

# Ten years after the crisis: lessons learnt and forward risks for the Belgian economy and the financial sector

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DE BELGIQUE VAN BELGIË

Eurosystem

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# Overview

I. Flashback: A crisis in different stages called for strong monetary policy actions

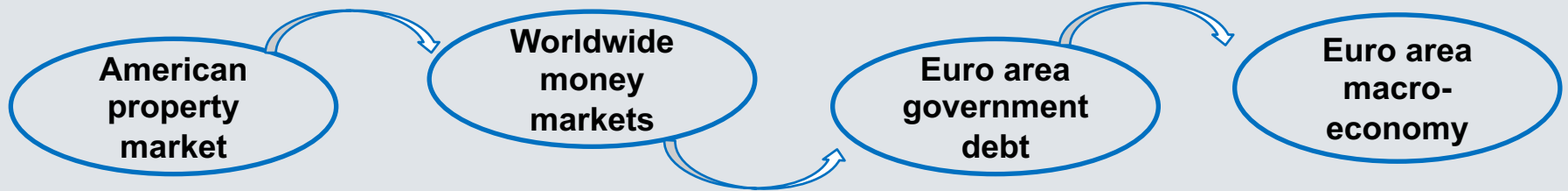
II. National and EU authorities also took their part in the policy response to the crisis

III. Where do we stand? Risks and challenges going forward for the Belgian economy

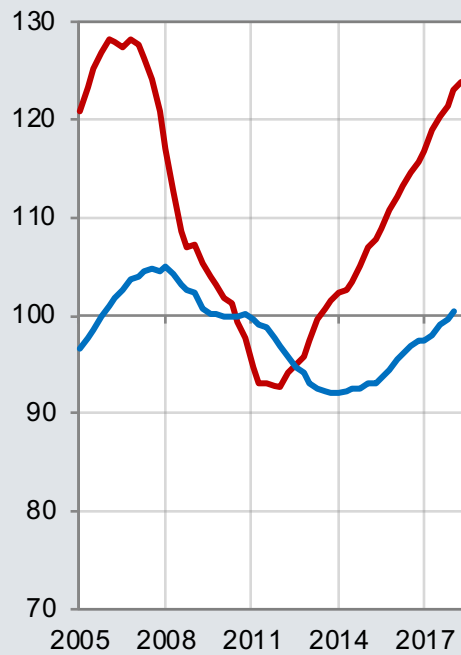
IV. Outlook for the financial sector and risks going forward



# A worldwide crisis in different phases

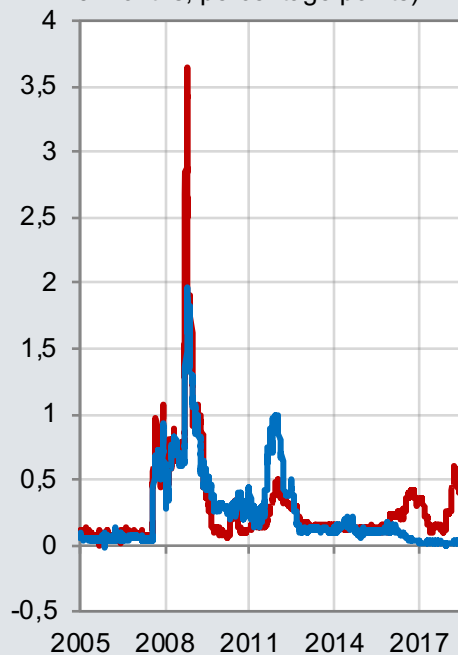


**House prices**  
(real indices 2010 = 100)



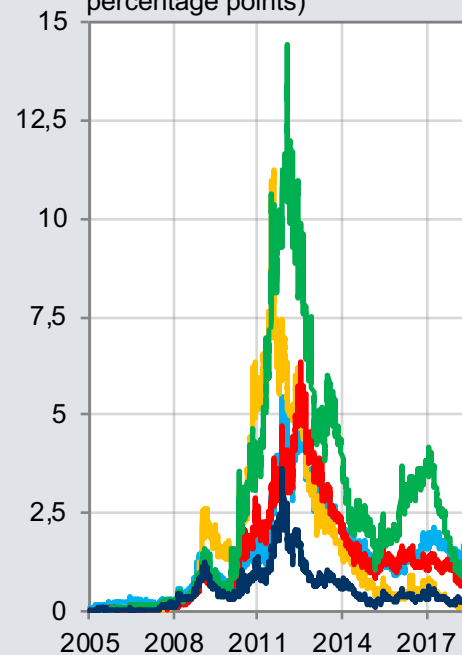
— United States  
— Euro area

**Money market**  
(spread between unsecured and secured loans; 3 months; percentage points)



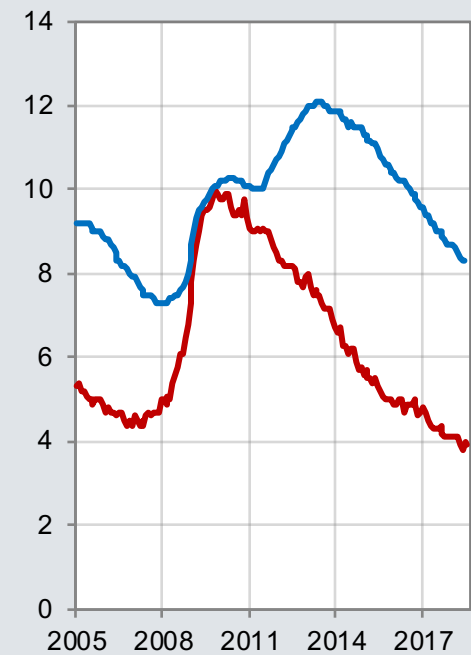
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**Government debt securities**  
(spread against 10-year Bund; percentage points)



— IT — IE — ES  
— PT — BE

**Unemployment rate (%)**



— United States  
— Euro area



# PHASE 1

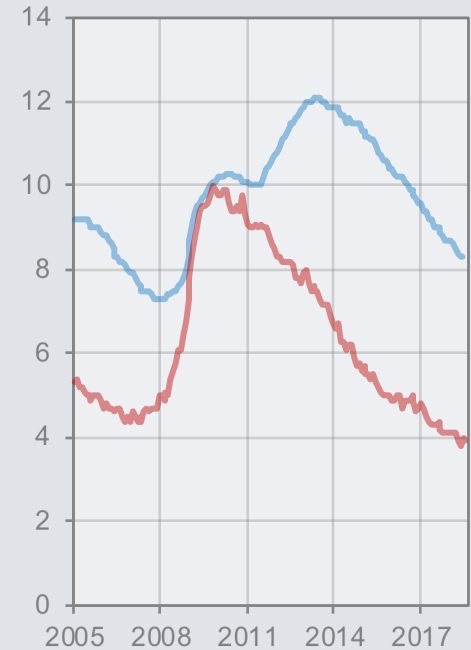
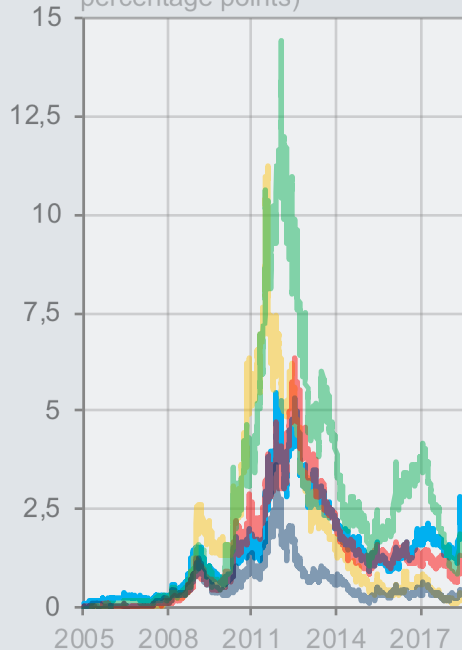
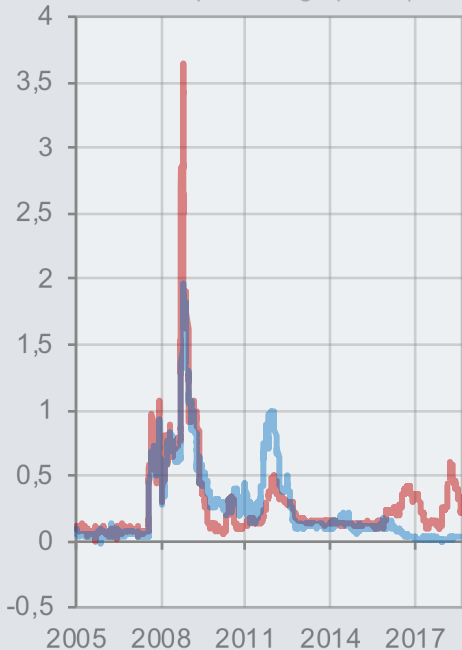
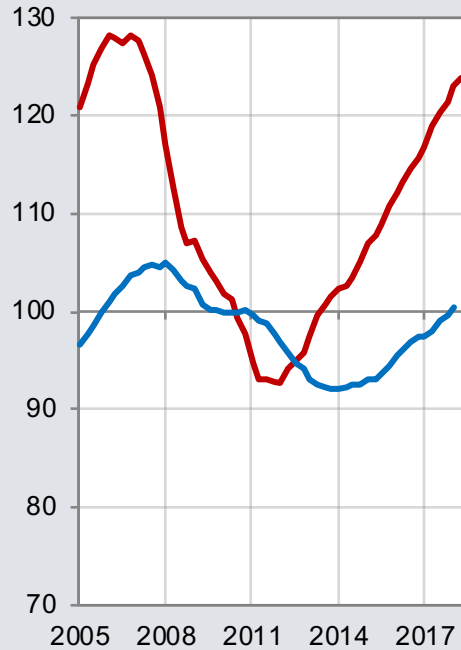


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**Unemployment rate**  
(%)



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Sources: OECD, Thomson Reuters Datastream.



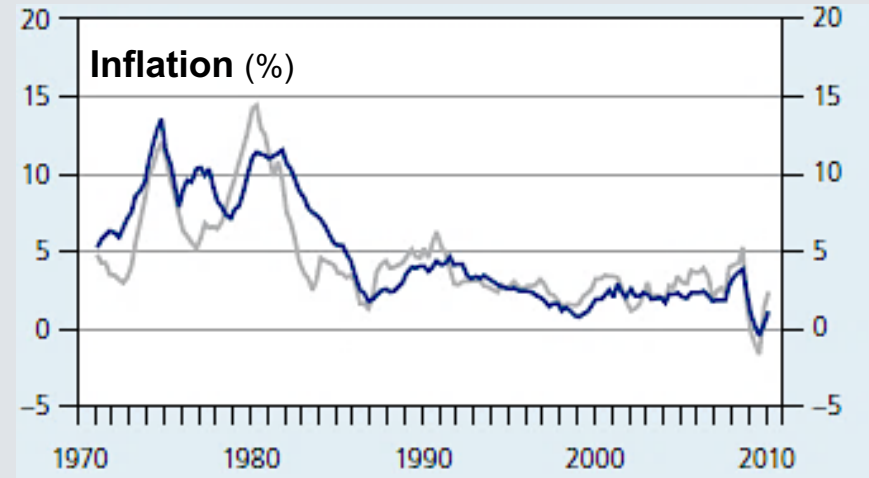
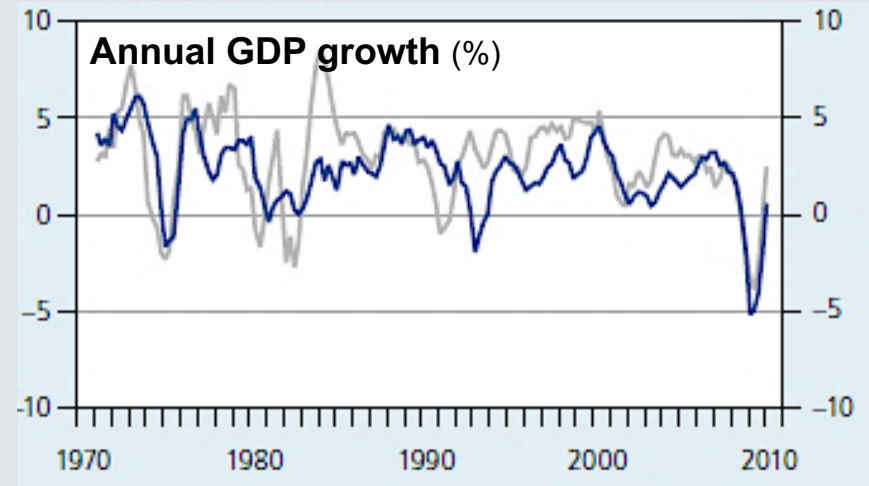
# Build-up of vulnerabilities in the pre-crisis period ...

## Macroeconomic environment

- Strong growth and low inflation (Goldilocks economy)
- Rising global imbalances
- Low interest rates → buoyant lending to households and companies

## Microeconomic factors

- Search for yield
- Financial innovation (e.g. securitisation)
- Underestimation of bank risk
  - (Too) easy regulation
  - Weak internal risk management
  - Inadequate supervision



— Euro area — US



# ... amplified the triggers of the financial crisis

## 'Subprime' crisis in US mortgage market in 2006

(following Fed interest rate hike)

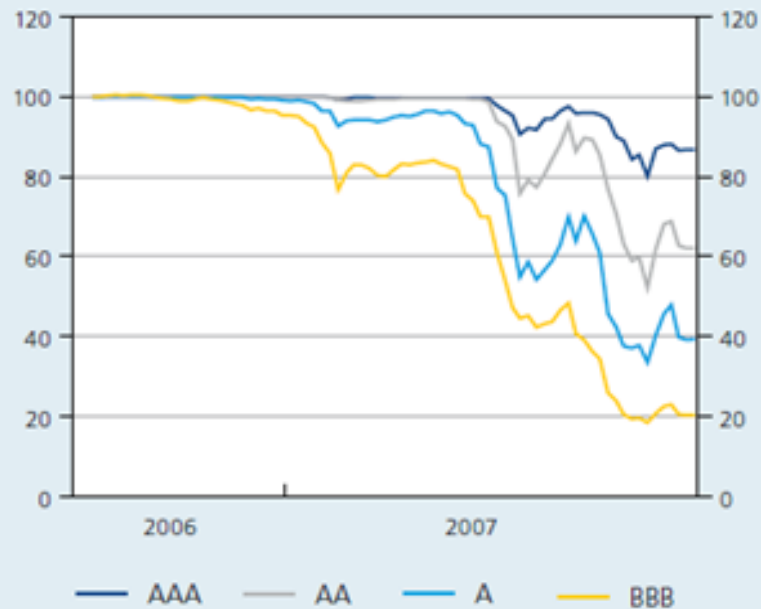


## Tensions spread globally in Summer 2007

- Increased uncertainty and risk repricing
- Liquidity crisis

PRICE INDICES OF SECURITIES BACKED BY SUBPRIME HOME EQUITY MORTGAGES IN THE UNITED STATES, ACCORDING TO TRANCHE RATINGS <sup>(1)</sup>

(index ABX.HE 2006-2, face value = 100, weekly data)

