Economic projections for Belgium – Autumn 2015

Introduction

Since the cut-off date for the Bank's spring projections, published in June 2015, the economic environment has changed quite considerably. Regarding world growth, the projections already took account of some weakening during 2015, mainly as a result of the slowdown in activity in a number of emerging economies. At present, in the light of the latest statistics, global growth outside the euro area even seems to be slightly lower than estimated in the spring projections. More significantly, however, the slowdown in world trade in the first half of 2015 was considerably sharper than expected, even though the estimates of the trade intensity of growth in the Eurosystem's spring projections were already very low and, in particular, were more cautious than some of the estimates published at that time by other international institutions. In fact, according to the latest statistics, the euro area's foreign markets actually contracted during the first two quarters of 2015, shrinking by around 1 % in each quarter. That is extremely unusual, and has not happened in recent times except during the great recession of 2009, although the contraction at that time was of course on a totally different scale. Although some revival is expected in the second half of the year, trade growth will remain well below global growth, and demand for imports from the euro area will be virtually unchanged in 2015.

The exact causes of the marked decline in world trade are not yet entirely clear. While volatility and uncertainty in the initial trade statistics may be a factor, it seems plausible that the principal explanation lies in the changing composition of world growth. Key points here are the declining share of the emerging economies in growth, but also the transition to a growth model based more on consumption and less on investment in certain countries such as China. However, it is noteworthy that, for the time being, the euro area's exports do not seem to have suffered too much from the slackening of global demand since they expanded by almost 3 % in the first half of 2015. In fact, euro area exporters have seen a considerable increase in their market shares in world trade, while exports from the euro area to the United States have also risen strongly. That can probably be attributed to the depreciation of the euro since the autumn of the previous year, when the markets began to anticipate the quantitative easing of European monetary policy which was decided in January 2015. In consequence, European exports became much more competitive. As the projections are based on the assumption that exchange rates will remain stable, any prolonged weakness of world trade will have a more serious impact on the growth of the euro area countries once the beneficial effect of the cheaper euro has disappeared.

On the financial markets, calm was gradually restored following the period of heightened volatility and plummeting share prices which began in the late spring. Stock markets staged a gradual recovery, and fears that the recent dip in Chinese share prices might reflect a sharper slowdown in the real economy have tended to fade away. Similarly, long-term interest rates which had risen strongly, as is evident in particular from government bond yields, have begun edging downwards. In Europe, Greece's persistent financial problems eventually led to a new agreement with the international creditors, easing the uncertainty somewhat, and that is reflected in the Greek economy's positive growth figures in the first six months of the year. The euro has also depreciated further since the beginning of November, mainly on account of strengthening market expectations concerning the widening divergence between the euro area's monetary policy and that of the United States, in particular, at the end of the year. Finally, after rallying at the start of the year, oil prices did not maintain their upward trend as predicted by the technical assumptions underlying the spring projections, but began falling again.

The initial indications suggest that, in the third quarter, the weakness of foreign demand nevertheless exerted a little more downward pressure on euro area growth which, according to the "flash" estimate, was down again slightly at a quarterly figure of 0.3 %. Activity did in fact lose momentum to some extent in a number of major economies such as Germany, Spain and Italy. Portugal recorded zero growth, while other economies such as Finland and Greece actually contracted further. Overall, however, the Eurosystem made only a slight downward adjustment to its growth forecasts for the euro area compared to the spring projections: the weaker export growth in 2016 and 2017 should be largely offset by more vigorous domestic demand, fuelled in particular by slightly stronger growth of private and public consumption.

The domestic political environment has also undergone fundamental changes since the spring projections. The current projections take account of the federal and regional government budgets for 2016 as well as the package of measures finalised by the federal government in 2015 in connection with the tax shift, which aims to transfer levies on labour incomes to certain forms of consumption and to financial incomes and transactions. Furthermore, while the new reductions in employers' social contributions exert direct downward pressure on labour costs, that effect will be partly negated from 2016 onwards by a higher wage indexation, due mainly to the various measures by the federal and Flemish governments leading to an increase in electricity prices. As a result, the effects of the index jump will fade away sooner than initially expected.

In that context, Belgium's growth forecasts for the next two years, presented in these autumn projections which were finalised on 19 November 2015, have undergone a slight downward revision. The downturn in activity in the second half of the year seems to concern Belgium, too – as is already apparent from the "flash" estimate of growth in the third quarter, at barely 0.2 % – and implies a downward adjustment of the growth estimate, particularly for 2016. Conversely, annual growth for 2015 has been adjusted upwards slightly owing to the more favourable carry-over effects associated with the revision of the national accounts for 2014. Taking account of the common technical and external assumptions underlying the Eurosystem forecasts, the main ones being described in box 1 in the first section of this article, the economic downturn should be short-lived and the recovery will then gradually strengthen. Annual growth in 2017 – estimated at 1.6 % – will moreover differ little from the figure in the spring projections. In that connection it should be remembered that there is a considerable degree of uncertainty inherent in estimates for later years. Moreover, the stronger growth is increasingly driven by investment and net exports, even if the annual results for those components are somewhat biased by specific factors, particularly purchases of intangible assets from abroad in the first quarter of 2015 which, while not affecting growth, gave rise to a proportionate increase in imports and corporate investment. As predicted in the spring projections, private consumption is likely to slacken owing to the combined effects of the gradual disappearance of the increased purchasing power generated by the decline in oil prices and the weaker growth of household incomes as a result of the wage moderation policy.

