 381</td><td>Debt Liab.: 156</td></tr>
<tr><td>Current Account (CA)</td><td colspan="7">Background. The CA balance averaged 0.3 percent of GDP over 2016-21 and has been on a downward path since a post–GFC peak of 1.4 percent of GDP in 2015. Volatility in the trade and primary income balances is driven in part by sizable operations of multinationals and large revisions. In 2022Q1-Q3, the CA balance swung to a deficit of 2.9 percent of GDP from a surplus of 0.4 percent of GDP (revised) in 2021, driven by a sharp deterioration of the trade balance. Net imports of fuels and related materials nearly doubled to €17 billion (3.1 percent of GDP) in 2022Q1-Q3 from the same period in 2021 reflecting surges in energy prices, accounting for one-fifth of total imports compared to an average of 12 percent in 2021Q1-Q3. Net exports of pharmaceutical products declined by 49 percent y/y to €8.7 billion in 2022Q1-Q3, reflecting a slowdown in shipment of coronavirus vaccines. Income and current transfers balances remained stable at -0.2 percent of GDP in 2022Q1-Q3. The cyclically adjusted CA in 2022 is projected at –2.5 percent of GDP, with a cyclical contribution of -1.5 percent of GDP largely due to the deterioration in the commodity terms of trade (-1.2 percent).

Assessment. EBA model preliminary estimates for 2022 yield a CA gap of –5.6 percent of GDP, based on a cyclically-adjusted CA balance of –2.5 percent of GDP, relative to an estimated norm of 3.2 percent of GDP. Adjustment for transitory COVID-19 effects on the CA is 0.1 percent of GDP: -0.3 percent of GDP for travel services (including tourism), and 0.4 percent of GDP for transport (subject to updates as new data become available). This is within a range estimated by IMF staff for the CA gap of between –5.9 and –5.3 percent of GDP, applying the standard error of the CA norm estimated at ±0.3 percent of GDP. The gap suggests that Belgium's external position is substantially weaker than the level implied by medium-term fundamentals and desirable policies.</td></tr>
<tr><td>2022 (% GDP)</td><td>CA: -4.0</td><td>Cycl. Adj. CA: -2.5</td><td>EBA Norm: 3.2</td><td>EBA Gap: –5.7</td><td>COVID-19 Adj. 0.1</td><td>Other Adj.: –</td><td>Staff Gap: –5.6</td></tr>
<tr><td>Real Exchange Rate</td><td colspan="7">Background. After a cumulative appreciation of the CPI-based REER by 7 percent between end 2015-2021, it depreciated by 0.6 percent in 2022, largely mirroring the depreciation of NEER. In contrast, the ULC-based REER appreciated by 1.5 percent in 2022, or by 10 percent since the tough in February 2020, reflecting relatively higher wage increases in Belgium.

Assessment. The IMF staff assesses the REER gap, based on the staff-assessed CA gap range, to be overvalued in the range of 7.2 to 8.0 percent, with a midpoint of 7.6 percent (applying an estimated elasticity of the CA balance to the REER of 0.74). EBA model estimates point to a REER overvaluation of 12.6 to 25.6 percent, based on the CPI-based REER index and level models.</td></tr>
<tr><td>Capital and Financial Accounts: Flows and Policy Measures</td><td colspan="7">Background. Gross financial outflows and inflows were on an upward trend prior to the global financial crisis as banks expanded their cross-border operations. These flows have shrunk considerably and become more volatile as banks have deleveraged. Short-term external debt accounted for 32 percent of gross external debt in 2022Q3. 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 large and positive NIIP reduces the vulnerabilities associated with high external public debt.</td></tr>
<tr><td>FX Intervention and Reserves Level</td><td colspan="7">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.</td></tr>
</table>

Annex III. Risk Assessment Matrix[1]

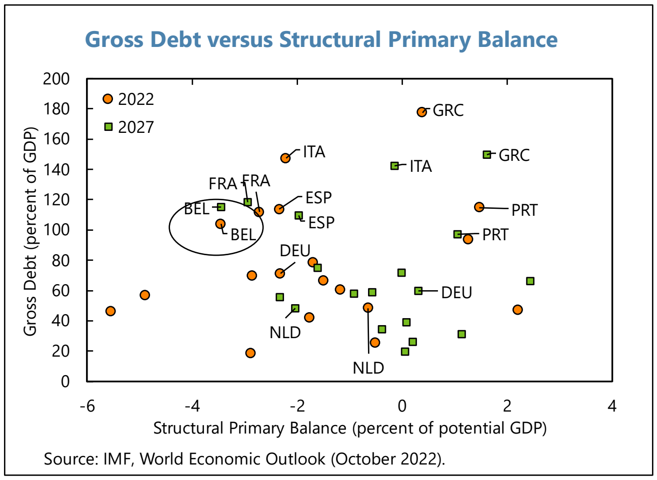
Source of Risks	Relative Likelihood	Time Horizon	Expected Impact	Policy Response
Global Risks				
Conjunctural Risks				
Abrupt global slowdown or recession. Global and idiosyncratic risk factors combine to cause a synchronized sharp growth slowdown, with outright recessions in some countries, spillovers through trade and financial channels, and downward pressures on some commodity prices. **Europe:** the fallout from the war in Ukraine is exacerbated by a gas shutoff by Russia, resulting in acute gas shortages and further supply disruptions, which triggers an EU recession.	Medium High	ST, MT	High Energy dependence on Russia and *direct* trade and financial links with Belarus, Russia, and Ukraine are relatively limited. However, *indirect* links and spillovers are important; depressed activity in key trading partners (e.g., Germany) is likely with disruption of energy supplies from Russia. Falling commodity prices may alleviate inflationary pressures.	With fiscal space highly constrained and with elevated inflation, fiscal stimulus should be avoided, particularly in a fragile financial market environment. Automatic stabilizers should be left to operate but be offset to prevent increases in the overall deficit. More active support, if needed to cushion the impact of a global slowdown on the most vulnerable groups, should be well-targeted, limited in scope to preserve fiscal room for maneuver in future crises, allow for efficient resource reallocation, and be offset in other areas.
De-anchoring of inflation expectations and stagflation. Supply shocks to food and energy prices sharply increase headline inflation and pass through to core inflation, de-anchoring inflation expectations and triggering a wage-price spiral in tight labor markets. Central banks tighten monetary policy more than envisaged leading to weaker global demand, currency depreciations in EMDEs, and sovereign defaults. Together, this could lead to the onset of stagflation.	Medium	ST, MT	High Near-universal automatic wage (and benefit) indexation may quickly translate de-anchored inflation expectations into wages and prices. International competitiveness would suffer, weakening the external balance and potential output. Tightening by central banks may lead to financing pressures, given elevated debt and deficit levels.	With monetary policy levers out of the direct control of the Belgian authorities, breaking the harmful effects of a wage-price spiral would require prompt response through discretionary fiscal tightening, possibly exceptional and temporary pause to the indexation mechanism, in addition to multiannual real wage restraint, and modifications to the indexation mechanism over the medium term.
Structural Risks				
Deepening geo-economic fragmentation and geopolitical tensions. Broadening of conflicts and reduced international cooperation accelerate deglobalization, resulting in a reconfiguration of trade, supply disruptions, technological and	High	MT	Medium Belgium is vulnerable to deglobalization due to strong cross-border real and financial linkages and the presence of multi-national corporations and large financial/payment services	Strengthen international competitiveness and accelerate diversification of export markets by advancing labor and product market reforms. Continue to enhance financial sector resilience by keeping an eye on

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path. 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.

Source of Risks	Relative Likelihood	Time Horizon	Expected Impact	Policy Response
payments systems fragmentation, rising input costs, financial instability, a fracturing of international monetary and financial system, and lower potential growth.			providers, heightening risks to economic dynamism and financial stability. Financial sector resilience and EU/euro area membership provide support.	emerging vulnerabilities, build appropriate buffers and develop adequate contingency plans.
Belgium-Specific Risks				
Expansionary fiscal policies and lack of fiscal consolidation may undermine trust in the government's ability to put public finances onto sustainable trajectory, raising borrowing costs and exacerbating already elevated sovereign debt levels.	**High**	**ST, MT**	**High** A large budget deficit requires continued access to financing. Reluctance by creditors to provide funding due to debt sustainability concerns may result in a substantial increase in borrowing costs and a need for a sharp fiscal adjustment, with negative consequences for growth and financial stability.	Re-orient energy support measures by to the most vulnerable households and sectors. Speed up fiscal adjustment by rationalizing expenditure while maintaining investment. Bring forward ambitious tax and social benefit reforms to rebuild buffers and enhance debt sustainability.
Disorderly adjustment of financial conditions may expose pockets of vulnerability among non-bank financial institutions, worsen the debt servicing capacity of borrowers, trigger a correction in house prices and generate tensions in sovereign debt markets.	**Medium**	**ST, MT**	**Medium** The financial system appears resilient and an orderly exit from low-for-long interest rates should benefit financial intermediaries. However, a disorderly adjustment of financial conditions, particularly if coupled with other economic shocks, would weaken financial sector buffers, adversely affecting credit provision and economic activity.	Deploy policy buffers and levers and take additional action to close policy gaps and address pockets of vulnerability. Discretionary fiscal tightening may be needed to help re-affirm credibility, reduce government bond yields, and stabilize the public debt ratio.
Cases of money laundering or other illicit activities and cyber risks including related to possible sanctions evasion, have the potential to affect Belgium's reputation as a financial center, and possibly undermine financial stability.	**Medium**	**ST, MT**	**High** Successful cyberattacks, as well as litigation costs and associated penalties, may undermine the viability of individual financial institutions with potential wider financial stability and reputational consequences. Sanctions evasion may also have consequences.	Build on progress assessing the implications of cyberthreats and incentivize fortification of cyber defense by financial institutions. Enhance anti-corruption and AML/CFT frameworks to further strengthen the protection of financial institutions against illicit activities and sanctions evasion.
Political uncertainty and fragmentation may intensify with federal elections approaching in 2024, delaying reforms necessary to lift potential growth onto a higher trajectory and to meet challenges arising from the energy crisis, climate change or digital transformation.	**High**	**MT**	**High** Prolonged inaction or misguided initiatives in policy areas demanding urgent attention may dampen economic output, weaken competitiveness, and aggravate social frictions.	Focus energy-support policies on the most vulnerable while preserving price signals. Step up communications on the urgency of reforms to address fiscal and debt sustainability. Prioritize reform initiatives for political feasibility and scope to lift economic potential. Improve coordination with sub-national governments.