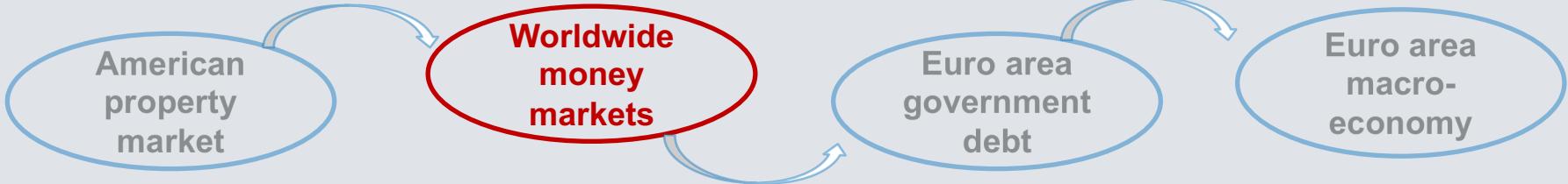


**September 2008:**

Bankruptcy Lehman Brothers  
Financial unrest escalated



# PHASE 2

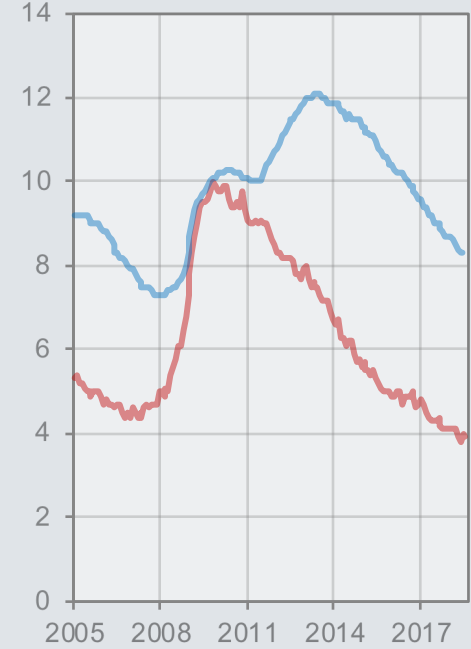
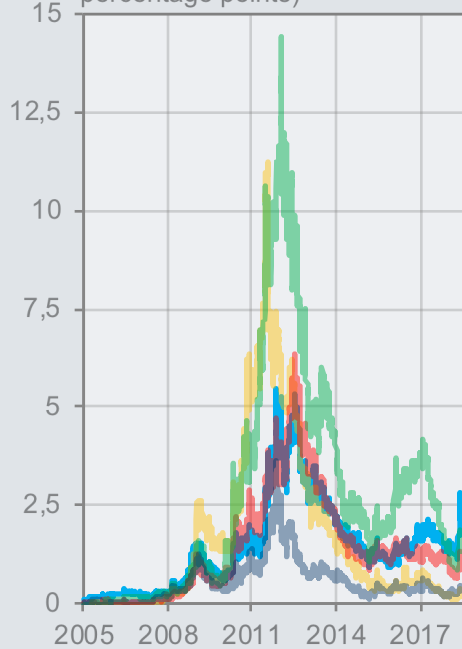
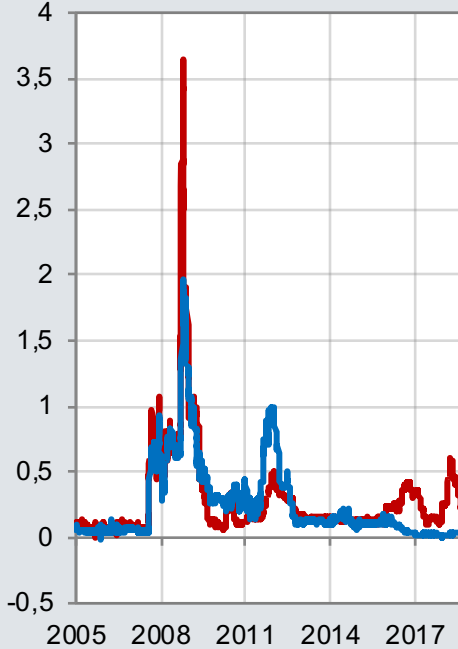
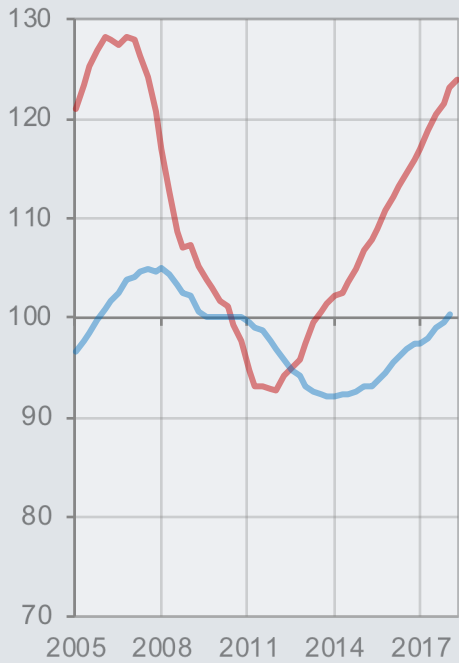


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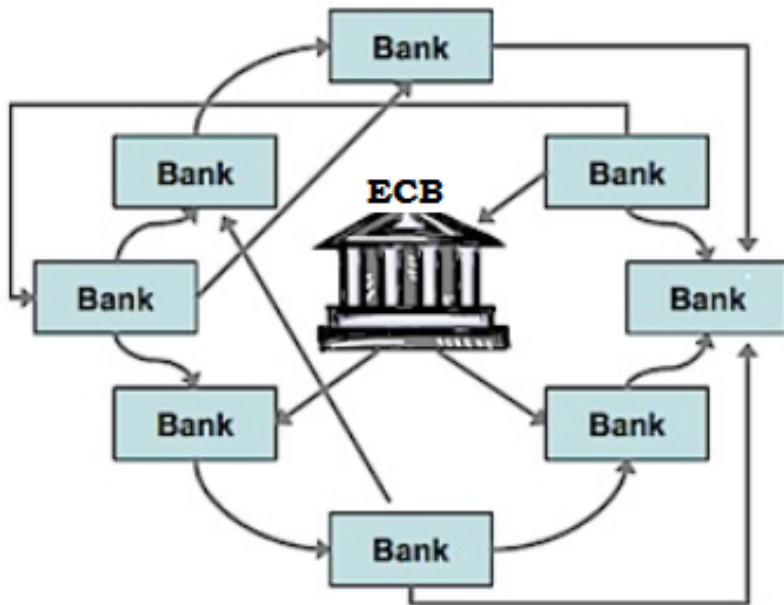
Sources: OECD, Thomson Reuters Datastream.



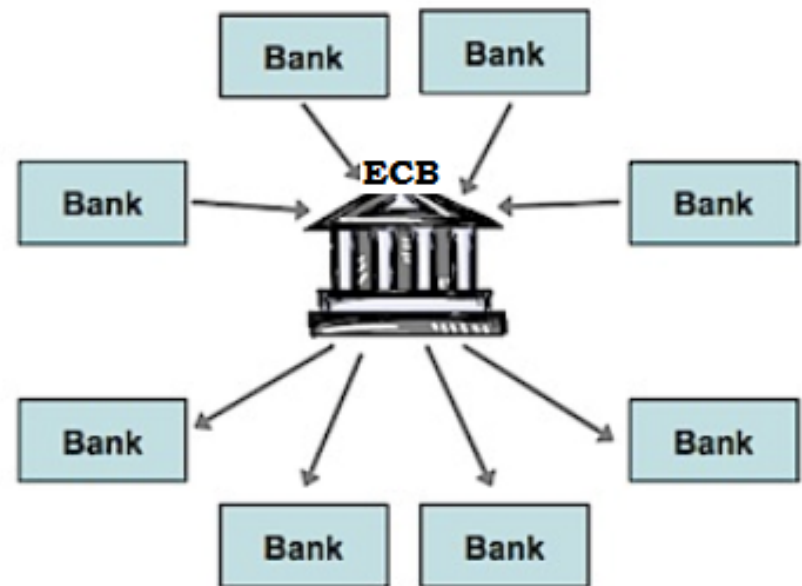
# In a context of financial turmoil, the ECB is "lender of last resort"

- ▶ Concern about the quality of bank balance sheets and collapse of Lehman Brothers lead to major turmoil on international money markets
- ▶ Borrowing money on the financial markets becomes virtually impossible for many banks
- ▶ Central banks and governments have to put together support measures

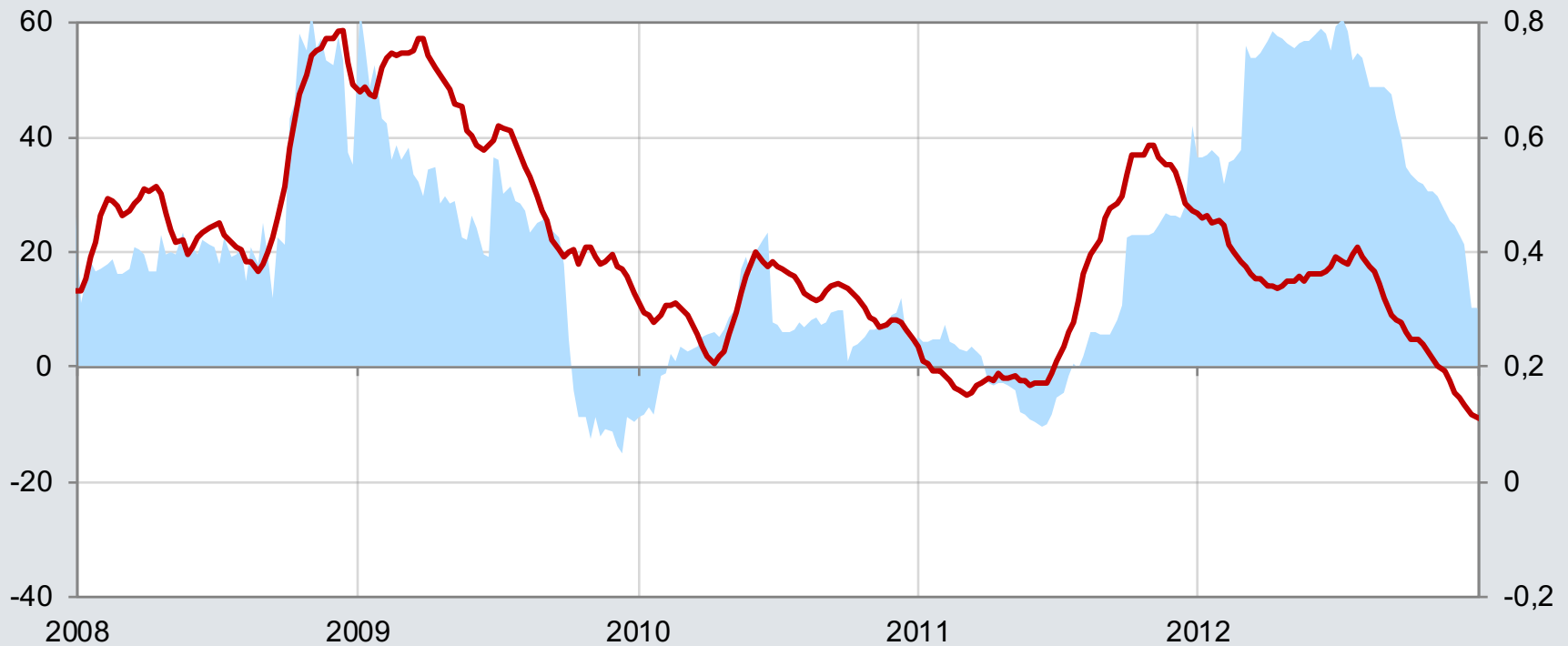
## Normal times



## Liquidity problems



# Between 2008 and 2012, the central bank balance sheet fluctuated along with the financial tensions and thus demand for liquidity from banks

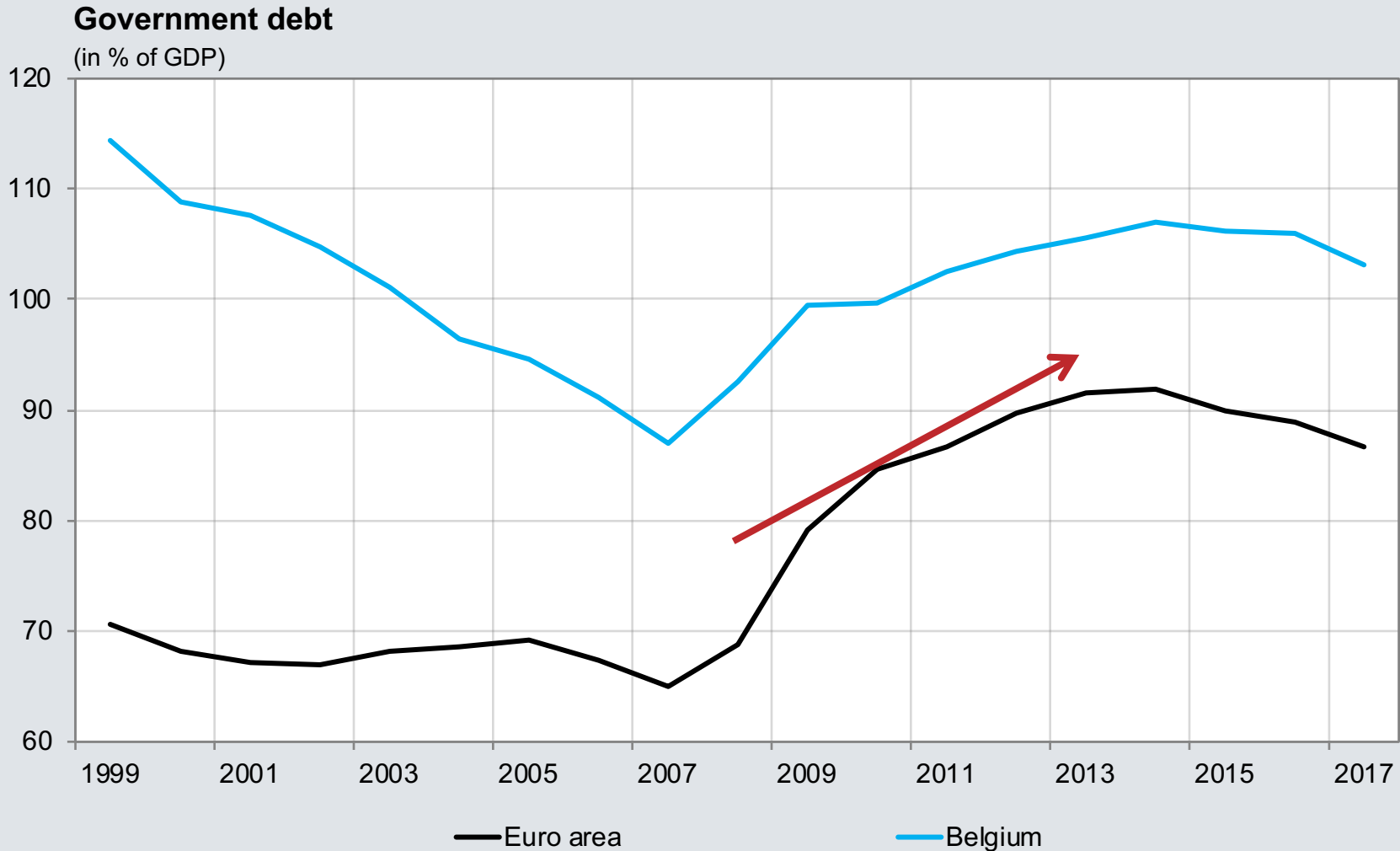


■ Eurosystem balance sheet total (year-on-year growth, left-hand scale)

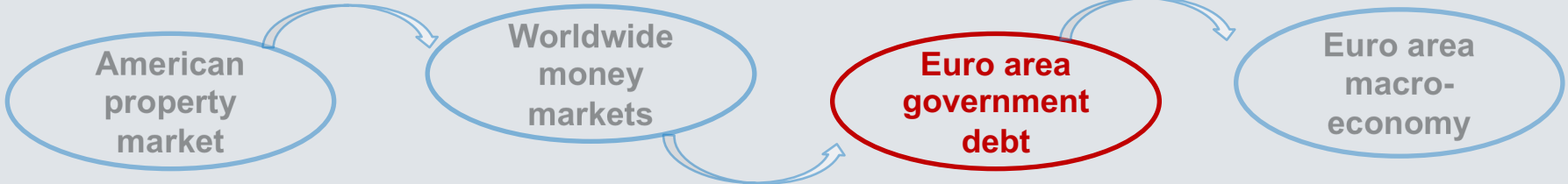
— Indicator of systemic stress in the financial system (CISS) (moving average over 5 weeks, right-hand scale)



