Economic projections for Belgium – Autumn 2011

Introduction

The vitality which underpinned the revival in global economic activity for two years rapidly faded during 2011, in a context of escalating uncertainty and worsening financial tensions. Up to the spring, it seemed that the consolidation of the recovery which had begun in mid-2009 might continue, particularly given the impetus of accommodating fiscal policies in the advanced economies and the vigour of the emerging economies. However, this respite was apparently not enough to ensure sufficient progress in the thorough rectification of the imbalances revealed or caused by the first wave of the financial crisis and by the 2008-2009 economic recession.

This time, the financial tensions centred mainly on the government bond markets of certain euro area countries. Since the prospects for a reduction in the high level of public debt were not considered adequate to restore a sustainable long-term path – either because of deficiencies in the fiscal consolidation measures, or because of doubts about the economy's growth potential – the yield differentials in relation to safe-haven assets increased dramatically. The obstacles hampering the implementation of the necessary structural measures in the various countries and, at European level, the debate over the economic safeguard mechanisms for economies encountering financing problems are greatly exacerbating the uncertainty for all economic agents. This environment is causing serious problems for financial institutions which hold large portfolios of government securities.

These difficulties are not confined to the euro area, since there is a similar debate on the fiscal policy to be conducted in the United States, and that is also fostering the climate of uncertainty. Moreover, the euro area's weakness could have an adverse effect on its trading partners.

Given this uncertainty and the weakening of external demand, the projections for the euro area produced as part of the twice-yearly exercise conducted by the Eurosystem – the results of which are published in the December 2011 issue of the ECB Monthly Bulletin – show a sharp downgrading of average GDP growth in 2012. In particular, a period of stagnating activity, or even a mild recession, is expected at the end of 2011 and in early 2012, while the subsequent recovery will be moderate. All the main categories of demand will contribute to the weakness of activity, including public expenditure on consumption and investment in the countries implementing fiscal consolidation.

In Belgium, activity and especially employment remained buoyant in early 2011. After that, however, the economy could not escape the adverse situation at European level and the weakening of domestic demand, Thus, according to the initial NAI estimate, GDP stagnated in the third quarter of 2011, and that sluggishness is likely to persist at the end of 2011 and the beginning of 2012. In addition to the general uncertainty over the economic outlook in Europe, there is also the uncertainty caused in Belgium by the protracted absence, up to recently, of a plan for structural budget retrenchment and reforms aimed at consolidating the economy's growth potential.

The economic projections discussed in this article were finalised as at 25 November 2011. They were drawn up on the basis of the Eurosystem's technical assumptions decided on 17 November, the main ones being described in the box in section 1. As is usual in the case of these exercises, the projections for public finances presented in section 4 only take account of measures which have been formally approved by the authorities and specified in sufficient detail at the cut-off date for the exercise. It was therefore not possible to take account of the 2012 budget measures announced after that date during the negotiations for the formation of the government. In order to avoid presenting outdated figures, the estimates for general government therefore do not go beyond 2011 in this article. The last section describes the risk factors surrounding the economic outlook. They are particularly serious in the current context; they concern, in particular, the definition and implementation of the essential measures to be taken in the euro area to contain and alleviate the sovereign debt crisis and the contagion affecting the financial institutions and, in Belgium's case, the ability to restore the public debt to a path which is sustainable in the long term and to strengthen the growth potential and competitiveness of the economy.

1. International environment and assumptions

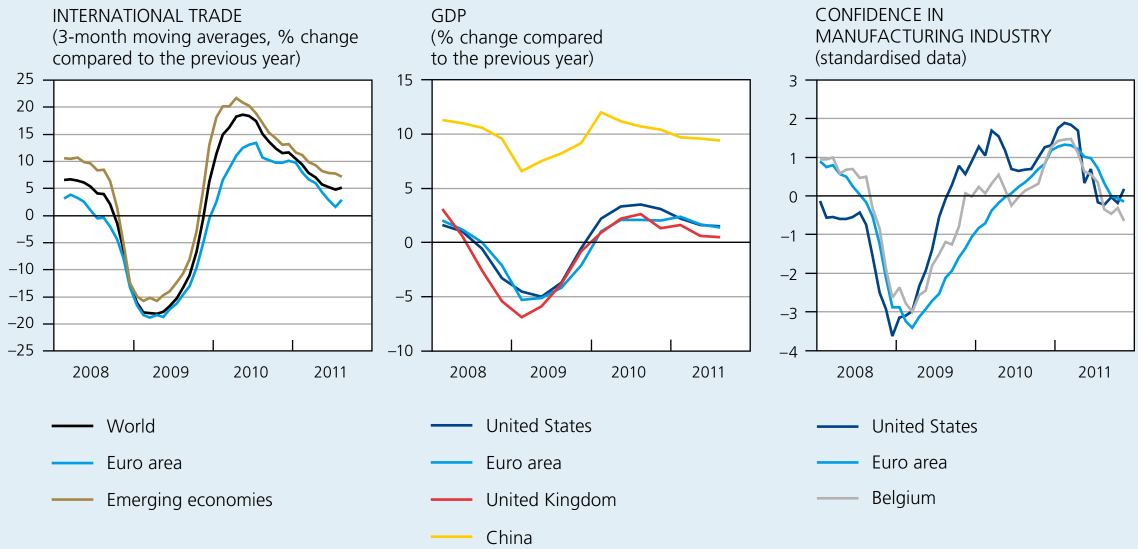
The global economy experienced a marked slowdown in activity and international trade during 2011. Although some deceleration was expected after two years of relatively sustained recovery in most economies, the loss of momentum exceeded predictions, hitting the advanced economies particularly hard.

At the beginning of the year, the slowdown was due partly to temporary factors such as the disruption of output in the regions affected by the earthquake and the tsunami in Japan on 11 March. These disasters did not only have an impact on the country's energy supply, they also disrupted certain motor vehicle or electronic equipment production chains worldwide. More fundamentally, the recovery in the United States was hampered by persistent problems on the property market and the labour market, in a context in which the fiscal policy stimuli initially applied to support the recovery ceased to have any effect. On the contrary, as in other advanced economies, the effects of fiscal consolidation began to depress demand.

