Economic projections for Belgium – Spring 2015

Introduction

Since the cut-off date for the autumn forecasts published in December 2014, the external environment for the Belgian economy has substantially changed. For instance, oil prices have not bottomed out as expected, but have continued to fall even more steeply. Despite the upward trend since early spring, oil prices, both in US dollars and in euros, are now significantly cheaper than expected in the autumn forecasts on the basis of forward contracts on the international markets at that time. In addition, monetary policy has been eased further in the euro area as well as in some other regions. In January 2015, the ECB decided to expand the existing programme for the purchase of certain types of securities, by also acquiring public sector bonds from March 2015 onwards. The ECB plans to purchase private and public sector assets totalling € 60 billion per month altogether until September 2016, and in any case until the ECB Governing Council can observe a persistent change in the inflation trend, in line with its medium-term objective of keeping inflation below but close to 2 %.

Partly as a result of that new monetary policy stance and the expectations concerning it, important financial market movements have occurred. On the one hand, the euro has continued to depreciate sharply, especially from the beginning of 2015, so that its value in dollars for the first quarter of 2015, for example, was around 10 % below the figure assumed in the autumn forecasts. On the other hand, market interest rates have fallen further to exceptionally low levels, and that decline has also fed through to a greater extent than previously in the rates applied to household and business loans. At the same time, stock markets have surged since the beginning of this year, though the strong financial market recovery was followed by a period of great volatility in early May when bond prices plummeted and equity prices underwent a limited correction, both in Europe and elsewhere. The euro has also appreciated slightly since mid-April. These recent developments may suggest that the financial markets' initial reaction to the ECB's quantitative easing was somewhat exaggerated, but they may also indicate a gradual rise in market expectations regarding future growth and inflation in the euro area compared to other regions. The recent movements in interest rates and the euro exchange rate, and their connection with monetary policy, are recounted in more detail in Box 1 of this article.

Growth prospects for the euro area have in fact improved since the autumn forecasts, as is evident, for instance, from the update of those estimates that the ECB published in March 2015. The latest quarterly statistics also confirm that the European economy is continuing to pick up. According to the first flash estimate, growth in the euro area strengthened further in the first quarter of this year ; the first indications are that this is due partly to the strong growth of private consumption. In addition, European growth is becoming more broadly based : for example, the French and Italian economies which had virtually stagnated in the preceding quarters are now recording stronger growth, while in Cyprus the deep recession has ended. Conversely, in a number of smaller euro area countries such as Greece and in certain Baltic countries, there has been a further contraction in activity. The uncertainty surrounding the outcome of the negotiations with international creditors in the former case, and geopolitical tensions with Russia in the latter case, are undoubtedly contributory factors here.

The rather more vigorous recovery of the European economy should be viewed as a catching-up process, linked to the sharp depreciation of the euro and positive confidence effects, with private consumption in particular being driven up relatively strongly by the favourable impact of lower oil prices on real household incomes. In contrast, the global growth outlook has not been revised upwards. In some major advanced countries, the growth rate has actually fallen significantly, while the deceleration in some emerging economies such as China has been sharper than expected. Moreover, international trade flows appear to be considerably less boosted by growth : the trade intensity of world growth is still remarkably low, as already stated in the autumn forecasts.

The domestic policy environment has hardly changed since the autumn projections, as the measures announced in the federal government agreement of October 2014 were almost fully included in those forecasts already. The minor changes mainly stem from new information on the precise implementation of certain measures. For instance, the activation policy for older unemployed persons and unemployed persons with employer top-up is being phased in more gradually than initially announced, so that the labour force and the unemployment rate do not suddenly increase in January 2015 as assumed in the autumn forecasts. Also, these estimates take account of higher-than-expected wage growth in 2016 on the basis of the draft interprofessional agreement dated January 2015, confirmed by the federal government. Finally, the temporary suspension of the indexation mechanisms was introduced later and in a different way from what had been anticipated in the autumn forecasts, but the estimated macroeconomic effects remain virtually unchanged. More generally, the labour cost moderation policy has also led to a significant relative improvement in competitiveness in these forecasts, in regard to the costs for Belgian firms exposed to international competition.

Against that backdrop, the current spring forecasts, finalised on 20 May 2015, also indicate that Belgium's recovery is strengthening and becoming somewhat more vigorous than in the autumn forecasts. The growth estimate has been raised slightly, primarily for 2015, to 1.2 %, though that is due partly to the NAI's upward revision of some quarterly growth statistics for 2014. Next year, growth should gather pace as expected to around 1.5 %, and in 2017 – for which estimates have been produced for the first time – economic activity is expected to accelerate a little further. It should be noted that estimates for later years inherently contain a substantial margin of uncertainty. The strengthening growth is supported mainly by rising net exports. That is due not only to the steady growth of Belgium's export markets according to the common technical and external assumptions underpinning the Eurosystem's estimates that are described in Box 2 in the first section of this article, but is also connected with the improvement in competitiveness resulting from the wage moderation policy. Although, as stated in the December 2014 article on the latest autumn forecasts, that policy initially depresses domestic demand, in the long run it has a greater impact on growth via export expansion.

The economic recovery and the favourable impact of the slow rise in labour costs continue to be reflected in the labour market. Over the three years, from 2015 to 2017, around 94 000 additional jobs should be created. That is well in excess of the increase in the labour force, despite the further rise in the participation rate. The unemployment rate is therefore predicted to fall gradually to around 8 % in 2017, although that is still higher than the average prevailing since the beginning of this century.

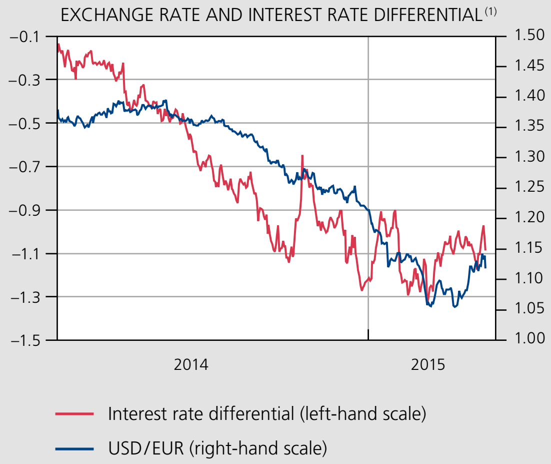
At the beginning of this year, inflation dipped to a low point, primarily owing to the steep fall in energy prices, but since April 2015 it has become positive again. According to the current forecasts, the average inflation rate this year will barely exceed the 2014 figure, but from 2016 it is expected to rise to around 1.5 %. Owing to the strong fluctuations in the volatile components, with the negative impact of the lower oil prices gradually giving way to a positive contribution to inflation, the average rate differs somewhat from underlying inflation. That figure, which has already clearly risen in the past few months, is predicted to remain relatively high for the rest of this year, owing to the upward impact of the cheaper euro on import prices, which will be noticeable primarily in the prices of industrial goods. After that, underlying inflation subsides gradually to around 1 % as a result of the very moderate rise in labour costs. The underlying inflation rate is not expected to rise again until 2017, mainly reflecting the increasing wage growth.

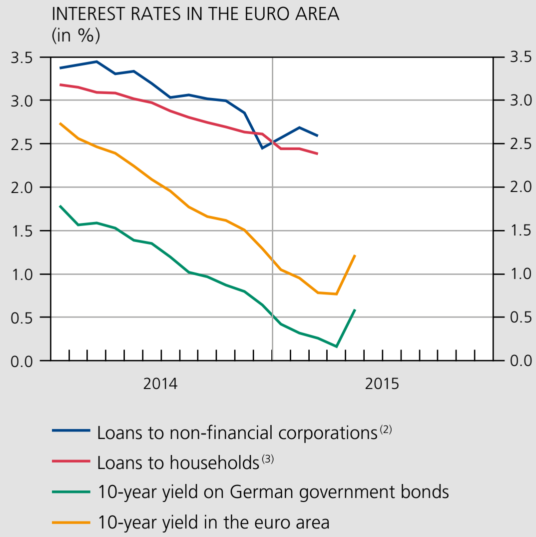
In regard to public finances, this year's budget deficit is expected to fall back below 3 % of GDP, mainly thanks to lower interest charges and, to a lesser extent, the consolidation measures. According to the forecasts, the deficit will then decline further to around 2 % of GDP in 2017, though it will still exceed the current nominal budget targets. Here it should be borne in mind that, in accordance with the Eurosystem rules for such projection exercises, the forecasts only take account of measures which have already been sufficiently specified by the government and have already been formally approved – or are very likely to be approved – on 20 May 2015, the cut-off date for the exercise. In addition, estimates of the budgetary impact of certain measures such as those concerning fraud prevention may differ from the amounts included in the budget.

Box 1 – The financial assumptions underpinning the projections and recent monetary policy measures

The projections presented in this article are based on financial assumptions that differ considerably from those underlying the previous projections published in December 2014. This box offers further information on the movement in two financial assumptions crucial to the projections, namely the euro exchange rate expressed in US dollars, and the level of the (longer-term) interest rates. Despite a steep rise from mid-April, both rates have recorded a marked fall in the past few months and are now at a much lower level than was assumed in the 2014 autumn forecasts. This downward trend in the first half of 2015 is actually part of a longer-term tendency, but is also clearly connected with the monetary policy environment, and above all with the recent further easing of policy in the euro area.

FINANCIAL ASSUMPTIONS





Sources: Bloomberg, ECB, Thomson Reuters Datastream.
(1) Differential between the one-year future interest rate on overnight interest rate swaps one year ahead in the euro area and in the US, in percentage points.
(2) Interest rate on loans to non-financial corporations with an initial rate fixation period of between one and five years.
(3) Interest rate on home loans to households with an initial rate fixation period over one year.

In that connection, January 2015 brought the announcement of new balance-sheet measures (the expanded asset purchase programme – EAPP) which have been implemented since March 2015. Of course, in accordance with the guidelines for these projections, those measures were not included in the December 2014 projections.