# The government also aided the banking sector (e.g. through capital injections), contributing to a rising debt ratio



# PHASE 3

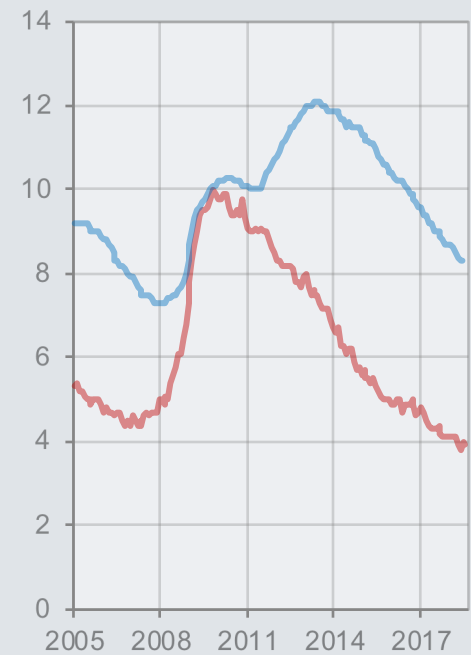
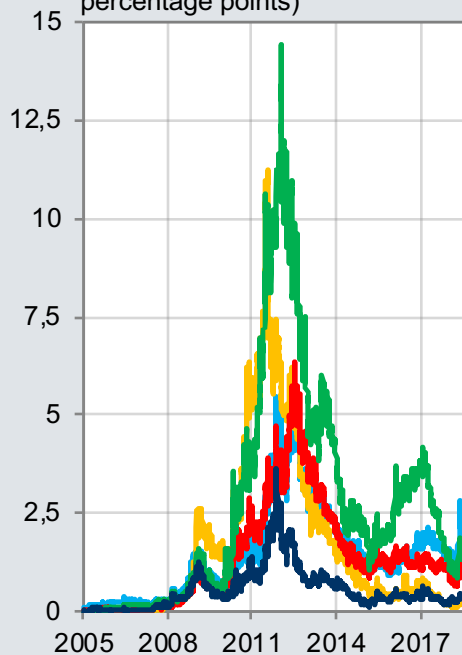
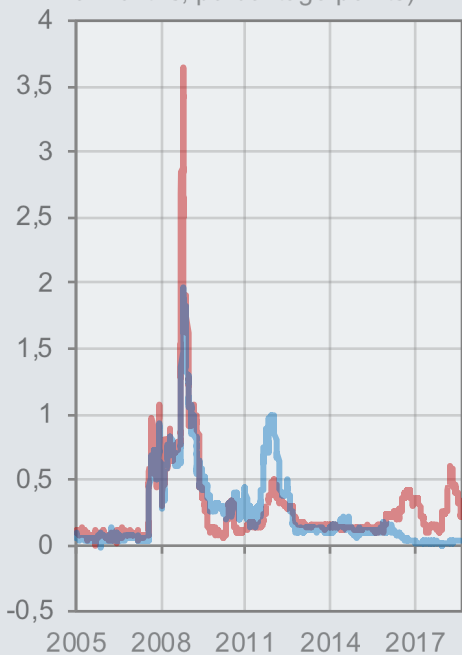
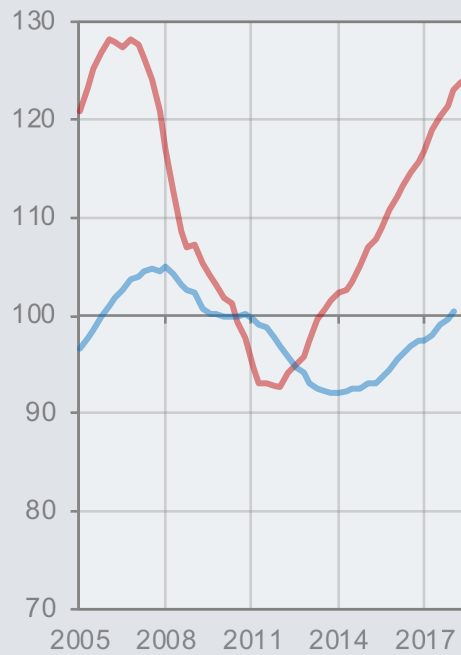


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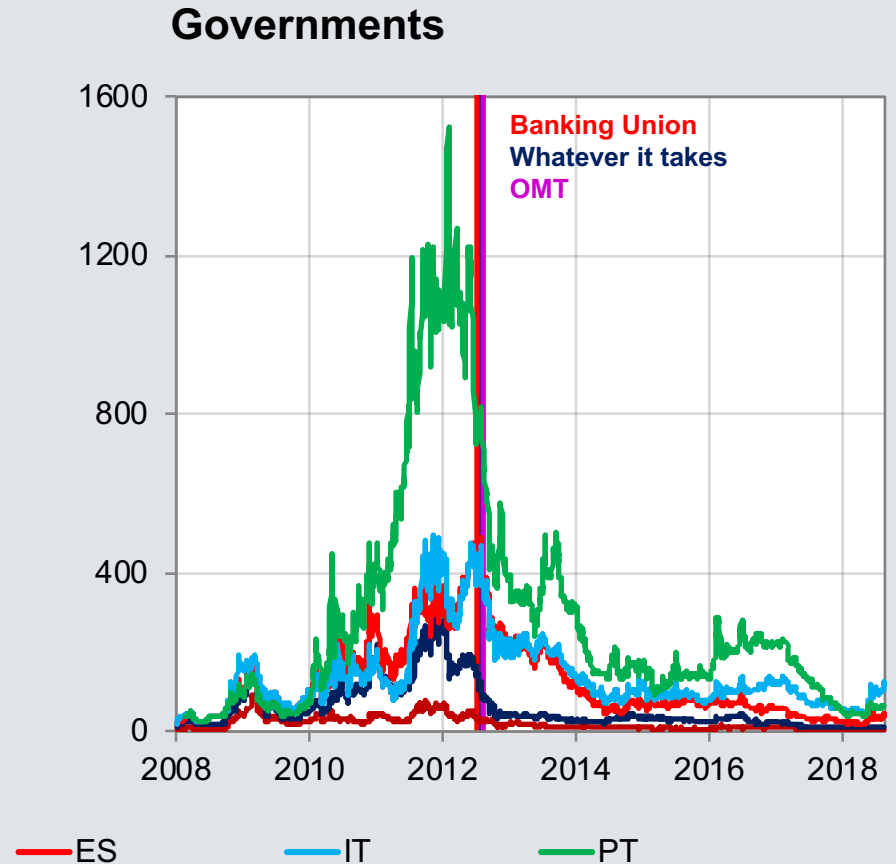
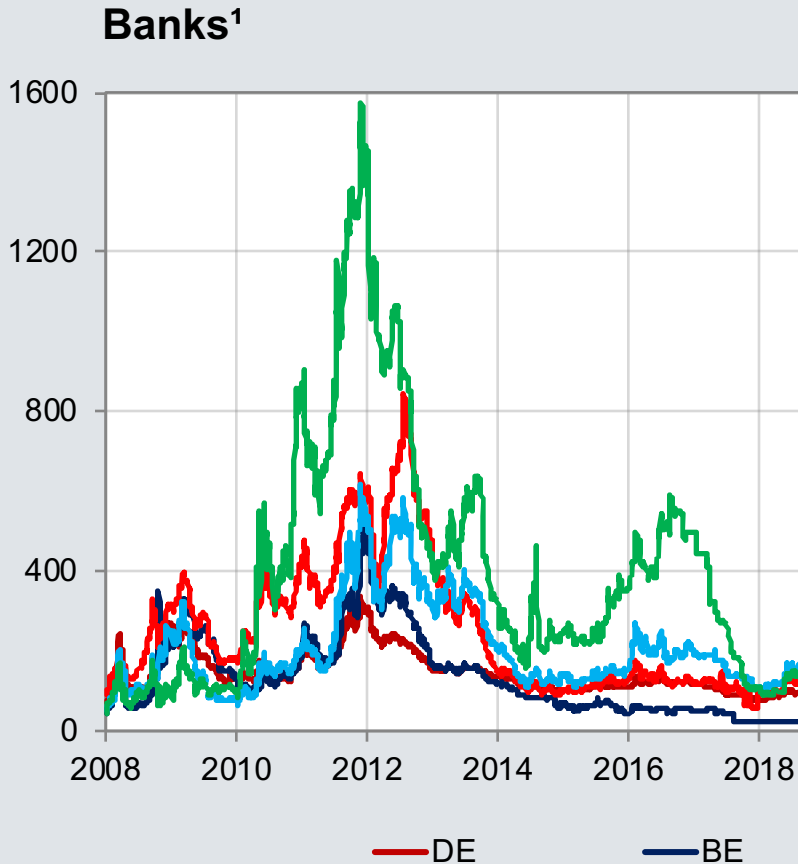
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Sources: OECD, Thomson Reuters Datastream.



# Mutual contagion between banks and sovereigns is finally halted in summer 2012 ...

(Credit Default Swaps (CDS), 5 year, senior, basis points)

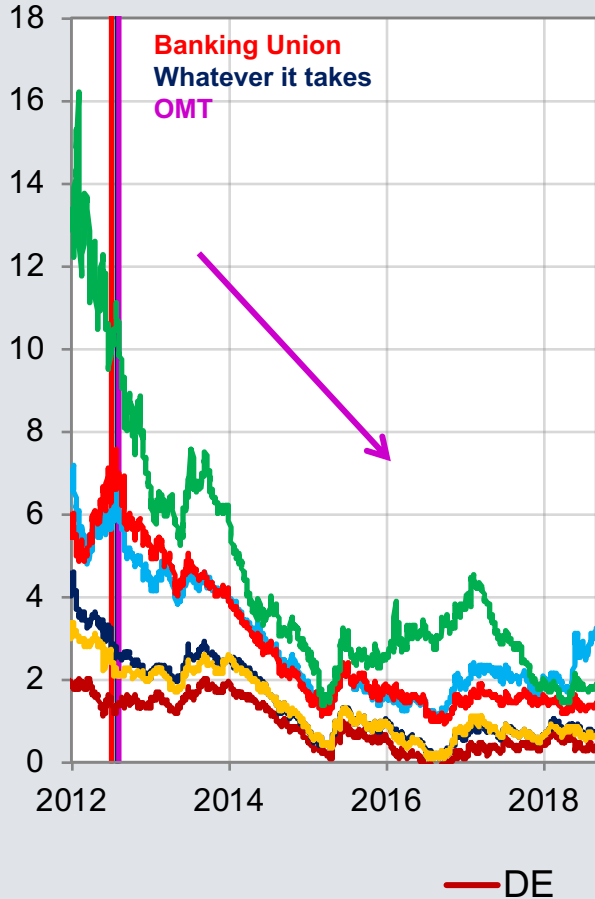


Source: Thomson Reuters Datastream.  
<sup>1</sup> Banks' country average.

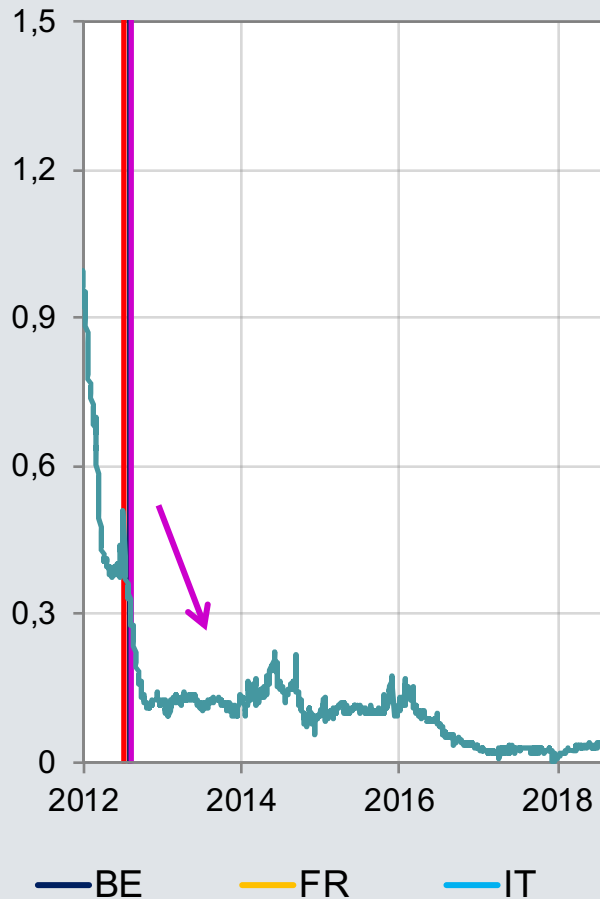


# ... after which the financial fragmentation in the euro area was greatly reduced

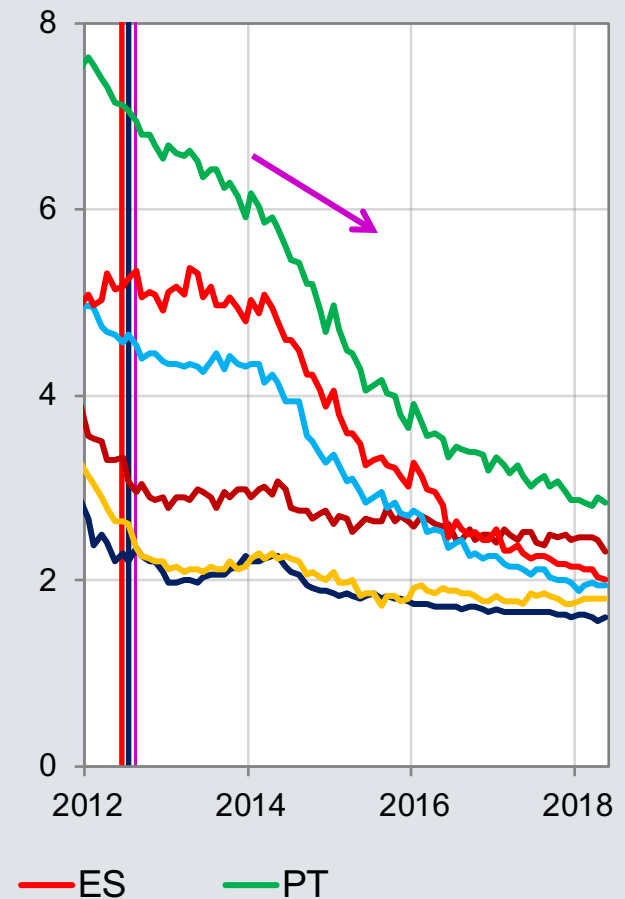
### Yields on 10-year government bonds (%)



### Money market (spread between unsecured and secured loans; 3 months; percentage points)



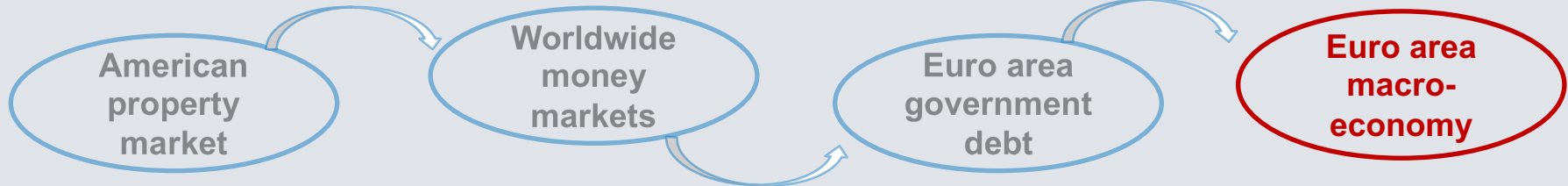
### Interest rate on NFC loans (lending up to €1 million, up to 1 year, %)



Sources: ECB, Thomson Reuters Datatsream.