The labour market recovery is unlikely to suffer much from the minor downward adjustment of the growth estimates, and is continuing unabated. Over the three years considered, namely from 2015 to 2017, almost 115 000 additional jobs should be created, i.e. even more than according to the spring projections, notably as a result of employment growth that slightly exceeded expectations in the first half of 2015. Despite the still rising participation rate and the bigger-than-expected increase in the population of working age owing to the relatively substantial influx of asylum seekers, employment growth exceeds considerably the growth of the labour force. As a result, the unemployment rate should gradually subside to around 8.1 % in 2017, though that is still higher than the average unemployment figure since the start of the century.

At the beginning of the year, inflation dipped to a low point, mainly as a result of the slump in energy prices, but returned to positive territory in April 2015 and has continued to rise since then. According to the current projections, the average inflation rate will only increase very little this year compared to 2014, but will gather pace significantly from 2016 to approach 2 %, and moderate only slightly in 2017. Despite the more favourable movement in oil prices, the inflation estimate is well above the figure given in the spring projections, and that is due entirely to the inclusion of various increases in indirect taxes decided by the federal and Flemish governments. Moreover, in 2016, about a third of total inflation will come from the direct impact of new taxes and higher consumption taxes. Owing mainly to the slump in oil prices, total inflation in 2015 is considerably lower than core inflation, which was in the region of 1.7 % in the final quarter of this year. The particularly modest rise in unit labour costs will subsequently drive down core inflation until about the beginning of 2017, even though the reduction in costs will be partly offset by the expansion of margins. Only after that will core inflation begin rising again, fuelled by the revival in the growth of labour costs from 2017.

Turning to public finances, the budget deficit is expected to remain just below 3 % of GDP this year. It will probably be 2017 before the deficit falls further. The improvement in the budget position over the projection horizon is due almost exclusively to the reduction in interest charges resulting from the low market interest rates. Moreover, the improvement is clearly smaller than predicted by the spring projections; the slightly less favourable growth estimates can only account for part of that, the main reason being the downward adjustment to the movement in the structural primary balance. Furthermore, these budget projections fall short of the government's current targets for absorption of the nominal and structural deficits. In this connection it should be remembered that, in accordance with the rules applicable to the Eurosystem projection exercises, the forecasts only take account of measures which have been formally adopted by the government – or which are very likely to be approved – and are specified in sufficient detail on the cut-off date for the exercise. Similarly, the additional expenditure approved by the federal government in the wake of the terrorist attacks in Paris has not yet been taken into account as that measure came after the cut-off date for these projections. Moreover, the estimates of the budgetary impact of certain measures such as those relating to fraud prevention deviate from the amounts included in the budget.

1. International environment and assumptions

1.1 World economy

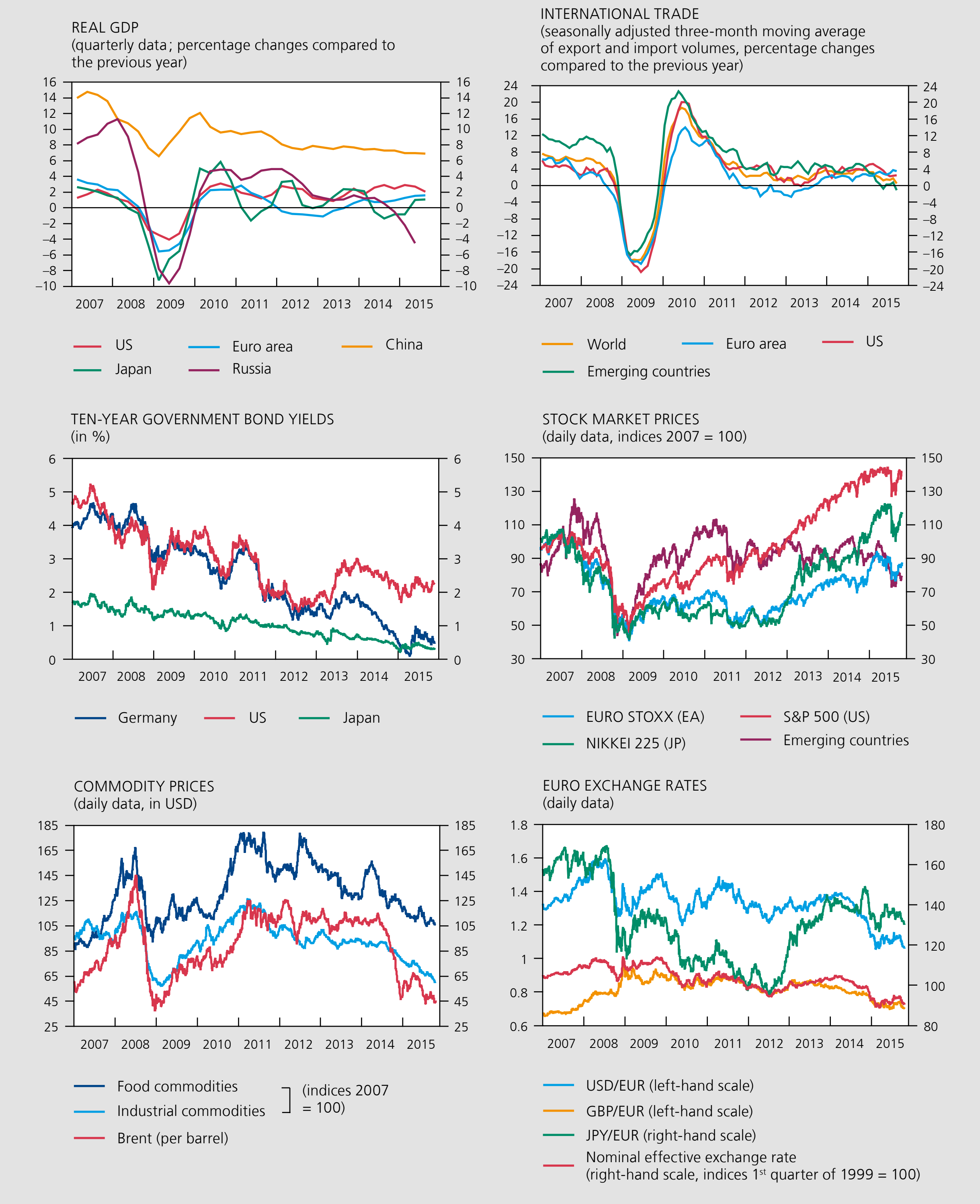
During the past year, the global economic recovery clearly ran out of steam owing to a sharp and widespread slowdown in the emerging economies, primarily China, and in the commodity exporting countries. Conversely, in most of the advanced countries, the economy continued to grow at a modest pace, supported by low oil prices and accommodative monetary policies. In the wake of the crisis, however, the low level of investment continues to depress (potential) growth.