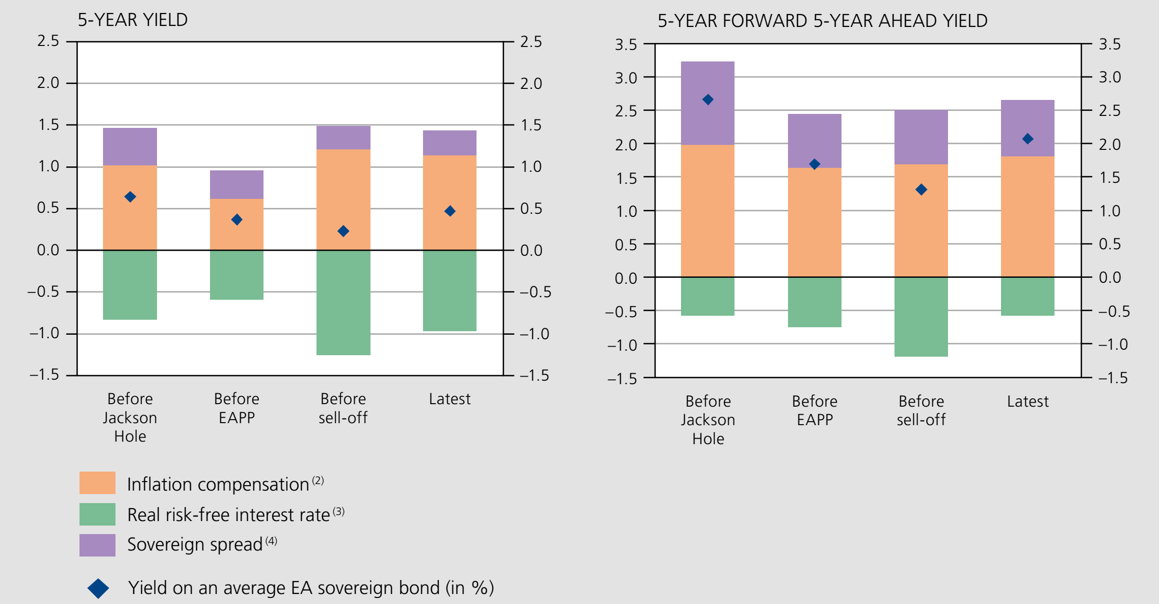
After two interest rate cuts, in June and September 2014, which had reduced the policy interest rates to an all-time low (and taken the deposit facility rate into negative territory), the said measures encouraged a further fall in market interest rates, and particularly in the yields on longer-term government bonds. Sovereign yields, which were already under pressure, partly because the ECB was expected to take such measures, declined further after the announcement of the programme and again when the purchases actually began in March 2015, and dipped to a historical low in the ensuing weeks. The steep fall in yields on government paper which, together with other market interest rates, form the benchmark for prices on other markets, were also reflected in bank lending interest rates. The euro exchange rate was likewise strongly influenced by the euro area's monetary policy. The euro fell sharply (by 18 %) against the dollar between May 2014 and May 2015, owing to the ever-widening differences in interest rate expectations between the two currencies. That is due to the divergent monetary policy stance in the two economies, with expectations of a tightening of US monetary policy coinciding with anticipation of further accommodation in the euro area.

However, these tendencies concerning both yields and the exchange rate were interrupted around mid-April 2015. In the case of the exchange rate, a slight appreciation was accompanied by a narrowing difference between interest rate expectations for the euro area and those for the US, since expectations for the euro area increased slightly while those for the US were revised downwards.

At about the same time, euro area government bonds recorded an about-turn, and yields rapidly soared. While nominal yields increased during May, their composition changed considerably. Breaking down ten-year government bonds in the euro area into various terms and components may shed some light on the recent tendencies.

BREAKDOWN OF YIELDS ON TEN-YEAR GOVERNMENT BONDS IN THE EURO AREA [1]

(in percentage points, unless otherwise stated)



Sources: Bloomberg, ECB.

(1) Yield on a composite euro area government bond comprising all issuers in all rating categories. The yield is broken down as follows: Yield in the euro area = inflation compensation + real risk-free interest rate + spread between government bonds in the euro area and the risk-free interest rate.

(2) Inflation compensation derived from inflation swap rates.

(3) OIS interest rate adjusted for inflation compensation for the corresponding time horizon.

(4) Spread between the yield on euro area government bonds and the risk-free interest rate (OIS) for the corresponding term.

Before Jackson Hole: average in the week from 18-22 August 2014.

Before EAPP: average in the week from 12-16 January 2015.

Before sell-off: average in the week from 13-17 April 2015.

Latest: average in the week from 11-15 May 2015.

As already stated, expectations of further accommodative monetary policy measures on the part of the Eurosystem (as hinted by ECB President Mario Draghi in his speech at Jackson Hole in August 2014) and the ensuing announcement and launch of the EAPP were reflected in considerably lower nominal yields for both short- and long-term maturities. Since the downward trend in inflation expectations was also reversed following the announcement of the EAPP, that led to a significantly more negative real interest rate, generally favourable to growth prospects. The changes in the other determinants of euro area sovereign yields (namely the spread between the yield and the risk-free interest rate) were smaller and often concerned a rise in the negative differential between the real risk-free interest rate and the German Bund yield as a result of the relatively limited supply of Bunds compared to the amounts that the Eurosystem planned to purchase. Since inflation expectations were virtually static, the recent interest rate peak was due mainly to a rise in the implicit real interest rate, primarily in the longer-term segment.

The steeper increases in the longer-term segment appear to indicate that the nominal interest rate for shorter terms has remained firmly anchored, partly as a result of the ECB's forward guidance. It should also be noted that both the nominal and the real interest rate are still below the level prevailing in the summer of 2014. Moreover, the rise in the long-term yields could be due to less negative term premiums in the context of a market correction following a very sharp rise and/or better long-term growth prospects, which are also likely to be expressed in higher real interest rates in the future. In that sense, these developments should not necessarily be interpreted too negatively.

1. International environment and assumptions

1.1 World economy

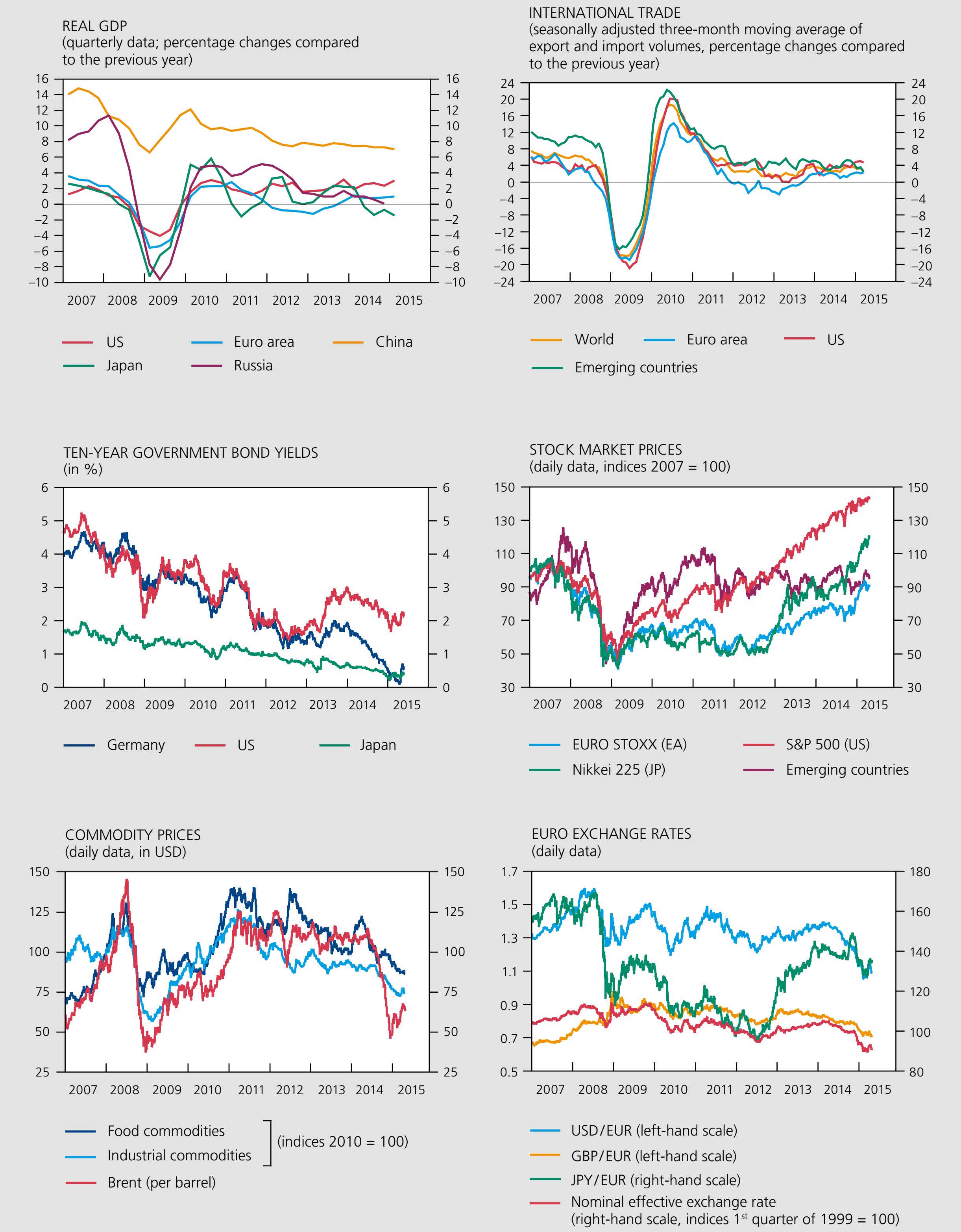
The uneven, steady recovery of the global economy continued in 2014 and in early 2015. Activity expanded further in the advanced economies. Apart from the accommodative monetary policy, the positive impact of the lower oil prices, i.e. on real household incomes and private consumption, was a key supporting factor in most cases. However, world growth was depressed by weaker activity in a number of large emerging countries and in the oil-exporting countries. Within the group of advanced economies, there has been a recent shift in growth dynamics in favour of the euro area.

Following a strong revival in economic activity in the United States during 2014, activity dipped slightly in the first quarter of 2015 owing to a strong dollar and a number of temporary factors such as a fall in investment in the energy sector and adverse weather conditions. Nonetheless, growth in the United States remains robust compared to that in the other advanced countries. The recovery also continues to be reflected in the labour market, with steady growth of employment and a decline in unemployment. However, the moderate wage growth could still indicate some under-utilisation of the labour potential, reflected partly in the persistently large number of people involuntarily working part-time.