Annex IV. Fiscal Adjustment

1. Adjustment needs are large and have increased. Under staff's baseline, general government structural deficits remain elevated over the medium term, driven by recent structural spending increases and higher outlays on aging-related and other benefits.[1] The primary deficit remains well above its debt-stabilizing level—by 2.9 ppts of GDP in 2027—and gross debt is on a high and rising trajectory (20 ppts above the pre-pandemic baseline by 2027).[2] Belgium's elevated and increasing medium-term primary deficit makes it an outlier among high-debt euro area countries. Interest expenses are expected to increase with rising yields, although costs are partly shielded by the long maturity of outstanding debt.[3] Public finances are vulnerable to a credit-and-liquidity crisis event.



2. The authorities' planned adjustment does not stabilize debt. Plans envisage adjustment of 1.4 percent of GDP over 2021-24, including annual fixed (0.2 percent of GDP) and variable components, the latter based on the level and growth of output. Plans were overtaken by events in 2022 (war in Ukraine, energy crisis), stalling consolidation. The 2023-24 budgetary plan incorporates variable effort of about 0.6 percent of GDP in 2023-24.[4]

3. A more ambitious, sustained adjustment is needed. To place debt on a downward path and reach structural balance by 2030 (the previous EU medium-term objective, MTO), staff calls for structural primary adjustment of 0.6 percent of GDP (or more) in 2023 and 0.8 ppts per year (or more) during 2024-30 (Alternative 1), anchored by cyclical and sustainability considerations.[5] Additional savings would be needed to facilitate higher investment spending.

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[1] Social benefit costs are projected to increase due to ageing by 1 ppt of GDP in 2022 (vs. 24.5 percent of GDP in 2019), by 3 ppts by 2030, 5.2 ppts by 2049, and 5 ppts by 2070 (Study Committee on Ageing). Covid-19 related structural spending increases involve permanent increases in healthcare and investment triggered by the pandemic.

[2] The debt stabilizing primary balance is -0.1 percent of GDP, if key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at 2027 levels.

[3] The average duration of federal debt was 10.5 years in October 2022, while the average interest rate was 1.36 percent. The authorities assess refinancing risks at 12 and 60 months of 12.8 percent and 36.4 percent, respectively, against risk limits of 17.5 percent and 42.5 percent for each category (Belgium Debt Agency).

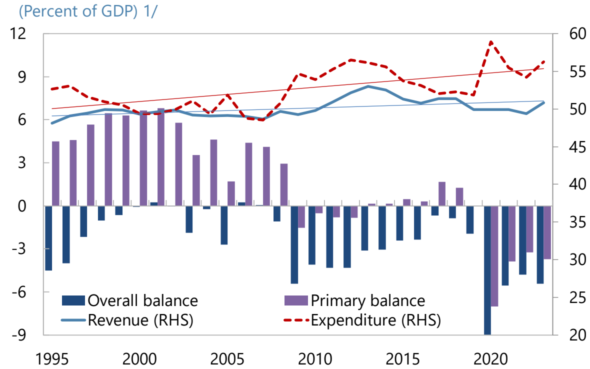
[4] The variable effort consists of about one-third each in expenditures reduction, additional revenues and miscellaneous items. For 2023-24, the government outlines expenditure measures from the underutilization of the appropriations in healthcare and at ministries and federal organizations; revenue measures from higher excise duties on tobacco, limitation on bank tax deductions, and the abolition of the notional interest deduction; and miscellaneous item from higher-than-expected revenues from the transposition of the e-commerce directive.

[5] Measuring adjustment in structural primary terms reflects more directly the discretionary effort.

4. The size and duration of the proposed adjustment are demanding and will require a comprehensive approach. Belgium has undertaken sustained, large fiscal adjustments in the 1980s and in 1993-2007, both with external policy pressures. Credible and systematic efforts are needed now to rationalize spending, including systematically incorporating spending reviews in budgetary processes, applying strict spending limits, increasing revenues via tax policy and revenue administration reforms, and enhancing growth and employment through decisive structural reforms. Enhancing cooperation and burden sharing among federal, regional, and community governments will be essential for the consolidation effort.

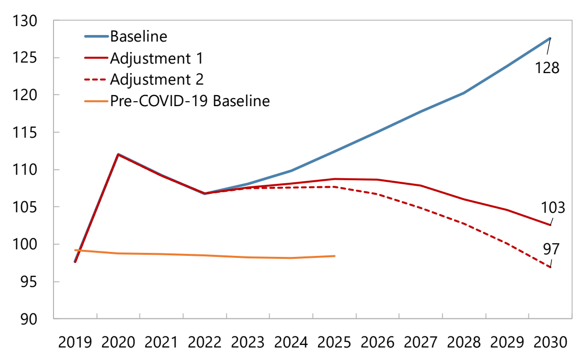
5. The proposed adjustment path is more gradual than that implied by a recent IMF Departmental Paper (DP/2022/014), reaching balance in 8 rather than 6 years (with the escape clause still operating in 2023). Reaching balance in 6 years would mean a lower cap for real spending growth (1 percent) and adjustment of more than 1 ppt of GDP per year (Alternative 2). The departmental paper also calls for upgrading of national medium-term fiscal frameworks (MTFF) and fiscal councils (to endorse projections, undertake DSAs, assess fiscal risks, and indicate whether expenditure ceilings and plans are consistent with targets/risks). Both paths involve significant, sustained adjustment to reach the debt-stabilizing and overall balances in a relatively short period.[6]

Fiscal Positions
(Percent of GDP) 1/



Sources: NBB and IMF staff calculations.
1/ Projections for 2022 and 2023.

IMF Public Debt Projections
(Percent of GDP)



Source: IMF Staff calculations.

[6] The simulations by the FPB, based on EU proposed Economic Governance Framework of November 2022, suggested broadly similar magnitude of adjustment for Belgium, requiring fiscal adjustment that could reach 4.0 percent of GDP (i.e., 1.0 percent additional adjustment per year) in 4 years, or up to 4.8 percent of GDP (i.e., 0.7 percent additional adjustment per year) in a longer adjustment period of 7 years contingent on proposing reforms and investments aiming at economic growth and debt sustainability. These adjustments are expressed as an increase in the primary balance of the general government compared to a projection under unchanged policies (see FPB January 26, 2023).

Table IV.1. Belgium: Illustrative Medium Term Fiscal Adjustment Paths

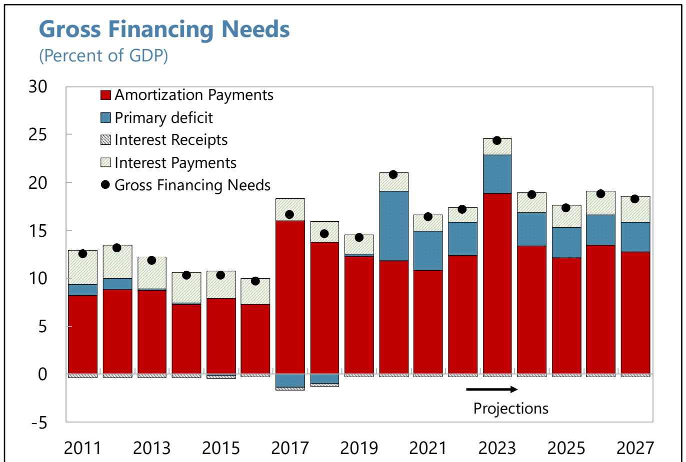
		2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	End Year-2023	Cumulative
					(In percent of GDP)								
IMF													
Baseline	Fiscal balance	-5.6	-4.8	-5.5	-5.4	-5.3	-5.4	-5.5	-5.5	-5.4	-5.5	0.0	
	Interest	1.7	1.6	1.7	2.1	2.3	2.4	2.7	2.8	2.8	2.9	1.2	
	Primary balance	-3.9	-3.3	-3.8	-3.2	-3.0	-3.0	-2.8	-2.7	-2.6	-2.6	1.2	
	Structural primary balance	-3.5	-3.6	-3.6	-3.1	-2.9	-3.0	-2.9	-2.7	-2.6	-2.6	1.0	
	ΔSPB	2.3	-0.1	0.0	0.5	0.2	0.0	0.1	0.2	0.1	0.0		
	Structural balance	-5.1	-5.1	-5.3	-5.2	-5.2	-5.4	-5.5	-5.5	-5.4	-5.5	-0.2	
	ΔSB	2.5	0.0	-0.2	0.1	0.0	-0.2	-0.1	0.0	0.1	-0.1		
	Debt	109.2	106.8	108.1	109.8	112.4	115.1	117.8	120.3	123.9	127.6	19.5	
Alternative 1	Fiscal balance		-4.8	-4.8	-4.0	-3.1	-2.5	-1.9	-1.1	-0.2	0.5	5.3	
	Structural primary balance		-3.6	-2.9	-1.7	-0.8	-0.1	0.8	1.7	2.5	3.3	6.3	
	ΔSPB			0.6	1.2	0.9	0.7	0.9	0.9	0.8	0.8		
	Structural balance		-5.1	-4.7	-3.8	-3.1	-2.5	-1.9	-1.1	-0.3	0.4	5.1	
	ΔSB			0.5	0.8	0.7	0.6	0.6	0.8	0.8	0.7		
	Effort 1/			**0.6**	**0.8**	**0.8**	**0.8**	**0.8**	**0.8**	**0.8**	**0.8**		**5.9**
	Debt		106.8	107.6	108.1	108.7	108.6	107.8	106.0	104.6	102.5	-5.1	
Alternative 2	Fiscal balance		-4.8	-4.7	-3.6	-2.5	-1.6	-0.7	0.3			5.0	
	Structural primary balance		-3.6	-2.8	-1.3	-0.1	0.8	1.9	3.1			5.9	
	ΔSPB			0.8	1.5	1.2	0.9	1.1	1.1				
	Structural balance		-5.1	-4.5	-3.4	-2.4	-1.6	-0.8	0.3			4.8	
	ΔSB		0.0	0.6	1.1	1.0	0.8	0.9	1.0				
	Effort 1/			**0.8**	**1.0**	**1.0**	**1.0**	**1.0**	**1.0**				**5.8**
	Debt		106.8	107.5	107.6	107.7	106.7	104.8	102.7			-4.7	
Government 2/													
	Fiscal balance		-5.2	-5.8									
	Interest		1.5	1.7									
	Structural primary balance		-3.4	-3.2									
	Primary balance		-3.8	-4.2									
	Structural balance		-4.9	-4.9									
	ΔSB		0.2	0.0									
	Effort by federal government 3/	**0.2**	**0.4**	**0.4**	**0.5**								
	Fixed	0.2	0.2	0.2	0.2								
	Variable		0.2	0.2	0.3								
	Debt		105.3	108.2									

