

Economic projections for Belgium – Autumn 2006

Introduction

In the spring of 2006, the macroeconomic projections for the euro area drawn up by the Eurosystem and the Bank's projections for Belgium assumed a consolidation of the cyclical improvement in progress at that time, despite the expectation that oil prices would remain at a high level. Since then, owing to revisions of the preliminary statistical estimates and new actual figures, it has become apparent that the expansion in activity in the first half of 2006 was stronger than indicated in those forecasts. In addition, having risen further during the summer, oil prices dropped by some 20 p.c., and have hovered around 60 dollars since October 2006.

These factors prompted an upward revision of the growth projections for the euro area, first in the intermediate results presented by the ECB in September, and then again in the Eurosystem projections published in the ECB's December 2006 Bulletin. In the case of inflation, the changes were smaller; they are due to the direct downward pressure exerted by energy prices.

Coinciding with the publication of new projections for the euro area, this article offers a brief presentation of the results for the Belgian economy. These were obtained using the same methods and procedures as in the spring⁽¹⁾, and incorporate information published since then. In particular, they take account of the new national accounts data published by the NAI⁽²⁾, and the new government budget projections for 2007. The projections

for Belgium were based on information available on 24 November 2006, including the very partial information on the restructuring of a large enterprise.

1. International environment and assumptions

Having displayed great vigour once again at the start of the year, world economic growth slowed slightly during 2006, mainly as a result of the cyclical downturn in the United States. However, underpinned by the dynamism of the emerging economies, it is likely to remain robust in 2007 in a context of generally favourable financing conditions and relatively high corporate profitability in the majority of economic regions.

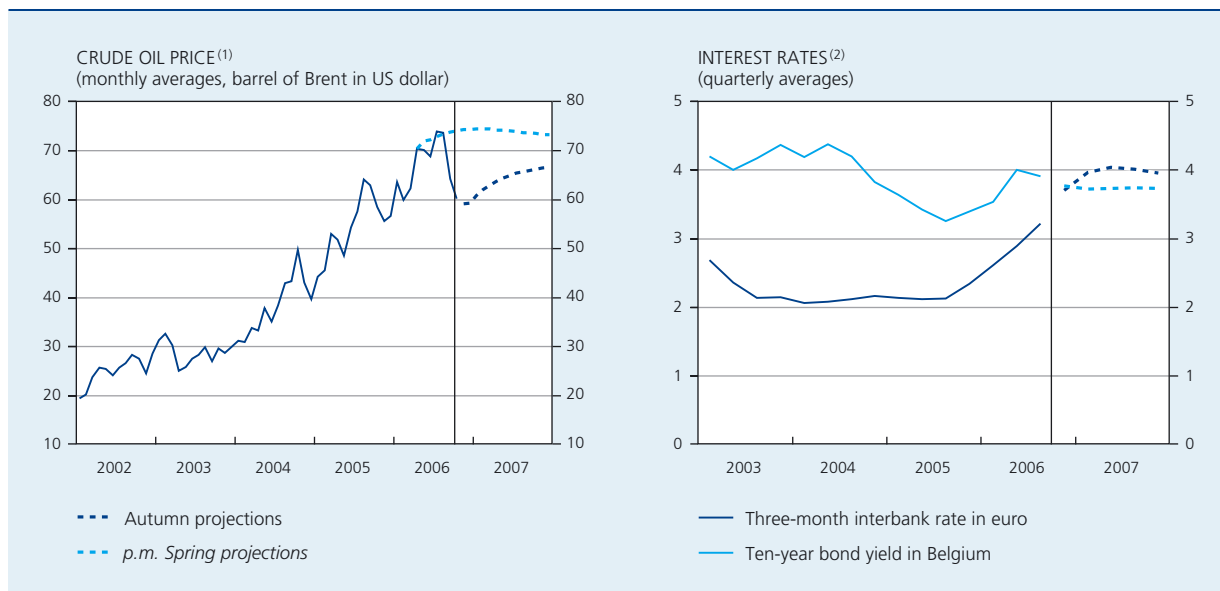
In addition, although oil prices are historically high at around 60 dollars per barrel, the about 20 p.c. fall in oil prices seen between August and October 2006 helped to reduce somewhat the impediments to growth. That movement was itself due to the cyclical slackening of demand, combined with favourable conditions for oil production – especially the clemency of the hurricane season in the Gulf of Mexico – and the perceived easing of geopolitical tensions.