In Japan, economic growth remains very modest. After the sharper-than-expected fall in the second and third quarters following the April VAT increase, activity expanded again quarter-on-quarter at the end of last year, albeit to a limited degree. In the first quarter of 2015, consumer confidence and real wage increases bolstered private consumption, and there was a revival of investment expenditure in manufacturing industry, but the significant contribution from stock-building points to a fragile recovery. Against that backdrop, the government announced new stimulus measures which, together with the cheaper yen, are intended to support growth.

In the euro area, while the economic situation had remained intrinsically fragile for much of 2014, activity began to pick up again from the end of last year. The recovery strengthened further in the first quarter of this year, with initial estimates indicating quarterly growth of 0.4 %. The euro area's economy benefited from a favourable environment, such as the extremely low level of interest rates and the euro depreciation, which were both encouraged by the extra policy accommodation offered by the ECB in the form of the said quantitative easing. The initial indications are that the strengthening growth is underpinned mainly by domestic demand and, more particularly, private consumption. Improving consumer confidence is

CHART 1 GLOBAL ECONOMIC ACTIVITY AND DEVELOPMENTS ON FINANCIAL AND COMMODITY MARKETS



Sources: CPB World Trade Monitor, OECD, Thomson Reuters Datastream.

also a factor. However, there has not yet been any strong, widespread revival in investment. In November last year, in order to tackle the persistently weak investment, the European Commission announced an Investment Plan for Europe, aiming to generate new investment totalling € 315 billion over the next three years.

The euro area's recovery is also becoming increasingly broadly based across the various Member States. Thus, growth in the so-called peripheral euro area countries was already picking up in 2014. The first quarter of 2015 brought a further considerable strengthening of economic activity in Spain, and the recovery also continued in Portugal. In addition, in the first quarter of 2015, activity in France, which had only risen very slightly in 2014, recorded a strong expansion. In Italy, too, where the economy had run out of steam in 2014, real GDP increased again in the first quarter. In contrast, in both Germany and the Netherlands, growth was somewhat slower in the first quarter, following vigorous expansion in the final quarter of 2014. However, in Greece, the economic recovery seen in the first three quarters of 2014 ground to a halt again. Activity in some Baltic countries was hit by the negative repercussions of the strained relations with Russia.

Inflation in the euro area, which had begun falling at the end of 2011, continued to decline in 2014. It eventually became negative in December as a result of the steep fall in oil prices, and in January it bottomed out when the HICP index was down by 0.6 % year-on-year. After that it began rising slowly again. It is expected to remain low in the months ahead, and to gather pace from the end of the year. That increase is likely to be supported by the impact of the ECB's recent policy measures on demand, the influence of the euro's depreciation, and the expected gradual revival in oil prices in the coming years.

Although the situation on the labour market remains very weak in a number of countries, it has improved slightly in the euro area. In addition, the disparities between Member States are gradually diminishing since the recent expansion in employment is largely based on improvements in the countries with the highest unemployment rates, such as Spain, Portugal and Greece. Despite rising employment and falling unemployment rates, however, wage growth in the euro area is still limited except in Germany.

Economic activity in the emerging countries has continued to moderate although the situation varied greatly between countries and regions. While growth declined slightly in China last year, it gathered pace in India – although the favourable figures for India are due partly to methodological revisions in the underlying data. If that trend continues this year, India will overtake China as the focal point of growth in the group of large emerging countries. In the context of declining growth figures and a persistent housing market correction, the Chinese authorities took measures to stimulate expansion. However, as the economy moves towards more sustainable development, that is very likely to be accompanied by a gradual growth deceleration. In some Latin American countries, the fall in commodity prices since the middle of last year has had an adverse impact on activity. While growth in Russia was likewise depressed by the steep fall in oil prices, the geopolitical tensions, international sanctions and financial market turmoil at the end of last year were also significant factors there.

By the beginning of 2015, the world trade revival from the middle of last year had already begun to lose momentum as a result of lower import volumes in the emerging countries, including China, Russia and the oil-exporting countries. Although world trade is expected to pick up as the economy recovers, it will probably do so more slowly than before the crisis.

On the financial markets, stocks have maintained their upward trend while exchange rates and interest rates have diverged more widely between the various countries and regions. In the advanced countries, equity prices surged again to reach record levels. Since the beginning of the year, European stocks have risen particularly strongly, boosted by positive news about the economic situation in Europe and the substantial liquidity creation. The yield on long-term government bonds in the advanced countries recorded a further sharp fall, notably on account of the highly accommodative monetary policy. Shorter-term yields actually became negative for a time in various European countries. Risk premiums on high-yield government bonds in the peripheral euro area countries also dropped to their lowest levels since the crisis, except in Greece where uncertainty over the political and financial situation resulted in a further tightening of financing conditions. However, May brought a period of greater volatility on the financial markets, with interest rates rising sharply and stock markets undergoing a modest correction.

Divergences in monetary policy also had a significant influence on the foreign exchange markets. Thus, particularly from the beginning of 2015, the euro depreciated further against the backdrop of the continued easing of monetary policy in the euro area, which contrasted with the expectation that monetary policy would shortly begin normalising, especially in the United States. Here, too, there was a correction in May with the euro rising against the US dollar, notably because the growth expectations

TABLE 1 PROJECTIONS FOR THE MAIN ECONOMIC REGIONS

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

	2013	2014	2015 e	2016 e
	Actual figures		Projections	
Real GDP				
World	3.3	3.4	3.5	3.9
of which:				
Advanced countries	1.3	1.8	2.3	2.5
United States	2.2	2.4	3.1	3.0
Japan	1.6	0.0	1.1	1.4
European Union	0.0	1.4	1.8	2.1
Emerging countries	4.9	4.6	4.4	5.0
China	7.6	7.4	7.0	6.8
India	6.9	7.2	7.6	7.9
Russia	1.3	0.6	–3.5	0.2
Brazil	2.5	0.2	–0.9	1.3
p.m. World imports	*3.1*	*2.6*	*3.8*	*5.1*
Inflation (1)				
United States	1.5	1.6	0.4	2.2
Japan	0.4	2.7	0.5	0.9
European Union	1.5	0.6	0.1	1.5
China	2.6	2.0	2.5	3.0
Unemployment (2)				
United States	7.4	6.2	5.4	5.0
Japan	4.0	3.6	3.6	3.5
European Union	10.9	10.2	9.6	9.2

Source: EC.
(1) Consumer price index.
(2) In % of the labour force.

for the American economy were adjusted downwards after the weak first quarter, and the expected normalisation of monetary policy was postponed somewhat.

Since the middle of last year, commodity prices have fallen steeply, with oil prices recording a particularly dramatic decline. Despite a slight rise in oil prices at the beginning of this year, and more recently a rise in the price of industrial commodities, prices remain at a low level. Although the more general fall in commodity prices implies that demand factors have also played a role, the slump in oil prices was due mainly to supply factors, and particularly the expanding supply of unconventional oil and the OPEC decision not to cut the production quota. In general, it is therefore assumed that lower oil prices will have a positive impact on world growth via the effect on real household incomes and corporate cost structures, which should offset the real loss of income for oil producers.

1.2 Estimates for the euro area

The Eurosystem's spring forecasts for the euro area are considerably more favourable than the latest autumn forecasts and are very similar to the March 2015 estimates by the ECB. This year, growth is expected to strengthen substantially to 1.5 %, rising to around 2 % in 2016-2017. The recovery will be supported by favourable external conditions, such as the cheaper euro and low interest rates, which are partly encouraged by monetary policy, including the said quantitative easing approved by the ECB Governing Council in January 2015. Economic growth

Box 2 – Assumptions adopted for the projections

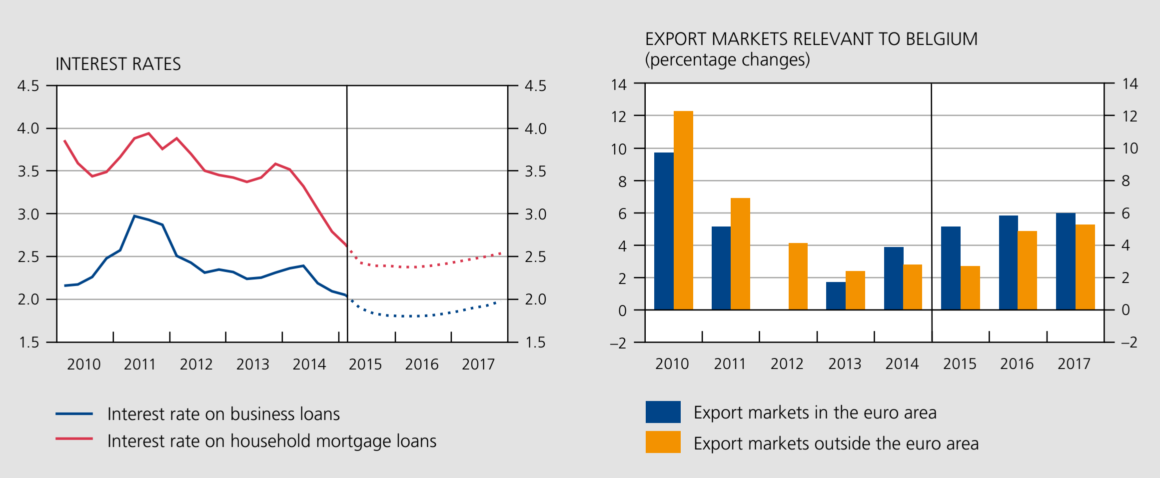
The macroeconomic projections for Belgium described in this article are the result of a joint Eurosystem projection exercise for the euro area. This projection exercise is based on a set of technical assumptions and forecasts for the international environment drawn up jointly by the participating institutions, namely the ECB and the national central banks of the euro area.

The projections assume that future exchange rates will remain constant throughout the projection period at the average levels recorded in the last ten working days before the cut-off date of the assumptions, i.e. 13 May 2015. In the case of the US dollar, the exchange rate then stood at $ 1.12 to the euro. Although the euro has appreciated again since mid-April, it remains well below its 2014 average of $ 1.33.