1/ Effort defined as the deviation of the change of the structural balance from its change under the baseline.
2/ Projections for general government in the 2023 Budgetary Plan released on October 15, 2022.
3/ Effort defined as deficit-reducing structural measures; implied by projected level and growth rate of real GDP.

Annex V. Debt Sustainability Analysis

Public debt sustainability risks remain elevated under staff's baseline scenario, given the rising level of outstanding debt, continuing high primary deficits, and rising interest rates over the medium term. Factors mitigating these risks include an extended maturity profile and a relatively stable domestic (and euro-resident) investor base. The projected medium-term public debt path is sensitive to a real GDP growth shock, a real interest rate shock, and combined shocks.

1. **Public debt sustainability risks remain high over the medium term.** Under the baseline, the public debt-to-GDP ratio is projected to resume an upward trajectory over the medium term, reaching 118 percent by 2027 under broadly unchanged policies, with growth recovering, the negative output gap closing over the medium term, and interest rates gradually rising. This reflects the combined effect of structural spending increases (some linked to COVID-19 measures—higher health-sector wages) and relief for the energy crisis, as well as increasing costs from aging and social benefits. The contribution from the decline in real interest rate as a driver for debt reduction also dissipates from 2024 onward, compared to the most recent DSA analysis. Gross financing needs are expected to increase to 24 percent of GDP in 2023 from 17 percent of GDP in 2022 and remain at elevated levels over the medium term. Refinancing of the debt stock at lower interest rates from 2017 through early 2022 provided a buffer against rising interest rates in the near-term, but less for medium-term interest costs. The projected medium-term public debt path is sensitive to a real GDP growth shock, a real interest rate shock, and combined shocks (macro-fiscal shock, contingent liability shock affecting growth).

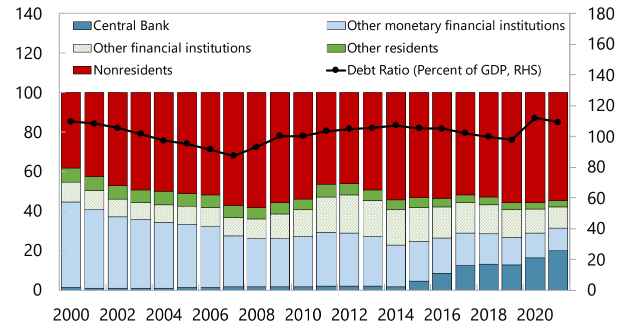


Sources: Belgian authorities; and IMF staff calculations.

2. **Low interest rates and a favorable debt profile have so far mitigated sustainability concerns related to the high debt level.** Belgium ranks among high-debt countries in the euro area (debt ratios above 100 percent). Government gross debt increased significantly after 2007, reflecting fiscal stimulus and support to the banking sector. After peaking at 107 percent of GDP in 2014, debt declined to 98 percent in 2019, supported in part by a favorable interest-growth differential. Debt rose to 112 percent of GDP in 2020, due to the sharp increase of the fiscal deficit—to 9 percent of GDP—arising from outlays to mitigate COVID-19 (and lower nominal GDP), before decreasing to 108 percent of GDP in mid-2022. The debt burden has remained manageable, as debt service has declined with lower interest rates. Average 10-year bond yields declined from a peak of 5.6 percent in 2000, turned slightly negative in 2020-21, and have since risen to about 1.7 percent in 2022. The weighted-average maturity of debt increased from 5.5 years in 2009 to 10.5 years at present, while

the effective interest rate declined by 230 bps to 1.5 percent in 2021. Close to 85 percent of the debt is owed by the federal government and 15 percent by regional governments, all of which is denominated in euros. About 45 percent of debt is held by residents, just below the 5-year average, of which less than half is held by the central bank (increasing over the last 7 years to 20 percent of outstanding debt in 2021). There is scope for remaining needs to be absorbed domestically (or by wider euro-area financial institutions).

Gross Debt of General Government by Residency and by Holders
(In percent of total)



Source: Haver Analytics.
1/ Debt held by residents are grouped under the central bank, other monetary financial institutions, other financial institutions, and other residents.

3. An increase in debt-servicing costs over the medium term adds to challenges of fiscal and debt sustainability. Higher borrowing costs will place strains on public finances at a time when fiscal resources are stretched. Belgium's 10-year bond yield rose to 3.2 percent at end-2022, the highest since mid-2012. Risk premia, measured by spreads over German yields, have averaged 56 bps in 2022, up from 30 bps on average in 2021, and may increase further if the government shows limited capacity to reduce deficits and debt via fiscal consolidation or to enact growth-enhancing structural reforms. The effective interest rate is projected to rise by close to 1 percentage point over 2023-27 to about 2.4 percent, adding further to the budgetary cost.

A. Baseline Scenario and Realism of Projections

4. The debt ratio will increase over the medium term under current policies and continued primary deficits, moderate growth, and rising real interest rates. More specifically:

- **Macroeconomic assumptions.** Growth is projected to slow to 3.0 percent in 2022, 0.2 percent in 2023, and 1.2 percent (potential) over the medium term. Inflation picked up sharply in 2022 and is expected to decline gradually and stabilize at just below 2 percent in the medium term.
- **Fiscal assumptions.** The baseline assumes current policies, with the overall fiscal deficit remaining elevated at 4.8 percent of GDP in 2022 and widening further to 5.4 percent of GDP in 2023, due mainly to energy relief measures. Aging and social-benefit pressures will keep the deficit elevated in the medium term. The structural deficit moves in step with headline deficits given the small or closed output gap. The primary deficit remains elevated at 2½ percent of GDP in 2027, well-above its debt-stabilizing level of 0.1 percent and the pre-crisis projection of 1.4 percent (2025).
- **Debt levels and gross financing needs (GFN).** General government debt is projected to have decreased to 107 percent of GDP in 2022, before increasing to 121 percent of GDP in the medium term. Long-term interest rates (benchmark 10-year bond yield) are projected to increase to 3.4 percent (average) in 2027, a rise of 160 bps from 2022 (average), an important departure from the previous period when low interest rates allowed for maturing debt to be refinanced at

lower rates. The effective rate will gradually rise to 2.4 percent in 2027, an increase of 84 bps, from the historical low of 1.5 percent in 2022. GFN average 19 percent of GDP over the projection horizon.

- **Realism of baseline assumptions.** The median forecast error for real GDP growth is close to zero (0.06 percent), while those for the primary balance (-0.69 percent), and inflation (-0.15 percent) are relatively small, measured over the period 2013–21.
- **Heat map.** Risks from the debt level are high, with the 85 percent threshold breached under all scenarios. GFN are below the benchmark of 20 percent of GDP under the baseline but exceed the benchmark under specific shocks. The external financing requirement of 77 percent of GDP in 2021 is significantly above the upper threshold, and the share of debt held by non-residents is relatively high at 55 percent of total.[1]

B. Stress Tests

- **Growth shock.** Real GDP growth is reduced by one standard deviation in 2023-24 (measured over 2011-20, 2.2 percentage points each year 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 increase in the debt-to-GDP ratio reaches 11 ppts in 2024 and remains broadly constant thereafter.
- **Interest rate shock.** This shock involves implications for debt sustainability of an increase in interest rates by 314 basis points (calibrated on the difference between the maximum real effective interest rate observed in 2012-22 and the average over the projection horizon) starting in 2023. The debt-to-GDP ratio reaches 122 percent of GDP (+2.5 percent) in 2027. Gross financing needs are 2.5 percentage points of GDP higher in 2027 relative to the baseline.
- **Exchange rate shock.** This shock assumes 13 percent depreciation in the real exchange rate in 2022, but has no material effect as virtually all debt is denominated in euro.
- **Primary balance shock.** This shock examines the implications of a revenue shock and a rise of interest rates leading to a cumulative 0.4 percentage points of GDP deterioration in the primary balance (one standard deviation: measured over 2011-20) in 2023-24. This shock leads to a modest increase in the debt-to-GDP ratio to 120 percent of GDP in 2027 (+2.7 ppts).
- **Combined macro-fiscal scenario.** This shock aggregates shocks to real growth, the interest rate, the exchange rate, and the primary balance while avoiding double-counting effects of individual shocks, debt and GFN reach 135 percent (+17.0) and 23 percent (+4.3) of GDP in 2027.
- **Contingent liability shock.** In this shock, non-interest expenditures in 2023 increase by the equivalent of 10 percent of banking sector assets, and growth slows by 1 standard deviation for two years (2023-24). Debt increases to 124 percent of GDP in 2027.