In contrast, despite the repercussions of weakening external demand, the emerging economies maintained their dynamism, increasingly buttressed by the rising average incomes of their population and hence the strengthening domestic demand. This trend is expected to continue in 2012, even though the rate of GDP growth may be slightly lower than in previous years, one factor being the continued efforts by the authorities to contain the risks of overheating which are becoming apparent in these economies.

The strength of demand from the emerging economies also explains why commodity prices on the international markets reverted to high levels at the beginning of 2011. In particular, while the price of a barrel of Brent was down

CHART 1 GLOBAL ECONOMIC DEVELOPMENTS



Sources: BEA, CEIC, CPB, EC, Thomson Reuters Datastream, NBB.

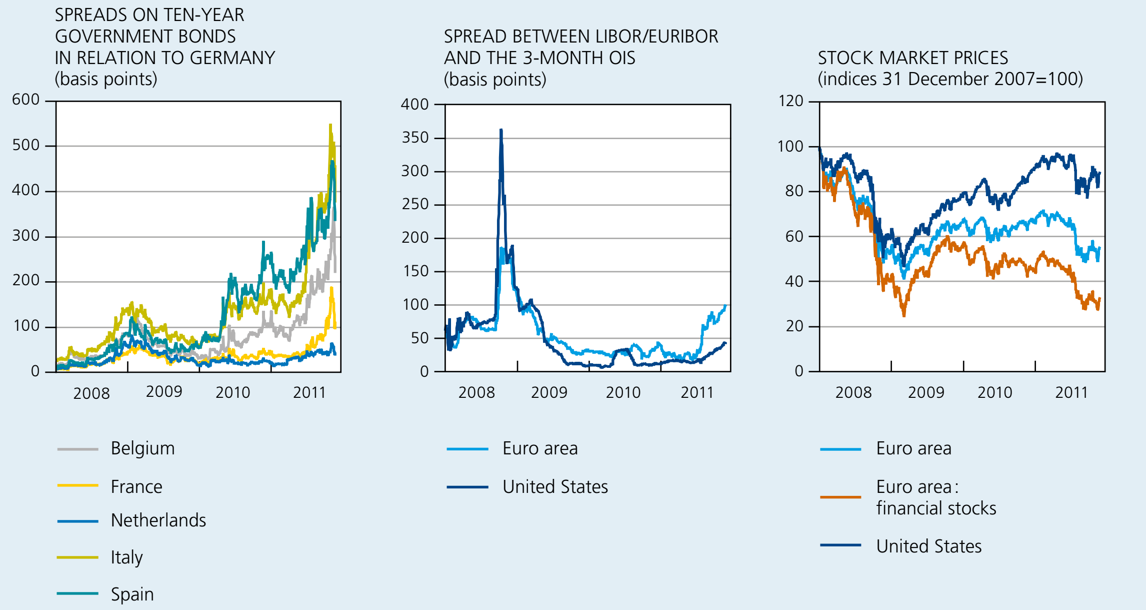
to $ 79.6 on average in 2010, by April 2011 it was back up to $ 123, or close to the pre-recession peak recorded in 2008. Since then, oil prices have only eased slightly, remaining steady at around $ 110 per barrel between August and October 2011, and – according to the forward contracts – they will only drop slightly below that level in 2012.

During the summer the economic situation deteriorated sharply, as is evident from the slump in the industrial confidence indicators both in the United States and in the euro area and the other advanced economies. That deterioration was accompanied by a considerable heightening of tensions on the financial markets, in a context of increased risk aversion. This time, these tensions were centred mainly on the government bond markets of certain euro area countries, but their effects spread to the financial institutions. Owing to the uncertainty which they engender in the assessment of the outlook for income and demand among private players, these tensions ultimately have a negative impact on the activity of the countries concerned and that of their trading partners.

In fact, the start of the slowdown in activity revived investors' fears about the ability of the States to repay their debts. In most of the advanced economies, not only the economic recession but also the measures aimed at strengthening the financial institutions during the first phase of the financial crisis led to a surge in the public debt and triggered dynamics which are considered unsustainable in the long term. The measures aimed at fiscal consolidation and structural reinforcement of growth are not deemed sufficient to remedy this situation. Moreover, the discussions on the establishment of safeguard mechanisms for countries in the euro area or the European Union facing serious financing problems greatly exacerbated the market uncertainty. The United States is also facing similar problems, as is evident from the debate on raising the limit on the public debt level in August, followed by the debate on the scale and nature of the consolidation measures.

On the government bond markets in the euro area, apart from the three countries – Greece, Ireland and Portugal – covered by the IMF and EU aid programme, a growing number of countries had to face a further rapid increase in spreads in relation to the yields on German Bunds. Just as the measures to support the financial institutions had contributed to the rise in the public debt ratio during the first phase of the financial crisis, the tensions affecting government securities now in turn had an impact on the position of the financial institutions. The fall in the value of these securities has a direct adverse effect on the value of their portfolios and on their funding. In

CHART 2 FINANCIAL TENSIONS



Source : Thomson Reuters Datastream.

TABLE 1	PROJECTIONS FOR THE MAIN ECONOMIC REGIONS (percentage changes compared to the previous year, unless otherwise stated)		
	2010	2011	2012
	Actual figures	Projections	
GDP in volume			
World	5.0	3.7	3.5
of which:			
United States	3.0	1.6	1.5
Japan	4.0	–0.4	1.8
European Union	2.0	1.6	0.6
China	10.3	9.2	8.6
India	8.5	7.5	7.5
Russia	4.0	3.9	3.8
Brazil	7.5	3.6	4.0
p.m. World imports	*14.0*	*6.5*	*5.0*
Inflation (1)			
United States	1.6	3.2	1.9
Japan	–0.7	–0.2	–0.1
European Union	2.1	3.0	2.0
Unemployment (2)			
United States	9.6	9.0	9.0
Japan	5.1	4.9	4.8
European Union	9.7	9.7	9.8

Source: EC (autumn forecasts, November 2011).
(1) Consumer price index.
(2) In % of the labour force.

these circumstances, there was a fall in the share prices of financial institutions on the stock markets. This deterioration in the position of the financial system in turn triggers speculation about the need for governments to provide further assistance for struggling institutions.