The assumptions concerning oil prices, which as usual take account of market expectations as reflected in forward contracts on the international markets, underwent a marked downward adjustment following the unexpectedly steep decline in prices that began in the autumn of 2014. However, according to the data from mid-May 2015, the price per barrel of Brent could gradually rise again over the projection period, from an average of $ 63.9 in the second quarter of 2014 to over $ 73 in the last quarter of 2017. Nevertheless, that is still well below the level reached in the first half of 2014.

The interest rate assumptions are also based on market expectations in mid-May 2015. The three-month interbank deposit rate remained at an exceptionally low level of roughly zero in the second quarter of 2015. The short-term interest rate is expected to stay at that low level for some time, and will only start to edge upwards at the end of the projection period to reach around 30 basis points by the end of 2017. The level of Belgian long-term interest rates, which rose strongly at the beginning of May, is likewise projected to increase gradually from 0.8 % in the second quarter of this year to over 1.5 % at the end of 2017. Despite the recent rise, the outlook for long-term interest rates was adjusted downwards quite sharply, compared to the assumptions for the latest autumn estimates.

INTEREST RATES AND VOLUME GROWTH OF EXPORT MARKETS
(in %)



Source: Eurosystem.

The predicted bank interest rates on business investment loans and household mortgage loans take account of the transmission generally apparent in relation to market rates. However, since the second half of 2014, that transmission appears to have improved somewhat, possibly on account of expectations concerning further injections of liquidity by the ECB and, in particular, the quantitative easing announced in January 2015. In comparison with the autumn forecasts, mortgage interest rates therefore also underwent a substantial downward adjustment for 2015, and particularly for 2016. The average mortgage interest rate is expected to remain around 2.4 % in the second quarter of 2015, and would only rise very slightly towards the end of 2017. The average interest rate on business loans, which is closer to the short-term segment, is also relatively flat : it is expected to decline by a further 10 basis points this year, before rising slowly at the end of the projection period.

Global economic growth excluding the euro area has been downgraded very slightly for 2015 and 2016 since the December 2014 autumn projections. The trade intensity of that growth was again somewhat less than expected. However, that was more than offset by the fact that the stronger European economic revival is driving up demand for imports from the euro area, which accounts for more than half of Belgian exports. In all, the foreign markets relevant to Belgium look set to expand by well over 5 % next year – which means an upward adjustment compared to the autumn forecasts – and should continue to grow in 2017.

The trend in Belgian exports is determined not only by the growth of those markets but also by the movement in market shares, and consequently by Belgium's competitiveness. The cost aspects of that competitiveness are affected by variations in the prices that competitors charge on the export markets. In 2015, competitors' prices on the export markets are set to rise by 3.5 %, after having fallen in both 2013 and 2014. A more modest increase of around 2.0 % is assumed for both 2016 and 2017. For 2015 and 2016, this means an upward adjustment compared to the autumn forecasts, which is of course largely due to the euro's depreciation in terms of the real effective exchange rate.

Overall, the adjustment of the assumptions compared to the latest autumn forecasts has a positive impact on Belgium's growth prospects.

EUROSYSTEM PROJECTION ASSUMPTIONS
(in %, unless otherwise stated)

	2015	2016	2017
		(annual averages)	
EUR/USD exchange rate	1.12	1.12	1.12
Oil price (US dollars per barrel)	63.8	71.0	73.1
Three-month interbank rate in euro	0.0	0.0	0.2
Yield on ten-year Belgian government bonds	0.9	1.2	1.5
Business loan interest rate	1.9	1.8	1.9
Household mortgage interest rate	2.5	2.4	2.5
		(percentage changes)	
Export markets relevant to Belgium (in volume)	4.2	5.5	5.7
Export competitors' prices	3.5	2.0	1.9

Source : Eurosystem.

will not only be stimulated by expanding exports but will also be reflected in a strong rise in domestic demand, and more particularly in private consumption and investment.

Inflation in the euro area reached a low point in January 2015, but has since climbed back, mainly as a result of rising oil prices. The forecasts point to a further rise in inflation to an average of 1.8 % in 2017. That is only partly due to the assumed reversal of the price pressure from volatile components such as the oil price, since underlying inflation – i.e. inflation excluding the volatile components – is also expected to rise during the projection period. That increase is attributable to strengthening demand and wage growth, but also to the delayed impact of the weaker euro, which makes imports more expensive.

The recent labour market recovery was stronger than might be expected on the basis of historical links between employment and economic growth. Wage moderation and the labour market reforms seem to be supporting that recovery and may have boosted the labour intensity of growth. In the coming years, employment should expand further, although that growth will be hampered towards the end of the projection period by supply shortages in certain countries where the unemployment rate has already dropped to a low level. For the euro area as a whole, the unemployment rate should continue to decline to reach 10 % in 2017, which is 2 percentage points below the 2013 figure.

The average budget deficit in the euro area is projected to fall to 1.5 % of GDP in 2017. However, that improvement is due largely to the strengthening economic activity and the further decline in interest charges as a result of the exceptionally low level of interest rates. Fiscal policy is expected to be virtually neutral over the period considered.

TABLE 2 EUROSYSTEM PROJECTIONS FOR THE EURO AREA

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

	2015 e	2016 e	2017 e
Real GDP	1.5	1.9	2.0
Household and NPI final consumption expenditure	1.9	1.6	1.6
General government final consumption expenditure	0.7	0.7	0.8
Gross fixed capital formation	1.9	3.5	3.9
Exports of goods and services	4.2	5.4	5.6
Imports of goods and services	4.8	5.8	5.9
Inflation (HICP)	0.3	1.5	1.8
Underlying inflation (1)	0.8	1.4	1.7
Domestic employment	0.9	0.9	1.0
Unemployment rate (2)	11.1	10.6	10.0
General government financing requirement (–) or capacity (3)	–2.1	–1.8	–1.5

Source: ECB.
(1) Measured by the HICP excluding food and energy.
(2) In % of the labour force.
(3) In % of GDP.

2. Activity and demand

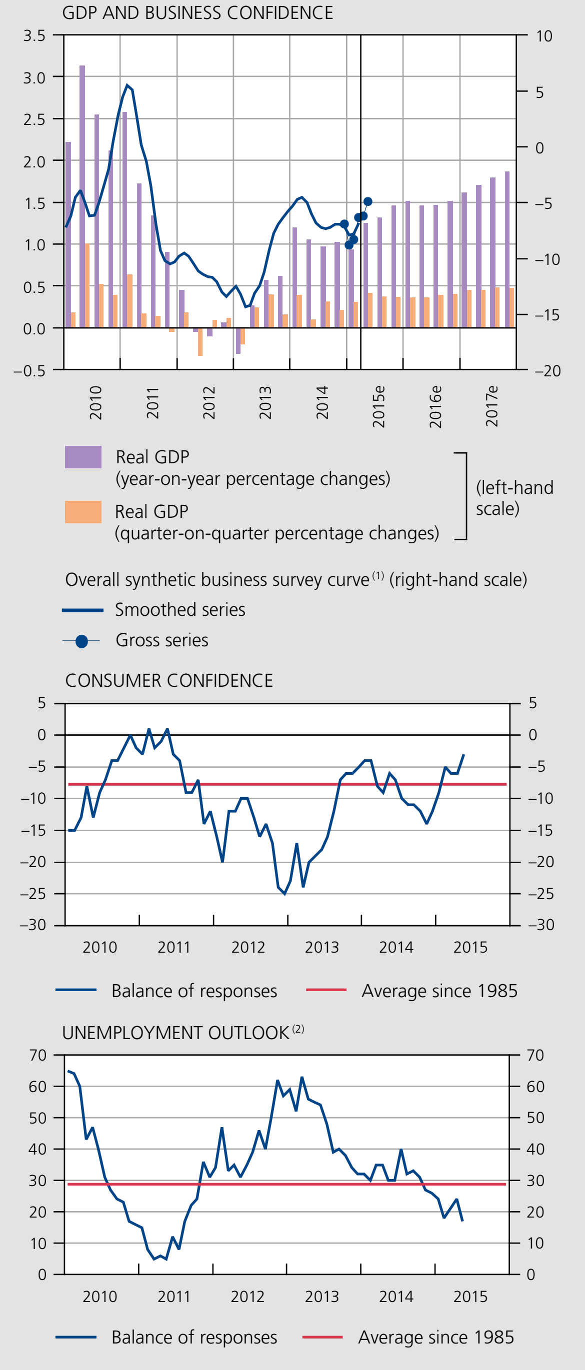
Since the second half of 2014, the Belgian economy has grown at a relatively constant, moderate pace corresponding to an annual growth rate of just over 1 %. The NAI's flash estimate, taken into account in the Bank's autumn forecasts for growth in the third quarter of 2014, has since been revised upwards very slightly to 0.3 %. According to the current quarterly statistics, quarterly growth was roughly the same for the final quarter of last year (0.2 %) and for the first quarter of 2015 (0.3 %), which is almost exactly in line with the autumn forecasts. The main factor supporting growth is the continuing expansion of activity in market services, while manufacturing activity declined slightly in the final quarter of last year. As regards the expenditure components, the strong growth of private consumption in the second half of the year was partly offset by a negative contribution from net exports, even after the adjustment for certain specific purchases of investment goods from other countries, which inflated both the import figures and business investment.

However, the Belgian economic recovery is more modest than that in the euro area, where growth was somewhat higher in the last two quarters. The Belgian recovery is also lagging behind the growth in the three main neighbouring countries. Although the first quarterly statistics always need to be interpreted with some caution, that seems to suggest that other countries are benefiting more from the improving situation in the euro area.

The still moderate pace of growth should also be seen in the context of the slow recovery of producer confidence. That confidence has gradually dwindled since the spring of last year, and – despite the limited improvement in the past few months – is still barely above its long-term average. The synthetic indicator of consumer confidence also weakened last year and did not show any marked improvement until the end of 2014. However, the element of the consumer confidence indicator that is significant for economic activity, and particularly for private consumption, namely the question about respondents' expectations regarding unemployment, has displayed a strong and almost constant tendency to improve since the beginning of 2013.

CHART 2 GDP AND CONFIDENCE INDICATORS

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



Sources: NAI, NBB.

(1) Non calendar adjusted data.