In the euro area, the rate of expansion in activity picked up significantly during the first half of 2006. It looks set to remain steady during the rest of the year and in 2007, except for a temporary dip in growth predicted for the first quarter in view of the effect which the increased rate of VAT in Germany will have on consumption and investment in housing. According to the new Eurosystem projections, having amounted to 1.5 p.c. in 2005, GDP growth should range between 2.5 and

(1) NBB (2006), "Economic projections for Belgium – Spring 2006", Economic Review, June 2006.

(2) The NAI now uses the method of chainlinking to estimate volume and price movements of the different variables. For an explanation of this change of method, see <http://www.nbb.be/doc/DQ/F/DQ3/HISTO/NFDC05.pdf>

CHART 1 PROFILE OF THE OIL PRICE AND INTEREST RATE ASSUMPTIONS



Source: ECB.

(1) Actual figures up to October 2006, assumption from November 2006.

(2) Actual figures up to the third quarter of 2006, assumption from the fourth quarter of 2006.

2.9 p.c. in 2006 and between 1.7 and 2.7 p.c. in 2007. The revival of business investment is expected to continue, still supported by foreign demand. The improvement in the labour market and disposable income will help to bolster private consumption.

In a context of moderate labour cost increases, inflation – which measured 2.2 p.c. in 2005 according to the HICP – should remain broadly at that level, ranging between 2.1 and 2.3 p.c. in 2006 and between 1.5 and 2.5 p.c. in 2007. The expected reduction in the contribution of energy prices is likely to be offset in 2007 by the increase in indirect taxes.

Box – Eurosystem Assumptions

The Eurosystem's economic projections for the euro area, and the Bank's corresponding projections for Belgium, are based on the following technical assumptions:

- the interest rates are based on market expectations. As an annual average, short-term interest rates in euro are projected to rise from 3.1 p.c. in 2006 to 4 p.c. in 2007. Long-term interest rates on Belgian bonds are projected at 3.8 p.c. and 3.7 p.c. respectively;
- bilateral euro exchange rates are held constant at their mid-November 2006 value, namely 1.28 US dollars to the euro;
- according to the price movements implied by forward contracts, the price per barrel of Brent on the international markets should average 64.6 dollars in 2007, against 65.5 dollars in 2006;
- the growth of Belgium's export markets in real terms, measured as the weighted sum of imports by partners, including those in the euro area, should top 9 p.c. in 2006, before dropping to around 6 p.c. in 2007;
- the export prices of euro area competitors are projected to rise by 2.5 p.c. in 2006 and 1.4 p.c. in 2007;
- the results for public finances are calculated by taking account of the macroeconomic environment and the budget measures which have already been announced and specified in sufficient detail.



EUROSYSTEM PROJECTIONS: RESULTS AND ASSUMPTIONS

	2005	2006	2007
(Annual averages)			
Projections for the euro area			
GDP in volume	1.5	2.5 – 2.9	1.7 – 2.7
Inflation (HICP)	2.2	2.1 – 2.3	1.5 – 2.5
Eurosystem assumptions			
Three-month interbank rates in euro	2.2	3.1	4.0
Ten-year bond yield in Belgium	3.4	3.8	3.7
Euro exchange rate against the US dollar	1.24	1.25	1.28
Oil price (US dollar per barrel)	54.4	65.5	64.6
(Percentage changes)			
Export markets relevant to Belgium	6.8	9.5	6.1
Competitors' export prices	2.4	2.2	1.2
of which: competitors from the euro area	2.3	2.5	1.4

Source: ECB.