# PHASE 4

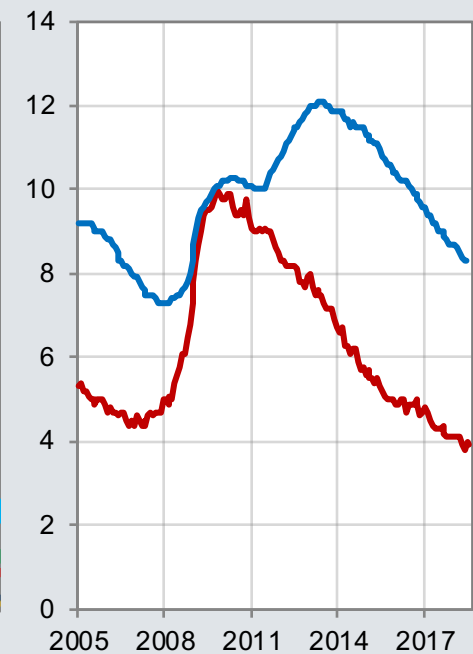
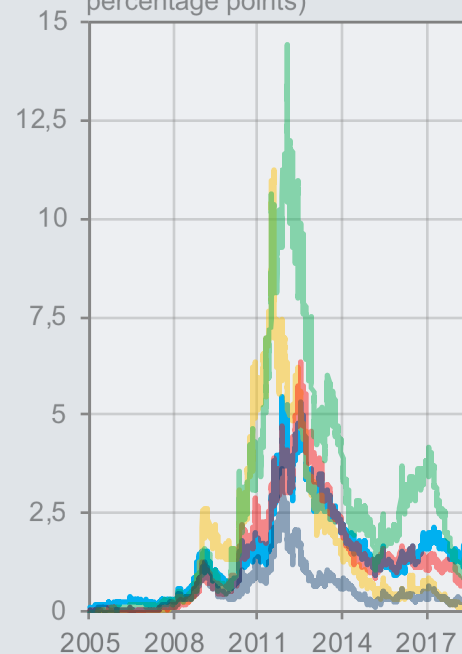
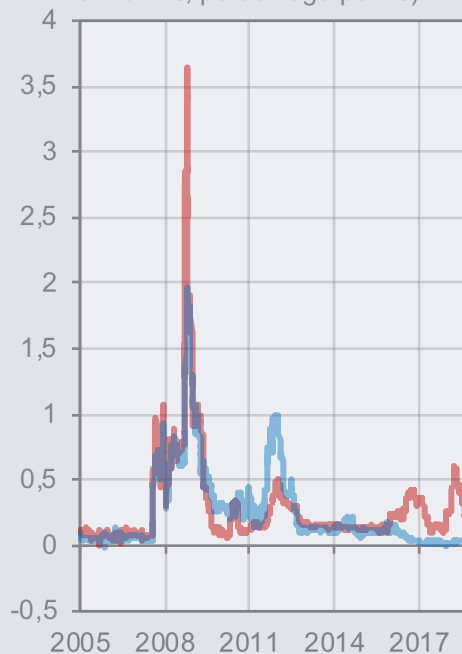
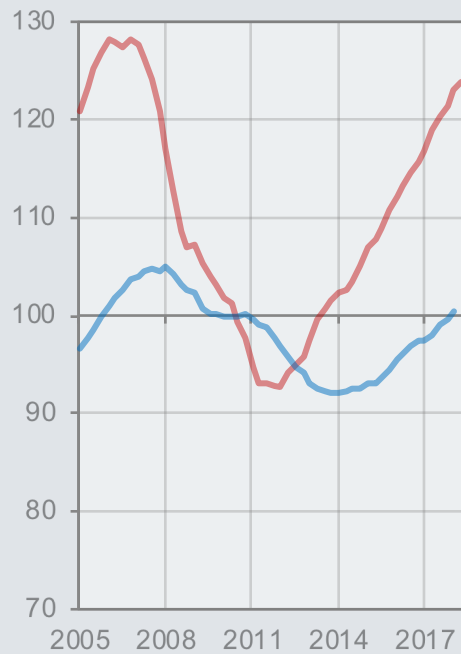


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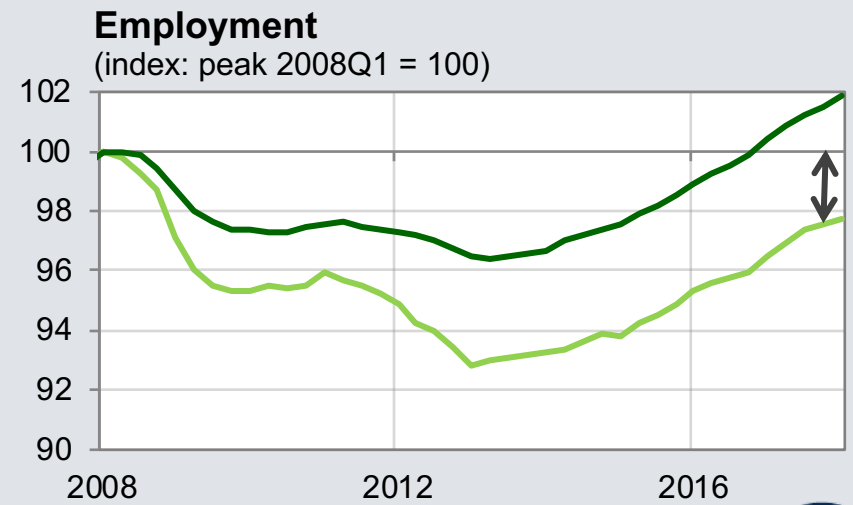
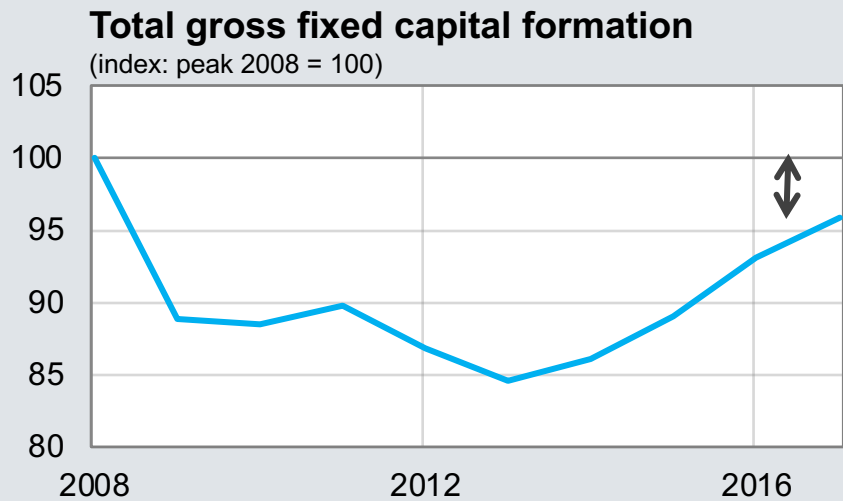
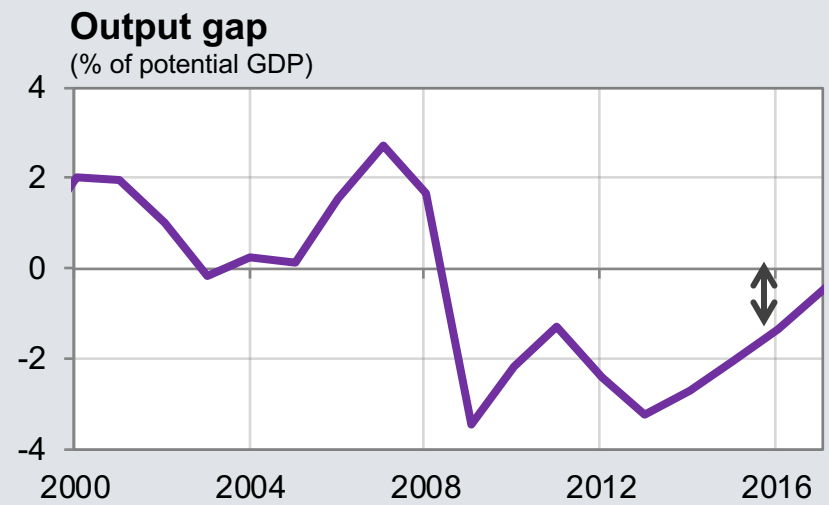
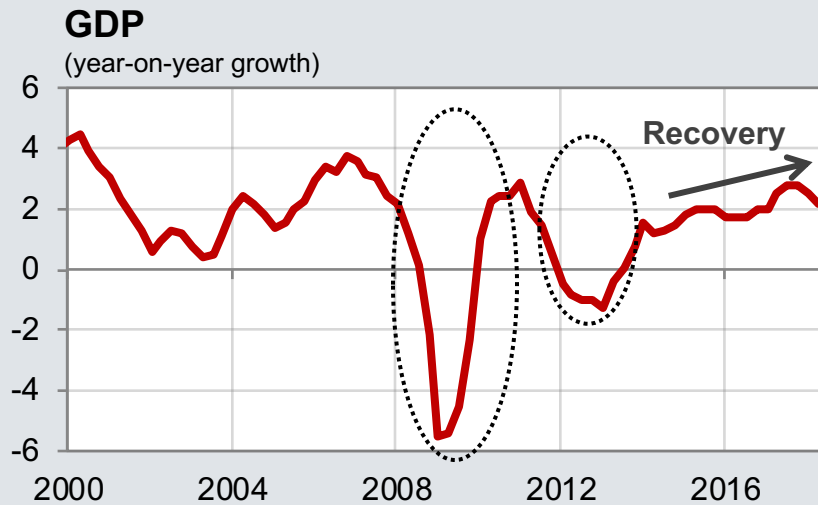
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# Double-dip recession in the euro area caused considerable economic slack ...

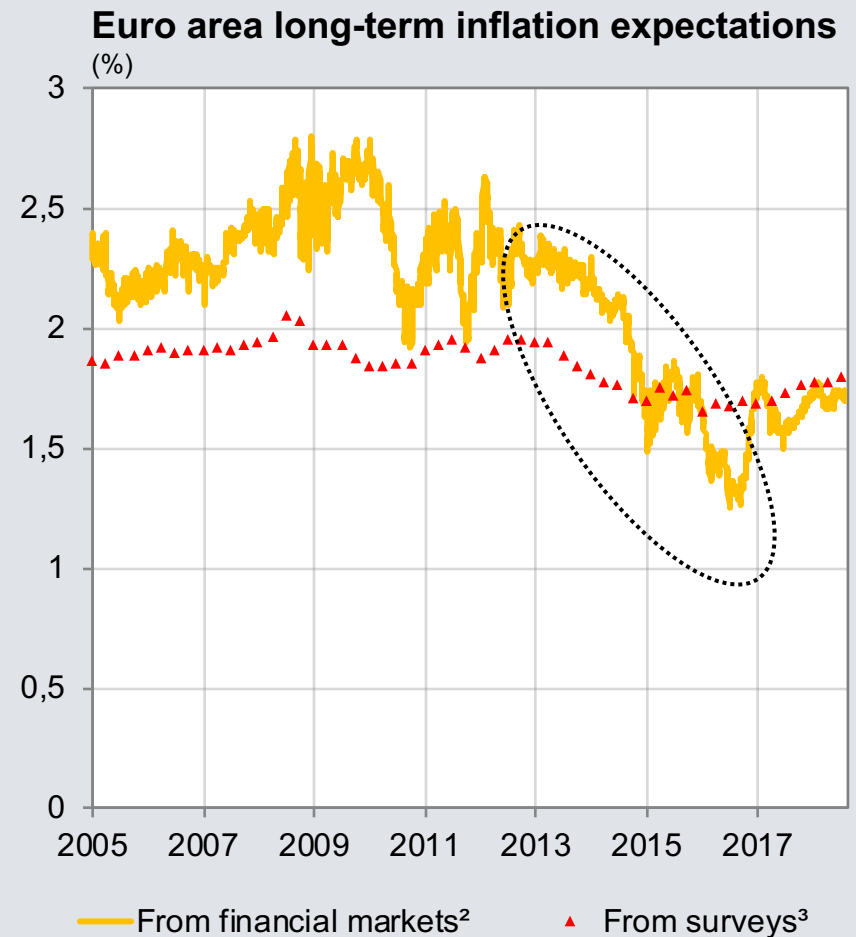
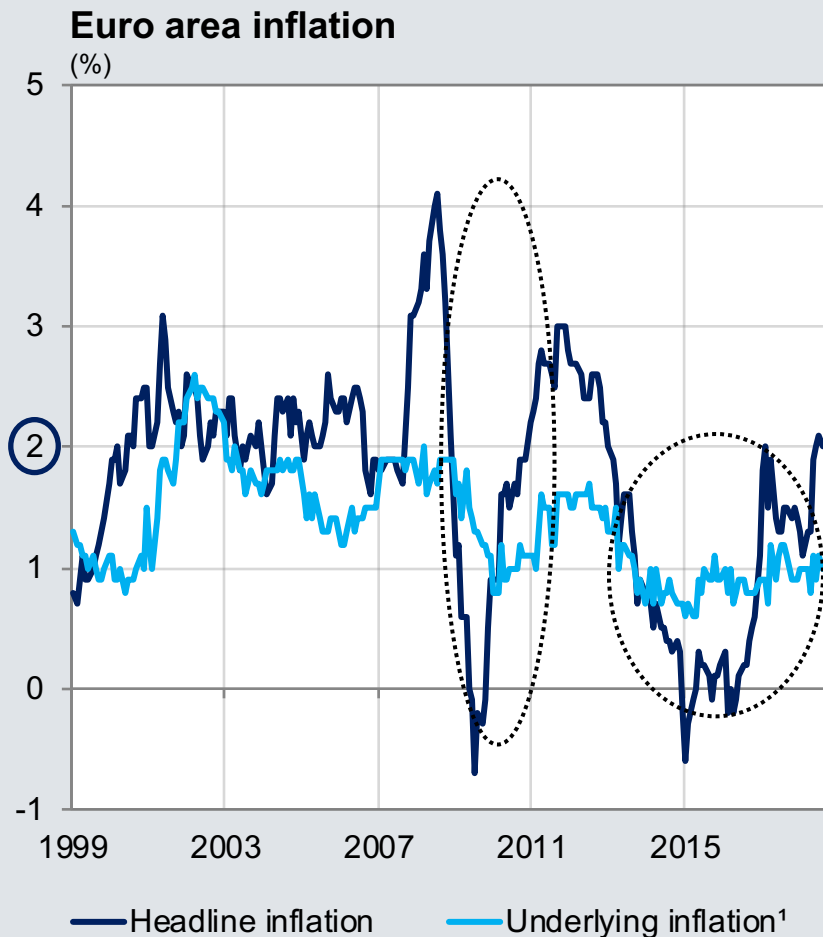


— In hours worked — In persons employed

Sources: EC, ECB.



# ... that pushed inflation down.



Sources: Bloomberg, ECB.

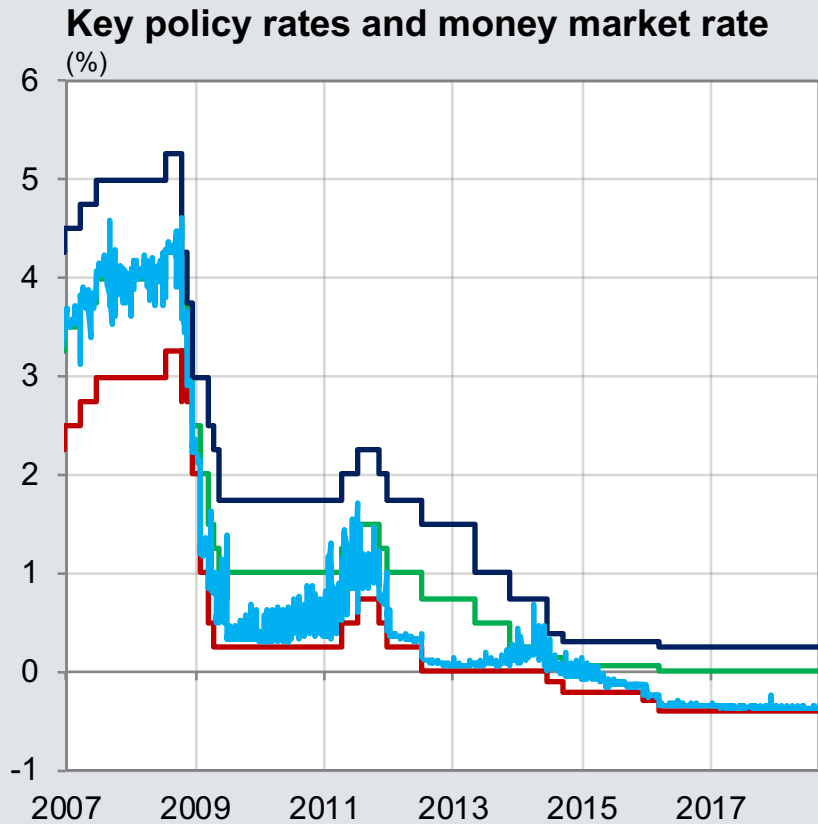
1 Total HICP inflation excluding energy and food.

2 Implicit inflation rate derived from swap contracts hedging the inflation risk in the euro area during a five-year period starting five years after conclusion of the contract.

3 Average of the aggregate probability distribution of five-year inflation expectations. The data were obtained from the ECB's quarterly survey of professional forecasters.