There has been severe pressure on activity in the emerging economies this year. The transition from an economy centred on investment and exports to a model driven more by consumption and services is curbing Chinese growth – although at around 7 % it is nevertheless still vigorous – and the growth of China's trading partners. To counteract the negative effects of this complex process to some extent, the Chinese autorities have taken various measures, including cutting monetary policy interest rates and boosting expenditure on infrastructure. The activity of the commodity exporting countries has again been hit by the collapse of commodity prices. Brazil and Russia, in particular, went into a deep recession, with factors specific to those countries also playing a role. In Brazil, the political uncertainty, precarious budget position and necessary fiscal consolidation were the main factors depressing activity. In Russia, it was the geopolitical tensions associated with the conflict in Ukraine, and their consequences in terms of international sanctions, that inhibited activity. India was relatively unscathed. Growth there was bolstered by structural measures which are having a positive impact on investment. Among the world's large economies, India is expected to be the one recording the strongest growth this year.

The slowdown in the emerging economies has had a bigger-than-expected impact on the growth of world trade, which is down sharply this year. While the fragility of the world trade revival in the wake of the crisis had essentially reflected the sluggishness of demand in the euro area, its current weakness is in fact attributable mainly to the contraction of import volumes from the emerging countries, primarily China. This is due in particular to the rebalancing of the Chinese economy mentioned above, since consumption and services are less trade-intensive than investment and industry. This rebalancing has also had a big impact on Chinese imports of commodities. In addition, global structural factors play a role in the sluggishness of world trade compared to world GDP growth. Thus, the expansion of global value chains seems at least to have slowed somewhat since the crisis, so that this is no longer supporting world trade growth to the same extent as before.

Among the main advanced economies, it is the United States that has so far seen the most vigorous recovery. After having dipped slightly in the first quarter of 2015 as a result of various temporary factors, activity picked up again in the second quarter. Household consumption is still the main driver of American economic growth. Apart from the aforesaid general factors which have buttressed the growth of the advanced countries, consumption is also underpinned by the improvement in both the labour market situation and household balance sheets. Moreover, average wages have also begun rising more strongly. On the other hand, the dollar's appreciation has depressed exports while investment in the energy sector has declined.

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



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

The recovery in Japan and the euro area is at an earlier stage in the cycle and remains modest. The fragile revival of the Japanese economy at the start of the year has been hit by the growth slowdown in China and in other Asian emerging economies, representing about half of Japanese exports. The rise in real wages has remained moderate, despite an historically low unemployment rate, and has been offset by a steep and unexpected increase in the household savings ratio, so that private consumption has remained weak. In the third quarter, stock-building inhibited growth, leading to a fall in activity for the second consecutive quarter. However, economic growth is expected to pick up by the end of the year. In particular, exports should benefit from the weakness of the yen, while private consumption, supported by a further wage increase and lower oil prices, should rally.

After the recovery in the euro area had gained momentum in the second half of last year and at the beginning of this year, growth diminished again somewhat in the ensuing quarters. Thus, quarter-on-quarter growth dropped from 0.5 % in the first quarter to 0.4 % and then to 0.3 % in the last two quarters. The dynamism of exports in the first half of the year was striking, given the sharp downturn in world trade, and may be considered in the light of the euro's depreciation resulting from the ECB's accommodative policy. However, the recovery in the euro area is based essentially on private consumption, which is underpinned by the rise in purchasing power following the decline in energy prices and, more structurally, the improvement in the labour market situation. In addition, investment should ultimately continue to be supported by persistently very favourable financing conditions. Nonetheless, the uncertainty and – in some Member States – the need to pursue debt reduction continue to depress investment, hence the absence of a stronger investment revival for the time being.

The economic recovery in the euro area has also become more broadly based. Some of the peripheral countries, in particular, are currently seeing vigorous growth, driven by the recent structural reforms and macroeconomic adjustment programmes, and supported not only by the improvement on the labour market but also by the recovery in the rest of the euro area. Despite the great uncertainty over the change of government at the end of 2014, followed by protracted negotiations on a new aid programme, the Greek economy – which had picked up in the first three quarters of 2014 – maintained its growth in the first half of 2015, notably thanks to a steep decline in household saving. However, in the third quarter activity faltered again. As regards the large core countries of the euro area, growth in France continued to gather pace although investment is still weak and unemployment will fall only gradually. In Germany, the recovery is based essentially on private consumption, supported by the sound labour market. The euro's depreciation has likewise had a beneficial impact on German exports which, moreover, are destined less and less for emerging countries and are increasingly supported by demand from the rest of the euro area and other advanced countries such as the United States.