2. Activity, employment and demand

As in the euro area, following a sluggish period at the beginning of 2005, economic activity in Belgium became considerably livelier in the fourth quarter of 2005 and at the beginning of 2006, with quarterly GDP growth attaining 0.9 p.c. in the first quarter and 0.7 p.c. in the second quarter. Apart from the support of robust foreign demand, the main factor in this improvement originated within the economy, in household expenditure on consumption and housing, and business investment. Having fallen to 1 p.c. in the third quarter of 2005, year-on-year GDP growth reached 3.1 p.c. in mid-2006, the fastest rise since the end of the year 2000.

As the cyclical catching-up effects fade away, GDP growth is expected to have slowed slightly in the second half of the year, settling into a sound course more in line with the scope for expansion in the medium term. According to the initial NAI estimate, quarterly GDP growth will have dropped to 0.6 p.c. in the third quarter of 2006, and the information obtained from the business surveys suggests that a similar figure will apply in the fourth quarter. In all, the growth rate will have doubled between 2005 and 2006, rising from 1.5 to 3 p.c., outpacing the average for the euro area. In a relatively neutral general environment in terms of foreign demand and exchange rates,

it is forecast to drop to 2.1 p.c. in 2007, a rate close to the estimates of the economy's potential.

Despite the temporary slowing of activity evident at that time, the rate of net job creation gradually accelerated during 2005 to reach an annual average of 1 p.c., following three years of restrained recruitment. It is forecast to maintain that level in 2006 and 2007, as the fluctuations in GDP growth are largely cushioned by the pro-cyclical nature of labour productivity. Thus, around 43,000 net additional jobs will have been created each year, on average, from 2005 to 2007. However, in view of the rapid expansion of the labour force since 2005, there will be hardly any reduction in the unemployment rate during the forecast period, at an average of 8.3 p.c. in 2007 compared to 8.5 p.c. in 2006.

The favourable trend in employment, and more generally in activity, has led to a faster increase than in previous years in the incomes which households obtain from their employment and self-employed activity, and – mainly via dividends – from their capital. In addition, their purchasing power has been sustained by the effects – which were substantial in 2006 – of the implementation of the last phase of the tax reform initiated in 2001. Thus, following an increase in real terms of just 0.9 p.c. in 2005 and a cumulative decline of similar size over the