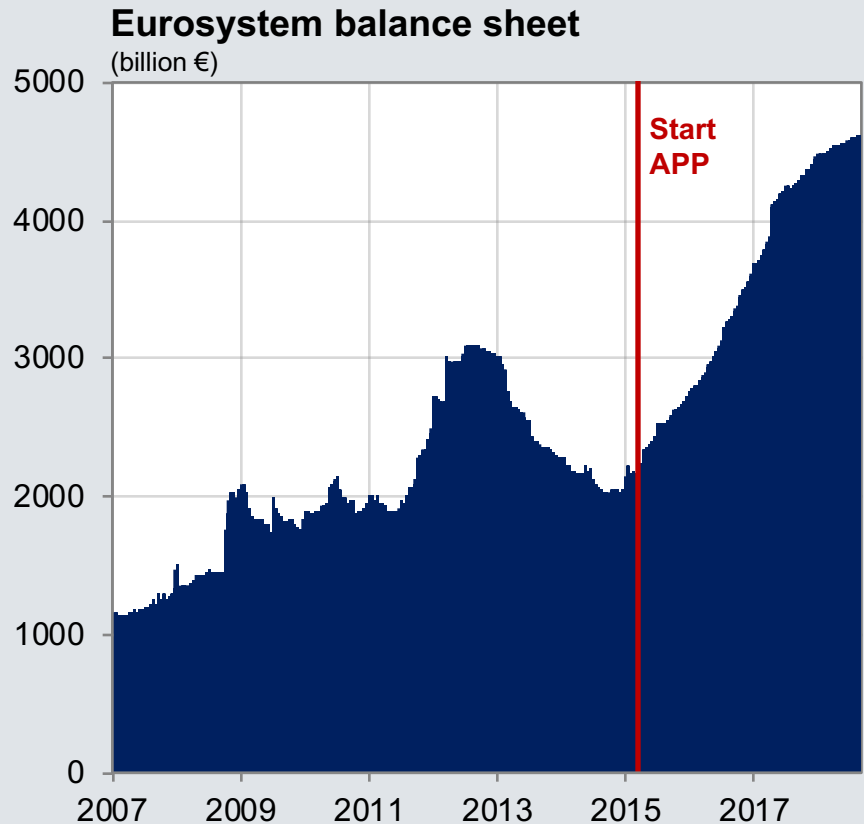


# Monetary stimulus intended to support the economy and bring inflation in line with its target

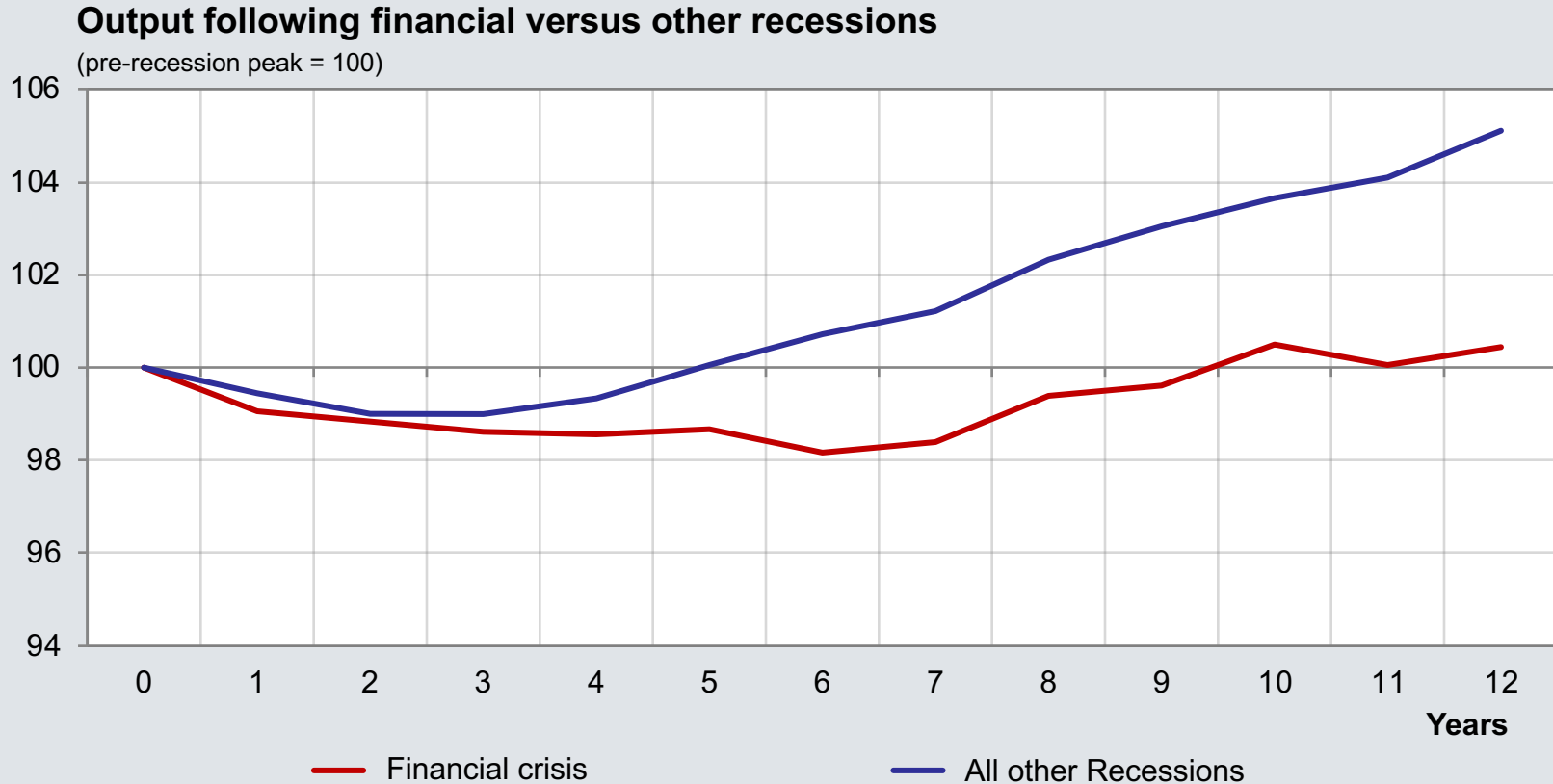


- Deposit facility rate
- Main refinancing rate
- Marginal lending facility rate
- Eonia

Source: Thomson Reuters Datastream.



# Recessions associated with financial crises are longer and more severe than other recessions



▶ How can we prevent them from happening again?



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## Increasing resilience in the medium term: reforms have been achieved but further steps may need to be taken

Realised		Unfinished agenda
Fiscal policy and surveillance	reform of Stability and Growth Pact (SGP)	increase transparency of the rules and improve implementation
		need for a fiscal stabilisation function?
Macro-economic surveillance	Macroeconomic imbalance procedure (MIP) and European Semester	improve implementation of country specific recommendations (CSR)
Emergency financial assistance	European Stability Mechanism (ESM)	Strengthening and further development of the ESM
Banking union	Single Supervisory Mechanism (SSM)	
	Single Resolution Mechanism (SRM) and Single Resolution Fund (SRF)	last resort fiscal backstop for the Single Resolution Fund
		European Deposit Insurance Scheme (EDIS)



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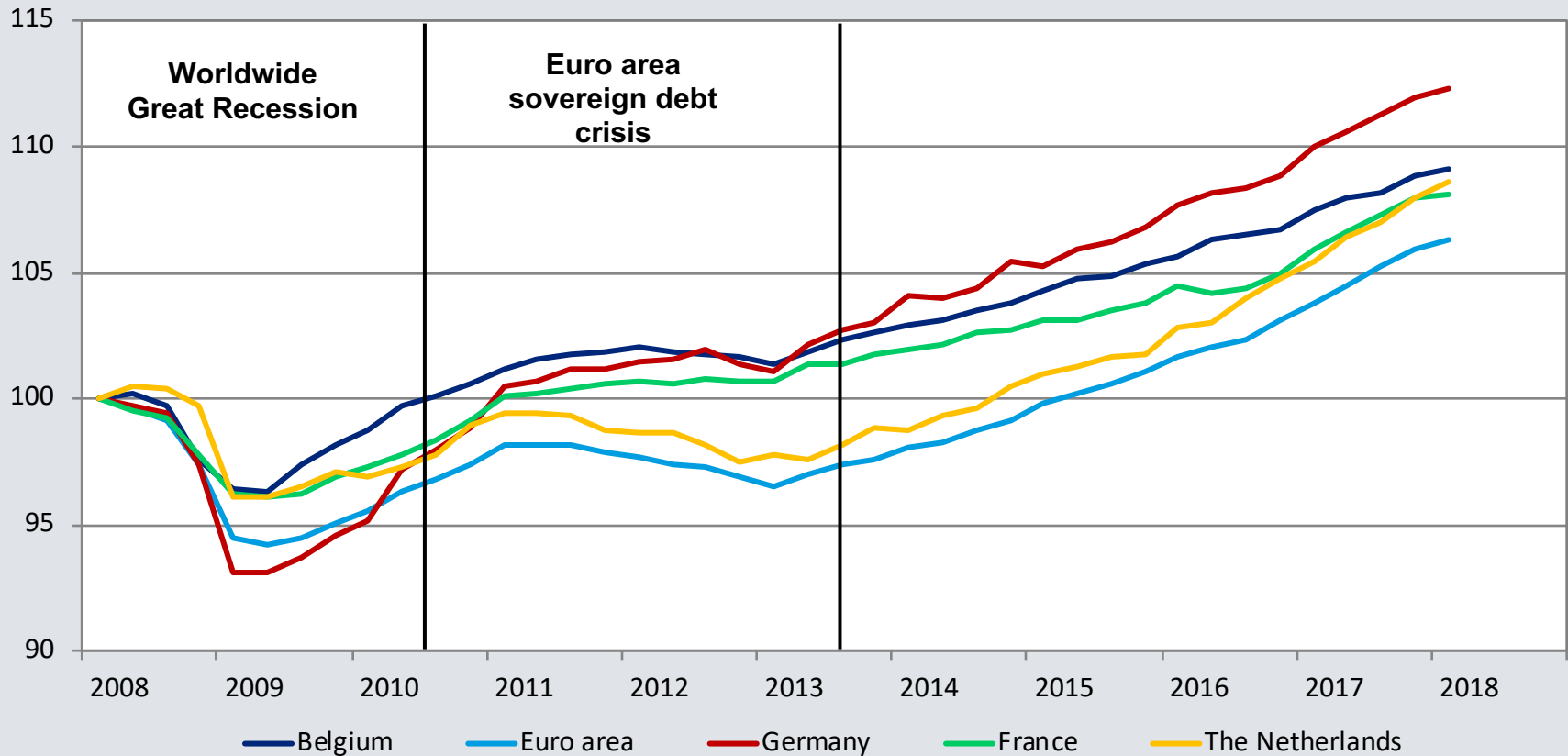
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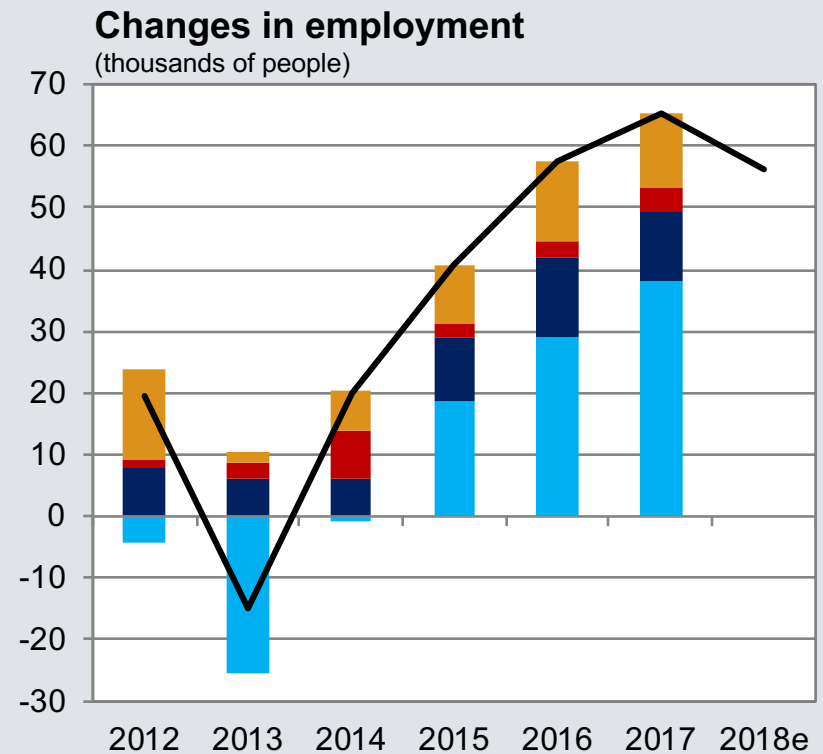
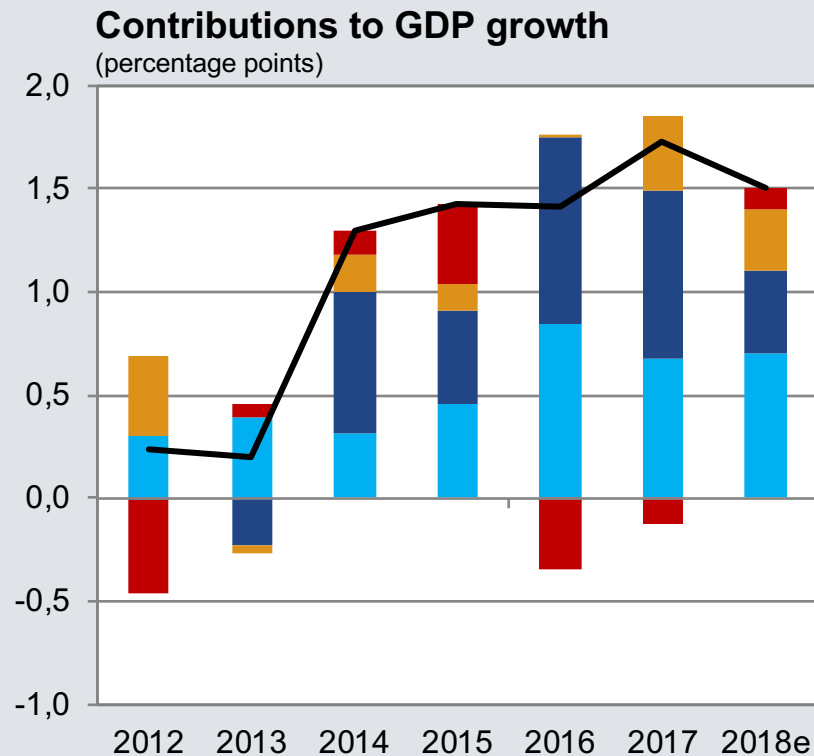
# In Belgium, activity has been growing at a continuous (but moderate) pace for 5 years

## GDP profile since the crisis

(Index 2008Q1 = 100)



# Economic growth is supported by domestic demand and strong job creations



- Net export<sup>1</sup> and changes inventories
- Public expenditures
- Private investment<sup>1</sup>
- Private consumption
- GDP (%)

- Administration and education
- Employees: Non-market sector
- Self-employed people
- Employees: Industry and market services
- Total

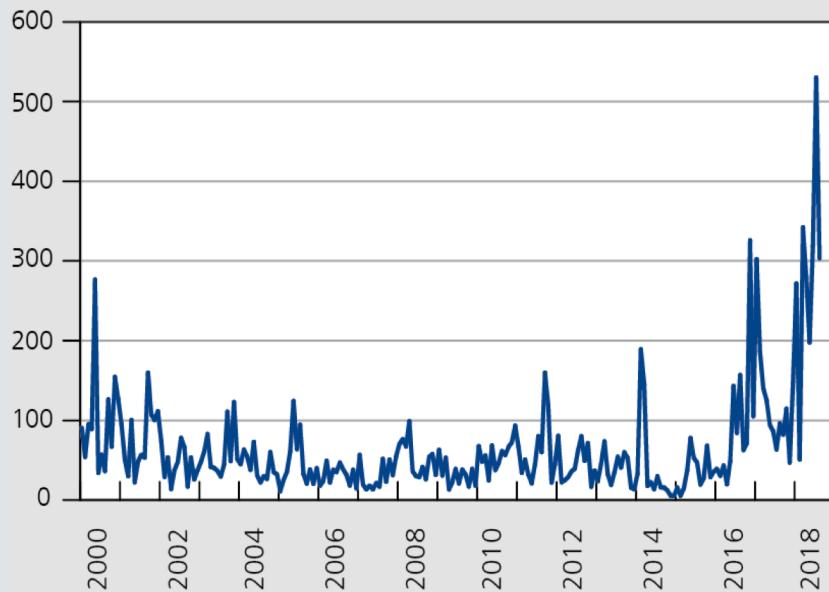
Sources: NAI, NBB.

<sup>1</sup> Data adjusted for major specific transactions.



# Activity is firming, but risks are looming: Mounting policy uncertainties worldwide...

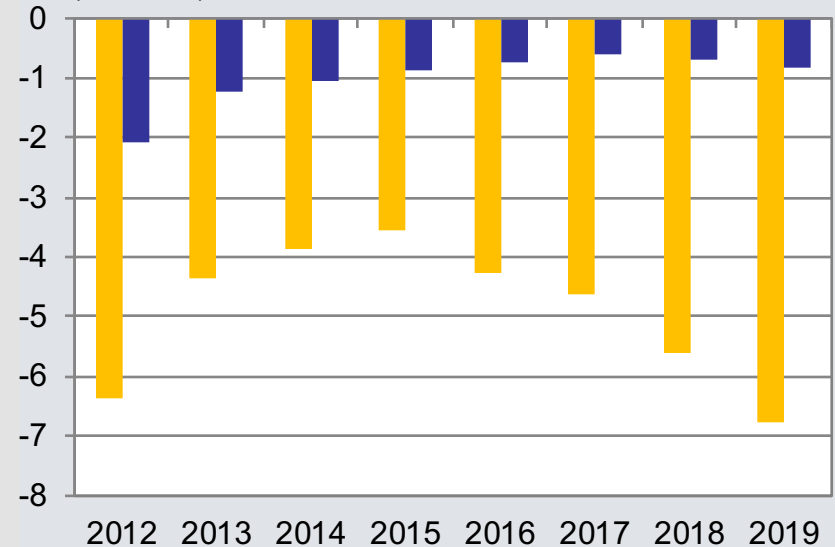
## Uncertainty index of US trade policy<sup>1</sup>



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## Policy-mix: structural fiscal balance

(in % GDP)



■ US     ■ Euro Area

Sources: Policy Uncertainty. Baker, Bloom et Davis (2016), EC.