Inflation in the euro area is very weak again this year, mainly because of the persistently low oil prices. It had begun falling from the end of 2011 and reached a low point in January 2015, when consumer prices declined by 0.6 % year-on-year. Although inflation then began rising again, it became negative again in September, following the further fall in commodity prices and the slight strengthening of the euro. However, from the end of this year, inflation is likely to regain momentum as the economic revival continues and oil prices bottom out before gradually going up again. The labour market situation is improving, and that is also driving down unemployment, which nevertheless remains higher than before the crisis and is still significant in some individual countries. In parallel with accelerating growth, employment should ultimately continue to expand, being also supported in some countries by fiscal and structural measures and by wage moderation.

This year, the financial markets have repeatedly faced episodes of heightened volatility, reflecting the growing concern over the weakness of activity in the emerging economies. In the initial months of the year, however, stock markets maintained the upward trend which had begun in 2014. Owing to the strong demand for long-term government bonds in the euro area, the yield on those instruments dropped to a historical low. Towards the start of the summer, however, financial market volatility increased again, with mounting concern over the situation in the emerging countries and the impact of the imminent normalisation of monetary policy in the United States. That uncertainty triggered a sharp fall in capital flows to the emerging economies, a widening of yield spreads and depreciation of the currencies of those countries, as well as a decline in share prices. In that context, it was mainly the most vulnerable countries that were affected, where credit expansion had accelerated sharply in recent years, fuelled by favourable financing conditions in the period following the financial crisis. It was primarily firms in certain emerging countries which saw a substantial rise in their debt ratio, often largely denominated in foreign currencies.

The impact on the financial markets of the protracted negotiations concerning a new financing programme for Greece was limited overall, as were the spillover effects on the peripheral euro area countries; evident from the weak repercussions on the risk premiums of those countries' government bonds. Conversely, markets were seriously disturbed by developments in China. Between 12 June and 8 July, the Chinese stock market slumped by more than 30 % as a result of some new measures taken by the Chinese supervisory authority in order to curb risky investment behaviour on the part of the shadow banking sector. The subsequent concerns were exacerbated by the People's Bank of China's announcement on 11 August of an adjustment to its foreign exchange policy. Although this decision was presented as a transition to a more market-conform valuation of the renminbi and although the resulting depreciation of the Chinese currency was small, the markets interpreted it as a signal that the Chinese economy would continue to slow down. Financial market volatility increased, stock markets fell, commodity prices declined and the flight into safe assets drove down yields on government bonds in the advanced countries. Later, calm was gradually restored on the financial markets.

As in the previous year, developments on the foreign exchange markets of the advanced countries reflected monetary policy divergences in the various economic regions. While the ECB announced an extension of its asset purchase programme on 22 January, the American central bank had ended its purchase programme in October of the previous year. The sharp depreciation of the euro against the dollar in the run-up to these events also persisted at the beginning of this year. However, as the markets began to expect postponement of the normalisation of monetary policy in the United States, the euro appreciated against the dollar to some extent during the year. Nevertheless, the euro depreciated again recently as the markets have clearly begun to take account of a new divergence in monetary policy between the euro area and the United States from December 2015.

After having fallen steeply from mid-2014, oil prices picked up again in the initial months of the year. This temporary rally followed signals indicating that production of shale oil in the United States was gradually being adapted to a decline in oil prices, and that global demand for oil was edging upwards again. Similarly, prices of

TABLE 1 PROJECTIONS FOR THE MAIN ECONOMIC REGIONS
(percentage changes compared to the previous year, unless otherwise stated)

	2014	2015 e	2016 e	2017 e
Real GDP				
World	3.3	3.1	3.5	3.7
of which:				
Advanced countries	1.8	2.0	2.3	2.3
United States	2.4	2.6	2.8	2.7
Japan	–0.1	0.7	1.1	0.5
European Union	1.4	1.9	2.0	2.1
Emerging countries	4.5	3.9	4.4	4.7
China	7.4	6.8	6.5	6.2
India	7.1	7.2	7.4	7.5
Russia	0.6	–3.7	–0.5	1.0
Brazil	0.1	–2.6	–0.5	1.2
p.m. World imports	*3.3*	*2.3*	*3.6*	*4.5*
Inflation (1)				
United States	1.6	0.2	2.1	2.3
Japan	2.7	0.8	0.7	1.8
European Union	0.6	0.0	1.1	1.6
China	2.1	1.7	2.5	2.5
Unemployment (2)				
United States	6.2	5.3	4.8	4.6
Japan	3.6	3.4	3.3	3.3
European Union	10.2	9.5	9.2	8.9

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

food and industrial commodities surged briefly in the first half of the year. During the summer, however, commodity prices resumed their downward trend. Although the weakness of demand in the emerging countries is a factor, it is primarily the abundant supply that continues to depress oil prices. As for metals, their prices have suffered mainly as a result of diminished demand from the emerging countries, although the increase in supply, in the wake of rising investment in mining production, is also playing a role.