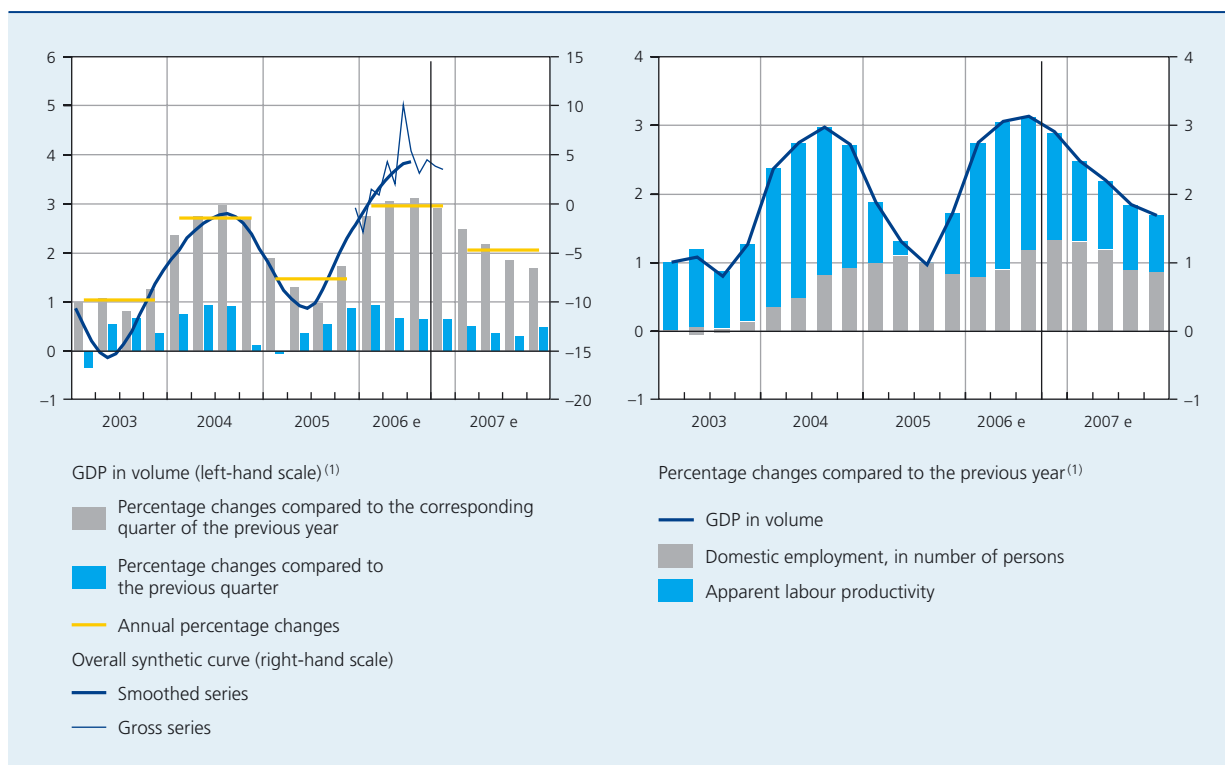
two preceding years, their disposable income is predicted to increase by 2.7 p.c. in the current year and 2.1 p.c. in 2007. Private consumption, which had played a full role in the cyclical upturn at the beginning of the year, is expected to grow by an average of 2.4 p.c. in 2006, then 2 p.c. in 2007. In a context of strengthening household confidence, owing to the easing of pressure on energy prices and the improvement in the general economic situation, combined with the rapid increase in disposable income, household savings are expected to remain steady over the projection horizon, at around 13.5 p.c. of disposable income. Once again, the bulk of those savings will be allocated to investment expenditure on housing, in the form of new construction or renovation. Maintaining the momentum seen in the two preceding years, that expenditure should increase by almost 5 p.c. in real terms in 2006 and 2007.

According to the revised national accounts data, 2004 saw a significant recovery in business investment, driven mainly by the service branches, before a slight ease in 2005. The expansion picked up again in 2006 at a more sustained rate than predicted, and extended into industry. In a favourable context in terms of operating profitability

and financing conditions, and taking account of the outlook for demand which appears to be solid, while the rate of capacity utilisation has increased as activity speeded up, business investment should increase by 5.8 p.c. in 2006 and 4.8 p.c. in 2007. However, these annual averages mask a gradual slowing down during the second year, as the cyclical accelerator effects ebb away. Public investment is expected to decline in the two years covered by the forecasts.

Boosted by the expansion of the euro area, foreign demand for Belgian goods and services is expected to remain a significant factor underpinning exports. During 2006, those exports gradually responded in a context of relatively stable exchange rates for the past two years. Export growth is expected to rise from 3.3 p.c. in 2005 to 3.9 p.c. in 2006 and 5.3 p.c. in 2007. Imports are expected to expand at a similar rate to exports in 2006, then more slowly in 2007, at 3.9 and 5.1 p.c. respectively. In contrast to the two preceding years, the contribution of net exports to GDP growth will thus become slightly positive, at 0.1 percentage point in the first year and 0.3 point in 2007.

CHART 2 GDP, BUSINESS SURVEY INDICATOR AND EMPLOYMENT
(Seasonally adjusted data)



Sources: NAI, NBB.
(1) Calendar adjusted data.