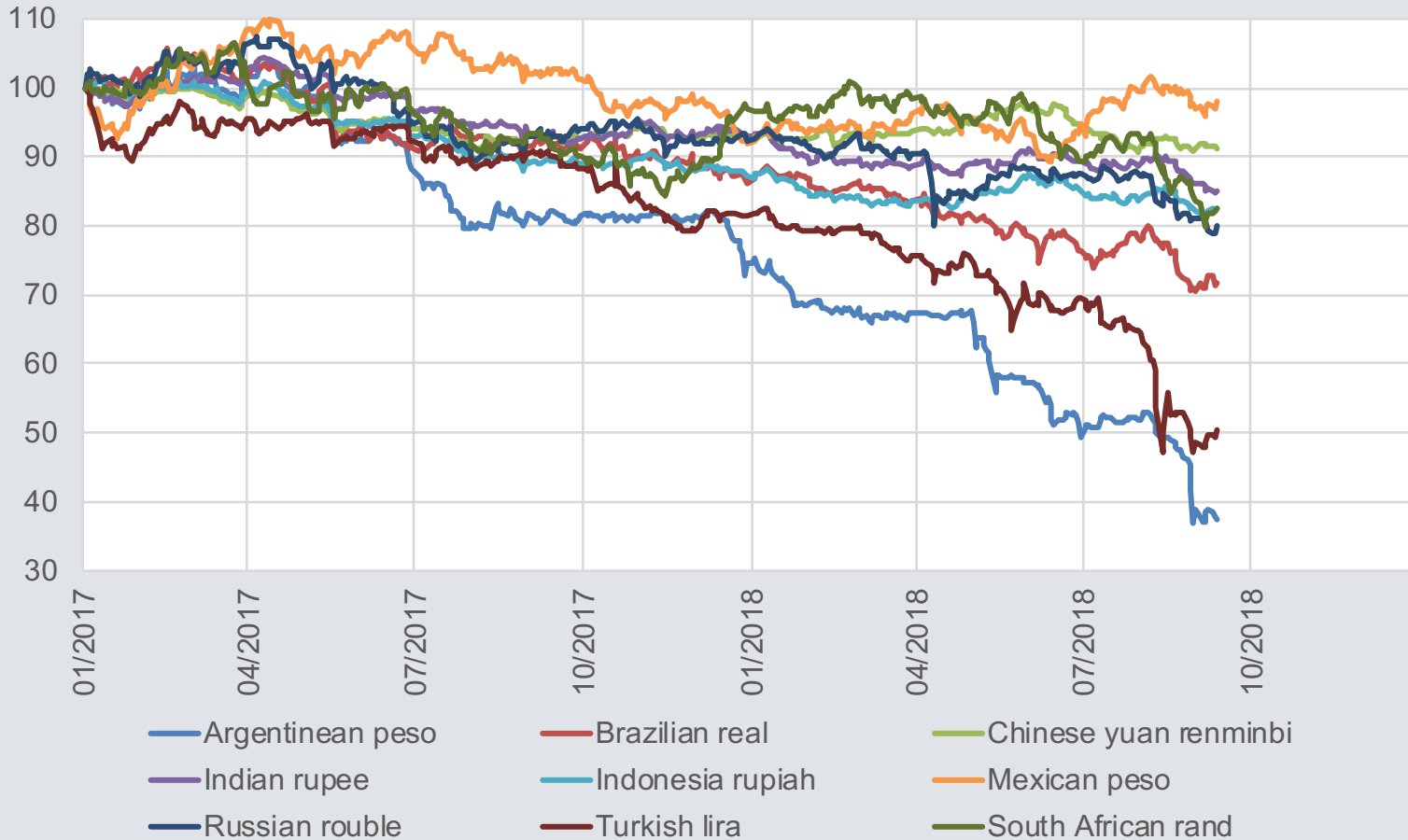
<sup>1</sup> Number of articles referring to the uncertainty of US trade policy in American newspapers.



# ... already impacted vulnerable emerging economies

## Currencies of many EMEs depreciated substantially in 2018

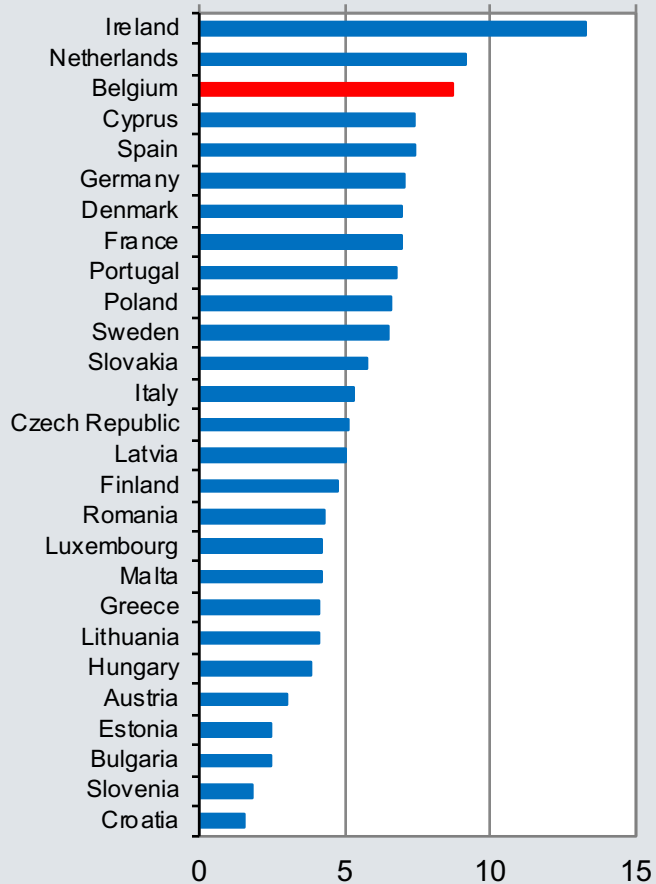
(EUR / EME currencies; 1 Jan. 2017 = 100)



# Risks in Europe: Brexit, Italy

## Share of UK in the export of goods

(in % of total export, 2015-2017)

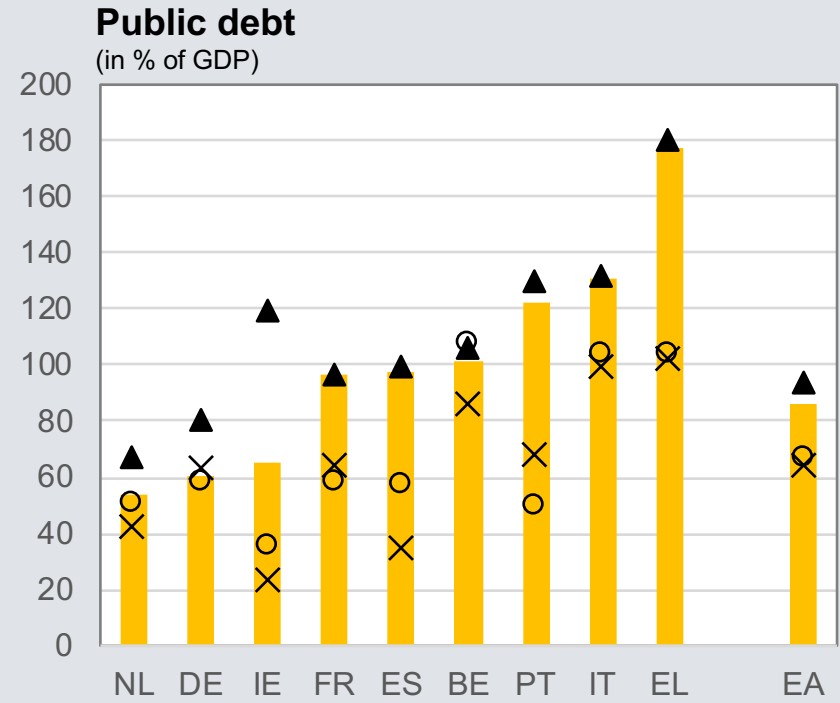
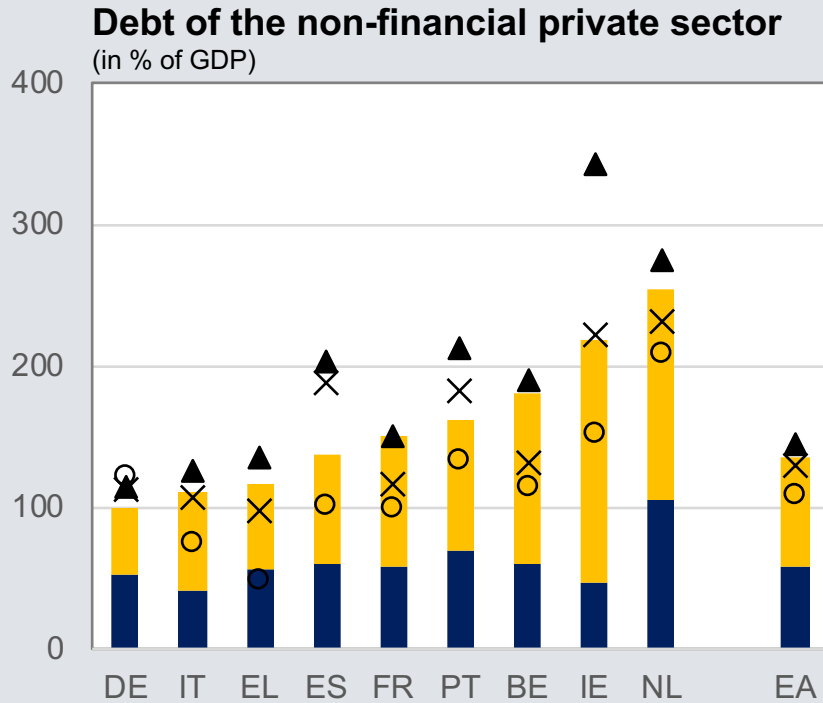


## Italy: 10-year sovereign bond spread

(basis points, with respect to German Bund)



# Debt levels are still elevated, as the deleveraging is slow and uneven across countries



- Non-financial corporations (2018 Q1)
- Households (2018 Q1)
- ▲ Peak of total private debt<sup>1</sup>
- Total private debt in 2000
- × Total private debt in 2007

- 2018<sup>2</sup>
- ▲ Peak
- 2000
- × 2007

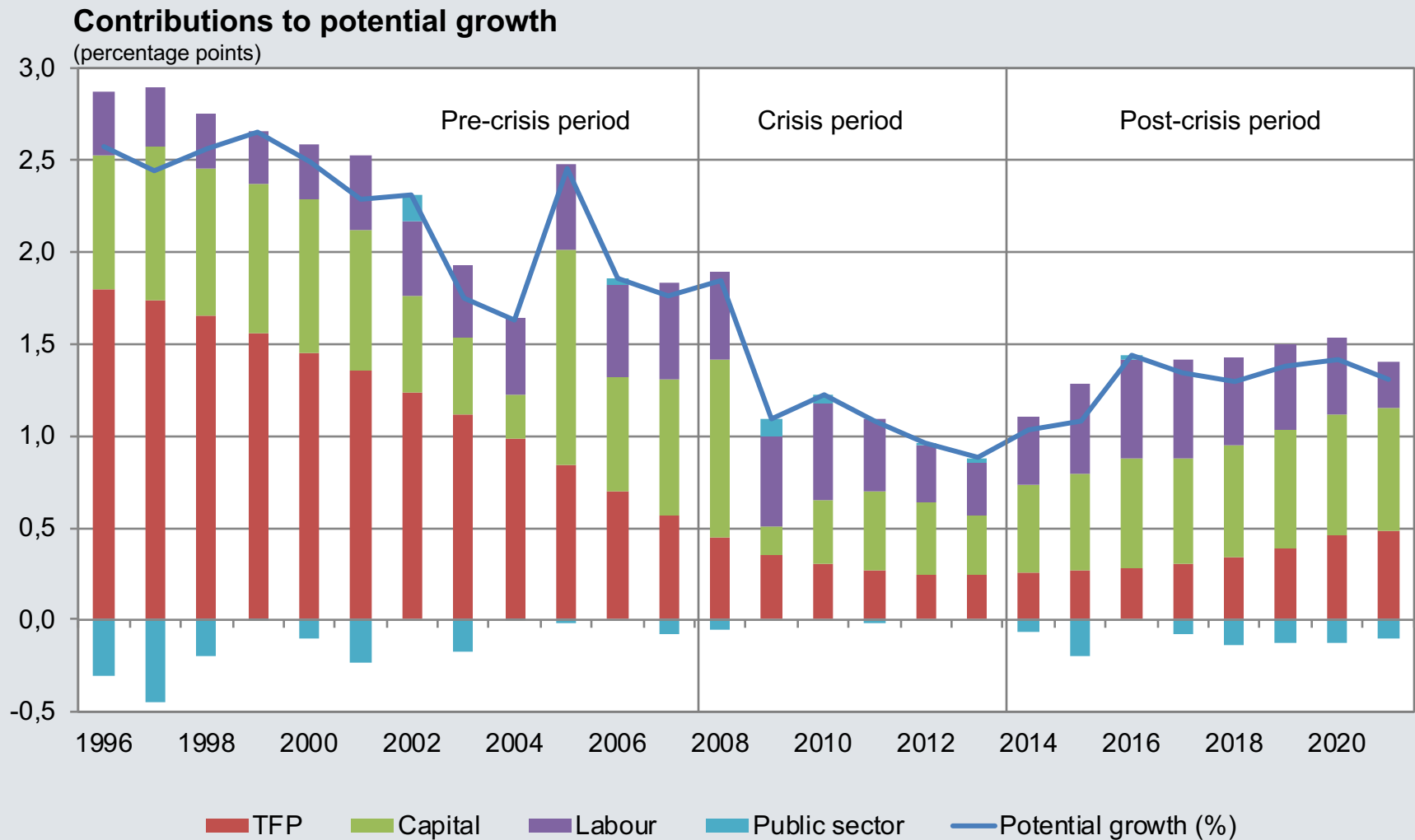
Sources: ECB, EC.

<sup>1</sup> Between 2008 and 2018.

<sup>2</sup> EC 2018 Spring forecast.