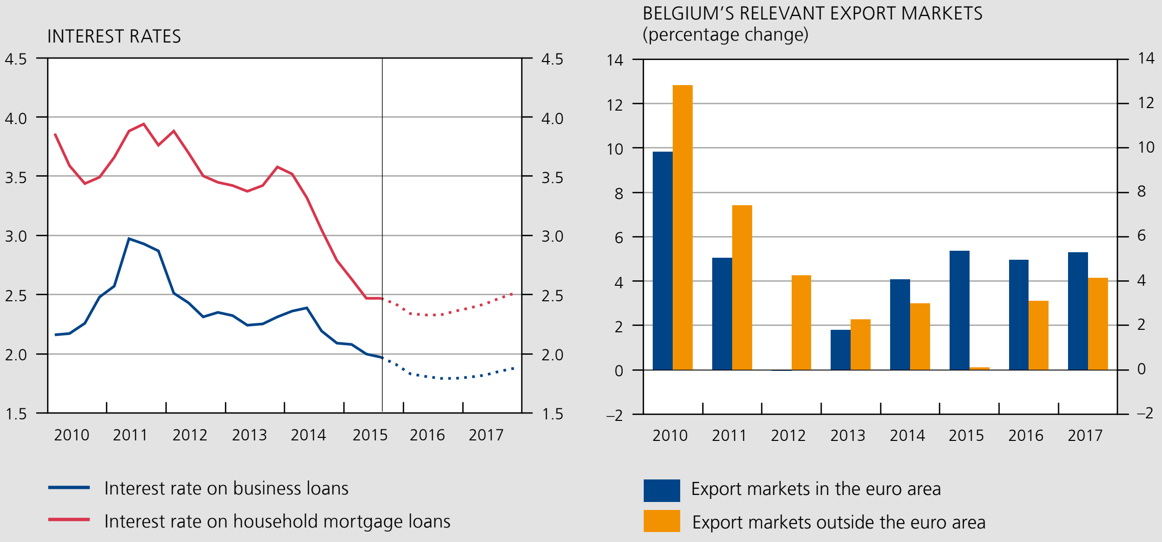
Box 1 – Assumptions adopted for the projections

The macroeconomic projections for Belgium described in this article form part of the joint Eurosystem projections for the euro area. That 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.

In the projections, it is assumed 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 November 2015. In the case of the US dollar, the exchange rate then stood at $ 1.09 to the euro.

As usual, the assumptions concerning oil prices take account of market expectations as reflected in forward contracts on the international markets. In mid-November 2015, following the decline which had begun in the autumn of 2014, the markets expected to see the price per barrel of Brent begin rising gradually over the projection horizon, from an average of $ 48.2 in the final quarter of 2015 to just under $ 58 in the last quarter of 2017. Once again, this implies a substantial downward revision compared to the assumptions for the spring 2015 projections.

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



Source: Eurosystem.

The interest rate assumptions are likewise based on market expectations in mid-November 2015. The three-month interbank deposit rate is projected at –10 basis points in the last quarter of 2015 and is actually likely to dip a little further after that before gradually rising by the end of the projection period to around –6 basis points. The level of Belgian long-term interest rates is projected to rise more sharply from 0.9 % in the fourth quarter of this year to 1.5 % at the end of 2017.

However, the predicted movement in bank interest rates on business investment loans and household mortgage loans may diverge somewhat from the movement in market rates. For instance, the average mortgage interest rate is unlikely to track the upward movement in long-term market rates and will probably remain fairly steady over the whole of the projection period, notably on account of the particularly accommodative monetary policy of the ECB and the resulting abundant liquidity. The average interest rate on business loans, which is closer to the short-term segment, is also expected to remain relatively constant over the projection period : at the end of 2017, it is forecast at 1.9 %, which is very similar to the current figure.

The outlook for global economic growth excluding the euro area has clearly worsened since the spring projections published in June 2015, particularly for the emerging economies. Moreover, the recent sluggishness of international trade mentioned above has led to a new downward revision of the trade intensity of world growth. That has a particularly adverse effect on the growth of foreign markets outside the euro area, which is predicted to subside to virtually zero in 2015, the lowest growth rate since the great recession of 2009. The expansion of foreign markets within the euro area has undergone a smaller downward adjustment in relation to the spring projections. Overall, the growth of the foreign markets relevant for Belgian exports should continue to strengthen steadily, approaching 5 % 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 prices that competitors charge on the export markets are a key factor in the cost aspects of that competitiveness. Partly as a result of the euro's depreciation, competitors' prices on the export markets will have risen by 3 % in 2015 whereas they declined in both 2013 and 2014. Rising inflation in the euro area, but also elsewhere, will gradually lead to renewed upward pressure on the prices of Belgian exporters' competitors in 2017, regardless of exchange rate fluctuations.

EUROSYSTEM PROJECTION ASSUMPTIONS
(in %, unless otherwise stated)

	2015	2016	2017
		(annual averages)	
EUR/USD exchange rate	1.11	1.09	1.09
Oil price (US dollars per barrel)	53.8	52.2	57.5
Interest rate on three-month interbank deposits in euro	0.0	–0.2	–0.1
Yield on ten-year Belgian government bonds	0.9	1.1	1.4
Business loan interest rate	2.0	1.8	1.8
Household mortgage interest rate	2.5	2.3	2.4
		(percentage changes)	
Belgium's relevant export markets	3.1	4.2	4.8
Export competitors' prices	3.0	1.0	2.2

Source : Eurosystem.

1.2 Estimates for the euro area

Regarding the euro area, the Eurosystem's autumn projections are a little less optimistic than they were in the latest spring projections, and are very similar to the estimates that the ECB published in September 2015. Growth is forecast to surge, reaching 1.5 % this year, and should even rise to around 2 % in 2017. The recovery is supported by favourable initial conditions, such as a cheaper euro and low interest rates which monetary policy has helped to bring about. Despite the relatively large gains in market shares, the weakening of foreign demand is likely to curb the growth contribution of net exports. Nonetheless, that will be offset by a strong rise in domestic demand and, more particularly, private consumption and investment.