TABLE 1 GDP, EMPLOYMENT AND MAIN CATEGORIES OF EXPENDITURE

(Percentage changes compared to the previous year, calendar adjusted data)

	2004	2005	2006 e	2007 e
GDP ⁽¹⁾	2.7	1.5	3.0	2.1
Total domestic employment in persons	0.6	1.0	1.0	1.1
Real disposable income	-0.1	0.9	2.7	2.1
<i>Components of expenditure⁽¹⁾</i>				
Final consumption expenditure of individuals	1.6	0.8	2.4	2.0
Final consumption expenditure of general government	2.1	-0.6	1.7	2.0
Gross fixed capital formation	6.9	5.2	4.7	4.0
Housing	9.0	3.5	4.6	5.0
Government investment	3.1	13.5	-2.5	-4.8
Business investment	6.7	4.8	5.8	4.8
Change in stocks ⁽²⁾	0.1	0.6	0.3	-0.6
Total domestic expenditure	2.9	2.0	2.9	1.9
Net exports of goods and services ⁽²⁾	-0.1	-0.4	0.1	0.3
Exports of goods and services	5.7	3.3	3.9	5.3
Imports of goods and services	6.2	4.1	3.9	5.1

Sources: NAI, NBB.

(1) In volume.

(2) Contribution to the change in GDP.

3. Prices and costs

Estimated on the basis of the HICP, total inflation, which had averaged 2.5 p.c. in 2005, should fall to 2.3 p.c. in 2006 and 1.9 p.c. in 2007. This downward trend, similar to the acceleration which went before it, reflects the movement in energy prices. In accordance with the easing of oil prices quoted on the international markets, the rise in these prices – which account for around 10 p.c. of the total HICP – should subside from 12.7 p.c. in 2005 to 0.9 p.c. in 2007.

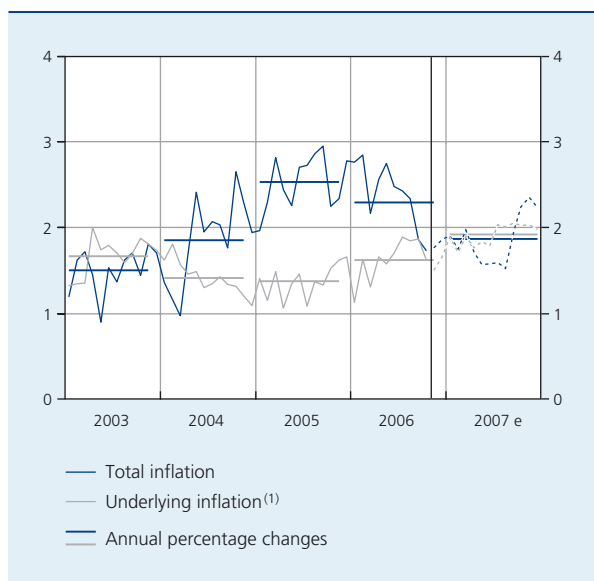
In contrast, the underlying trend in inflation edged upwards from mid 2005, as the effects of the euro's earlier appreciation faded away and the impact of the commodity price rises was passed through in the prices of industrial goods. The gradual acceleration in underlying inflation is predicted to continue during the forecast period, rising from 1.4 p.c. in 2005 to an average of 1.9 p.c. in 2007. For that last year, the introduction of the general packaging levy on 1 July 2007 and the increase in excise duty on tobacco, measures included in the 2007 budget, will probably push up inflation by 0.2 point.

Furthermore, inflation measured by the national CPI came to just 1.7 p.c. in 2006, while in previous years this inflation rate was higher than that according to the HICP, owing to the obsolescence of the weights used in the first index. This lower figure stems from the method used to revise the national CPI in January 2006. The social partners followed broadly the same method for fixing the conversion coefficient applicable to the health index, with the same effects on the change in 2006. From 2007 onwards, the inflation figures according to the HICP should be very comparable to those based on the national CPI.

Unit labour costs are expected to rise by 0.7 p.c. in 2006 and 1.2 p.c. in 2007, following an annual increase averaging 0.5 p.c. in the previous two years. Over the whole of the recent period and the forecast period, cyclical movements in labour productivity are the dominant factors influencing the change in these costs from one year to the next. That change was negative in 2004 and will be small in 2006, years in which activity quickened pace; in contrast, it was larger in 2005, reaching 1.5 p.c., owing to the meagre increase in productivity. The cyclical effects are likely to be more or less neutral in 2007. As for hourly

CHART 3 INFLATION

(HICP – percentage changes compared to the corresponding period of the previous year)



Sources: EC, NBB.