[1] Belgium has one of the strongest net international investment positions in the euro area, and a substantial portion of the external financing needs of non-financial corporations stems from intragroup lending.

Figure V.1. Belgium: Public Sector Debt Sustainability Analysis—Baseline Scenario

(In percent of GDP, unless otherwise indicated)

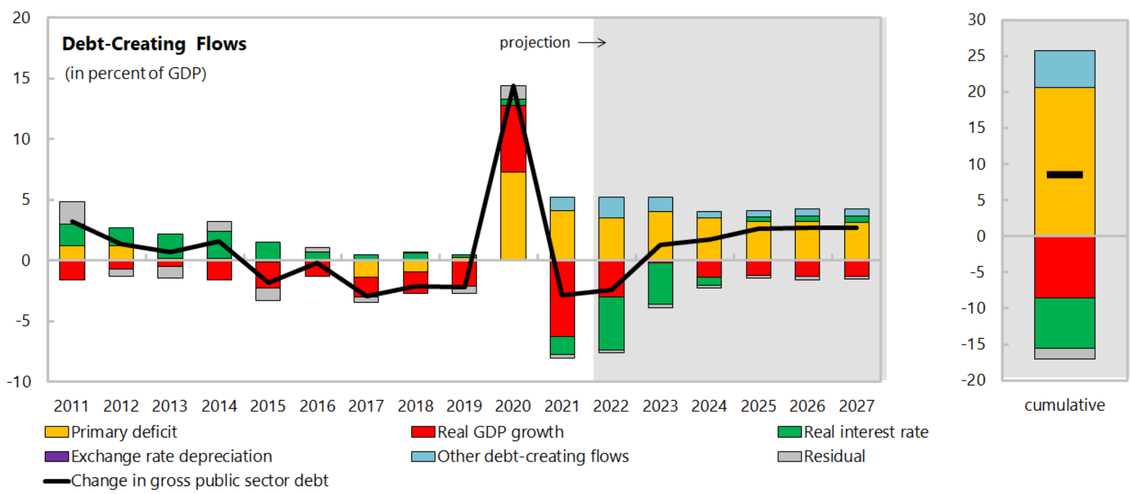
Debt, Economic and Market Indicators [1/]

	Actual 2011-2019 [2/]	2020	Est. 2021	Projections 2022	2023	2024	2025	2026	2027
Nominal gross public debt	103.4	112.0	109.2	106.8	108.1	109.8	112.4	115.1	117.7
Public gross financing needs	12.6	20.8	16.4	17.2	24.4	18.7	17.3	18.7	18.0
Real GDP growth (in percent)	1.5	-5.4	6.1	3.0	0.2	1.3	1.2	1.2	1.2
Inflation (GDP deflator, in percent)	1.6	1.5	2.9	5.7	5.0	2.7	1.8	1.8	1.9
Nominal GDP growth (in percent)	3.1	-3.9	9.2	8.9	5.3	4.0	3.0	3.1	3.1
Effective interest rate (in percent) [4/]	2.8	1.9	1.6	1.5	1.7	2.0	2.2	2.2	2.4

As of January 11, 2023		
Sovereign Spreads		
10Y bonds (bp) 3/	57	
5Y CDS (bp)	10	
Ratings	Foreign	Local
Moody's	Aa3	Aa3
S&Ps	AA	AA
Fitch	AA-	AA-

Contribution to Changes in Public Debt

	Actual 2011-2019	2020	Est. 2021	Projections 2022	2023	2024	2025	2026	2027	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	-0.3	14.4	-2.8	-2.4	1.3	1.7	2.6	2.6	2.7	8.6	
Identified debt-creating flows	-0.2	13.2	-2.6	-2.2	1.5	2.0	2.9	2.9	2.9	10.1	
Primary deficit	0.1	7.3	4.1	3.5	4.0	3.5	3.2	3.2	3.1	20.6	-0.1
Primary (noninterest) revenue and grants	51.2	49.7	49.7	49.1	50.6	51.0	51.2	51.1	51.1	304.1	
Primary (noninterest) expenditure	51.2	57.0	53.8	52.7	54.6	54.5	54.4	54.3	54.2	324.6	
Automatic debt dynamics [5/]	-0.3	5.9	-7.8	-7.4	-3.6	-2.0	-0.9	-0.9	-0.7	-15.6	
Interest rate/growth differential [6/]	-0.3	5.9	-7.8	-7.4	-3.6	-2.0	-0.9	-0.9	-0.7	-15.6	
Of which: real interest rate	1.2	0.5	-1.5	-4.3	-3.4	-0.7	0.4	0.4	0.5	-7.1	
Of which: real GDP growth	-1.5	5.4	-6.3	-3.1	-0.2	-1.4	-1.2	-1.4	-1.3	-8.5	
Exchange rate depreciation [7/]	0.0	0.0	0.0	...	...	...	...	...	...	...	
Other identified debt-creating flows	0.0	0.0	1.1	1.7	1.2	0.5	0.5	0.6	0.6	5.1	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Stock-flow adj. and debt management	0.0	0.0	1.1	1.7	1.2	0.5	0.5	0.6	0.6	5.1	
Residual, including asset changes [8/]	-0.1	1.2	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-1.5	



Source: IMF staff.

1/ Public sector is defined as general government.

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 $ae(1+r)$.

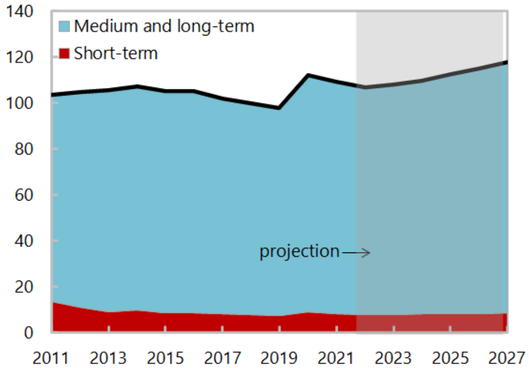
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

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.

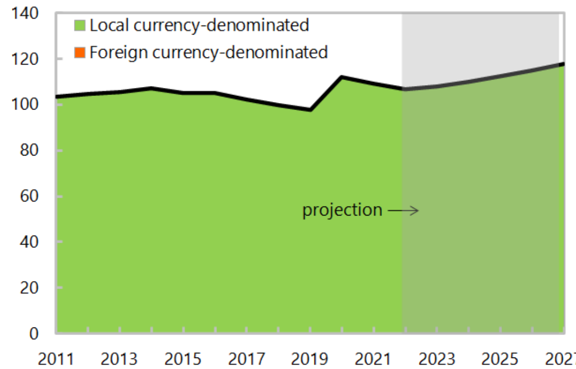
Figure V.2. Belgium: Public Debt Sustainability Analysis—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



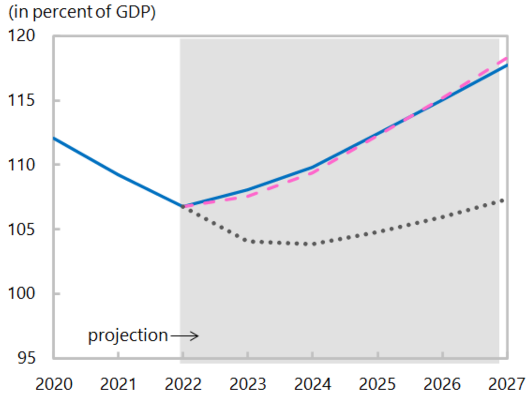
By Currency
(in percent of GDP)