Coming on top of the slowdown in external demand and the short-term effects of the efforts to restore sound public finances, these financial tensions and the severe uncertainty depress domestic demand for consumption and investment. For their part, the monetary authorities responded to the development of a recessive spiral between the problems of public finances, those of the financial institutions and the developments in real activity. The ECB Governing Council cut its key interest rates by 25 basis points on 3 November 2011, and the various measures strengthening the granting of liquidity were maintained or reinforced in the United States, while they were reactivated in the euro area [1].

In this context, the prospects for the growth of activity in 2011 and 2012 for most of the advanced economies were downgraded in recent months. According to the EC's autumn forecasts, GDP growth in the United States will be only 1.6 % in 2011 and 1.5 % in 2012. For the European Union as a whole, growth is actually forecast to fall from 1.6 % in 2011 to 0.6 %. Among the main advanced economies, only Japan is expected to see any acceleration between those two years, but that will be merely an automatic rebound effect following the loss of

(1) On 8 December 2011, the ECB Governing Council decided to cut the key interest rates by a further 25 basis points and to reinforce the measures for granting liquidity to the financial institutions.

TABLE 2 EUROSYSTEM PROJECTIONS
(percentage changes compared to the previous year)

	Euro area			*p.m. Belgium*		
	2010	2011	2012	*2010*	*2011*	*2012*
Inflation (HICP)	1.6	2.6 / 2.8	1.5 / 2.5	*2.3*	*3.5*	*2.4*
GDP in volume	1.8	1.5 / 1.7	–0.4 / 1.0	*2.3*	*2.0*	*0.5*
of which:						
Private consumption	0.8	0.3 / 0.5	–0.4 / 0.6	*2.3*	*1.0*	*0.2*
Public consumption	0.5	–0.3 / 0.5	–0.5 / 0.7	*0.2*	*1.3*	*2.9*
Investment	–0.6	1.6 / 2.4	–1.6 / 1.8	*–0.9*	*4.9*	*1.2*
Exports	10.8	5.4 / 7.2	0.3 / 6.1	*9.9*	*5.5*	*1.7*
Imports	9.2	4.0 / 5.4	–0.5 / 5.1	*8.7*	*6.0*	*2.1*

Sources: ECB, NBB.

output during the current year. In general, such growth rates would be insufficient to achieve any significant reduction in unemployment.

Against this backdrop of severe financial tensions, plummeting business and consumer confidence, and the slackening pace of external demand, the Eurosystem projections for GDP growth in the euro area were also substantially downgraded. They now range between –0.4 and 1 % in 2012, a modest recovery being predicted during the year after a period of stagnation, or even mild recession, in late 2011 and early 2012. As an annual average, GDP is forecast to grow in real terms by around 1.5 to 1.7 % in 2011. The divergences in performance between euro area countries will continue to be significant ; they are due, in particular, to the scale of the adjustment efforts to be made in regard to public finances or the restoration of the competitiveness of the economies with serious imbalances to correct.

Inflation in the euro area came to 3 % from September to November 2011, owing to the high level of energy and food prices in recent months. This base effect should fade away during 2012, while domestic pressures on costs – particularly labour costs – should continue to be contained. According to the Eurosystem projections, annual average inflation in the euro area is put at between 1.5 and 2.5 % in 2012, compared to a range of 2.6 to 2.8 % in 2011.

Box – Assumptions adopted for the projections

Produced as part of a joint exercise, the Eurosystem's economic projections for the euro area and the Bank's projections for Belgium are based on a set of technical assumptions and forecasts for the international environment drawn up jointly by the ECB and the national central banks of the Eurosystem.

Exchange rates are held constant at the average levels recorded in the last ten days before the cut-off date for the assumptions, in mid-November 2011. This gives a USD/EUR exchange rate of 1.36, which is a little below the 2011 average (1.40).

In line with the implicit prices reflected in forward contracts, the price of a barrel of Brent crude on the international markets is expected to increase from an average of $ 79.6 in 2010 to $ 111.5 in 2011, before dropping back to $ 109.4 in 2012.

In view of the expected slowdown in imports by Belgium's partners both within the euro area and in third countries, the volume growth of the export markets is expected to fall from over 10 % in 2010 to 5.8 % in 2011 and 3.7 % in 2012.

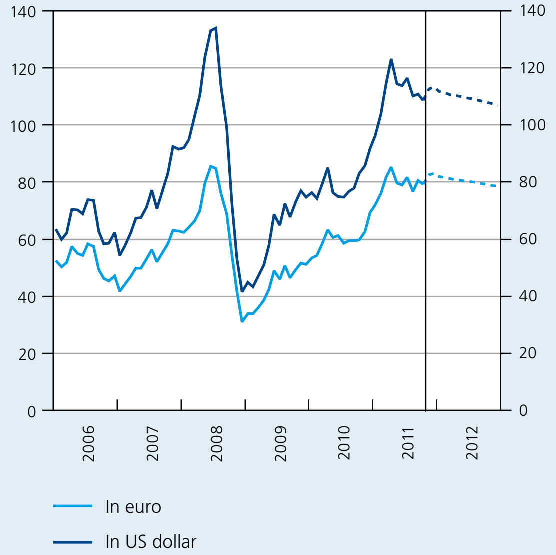
The interest rate assumptions are also based on market expectations up to mid-November 2011. As an annual average, three-month interbank deposit rates are projected to rise from 0.8 % in 2010 to 1.4 % in 2011, before dropping to 1.2 % in 2012. This fall mainly reflects the key interest rate cut made by the ECB Governing Council on 3 November and, more generally, the deterioration in the economic climate.

Yields on ten-year Belgian government bonds are estimated at 4.3 % in 2011 and 5.1 % in 2012, compared to 3.5 % in 2010. The increase in the yields on Belgian government bonds is due partly to the widespread rise expected for the euro area in 2012, and partly to the recent widening of the spread in relation to yields on German Bunds, which reached 277 basis points in November 2011. The assumptions keep this differential constant up to the end of the projection period.

