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A key role in global capital markets

By Koen Geens, Minister of Finance, Belgium

Belgium is one of the few euro area countries with GDP now above pre-crisis levels. Most forecasting institutions expect its growth rate in 2014 to be around 1.4%, which would be higher than the EA18 average. Investors and rating agencies appreciate Belgium's diversified and open economy. Moreover, our country has a significantly positive net international investment position thanks to its strong private sector.

Despite sustained efforts by the current government, such as the sale of several assets and a structural reduction of the deficit, Belgium still has a high government debt ratio, the origins of which lie in the 1970s and the 1980s of the previous century.

Having peaked at 134.1% of GDP in 1993, its debt ratio fell to 84.1% of GDP in 2007, before increasing again to about 100% of GDP in 2013 as a result of the crisis, which forced the Belgian government to rescue a number of private banks and to contribute to the European funds EFSF and ESM. Yet, the government is planning further actions to bring its debt ratio down to a sustainable level. To this end, the budget deficit will be further reduced: in 2013, the government deficit was reduced to 2.6% of GDP, which resulted in the return to a primary surplus for the first time since 2008. While the nominal deficit is expected to remain below 3.0% of GDP and the primary surplus is expected to further rise in a scenario of unchanged policy, the government plans a budgetary trajectory that envisages reaching the medium term objective of a structural budget surplus of 0.75% of GDP within a few years.

The Belgian government is indeed convinced that achieving a lower public debt ratio is essential to cope with some major challenges such as the costs of ageing. Ageing related costs are expected to increase with 3.3% of GDP by 2030, and 5.4% of GDP by 2060, in a scenario of unchanged policy. Further reforms such as the pension reform undertaken by the government in 2012 can change the outcome and lead to lower increases in public spending on social security. But reducing public debt in the coming years is nevertheless a matter of intergenerational solidarity.

Keeping the market's confidence

A sustainable debt ratio is also indispensable to keep the confidence of financial markets. By bringing political stability and taking structural reforms, the Belgian government contributed considerably in decreasing the spread between French OATs and Belgian government bonds yields from close to 2% by the end of 2011 to about nil today.

As mentioned above, one of the factors that have caused government debt to increase again was the government support to a number of Belgian financial institutions. The Belgian government offered significant support for more than 6% of GDP in the early days of the crisis, accompanied by sizeable government guarantees. As of today, a number of these support measures have been run down: the portfolio of Royal Park Investments (the 'bad bank of Fortis') was sold, and the government sold its remaining stake in BNP Paribas Fortis. Both operations were beneficial to the government. In addition, a number of government guarantee contracts were terminated, or significantly reduced in size. Yet the government is still a significant shareholder or creditor of some financial institutions. The government guarantees for Dexia are still significant and now constitute the vast majority of the overall government guarantees.

Belgium's financial institutions have been running ahead of the deleveraging process that took place all over Europe. With an overall core tier capital ratio of 14.6% (2012, Basel II) and several institutions confirming that their capital structure is already compliant with the upcoming — fully loaded — Basel III rules, the banking sector should be able to deal with future challenges. Belgian banks also have significant funding through household deposits, leading to favourable loan-to-deposit ratios.

At the end of April, the Belgian federal parliament adopted a new 'banking law' that contains more severe regulation than is currently adopted in the EU, and which anticipates future European legislation in this regard.

In this publication, the capital market operations of Belgium's main institutions are discussed, including those of the sovereign, which has enjoyed a very benign funding environment since the brief spike in government bond yields at the end of November 2011. The Belgian Debt Agency seized the opportunity to lengthen the duration of its debt portfolio: it now has one of the very longest average maturities (7.65 years) in the euro area. Other actors also intelligently used funding opportunities, as you will read in this document.

It is my ambition to take further actions to reduce the Belgian public debt ratio, and doing so I am confident that Belgium will continue to play an important role on the world's capital markets. ▲

Breaking the political deadlock

With one of the best education systems in the eurozone and an economy that performed well relative to others in the currency bloc during the 2008 financial crisis, at first glance Belgium looks in good health. But with an ageing population, minimal political will to improve competitiveness and a lack of graduates in science, technology and engineering, the small country has many reforms to make. **Craig McGlashan** reports.

AS BELGIUM is home to several of Europe's biggest ports, it is no surprise that the country's economy relies heavily on exports. It leads the world in diamond and carpet exporting, while vegetable fibres, chocolate and glass are also big money spinners for the country. Germany, France and the Netherlands are Belgium's biggest trading partners, each taking around 15% of the country's exports. The UK takes around half that, while Italy and the US take roughly 5% each. But it has work to do to diversify the ports its products sail to.

"Belgium has a competitiveness problem"

Johan Van Gompel, KBC

"A relatively high share of our exports go to other EU countries, rather than emerging markets," says Johan Van Gompel, senior economist at KBC in Brussels. "Export growth in Germany was in line with the development of world trade in [the] past decade whereas for Belgium it was below. The government needs to incentivise companies to export."

But while Belgium has work to do to boost its links with emerging markets such as China, it still has enough of a connection to feel the pain when some of those countries experience problems.

"Belgium has a relatively open economy so is incredibly reliant on what's happening in world trade," says François Cabau, European economist at Barclays in London. "The potential slowdown in China is a big risk."

Belgium did not fare as badly as most other eurozone countries during the 2008 financial crisis, with only Germany and Austria performing better in terms of economic activity and also employment, says KBC's Van Gompel. But with tight trading links to its peers in the eurozone, the recovery from the eurozone debt crisis has been a crucial aspect in Belgium's own return to growth.

"Our economy also recovered from the double dip recession in 2012 and early 2013 and in the final quarter of last year growth was quite strong," he says. "As a small open economy, we are dependent on exports and those to other European countries are still very important. So the economic recovery in Europe and the eurozone in particular has been very important. The recovery over the past few quarters has also been driven by domestic demand, especially consumer spending. It was already strong in the first quarter of 2013 but in the second half of last year corporate investment steadily picked up. There's a broad-base recovery in Belgium."

KBC predicts growth of 1.2% in the economy this year and 1.6% in 2015, while Barclays has a figure of 1.4% in 2014 and also 1.6% next year. Both estimates are more conservative than the European Commission and the Belgian Federal Planning Bureau, however. KBC and Barclays' predictions are lower in part because Belgium still has a lot of fiscal austerity ahead. But Barclays' Cabau is optimistic about the country's ability to meet the task.

"The nice thing about the Belgian economy is that it's well managed — even without a government for more than a year," he says, referring to the 589 days Belgium spent without an executive between the resignation of prime minister Yves Leterme in April 2010 and the formation of the current government in December 2011.

"The deficit is already below the 3% threshold, the one big issue is the large public debt. But we believe the debt will already start to edge down this year then continue to fall afterwards to below 100% in 2015, having been at 101% in 2013."

Dividing difficulties

But there are serious obstacles on Belgium's path to reform — obstacles made all the more difficult to navigate around given the fractious nature of Belgian politics that allowed the country to break the record for a democratic state to go without an executive between 2010 to 2011.

"Belgium has a competitiveness problem," says KBC's Van Gompel. "We have lost unit labour cost competitiveness to Germany and our main trading partners over the past decade. The government has taken measures to counter that problem but it is still not enough. It is not being met with enough urgency and this will weigh on our export performance in the years to come."

Part of Belgium's lack of competitiveness lies in a system it has held on to that others have long wiped from the statute book, according to economists.

"Inflation is good because it helps reduce the level of debt," says Barclays' Cabau. "But it's a double-edged sword because Belgium is the only country in the eurozone that still has a direct link between inflation and wages. When you have a small open economy you are all the more open and exposed to external shocks and in particular energy prices, so you have the potential to have higher inflation than other countries. That affects competitiveness, as wages go at quite a buoyant pace."

The government has taken steps to tackle the problems arising from wage indexation, including taking retail sales periods in January and June/July into account when formulating inflation figures.

But Belgium also has a wage normalisation system that says that the wage cost per employee should not increase by more than the average of its three neighbouring countries. Since it was introduced in the mid-1990s, a wage cost disadvantage of about 5% has been built up, according to KBC's Van Gompel. He also worries about the political will to break the wage and inflation link.

"The government is very eager to change the automatic wage indexation system," he says. "But there is a lot of opposition and it's hard to push through legislation when governments rarely have large majorities. But it needs to look at whether the system as a whole should be removed."

Political stalemates have also caused problems on other reforms, but hopes remain that some of these could be resolved when voters go to the polls to elect a new federal government on May 25.

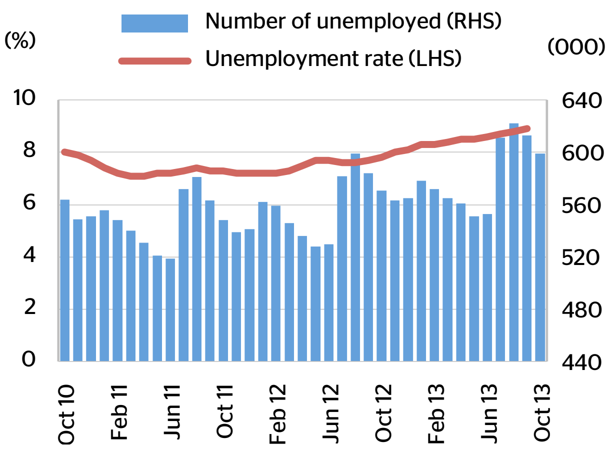
"One discussion they can't reconcile is VAT," says Barclays' Cabau. "A lot of peripheral countries sifted taxation away from labour on to consumption. There has been a project of hiking VAT with an offset on the labour side. That didn't see daylight in Belgium but that could be part of a deal for a coalition after the election. Hopefully a government can form swiftly after the elections, not only to show stability and avoid any accident in terms of funding in bond markets but also to bring through some of the structural reforms, while at the same time minimising the unit labour costs that keep increasing."

While Belgium performed much better through the crisis than most other eurozone countries — its economy is 1% larger than when the 2008 financial crisis started — a new government could learn lessons from some of those that suffered the most, according to Cabau.

"[Productivity] will be a key topic of the upcoming election because it's a European Commission recommendation and it's also what peripheral countries have done," he says.

"They have managed to quite significantly reduce unit labour costs, either through increased productivity like in Portugal or Spain, or through an outright fall in wages like in Greece. Belgium is in a similar basket to Italy and France, where reforms on competitiveness are pending and need to be made in a decisive and forceful way. If it is improving less than other countries it could pose some structural threats on the recovery and the debt trajectory. Spain is a good example of a country with low productivity [that] has gained export market share, productivity and cost competitiveness. That example needs to be exported to other countries."

Labour market deterioration



Source: Belgostat, NBB

Demographic deficits

There are some problems even a new government may struggle to solve, however. The country has one of the highest costs of ageing in the EU, while the structure of the state itself — between Flemish-speaking Flanders and French-speaking Walloon — has been in a large part responsible for its political disconnect in recent decades and has a similar effect on the economy.

"We have two main regions, Flanders and Walloon, and up until now the real divergences are quite high," says KBC's Van Gompel. "In Flanders the unemployment rate is low, but it is quite high in Walloon and has been structurally high for decades."

There are also difficulties at the other end of the working age scale. Belgium has a very strong education system — the Organisation for Economic Co-operation and Development's most recent Programme for International Student Assessment in 2012 awarded it a score of 508, above the mean score of 500 and below only Finland, Estonia, France, the Netherlands, Italy and Germany in the eurozone. But the career choices young people are making are not the ones the economy needs, according to Van Gompel.

"Belgium has a relatively open economy so is incredibly reliant on what's happening in world trade"

François Cabau, Barclays

"We need a more flexible labour market, more attention on innovation and a more growth-friendly environment," he says. "We have a very good educational system but we do not have enough young people studying science, technology and engineering. There is no steering — it's changing gradually, but there needs to be more direction. Our vacancy rate is quite high — a lot of companies look for engineers but can't find them. There need to be better incentives." ▲

Coene: foundations are laid for Europe's revival

Luc Coene took over as governor of the National Bank of Belgium in April 2011 in the teeth of the eurozone debt crisis. Almost three years to the day, *GlobalCapital*'s **Tessa Wilkie** sat down with him to discuss the dawning economic recovery, the importance for Europe's governments to finally nail structural reforms, the role of the ECB and the prospects for sustained growth not only in Belgium but across the eurozone.

GlobalCapital: **How happy are you with growth in the eurozone?**

We would like to have higher growth than we're seeing at the moment, but that is not something that central bankers can make happen — that is something for eurozone governments to make happen. What the European Central Bank can do is buy time so that the economy can keep accelerating — governments need to implement structural reforms to harness the growth of the economy. We can buy time but time is limited. At a certain moment we won't be able to buy any more and if by then the structural reforms haven't been put in place then we will face a much more difficult situation of persistently low growth.

GlobalCapital: **Can the ECB do much more to help? Expectations that the ECB could introduce quantitative easing seem to have helped peripheral eurozone sovereign bond yields drop over the past month. Is there potential for the ECB to do more or is the market getting ahead of itself?**

The market is getting ahead of itself. There is not much the ECB can do. In the periphery countries things are really turning around. The economic situation in Spain, Portugal, Ireland and even in Greece is improving — the worst is behind us. It would be a pity to abandon a strategy that is working, to change gear — for example by trying quantitative easing or delaying budgetary adjustments or structural adjustments.

The ECB has laid the foundation for the revival of the economies and changing policy now won't help. We have to let this revival take its own pace. Growth is improving in the periphery, and it's a matter of urgency to have those reforms implemented to maintain the pace of the budget consolidation so we can use growth to facilitate the adjustment process.

QE has to do with the issue of too low inflation and the jury is still out on whether this is a temporary phenomenon or a structural phenomenon. Only when we are convinced it is a structural issue will we move in the direction of forms of quantitative easing in the form of buying ABS or corporate securities to try to improve the situation.

GlobalCapital: **Would a further ECB rate cut be helpful for growth?**

If low inflation is maintained for a much longer time than initially thought, then we would have to make a more accommodative policy. We will have to see how inflation develops and what the outlook is for the medium term.

GlobalCapital: **Moving on to Belgium, specifically. Economic growth appears to be accelerating. Are you happy with the pace of it?**

Belgium has passed the crisis well compared with other countries. Together with Germany we have a level of GDP that is higher than before the crisis, whereas for most economies in Europe the level of GDP is not as high as it was before 2007. Belgium has absorbed the crisis well. The situation is slowly improving. Last year growth was 0.2% and this year it will be around 1.2%. That's an improvement but it is very gradual. There are a number of challenges that the government has already begun to tackle, in terms of labour markets and wages, but there is much more to be done.