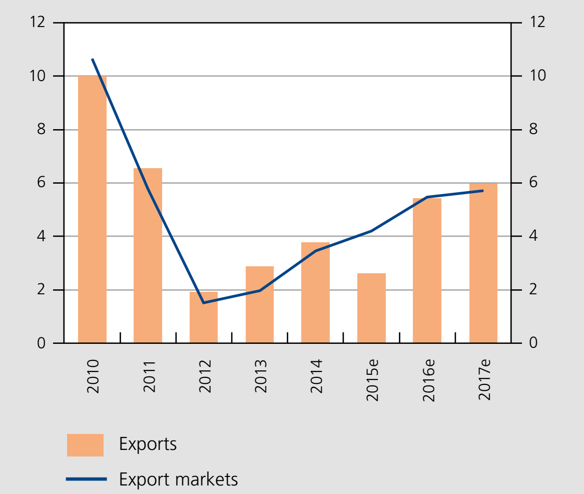
(2) In regard to the outlook for unemployment, a rise in the chart indicates a deterioration and a fall indicates an improvement.

The "nowcasting" models used at the Bank, such as the BREL model described in the June 2014 Economic Review, use confidence indicators of this type, but they also use other data which are available more frequently and sooner than the quarterly statistics for the purpose of short-term predictions. On the basis of those predictions, a slightly higher growth figure of 0.4 % can now be expected for the second quarter of 2015 as well. According to the current forecasts, that rate of expansion should be maintained in the second half of the year, bringing annual growth to around 1.2 % for 2015. In the following two years, activity is expected to accelerate gradually to reach 1.7 % in 2017.

As regards the annual figures, the increased growth during the projection period is due largely to the rising contribution from net exports, since the favourable effects of labour cost moderation on competitiveness ultimately lead to stronger export growth. The contribution from domestic demand excluding changes in inventories is expected to be smaller this year, though this is largely related to the disappearance of specific transactions that boosted both imports and business investment in 2014. In 2016, that contribution is likely to remain unchanged at 1.3 percentage points, and should only go up slightly in 2017. Finally, changes in inventories have seriously curbed GDP growth in the three preceding years, with an average negative contribution of 0.8 percentage point. Although we cannot rule out the possibility that firms may reduce their stocks more slowly or build them up

CHART 3 EXPORTS AND EXPORT MARKETS

(data adjusted for seasonal and calendar effects, percentage changes compared to the previous year)



Sources: NAI, NBB.

faster in the near future, the technical assumption made for all quarters in the projection period is that changes in inventories would be neutral for growth, partly on account of the great statistical uncertainty surrounding this concept.

In 2015, the growth contribution of net exports is still around zero, which is slightly lower than in 2014. Nonetheless, Belgian exports will clearly gain from the improvement in cost competitiveness. In that connection, the impact of the very modest recent rise in labour costs will be further enhanced by the cost advantage of the cheaper euro, which supports direct or indirect exports to markets outside the euro area. The quarterly growth of Belgian exports is therefore accelerating in comparison with 2014, and is clearly outpacing the expansion of the export markets. On an annual basis, the strong growth of exports is far less obvious and actually falls short of last year's figure, owing to spillover effects resulting partly from the sharp decline in exports in the final quarter of 2014 according to the current statistical data. That spillover effect also explains why, on an annual basis, a loss of market share is still recorded in 2015. Moreover, imports will again be driven higher by additional major purchases of specific investment goods from other countries.

According to the forecasts, however, export growth will gain momentum in the ensuing two years and generate a positive and increasing growth contribution from net exports. Although it is assumed that the euro exchange rate remains unchanged from May 2015, and therefore has no further impact on the relative costs of firms within and outside the euro area, Belgian exports are further supported by gains in cost competiveness attributable to the policy measures restricting labour costs. That also ensures that Belgian exporters will continue to expand their market share throughout the projection period, as they have done over the past four years. Since imports will rise somewhat more slowly, partly as a result of improved competitiveness, the growth contribution of net exports is positive in all quarters from the second half of 2015 onwards. However, according to the forecasts, the growth contribution will diminish slightly towards the end of the projection period since labour costs will begin to rise a little faster, particularly in 2017.

The fact that the growth of domestic expenditure, excluding changes in inventories, increases only slightly over the whole projection period masks divergent trends in the sub-components of domestic demand. The contribution of private consumption gradually declines and public consumption is also expected to record limited growth in the final two years, while the increase in investment accelerates.

In the second half of 2014, private consumption expanded relatively strongly, with quarterly growth averaging 0.6 %. The said improvement in the outlook for unemployment, which boosted confidence, is part of the reason. Another decisive factor is the favourable impact of the sharp fall in oil prices on real household incomes. However, according to the current forecasts, that high growth rate for private consumption will gradually subside to a much lower pace of around 0.2 % per quarter, and will only edge upwards again during 2017.

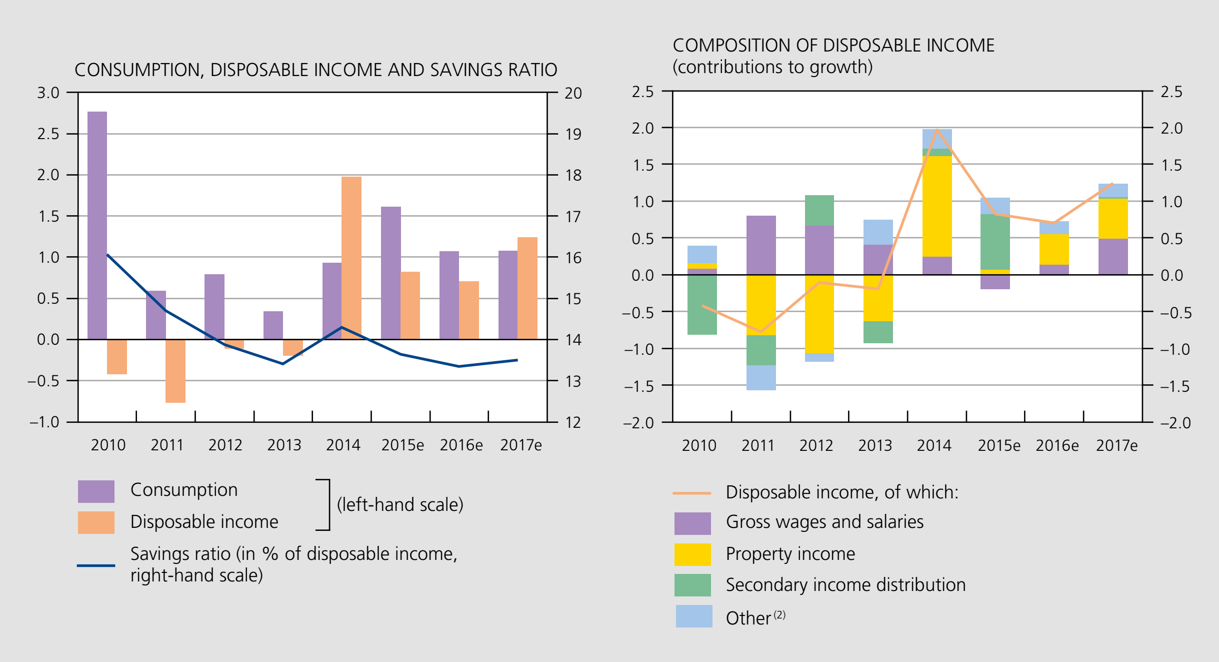
This deceleration in household consumption is due mainly to the movement in household incomes, and more specifically the income from labour and replacement benefits which are less likely to be allocated to savings than property incomes. Despite rising employment and the (small) increase in contractual pay in 2016, the real growth of labour incomes is negative in 2015 and extremely modest in 2016 owing to the temporary suspension of the indexation mechanisms. It is not until 2017, when the indexation mechanisms gradually start operating again, that labour incomes are expected to rise faster than in 2013 and 2014. Taking account of the usual inertia in consumption patterns, however, households will only gradually adapt their consumption in line with that income growth, so that the savings ratio falls further to a historical low. Consequently, the downward trend that was interrupted last year by the very sharp rise in property incomes that are typically saved to a relatively greater extent, will continue until 2016. In the final year of the projection period, the household savings ratio then rises slightly, primarily on account of the growing importance of property incomes in a context of rising interest rates.

The forecasts also point to a slow real rise in investment in housing. In 2014, that investment recorded modest positive year-on-year growth for the first time after two successive years of contraction. According to the forecasts, it will continue rising slowly over the projection period, with growth being further underpinned by the very low nominal mortgage interest rate. The reform of the housing bonus that – certainly in the Flemish Region – will ultimately have a significant financial impact on households, should have only a relatively limited influence on the trend growth of investment. At the end of the projection period, despite the gradual recovery, the volume of investment in housing will still be around 8 % below the level prevailing before the great recession.

The main reason for the small decline in the volume of business investment in 2015 is that the previously mentioned specific factors which boosted investment (and imports) last year have largely disappeared. Without those specific factors, the volume of business investment

CHART 4 HOUSEHOLD CONSUMPTION AND DISPOSABLE INCOME [1]

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

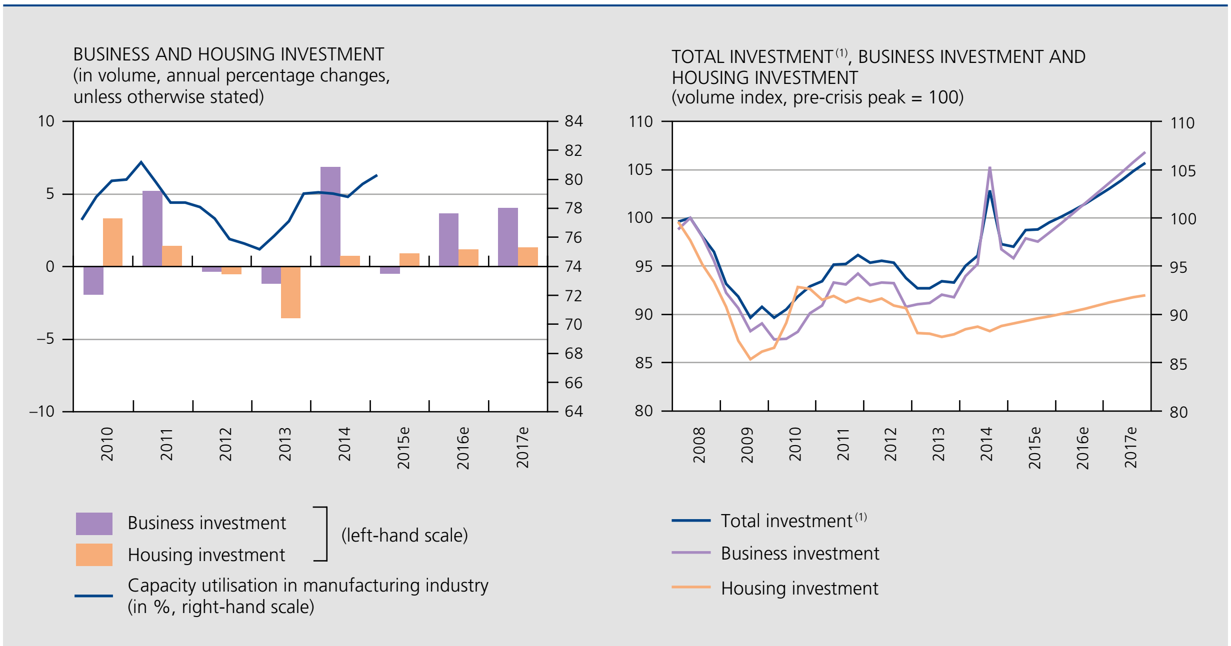


Source: NBB.