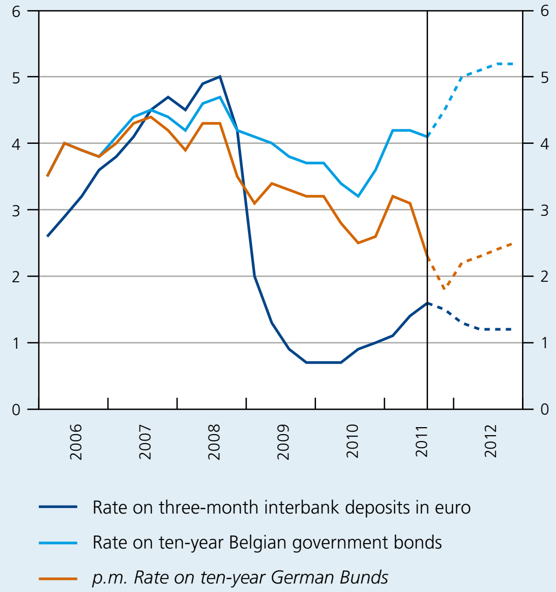
The expected movement in rates charged by banks on business investment loans and private mortgage loans takes account of the transmission which usually occurs in relation to the benchmark rates. Thus, mortgage interest rates are influenced to a great extent by the yields on ten-year government bonds, while the rates charged on business loans depend on shorter maturities.

ASSUMPTIONS CONCERNING THE MOVEMENT IN OIL PRICES AND INTEREST RATES

CRUDE OIL PRICES [1]
(monthly averages per barrel of Brent)



INTEREST RATES [2]
(quarterly averages)



Source: ECB.
(1) Actual figures up to October 2011, assumptions from November 2011.
(2) Actual figures up to the third quarter of 2011, assumptions from the fourth quarter of 2011.

EUROSYSTEM PROJECTION ASSUMPTIONS

	2010	2011	2012
		(annual averages)	
Interest rate on three-month interbank deposits in euro	0.8	1.4	1.2
Yield on ten-year Belgian government bonds	3.5	4.3	5.1
EUR/USD exchange rate	1.33	1.40	1.36
Oil price (US dollars per barrel)	79.6	111.5	109.4
		(percentage changes)	
Export markets relevant to Belgium	10.1	5.8	3.7
Competitors' export prices	6.1	4.0	1.9

Source: ECB.

2. Activity, employment and demand

In Belgium, too, at the beginning of 2011 it looked as if the revival in activity which had begun in mid-2009 might persist. Year-on-year, GDP grew by 2.9 % in the first quarter, and was up by 2.2 % in the second quarter. As the economy climbed out of recession, the growth basis widened from exports to domestic demand, with private consumption first followed by business investment at the beginning of 2011 making a positive contribution to growth.

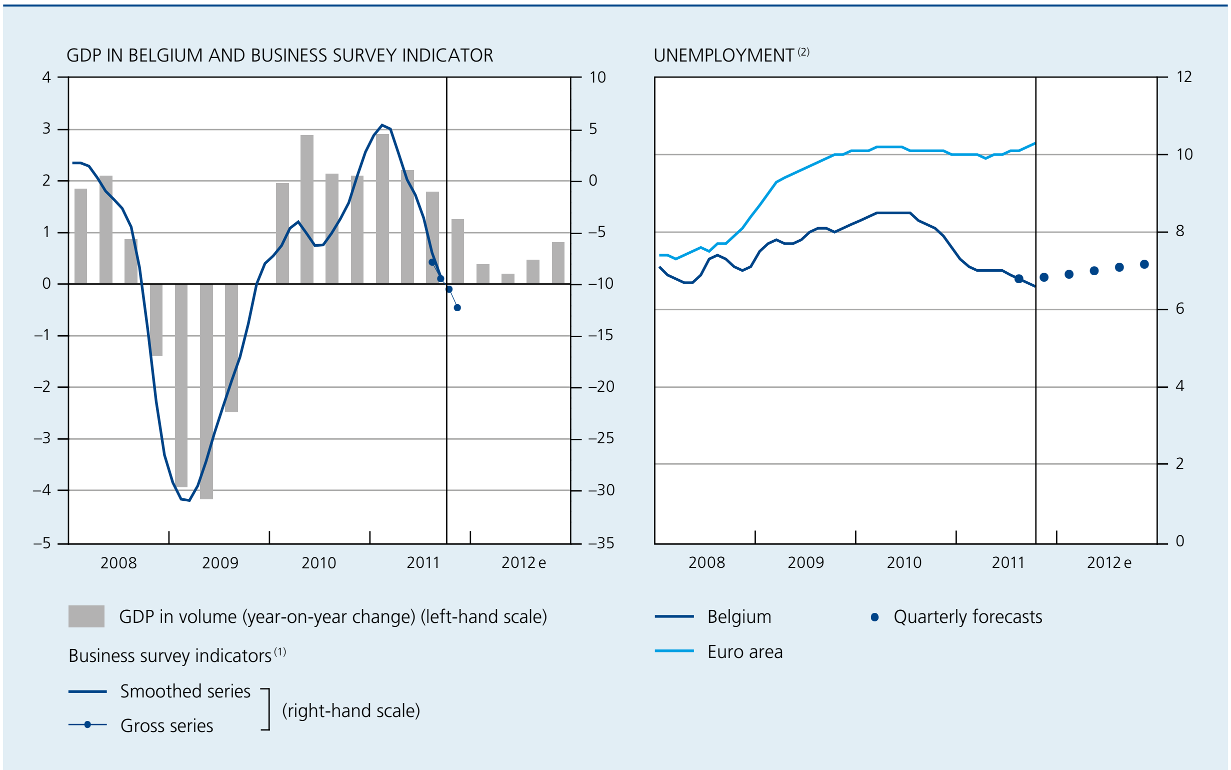
The deterioration in the external environment, the rising financial tensions and the accompanying heightened uncertainty brought that trend to an abrupt halt during the summer of 2011. According to the NAI's flash estimates, GDP stagnated in the third quarter and – taking account, in particular, of the adverse trend in the economic indicators – growth is expected to remain close to zero at the end of the year and in early 2012. Activity is expected to pick up thereafter, supported in particular by foreign demand. However, the revival is likely to be restrained by the continuing uncertain outlook, in a context of essential retrenchment of public finances and strengthening of the financial institutions.