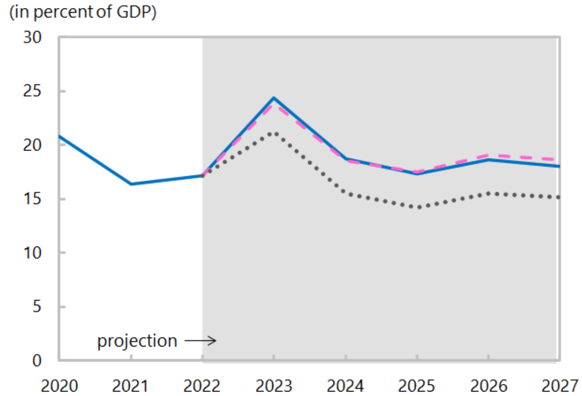
Alternative Scenarios

Baseline   Historical   Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



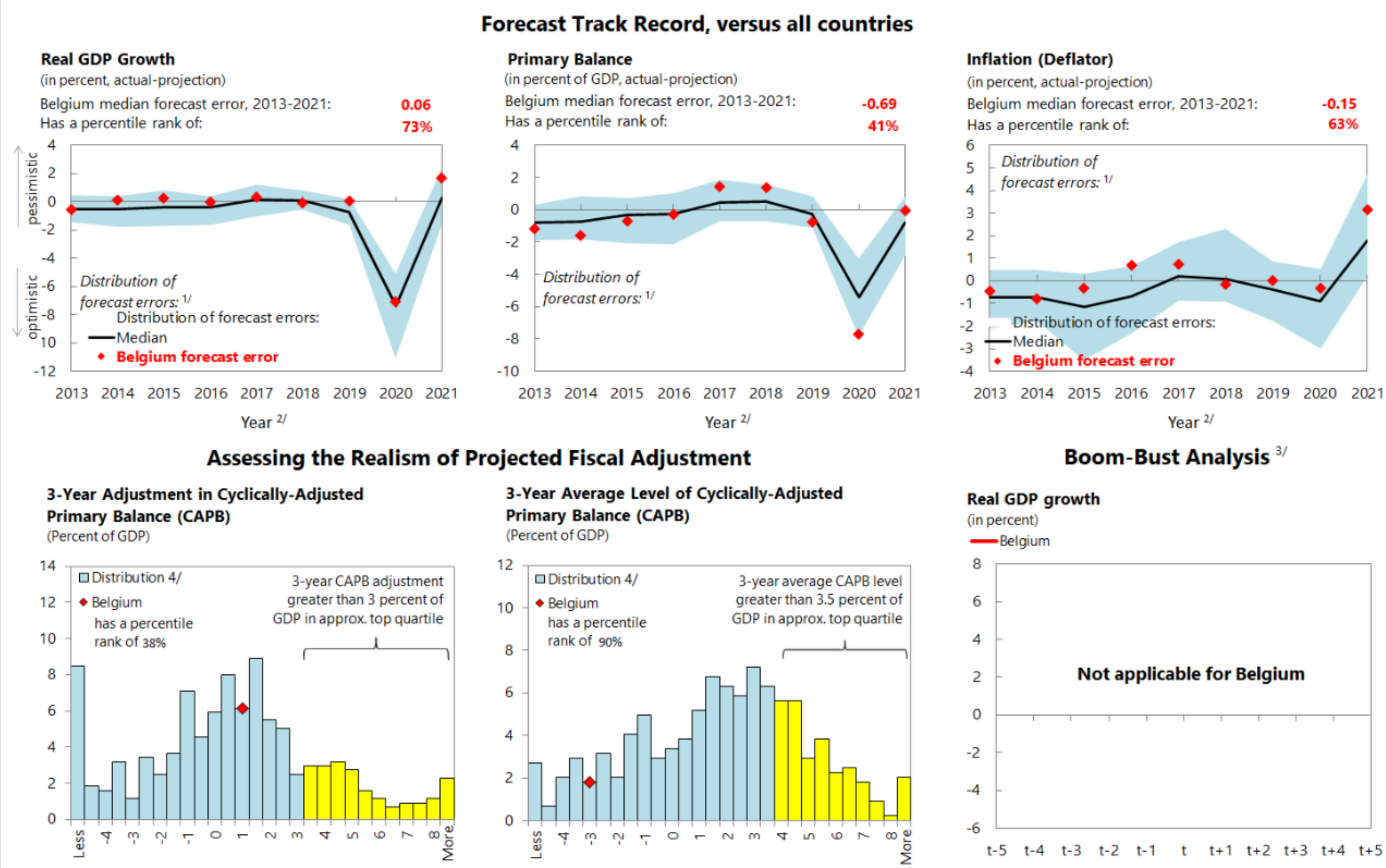
Underlying Assumptions
(in percent)

Baseline Scenario	2022	2023	2024	2025	2026	2027
Real GDP growth	3.0	0.2	1.3	1.2	1.2	1.2
Inflation	5.7	5.0	2.7	1.8	1.8	1.9
Primary Balance	-3.5	-4.0	-3.5	-3.2	-3.2	-3.1
Effective interest rate	1.5	1.7	2.0	2.2	2.2	2.4
Constant Primary Balance Scenario						
Real GDP growth	3.0	0.2	1.3	1.2	1.2	1.2
Inflation	5.7	5.0	2.7	1.8	1.8	1.9
Primary Balance	-3.5	-3.5	-3.5	-3.5	-3.5	-3.5
Effective interest rate	1.5	1.7	2.0	2.2	2.2	2.4

Historical Scenario	2022	2023	2024	2025	2026	2027
Real GDP growth	3.0	1.3	1.3	1.3	1.3	1.3
Inflation	5.7	5.0	2.7	1.8	1.8	1.9
Primary Balance	-3.5	-1.1	-1.1	-1.1	-1.1	-1.1
Effective interest rate	1.5	1.7	2.4	2.6	2.8	3.1

Source: IMF staff.

Figure V.3. Belgium: Public Debt Sustainability Analysis—Realism of Baseline Assumptions



Source : IMF Staff.

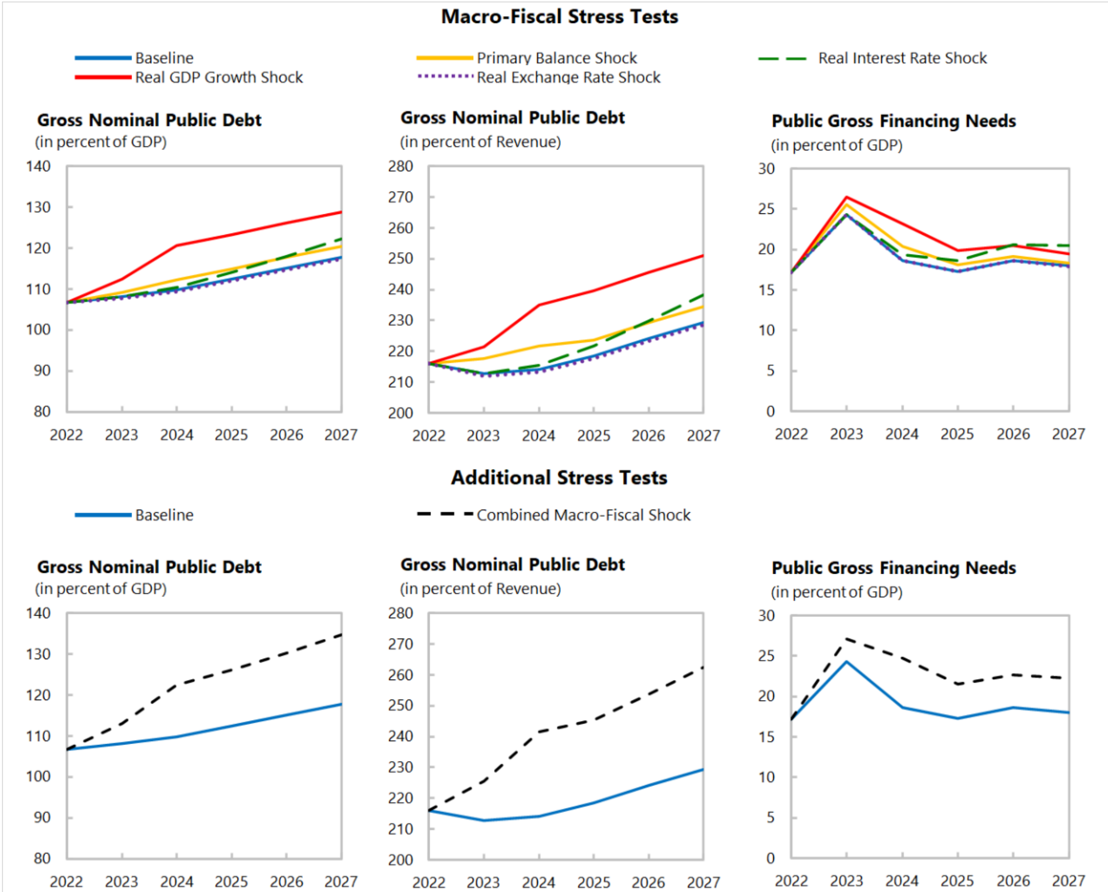
1/ Plotted distribution includes all countries, percentile rank refers to all countries.

2/ Projections made in the spring WEO vintage of the preceding year.

3/ Not applicable for Belgium, as it meets neither the positive output gap criterion nor the private credit growth criterion.

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.

Figure V.4. Belgium: Public Debt Sustainability Analysis—Stress Tests



Underlying Assumptions
(in percent)

Primary Balance Shock	2022	2023	2024	2025	2026	2027
Real GDP growth	3.0	0.2	1.3	1.2	1.2	1.2
Inflation	5.7	5.0	2.7	1.8	1.8	1.9
Primary balance	-3.5	-5.2	-4.7	-3.2	-3.2	-3.1
Effective interest rate	1.5	1.7	2.1	2.3	2.3	2.5
Real Interest Rate Shock						
Real GDP growth	3.0	0.2	1.3	1.2	1.2	1.2
Inflation	5.7	5.0	2.7	1.8	1.8	1.9
Primary balance	-3.5	-4.0	-3.5	-3.2	-3.2	-3.1
Effective interest rate	1.5	1.7	2.7	3.1	3.4	3.8
Combined Shock						
Real GDP growth	3.0	-2.0	-0.9	1.2	1.2	1.2
Inflation	5.7	4.5	2.1	1.8	1.8	1.9
Primary balance	-3.5	-6.2	-7.2	-3.2	-3.2	-3.1
Effective interest rate	1.5	1.7	2.7	3.2	3.5	3.9

Real GDP Growth Shock	2022	2023	2024	2025	2026	2027
Real GDP growth	3.0	-2.0	-0.9	1.2	1.2	1.2
Inflation	5.7	4.5	2.1	1.8	1.8	1.9
Primary balance	-3.5	-5.6	-6.6	-3.2	-3.2	-3.1
Effective interest rate	1.5	1.7	2.1	2.3	2.4	2.5
Real Exchange Rate Shock						
Real GDP growth	3.0	0.2	1.3	1.2	1.2	1.2
Inflation	5.7	5.5	2.7	1.8	1.8	1.9
Primary balance	-3.5	-4.0	-3.5	-3.2	-3.2	-3.1
Effective interest rate	1.5	1.7	2.0	2.2	2.2	2.4

Source: IMF staff.