(1) Data deflated by the household consumption expenditure deflator.

(2) 'Other' comprises the gross operating surplus and gross mixed income (of self-employed persons).

CHART 5 PRIVATE INVESTMENT



Sources: NAI, NBB.

(1) Also includes public investment.

TABLE 3 GDP AND MAIN EXPENDITURE CATEGORIES

(calendar adjusted volume data; percentage changes compared to the previous year, unless otherwise stated)

	2013	2014	2015 e	2016 e	2017 e
Household and NPI final consumption expenditure	0.3	0.9	1.6	1.1	1.1
General government final consumption expenditure	1.1	1.0	1.2	0.6	0.8
Gross fixed capital formation	–2.1	5.1	0.7	2.7	3.2
general government	–4.3	4.2	8.1	–0.4	1.2
housing	–3.5	0.8	1.0	1.2	1.3
businesses	–1.2	6.9	–0.4	3.7	4.1
p.m. Domestic expenditure excluding change in inventories	*0.0*	*1.9*	*1.3*	*1.3*	*1.5*
Change in inventories (1)	–0.7	–1.0	–0.1	0.0	0.0
Net exports of goods and services (1)	1.0	0.2	0.0	0.2	0.3
Exports of goods and services	2.9	3.8	2.6	5.4	6.0
Imports of goods and services	1.7	3.6	2.6	5.3	5.8
Gross domestic product	0.3	1.1	1.2	1.5	1.7

Sources: NAI, NBB.
(1) Contribution to the change in GDP compared to the previous year, percentage points.

would rise at a relatively constant pace corresponding to annual growth of around 4%. The substantial cash reserves, expanding operating surplus and low interest rates in combination with easier financing conditions promote the investment revival. Moreover, the capacity utilisation rate in manufacturing industry has exceeded the long-term average for some time now. Rising demand will therefore increasingly trigger investment in expansion. The escalating impact of that on investment growth will only be offset to a very limited degree by the assumed rise in interest rates from the beginning of 2016.

In regard to public expenditure, the public consumption growth rate is expected to slow down from next year as a result of the consolidation measures, notably staff cuts, and will fall to an unusually low level, clearly below the growth rate of private consumption. This year, public investment is set to record a large volume increase, partly because of the accelerated construction of schools in the Flemish Region; that will be followed by a modest decline in 2016 and moderate growth in 2017.

3. Labour market

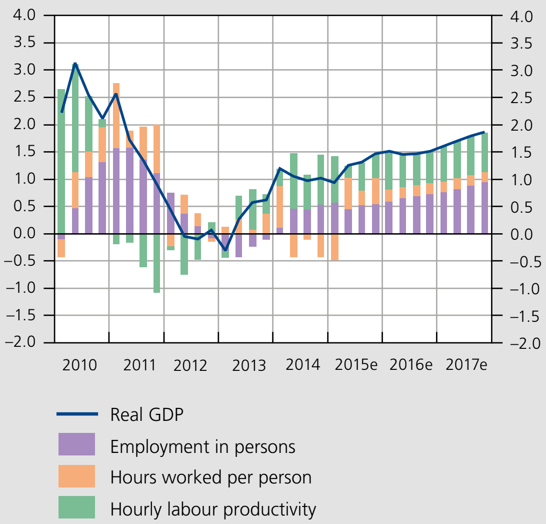
In 2014, labour productivity increased quite sharply, which is not unusual in the first phase of an economic recovery. The volume of labour therefore expanded only slightly: the rise in employment was largely offset by a marked fall in the average number of hours worked. Although the forecasts indicate that productivity will rise further, albeit at a very modest pace, economic growth is likely to receive more support from the use of labour over the projection period.

The growth of the volume of labour is therefore expected to strengthen in 2015 and to be maintained in the subsequent two years. The average number of hours worked per person is forecast to increase at a relatively constant pace, although the wide fluctuations in 2014 will continue to have a significant impact on annual growth in 2015. As a result of the very mild winter, the average working time in the first quarter was much higher than normal, particularly in construction. In the second quarter, adverse weather conditions produced the opposite effect. Finally, in the fourth quarter, strikes significantly reduced the hours worked per person. Overall, employment during the period 2015-2017 is set to increase by 94 000 units. Demand for labour is not only influenced by the accelerating expansion of activity but also by the fact that the wage cost moderation policy makes this production factor relatively cheaper.

In that context, and in contrast to previous years, the biggest contribution to this increase is expected to come from paid employment in the sectors sensitive to the business cycle. The heavily subsidised "other services" sector (primarily health care and social services) is also likely to make a considerable contribution. It should be noted that the rate of employment expansion under the service voucher

CHART 6 DOMESTIC EMPLOYMENT, WORKING TIME AND PRODUCTIVITY

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



Sources: NAI, NBB.

scheme, concentrated mainly in the private market sector, will slow down, as the number of vouchers redeemed – after eleven years of strong growth – has no longer risen since 2013. That is due partly to the gradual saturation of demand (service vouchers are used by almost one in five households), an effect that is augmented by the increase in the cost to users, and partly to recruitment difficulties as the staff turnover rate is high. In the civil service and education sector, staffing levels will decline throughout the projection period as a result of non-replacement of some staff lost through natural wastage; that should reduce staff costs in the various echelons of government. In contrast, self-employed activity is likely to make a positive contribution to employment growth as it has done in the past. One noteworthy point is the rise in the number of pensioners who have used the additional scope for combining a pension with earned income, and have embarked on a self-employed activity in recent years.

Although the population of working age has stopped growing, the rising participation rate continues to expand the labour force. However, that growth will not keep pace with employment, so that unemployment will decline, and the fall will accelerate over the reporting period. On an annual basis, the number of unemployed job-seekers is forecast to average 562 000 in 2017, which is 35 000 fewer than in 2014. That should be reflected in the harmonised unemployment rate which is set to fall from 8.5 % of the labour force in 2014 to 7.9 % in 2017.

The rise in the participation rate over the projection period is due partly to the end-of-career measures introduced by the present government and its predecessor: raising the minimum age for early retirement, imposing stricter age

TABLE 4 LABOUR SUPPLY AND DEMAND

(calendar adjusted data; change in thousands of persons compared to the previous year, unless otherwise stated)

	2013	2014	2015 e	2016 e	2017 e
Population of working age	12.0	7.5	8.4	7.4	1.7
Labour force	11.5	31.6	17.2	21.4	20.1
National employment	–13.0	17.6	23.9	30.6	39.5
Frontier workers	–0.7	–0.1	0.0	0.0	0.0
Domestic employment	–12.4	17.7	23.9	30.6	39.5
Self-employed persons	6.7	7.2	7.9	8.9	9.4
Employees	–19.1	10.6	16.0	21.8	30.1
Branches sensitive to the business cycle	–23.4	0.0	9.2	15.2	23.7
Public administration and education	2.2	0.6	–3.9	–3.2	–3.4
Other services	2.1	10.0	10.7	9.7	9.8
Unemployed	24.5	14.0	–6.7	–9.2	–19.4
p.m. Harmonised unemployment rate (1)	8.4	8.5	8.5	8.3	7.9

Sources: EC, NAI, NBB.
(1) In % of the labour force (aged 15 years and over).

conditions for the scheme concerning unemployment with employer top-up (formerly the pre-pension scheme), abolishing the status of older unemployed persons, raising the age limits in regard to availability for the labour market for new unemployed persons with employer top-up, etc.

4. Prices and costs

These spring forecasts allow for very modest labour cost growth. In both 2015 and 2016, hourly labour costs are predicted to rise more slowly than last year, when their growth had already decelerated sharply. Labour costs are not expected to gather momentum until 2017. In view of the estimated labour productivity, this means that labour costs will remain virtually unchanged in 2015-2016, as they did last year, and increase by almost 1 % in the final year of the projection period.

The labour cost projections for the period 2015-2016 are greatly influenced by the federal government's measures to improve the competitiveness of the Belgian economy, e.g. by reducing labour costs. One of the main factors behind wage moderation is the temporary suspension of the indexation mechanisms and its indirect impact on inflation.

The introduction of a 2 % indexation suspension from May 2015 – by freezing the smoothed health index, calculated as the average of the health index over the past four months – has a direct effect on labour costs. Although there is still some indexation as a result of the specific characteristics of the mechanisms used, the effect on wage growth will be very small. In view of the expected movement in the health index, the suspension will continue until the first quarter of 2017. After that, indexation will be resumed in the same way as before. Wages are unlikely to rise immediately; the effect of the indexation will be gradual, varying according to the numerous systems laid down by the joint committees.

Real collectively agreed wages are likely to remain frozen in 2015, in line with the provisions of the central agreement for 2015-2016 adopted by the government. In contrast, gross wages can increase by a maximum of 0.67 % in 2016. These pay increases comprise an initial instalment of 0.37 %, subject to employers' social security contributions, and a second instalment of no more than 0.3 %, which is exempt from additional levies. After three years with no real increase in the pay scales, it can be assumed that this scope will be fully utilised, especially as there are likely to be tensions in various labour market segments as the economy picks up. That factor could also lead to direct pay increases at company level, recorded in the wage drift.