We have elections on May 25 and the next government will have a number of issues to address. One of these is competitiveness, and the government should also work on innovation — research and development — to make sure we can strengthen our competitiveness and strengthen the economic basis to maintain the social security system. There is a lot of work

Luc Coene: "We have to let this revival take its own pace"

there because we have an ageing population and a high debt burden. Work has already begun but the next government will have a lot to do to bring growth levels higher.

GlobalCapital: **Do you think, for example, the labour market needs further reforms to make it more competitive compared with other European countries?**

When we talk to companies there are two issues on the table: that is flexibility of the workforce and linked to that is high wage costs. Addressing these issues requires further improvement in the functioning of the labour market.

GlobalCapital: **Belgium is going into an election and has gone through periods of political instability in recent years. Reforms to improve labour flexibility and reduce high wage costs are perhaps not vote winners. Are you concerned that Belgium could struggle to form a government again and that that could hurt the recovery?**

There isn't a high risk of a repetition of what happened in 2007 and 2011. The political body in the country has realised that a repetition of those situations would be devastating for the economy. The situation is also fundamentally different to in 2011. At the end of 2011 there were doubts about survival of the eurozone and fears about a break-up of the entire system. The situation is clearly much better — there is no more fear about the collapse of the system. I don't expect to see a sharp increase in government bond spreads to Bunds this time around.

GlobalCapital: The debt to GDP ratio is set to peak at around 100% in 2014-2015. Can the incoming government tackle this?

The debt ratio was much higher in the 1990s and before the crisis we had brought it back to 85%. The crisis has pushed debt back up. The government submitted a stability programme to the European Commission that aims to have a small surplus in 2016, and that will bring about an automatic reduction in debt levels, year after year. There is a good consensus in Belgium about sticking to the adjustment path and bring debt down as much as possible. We have experienced in the past the detrimental impact that too high debt levels has on the economy, on interest rates. This is one of the major issues that will be tackled by the next government.

The second advantage we have is that the government that will be elected later this month will have a five year tenure. That is unusually long and allows the government a good start at passing good measures at the beginning so they can wait for the effects of the measures to be seen before the end of the legislature.

GlobalCapital: The banking system has had its ups and downs over the past few years. Belgium's banks have deleveraged fast. Are you happy with the pace of deleveraging and have the banks been able to do that without any detrimental effect to the economy, to the supply of credit to businesses and individuals?

Absolutely. The banks have mainly deleveraged by shedding external activities — by splitting off or selling businesses. So on the domestic side banks' balance sheets are the same as they were before. The banking system has provided credit to the Belgian economy throughout the crisis.

The deleveraging has been a very positive development, but it means that there is much more concentration in the domestic market and that means much more competition in the domestic market. That weighs on the profitability of financial institutions. That is forcing them to adjust and manage their institutions in a more cost-effective way.

GlobalCapital: Are you concerned about the level of profitability?

The level of profitability is reasonable at the moment but the intense competition will weigh on further improvements in profitability. Banks need to improve profitability because they need to boost their capital buffers to be fully compliant with Basel III in two years.

GlobalCapital: Do you expect Belgium's banks to do well in the Asset Quality Review in November?

The AQR is a very good exercise and an important one to go through. It will bring back confidence in the quality of the banks' balance sheets, which has been lacking. I don't foresee many problems. Banks have been restructuring over the past two to three years. They have strengthened their capital bases and increased provisioning and I expect that to show in the AQR.

GlobalCapital: You said the AQR should bring confidence around the quality of banks' balance sheets. I remember in the last round of stress tests everyone got quite het up about them, and then when they had passed without any major blows people were saying they didn't have any teeth. Do you expect that to happen this time around?

The conditions for the stress test include a 6%-7% drop in GDP and a substantial fall in housing prices, flat inflation and an increase in interest rates. That's a serious stress test. I wouldn't be surprised to see some institutions here and there to run into problems, but I don't expect there to be a large number. A lot of adjustment has taken place over the past few years and most banks have built sufficient buffers.

GlobalCapital: Banks are dealing with a raft of regulation. Are you confident that Belgium's banks are prepared for Basel III?

Banks are moving in the right direction to be fully Basel III compliant in terms of liquidity and in terms of capital. It imposes additional burdens on the banks. The crisis has shown that having these levels of capital and liquidity is essential to avoid a repetition of it.

The government has approved a new banking law which implements CRD IV into the Belgian legislation. We are now much better equipped to deal with exceptional circumstances. It goes further in that imposes restrictions on banks' trading activities. It will allow them to carry out what is needed for normal business but not engage in speculative behaviour. This will require banks to adjust and we need to give them some time to adjust their business models.

GlobalCapital: How will banking union affect Belgium's banks?

The crisis has shown the extreme difficulty of dealing with cross-border banking systems in times of stress. The way that regulation is implemented across countries differs. We need a level playing field. Banking union will greatly improve the workings of the financial system in the euro area as a whole.

The AQR is very important in this. It will ensure we start the new system with sound banks, with adequate internal provisioning, capital buffers and liquidity. Having a financial system managed on a European footing should have a positive influence on growth in the European economy as investors will know that the banking system is adequately capitalised.

GlobalCapital: There is still a strong link between Belgium's banking system and its sovereign. Are you worried about that?

Most of the state aid has now been repaid although there are still some parts outstanding. For Dexia there is a guarantee outstanding to aid funding while it is in run-off mode. The size of the balance sheet and length of asset maturities for Dexia is such that it needs to run down year after year. I'm confident most of the assets will be repaid in time. ▲

Small is beautiful: Belgium makes most of economic recovery

This year the Belgian Debt Agency printed a pair of benchmarks that heralded a return to the pre-crisis era of debt financing. One was a 10 year, which attracted the largest book Belgium had seen on such a deal since 2008.
The Belgian economic recovery accelerated last year and is outpacing many countries in the eurozone. But challenges remain. No stranger to political instability, Belgium will enter national and regional elections in late May and the next administration has plenty of work to do to shore up the economic recovery, as well as address long term problems such as Belgium's ageing population and a high level of debt to GDP.
GlobalCapital gathered key banks and investors to a roundtable with the Belgian Debt Agency at its offices in Brussels to discuss the main issues facing the market for Belgian debt in 2014 and beyond.

Participants in the roundtable were:

Lee Cumbes, head of SSAR DCM EMEA, Barclays

Nick Dent, head of EMEA syndicate, Nomura

Katherine Dior, head of DCM Belgium and Luxembourg, BNP Paribas

Koen Hoffman, chief executive, KBC Securities

Anne Leclercq, director, treasury and capital markets, Belgian Debt Agency

Paul Spurin, European DMO relationship manager, Nomura

Emmanuel Vander Elst, portfolio manager, AG Insurance

Steven Vanneste, economic advisor (Belgium and Luxembourg) BNP Paribas

Tessa Wilkie, SSA Markets editor, *GlobalCapital*

GlobalCapital: This year there has been a real improvement in the eurozone sovereign debt situation — Greece has just returned to market with a bond, for example. Within the eurozone the Belgian economy has been growing faster and faster. What is the outlook for the economy? Will growth accelerate?

Anne Leclercq, Belgian Debt Agency: The growth estimate for 2014 is 1.4%, which is quite an improvement in comparison with before. The base for this growth outlook is a mix of domestic demand and exports, as evidenced by the positive trend in consumer and business confidence during the last quarters.

We believe that in 2014 Belgium will benefit from very solid domestic fundamentals, as well as from an improvement in the economy in the European Union countries.

Domestic involvement is supported in Belgium by resilient labour employment, and also wealthy financial holdings from Belgian households.

On the other hand a return to growth in the euro area — particularly in Germany — and also growth in the US will stimulate exports. With 80% of Belgium's GDP being exported this is an important factor in the recovery.

That being said there are vulnerabilities. One of the key elements in achieving this growth is the situation of the labour market, and more precisely the competitiveness of the labour market. The government adopted a competitiveness pact in 2013, including measures to reduce the labour costs and increase labour market participation. The next government will have to implement some more measures. I'm quite confident that this will happen. There is a consensus between all political parties that competitiveness of the labour market is a top priority.

Koen Hoffman, KBC Securities: Our internal predictions are 1.2% growth in 2014 and 1.6% for next year. The focus for local and international investors will be on two key elements. One is labour market competitiveness which Anne has already mentioned, but secondly — and it goes hand in hand with the first one — is the competitiveness of government finances, the way that Belgium's household is being run.

If you look back over the last couple of years, the government has done well. You can see that in the way that the sovereign's bond yields have dropped. But how this will go on and whether the European Union will get involved in Belgium's finances are key questions.

GlobalCapital: I'm interested to hear the investor perspective.

Emmanuel Vander Elst, AG Insurance: We see growth at slightly below 1.5% in 2014, and that is driven by domestic consumption. We see investments picking up as well, and of course competitiveness is an issue.

Steven Vanneste, BNP Paribas: But if we look at the performance of Belgium since the start of the eurozone debt crisis, year after year it has outperformed the eurozone average, and that is thanks to solid domestic fundamentals. A wealthy household sector is one major element.

For this year we expect Belgium to perform in line with the eurozone, but if we look at where Belgium is relative

Steven Vanneste
BNP PARIBAS

to the start of the crisis, it would, at the end of 2014, be 2% above the level of growth it had going into the crisis, while the eurozone average will be at 2% below. That said, there are vulnerabilities, but these are more issues that impact the longer-term growth potential of Belgium.

Paul Spurin, Nomura: As Anne touched upon, Belgium is an export driven economy, so it has done very well because big economies like Germany, France and Holland have done very well over the last few years. Clearly that's out of the control of Belgium.

GlobalCapital: So as the eurozone recovers would you expect economic growth in Belgium to increase even more?

Leclercq, Belgian Debt Agency: Yes, almost 40% of our exports are to neighbouring countries. If those neighbouring countries, and more particularly Germany, are performing, it immediately has a positive effect on Belgium's economy. Export destinations are diversifying. Since 2008, the share of exports to Asia has risen to 11% and to the Americas to almost 8%.

In 2010 and 2011 the Belgian economy grew 2.3% and 1.8% respectively, mainly driven by exports to Germany. Germany at that time was benefiting from some of its government's efforts to stimulate the economy. We benefited from that without the Belgian government having to invest in important stimuli.

Hoffman, KBC: And that is where the risk is, too. My real worry would be that if the competitiveness towards the economy in Germany, for example, were to deteriorate, then it would have an almost immediate impact on the competitiveness of the Belgian economy as is today.

Vanneste, BNP Paribas: It is worth noting the geographical specialisation of Belgian exports, which is traditionally oriented towards its neighbouring countries — Germany, France and the Netherlands. But we also see the growing importance of the emerging markets, like India and China. Belgium is slightly rebalancing towards exporting to faster growing markets, and that is an improvement.

Hoffman, KBC: The fastest growth in our group — other than Asia — would be Africa, which might be the biggest challenge and the biggest advantage for Belgium, because of Belgium's historical associations with that continent.

Lee Cumbes, Barclays: Belgium is well regarded as a diverse economy, a well balanced economy, and we've heard evidence for that here. It is also a country that has been through some testing periods in the past — not just during the eurozone debt crisis — and it has been proven to be a well-managed, disciplined country.

GlobalCapital: Anne mentioned the government taking measures to improve the competitiveness of the economy. Elections are coming up soon and Belgium has a past record of governmental instability. Is that a concern for investors? What do banks around the table feel about the political situation?

Leclercq, Belgian Debt Agency: The periods of longer political instability, and I'm referring to 2007 and 2011, did not have a meaningful impact on economic figures and public finances in Belgium. If we were to have a very long period of political instability after the elections then this might affect the ability to put in place the reforms — which are necessary. This will not have an immediate impact but rather an impact on longer term growth potential.

However all major political parties that are in the running for government take competitiveness and sound debt metrics very seriously.

Hoffman, KBC: On balance it wouldn't be positive if it took a long time to form a government again, but to compare the two periods is not really fair. One was when Belgium, and Europe, were in a period of economic stagnation and that is not the case today. All the politicians in Belgium smelt sulphur during the debt crisis — none of them want to go back to that period again.

Katherine Dior, BNP Paribas: There are two elements that really differ compared to the period that we experienced in 2011. We've been through the European government bond crisis, and with Draghi's reactions in mid-2012 that issue has been set aside. There is no longer a political threat to the eurozone.

The reaction of Belgium to the crisis in 2011 was quite drastic. Domestic investors, going right down to the full breadth of retail investors, stepped in to support the sov-

Katherine Dior
BNP PARIBAS

ereign's bonds. The State Notes campaign — the Belgian debt product targeted at retail investors — at the end of 2011 is a very good example of this. That showed the investor community that there is an implicit kind of cap, in terms of yield, where the domestic investor base will step in. That will prevent Belgian sovereign bonds spiking in the way they did in 2011, even if we face more difficult times after the elections. If there is a spike because of the election it will be much less pronounced because of these two factors.

Nick Dent, Nomura: Belgium has been through patches of political instability in 2007 and 2011. Domestically there are still a few questions to be answered, whether that's the independence question or confederalism. Perhaps some of this isn't as big an issue as it used to be as domestic politics has been watered down over the past two years.

It is an issue that will be at the forefront of investors' minds just as we go into the next round of elections in Belgium. But potential political instability is something that a lot of people have just got used to over the years. It's not just a Belgian question. You can see it going through in the UK with the rise of independence parties and anti-EU parties, and potentially Scottish independence as well. Belgium used to be an outlier with some of these questions within Europe, but now it's a question that has been posed in the UK and in Spain as well.

Cumbes, Barclays: I agree. From the international perspective markets are very calm. Maybe investors should analyse possible scenarios where there are difficulties arising from the elections, but that isn't the consensus expectation.

Investors have seen that the general population and the authorities are very focused on tight fiscal management and controlling debt to GDP levels. Belgium is outperforming the eurozone average and has ended up with a GDP that is larger than it was pre-crisis. Even in the most testing times Belgium kept its discipline.

Leclercq, Belgian Debt Agency: What is at stake in these elections is much more the long term goal of making sure that we create a more competitive economy, rather than a next State Reform. The outgoing government agreed upon a sixth State Reform, which is only partially implemented and will be further implemented in July. There is no reason for the political parties to reopen the debate on further reforms going into the election. This is clear when looking at the party programmes.