Overall, the projections for Belgium presented here show GDP growing by 2 % in 2011 and 0.5 % in 2012. These figures have been revised downwards by 0.6 and 1.8 percentage points respectively since the projections published in June.

After having proved unexpectedly resilient at the height of the 2008-2009 recession, job creation responded particularly strongly to the revival in activity from the beginning of 2010. As an annual average, the volume of labour was up by 1.1 % in 2010 and 1.8 % in 2011. The increase in the number of persons in work was 0.3 percentage point lower in each of those years, owing to the normalisation of the implicit working time per employee. Whereas the flexibility systems permitting a downward adjustment in working time – notably temporary lay-offs – had been heavily used in 2009, recourse to those systems diminished as activity picked up. In view of the

CHART 3 ACTIVITY AND UNEMPLOYMENT

(data adjusted for seasonal and calendar effects, unless otherwise stated)



Sources : EC, NAI, NBB.
(1) Seasonally adjusted data.
(2) Harmonised unemployment rate (15 years and over) as a percentage of the labour force.

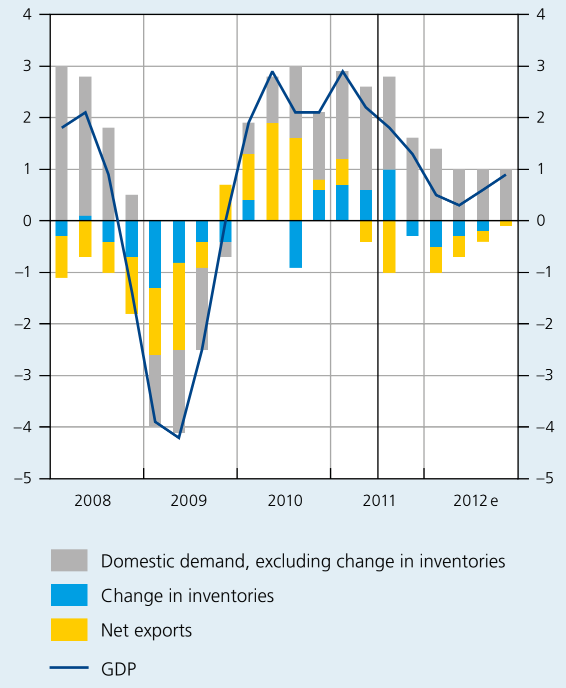
serious deterioration in the business climate, employment is forecast to grow by no more than 0.4 % in 2012, with the volume of labour expanding by 0.2 %.

The annual average growth rates partially conceal the movement in employment during the year, as most net job creation was concentrated between the beginning of 2010 and the second quarter of 2011. Altogether, around 63 000 additional jobs were created in net terms – i.e. the difference between new jobs and jobs which have been abolished – during 2010, followed by a further 38 000 in the first half of 2011. Subsequently, the expansion of employment slowed considerably, though it remained slightly positive. Between mid-2011 and the end of 2012, domestic employment is forecast to expand by around 23 000 units. This growth is expected to come from the continuing rise in the number of persons employed under the service voucher system and in the health sector and other non-market services. Apart from these jobs, significant losses of around 15 to 20 000 jobs are expected in the branches sensitive to the business cycle.

Taking account of the combined effects of the slackening pace of net job creation and the steady rise in the number of persons entering the labour market, the declining trend in unemployment seen in recent months, down from 8.5 % in the spring of 2010 to 6.6 % in October 2011, will be reversed in 2012. On average, the harmonised unemployment rate is predicted at 7 % in that year.

CHART 4 MAIN COMPONENTS OF DEMAND

(contribution to GDP growth, in percentage points; data adjusted for seasonal and calendar effects)



Sources: NAI, NBB.

In parallel with the favourable trend in employment, the factors generating demand widened during 2010 and in early 2011, providing a more balanced basis for GDP growth. While net exports had been the first to join in the revival in activity from mid-2009, the change in inventories soon ceased to hold back growth and then began making a positive contribution at the end of 2010 and the beginning of 2011. The other components of domestic demand also gathered strength. The resurgence of financial tensions and the widespread deterioration in the business climate and the outlook cast a dark shadow over this picture. At the end of 2011 and in 2012, net exports and the change in inventories are both expected to make a negative contribution to growth, while the support provided by domestic demand should dwindle rapidly.

After having benefited up to the first quarter of 2011 from the renewed vigour of external demand, particularly that originating from the emerging economies and their main suppliers, including Germany, exports of goods and services began to suffer from the general loss of momentum on those markets from the second quarter. The expansion of foreign markets is projected to continue at a modest pace in the coming quarters, with growth subsiding from 10.1 % in 2010 to 5.8 % in 2011 and 3.7 % in 2012, according to the Eurosystem's assumptions. This time, the foreign markets are therefore not expected to contract, in contrast to what happened in 2009 when world trade declined by more than 10 % in volume. Overall, the volume of Belgium's exports is expected to display a similar profile, with the growth forecast down from 9.9 to 5.5 %. In 2012, growth is likely to amount to just 1.7 %, as the latest indicators obtained from the foreign trade statistics and the business surveys suggest a temporary dip in exports of goods by Belgium at the end of 2011, and therefore an adverse starting point for the ensuing year.

In comparison with the other components of domestic demand, household consumption growth had picked up fairly quickly following the crisis: after a sharp deceleration in 2009, consumption grew by 2.3 % in real terms in 2010. This expansion was due largely to the rapid decline in the savings ratio, as households became more optimistic again about the economic outlook, particularly in regard to employment. This effect did not strengthen further in 2011, so that private consumption was 1 % up against the previous year, a figure similar to the growth of purchasing power. The impact of high inflation which, since the end of 2010, has eroded the rise in disposable incomes by more than 3 percentage points, was compounded from the summer by the loss of consumer confidence. In this regard, Belgian households have been affected not only by the general deterioration in the economic climate in Europe and by the financial tensions, but also by the protracted debate over the budget prospects in Belgium. Thus, the volume of private consumption is set to rise by only 0.2 % in 2012, owing to the combined effects of a meagre 1.2 % increase in disposable income and a 0.8 percentage point rise in the savings ratio in 2012. That puts the savings ratio at 17 %, or slightly above the figure for 2000 to 2007. In this very uncertain context, and taking account of the gradual rise in mortgage interest rates, household investment in housing is likely to fall again in 2011 and 2012, by around 1.5 % per annum. In 2010, it had been temporarily underpinned by the measures to revitalise construction, notably via a cut in the VAT rate for the first tranche of new building work.