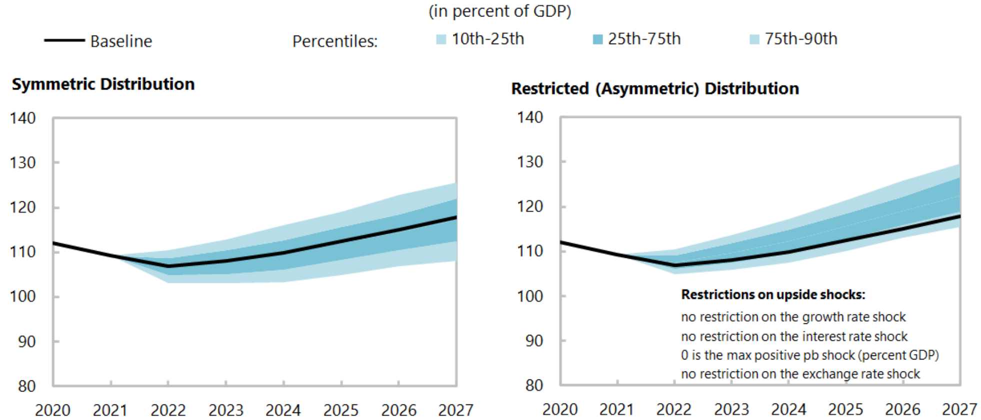
Figure V.5. Belgium: Public Debt Sustainability Analysis—Risk Assessment

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

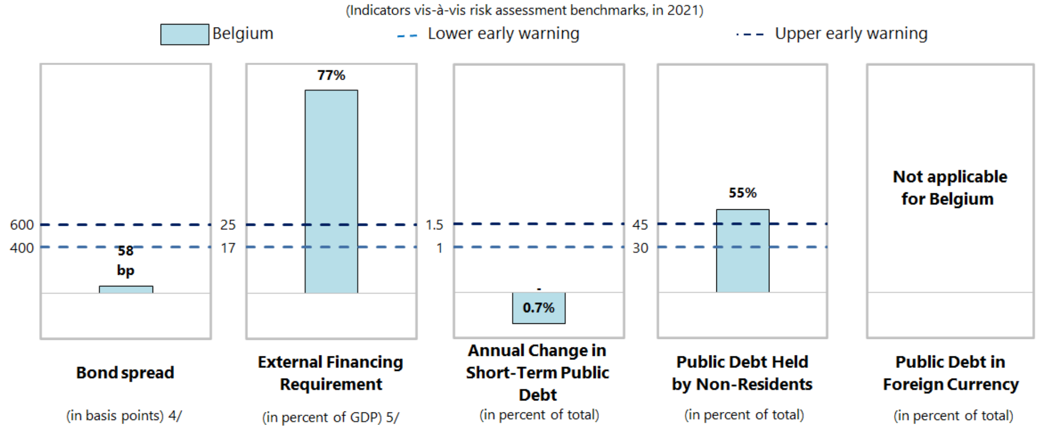
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2021)



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.

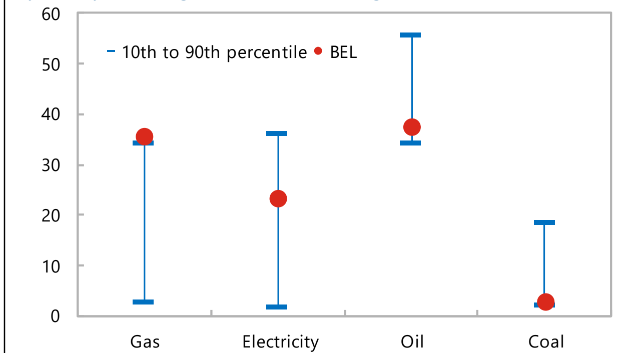
4/ Long-term bond spread over German bonds, an average over the last 3 months, 13-Oct-22 through 11-Jan-23.

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.

Annex VI. Energy Support

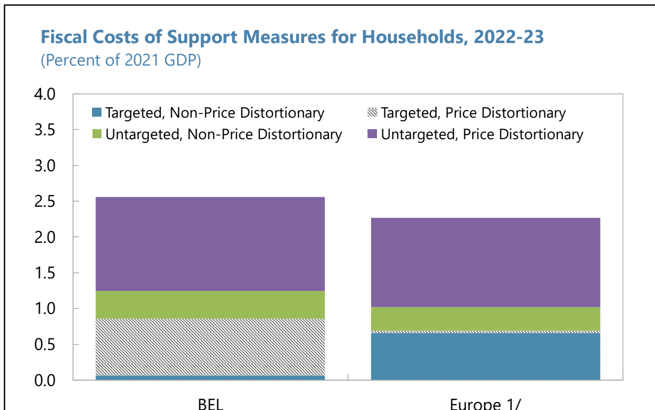
1. Belgian households are relatively highly exposed to gas—mainly from Norway and the Netherlands—with a quick pass-through of price changes.[1] The authorities have provided several rounds of timely, somewhat targeted, and timebound (until March 2023 in most cases) support to help households cope with higher energy bills (table). More recently, measures have been considered to help businesses deal with higher energy prices.

2. Expansion of social energy tariffs provided targeted support to the most vulnerable, already covered by existing social safety programs. A basic energy package provided gas and electricity vouchers to lower- and middle-income households in the winter months. Some degree of targeting was achieved through an income tax surcharge or "claw-back" for top-income earners. Some measures, such as reduction of the VAT rate on gas and electricity from 21 to 6 percent and lowering of excise duties for petrol and diesel provided quick purchasing power protection but were not targeted and did not incorporate price signals to reduce consumption.



Sources: Bloomberg, Eurostat, ENTSOE, IMF staff calculations.

3. Fiscal costs of energy measures for households and businesses reached 2.3 percent of GDP for 2022-23, somewhat higher than the average for Europe. About two-thirds of the measures were untargeted and four-fifths were price distortionary. Given existing cost-of-living safeguards via wage and benefit indexation, it is important to limit the cost of energy support measures and to better target aid to the most vulnerable 20–40 percent of households. Moving to cash transfers or block pricing based on a discount for a basic consumption level would help retain price signals, facilitate savings, and cut costs. Support to firms should be targeted to viable, energy-intensive sectors, capped, and linked to actions to reduce energy consumption.



Sources: National authorities; and IMF staff calculations.
1/ Simple averages for countries that have introduced such measures.

[1] Natural gas accounted for 30 percent of gross electricity production and 80 percent of gross heat production in Belgium; direct exposure to Russia is limited to 4-6 percent of gas imports.

Table VI.1. Belgium: Support Measures for Households and Businesses to Reduce Cost of Energy, 2022–23

		Targeted	%GDP		Untargeted	%GDP
Non-price distortionary	H	Support for social sector that targeted support for households (subnational)	0.0	B	A temporary energy unemployment support for laid-off due to energy related issues.	...
	B	Support for energy intentive firms (subnational)	0.0	B	Reduction (by 7.07% in 2023Q1-Q2) and deferral (7.07% in 2023Q3-Q4) of employers' social security contributions.	0.2
				B	Moratorium on business bankruptcies caused by actions of energy suppliers.	...
				H	Support for schools and social sectors; other support measures (subnational)	0.1
				B	Other direct aids granted to firms (subnational)	0.1
Price distortionary	H	Expansion of social energy tariffs for vulnerable households; Feb 2021- Mar 2023.1/	0.3	H	VAT reduction (21% to 6%) on electricity (from Mar) and gas (from Apr); permanent at 6%.	0.7
	H	Refinancing of social heating fund and social rate for collective heating beneficiaries	0.0	H/B	Excise duties reduction for petrol and diesel. 3/	0.2
	H	Basic energy package of 196 euros/household for lower-middle income households for Nov-Dec 2022, extended to Jan-Mar 2023. 2/	0.4	H	Heating premium/vouchers for households; extended to Mar 2023.	0.2
				H/B	Energy contribution: transformation to excise duties	0.0
				B	Excise duties reduction on gas and electricity to the European minimum in Nov-Dec 2022 and extension to 2023Q1	0.0
				B	Cut in electricity rates for public service obligations (subnational).	0.0
Total						**2.3**

Sources: Belgian Authorities; and IMF staff calculations.

H: Households; B: Businesses.

1/ Social energy tariffs are applied automatically to households that receive welfare benefits (i.e., living wage, income guarantee for the elderly, allowance for serious disability). The coverage was doubled to cover about one million households (about one in five households) with the expansion of eligibility (to include pensioners, single parents in financial difficulty, whose with gross income not more than 20,000 euros per year, etc.) in February 2021. Social tariffs for electricity are about one-half and for gas about one-quarter of average commercial rates.

2/ An automatically applied discount up to €135 for gas and €61 for electricity per month—€196 per month, for variable energy contracts and fixed contracts that were renewed after October 1, 2021. It is not eligible for social energy tariff recipients and singles (couples) with an annual taxable income of more than 62,000 euros (125,000 euros). The top 15 percent income earners will pay back partially through a special levy on their income tax.

3/ A new excise duties regime will be introduced after the energy crisis has stabilized, that only applies when prices are low (cap at the amount paid in 2021 when the 21 percent VAT rate still applied) while exempting base consumption (3,000 kWh of electricity and 12,000 kWh of gas).

Annex VII. Main Recommendations from the 2017 FSAP: Follow-up

The authorities have continued to follow up on recommendations from the 2017 FSAP, including on: systemic risk analysis, including stress testing, and monitoring of non-bank financial institutions; prudential policy, supervision and oversight, including macroprudential tools and implementation; on the financial safety net and crisis management. On AML/CFT, recommendations have already been implemented. A new FSAP was launched in late 2022.