Dior, BNP Paribas: For the first time in years, these elections will be held at both federal and regional levels. That bodes well in terms of having five years of stability in which Belgium would be able to work, once the government is formed. But Belgium has proved before that, even without a government, the country can still function.

Hoffman, KBC: On the one hand investors will look at the debt to GDP level. It's high, but Belgium has been able to keep it roughly at the same level — which can't be said for many peers or competitors. When you're on roadshows or talking to investors it's a given that they will mention that. Any political measure that will keep that ratio at more or less at the same level is going to be supportive.

One of the turning points was when the local investment community said that it wanted to support the government's funding. The Belgian Debt Agency operates with respect for the local investor as well as working with international investors.

If politicians keep the debt to GDP at a level — even if it is a high one — it will be seen more as a strength than anything else. Whereas having a changing government that was struggling to find consensus used to be known as a Belgian disease, it is now known more as a European-wide problem.

Leclercq, Belgian Debt Agency: The debt ratio, 101.5%, should be put into perspective. Firstly, the increase in Belgium's debt to GDP levels since the beginning of the crisis was around 15% — only half of the average increase in the eurozone, which amounted to 30%.

Secondly it is more important to look at the trajectory of the debt ratio — which next year will be on a downward path. The internal debt dynamics are favourable. Last year Belgium reduced the budget deficit to below the 3% threshold of the European Union's excessive deficit procedure and printed a primary surplus. Growth

Anne Leclercq
BELGIAN DEBT AGENCY

strengthening and reduced interest costs will continue the downward trajectory for the debt to GDP ratio.

This is a very credible story for investors. Belgium has a good track record on reducing the debt to GDP ratio. In the 14 years before the crisis the debt to GDP ratio was reduced by 50%, which is quite an achievement.

GlobalCapital: Are you hearing any other concerns that investors are citing for the Belgian economy? The connection between the sovereign and the banking system is still quite high. Is that a worry?

Dent, Nomura: There are two main risks at the forefront of investors' minds. The first is that the linkages between the sovereign and banks remain quite elevated, at around 12% of GDP in Belgium. It's probably less of an immediate risk — it's more of a tail risk as stress has been reduced within the system, and a lot of this sovereign support is starting to be repaid.

The second risk to the economy is lower inflation, and again, that is a risk across the eurozone, not just within Belgium. It is a point the ECB was perhaps slightly behind the curve on, and now seems to be ahead of the curve on, given the amount of press time spent talking about tools that it could have at its disposal to combat that.

Cumbes, Barclays: When you talk to international investors, the main risks are external and are ones that any developed economy is facing. So whether you are talking about the slowdown in China, or whether quantitative easing in Japan will work, or how the US recovery will proceed in the face of tapering from the Federal Reserve, or the situation in Russia — these are questions that every major economy is facing right now. Those are the questions that would be placed around Belgium.

Some local issues, for example Belgian banks' results in the Asset Quality Review, were previously seen as a source of concern, but equally, could boost growth. The AQR will clear up one of the last areas where there is some uncertainty when investors look at Europe.

The challenges for Belgium are challenges that every developed economy faces, but there are known ways of countering these issues. As Nick said, for example, on the inflationary situation in Europe, investors trust that the ECB has the tools and the wherewithal to face that.

Spurin, Nomura: Low inflation, or even the threat of deflation, has gone from being a major concern to a positive for the bond market, given the change in stance at the ECB.

We're not quite sure what form quantitative easing could take, or whether Mario Draghi is hoping that just talking about it is enough to not need to actually do it. But that's another reason for investors to buy European government bonds. Especially anything with some sort of spread or meaningful yield, as QE in most forms is going to be very positive for the eurozone bond market. One of the big concerns has potentially become a big positive for European government bonds.

Vanneste, BNP Paribas: Looking at the Belgian sovereign's exposure to the banking sector, it has been gradually reduced, for example via the loan reimbursement of KBC and the sale of Royal Park Investments. The rating agencies have not expressed concern, as the outlook for the Belgian banks, as a whole, is stable. Belgian banks are, compared with their European peers, better capitalised, and enjoy a very stable funding environment.

Leclercq, Belgian Debt Agency: The deleveraging of the banks after the crisis has been very large. Belgian banks' balance sheets were about €1.6tr before the crisis hit, and they have been reduced to less than €1tr, which is an amazing reduction. Also the just approved European banking union will further disconnect the ties between the sovereign and the banking sector.

GlobalCapital: How comfortable are you as an investor with the links between the sovereign and the banking system?

Vander Elst, AG: It's not something we're overly worried about. Most of the risks that Belgium is facing are the same risks everywhere in Europe. Low inflation might actually, in the case of Belgium, be of an advantage, because it would have a positive impact on salary increases, which are linked to inflation, and that would increase competitiveness. Absolute debt levels are not an issue either. As an investor we look at how the debt burden is evolving. The debt burden is growing at a slower pace than in most European countries.

Cumbes, Barclays: The issues with the banking system have been identified, stabilised, controlled, and inflation is 1% or thereabouts. Then you look at some countries in southern Europe that are going through a heavy period of deleveraging and internal devaluation to regain competitiveness. Maybe through Belgium you can see where the upside for them is as they come out of that more difficult period. Headwinds are reducing, financial market pricing looks better — that should filter through to the real economy. We certainly see much better appetite and pricing for peripheral corporate bonds and capital issuance of banks — that should also start to feed through.

Hoffman, KBC: On top of southern Europe and France, we used to have a lot of competition coming from Holland. For the first time in many years investors regard Belgium as a better alternative to Holland.

Leclercq, Belgian Debt Agency: If we set aside credit and yield and look at other factors investors are considering when they look at investing in Belgium — there's the question of liquidity.

For government bonds, which most of the time are quite expensive in comparison with other investment opportunities, liquidity is the main advantage versus the latter. Together with our primary dealers the BDA puts a lot of effort in offering liquid bonds. Our benchmarks, launched through our syndicated issues are large from the start, €3bn-€5bn in size, and their distribution is well diversified. Moreover our PDs have an obligation to continuously make markets in our bonds — that creates liquidity.

Vander Elst, AG: Liquidity is important for us, of course, but what is even more important is the yield, and there I have to say: it's good for you, but not so good for us.

GlobalCapital: We've had some interesting trading in European government bonds, where we've seen Ireland at points trading inside the UK, for example, as investors look to pick up yield. How is that affecting Belgium. Are some investors saying the yield is too low for them or are they looking at the spread to Germany and saying that Belgium offers a great pick-up over Bunds?

Emmanuel Vander Elst
AG INSURANCE

Dent, Nomura: You still have a number of funds with purely core mandates — the old triple-A mandate, if you like. There is still scope for that investor base to extend further into semi-core countries and beyond.

Liquidity isn't as much of a concern as it used to be, particularly as the primary market is coming back into full force. Debt agencies are able to deliver large new issue transactions and we are seeing the return of the €5bn benchmark deal, which gives borrowers liquidity from the start.

Within that, accounts are looking to pick up spread, particularly in this low rates environment.

Rates in Europe could be low for some time, and that looks more likely with the potential advent of QE. Picking up some spread will become more important, and it will be very important in the short to medium parts of the curve. At the longer end, bonds may trade more on a macro level, but in the short end to the belly of the curve is where accounts are looking to sell Holland and buy Belgium, for example.

Spurin, Nomura: Pre-crisis there were large amounts of liquidity offered by banks in all European government bonds, whether it was for Greece, Portugal or Ireland. We all agree now that what investors were demanding for liquidity was not enough back then.

I think we are at a happy medium now, where it's right that investors demand some sort of premium for a slight lack of liquidity in certain markets. You have to view over the medium to long term. If yields crunch much lower, and this search for return intensifies, investors might be tempted to nibble into this liquidity premium.

From the bank trading desk point of view, the levels of liquidity now that are being given to investors — right the way across the European government bond spectrum —are back to an impressive level. The levels of liquidity everywhere in the eurozone, perhaps with the exception of some peripheral markets, is ample.

Paul Spurin
NOMURA

Cumbes, Barclays: There is some focus about yield levels having been higher in the not so distant past. But equally, if you talk to the global investor base, investors want to buy euro assets because they see a stability there that they might not see in the UK or in the US, because of the path of the likely central bank behaviour there.

When you're marketing debt, it is important to have a very good grip on the fact that you go through cycles. You go through cycles of yield levels and you go through cycles of what the dominant investor base is. Some investors will buy for outright yield, some will buy for the asset swap levels, and some will buy for relative value. We're in a period at the moment where asset swap levels and the bank demand is very important.

Leclercq, Belgian Debt Agency: When comparing premia for Belgium more specifically before the crisis and after the crisis it is fair to say that before the crisis liquidity and credit premia were almost nil. When you look at the premium which Belgium pays now versus Germany and — much less —versus France, it is much more a credit premium rather than liquidity premium. Even throughout the crisis Belgian bonds remained liquid. The markets are gradually acknowledging the improving fiscal situation of Belgium — the downward trajectory of the debt to GDP ratio, the improvement of other debt metrics.

Vander Elst, AG: I would agree that even during the crisis liquidity has remained rather good for Belgium in comparison to other countries. As for the credit spread, there is some potential for spread tightening, especially if you compare Belgium with countries like France.

Hoffman, KBC: There are two separate issues here on the table. One is country or sector rotation. That's something, that as a country, you never manage. If all of a sudden the Greek economy were to do improve, then investors would place more money in Greek bonds, and you would have a rotation from low yield to high yield.

Liquidity has been there in Belgian bonds, because the Treasury has always looked after different classes of investors, so you always have a buyer when you have a seller, and that's what creates liquidity.

At the same time you have to go for consistency in the way you communicate to the market, because you can only communicate what your country is doing, and the more consistency that you get the more that your credit risk pricing will reflect your actual credit risk.

Leclercq, Belgian Debt Agency: Coming back to credit, even during the crisis we continued our roadshows, explaining the credit and what measures the government was taking. This is very important — to have a continued dialogue with investors whether you have a good story or a less good story, or a story on improvements.

For example, in 2013, we met with around 200 investors in one-on-one meetings. This requires a considerable effort, but it enables us not only to tell the credit story, but also to hear what the investment strategy of different investors is, to hear what bond issues are wanted by the market.

That is another important element of our strategy next to being predictable and being regular —listening to the market, and issuing where there is demand.

Hoffman, KBC: That's one of the reasons why the reflection of the risk in bond pricing is close to the actual risk itself, because if you communicate in a transparent, open, consistent way, that's what you manage yourself.

Spurin, Nomura: That brings us back to our political question, and why the Belgian bond market was so unaffected by a prolonged period without a government. That comes down to solid debt management and everything that Anne has mentioned — the regular approach, consistency, being very open, and working hard with investors and roadshowing. You can't afford just to see clients when times are good, or when you have a good story.

Dior, BNP Paribas: Belgium has a good track record. The Debt Agency is able to show that it has lengthened the average maturity of the debt and lowered the cost of funds, and at the same time reduced future needs because it has extended the average maturity and managed the debt well. It means that future needs are pushed back, which makes Belgian debt even more attractive.

Dent, Nomura: Something that we hear all the time from the global investor base is that the reach through to investors has got bigger, and so the softer factors sometimes come into play a little bit more. Where investors sometimes come out, after looking at a fact sheet of the macro environment and what is going on in an economy, is actually looking at who is managing this debt. It does get a bit personalised, particularly in a spread compression environment. When investors are trying to pick up a handful of basis points, rather than a large amount, it becomes very important, as Anne mentioned, to do the work with the investors.

Investors take a lot of comfort from the fact that the people running the debt management office are the same people as they were through the crisis. They like that there is consistency behind the message.

Every year on their annual funding programme, Belgium has always been a very early mover in the market; they've always been on the front foot, often appearing in the first week in January to get transactions done. Then the message throughout each year is about being ahead of their funding schedule. That has certainly helped bring investors back into the fold very quickly post-crisis.

Leclercq, Belgian Debt Agency: Coming back to what Katherine was saying, even during the crisis, upon market demand, Belgium issued quite a lot of longer term bonds. We printed two 30 year bonds, two 20 years and one 15 year. Hence the average maturity of the debt portfolio increased substantially. At the beginning of 2010 it was six years, and in April 2014 it stood at 7.65 years, which is almost the longest average maturity within the eurozone. This improves fiscal sustainability and reduced our refinancing risk. To put a figure on what Katherine has said the average implicit yields of our total debt decreased from 4% before the crisis to 3.27% notwithstanding the lengthening of the portfolio. Also the service cost of our debt decreased, it is now slightly under 3%, whereas before it was above 3.5% of GDP.

Nick Dent
NOMURA

Investors see a consistent strategy, a strategy where the Debt Agency listens to investors. During the crisis we added two instruments onto our range of products: the MTN programme and Schuldscheine. The idea behind adding those products was investor diversification.

The best example of that is Schuldscheine, which is geared to German investors — mostly long term investors. By issuing that product we have been able to attract interest from German investors in Belgian debt instruments and meet them so as to present the credit. Before, we weren't able to meet them as they wouldn't be interested in Belgium OLO benchmarks.

The minute we began issuing Schuldscheine, German investors became interested in the credit and even bought our public deals afterwards.

As a medium sized issuer, we are not immediately on the radar of some investors. We have to make sure that they are attracted by an instrument that suits them.

GlobalCapital: Going back to the investor relation strategy, your 10 year benchmark earlier this year attracted the biggest book on a Belgian 10 year since 2008. So that seems to have paid off.

Leclercq, Belgian Debt Agency: As from 2013 we definitely entered a new era. There was a positive mood that helped us to not only have order books of €11bn but also to print syndicated benchmarks of €5bn again, notwithstanding the low yield offered.

GlobalCapital: Are the deals attracting new investors, or are they mainly investors returning since the crisis?

Leclercq, Belgian Debt Agency: It is a mix. We have seen new investors coming into our books. More specifically in our 20 year transaction we saw quite a bit of demand from the US — this is very new.

On the other hand we haven't seen the return of Asian investors in our primary deals, which admittedly in 2014 have all been of 10 years or longer. They are however present in secondary markets. But there is still some work to do there: pack our bags, go to Asia and make sure that we visit those investors, so that they will be present in the next deals.