# The crisis intensified the downward trend in potential growth in Belgium...



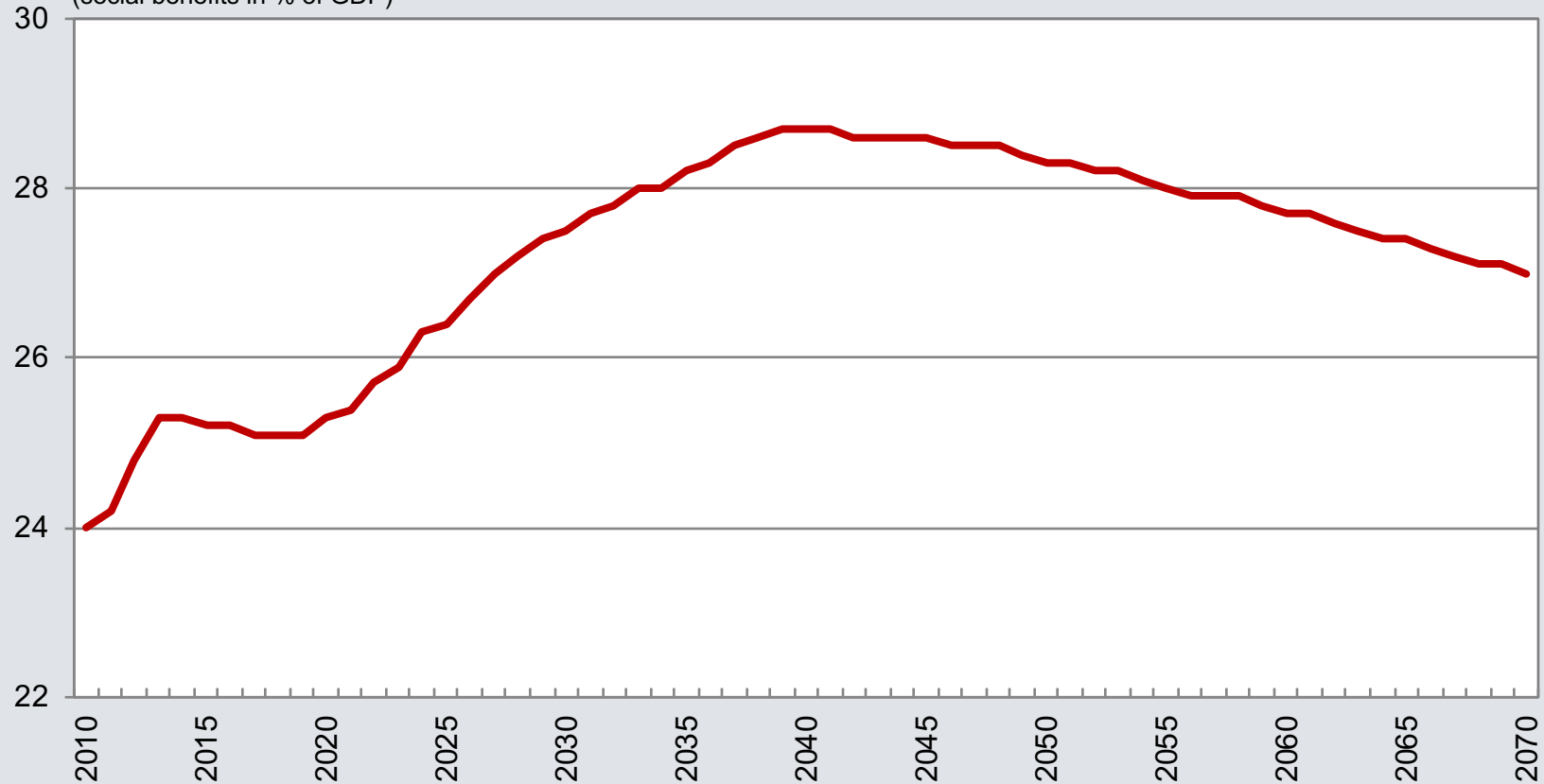
Sources: NAI, NBB.



# ...intertwined with the unfolding of population ageing

## Budgetary cost of population ageing

(social benefits in % of GDP)



# The employment rate should increase further in Belgium

## Employment rate of risk groups

(2017, in % of the corresponding population aged between 20 and 64 years)

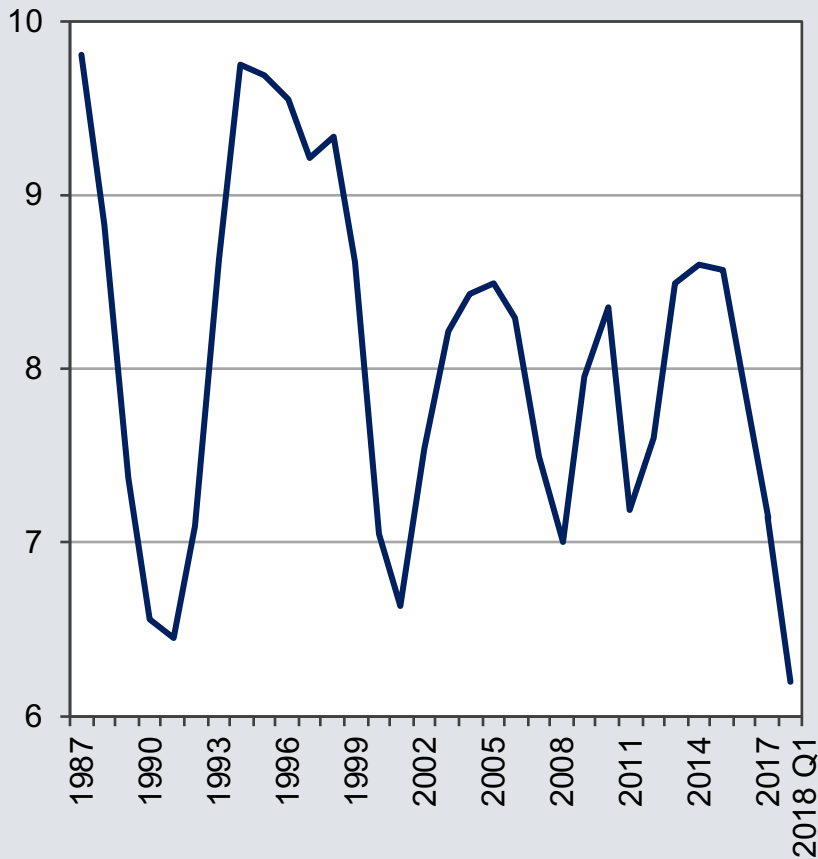
	BE	EU
<b>Total</b>	68,5	72,1
<b>Women</b>	63,6	66,4
<b>Low skilled</b>	45,9	54,9
<b>55-64 years</b>	48,3	57,1
<b>Non-EU citizens</b>	41,6	57,4



# The transition towards the labour market should be enhanced, in a context of shortages

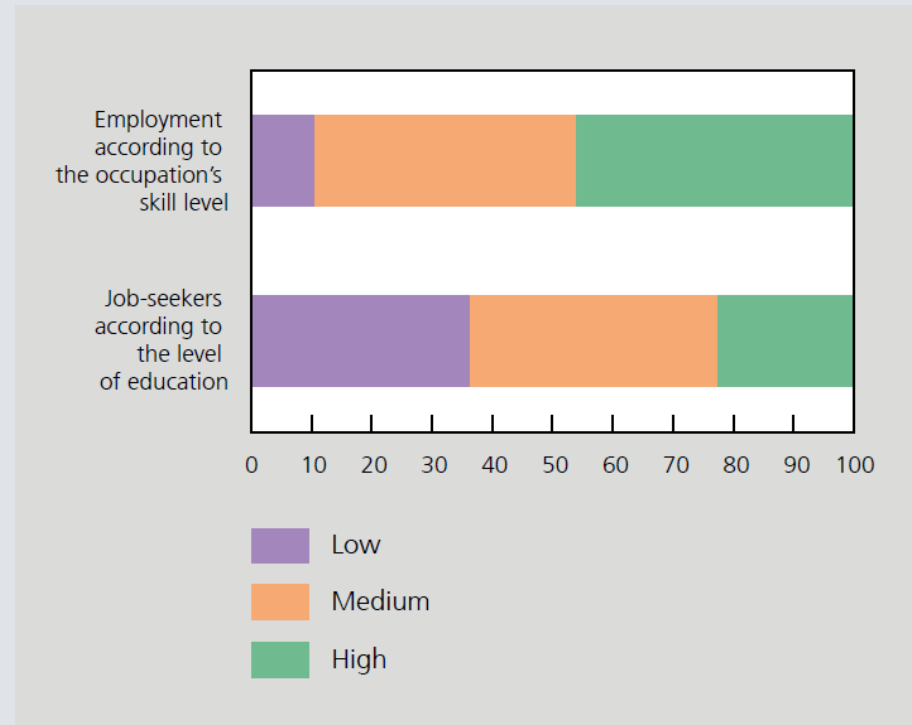
## Unemployment rate

(in % of population aged 15-64 year)



## Difficulties in matching supply to demand

(breakdown of employment by skill level and unemployment by level of education, in % of the population aged between 15 and 64 years, 2016)



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# Main drivers of restructuring in the banking sector

- ▶ Measures imposed by the European Commission on a number of Belgian financial institutions in return for the state aid received
- ▶ Fundamental revision of the regulatory frameworks for banks (Basel 2.5 and Basel 3) and insurance companies (introduction of Solvency II) which integrated the lessons of the crisis
- ▶ Lessons learned during the crisis by bankers as regards the weaknesses in the business models of the pre-crisis period
- ▶ Combination of an unusually low interest rate environment with the increasing digitalisation of finance



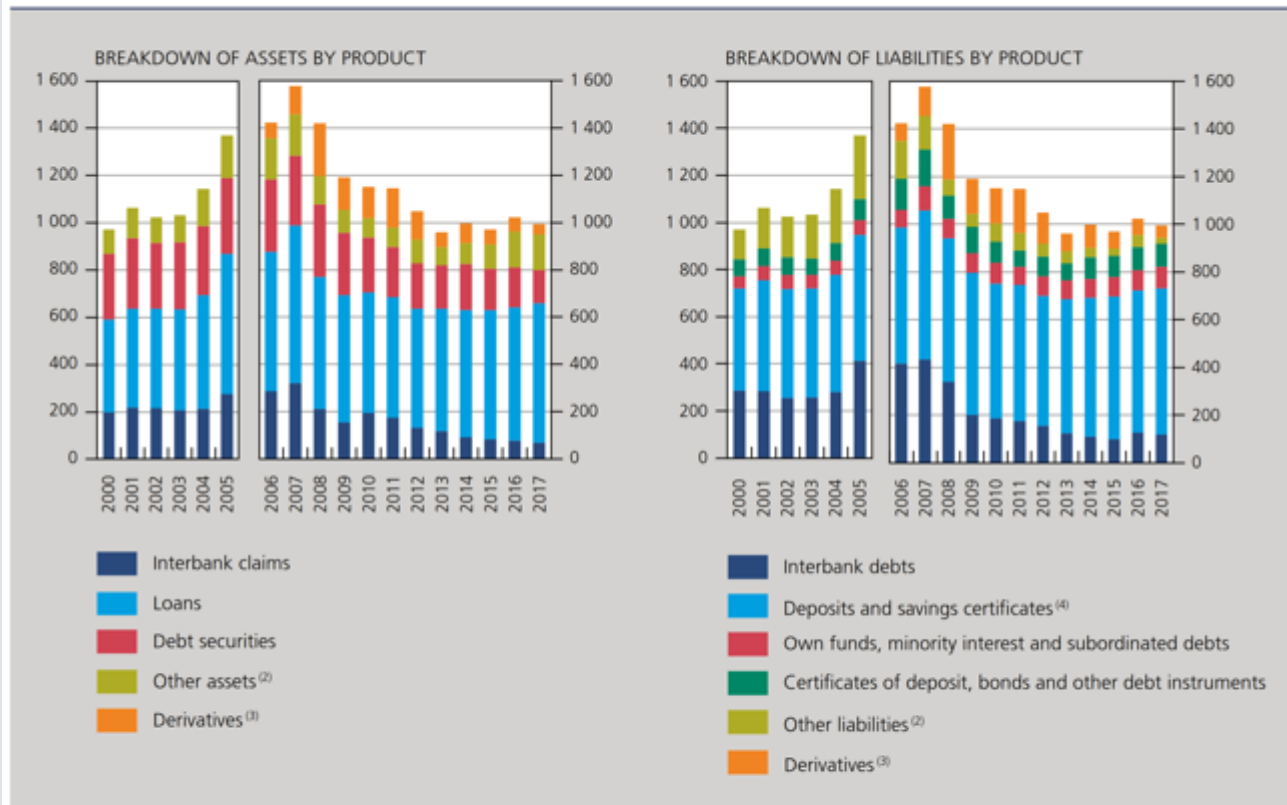
# Ten years after the crisis - outlook for the financial sector and risks going forward

- ▶ Belgian banking and insurance sectors are back to a relatively sound financial situation, thanks to major restructuring efforts in the post-crisis years
- ▶ Bank restructuring significantly reshaped the business model :
  - back to basics : increased focus on financial intermediation
  - back to Belgium : sharp reduction in non-core foreign assets
  - more robust balance sheet (less leverage; more liquidity)
- ▶ Insurance restructuring mainly driven by the low interest rate challenge for traditional life insurance



# Bank restructuring and deleveraging ...

**CHART 4** BALANCE SHEET STRUCTURE<sup>(1)</sup>  
(consolidated end-of-period data, in € billion)



Source: NBB.

(1) Data compiled in accordance with the Belgian accounting rules until 2005 (Belgian GAAP) and IAS/IFRS from 2006.

(2) "Other assets" mainly comprise balances with central banks, shares, tangible and intangible assets and deferred tax assets. "Other liabilities" are primarily short positions, liabilities other than deposits and debt securities, provisions and liabilities for defined benefit obligations. From the third quarter of 2014, liabilities linked to transferred assets are no longer recognised under "other liabilities" but are included under different items on the liabilities side.

(3) Derivatives are recorded at their market value, including, from 2007, income receivable and expense payable.

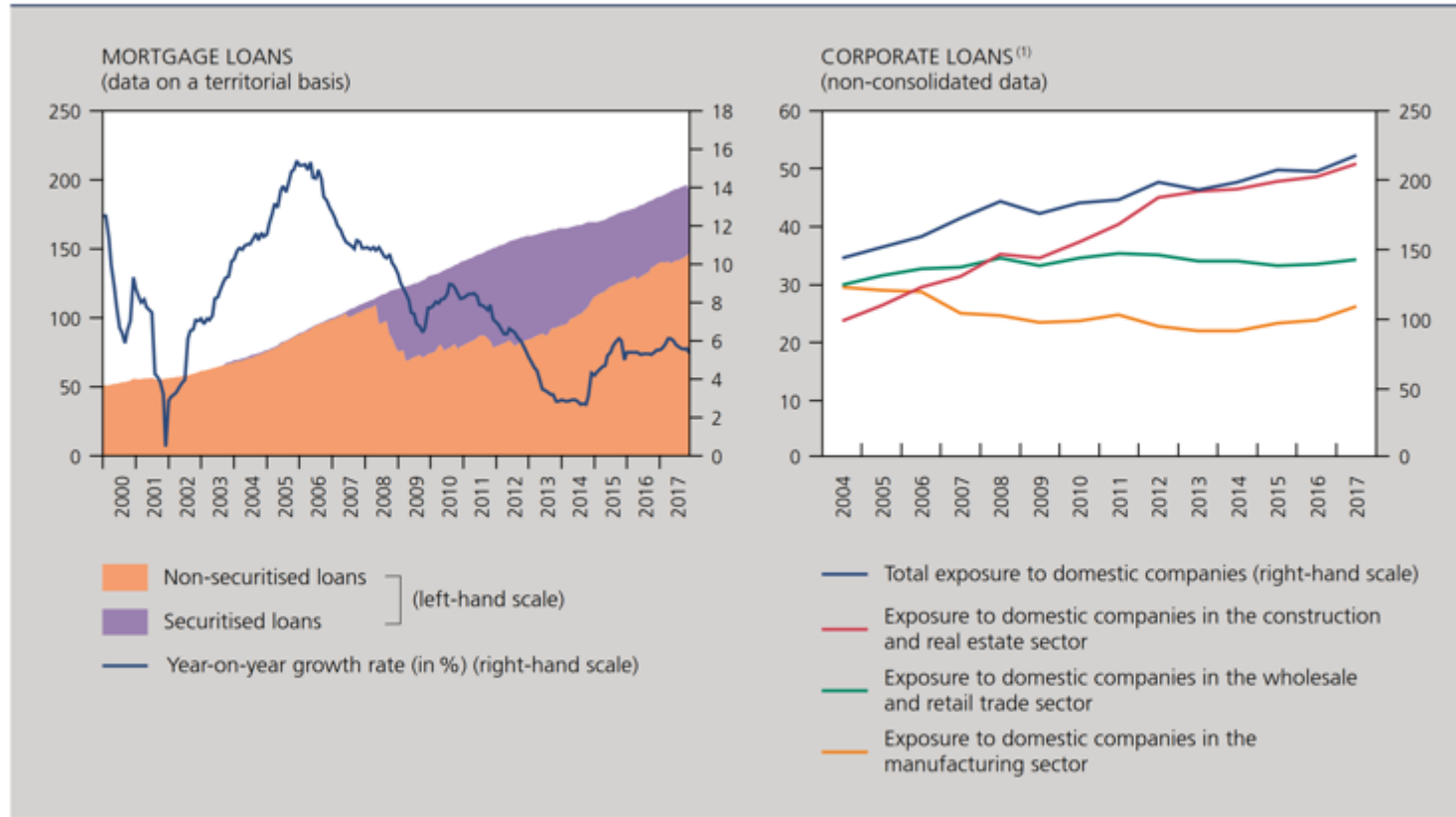
(4) From the third quarter of 2014, savings certificates are no longer included in "deposits and savings certificates" but are recorded under "certificates of deposit, bonds and other debt instruments".