(1) Measured by the HICP excluding unprocessed food and energy.

labour costs, these are expected to maintain a steady annual rate of increase at around 2¼ p.c.

Over the period 2005-2006 as a whole, the rise is projected to reach 4.6 p.c.⁽¹⁾, a figure very close to the 4.5 p.c. indicative norm confirmed by the government following the central pay negotiations, but that did not prevent a further deterioration in relation to the average for the three neighbouring countries, where the increase in hourly labour costs proved smaller than initially forecast.

The 2.2 p.c. rise in hourly labour costs assumed for 2007 is a technical assumption based on the average movement in labour costs predicted for the three neighbouring countries, as prescribed by the law of 1996 on the promotion of employment and the safeguarding of competitiveness; it therefore does not in any way anticipate the outcome of the current negotiations between the social partners.

4. Public finances

Taking account of the latest information, public finances should end the year 2006 more or less in balance. In comparison with the Bank's spring estimate, the current forecasts show an improvement in the balance totalling 0.3 p.c. of GDP, despite the cost to the budget of the decisions taken in the meantime to grant a "professional allowance" by raising the fixed professional expenses deductible against personal income tax, and to increase the family allowances at the start of the school year for children aged between 6 and 18 years. Regarding revenues, the structural acceleration in corporate tax assessments should generate additional revenues totalling 700 million euro. On the expenditure side, the cost of health care proved less than expected in the first half year. The proceeds from the sale of the Belgian embassy building in Tokyo exceeded the original forecast. In that connection, it should be mentioned that the autumn estimate still allows for a property transaction worth 0.2 p.c. of GDP which was planned for 2006 but has not yet been effected, which implies a substantial downside risk. Finally, the draft budget showing a balance was

(1) In the technical report on the maximum margins available for the movement in labour costs, published on 8 November 2006 by the Secretariat of the Central Council for the Economy, the rise in hourly labour costs is estimated at 4.7 p.c. for 2005-2006.

TABLE 2 PRICE AND COST INDICATORS

(Percentage changes compared to the previous year)

	2004	2005	2006 e	2007 e
Total HICP	1.9	2.5	2.3	1.9
of which: energy products	6.6	12.7	7.0	0.9
<i>p.m. National ICP</i>	2.1	2.8	1.7	1.8
GDP deflator	2.4	2.1	1.7	1.8
Labour costs in the private sector				
Unit costs	-0.4	1.5	0.7	1.2
Hourly costs	2.4	2.2	2.3	2.2

Sources: NAI, NBB.

based on GDP growth of 2.2 p.c., whereas the Bank revised that figure upwards to 2.5 p.c. in the spring projections and 3 p.c. at present.

The projection relating to the general government balance in 2007 has been upgraded significantly in comparison with the spring estimate, which still predicted a deficit of 1.2 p.c. of GDP. That improvement is attributable to the level effect caused by the slower rise in health care expenditure in 2006, the more favourable growth outlook since the spring estimate, and the impact of the autumn budgets. Turning to structural measures, these mainly concern the introduction of a general packaging levy, an increase in the excise duty on tobacco, and new measures to combat tax evasion and promote more efficient revenue collection. On the other hand, the allowance for fixed professional expenses deductible against personal income tax will be increased slightly once again. As regards non-recurring measures, which should improve the budget outcome by 0.4 p.c. of GDP, 0.2 percentage point of that is due to new property transactions by the Federal State. Also, it is temporarily more advantageous for companies to distribute or invest certain tax-exempt reserves. Furthermore, the deadline for payment of social security contributions on holiday allowances has been accelerated in the case of employment contracts which

have been terminated. In addition, the investment grant for the BNRC group will be based on the actual rate of investment, which will cut expenditure in 2007. Finally, a new securitisation operation concerning direct taxes is planned. Overall, the projections now point to a deficit of 0.4 p.c. of GDP for general government in 2007.