Following a cumulative decline of around 11 % in 2009 and 2010, the volume of business investment is predicted to recover by 7.8 % in 2011. This catch-up will take place against the backdrop of a marked increase in capacity utilisation rates – up from 70.1 % in April 2009 to 81.2 % in April 2011, which is close to the average for the past two decades according to the survey of manufacturing industry – in parallel with the strengthening of final demand and the restoration of corporate profitability. The gross operating surplus of firms in fact climbed by 10 % in 2010, and is set to rise by a further 6.1 % for 2011, bolstering the internal financing capacity of companies. With the weakening of demand and the substantial decline in capacity utilisation rates in industry during 2011 – down to just 78.4 % in October 2011 – business investment is forecast to slow down in 2012, growing by just 1.7 %.

Finally, government spending on consumption is forecast to expand in real terms by 1.3 % in 2011 and 2.9 % in 2012, in the absence of specific measures to restrain it. Government investment is likely to record sustained growth in 2011 and 2012 of over 5 % per annum, owing to the impending local elections.

TABLE 3 GDP, EMPLOYMENT AND MAIN EXPENDITURE CATEGORIES
(percentage changes compared to the previous year, calendar adjusted data)

	2009	2010	2011 e	2012 e
GDP (1)	–2.7	2.3	2.0	0.5
Total volume of labour (2)	–1.6	1.1	1.8	0.2
Total domestic employment in persons	–0.2	0.8	1.5	0.4
p.m. Change in thousands of persons	*–7.6*	*37.0*	*68.3*	*18.3*
Real disposable income of individuals	2.9	–0.5	0.9	1.2
Expenditure components (1)				
Private consumption expenditure	0.8	2.3	1.0	0.2
Consumption expenditure of general government	0.8	0.2	1.3	2.9
Gross fixed capital formation	–8.1	–0.9	4.9	1.2
Housing	–9.2	1.6	–1.5	–1.3
General government	7.2	–1.8	5.4	5.3
Enterprises	–9.3	–1.6	7.8	1.7
p.m. Domestic expenditure excluding change in inventories (3)	*–1.3*	*1.1*	*1.8*	*1.1*
Change in inventories (3)	–0.7	0.0	0.5	–0.3
Net exports of goods and services (3)	–0.7	1.2	–0.2	–0.3
Exports of goods and services	–11.3	9.9	5.5	1.7
Imports of goods and services	–10.6	8.7	6.0	2.1

Sources: NAI, NBB.
(1) In volume.
(2) Total number of hours worked in the economy.
(3) Contribution to change in GDP.

3. Prices and costs

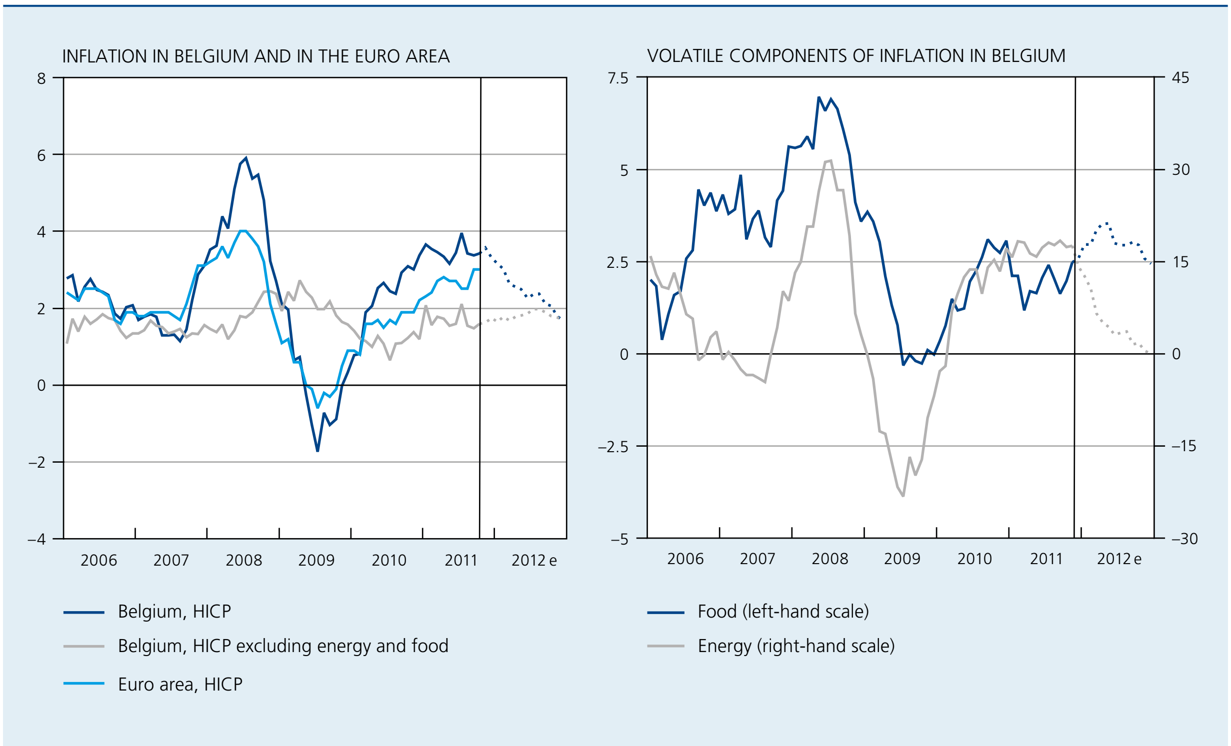
Since the end of 2010, consumer price inflation in Belgium has been running at significantly above 3 %. According to the current projections, it is likely to exceed that rate until the initial months of 2012 before gradually subsiding to around 2 % at the end of the year. Inflation is estimated at an average of 3.5 % in 2011 – compared to 2.7 % in the euro area – and 2.4 % in 2012.