Inflation in the euro area dropped to a low point in January 2015 but has since picked up, mainly as a result of the resurgent oil price; nevertheless, it will remain at virtually zero, on average, this year. The projections assume that inflation will continue rising to an average of 1.6 % in 2017. That picture is due only partly to the expected reversal of the pressure from prices of volatile components such as oil prices. In fact, core inflation – i.e. inflation excluding those volatile components – is also set to virtually double during the projection period, rising to 1.6 % in 2017. That rise is attributable not only to accelerating wages and the increase in corporate profit margins but also to the delayed impact of the weaker euro which makes imports more expensive.

The labour market recovery strengthened this year, and employment is expected to continue expanding at a relatively rapid pace until 2017. Of course, that improvement will be encouraged by the strengthening economic growth and by the impact of both the recent labour market reforms and the specific measures designed to curb the rise in labour costs in certain countries. In the euro area as a whole, unemployment is set to continue falling, dropping to around 10 % in 2017, almost two percentage points below the 2013 figure. The increase in net immigration due to the influx of refugees will expand the labour supply.

The average budget deficit in the euro area is forecast at 1.8 % of GDP in 2017. However, that decline will be due solely to the improvement in the economic situation and the continuing fall in interest charges resulting from the abnormally low interest rates. Conversely, the fiscal policy stance is likely to ease slightly during the period considered.

2. Activity and demand

During the first half of 2015, economic activity regained momentum in Belgium, recording an average growth rate comparable to that seen in the second half of 2014 and corresponding to annual growth of around 1.5 %. Growth was driven largely by the strong expansion of private consumption, itself supported by improved consumer confidence and, more particularly, the prospect of lower

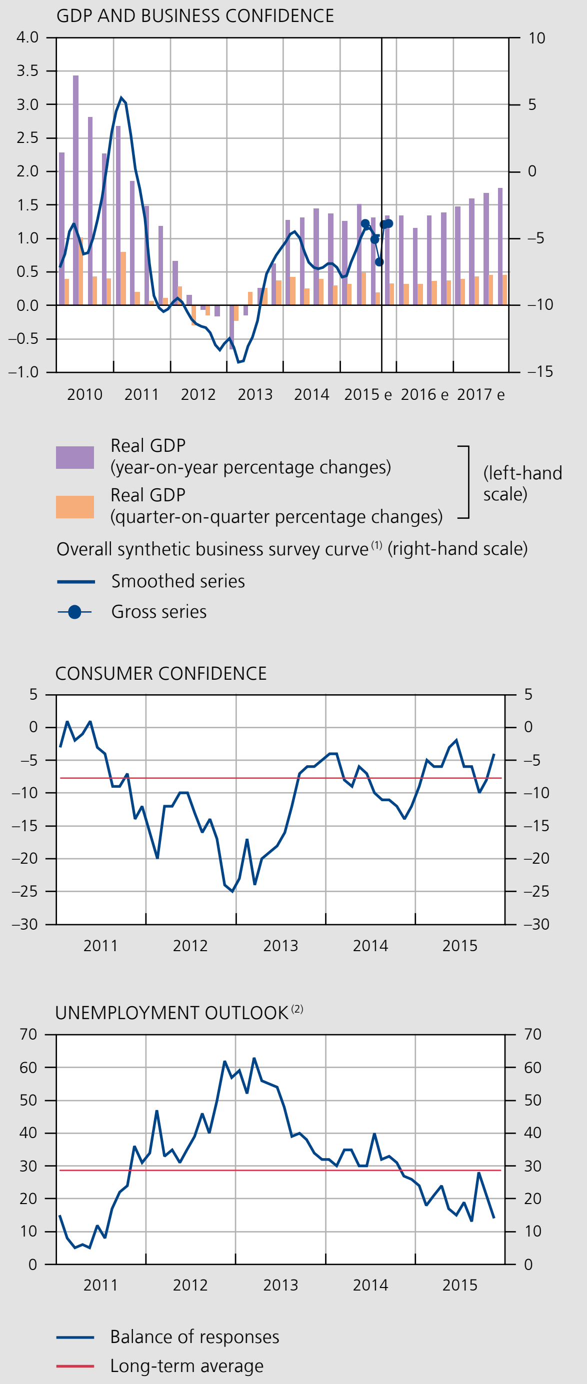
TABLE 2 EUROSYSTEM PROJECTIONS FOR THE EURO AREA
(volume data, percentage changes compared to the previous year, unless otherwise stated)

	2015 e	2016 e	2017 e
GDP	1.5	1.7	1.9
Household and NPI final consumption expenditure	1.6	1.9	1.7
General government final consumption expenditure	1.4	1.2	1.0
Gross fixed capital formation	2.3	2.8	3.8
Exports of goods and services	4.8	4.0	4.8
Imports of goods and services	5.3	4.8	5.3
Inflation (HICP) (1)	0.1	1.0	1.6
Core inflation (1) (2)	0.9	1.3	1.6
Domestic employment (1)	1.0	1.0	1.0
Unemployment rate (3)	11.0	10.5	10.1
General government financing requirement (–) or capacity (4)	–2.0	–2.0	–1.8

Source: ECB.
(1) Percentage changes compared to the previous year.
(2) Measured by the HICP excluding food and energy.
(3) In % of the labour force.
(4) In % of GDP.

CHART 2 GDP AND CONFIDENCE INDICATORS

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



Sources: NAI, NBB.
(1) Non seasonally adjusted data.
(2) In regard to the outlook for unemployment, a rise in the chart indicates a deterioration and a fall indicates an improvement.

unemployment, and by the rise in real incomes resulting from the sharp fall in oil prices. On the production side, the recovery was evident in all major branches of activity, even though growth was underpinned mainly by the expansion of activity in market services.