GlobalCapital: You mentioned your 20 year deal from this year. When we covered that deal many people were saying 20 year is the new 30 year, because Solvency II means that insurers are looking to buy 20 year paper. Is this another change in the investor base that we will see more evidence of in future?

Dent, Nomura: There has clearly been a shift that way. There is still detail to be worked through on Solvency II. The devil will be in the detail but it is clear that 20 years has become a point on the curve that investors want and need in terms of a liquid point to mark-to-market.

Solvency II has its merits, in terms of opening up that part of the curve, but there are other factors involved as well — such as being able to hit a 3% coupon.

The demand profile is shifting around quite a lot: at the time of Belgium's 20 year there was a lot of US demand coming back into play in the eurozone. Asia has been a little bit slower, but after the Japanese year end, from April onwards, we have seen demand picking up for longer durations from the eurozone.

Spurin, Nomura: We don't know enough about Solvency II yet to say that it will have a big impact. It wasn't the driver behind the success of this 20 year bond. The 20 year part of the curve has always been slightly special and of particular interest to a specific set of investors that look to match liabilities. This deal was more a case of just the right yield levels and right levels of demand from the more traditional investors.

The US example is interesting. One of the unusual benefits to come out of the crisis is that, globally, investors are much more aware of everything to do with the eurozone now. They are familiar with big issuers, medium sized issuers and small issuers, as well as the various intricacies of the economies. Whether we go to the US or Japan, or other parts of Asia, the amount of interest and knowledge of the eurozone is very high.

At the beginning of the crisis we could go overseas and talk to large investors about Belgium, and all they really wanted to ask about was the eurozone and the crisis, and whether there was still going to be a euro single currency in 12 months. But now with the recovery well underway, they are more aware of the merits of each country.

Leclercq, Belgian Debt Agency: We really welcomed the presence of US investors in the 20 year deal, as it helped us to further diversify the investor base. And as we know, that helps the liquidity of the bond.

GlobalCapital: I'd like to touch further on regulation. Lee mentioned that bank treasuries are big buyers at

the moment. For the whole SSA sector that seems to be a captive investor base for regulatory reasons.

Dent, Nomura: This investor base has gone through a cycle and has matured quickly. Initially it was driven simply by excess cash and liquidity on balance sheets, which drove a lot of investment decisions from the bank treasuries. There were some good names and some bad names involved in terms of the ability to either hold paper for long periods of time, or their willingness to take profits quickly.

Bank treasuries have emerged as a very strong investor base, driven by regulation where they need to hold bonds for liquidity purposes. If they sell, they have to replace it. As there isn't much out there that investors can replace their bonds with to still fit the regulatory requirement, it is very much a buy and hold investor base.

That is clear both for sovereign bonds, but also across the SSA sector, as a very meaningful investor base, and one that has become more evident in terms of investor relations work as well. It's definitely an investor base that has been through a quick cycle, and has now emerged as one which is very important.

Hoffman, KBC: For the first time Belgium has become a solid holding in the core portfolio of investors. You have investors, both in the US and across the globe that invest in Belgian sovereign debt as a core holding whereas two to three years ago investors were buying Belgium because they were looking at a short term recovery theme, which turned out to be true.

The consistency in Belgium's approach has led to them becoming a core holding, and that is reflected in the diversity of the investor base.

We did investor meetings with politicians in New York six or seven years ago, and we had maybe five or six people round the table that wanted to see the prime minister of Belgium. If we were to do that again we would have one on ones with the big insurance companies. That says it all.

Leclercq, Belgian Debt Agency: This positive trend started at the beginning of 2012. Belgium issued a 10 year with a yield of 4.25% in January 2012, and in January 2013 we printed a 10 year at 2.25%. That's great performance but it was backed by an improving credit story. I agree that now Belgian bonds have become more of a core holding than just a quick buy.

The knowledge that investors have about our economy, about what is going on, is much deeper and much broader. A lot of investors do not only rely on rating agencies any more but make their own analysis, even on a smaller country within the eurozone like Belgium.

GlobalCapital: Just to go back to the regulatory point: we are going through a big period of regulatory change, which is affecting everyone. One issue also is cost of the business for banks, and pressures on banks in terms of using their balance sheet. I was wondering if that's had a negative impact, or if that's not really affected the Belgian sovereign debt market yet?

Cumbes, Barclays: It's clear that capital and balance sheet is a more strictly managed resource these days, but it will go where there is attractive business, and there is still a large market for eurozone debt.

The basic point is that increased regulations are here to stay, and will remain an ongoing part of our working lives. You have early adopters and later adopters in terms of getting up to the required levels, whether insurers for Solvency II or whether it's for the leverage ratios, or the bank liquidity ratios. What is more, the regulation is still evolving, so it remains a big influence on the investor base and on the dealer side, which is something we've got to keep a very close eye on to assess impact.

Lee Cumbes
BARCLAYS

Leclercq, Belgian Debt Agency: The issuer indeed should keep a very close eye on the impact of regulations on for example banks' balance sheets and the effect on PD involvement in their markets.

We have to make sure that our primary dealers remain interested in Belgium as a country, remain interested in doing the market making, going to the primary markets, which sometimes can be costly as well. Our debt management strategy should also include elements that entice interest from the primary dealers.

Spurin, Nomura: The cost of capital is high. Balance sheet is a reasonably scarce resource on most trading floors so, yes, the way that the market is traded is slightly different from the way that it was five or six years ago. There's a little less warehousing of bonds and debt, which can lead to — in the very short term — periods of volatility as investors get involved, but it's not enough to interrupt the bigger theme of improving sentiment and reducing lower yields.

It has changed the way banks approach trading, not just in Belgium, but also across the whole of the eurozone, but liquidity still remains high.

GlobalCapital: Is regulation concerning the investor side?

Vander Elst, AG: As an insurance company Solvency II is an issue. Insurers will always be looking at longer dated bond issuance. Life insurers, certainly, have longer dated liabilities, and having an interest rate mismatch is expensive under Solvency II.

From that point of view we will be looking at longer dated issues, especially from Belgium because that's in some way our benchmark for liabilities. Profit sharing is all linked to OLO rates.

GlobalCapital: A lot of what we've been hearing this afternoon has been very positive. I was wondering if anyone has any concerns that we haven't mentioned already for the outlook for this market?

Hoffman, KBC: The real issue is what will happen with yields in the US and whether there will be a complete disconnection with Europe. That might lead to a change in the flow of money going back and forward between the US and Europe.

Another issue is that a lot of the investor base, both banks and insurance companies, have reduced their equity allocation. The direction has been one way for some time — out of the very big equity class, and into bonds. If these fundamentals were to change that could have an impact. This is not a country-specific issue, but it could have an impact despite what happens in Belgium on a country level.

Koen Hoffman
KBC SECURITIES

Leclercq, Belgian Debt Agency: I agree. There is a shift in asset class that might affect government bonds, but the main attraction of government bonds is liquidity, and as such they will always form the basic layer of a portfolio. Liquidity in our bonds is something we take care of: making sure that we motivate our primary dealers to make markets in our bonds and participate at the auctions. Our main funding instrument is the OLO programme,

Funding through other instruments is only a supplement to the OLO programme so as not to damage the size and liquidity of our standard instrument. It's also one of the reasons why we have not started with an inflation-linked OLO programme.

Everything is in place from a legal and technical point of view to issue inflation-linked bonds. However as funding needs are limited to €33bn this year and likewise for the coming years there is not sufficient raw material to start a liquid OLO inflation-linked programme without damaging the liquidity of the OLO programme. So if we were to issue inflation-linked bonds it would be under the EMTN programme and not as large, liquid benchmarks. The limited funding needs prevents us from supporting two large programmes.

GlobalCapital: I was going to ask you if you had any plans to explore new areas of issuance — are inflation-linked bonds the main one?

Dent, Nomura: That's probably the key area. Inflation-linked bonds are being discussed a lot as we are at the turning point of the economic cycle. We clearly see demand for linkers picking up and demand for floating rate note products picking up as well.

If an issuer is not doing a big, liquid euro benchmark, there are other options available that are also beneficial to the taxpayer.

The one thing that would historically stick out for me is a three or five year dollar deal. That used to be very beneficial to an issuer at certain points of the year, but that has waned over the last few months as all the curves have flattened and the euro/dollar basis swap has become less negative. We can't see what will happen in the future. It has meant that there are other options starting to spring up, not just in the dollar market, but in other currencies such as the Kangaroo market, which has grown a lot over the past year or two.

Leclercq, Belgian Debt Agency: If you divert from your OLO programme your financing should be cost efficient and there are not that many opportunities to do so.

Schuldscheine has been cost efficient up to now. Dollar issuance has been too. We have raised approximately $10bn since the start of the MTN programme. But we have to continue to look to other opportunities. If they pop up, we'll take them. If they do not, then we continue just funding through the OLO programme, which works well.

Spurin, Nomura: The time for innovation was maybe two, three or four years ago. The Debt Agency innovated with the retail bond that we talked about at the beginning, and that was the big success. That gave security to the markets at a time when maybe international investors weren't so sure about Belgium.

But the message we are getting — and it's a good message — is that markets are normalising, so now is the time to go back to vanilla issuance and being very predictable. Investors like that.

Dior, BNP Paribas: Belgium has proven that it does not need to diversify further, so why would the Debt Agency take the risk of not being cost effective and at the same time take the risk of cannibalising what they are there to do best — which is OLOs?

As you said, innovation might have been the theme a few years ago, but now there's more of a downside to it than an upside for the Debt Agency. Even if investors ask for inflation-linked bonds from time to time, there is no real need for the Debt Agency to do so.

Cumbes, Barclays: Alternative issuance is another form of backstop. The giant retail bond was the most effective weapon at that time, but the option to issue in many different currencies or structures is also another sort of backstop. It just shows investors that there's another route to funding, taking some pressure off OLOs which can help performance.

I was interested in the points about investors shifting between asset classes, because if we think back to pre-crisis, one of the things we talked about a lot then was the demographic situation — the ageing population and the impact on pensions — and how investors could better match assets and liabilities. We were thinking about how funds should maybe switch between equities and long-dated fixed income and inflation-linked bonds. Some of that's been happening.

The challenge ahead of the Agency has changed a little bit. Cost efficiency is always at the heart of matter, but I'm sure we'll all be knocking on the door in the future, to talk about still longer-dated issuance and inflation-linked bonds as well, as the markets normalise and focus changes.

Leclercq, Belgian Debt Agency: The issue mentioned of the ageing population is an important topic in Belgium and politicians are very much aware of it. Some reforms have been done already but they are not sufficient. One of the main reasons for reducing the debt to GDP ratio is exactly this issue. Only then the pay as you go system, the Belgian pension system, will still be payable in 10 to 15 years from now. ▲

Reshaped banking sector aims to catch recovery wave

Nearly blown away by the financial crisis, Belgium's banking sector is returning to health much changed, in many cases leaner and fitter. Big challenges remain, however, most pressingly the EBA's stress tests and the ECB's asset quality review. **Elliot Wilson** reports.

"ANY IDIOT", SAID the great Russian dramatist Anton Chekhov, "can face a crisis. It's the day-to-day living that wears you out." Belgium, and in particular the tiny handful of sizeable lenders still sequestered in Brussels, would recognise the sentiment. Perhaps no other banking sector in the eurozone's northern reaches was so categorically hobbled and humbled by the financial crisis.

Fortis, once a European financial services powerhouse, was dismantled and split in two, with the Belgian half sold to France's BNP Paribas. Dexia, nationalised and ultimately renamed Belfius, was saved from perdition by the state. KBC Bank, a better-run player in the Benelux states and across central and eastern Europe (CEE), largely retained its shape and form, but only after accepting a €7bn joint bail-out from the federal and regional-Flemish governments.

Since then, the fortunes of KBC and Belfius have continued to diverge.

The latter drops in on the bond market quite regularly. Since the covered bond market re-opened in 2012, the lender has called in on investors on eight occasions, most recently in January 2014, raising a combined total of $2.35bn, according to Dealogic.

And in September 2013, Belfius heartened investors by debuting in the senior unsecured market, printing a €500m five year bond at mid-swaps plus 97bp. Lead managers, including Deutsche Bank and Morgan Stanley, struggled at first to boost interest in the lender, which lacked name recognition, though persistence paid off and the final order book topped €750m. So far, though, the Brussels-based institution has shied away from the temptation to raise additional tier one capital, unlike domestic rival KBC, and a rising number of its northern European peers.

"We are most of the way there in terms of the market's recovery. It has taken a long time but there is finally light at the end of the tunnel"

Kiri Vijayarajah, Barclays

Belfius' biggest problem is not capital, but, noted Fitch Ratings in a December 2013 report, its lack of momentum. In spite of posting an interim profit in the first half of 2013, after two years of operating losses, Fitch flagged up the bank's stodgy revenues, "moderate" financial performance and stubbornly high cost base. The ratings agency also took an unwitting dig at Belfius's understandable aversion to risk. Despite boasting a "solid retail and public finance franchise", offering a "good customer-driven funding mix", the bank's low risk loan book guaranteed only "modest profitability" for the foreseeable future, Fitch warned.

Returning to health

Then there's the issue of the bank's relisting plans. Belfius draws comparison to a brace of fellow European banks brought to their knees following the collapse of Lehman Brothers. Amsterdam-based ABN Amro is closing in on a listing likely to take place after mid-2015, with the UK's RBS likely to follow in its footsteps. But an initial public offering is deemed to be farther off for Belfius. "The Belgian government is still working out what to do with Belfius," notes Kiri Vijayarajah, a banking analyst at Barclays in London. "It doesn't appear, from any of the messages emanating from the bank's leadership over the past year, that a privatisation is imminent."

Not that things are all doom and gloom in Belgium. For many, 2013 was the year the banking sector finally emerged blinking into the pale sunlight. Belfius's inaugural senior unsecured bond sale helped: pricing on the issuance, notes Vijayarajah, "was not dissimilar to the pricing we've seen from equably sized French or German banks".

The Barclays analyst also believes that the stain imprinted on the nation's banks by a series of bail-outs and restructurings, each more painful than the last, is starting to wash out. "We are now most of the way there in terms of the market's recovery. It has taken a long time — longer than anyone could have foreseen — but there is finally light at the end of the tunnel," he says.

Long in the making, this process of rectification has only been possible thanks to eurozone governments proving willing belatedly to improve their once-wayward lenders, by slimming loan books, divesting non-core interests and boosting capital adequacy levels.