The high level of overall inflation in 2011 is largely due to the volatile inflation components. In particular, the prices of energy products included in the HICP basket increased by 10 %, on average, in 2010 and will have risen by a further 17 % over 2011 as a whole. The reason lies mainly in the rapid rise in petroleum product prices on the international markets. Crude oil reached $ 123 per barrel of Brent in April, and remained persistently high thereafter at around $ 110 per barrel. Taking account of the assumption of a slight decline in petroleum product prices during the period covered by the projections, the base effects resulting from fluctuations in those prices should become less marked, which accounts for the expected decline in inflation. However, that movement is partly offset by the considerable increase in the electricity supply tariffs in large areas of Flanders, which will have an estimated impact on the energy component of inflation amounting to around 1 percentage point in 2011 and 2012 ; it is due to the substantial cost of the regional subsidies for the installation of photovoltaic panels.

While the energy component is expected to bring a gradual deceleration in 2012, underlying inflation is likely to remain high. It increased at the end of 2010 and in early 2011, rising from an average of 1.1 % in 2010 to 1.7 % in April 2011 – driven mainly by services – and is expected to remain slightly above that level. This movement is due partly to the allowance for higher fuel and food prices in airline tickets or catering services, for example. Price adjustments directly linked to inflation or other reference indices for a range of services are another contributory factor. Finally, it is also supported by the strong rise in labour costs, itself fuelled largely by wage indexation based on the health index.

After remaining stable in 2010, unit labour costs in Belgium's private sector are set to increase significantly in 2011 and 2012 by 2.2 and 2.9 % respectively. This strong

CHART 5 INFLATION
(HICP, % change compared to the corresponding period of the previous year)



Sources : EC, NBB.

TABLE 4 PRICE AND COST INDICATORS
(percentage changes compared to the previous year)

	2009	2010	2011 e	2012 e
Total HICP	0.0	2.3	3.5	2.4
Energy	–14.0	10.0	17.0	4.3
Total excluding energy	1.9	1.3	1.8	2.1
GDP deflator	1.2	1.8	2.5	2.3
Labour costs in the private sector:				
Unit labour costs	4.0	0.0	2.2	2.9
Hourly costs	2.8	0.9	2.5	3.3

Sources: EC, NAI, NBB.

acceleration of unit labour costs is due to the combination of anaemic productivity gains and a stronger rise in hourly labour costs. Overall, the cumulative increase of more than 5 % during the two years covered by these forecasts significantly exceeds the EC and OECD predictions for the three main trading partners – Germany, France and the Netherlands – thus eroding the competitiveness of Belgian firms.

In 2010, apparent labour productivity had picked up by 0.9 %, owing to the absorption of firms' labour reserves which had been under-used during the 2008-2009 recession. In reality, this gain was relatively small, and was insufficient to restore the level of productivity to its potential path following the losses suffered during the first phase of the crisis. In addition, the deteriorating economic conditions during the second half of 2011 and in 2012 will bring the productivity gains down to 0.3 and 0.4 % per annum for those two years, well below the average figures. Meagre productivity gains have been a feature of the Belgian economy since 2007. During periods of weak business activity, this is due to the practice of labour hoarding and the low level of investment. Apart from these cyclical fluctuations, it could also be due to the use of low-skilled workers, supported by the various employment promotion measures mentioned above. However, there is hardly any sign of that in a smaller average rise in labour costs, which one might expect if the proportion of this type of job is increased.

The growth of hourly labour costs is forecast to gather pace from 0.9 % in 2010 to 2.5 % in 2011 and 3.3 % in 2012. This strong acceleration is very largely due to the automatic indexation of wages. According to the projections, the health index of consumer prices – used as the reference for indexation – should rise by 3.1 % in 2011 and 2.4 % in 2012. However, in view of the time lags which result from the indexation mechanisms applied by the various joint committees, the impact on wages will be a little more pronounced in the second year. Apart from indexation, the assumption adopted for the movement in hourly labour costs in the private sector in 2011 and 2012 essentially takes account of the maximum 0.3 % increase in negotiated wages planned for the second year under the draft central agreement imposed by the government.

4. Public finances

The projections for public expenditure presented in this article do not go beyond 2011, since the budgetary agreement concluded on 26 November 2011 in connection with the formation of the federal government came after the cut-off date for the projections.

On the basis of the latest information, public finances should end the year 2011 with a deficit of 4.2 % of GDP, which is 0.1 % of GDP higher than the previous year's deficit.

Fiscal and parafiscal revenues are projected to remain stable as a ratio of GDP in 2011. Although taxes on goods and services will decline owing to the fall in consumption of tobacco products and road fuel, which are relatively heavily taxed, particularly via excise duties, the levies on labour will increase slightly. Conversely, non-fiscal and non-parafiscal revenues will surge in 2011, partly on account of the new levy under the deposit protection system, and partly because of the strong increase in payments to the government in compensation for the support given during the financial crisis, particularly following

TABLE 5 GENERAL GOVERNMENT ACCOUNTS [1]

(in % of GDP)

	2009	2010	2011 e
Revenue	48.0	48.8	48.9
Fiscal and parafiscal revenue	42.7	43.2	43.2
Other	5.2	5.5	5.8
Primary expenditure	50.1	49.5	49.8
Primary balance	–2.2	–0.7	–0.9
Interest charges	3.6	3.3	3.3
Financing requirement (–) or capacity	–5.8	–4.1	–4.2
p.m. Effect of non-recurrent factors	*–1.0*	*0.0*	*–0.1*
Consolidated gross debt	95.9	96.2	97.7

Sources: NAI, NBB.
(1) According to the methodology used in the excessive deficit procedure.

the first payment by KBC in this respect for the funding injected by the authorities.

Primary expenditure, which still stood at 49.5 % of GDP in 2010, is set to increase to 49.8 % of GDP in 2011. That rise is due essentially to the measures taken following the problems encountered by Holding Communal, a major shareholder in Dexia, whose share price collapsed. Those events led to a capital transfer amounting to 0.2 % of GDP from the government to that institution [1].

Interest charges should remain fairly stable in 2011. The public debt is expected to increase, but the impact on interest charges should be almost entirely neutralised by the – albeit modest – reduction in interest rates.