Recommendation	Timing*	Status
Systemic Risk Analysis		
Enhance the risk analytical framework by: (i) incorporating bank stress testing into the toolkit for systemic risk assessment and macroprudential policy. (ii) extending the horizon of insurance stress tests. (iii) intensifying monitoring of insurers' mortgage loan portfolios and related underwriting standards. (iv) in cooperation with the FSMA, further developing the shadow banking monitoring framework. (v) enhancing the coverage and quality of commercial real estate (CRE) data. (NBB)	ST	(i) In 2021, the NBB undertook a full top-down stress test for Belgian LSIs and, in 2021 and 2022, a top-down NII stress tests for Belgian SIs and LSIs in "low for long" and "high" interest rate environments. In 2022, the NBB also redeveloped a top-down credit risk tool for all Belgian banks (incl. subsidiaries). (ii) In the 2021 EIOPA and 2021 and 2022 NBB stress tests, the concept of reactive management actions was introduced, a first step into the development of a multi-period scenario. A fully-fledged multi-period stress test scenario has yet to be put into practice at national and European level. (iii) No new actions taken. (iv) An update of the NBB-FSMA report on asset management and non-bank financial intermediation in Belgium is in progress. (v) The NBB is pursuing further work on closing data gaps for CRE analysis, in line with the ESRB Recommendation on Closing Data Gaps in real estate.
Prudential Policy, Supervision, and Oversight		
Approve promptly the new macroprudential measures proposed by the NBB and enhance the NBB's ability to implement cyclical macroprudential tools in a timely manner. (MoF)	ST	(i) The macroprudential measure dedicated to risks in the residential real estate market was replaced by a Sectoral Systemic Risk Buffer from May 1, 2022, calibrated at 9%, and enacted by Royal Decree. (ii) The CCyB remained de-activated and supervisory expectations regarding credit standards for new mortgage lending (LTV, DTI, DSTI) remain in place.
Continue to strengthen bank supervision by: (i) ensuring the reliability and consistency of internal models and (ii) proactively assessing loan classifications to ensure prudent provisioning practices. (NBB/SSM)	C	(i) NBB continues the follow-up of TRIM, including the review of banks' preparedness to EBA Repair implementation. (ii) The IFRS 9 benchmarking exercise, piloted in 2019, is becoming an integral part of the annual benchmarking exercises conducted by EBA, making them mandatory and covering the entire balance sheet of banks, thereby working towards a harmonization of provisioning practices.
Adjust to insurers' evolving risk profiles by: (i) seeking to address the sector's increasing liquidity risk; (ii) continuing to analyze the business growth of reinsurance operations; and (iii) engaging with the industry to	ST	(i) In 2022, the NBB published a circular on liquidity risk management for the (re)insurance sector, based on the principles of liquidity risk management as introduced in the ICPs. It imposes measures around liquidity risk management and mitigation with

Recommendation	Timing*	Status
gradually improve the quality of insurers' capital. (NBB)		reporting commencing in April 2023. (ii) Supervision and risk mitigation of reinsurance operations has been enhanced by the introduction of EIOPA principles on the use of risk mitigation techniques by insurance undertakings in the ORSA circular and the governance circular. (iii) No new actions taken.
Enhance FC supervision by: (i) setting supervisory expectations for FC governance and risk management; and (ii) enhancing monitoring of intra-group transactions at FC level and the risk of regulatory arbitrage between insurance and banking sectors. (NBB/SSM)	ST	(i) No new actions taken. (ii) The NBB stands ready to contribute to the ECB's mapping of potential or proven cases of regulatory arbitrage.
Enhance SWIFT oversight by (i) aiming at complementing the NBB's use of moral suasion in the oversight of SWIFT with additional regulatory and supervisory powers; (ii) broadening membership in the SWIFT Oversight Forum; and (iii) improving information sharing on SWIFT oversight and assurance reports. (NBB)	ST	(i) Exclusive use of moral suasion for SWIFT oversight is under reconsideration due to evolving geopolitical, regulatory, technological and competitive environments. (ii) SWIFT oversight composition mirrors CPMI membership, participation of Bank of Russia has been suspended. (iii) Information sharing remains embedded in SWIFT oversight activities.
Financial Safety Net and Crisis Management		
(i) Ensure the feasibility of resolution strategies for banking groups with systemically important subsidiaries (SRM); (ii) prioritize resolution planning for the two less significant institutions with the highest share of insured deposits. (NBB)	MT	(i) Work by the Single Resolution Board to operationalize single point of entry strategies has started. (ii) Resolution plans of LSIs have been approved and are subject to a two-year cycle except for some LSIs requiring a yearly plan.
Strengthen the DIS by (i) publicly committing to shortening the DIS pay-out period to seven days by 2019: (ii) establishing credit lines with the MoF and segregating the Guarantee Fund from government funds. (MoF)	ST	(i) Repayment period is gradually reduced to seven working days by 31 December 2023. (ii) A draft bill is in train to allow the Guarantee Fund to request advances from the Treasury and segregating it from the Treasury.
AML/CFT		
Ensure adequate transparency of beneficial ownership of legal persons and arrangements. (MoF)	MT	No new actions taken, the national UBO register is fully operational.
*C=continuous; I=immediate (within one year); ST=short term (within 1–2 years); MT=medium term (within 3–5 years)		

INTERNATIONAL MONETARY FUND

BELGIUM

February 9, 2023

STAFF REPORT FOR THE 2022 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared by: IMF European Department

CONTENTS

FUND RELATIONS

(As of December 31, 2022)

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)	4,640.78	72.39
Reserve Tranche Position	1,769.95	27.61
Lending to the Fund		
New Arrangements to Borrow	38.28	

SDR Department:

	SDR Million	Percent of Allocation
Net Cumulative Allocation	10,467.71	100.00
Holdings	10,674.01	101.97

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				
	2023	2024	2025	2026	2027
Principal					
Charges/Interest	0.13	0.13	0.13	0.13	0.13
Total	0.13	0.13	0.13	0.13	0.13

[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 Arrangements:

- The exchange rate arrangement of the euro area is free floating. Belgium participates in a currency union (EMU) with 19 other members of the EU and has no separate legal tender. The euro, the common currency, floats freely and independently against other currencies. Belgium has accepted the obligations under Article VIII, Section 2(a), 3, and 4 of the IMF's Articles of Agreement, and maintains an exchange system free of multiple currency practices and restrictions on the making of 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 September 8, 2021. The Executive Board assessment and the staff report (IMF Country Report No. 21/209) are available at link. Belgium is on the standard 12-month consultation cycle.

Capacity Development (CD)

Belgium has received direct IMF technical assistance since the last Article IV consultation in two areas—through a review of tax policy analysis and proposals that were utilized in a tax reform blueprint issued by the Deputy Prime Minister and Finance Minister in July 2022 and in support for analysis of gaps in revenue collections under Belgium's value-added tax.

Belgium is an important financial supporter of IMF externally-financed capacity development (technical assistance and training), including country-specific and regional projects as well as IMF multi-partner CD vehicles (regional and thematic trust funds and CD centers). Belgium has also been a financial supporter of other IMF initiatives, including for low-income countries via the Poverty Reduction and Growth Trust and for debt relief.

Financial Sector Assessment Program (FSAP) Participation:

- **Belgium: Financial System Stability Assessment** — IMF Country Report No. 18/67

Summary: The FSAP conducted in late 2017 concluded that the Belgian financial sector has become more resilient as a result of structural changes experienced since the global financial crisis, but is facing growing vulnerabilities, mostly in the form of risky mortgages. Nonetheless, banks and insurance companies remain capable of absorbing credit, sovereign, and market losses in the event of a severe deterioration in macro financial conditions. To contain rising mortgage-related risks, macroprudential policies recently proposed by the NBB should be enacted promptly. Other risks, including banks' capacity to cope with interest rate shocks, credit risk vulnerabilities in selected portfolios, and growing liquidity risk in insurance companies, should be monitored closely.

Financial sector supervision and crisis management arrangements have been upgraded markedly. However, the transition to a full banking union must be carefully managed by national and

European authorities given the presence in Belgium of large subsidiaries of euro area banks. Sufficient capital and loss absorbing capacity should be kept in these subsidiaries to ensure the viability of group resolution strategies. The NBB and European authorities should continue ongoing efforts to upgrade their supervisory and crisis management frameworks and operational capacity, including by prioritizing the resolution planning for important banks and strengthening the deposit insurance system. It will also be important to address the challenges posed by complex financial conglomerates, ongoing changes in the risk profile of the insurance sector, and potential challenges arising from the low quality of some insurers' capital.

The oversight arrangement for the Belgium-based Society for Worldwide Interbank Financial Telecommunication (SWIFT) has proven effective but is being challenged by new risks. To strengthen the NBB's ability to exercise its role as overseer and protect Belgium's reputation as a key hub for financial market infrastructures, the authorities should consider complementing the NBB's use of moral suasion with regulatory and supervisory powers and should enhance the NBB's ability to share information with foreign authorities.

- The next FSAP assessment was launched with a scoping mission in late 2022 and will be aligned with the 2023 Article IV consultation cycle with Belgium.

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

Belgium underwent a mutual evaluation of its AML/CFT regime by the Financial Action Task Force (FATF) in 2015. The FATF 2015 report noted that Belgium has the core elements of a sound AML/CFT regime, although some elements are not yet fully in line with the 2012 FATF Recommendations. Following the adoption of the mutual evaluation report, Belgium was placed in enhanced follow-up process. The latest report in September 2018 (third enhanced follow-up) noted Belgium's progress in strengthening its framework to tackle money laundering and terrorist financing since the mutual evaluation. However, efforts need to continue to fully implement the FATF Standard, including Recommendations 13 and 14 on corresponding banking, and money and value transfer services.

STATISTICAL ISSUES

As of January 31, 2023

I. Assessment of Data Adequacy for Surveillance
General. 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.
National Accounts. 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. The NBB is responsible for compiling the 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.
Price Statistics. A consumer price index and industrial producer price index are compiled according to best practices and published monthly. Producer price indexes for services activities are disseminated quarterly.
Government Finance Statistics. 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.
Monetary and Financial Statistics. Monetary and financial statistics data are available in standardized report forms - SRF 1SR for central bank, SRF 2SR for other depository corporations. The data are disseminated on a monthly basis through the *International Financial Statistics*. The NBB also reports data on some key series of the Financial Access Survey (FAS), including mobile and internet banking information.
Financial Sector Surveillance. Belgium reports financial soundness indicators (FSIs) to STA on a quarterly frequency, including 16 core FSIs and eight encouraged FSIs for deposit takers, and nine encouraged FSIs for other sectors.
II. Data Standards and Quality
Belgium adheres to the IMF's Special Data Dissemination Standard (SDDS) Plus since January 26, 2023, and publishes the data on its National Summary Data Page. The latest Annual Observance Report is available on the Dissemination Standards Bulletin Board.