Assuming that no new measures are taken, the budget balance will therefore deteriorate in 2007 compared to the previous year, even though interest charges will have fallen once again – albeit at a slower rate than in earlier years – and despite the reduction in local authority investment expenditure which is normal in the years following the local elections. This movement is largely due to the non-recurring measures which were taken into account in the estimate and which will have less impact than in 2006. In addition, public revenues are also expected to shrink in relation to GDP, because earned incomes – which are taxed relatively heavily – are growing more slowly than GDP.

The difference in relation to the surplus of 0.3 p.c. of GDP announced by the government for 2007 is due to various factors. Apart from some differences in the estimate of expenditure and revenue, the projections follow the ESCB methodology and take no account of budget measures

TABLE 3 GENERAL GOVERNMENT ACCOUNT⁽¹⁾
(Percentages of GDP; Eurostat point of view, unless otherwise stated)

	2004	2005	2006 e	2007 e
Revenues	49.2	50.0	49.1	48.7
of which: fiscal and parafiscal revenues	44.4	44.8	44.3	44.0
Primary expenditure	44.5	48.0	45.0	45.1
Primary balance	4.7	2.0	4.1	3.6
Interest charges	4.7	4.3	4.1	4.0
Borrowing requirement (–) or capacity (Eurostat) ⁽²⁾	0.0	–2.3	0.0	–0.4
Borrowing requirement (–) or capacity (NAI) ⁽²⁾	0.0	0.1	–0.1	–0.4
<i>p.m. Effect of temporary measures (Eurostat)⁽²⁾</i>	<i>0.8</i>	<i>–2.0</i>	<i>0.7</i>	<i>0.4</i>
<i>Effect of temporary measures (NAI)⁽²⁾</i>	<i>0.8</i>	<i>0.4</i>	<i>0.7</i>	<i>0.4</i>
Consolidated gross debt (Eurostat) ⁽²⁾	94.3	93.2	89.6	87.2
Consolidated gross debt (NAI) ⁽²⁾	94.3	91.5	87.9	85.7

Sources: EC, NAI, NBB.

(1) In accordance with the methodology used in the framework of the excessive deficit procedure (EDP), which includes the net interest income generated by certain financial transactions such as swaps and forward rate agreements (FRAs).

(2) The data on Belgium's public finances which the NAI notified to the European authorities on 29 September 2006 were based on the principle that the Railway Infrastructure Fund (RIF) is not part of the general government sector. Eurostat decided to adjust these figures in its publication dated 23 October 2006, considering that the RIF should be included in the general government sector. Eurostat also took the view that the imputation of the debt to the general government sector should not be regarded as an "other change in volume" following a change in sector classification and structure, but that it constituted an assumption of debt which should be recorded as a general government capital transfer to the non-financial corporations sector. The view taken by Eurostat is reflected in a negative impact of 2.4 p.c. of GDP in 2005, but a positive – though admittedly modest – impact of 0.05 p.c. of GDP in 2006 and 2007. No account is taken of the potential effect on the general government accounts if the RIF were to be reclassified in the non-financial corporations sector in 2006.

which have not yet been specified in sufficient detail, such as the intention to take over the first-pillar pension liabilities of companies in exchange for non-recurring capital transfers, which should generate revenue totalling 500 million euro.

In 2006 and 2007, the public debt will continue gradually contracting. The debt level will fall by around 6 p.c. of GDP over those two years.

5. Assessment of the uncertainty surrounding the projections

The stronger than expected acceleration in activity at the end of 2005 and the beginning of the current year accounts for much of the 0.4 percentage point upgrading of the GDP growth figure for 2006. Apart from that, the new forecasts for Belgium are in line with those presented in the spring, predicting a rate of expansion which, though less dynamic than at the start of the year, will remain robust in 2007 and will be based on both business and household demand and demand for exports.

The recent fall in oil prices makes this risk factor less important, even though its effect on inflation in Belgium is offset by the planned increase in taxes on tobacco and packaging in 2007.