KBC has so far repaid more than half of its €7bn bail-out proceeds, fully settling its debt to the federal Belgian government. In a February 14 research note, Deutsche Bank reckoned that while KBC "had the potential" to repay all outstanding state aid in full in 2014, it opted to delay repayment by at least a year due to the upcoming stress tests and asset quality review (AQR) set to be rolled by the European Central Bank, the incoming single regional banking regulator.

Leaner, fitter

The bank has also been busy reducing headcount and divesting units, in an effort to trim costs. In 2013, the group cut 8,000 employees, or around 22% of its workforce, largely by selling majority stakes in its Serbian and Russian units. "KBC has executed on most of its important restructuring operations," notes Deutsche Bank's research team in Paris. "They have successfully sold most of the assets the European Union originally targeted for sale, and that is helping them to emerge in stronger and ruder health."

Adds Paul Formanko, head of CEEMEA banks research at JP Morgan: "KBC is moving steadily towards normalisation." He points to "improving profitability, organic capital rebuild, and the prospect of higher dividend payouts". Net profit surged to €1.015bn in 2013, against €612m the previous year. JP Morgan tips net interest income to rise from €4bn in 2013 to just north of €4.5bn in 2016, with net interest margins inching up to 1.9% from 1.79%.

KBC is also reinvesting in key markets, in resurgent parts of the eurozone and across the CEE region, though so far the news from its slimmed down empire is mixed. Profits remain driven by the lender's Belgian and Czech Republic units: the latter alone contributed €555m to underlying earnings in the full year 2013. But the remaining international divisions proved either of peripheral importance or, in Ireland's case, represented a significant drag on earnings.

KBC Bank Ireland in the full year 2013 posted a loss of just shy of €1bn, against a €306m loss in 2012, largely due to soaring loan-loss impairments related to Ireland's own groundbreaking asset quality review. Bank executives leavened the picture, insisting that with the AQR behind them, the Irish unit could focus on returning to health. Total deposits at KBC Bank Ireland, noted group chief executive Johan Thijs in his year-end review, jumped €2.9bn in 2013, while the number of net new retail customers increased by 34,000. This tipped the bank's Irish operations to return to profit by 2016.

Institutional investor hunger

KBC has in recent times also benefited from renewed appetite among institutional investors, both from Europe and, increasingly, from North America and Asia, for higher yielding paper printed by eurozone financial institutions. In January, it sold $1bn worth of contingent-capital, or CoCo bonds — a form of additional tier one capital that can act as reserve capital if a bank runs into trouble.

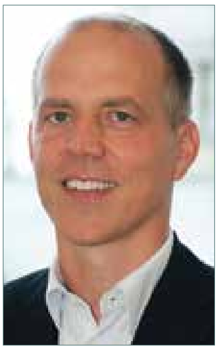
The capital, a crucial form of fresh funding for lenders preparing for stress tests later this year meted out by the European Central Bank (ECB), can also be converted into shares, temporarily written down, or, in extreme cases, wiped out if a bank's capital sinks below an agreed level. Investors will, for example, lose money on KBC's January CoCos if the bank's common equity tier one capital adequacy ratio (CAR) falls below 7% at the end of any quarterly financial period. At present though this seems unlikely — the group's end-2013 CAR stood at 11.2%.

The sale also made good timely sense. CoCo bonds aid lenders seeking to boost tier one capital as the deadline approaches for the ECB's stress tests and asset quality review. "KBC's sale hit the market at the right time," says a syndicate banker based in Paris. "They needed to test investor appetite, and, clearly, investors like what they saw."

Demand for the 10 year CoCos, which offered a yield of 8%, topped $8.5bn. The average return on subordinated bonds in Europe, according to data from Markit at the end of March 2014, is just shy of 3.9%.

There is a "high-risk appetite" for debt issued by lesser known European institutions

Patrick Vogel, Schroders



Nor was KBC Group finished there. In mid-March, the bank completed its debut €1.4bn additional tier one (AT1) bond. Early signs on the sale, a perpetual non-call five year print, were good. Europe's AT1 market sprang to life in March, with a cluster of European lenders, from Britain's Nationwide Building Society, to Spain's Santander and Denmark's Danske Bank, all tapping the market. Investors piled in, attracted as much by the eurozone's improving economic fundamentals, as by the lack of viable alternative investment products.

Some bankers have speculated that lenders could raise as much as €150bn from AT1 issuances in 2014. European issuance in the first quarter alone hit $9.4bn, according to Dealogic, against a record $15.2bn in the full year of 2013. Patrick Vogel, head of European credit at Schroders, isn't alone in pointing to a "high-risk appetite" for debt issued by relatively weak or lesser known

2013-2014 year-to-date debt capital issuance by Belfius Bank*

Deal pricing date	Total deal value $m	Deal type
02 Apr 2014	689	Medium-Term Note
21 Jan 2014	677	Covered Bond
19 Sep 2013	669	Corporate Bond-Investment-Grade
21 Jan 2013	666	Covered Bond
28 May 2013	647	Covered Bond
31 Jul 2013	597	Medium-Term Note
28 Oct 2013	207	Corporate Bond-Investment-Grade
14 Jan 2014	137	Covered Bond
06 Aug 2013	133	Medium-Term Note
24 Jan 2013	100	Covered Bond
12 Jun 2013	66	Covered Bond
23 Jul 2013	66	Corporate Bond-Investment-Grade
26 Mar 2013	65	Medium-Term Note
21 Mar 2013	32	Covered Bond
06 Jun 2013	20	Covered Bond

All deals current at April 14, 2014

Source: Dealogic

European institutions.

But the KBC sale also highlighted the new market's volatility. Additional tier one capital has its drawbacks, and the KBC sale also underlined the uncertainty felt by many investors. Despite generating initial orders in excess of €10bn, demand slipped to €7.3bn when guidance was revised downward from 5.75% to 5.5%-5.625%. For now, though, bankers and analysts see demand for new issuance, from both KBC and its peers, remaining robust as spring turns to summer.

"There's no reason why AT1 issuance, which has done well until now, will not remain strong for some time to come," says Deutsche Bank's Paris research team. "All [European] banks need them to help to maintain, and to boost, tier one capital levels as we prepare for stress tests [and] the AQR. If anything, I would see the pace of issuance accelerate."

Bankers interviewed for this story, though, hedged against a likely future AT1 issuance from Belfius. "There's nothing in the pipeline there at the moment from what I can see, though that might change," says one Paris-based debt capital markets banker.

Stress testing

Perhaps the biggest question facing lenders in Belgium — and across the continent — is the level of pain ECB officials and their overlords are prepared over the coming months to inflict on an industry still recovering from the worst financial crisis in the European Union's short history.

EU regulators in mid-April met officials at the central bank to secure a consensus agreement on how to benchmark the stringency of stress tests. Belgian lenders, including domestic players like KBC and Belfius, as well as leading foreign controlled domestic players such as BNP Paribas Fortis, will need to prove to stern-faced ECB officials that they have the capital reserves and institutional capability to guard against adverse future economic events such as slumping asset prices, a rising interest rate environment, deflationary pressures and declining economic output.

The struggle for officials is to prove that stress tests are strict enough to winkle out lenders who might be hiding their weaknesses under a bushel, without fatally undermining the renascent sector. Europe would also struggle financially to afford a renewed wave of bank bail-outs if too many lenders fail the criteria, set to be unveiled by the central bank in late April or May.

Global investors in the first months of 2014 turned bullish on European banks, even proving willing to snap up the debt of peripheral, second tier eurozone lenders. But the stress tests will prove a sterner examination, both of Europe's lenders, as well as the union's willingness properly to police itself. Done properly, they will remove any lingering doubts over bank fundamentals, while drawing a line under the European Banking Authority (EBA), the largely ineffectual outgoing regulator.

Heavily concenrated

Belgium is likely to be at the heart of the ECB's thinking in the weeks ahead. The banking sector is heavily concentrated, with three major players — BNP Paribas Fortis, KBC, and Belfius — controlling around two thirds of the market. Analysts see no particular reason, superficially at least, to fret about the domestic sector's prospects.

In its April 1 European Credit Tracker, UBS noted that credit growth increased by 4.7% year on year in February, second only among the European Union's 28 member states to Slovakia. Leading the charge was mortgage financing, which surged 10.9% year on year in February. "There are very clear signals out there that Belgian banks are willing to lend again, and are lending again," says Michael Pearce, an economist at Capital Economics in London.

Yet regulators only have to look back to previous stress tests to remind themselves of the dangers inherent in hoping for the best. In 2010, just months after being handed a clean bill of health by the Committee of European Banking Supervisors, the EBA's even more-ineffectual forerunner, Dexia suffered a bank run and failed, leading to a state bail-out and the creation of Belfius.

"There are very clear signals out there that Belgian banks are willing to lend again, and are lending again"

Michael Pearce, Capital Economics

Klaus Regling, head of the eurozone's rescue fund, admitted in April that previous stress tests were "not very convincing", noting that the stress tests being prepared by the ECB will be "much stricter".

Belfius, analysts say, is more of a wild card, a purely domestic bank founded from the ashes of a lender that failed nearly two years after the initial shocks of the financial crisis. Yet few expect them to struggle to convince the ECB that they present a risk to the eurozone's finances should the region's economic fortunes again turn sour. In its December 2013 report on the lender, Fitch noted the "sound" quality of the bank's customer loan book, which boasted a low level of impaired loans (2.6%) "well covered" by impairment reserves of 70.1%. Exposure to peripheral eurozone debt, notably bonds issued the Spanish and Greek governments, had meanwhile "declined significantly". ▲

KBC Bank financials (€m)

Metric	2012	2013	2014E	2015E	2016E
Net interest income	4,532	4,044	4,020	4,173	4,508
Loan impairments	-1,195	-1,729	-810	-527	-616
Reported profit	612	1,015	1,484	1,861	2,155
Net interest margin (%)	1.89	1.79	1.8	1.83	1.9
NPL ratio (%)	5.3	5.9	6	5.2	4.6
Return on assets (%)	0.4	0.4	0.6	0.8	0.8

Source: Dealogic

Belgian corporates are the belles of the eurozone ball

Although small, Belgium has one of the most thriving corporate financing markets in Europe. Issuers of all sizes are welcomed into the fold by a range of investors, and more firms are planning to make the step up from funding with Benelux retail investors to the Eurobond market, writes **Michael Turner**.

CONSIDER THESE *GlobalCapital* headlines from 2014 (slightly amended to stop easy guesses) and see if you can work out which western European economy these issuers all hail from:

"Company X sells biggest long corporate FRN since crisis", "Company Y makes first appearance with strongly sold bond", and "Investors gobble up (a different) unsecured FRN".

Even taking into account the hyperbole headline writers love, those are some strong statements. If you guessed that the issuers came from France, with its fifth place ranking in the world economy, according to US estimates, you would be wrong.

If you said Germany, with the fourth largest GDP output in the world last year, you would be wrong again.

So where do these stars of the bond market reside? The answer lies between continental Europe's two largest economies — in the Kingdom of Belgium.

Although Belgium has far fewer multinational companies than its neighbours, this has not stopped the country's firms from making their mark in the capital markets over the past few years. 2014 has been no different, with $9.875bn-equivalent of corporate bonds printed.

This is the highest first quarter amount in Belgium in the past five years, with last year's $6.8bn-equivalent Q1 volumes the second highest, according to Dealogic.

"The fact that Belgium is home to only a few multinationals is not an issue," says Marco Baldini, head of European corporate and SSA bond syndicate at Barclays in London. "In this respect, Belgium is no different to several other European countries such as Austria, Portugal, Norway, Ireland or Denmark.

"From a market technical standpoint, Belgium is actually home to one of the largest corporate borrowers in the world — AB InBev."

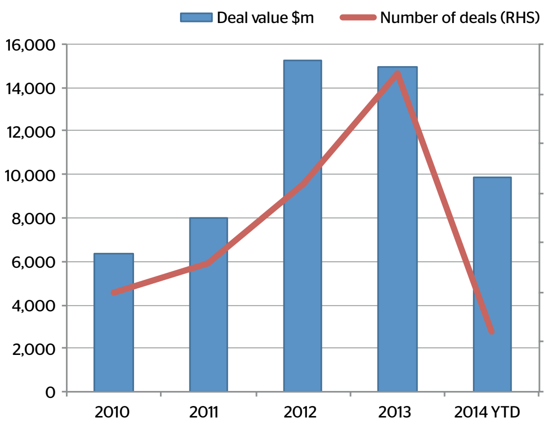
Brewer Anheuser-Busch InBev (A2/A) is undeniably Belgium's biggest issuer. The firm has printed $9bn-equivalent of bonds this year, dwarfing the year's second most prolific issuer, Belgacom, with $829m-equivalent, according to Dealogic.

"In terms of Belgian blue chips," says Dennis Duinslaeger, origination debt capital markets at KBC, "AB InBev catches the eye of the investors as a global multinational player with a huge funding requirement, allowing them to tap the market any way they want.

"It has the capability to push market trends and put itself in the spotlight in Europe for institutional desks."

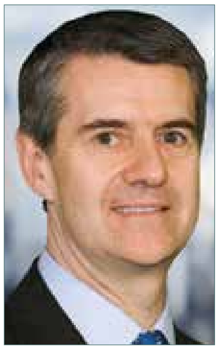
This was amply proven at the end of March this year when AB InBev was responsible for the biggest long dated corporate FRN since the crisis when it printed €2.5bn of four, 7.5 and 12 year notes.

Belgian corporate bond issuance 2010-2014 YTD



Source: Dealogic

"Given the expectation that interest rates in dollars and sterling are going to rise, then for investors, floating rate notes make sense as a defensive instrument"



Morven Jones, Nomura

The four year tranche was a floating rate note, meaning that the deal was the largest corporate FRN sold to euro investors with a maturity of more than two years since before 2008.

And the deal showed no signs of strain. Investors leapt into the FRN and long tranches of the trade. The FRN portion pulled in a €1.75bn order book, allowing the leads to allocate €850m at the tight end of the 38bp-40bp over Euribor guidance.

Stay defensive

FRNs are not popular with all mainstream investors because some want certainty on future returns. Nonetheless, FRN issuance is here to stay, according to Morven Jones, Nomura's head of debt capital markets, Europe, Middle East and Africa in London.

"Given the expectation that interest rates in dollars and sterling are going to rise, then for investors, floating rate notes make sense as a defensive investment," says Jones, adding that this is particularly true in the bank treasury market and for money market investors.