Key Publicly Accessible Websites for Macroeconomic Data and Analysis:

NBB.Stat, 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, https://www.highcounciloffinance.be
Central Economic Council, www.ccecrb.fgov.be

Belgium: Table of Common Indicators Required for Surveillance
(As of January 31, 2023)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]
Exchange Rates	Jan.2023	Jan.2023	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Dec.2022	Jan.2023	M	M	M
International Investment Position	Q3:2022	Dec.2022	Q	Q	Q
Reserve/Base Money	Dec.2022	Jan.2023	M	M	M
Broad Money	Dec.2022	Jan.2023	M	M	M
Central Bank Balance Sheet	Dec.2022	Jan.2023	M	M	M
Consolidated Balance Sheet of the Banking System	Dec.2022	Jan.2023	M	M	M
Interest Rates[2]	Jan.2023	Jan.2023	D	D	D
Consumer Price Index	Dec.2022	Jan.2023	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]—General Government[4]	Q3: 2022	Dec. 2022	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing[3]—Central Government[5]	Dec.2022	Jan.2023	M	M	M
Stock of Central Government Debt	Dec.2022	Jan.2023	M	M	M
External Current Account Balance	Sep.2022	Dec.2022	M	M	M
Exports and Imports of Goods and Services	Sep.2022	Dec.2022	M	M	M
GDP/GNP	Q4:2022	Jan.2023	Q	Q	Q
Gross External Debt	Q3:2022	Dec.2022	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)

Statement by Mr. Dresse and Mr. Verhelst on Belgium

February 27, 2023

The authorities thank Mr. Horton and his team for the engagement and candid discussions during the Article IV consultation, which were enhanced by the return to a face-to-face mission. They broadly concur with the thrust of staff's analysis. While economic conditions have been challenging in 2022, the Belgian authorities have taken decisive actions to maintain citizens' purchasing power, the country's energy security, and to protect the vulnerable from the consequences of the energy crisis. Efforts are underway to further implement structural reforms and the authorities are committed to consolidate public finances in the coming years.

Recent data point to somewhat better economic outcomes than previously expected. In its most recent forecast for 2023, the European Commission projects growth at 0.8%, 0.6 percentage points higher than staff, and revised the inflation forecast down to 4.3%. The economy also held up better in 2022 than previously expected, confirmed by staff's 2022 growth forecast of 3%. GDP grew by 0.1% in the final quarter of 2022, hence avoiding a recession. Job creation has been strong in 2022, with employment growth at 1.8 %. Consumer and business confidence has also recovered in recent months, from a low point in mid-2022.

Fiscal policy – towards a consolidation of public finances

Based on the latest estimates, the budget deficit for 2022 is likely to be smaller than previously estimated. According to preliminary estimates by the State Secretary for the Budget, the 2022 budget deficit will amount to around to 4% of GDP. This better-than-expected outcome is driven by both higher income and less spending than previously planned, in line with the somewhat stronger economic data.

Belgium is fully committed to reducing its government deficit in the years to come to a level that puts debt on a sustainable declining path. A budgetary review for 2023-24 will be conducted in March 2023, in order to reassess the budgetary strategy. The authorities will take stock of the recent revenue and expenditure developments and the macroeconomic outlook, both of which are cautiously on the upside. In doing so, they will continue to balance the need to ensure fiscal sustainability without jeopardizing the recovery of economic activity. In the medium term, the outcomes of the spending reviews will be instrumental in identifying structural efficiency gains alongside further deficit reducing policy changes, including pension and labor market reforms.

In a context of rising interest rates worldwide and with the ECB's net asset purchases having been discontinued, Belgian government securities continue to generate sustained market interest. As staff rightly points out, the debt management strategy has contributed to strengthening market confidence. Also, in response to market demand, the Belgian Debt Agency has lengthened maturities during the period of low interest rates, thereby reducing refinancing risks. The average maturity is now more than 10 years, with an average implicit interest rate at 1.5%.

The objective to lower the deficit is shared among the different government layers in Belgium. The selected issues paper on fiscal federalism points to the specific structure of the Belgian federal state and rightly notes the need to coordinate between the different entities. All levels of government in Belgium share the responsibility to ensure the sustainability of public finances. The COVID-19 crisis, Russia's war in

Ukraine, and specific factors such as the floods that hit the Walloon Region in 2021, resulted in a debt increase for all levels of government. They will all make consolidation efforts in line with the European Framework.

The authorities have narrowed the focus of their energy measures and are taking steps to target support further. After broad-scale support measures at the beginning of the energy crisis, Belgium has gradually shifted to more targeted and more limited support measures. Under the so-called "basic energy package", a bill reduction on electricity and gas during the winter period, the financial support received is subject to income tax, meaning a larger portion is recouped from higher-income households. In February 2023, the Belgian federal government took a further step by keeping the VAT on gas and electricity at 6 percent for residential contracts and offsetting its budgetary impact by introducing excise duties on gas and electricity from April on. The level of these excise duties will depend on international energy prices and will be consumption-driven, with higher consumption being subject to higher duties. Furthermore, stricter eligibility criteria will also reduce the number of people benefiting from a reduced social tariff.

The authorities wish to thank IMF staff for their effective engagement on tax issues throughout 2022. The IMF has assisted Belgian authorities in calculating the VAT collection gap. The results of this analysis will feed into the administration's work, focusing on the areas where gaps are pronounced. In addition, the IMF's input has been actively used in the drafting of a tax reform blueprint prepared by the Minister of Finance. In the coming period, a first package of proposals will be brought to the table. The IMF's support will help guide work on tax reforms in the coming years.

Financial sector – strong buffers, but close vigilance is warranted

The Belgian financial sector remains in a strong financial position and is well positioned to support the real economy. Financial institutions have so far adapted well to the new environment of geopolitical fragmentation, asset price corrections, high inflation, rising interest rates and less favorable growth prospects. Non-bank financial intermediation was resilient in 2022, supported by prudent risk management. Financial sector firms maintained strong buffers, with Tier 1 capital in the banking sector at 17.1% and a solvency rate in the insurance sector at 227%. This enables them to absorb possible unexpected losses, without impairing their functions vis-à-vis the real economy.

The authorities agree with staff on the need to preserve resilience and ensure adequate provision of credit. Given the signs of a downward turning point in the financial and credit cycles, the reactivation of the countercyclical capital buffer has been postponed, to ensure that banks can use their ample capital reserves. In view of potential vulnerabilities, macroprudential measures for mortgages were maintained. Macroprudential expectations continue to discipline the mortgage lending conditions at origination. Price growth in the housing market has slowed in 2022, yet prices continued to grow in nominal terms. The housing market in Belgium has historically been stable compared to peers, *inter alia* avoiding a pronounced drop in prices during the global financial crisis. Risks linked to higher interest rates are in addition mitigated, as more than 70% of mortgages carry a fixed interest rate for the whole maturity of the loan. If vulnerabilities nonetheless were to materialize, a sectoral systemic risk buffer has been put in place, corresponding to €2 billion, to finance losses or solutions for borrowers facing repayment problems. The National Bank of Belgium has also increased its focus on the prevention of money laundering and terrorist financing, with a comprehensive action plan in which higher risk in certain sectors is accompanied by heightened vigilance and inspection.

Authorities are looking forward to the IMF's Financial Sector Assessment Program for Belgium, which will be carried out mainly in 2023. A first scoping mission took place at the end of 2022, with two additional missions later this year. Belgium attaches great importance to financial surveillance by the IMF, including in its own jurisdiction. The authorities are working closely with staff. As during previous occasions, they will carefully consider the findings and act on the recommendations of the assessment.

Structural policies – continued commitment to long-term reforms

The federal government and the subnational levels of government are committed to increase the employment rate. The federal government has set an employment rate target of 80% by 2030. To meet this target, Belgium is working to both reduce the number of unemployed, and to increase overall labor market participation. In 2022, Belgium intensified its back-to-work policy, with more coaching and financial enticements to bring currently inactive people to the labor market. The authorities expect to reap the benefits of this policy in the coming years. Employment efforts are furthermore tailored to the needs of the different regions, with a focus on increasing overall employment rates in Brussels and Wallonia and addressing labor market bottlenecks in Flanders.

Policy reforms are being further implemented to support growth and improve the sustainability of public finances in the longer term. The federal government is currently discussing the pension policy. Reforms to the pension system will enable the unlocking of resources from the EU's Recovery and Resilience Facility, which in turn allows for investments underpinning Belgium's long-term growth potential

The authorities note that automatic wage indexation has been helpful in protecting purchasing power in Belgium and buttressing consumer confidence. Indexation is furthermore not expected to lead to inflation higher than the EU average in the period 2022-23. The indexation mechanism is coupled with a wage law, which ensures that wages do not deviate on a structural basis from neighboring countries, as indicated in the staff's analysis. The authorities aim to preserve the benefits of wage indexation while being mindful of drawbacks for the economy. Together with trade unions and employers, the authorities will continue to monitor the functioning of the automatic indexation.

Belgium is working towards meeting the net-zero by 2050 objective, including by moving away from fossil fuels towards electrification of energy consumption. Efforts are ongoing to electrify heating and transport, as well as reducing overall energy consumption. The selected issues paper on accelerating emissions reductions provides useful input into meeting Belgium's objectives. Besides examining price-based policies, the authorities are increasing investments to address climate change. An agreement has furthermore been reached in January 2023 to extend the operations of certain nuclear reactors by ten years. This will help bolster energy security and affordability in the uncertain times ahead.

The Belgian authorities look forward to a continuation of the productive interaction with Fund staff.