The other risk factors mentioned at the time of previous projection exercises continue to apply, particularly the persistently large current account imbalances at world level, with potential implications for exchange rates and interest rates, and the effects on German economic agents of the planned increase in indirect taxes in 2007. However, that country's economic recovery now appears equally solid, and business and consumer confidence has shown a particularly marked improvement there.

Incorporating the recent national accounts figures, the Bank's forecasts show GDP growth in 2006 as slightly higher than the figures published since the autumn by the NAI and the international institutions. The other figures fall in the middle of the predicted range. That range is fairly narrow, reflecting a broad consensus among forecasters.

TABLE 4 COMPARISON OF THE FORECASTS FOR BELGIUM
(Percentage changes compared to the previous year, unless otherwise stated)

	Real GDP		Inflation ⁽¹⁾		Budget balance ⁽²⁾		Date of publication
	2006	2007	2006	2007	2006	2007	
NBB – Autumn 2006	3.0	2.1	2.3	1.9	0.0	-0.4	December 2006
<i>p.m. Spring 2006</i>	2.5	2.0	2.4	1.9	-0.3	-1.2	June 2006
NAI	2.7	2.2	1.9 ⁽³⁾	1.9	-	-	October 2006
IMF	2.7	2.1	2.4	1.9	0.0	-0.7	September 2006
EC	2.7	2.3	2.4	1.8	-0.2	-0.5	November 2006
OECD	2.9	2.3	2.4	1.7	0.0	-0.2	November 2006
Belgian Prime News	2.7	2.0	2.3	2.0	-0.1	-0.6	September 2006

(1) HICP, except NAI: national consumer price index.

(2) Percentages of GDP.

(3) The introduction in January 2006 of the new national consumer price index results in a 2006 inflation figure which is estimated to be 0.5 point lower when measured by the national index as opposed to the HICP.

Annex

PROJECTIONS FOR THE BELGIAN ECONOMY: SUMMARY OF THE MAIN RESULTS

(Percentage changes compared to the previous year, unless otherwise stated)

	2003	2004	2005	2006 e	2007 e
Growth (calendar adjusted data)					
GDP in volume	1.0	2.7	1.5	3.0	2.1
Contributions to growth:					
Domestic expenditure, excluding change in stocks	0.9	2.7	1.3	2.6	2.3
Net exports of goods and services	0.2	-0.1	-0.4	0.1	0.3
Change in stocks	0.0	0.1	0.6	0.3	-0.6
Prices and costs					
Harmonised index of consumer prices	1.5	1.9	2.5	2.3	1.9
Health index	1.5	1.6	2.2	1.7	1.9
GDP deflator	1.6	2.4	2.1	1.7	1.8
Terms of trade	-0.3	-0.2	-1.0	-0.3	-0.2
Unit labour costs in the private sector	0.0	-0.4	1.5	0.7	1.2
Hourly labour costs in the private sector	1.5	2.4	2.2	2.3	2.2
Hourly productivity in the private sector	1.5	2.8	0.7	1.6	1.0
Labour market					
Domestic employment					
(annual average change in thousands of units)	0.6	26.5	40.8	44.0	45.0
Harmonised unemployment rate ⁽¹⁾ (p.c. of the labour force) ...	8.2	8.4	8.4	8.5	8.3
Incomes					
Real disposable income of individuals	-0.8	-0.1	0.9	2.7	2.1
Savings ratio of individuals (p.c. of disposable income)	14.4	13.2	13.2	13.4	13.5
Public finances⁽²⁾					
Primary balance (p.c. of GDP)	5.4	4.7	2.0	4.1	3.6
Borrowing requirement (-) or capacity of general government (p.c. of GDP)	0.0	0.0	-2.3	0.0	-0.4
Public debt (p.c. of GDP)	98.6	94.3	93.2	89.6	87.2
Current account					
(p.c. of GDP according to the balance of payments)	4.1	3.5	2.5	1.9	1.9

Sources: EC, NAI, NSI, NBB.

(1) Adjusted series (Eurostat).

(2) In accordance with the method used for the excessive deficit procedure (EDP), and taking account of Eurostat's decision dated 23 October 2006 (see table 3).