In 2016, a new cut in employers' social security contributions should reduce labour costs by 0.4 percentage point. That measure forms part of a package of reductions in charges amounting to some € 960 million, which also includes payroll tax reductions. Since the latter are

TABLE 5 PRICE AND COST INDICATORS

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

	2013	2014	2015 e	2016 e	2017 e
Labour costs in the private sector					
Labour costs per hour worked	2.4	0.8	0.3	0.6	1.6
of which indexation	1.9	0.8	0.2	0.2	0.5
Labour productivity (1)	0.2	0.9	0.3	0.6	0.7
Unit labour costs	2.2	–0.1	0.0	0.1	0.9
Underlying inflation (2)	1.4	1.5	1.5	1.3	1.4
Energy prices	–4.6	–6.0	–7.2	2.5	1.0
Food prices	3.6	0.8	1.5	1.9	1.9
HICP	1.2	0.5	0.6	1.5	1.5
Health index	1.2	0.4	0.8	1.2	1.4

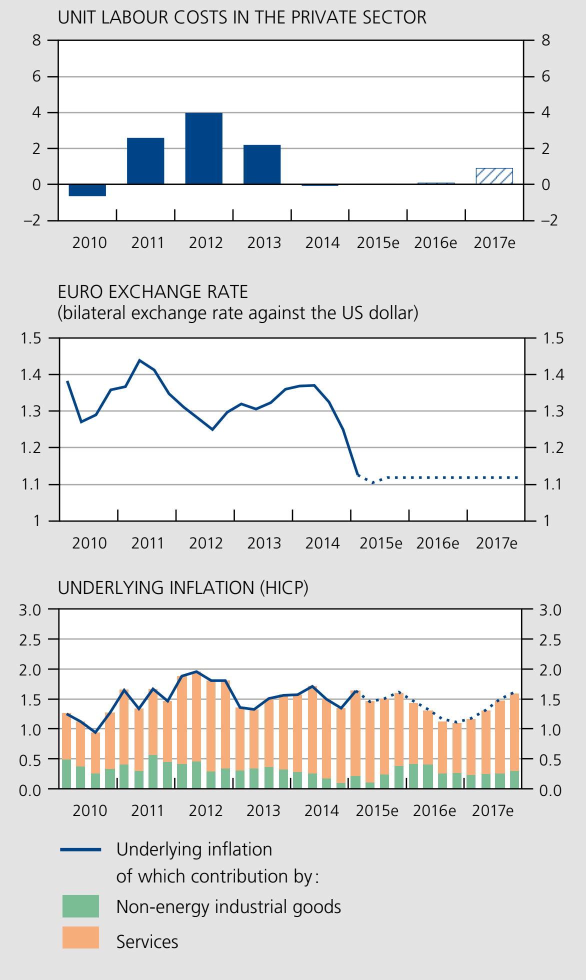
Sources: EC; FPS Employment, Labour and Social Dialogue; NAI; NBB.
(1) Value added in volume per hour worked by employees and self-employed persons.
(2) Measured by the HICP excluding food and energy.

considered as "wage subsidies", that part of the package is not taken into account in calculating labour costs according to the national accounts definition, and is therefore also excluded from the assessment of the trend in the wage gap. Employers' contributions should have a slightly negative impact on labour costs in 2015, mainly as a result of the fall in the contribution to the Business Closure Fund and the normalisation of the number of redundancy payments following the effect of the substantial corporate restructurings in 2014.

The collectively agreed wage increases for 2017 are as yet unknown since the negotiations on the future interprofessional agreement will not start until the end of 2016, on the basis of the wage gap in relation to neighbouring countries reported at that time by the Central Economic Council (CEC). At the end of 2014, the CEC had estimated the labour cost handicap at 2.9 %. The acceleration in labour costs predicted in the current projections does not anticipate the outcome of the next interprofessional agreement. Apart from assuming that the indexation freeze will end, this prediction allows for negotiated increases amounting to roughly 1 %, in view of the scope for growth which will presumably result from the gradual reduction in the cumulative wage gap since 1996 (expressed as hourly labour costs in the 1996 law). In all, the rise in nominal hourly labour costs should ease considerably, dropping from 2.4 % in 2013 to 0.8 % in 2014, and then amounting to 0.5 % in 2015 and 0.6 % in 2016, after which the growth rate will accelerate somewhat to 1.6 % in 2017.

CHART 7 LABOUR COSTS AND UNDERLYING INFLATION

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



Source: NBB.

In principle, the very modest rise in labour costs should gradually be reflected – after some time – in prices, and more specifically in underlying inflation which excludes the prices of the volatile components, namely food and energy. In the shorter term, however, the recent sharp depreciation of the euro will drive up underlying inflation, because the cheaper euro means higher import prices, pushing up inflation in the case of imports or goods comprising imported intermediate inputs. Since that is less applicable to the services sector, the main upward pressure on prices is seen in non-energy industrial goods. For that reason, underlying inflation – which has already risen sharply to an average of more than 1.6 % in the first four months of 2015 – will continue to hover around that level for the rest of the year. Then, once the exchange rate effect has faded away, the impact of the virtually flat labour costs would become more apparent, according to the projections, causing underlying inflation to decline to just over 1 % by the end of 2016. In 2017, domestic cost pressure then increases again as a result of stronger wage growth, and that is gradually reflected in rising underlying inflation.

It should nevertheless be added that, in Belgium, underlying inflation has so far remained relatively high compared to that in the euro area and in the main neighbouring countries, primarily because of the more persistent price rises in the service sector. Furthermore, the transmission of (labour) costs into prices depends on the degree of competition on the markets, and is not necessarily symmetrical, certainly in view of downward price rigidities. This asymmetry, combined with the existence of various indexation mechanisms in pricing that cause some prices to adapt only slowly to declining inflation, could potentially explain the relatively persistent underlying inflation. According to the current inflation forecasts, the factors which have recently maintained underlying inflation at a high level will therefore gradually give way to the downward influence of the very modest domestic cost pressure.

Headline inflation is determined not only by underlying inflation but also by the movement in the prices of the volatile components, namely energy and food. Primarily as a result of the slump in energy prices, inflation has remained clearly below the underlying inflation trend in the recent period, and was actually negative from December 2014 to March 2015. The impact of the lower price of Brent crude oil was further reinforced by the cut in the VAT rate on electricity, from 21 % to 6 %. That measure was implemented in April 2014 under the Pact for Competitiveness and Employment, and had a negative effect on electricity prices up to April 2015.

Taking account of the rising oil price according to the assumptions presented in Box 2, the negative impact of energy prices on headline inflation should gradually diminish and turn into a positive contribution from 2016. Together with the expected steeper rise in food prices, that will lead to a marked increase in inflation despite the initially flat and then declining underlying inflation trend: this year, inflation will be barely any higher, on average, than last year, but from 2016, the annual average will rise to 1.5 %. The health index, which is calculated as the national consumer price index excluding alcohol, tobacco and motor fuel, will also increase from 0.8 % in 2015 to 1.4 % in 2017.

5. Public finances

5.1 General government balance

According to the data published by the NAI in April 2015, the Belgian government recorded a deficit of 3.2 % of GDP in 2014. In the macroeconomic context described above, that deficit is likely to drop to 2.7 % of GDP in 2015, declining further to 2.4 % of GDP in 2016 and 2 % of GDP in 2017.

The improvement in the overall balance is due largely to the decline in interest charges, since it is likely that maturing government loans can be refinanced at interest rates favourable to the government. The consolidation measures introduced by the federal government and the

TABLE 6 GENERAL GOVERNMENT ACCOUNTS (1)
(in % of GDP)

	2014	2015 e	2016 e	2017 e
General government				
Revenue	51.1	50.7	50.4	50.3
Fiscal and parafiscal revenue	44.7	44.6	44.3	44.2
Other	6.4	6.1	6.1	6.1
Primary expenditure	51.3	50.7	50.2	49.9
Primary balance	–0.2	0.1	0.2	0.4
Interest charges	3.1	2.7	2.5	2.3
Net borrowing (–) or net lending	**–3.2**	**–2.7**	**–2.4**	**–2.0**
p.m. Effect of non-recurring factors	*0.4*	*0.2*	*–0.1*	*0.0*
Overall balance per subsector				
Federal government	–2.6	–2.1	–2.0	–1.5
Social security	–0.1	0.0	0.0	0.0
Communities and Regions	–0.3	–0.4	–0.3	–0.2
Local authorities	–0.3	–0.2	–0.1	–0.2
Debt	**106.6**	**107.0**	**107.6**	**106.8**

Sources: NAI, NBB.
(1) These figures include the advances on the regional additional percentages on personal income tax although, according to the methodology of the ESA 2010, those advances are regarded as purely financial transactions and the regional additional percentages are only taken into account at the time of collection.

governments of the Communities and Regions should also help to improve the budget balance. Those measures are designed to cut government spending. As a result, primary expenditure should fall as a percentage of GDP, but government revenue is also likely to decline.

The deficits are concentrated mainly on the federal government. Social security should balance its budget since it receives a grant from the federal government for that purpose. The Regions and Communities and local authorities are projected to record small deficits.

It should be noted that these projections only take account of budget measures which have already been announced and are specified in sufficient detail. They disregard the influence of decisions yet to be taken, e.g. in producing the budgets for 2016 and 2017. The April 2015 stability programme aims at restoring a structural budget balance by 2018. These projections reveal that the attainment of that objective will require additional consolidation measures.

5.2 Revenue

Public revenues expressed as a percentage of GDP are projected to fall by 0.4 percentage point in 2015 and by a further 0.3 and 0.1 percentage point respectively in 2016 and 2017. This means that the decline in revenues that began in 2014 will persist.

The contraction of revenues in 2015 is due mainly to the reduction in the income that the State receives from various financial institutions and a fall in the direct taxation of individuals. The latter revenues are depressed both by the relatively weak rise in the wage bill and by a series of measures. This concerns both structural measures, such as the increase in the fixed business expenses deductible via the payroll tax, and temporary factors such as the end of the anticipation effect relating to the measure concerning liquidation gains or the delayed assessments which had driven up revenues in 2014. The tax regularisation revenues are also expected to decline steeply. Conversely, corporation tax will benefit from the cut in the notional interest deduction for companies, as a result of the reduction in the reference interest rate. In addition, the restriction on the use of the notional interest system by the banks and the tax levied on some intermunicipal structures should contribute to the growth of these revenues. Finally, capital taxes are subject to divergent influences, the downward effect of the gradual ending of the tax regularisation being offset by the early collection of taxes on pension savings and by the catch-up effect of the delayed collection of inheritance taxes in the Flemish Region.