As to whether more companies will use floaters in the coming months, it will ultimately depend on cost above all else, according to Jones.

"If issuers think they're going to achieve a lower cost on Libor-equivalent terms on a floater rather than a fixed rate product," he says, "clearly they're going to be willing to issue FRNs."

But as with AB InBev's floating four year tranche, this asset class doesn't provide maturities as long as fixed rate bonds. So DCM bankers are unlikely to see fixed rate bond volumes get nudged out by floaters any time soon.

"In Europe, the conventional wisdom at the moment is that interest rates will probably go lower," said Jones. "And on that basis, investors will remain comfortable with fixed rate bonds."

Uptick on the horizon

Meanwhile, investment grade Belgian companies have been joining in on funding trends seen elsewhere in western Europe.

Chemical firm Solvay (Baa2/BBB+) joined the growing fashion for hybrid capital issuance in November 2013, with a €1.2bn perpetual hybrid split across two tranches. And according to DCM bankers, Solvay won't be the last Belgian firm to issue such debt in the coming months.

Duinslaeger says: "Solvay is one of the other Belgian corporates jumping on the bandwagon in the past couple of months by issuing a hybrid, and we know that a number of other Belgian corporates are interested as well."

There is a small wave of hybrid refinancing expected in the coming 12 months, as issuers that printed hybrid deals in 2010 reach their five year first call option dates.

"It is our guess that you will see quite a bit of refinancing of those issues in the second half of this year, going into early next year," says Jones at Nomura. "The Belgian market is really dominated by a small number of large companies so activity over the next 12 months will likely be driven by those names."

Refinancings of conventional debt, as well as debut issuers are also expected to make an appearance this year.

"We're at the point where we see refinancings due, both in the institutional and retail market," says Duinslaeger. "Together with new issuances, this will guarantee a large activity in the Belgian fixed income market, in line with the past years."

SMEs too

It's not just Belgium's big companies that are finding a warm reception from the markets.

A small but growing market is evolving for small and medium sized enterprises that are looking to move away from bilateral and small syndicated loans.

The popularity of private placements and retail bond issues of €100m or below has increased among Belgium's midcaps, according to DCM bankers.

In the first quarter of 2014, there were 14 deals of €100m or below, totalling €437.5m. This accounts for more than 10% of the wider bond market in Belgium, according to KBC estimates.

"SMEs generally raise around €100m, but there have been a few instances of €75m, €50m or lower and the trend is towards smaller tranches," says Duinslaeger at KBC. "The flipside is that, when issuing such small deals, corporates need to find a way to offset the high cost of funding."

Medium sized companies have had their confidence bolstered by the successes of Belgium's blue chips, like Solvay, according to DCM bankers.

"There was a shift from the institutional market to the retail market, better known as the 'Belgian dentist'," says Duinslaeger. "We also noticed the interest of non-listed companies, all in a broad field of sectors."

Belgian companies, including unrated gas storage and transmission firm Fluxys and waste management firm Shanks, have issued retail bonds to Benelux investors totalling €450m in the past two years.

And those looking to move away from the retail market and join the ranks of Eurobond issuers will find a warm reception, according to Baldini at Barclays.

"Over the past few years a handful of Belgian companies such as unrated biotech company UCB, utility Eandis, Infrabel and Brussels Airport have issued debut euro benchmarks with great success," Baldini says.

"Such is the standing of Belgian companies in the eyes of international investors that several have specifically attempted to diversify away from the retail market. I don't see Belgian issuers having any trouble establishing their credits in the market." ▲

Drinking it in: why AB InBev is the investors' darling

AB INBEV IS undeniably the king of Belgian corporate issuers. At $9bn-equivalent, the firm has this year printed more than nine times the amount of Belgium's next most prolific corporate issuer of 2014, Belgacom.

So what makes AB InBev such an attractive opportunity for bond investors?

The firm is truly multinational

In 2013, AB InBev made 89.5% of its $17.2bn Ebitda outside Europe. The bulk of this was in the Latin American market, with Mexico accounting for 10.8% and the rest of South America responsible for 40.9% of Ebitda. Only 7.5% of the company's 2013 Ebitda, and 10.5% of revenues, were made in Europe for the year.

Consumers love beer

Demand for two of AB Inbev's most recognisable brands, Budweiser and Corona, increased globally last year.

Budweiser offers the most interesting story for both bond and equity investors. The beer increased its sales volumes by 6.4% last year because of increased demand in less established markets Russia and China, alongside AB InBev strongholds Brazil and the UK.

The eurozone is homogeneous

Ultimately, investors do not look at AB InBev as a Belgian issuer, but rather, a eurozone issuer. This puts AB InBev alongside any of Europe's other big firms when investors are considering where to put their money. "That's the beauty of the eurozone," says Marco Baldini, head of European corporate and SSA bond syndicate at Barclays in London. "It is made up of various member states, which each contribute to corporate issuers in our market, and we continue to view the market as a whole rather than its component parts." ▲

Belgian regulator leads charge for greater investor protection

The Belgian Financial Services and Markets Authority (FSMA) is a driving force for supervisory measures to strengthen investor protection in Europe. Chairman **Jean-Paul Servais** is a member of the International Organization of Securities Commissions and also chair of the European Securities and Markets Authority's Investor Protection and Intermediaries Standing Committee. He told **Robert McGlinchey** how investor protection is being strengthened from both a Belgian and EU perspective.

GlobalCapital: Looking back over the past 12 months in the areas that you supervise — listed companies, product supervision, consumer education — are there any examples where the FSMA reacted to an event that led to the continuation of the orderly operation of the Belgian capital markets?

The FSMA is one of the few regulators to continue to conduct real-time supervision of the regulated market. If it notices an unexplained change in price or volume, it immediately contacts the listed company in question. If necessary, trading in the share is suspended pending the publication of a press release to ensure that the market receives correct information. We consider this real-time supervision of the market to be one of the most efficient measures for preventing market abuse. In 2013, the FSMA suspended trading on several occasions pending the publication of such a press release. During the same year, parliament extended MiFID-like rules of conduct to the insurance industry. It is a major step in terms of investor protection but also to ensure a level playing field in the distribution of substitute products. Besides, the FSMA is one of the first authorities to conduct on-site inspection for compliance with MiFID rules of conduct. The results of the first round of on-site inspections can be [viewed] on the FSMA website.

GlobalCapital: We have had an abundance of regulatory changes from the European Commission and the European Securities and Markets Authority. As initiatives such as EMIR and MiFID II gather pace, and the number of clearing houses and trade repositories increase, how has the FSMA developed its systems, staffing and divisions?

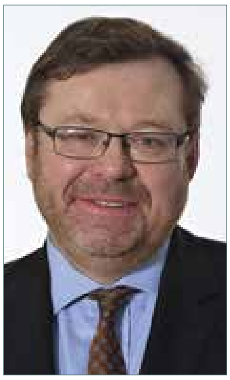
The missions of the FSMA have been considerably reinforced by the law called 'Twin Peaks II'. The focus is on investor protection and investor education. The government authorised the FSMA to hire 80 additional staff for these new missions. A new organisation chart will also be adopted shortly to reflect these changes and these new missions.

GlobalCapital: The FSMA has been very active in working to strengthen the protection of investors of financial products, particularly structured products. Can you discuss the reasons for the changes proposed by the FSMA in its consultation on a draft Royal Decree that imposes obligations on the marketing of financial products, the feedback you received and the process?

The objective is to introduce a global approach to financial products whatever the wrapping (Ucits, structured deposits, notes, insurance products). It proposes to apply the same rules to regulating all commercial communications relating to those products. One innovation is the obligation to calibrate the examples based on certain intervals on a distribution curve. This will allow for more objective information on the working of structured products in different market conditions. The text is now under discussion at political level.

GlobalCapital: How do you respond to some officials who say that the complexity of a structured product does not correlate with the riskiness of that product?

We see complexity as a risk. There is a risk that the investors do not understand what is being offered to them and that they buy products which do not match their needs. The moratorium on particularly complex products is a big success in Belgium. All Belgian banks, asset managers and insurance companies have signed on. It does not prevent them from selling products, but the offer is simpler and more transparent. Based on an internal study, we see that complexity has been reduced by half.



Jean-Paul Servais: "The moratorium on complex products is a big success"

GlobalCapital: Do you think there can be a European-wide regulatory framework for structured products, even though local markets, such as the UK, Germany and Belgium, for example, operate differently in terms of popular products, product sophistication and investor understanding?

There is room for a wide regulatory framework for structured products. ESMA recently published good practices for structured retail products. At the same time, one must acknowledge that while the offer is global, the demand is local. It is therefore normal, especially since the financial crisis, for the specificities of the demand to take account of the aversion to risk or complexity of the consumers. It is an important element of the industry's efforts to rebuild the trust of consumers.

GlobalCapital: What is the Investor Protection and Intermediaries Standing Committee working on?

I expect that the activities of the standing committee will be focused mainly on the implementation of MiFID II, which is an enormous project. It includes advice for level two measures and binding technical standards. ▲

Belgium in figures: an economic snapshot

Over the following pages, *GlobalCapital* provides a snapshot of Belgium's macro-economic, bond market and bank sector data from the leading rating agencies. For more detailed information, please refer to the websites of these institutions.

Standard & Poor's: AA • Moody's: Aa3 • Fitch: AA- All Stable Outlook

SELECTED KEY OFFICIALS

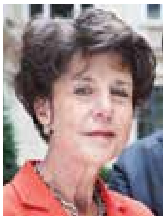
BELGIAN FEDERAL CABINET

Koen Geens
Minister of finance and sustainable development

Johan Vande Lanotte
Minister of economy, consumer affairs and the North Sea

Olivier Chastel
Minister of budget and administrative simplification

BELGIAN DEBT AGENCY



Anne Leclercq
Director, treasury & capital markets, Belgian Debt Agency

Jean Deboutte
Director, Strategy and Risk Management

NATIONAL BANK OF BELGIUM

Luc Coene
Governor

Jean Hilgers
Director — treasurer

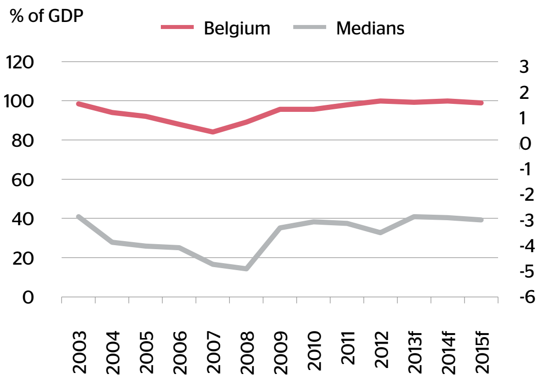
Mathias Dewatripont
Director — prudential policy and financial stability

KEY ECONOMIC INDICATORS

	2008	2009	2010	2011	2012	2013	2014F	2015F
Real GDP (% change)	1.0	-2.8	2.3	1.8	-0.1	0.2	1.2	1.5
CPIInflation(yearend, % change)	2.6	0.3	3.1	3.5	2.2	1.0	1.2	1.4
General Government Balance/GDP	-1.1	-5.6	-3.9	-3.9	-4.1	-2.7	-2.6	-2.7
General Government Primary Balance/GDP	2.8	-1.9	-0.4	-0.4	-0.6	0.5	0.5	0.5
General Government Debt/GDP	89.2	95.7	95.7	98.0	99.8	99.7	100.7	100.5
General Government Debt/Revenues	183.0	199.0	196.4	197.5	195.8	193.2	196.1	196.1
General Government Interest Payments/Revenues	7.9	7.7	7.2	7.0	6.8	6.2	6.0	6.1
Current Account Balance/GDP (%)	-1.3	-0.6	1.9	-1.1	-2.0	0.0	0.3	0.4