# ... but dynamic domestic lending

**CHART 10 BELGIAN BANKS' EXPOSURE TO THE DOMESTIC REAL ESTATE MARKET**

(non-consolidated data, in € billion, unless otherwise stated)

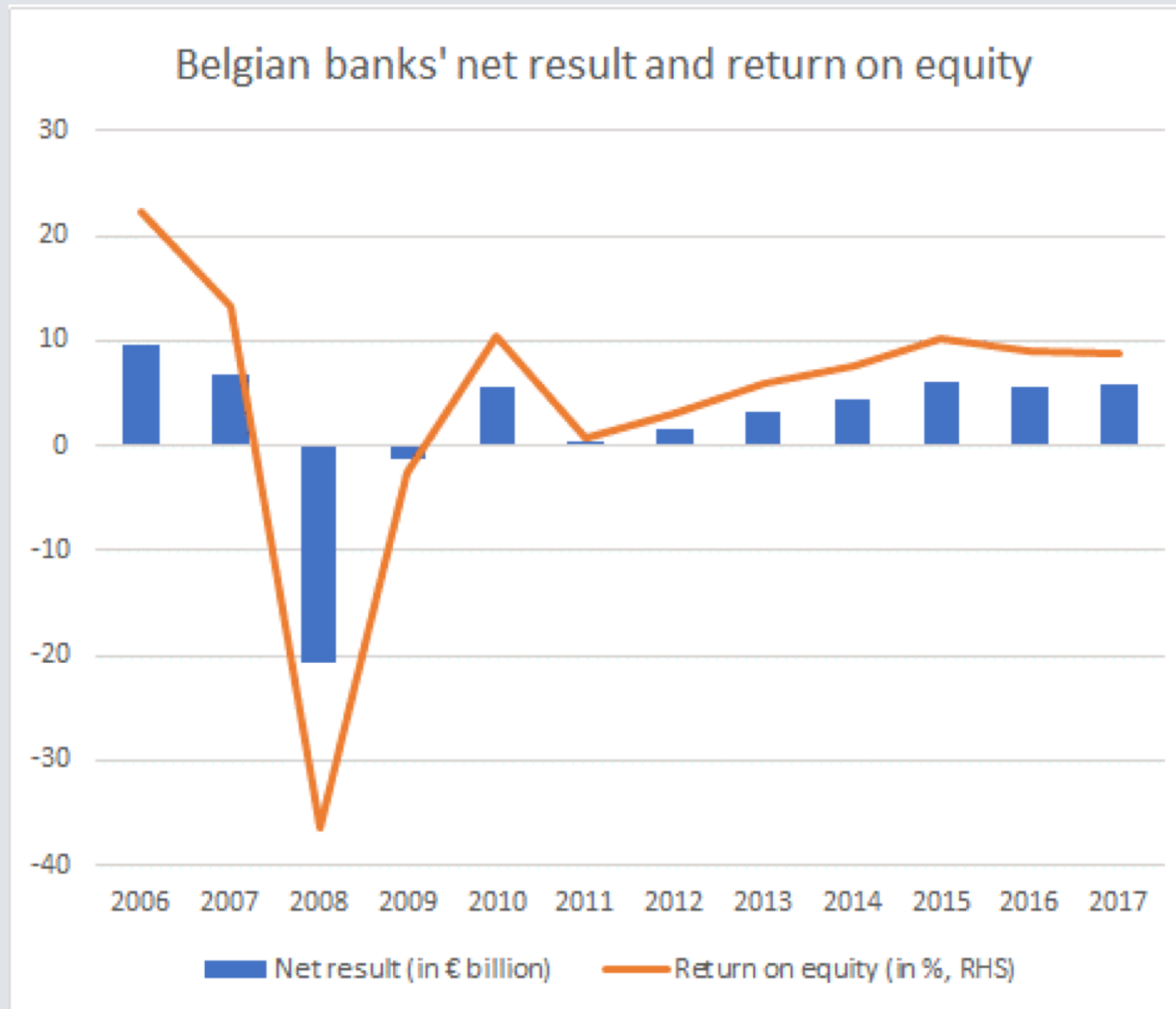


Source: NBB.

(1) Authorised exposure amounts (maximum loan balance or credit limit authorised).



# Banks recovered their profitability ...



## ... and raised their resilience

▶ Key ratios for the banking sector

In %	2016	2017	2018 (June)
Return on equity	9.2	8.9	8.1
Return on assets	0.6	0.6	0.5
CET1 capital ratio	15.7	16.2	15.3
Liquidity coverage ratio	140	138	133



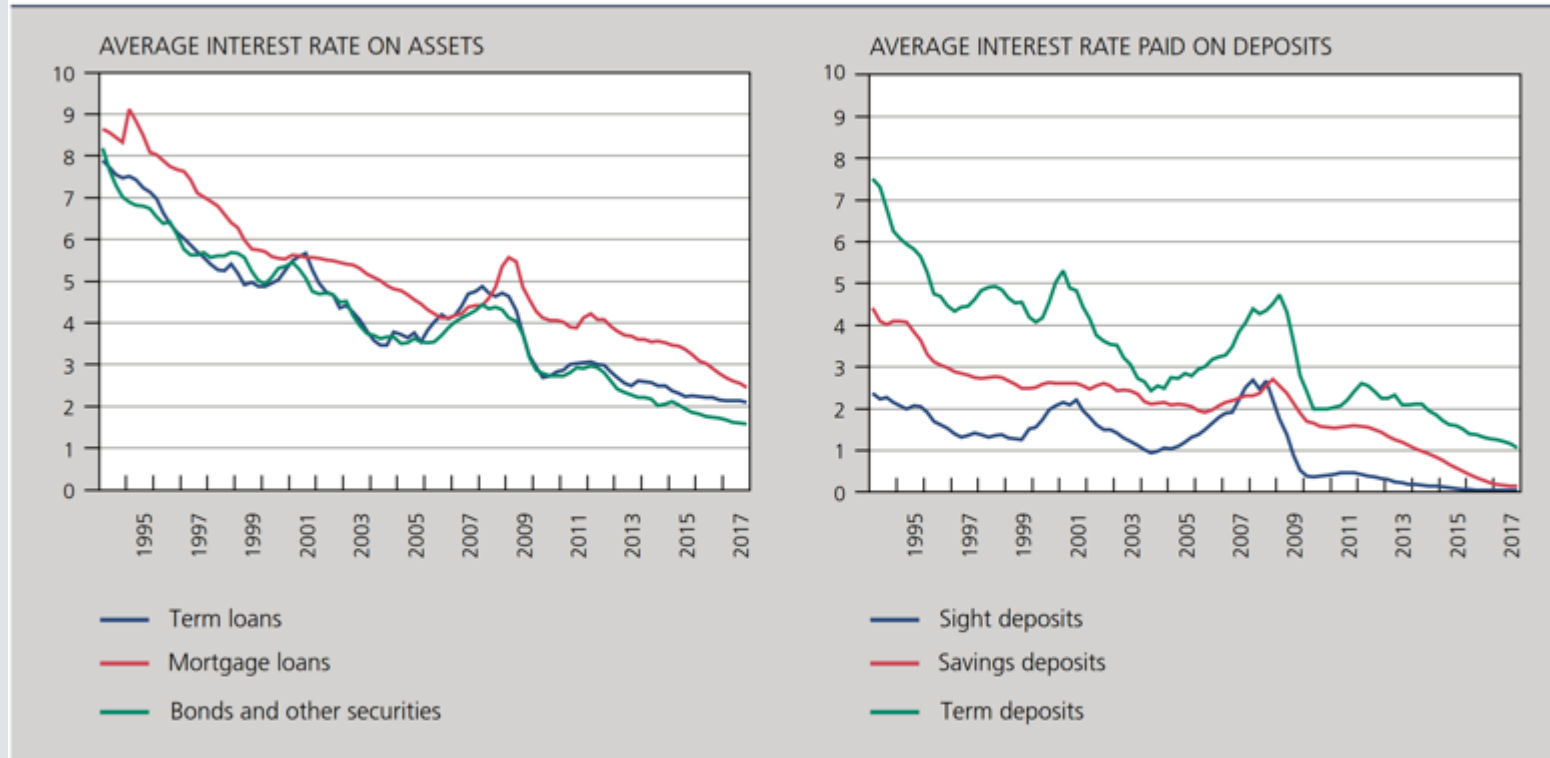
# Risks / challenges going forward

- ▶ Adverse interest rate scenarios :
  - Low-for-long
  - Snapback
- ▶ Belgian residential real estate market
- ▶ Digitalisation



# Adverse interest rate scenarios : banks

**CHART 9**      **IMPLICIT YIELDS ON ASSETS AND DEPOSITS<sup>(1)</sup>**  
 (non-consolidated data, in %)



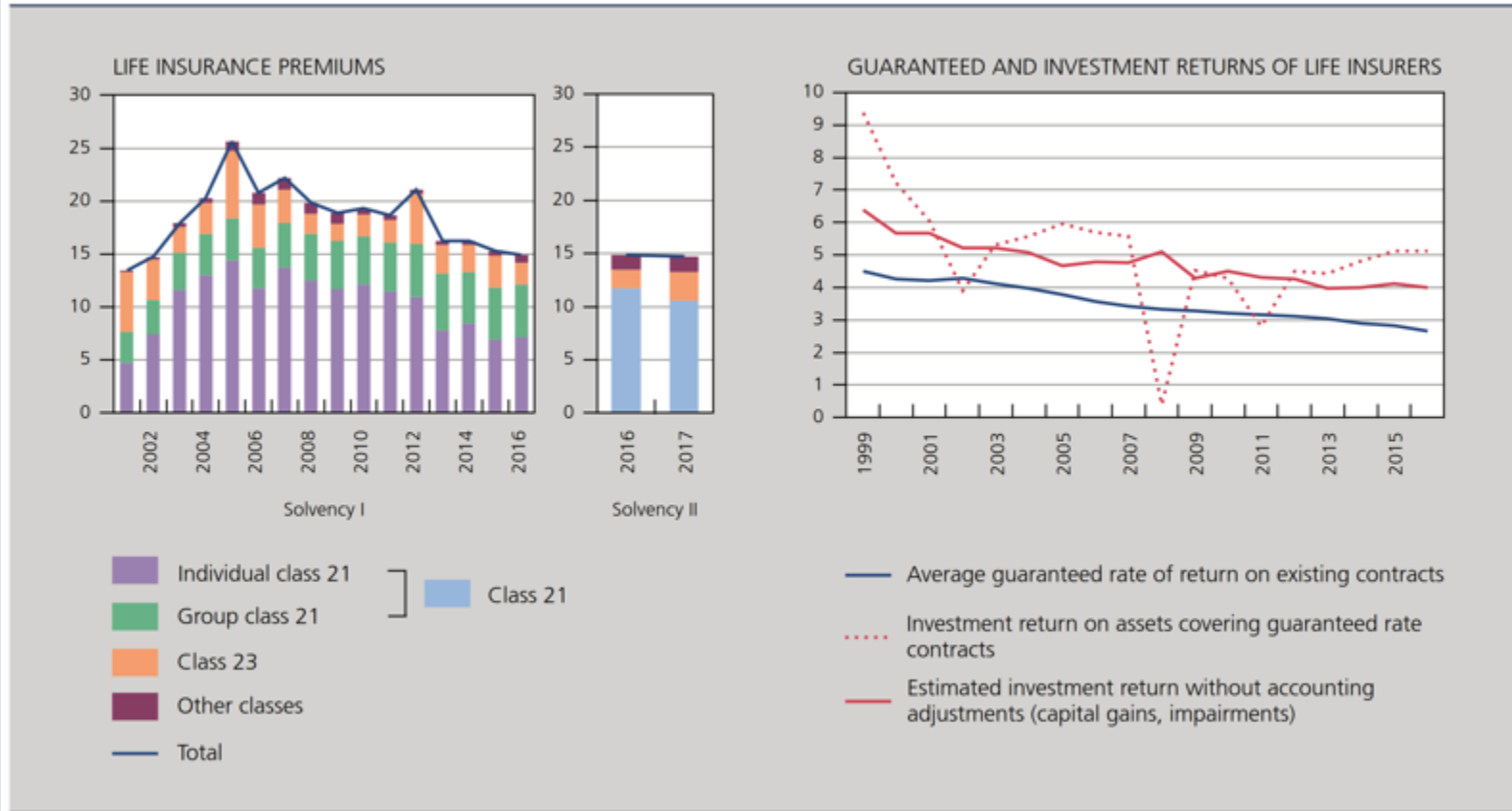
Source: NBB.

(1) Implicit yields are calculated as the ratios between the 12-month cumulative flows of interest actually received and paid and the average volume of corresponding assets or liabilities during the same period.



# Adverse interest rate scenarios : insurance

CHART 5 LIFE INSURANCE BUSINESS ACTIVITY

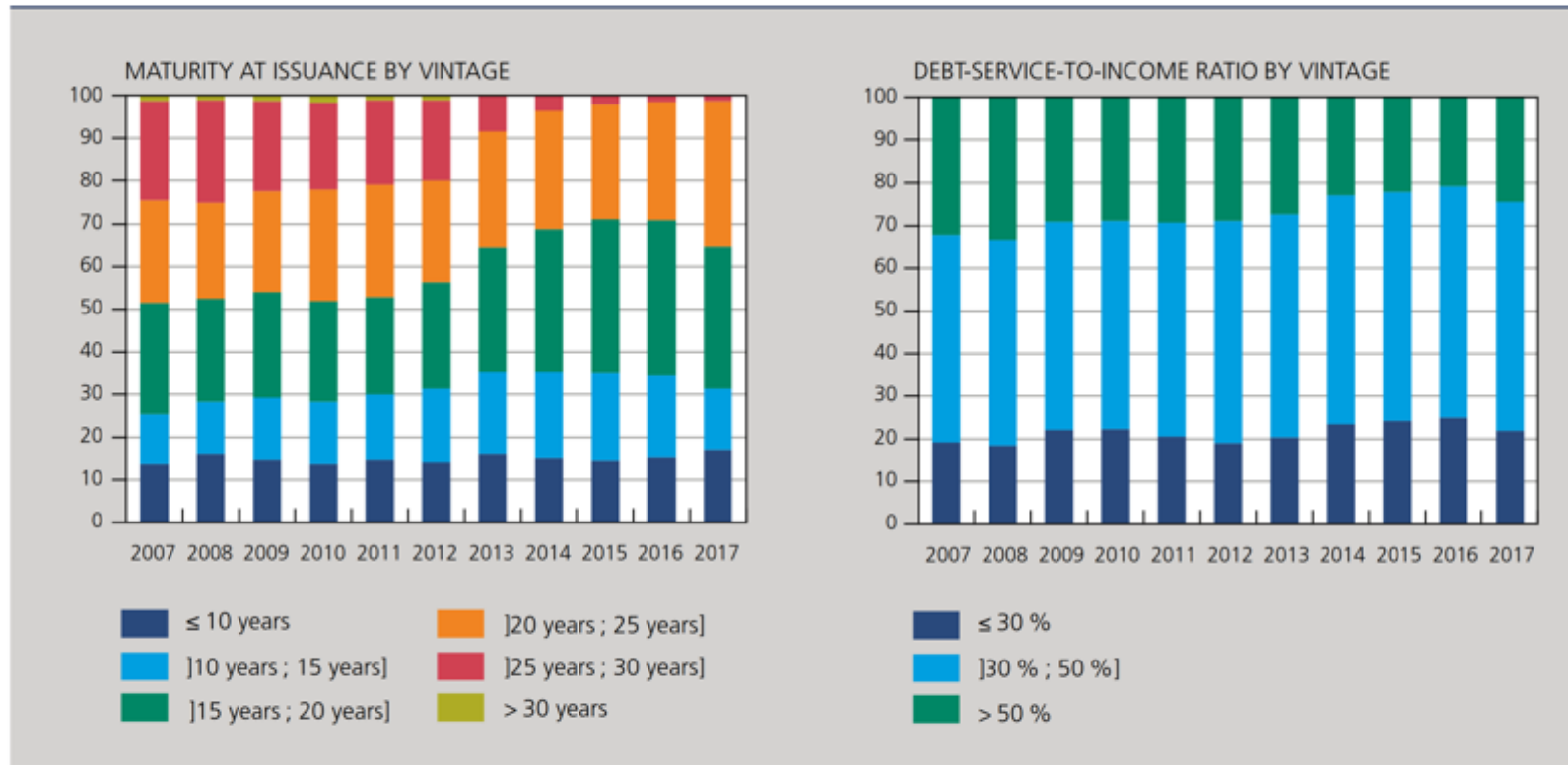


Source: NBB.



# Residential real estate market

**CHART 8** LENDING CRITERIA APPLIED TO BELGIAN MORTGAGE LOANS  
(in % of the total amount of loans granted during a given vintage)



Source: NBB.



# Digitalisation

- ▶ Opportunities :
  - Cost savings / efficiency gains
  - Improved customer relationship
- ▶ Risks :
  - « Miss the boat »