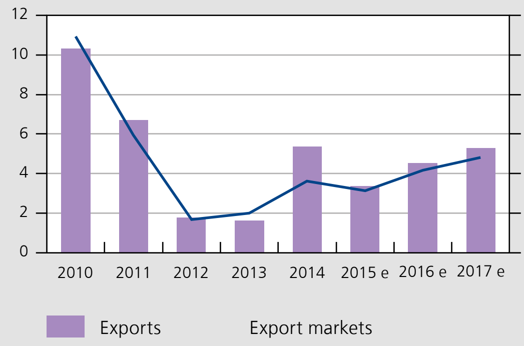
However, from the summer, the Belgian economy like that of the euro area ran out of steam. Although the growth estimated by the Bank in June 2015 for the second and third quarters is fairly close to the current quarterly statistics, according to the NAI's initial "flash" estimate that weakening seems to be slightly more pronounced than was assumed in the spring projections: quarterly growth, which still came to 0.5 % in the second quarter, dropped to barely 0.2 % in the third quarter. That fall is clearly linked with the global economic slowdown, which is accompanied by a marked deterioration in confidence indicators. Consumer confidence has been declining steeply after June, dropping for a time below its long-term average. Another striking point is that in September – following a tendency to improve for about a year – the unemployment outlook suddenly deteriorated to the level prevailing at the end of the previous year, although that was probably due mainly to the heightening of specific geopolitical tensions. Business confidence has also dipped sharply since the summer according to the Bank's surveys.

However, these confidence indicators show a recovery at the start of the final quarter. Against that background, our short-term forecasts for that quarter indicate a slight increase in quarterly growth at around 0.3 %, which would ultimately put year-on-year growth at 1.4 % for 2015. Growth is projected to dip very slightly in 2016 before regaining strength to reach 1.6 % in 2017. In comparison with the 2015 spring projections, the current estimates imply a small upward revision in the annual growth expected for 2015, despite the slightly sharper slowdown in the second half of the year. However, that is due purely to a carry-over effect which, owing to the upward adjustment of growth for 2014 in the annual accounts published at the end of September 2015, is more favourable than was suggested by the statistics available at the time of the spring projections.

Domestic demand will have provided substantial support for year-on-year growth in 2015, even though private consumption slowed significantly in the second half of the year as a result of waning confidence and the gradual disappearance of the favourable impact of lower oil prices on income growth. Moreover, changes in inventories are also making a positive contribution to growth; firms curbed their stock reduction or speeded up their stock-building in the first half of the year, for the first time since 2011. Although it is possible – and even probable – that the same

CHART 3 EXPORTS AND EXPORT MARKETS

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



Sources : NAI, NBB.

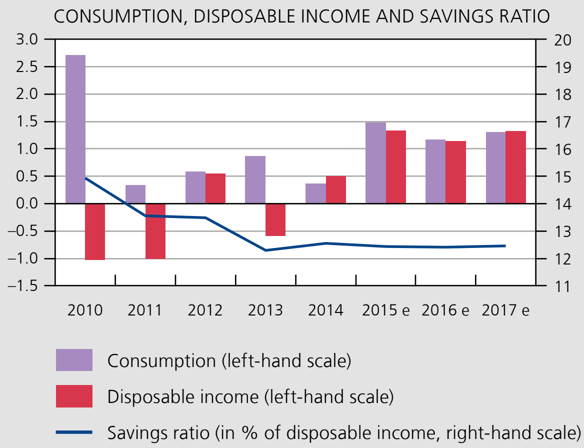
will apply in the near future, according to the technical assumptions adopted for all the quarters in the projection period, changes in inventories are as usual assumed to be growth-neutral, in particular in view of the great statistical uncertainty surrounding that concept. Furthermore, the positive contribution of inventories in 2015 is almost entirely offset by a negative growth contribution from net exports. Although exports have maintained an upward trend as a quarterly average and were stimulated in particular by the euro's depreciation, imports have risen faster on an annual basis. In that regard, it should be borne in mind that – although there was no impact on GDP growth – a number of major purchases of specific investment goods from abroad distorted the import growth figures somewhat, and consequently distorted business investment and domestic demand. Owing to carry-over effects, that will likewise apply to the 2016 growth figures. Leaving aside these specific factors, net exports are predicted to make a small positive contribution to growth in 2015.

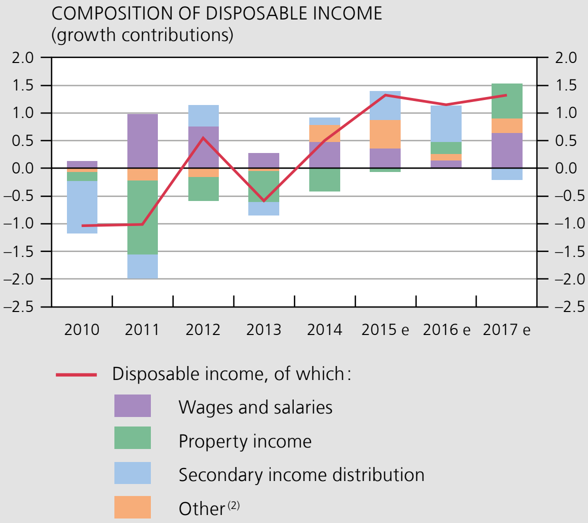
While the growth estimate for the next two years – being slightly more cautious than in the spring projections – can be linked to the weaker spillover effect due to the moderate slackening of growth in the second half of 2015, it is attributable more generally to the downward adjustment to Belgium's export markets, as mentioned in Box 1.