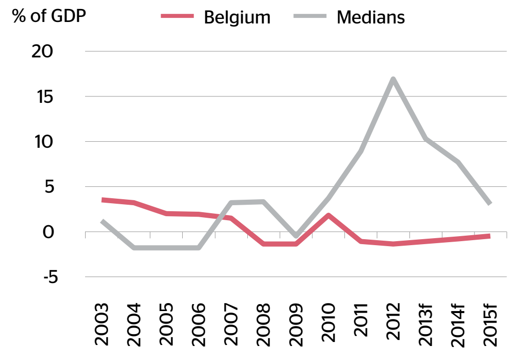
Source: Moody's

GENERAL GOVERNMENT DEBT



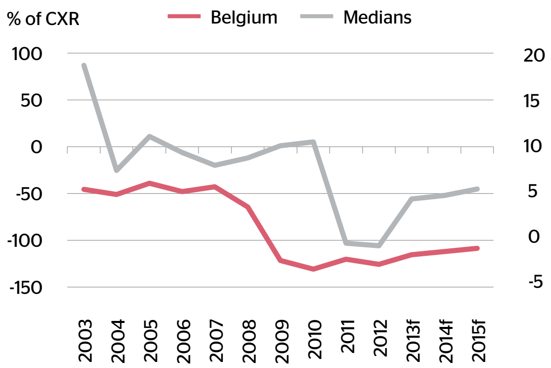
Source: Fitch

CURRENT ACCOUNT BALANCE



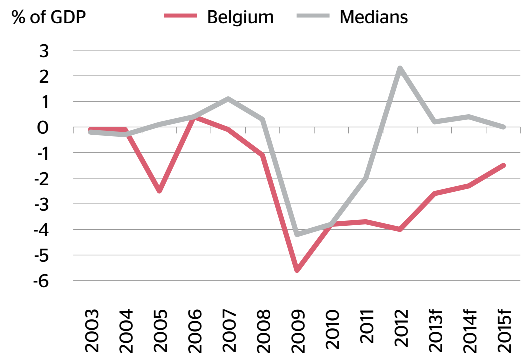
Source: Fitch

NET EXTERNAL DEBT



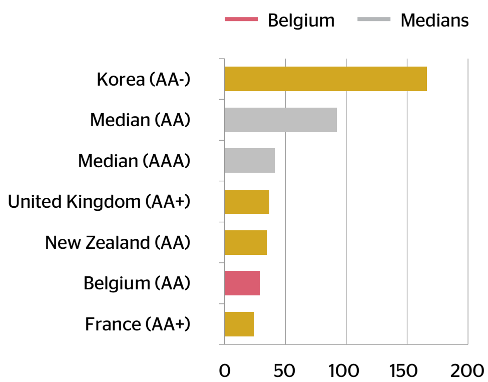
Source: Fitch

GENERAL GOVERNMENT BALANCE



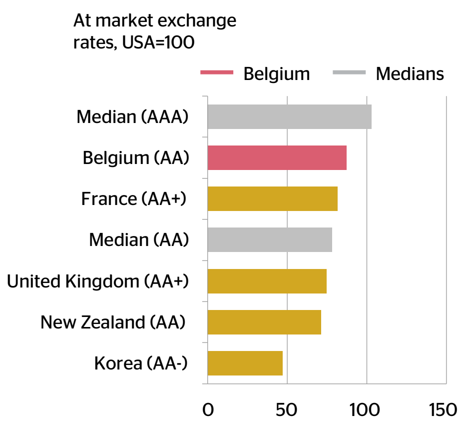
Source: Fitch

INTERNATIONAL LIQUIDITY RATIO, 2013 %



Source: Fitch

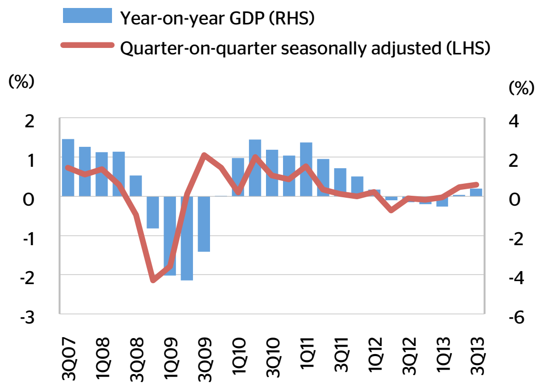
GDP PER CAPITA INCOME, 2013E



Source: Fitch

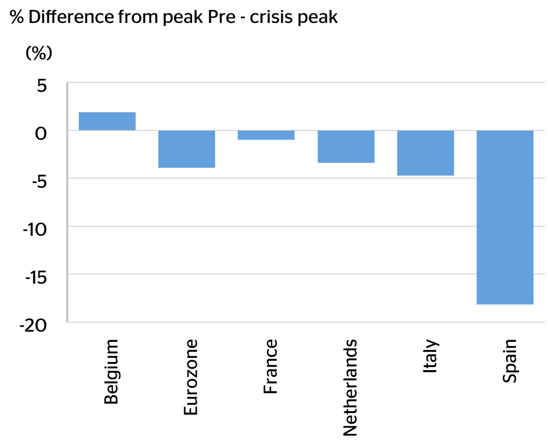
BELGIUM IN FIGURES

GDP GROWTH



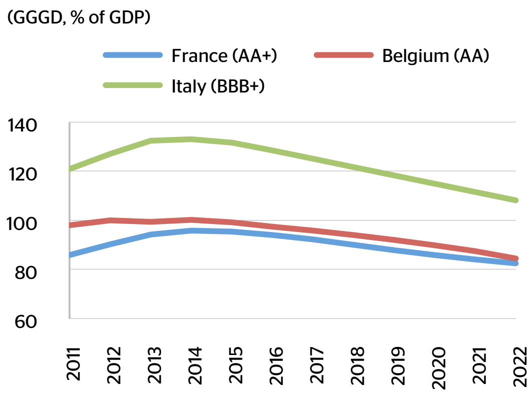
Source: Belgostat, Datastream

EMPLOYMENT



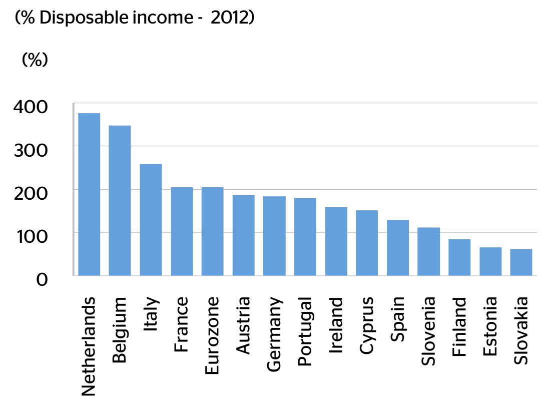
Source: Eurostat

BELGIAN PUBLIC DEBT: FROM ITALY TO FRANCE



Source: Fitch

NET FINANCIAL WEALTH



Source: Eurostat

DOMESTIC MARKET SHARES OF THE FIVE LARGEST BELGIAN BANKS

	total assets (in PLN million as of 30 June 2013	Domestic market share (loans, in %, as of 30 June 2013	Domestic market share (deposits, in % as of 30 June 2013	Long-term Bank deposit Rating (local currency) and Outlook	Standalone credit Strength and Outlook	Notches of uplift for external support
BNP Paribas Fortis	271,738	24%	23%	A2 / Stable	C- / Stable / baa1	2
KBC Bank NV	224,840	19%	20%	A3 / Stable	D+ / Stable / baa3	3
Belfius Bank SA/NV	193,578	13%	15%	Baa1 / Stable	D- / Positive / ba3	5
ING Belgium SA/NV	163,166	ca 19%	ca 18%	A2 / Negative	C- / Negative / baa1	2
AXA Bank Europe [1]	39,217			A2 / Negative	D+ / Stable / baa3	4

1] Total assets as at 31 December 2012
Notes: Long-Term Bank Deposit Ratings reflect a bank's stand-alone credit strength and support considerations. A bank's standalone credit strength reflects its creditworthiness without considering support. The table shows banks' standalone credit strength as indicated by our Bank Financial Strength Ratings (BFSR) ratings (on a scale from A to E), the corresponding trend, and the standalone BFSR mapped to a baseline credit assessment (BCA). For more detail, see Moody's banking methodology webpage (follow hyperlink). Some market shares are based on estimates, as consistent data is not publicly available for all banks.
Source: Banks' reports, Moody's estimates

STANDARD & POOR'S OPINION

Overview

We view the gradual consolidation of Belgium's multilayered governance framework, as it implements state and economic structural reforms, as key to resolving its structural economic and budgetary policy challenges.

We are revising the outlook to stable and affirming our 'AA/A-1+' unsolicited long- and short-term sovereign credit ratings on Belgium.

The stable outlook incorporates our view that Belgium's credit metrics are stabilising and that there is a less than one-in-three probability that we will raise or lower the ratings.

Rating action

On February 28, 2014, Standard & Poor's Ratings Services revised its outlook on the Kingdom of Belgium to stable from negative. At the same time, we affirmed our 'AA/A-1+' long- and short-term foreign and local currency unsolicited sovereign credit ratings on Belgium.

Rationale

The outlook revision reflects our view of the gradual consolidation of Belgium's multilayered governance framework in the context of the ongoing state reform and the implementation of economic and structural measures, coupled with stabilising credit metrics.

Our ratings on Belgium reflect our view of the economy's high levels of economic prosperity (GDP per capita forecast to be €47,200 in 2014); its strong net external asset position; and its relatively strong institutional effectiveness, despite sporadic political stalemates. These strengths are moderated by our view that fiscal flexibility is constrained by the high government debt ratio (net government debt to GDP estimated to be 92% of GDP in 2014), combined with a relatively high tax burden (45% of GDP).

Belgium's GDP has proven its resilience to economic and financial crisis since 2008. We estimate that it will grow in real terms by an average of 1.2% a year over 2014-2017, based on domestic demand and exports. That said, if Belgium's major trade partners, particularly France and the Netherlands, were to see a weaker-than-expected economic recovery, our forecasts would likely be affected. The economy's vulnerability to external risks is compounded by the economy's gradual loss of competitiveness, as demonstrated by factors including the emergence of a trade deficit since 2008 and a loss of export market share.

In 2013, the government adopted a Competitiveness Pact, which includes measures aimed at reducing labor costs and increasing labor market participation from its relatively low level. It also aims to increase non-cost competitiveness by addressing inefficient product markets and offering support for research and development (R&D). We consider that these measures are unlikely to meaningfully improve exports competitiveness without additional changes. If left unchecked, we anticipate that the remaining structural labor market rigidities and unfavorable trends in the labor cost gap between Belgium and its three main trade partners--Germany, France, and the

Netherlands — compounded by demographic changes, such as the aging population, will curb the economy's growth potential over the medium-to-long term.

As such, we believe that the current account deficit, which emerged in 2008 in line with the trade deficit, is unlikely to be significantly reversed between 2014 and 2017. One of the factors fueling the deficit is the weakening of the income balance, triggered by low yields and a relatively strong euro, which are affecting the gap between dividend payments and interest incomes. Despite these recent unfavorable developments in the balance of payments, we expect Belgium to maintain a strong net external asset position at about 43% of current account receipts in 2014.

We consider that the adoption of the latest state reforms should help restore governance effectiveness, increase the institutional integrity of the state, and make delivery of public services more efficient. The reforms include giving regions and communities an incentive to improve expenditure efficiency.

In a cooperation agreement aiming at implementing the European Fiscal Compact, regions and communities have committed to a balanced budget in the medium term. At the same time, while the regions and communities will gain control over new competences, that is, about 32% of the general government spending against 25% currently, federal transfers are expected to fall gradually.

Compared with 2009-2011, we consider that the government's budgetary policy helped reduce the general government deficit to 3.2% of GDP in 2012 (excluding the transfers related to financial institutions) and below 3% in 2013. We expect the deficit to remain below this threshold in 2014-2017. However, we consider that the government's plans to achieve a budgetary surplus from 2016, to help it finance pensions in the long term, will be difficult to achieve. We believe fiscal flexibility will be constrained on the revenue and expenditure side in 2014-2017 by the government's recent budgetary measures aimed at supporting potential growth. For example, the government plans cuts in corporate social contributions, to reduce value-added tax (VAT) rates for household electricity, and to increase regional R&D subsidies.

Nevertheless, we anticipate that Belgium's general government fiscal deficits will continue to be somewhat smaller than those of eurozone peers. As a result, we expect net government debt will prove to have peaked at the end of 2013 at just above 92% of GDP. Thereafter, we expect to see a slow decline to approximately 90% of GDP in 2017 (excluding the guarantees related to the European Financial Stability Facility.)

We consider that the risk that financial contingent liabilities will crystallise has abated. The banking sector has shrunk since the 2008 financial crisis; banking assets were 2.8x GDP at mid-year 2013, down from 4.7x at the peak in 2007. The deleveraging helped to lower Belgian banks' risk exposures.

Meanwhile, Belgian banks have generally improved their capital ratios. That said, the maximum guaranteed amount of liabilities from Dexia Credit Local and Dexia S.A. amounted to €43.7bn at year-end 2013 (11.1% of GDP).

Outlook

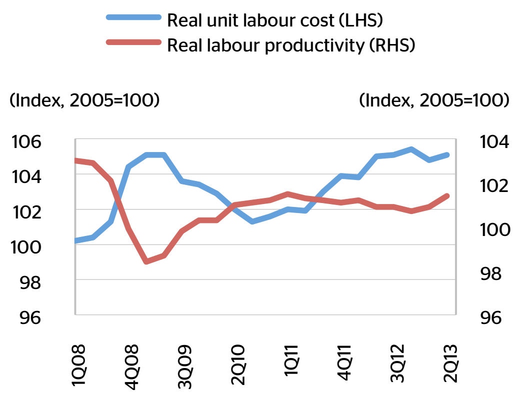
The stable outlook incorporates our view that Belgium's credit metrics are stabilising and that there is a less than one-in-three probability that we will raise or lower the ratings.

We could lower the ratings if, contrary to our expectations, economic growth prospects deteriorate. This could occur if the government fails to address the remaining structural rigidities that hinder the economy's competitiveness and productivity. We could also lower our ratings on Belgium if it appears to us that net general government debt is likely to exceed 100% of GDP because the government has reversed its budgetary strategy, growth has weakened, and one-time items have increased debt.

We could raise the ratings if net general government debt fell below 80% of GDP and if improved economic competitiveness were to lead to consistent current account surpluses and significant increase in economic growth.

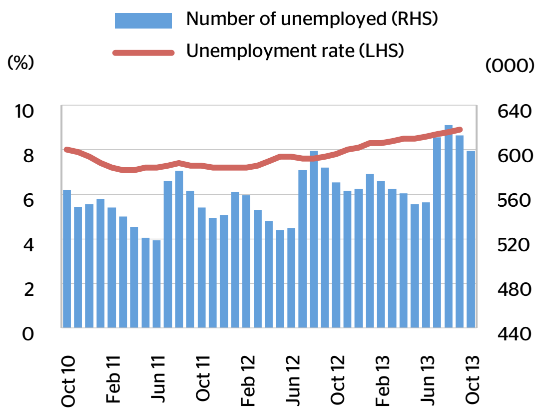
February 28, 2014

LABOUR PRODUCTIVITY VS UNIT LABOUR COSTS



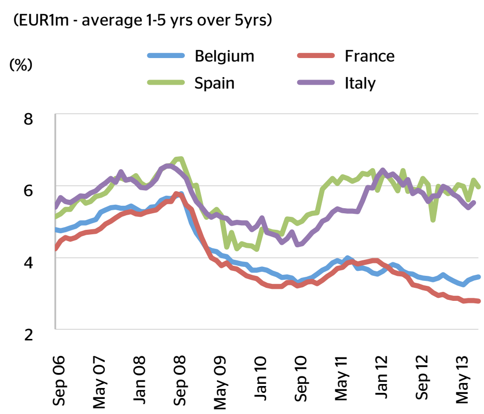
Source: Eurostat

LABOUR MARKET DETERIORATION



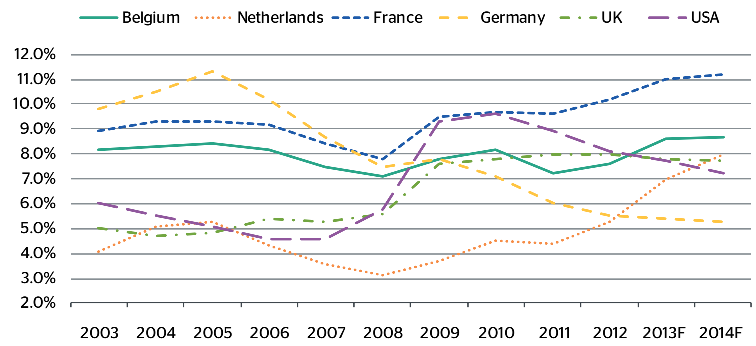
Source: Fitch

LENDING RATES TO NEW BUSINESSES



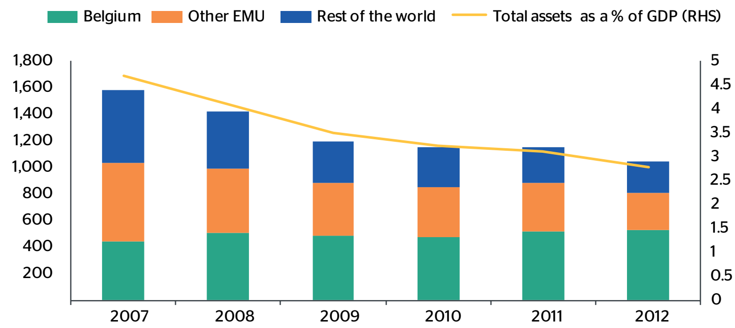
Source: Fitch

UNEMPLOYMENT RATE



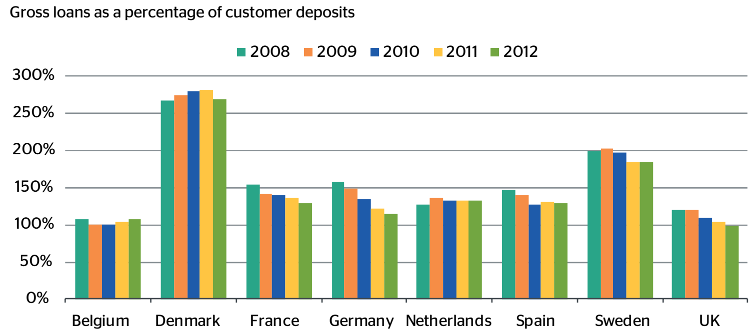
Source: Moody's Statistical Handbook

BELGIAN BANKS REDUCE THEIR BALANCE SHEETS SINCE 2007 (€BN)