The persistently modest wage increases and the new rise in the fixed business expenses allowance will have a very marked negative impact on fiscal and parafiscal revenues in 2016. Those factors reinforce the substantial effect of the return to a rate of personal income tax collection more in line with the past. A general decline in social security contributions is also foreseen as a result of the measures taken to cut employers' contributions in order to improve firms' competitiveness and revive employment. Only the corporation tax revenues are forecast to rise, thanks to improved corporate profitability and the new reduction in the reference interest rate for calculating the tax allowance for risk capital. Indirect taxes are also expected to benefit from the VAT measures and the reintroduction of the ratchet system for diesel, whereas non-fiscal and non-parafiscal revenues will remain relatively stable.

In 2017, the restrictive wage policy will continue to depress tax revenues, albeit to a lesser extent than in previous years. Most revenues, both fiscal and parafiscal, are predicted to remain almost stable in relation to 2016.

5.3 Primary expenditure

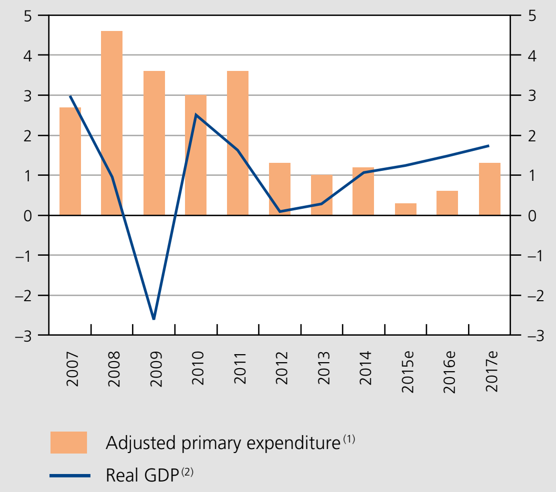
Primary expenditure is set to decline considerably in relation to GDP in 2015 and in the two subsequent years. Nominal public expenditure would grow more slowly than economic activity. Primary expenditure is expected to fall from 51.3 % of GDP in 2014 to 49.9 % in 2017.

That decline reflects the government's economy measures introduced after the elections on 25 May 2014. The main effect is attributable to the index jump which seriously curbs the growth of social benefits and wages in 2015 and 2016, and to some extent in 2017 as well, for each government sub-sector. In addition, the federal government aims to prune its operating expenses by reducing its purchases of goods and services and cutting its workforce. It has also decided to scale down its subsidies to public enterprises and its development cooperation budget. Furthermore, the growth of social security expenditure will be moderated by a range of measures to cut the rise in health care spending to a maximum of 1.5 %. Finally, the Communities and Regions have also adopted economy measures, e.g. in regard to subsidies and education.

After adjustment for the influence of one-off and cyclical factors and for the indexation effect, real primary expenditure is projected to record a modest 0.3 % rise in 2015, which is 1 percentage point below real GDP growth. In 2016 and 2017, the adjusted expenditure is likely to increase slightly faster by 0.6 and 1.3 % respectively, but will still be outpaced by real GDP growth. This moderation,

CHART 8 PRIMARY EXPENDITURE OF GENERAL GOVERNMENT AND GDP

(percentage changes compared to the previous year)



Sources: NAI, NBB.

(1) Primary expenditure deflated by the GDP deflator and adjusted for cyclical, non-recurring or fiscally neutral factors, and for the effect of indexation. The latter is due to the difference between, on the one hand, the actual indexation (or the theoretical figure for 2015 and 2016, in keeping with the approved suspension of the indexation mechanisms) of public sector wages and social security benefits and, on the other hand, the rise in the GDP deflator.

(2) Data adjusted for calendar effects.

attributable partly to the restrictions on social benefits and the government wage bill as a result of the index jump, should enhance the consolidation tendency apparent in public finances in recent years.

5.4 Debt

The debt ratio has risen steadily since 2008, reaching 106.6 % of GDP at the end of 2014. In 2015, the public debt is projected to rise further to 107 % of GDP.

That rise is due to endogenous factors which drive up the debt ratio by 0.4 percentage point of GDP. That increase results from relatively low nominal GDP growth, which is expected to be weaker than the implicit interest rate on the public debt, combined with a primary balance of 0.1 % of GDP.

The exogenous factors, so called because they influence the debt but not the overall balance, are forecast to push up the debt slightly, by 0.1 percentage point of GDP. That is due partly to the expected increase in lending by the *Vlaamse Maatschappij voor Sociaal Wonen* and the *Vlaams Woningfonds*, the new repayment by KBC amounting to 0.1 % of GDP, and the planned capital reduction by the mixed (public and private) management of the electricity and gas distribution networks in Flanders in favour of Flemish municipalities. Debt management will have virtually no impact on the debt ratio, as the effect of the substantial issue premiums will be offset on the one hand by a relatively high coupon interest payment in relation to market interest rates, and on the other hand by losses recorded as a result of cancellation of interest rate swaps and other derivatives.

In 2016, the public debt is set to increase further to 107.6 % of GDP, owing to exogenous factors relating to the management of the public debt. In 2017, the debt ratio is projected to fall to 106.8 % as a result of endogenous factors, as the expectation is that nominal GDP growth will exceed the implicit interest rate on the public debt while the primary balance should be slightly positive. That should set the public debt on a downward path again for the first time since the eruption of the financial crisis.

6. Risk factor assessment

The current spring forecasts confirm the gradual recovery scenario and comprise a small upward revision compared to the autumn estimates, partly as a result of cheaper oil and the euro's depreciation. They are also in line with the estimates of the other institutions: as regards economic growth, they deviate only very slightly from those of the Federal Planning Bureau and the European Commission (EC). Of the latest estimates, only those produced by the OECD predict stronger growth. The inflation estimates exhibit somewhat larger divergences: the other institutions expect inflation to increase more slowly, perhaps because these spring forecasts assume that the oil price will rise more steeply by 2017, compared to the assumptions used by the other institutions. But this relatively close convergence of the macroeconomic estimates should not detract attention from the great uncertainty which inevitably surrounds such projections.

In that connection, there are still downside risks concerning the external environment. For instance, a further heightening of geopolitical tensions could depress European growth. In addition, there is still a risk that the deceleration in growth in China and other emerging countries will be sharper and longer lasting than is currently expected according to the international assumptions. Finally, there is still uncertainty over the sustainability of the recovery in some advanced countries, as was recently evident from the relatively weak first quarter recorded by the US and British economies. On the other hand, it is always possible that the euro area's recovery could turn

TABLE 7 COMPARISON WITH ESTIMATES OF OTHER INSTITUTIONS

(in %)

Institution	Publication date	Real GDP growth			Inflation (HICP, unless otherwise stated)		
		2015	2016	2017	2015	2016	2017
IMF	April 2015	1.3	1.5	1.5	0.1	0.9	1.1
Consensus Economics	May 2015	1.3	1.6		0.3	1.6	
EC	May 2015	1.1	1.5		0.3	1.3	
Federal Planning Bureau	May 2015 (1)	1.2	1.6	1.7	0.2	1.2	1.2
OECD	June 2015	1.3	1.8		0.0	1.3	
NBB	June 2015	1.2	1.5	1.7	0.5	1.6	1.6

(1) Economic Outlook 2015-2020. The inflation figures are derived from the NCPI which may differ slightly from the HICP.

out to be more vigorous, either because the still relatively cheap euro has a bigger impact on net exports or via the more beneficial influence of confidence effects on private consumption and investment.

Turning to the financial markets, when the estimates were finalised it was still unclear whether calm had been restored following the period of severe volatility in May. Further interest rate rises or a further appreciation of the euro could hamper the recovery. In addition, the outcome of the negotiations between Greece and the international creditors remains a source of uncertainty.

Attention should also be drawn to the way in which the recent government competitiveness-enhancing measures were included in the projections. As was already the case in the autumn forecasts, and as explained in detail in Box 1 of the relevant article in the December 2014 Economic Review, it is assumed that the slower growth of nominal wages will feed through into prices to a significant extent, albeit after some delay. If this happens more slowly or more quickly, to a greater or to a lesser extent than expected, or if the economic agents such as employers, investors and foreign customers for Belgian exports do not respond to lower wages and prices in the way that these projections assume, economic activity, employment, the budget balance or inflation could deviate from these spring projections.

Finally, it must be remembered that these estimates naturally take no account of any new measures that the government may take in the future.

Annex

PROJECTIONS FOR THE BELGIAN ECONOMY: SUMMARY OF THE MAIN RESULTS

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

	2014	2015 e	2016 e	2017 e
Growth (calendar adjusted data)				
Real GDP	1.1	1.2	1.5	1.7
Contributions to growth:				
Domestic expenditure, excluding change in inventories	1.9	1.3	1.3	1.5
Net exports of goods and services	0.2	0.0	0.2	0.3
Change in inventories	–1.0	–0.1	0.0	0.0
Prices and costs				
Harmonised index of consumer prices	0.5	0.6	1.5	1.5
Health index	0.4	0.8	1.2	1.4
GDP deflator	0.6	0.9	1.0	1.4
Terms of trade	0.5	1.0	–0.3	–0.2
Unit labour costs in the private sector	–0.1	0.0	0.1	0.9
Hourly labour costs in the private sector	0.8	0.3	0.6	1.6
Hourly productivity in the private sector	0.9	0.3	0.6	0.7
Labour market				
Domestic employment (annual average change in thousands of persons)	17.7	23.9	30.6	39.5
Total volume of labour (1)	0.3	0.7	0.9	1.1
Harmonised unemployment rate (in % of of the labour force aged over 15)	8.5	8.5	8.3	7.9
Incomes				
Real disposable household income	2.0	0.8	0.7	1.2
Household savings ratio (in % of disposable income)	14.3	13.6	13.3	13.5
Public finances				
Primary balance (in % of GDP)	–0.2	0.1	0.2	0.4
Overall balance (in % of GDP)	–3.2	–2.7	–2.4	–2.0
Public debt (in % of GDP)	106.6	107.0	107.6	106.8
Current account (according to the balance of payments, in % of GDP)	1.4	1.4	1.4	1.6

Sources: EC, DGS-ADS, NAI, NBB.
(1) Total number of hours worked in the economy.