The government debt ratio are driven up by the loans which the Belgian State contracted in order to finance the purchase of Dexia Bank Belgium and by the loans granted to Greece, Ireland and Portugal.

5. Risk factor assessment

In line with the Eurosystem projections for the euro area, the results presented here for Belgium show activity stagnating at the end of 2011 and in early 2012, followed by a modest recovery in the second half of the year. On that basis, the GDP growth forecast is lower than the ones published in recent months by other institutions, with the exception of the OECD. Nonetheless, the risks surrounding these projections – if they were to materialise – seem predominantly, or even almost exclusively, likely to curb activity even further.

In view of the normal volatility of short-term movements in activity and the usual statistical data revisions, a modest decline in GDP in any particular quarter is not ruled out, even in the baseline scenario adopted for these projections. However, in this scenario, the absence of a severe recession in the short term and the return to growth

(1) Because of the uncertainty in this matter, the projections take no account of the potential impact of the guarantee, amounting to 0.4 % of GDP, granted to the cooperative partners in the Arco Group.

TABLE 6 COMPARISON OF THE FORECASTS FOR BELGIUM

(percentage changes compared to the previous year)

	GDP in volume		Inflation [1]		Budget balance [2]		Publication date
	2011	2012	2011	2012	2011	2012	
NBB – Autumn 2011	2.0	0.5	3.5	2.4	–4.2	n.	December 2011
p.m. Spring 2011	*2.6*	*2.2*	*3.4*	*2.2*	*–3.5*	*–4.1*	*June 2011*
NAI	2.4	1.6	3.5	2.0	n.	n.	September 2011
IMF	2.4	1.5	3.1	2.0	–3.5	–3.4	September 2011
EC	2.2	0.9	3.5	2.0	–3.6	–4.6	November 2011
OECD	2.0	0.5	3.4	2.5	–3.5	–3.2	November 2011
p.m. Actual figures for 2010	*2.3*		*2.3*		*–4.1*		

(1) HICP, except for NAI: national consumer price index.
(2) In % of GDP.

during 2012 imply that the uncertain climate is easing, or at the very least that it is having a less severe effect on the behaviour of firms and households. Clearly, this presupposes that the sovereign debt crisis in the euro area does not worsen and that its repercussions on the financial institutions are contained.

Even if there is stabilisation at this level, the financial institutions must proceed to complete a radical restructuring in order to rectify their position and adapt to the new environment in regard to market conditions and prudential regulation. That will entail a reduction in the size of their balance sheet or an increase in capital. Depending on how this adjustment is carried out, lending to businesses and households could be affected to a greater extent than foreseen, and thus impair the recovery.

In addition, in some euro area countries, the fiscal consolidation needs to continue and be reinforced in order to attain the targets set by the stability programmes.

More generally, the situation in the euro area presents a risk for partners in other economies around the world, on top of their own specific problems. A greater than expected weakening of demand in the United States, the United Kingdom or the emerging economies, which are among Europe's main trading partners, would damage one of the potential sources of the recovery.

More specifically in regard to Belgium, in view of the time taken to reach agreement, the new government's budget measures could not be incorporated in these projections. On the one hand, some of those measures are likely to restrict activity and incomes. On the other hand, if they permit a credible reform of the public accounts and bringing the debt to a path which is sustainable in the long term, they could encourage households to reduce the precautionary savings which they would otherwise have accumulated to guard against the threats which a derailment of public finances would present for their income prospects. Fiscal consolidation could also reduce the risk premium included in interest rates.

In general, structural measures for the labour market and pensions should also provide long-term support for fiscal consolidation and the strengthening of the economy's growth potential and competitiveness. In that regard, the expected rise in inflation, and hence labour costs, exceed the figures for competitors, and therefore threaten the expansion of activity and employment.

Annex

PROJECTIONS FOR THE BELGIAN ECONOMY: SUMMARY OF THE MAIN RESULTS

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

	2008	2009	2010	2011 e	2012 e
Growth (calendar adjusted data)					
GDP in volume	0.9	–2.7	2.3	2.0	0.5
Contributions to growth:					
Domestic expenditure, excluding change in inventories	2.0	–1.2	1.1	1.8	1.1
Net exports of goods and services	–0.8	–0.7	1.2	–0.2	–0.3
Change in inventories	–0.3	–0.7	0.0	0.5	–0.3
Prices and costs					
Harmonised index of consumer prices	4.5	0.0	2.3	3.5	2.4
Health index	4.2	0.6	1.7	3.1	2.4
GDP deflator	2.2	1.2	1.8	2.5	2.3
Terms of trade	–2.4	3.4	–1.5	–1.1	0.0
Unit labour costs in the private sector	3.5	4.0	0.0	2.2	2.9
Hourly labour costs in the private sector	3.6	2.8	0.9	2.5	3.3
Hourly productivity in the private sector	0.1	–1.2	0.9	0.3	0.4
Labour market					
Domestic employment (average annual change in thousands of persons)	79.1	–7.6	37.0	68.3	18.3
p.m. Change during the year, in thousands of persons [1]	*63.1*	*–23.2*	*63.4*	*55.7*	*4.8*
Total volume of labour [2]	1.5	–1.6	1.1	1.8	0.2
Harmonised unemployment rate [3] (in % of the labour force)	7.0	8.0	8.4	6.9	7.0
Incomes					
Real disposable income of individuals	2.2	2.9	–0.5	0.9	1.2
Savings ratio of individuals (in % of disposable income)	16.8	18.4	16.2	16.2	17.0
Public finances [4]					
Overall balance (in % of GDP)	–1.3	–5.8	–4.1	–4.2	n.
Primary balance (in % of GDP)	2.5	–2.2	–0.7	–0.9	n.
Public debt (in % of GDP)	89.3	95.9	96.2	97.7	n.
Current account (according to the balance of payments, in % of GDP)	**–1.6**	**–1.7**	**1.5**	**0.9**	**0.3**

Sources: EC, DGSEI, NAI, NBB.

(1) Difference between the fourth quarter of the year concerned and the fourth quarter of the previous year.

(2) Total number of hours worked in the economy.

(3) In % of the labour force (15-64 years), non calendar adjusted data.

(4) According to the methodology used in the excessive deficit procedure (EDP).