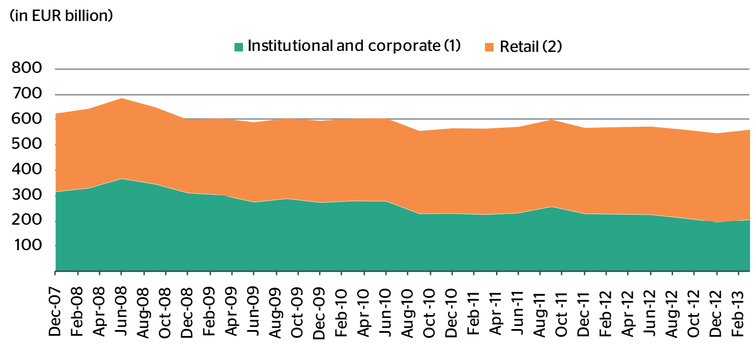
Source: National Bank of Belgium

EU BANKING SYSTEMS' LOAN-TO-DEPOSIT RATIOS



Source: Moody's Investor Services

BELGIAN BANKS' SHARE OF FUNDING FROM RETAIL DEPOSITS IS GROWING



Source: National Bank of Belgium

MOODY'S OPINION

Credit strengths

Belgium's credit strengths include:

- Track record of prudent macroeconomic management
- Diversified and well-balanced economy

Credit challenges

Belgium's credit challenges include:

- High government debt levels
- Non-negligible contingent-liability risks from the banking sector

Rating rationale

Belgium's Aa3 government bond rating is underpinned by our assessment of the very high levels of economic, and institutional strengths, the moderate strength of the government's financial strengths and its low susceptibility to event risk.

Our very high (-) assessment of Belgium's economic strength reflects its robust, diverse economy with limited macroeconomic imbalances and a wealthy, skilled population. Its export sector's solid performance has been supported by its location in the heart of western Europe; its relative economic competitiveness (Belgium ranks 17th out of 148 in the latest World Economic Forum's Global Competitiveness Report); and high productivity. In addition, Belgium's domestic demand is relatively strong, supported by sound household and private-sector balance sheets. Moreover, credit supply in Belgium has not been severally affected by the deleveraging of the country's banking sector (as the latter has been focused on external markets).

However, Belgium's growth model faces medium-term challenges (1) to maintaining its competitiveness, which has been eroded by the impact of the wage-indexation mechanism; and in general, higher inflation than in the rest of the euro area; and (2) increasing labour participation. The authorities have begun to address these issues with measures such as altering the strength of the wage-indexation mechanism and reforming gas and electricity retail prices, and we expect policy momentum in this area to continue.

Our very high (+) assessment of Belgium's institutional strength is based mainly on the authorities' track record in executing a prudent and adaptable fiscal policy, as well as by high scores on World Bank Governance Indicators.

An indication of the success of this fiscal policy is that the Belgian government has a solid track record of debt reduction prior to the global financial crisis: it brought government debt down to 84% of GDP in 2007 from its peak of 138% in 1993. During the crisis, the very same ratio increased by 16% of GDP from 2007-2013, compared to an increase of 29% of GDP for the euro area as a whole. In addition, shortcomings revealed during the crisis led the authorities to gradually strengthen Belgium's financial, regulatory and supervisory frameworks.

Our moderate (+) assessment of Belgium's fiscal strength balances its high government debt of around 100% of GDP – higher than the debt levels of its Moody's-rating category peers – with the debt's relative affordability, which is reflected by interest expenditures that are around 6% of government revenues. Belgium's debt composition (e.g., with an average maturity in the 7-8 years) shields the debt burden from the adverse effects of interest and exchange-rate fluctuations over the medium-term. We expect that the government will continue with its fiscal consolidation measures aimed at keeping the deficit within prudent margins below the 3% of GDP threshold. We also forecast debt will stabilise at around 100% of GDP in 2014-15 before a subsequent decline. An indicator of this is Belgium's good track record in this regard and its relative fiscal flexibility from the expenditure side (revenues are constrained due to an already-high compulsory contribution rate of 47% in 2012).

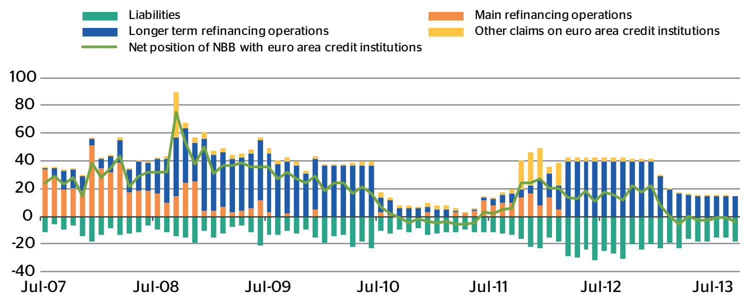
Our low (+) assessment of Belgium's susceptibility to event risk is driven by the government's exposure to material, yet receding banking sector risks and uncertainties, as reflected by the stable outlook on the Belgian banking sector. We consider that the main risk stems from the run-off process of Dexia Credit Local (DCL, Baa2 negative). However, we note that the process is now clearer and that the risk of a possible need for further support from both the Belgian governments is manageable.

Rating outlook

In March 2014, we changed the outlook to stable from negative to reflect (1) the diminished risk that Belgium's government balance sheet will be affected by a further crystallisation of contingent liabilities from the banking sector; and (2) our expectation that the government will continue with its fiscal consolidation measures, which we believe will support a reversal in government debt, to around 100% of GDP in 2014-15.

March 7, 2014

CLAIMS OF THE NATIONAL BANK OF BELGIUM ON BELGIAN BANKS (€BN)

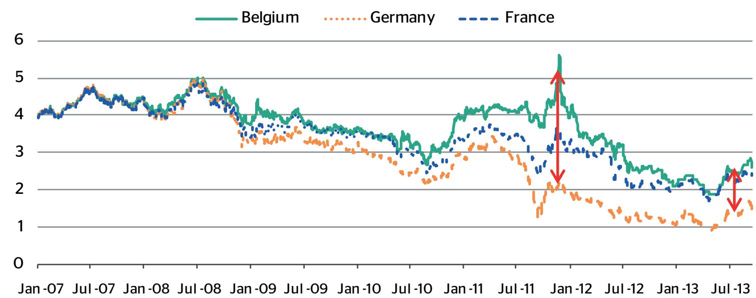


(1) The figures include claims on all euro zone institutions, however claims outside Belgium would be negligible

Source: National Bank of Belgium

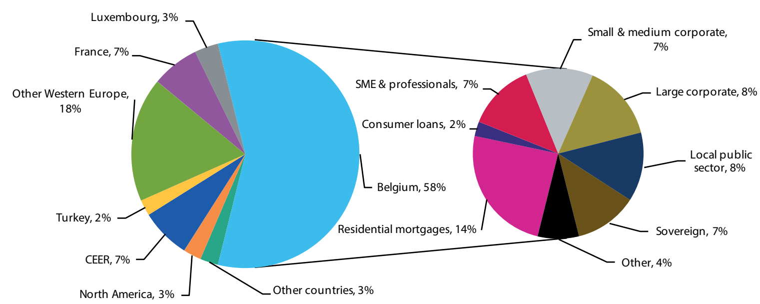
10 YEAR GOVERNMENT BOND YIELDS

(in %, for Belgium, France, Germany)



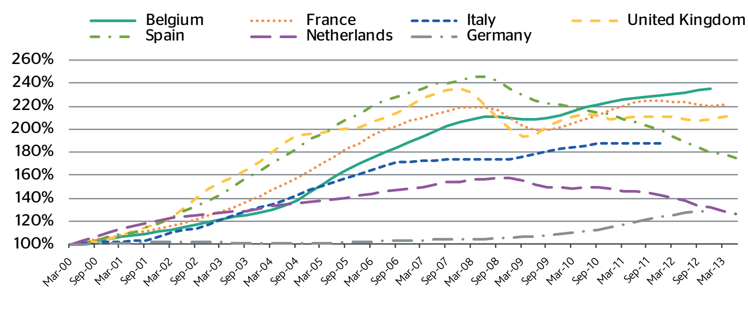
Source: National Bank of Belgium

BREAKDOWN OF THE FOUR LARGEST BANKS' CREDIT EXPOSURES



Source: Moody's Investors Services Company Report

HOUSING PRICE INDICES IN EUROPE



Source: Moody's Data Buffet

FITCH OPINION

Key Rating Drivers

Ratings Affirmed: Fitch Ratings has affirmed Belgium's Long-Term Foreign- and Local-Currency IDRs with Stable Outlooks. This reflects the government's progress in reducing the deficit and Fitch's assessment that public debt will peak in 2014. The rating is supported by strong fundamentals and a net foreign asset position.

Debt Close to Peak: Fitch estimates that public debt will peak at close to 100% of GDP in 2014. This is one year later but at the same level relative to Fitch's latest rating review. The slight deterioration reflects a weaker deflator in 2013-2014 and slower fiscal consolidation than previously envisaged, with public debt to GDP now forecast to reduce to 87% by 2021, compared with 79% previously. In Fitch's view, public debt dynamics remain within the tolerance of the 'AA' rating.

Deficit Reduction on Track: Fitch estimates the general government deficit at 2.6% of GDP in 2013. This implies that Belgium should exit the excessive deficit procedure next year. For 2014 we project a deficit of 2.3% of GDP, which is higher than the authorities' target (2.1%). In our view, the possibility of a renewed political deadlock following the May 2014 elections is real and increases risks of fiscal slippage. However, experience with protracted periods of caretaker governments suggests that any slippage would be contained.

Out of Recession: The Belgian economy exited recession in 2Q13. Fitch forecasts a modest recovery (1%) to start in 2014 following two years of stagnation in 2012-2013. Unemployment is rising and Fitch expects it to peak in 2014 at 9%. However, householdsÐ strong balance sheets will support private consumption despite labour market dynamics.

Losing Competitiveness: Labour costs in Belgium have outpaced those of the three main trading partners (Germany, France and the Netherlands) causing losses in competitiveness. Following years of current account surpluses, Belgium is now running deficits. There are signs that the Belgian economy is also losing competitiveness against some peripheral eurozone countries.

Banks' Risk Receding: Risks arising from the banking sector are gradually receding. And contingent liabilities have declined in 2013. KBC Group has repaid ahead of schedule over half of the €7bn of state aid it received and Fitch does not expect additional capital injections into Dexia. The Belgian state sold its 25% stake in Fortis to BNP Paribas for €3.25bn (0.9% of GDP). The full amount has been earmarked to reduce public debt.

Rating Sensitivities

Higher Debt: Material divergence from the fiscal targets leading to the public debt ratio peaking higher and later – for example caused by fiscal easing, growth underperformance or a sizeable state recapitalisation of the banking system – would put pressure on the rating.

Policy Slippage: Loss of economic and policy momentum, for example caused by a prolonged political standstill following the 2014 elections, leading to weaker growth or material fiscal slippages would also be negative for the rating.

Growth and Debt Reduction: Fitch does not see any strong upward rating pressure in the near term. However, a material reduction in the public debt ratio that increases the scope to accommodate future shocks or tangible improvement in competitiveness leading to higher medium-term potential growth rate could lead to a positive rating action.

Strengths

• Belgium is richer than most 25AA peers and has strong institutions. It also has greater macroeconomic stability.

• Private sector debt is lower than for peers and the household sector is a sizeable net creditor. The absence of balance-sheet adjustment pressures, which are currently a problem for several other eurozone peers, supports Belgium's GDP growth prospects

• External finances are strong compared with the 'AA' peer group. BelgiumÐs external balance sheet is solid after several decades of current account surpluses; the country is a net external creditor.

• Fiscal credibility is sound. The Belgian authorities have a proven track record of consolidation and debt reduction. The size and stability of government revenue is a further strength.

• Belgium has an exceptionally large and stable revenue base.

Weaknesses

• Public debt close to 100% of GDP makes Belgium an outlier compared with rating peers. A large debt stock increases interest-rate risk and provides less fiscal space to cope with future shocks.

• The banking sector, with a balance sheet over 3x GDP, represents a large contingent liability on the sovereign. Nevertheless, the sector appears on the mend and contingent liabilities related to it have declined to 13.5% of GDP in February 2013 from 15.7% in 2012.

• Political stability is lower than in most high-grade sovereigns due to fractious disputes about the future shape of the state. The country underwent 541 days of political deadlock before forming a six-party coalition government in December 2011. The federal and regional elections in May 2014 may lead to another political standstill.

• The costs of an ageing population are rising and will exert more pressure on public finances unless measures to address this issue are adopted promptly.

November 22, 2013

BARCLAYS

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