Nevertheless, net exports will continue to make a positive, if small, contribution to growth over the next two years. Moreover, that is also the case following adjustment of the statistics to neutralise the effect of the specific purchases of foreign investment goods, it being understood that a number of major investments in the shipping sector are still taken into account for 2016.

CHART 4 HOUSEHOLD CONSUMPTION AND DISPOSABLE INCOME (1)

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





Sources : NAI, NBB.
(1) Data deflated by the household consumption expenditure deflator.a
(2) "Other" comprises the gross operating surplus and gross mixed income (of self-employed persons).

More generally, the various measures aimed at moderating labour costs, such as the index jump, reductions in employers' charges and restrictions on the increase in collectively agreed wages, should lead to an improvement in the cost competitiveness of Belgian exporters. The increase in unit labour costs, which will be examined in more detail in section 4, is in fact still well below that recorded in the main neighbouring countries and in the euro area as a whole. Although this cost advantage is only reflected in prices after a time lag, and not necessarily in full – generating an increase in corporate margins, particularly in the short term – it will exert a moderating effect on prices of tradable goods and services, in particular, which will benefit exports. These projections therefore assume that Belgian exports will increase their market shares further by around 0.2 % to 0.5 % per annum.

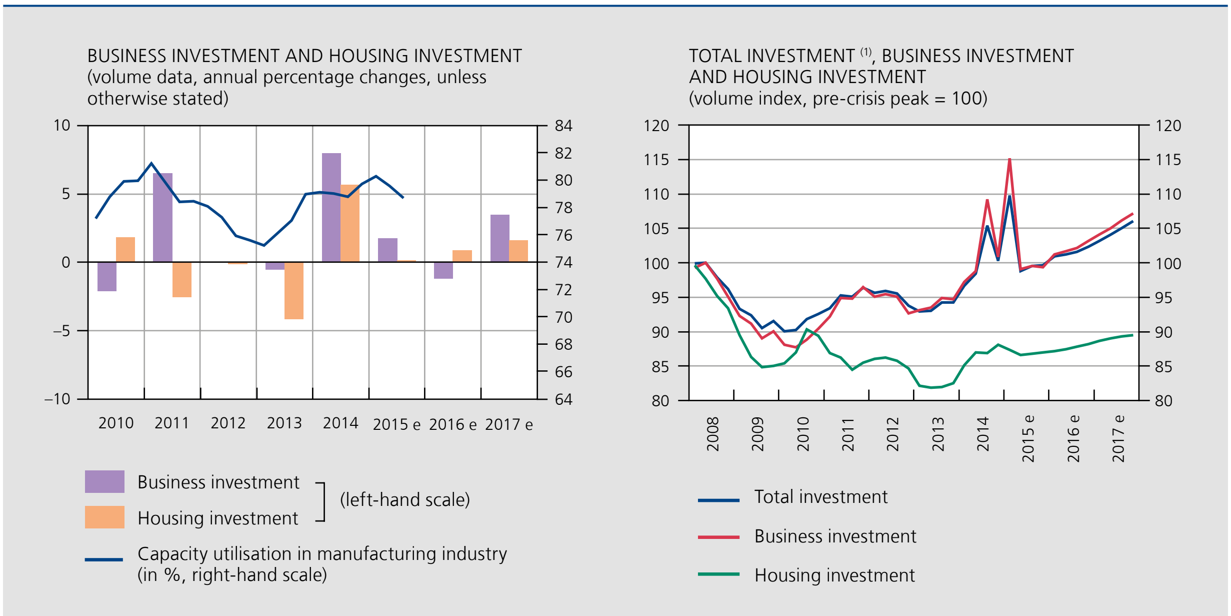
At the end of the projection period, the growth contribution of net exports will diminish. On the one hand, exporters will make smaller gains in market shares during 2017, owing to the marked rise in labour costs in that year. Also, the growth of domestic expenditure, including private consumption in particular, will drive up import growth.

In regard to domestic expenditure, private consumption is set to rise at a fairly moderate pace over the projection period as a whole, after declining from the summer of this year. The main reason for that is the limited growth of household incomes, attributable chiefly to primary labour incomes. Despite rising employment and the – admittedly small – increase in contractual wages, the latter should remain fairly flat in real terms in 2016. That is due to the impact of the index jump, which will continue to be felt until 2016, and the various increases in indirect taxes and levies on private consumption of electricity, introduced by the Flemish authorities. In addition, some of the increases in indirect taxes, such as excise duty on alcohol, tobacco and diesel, exert no upward effect on the health index and therefore do not cause an increase in indexation.

The very weak growth of primary labour incomes is also offset to a small degree by a more favourable distribution of secondary incomes. That results in particular from the cut in personal income tax, mainly in the case of low and middle incomes, introduced via the tax shift. In general, the growth of real household incomes will subside somewhat in 2016. Households are likely to cut their consumption to much the same degree so that their savings ratio will remain at the historically low level which it reached in 2015, and which is very similar to the average for the euro area.

In 2017, a marked revival in real labour incomes is expected, owing to the combined effects of stronger nominal wage growth supported by the reactivation of the indexation mechanisms and a slight dip in inflation. Insofar as Belgian households have substantial net financial assets, the assumed rise in the long-term interest

CHART 5 PRIVATE INVESTMENT



Sources: NAI, NBB.
(1) Also includes public investment.

rate, like the increase in corporate dividend payments, will trigger a steep rise in property incomes in 2017. However, a relatively larger proportion of those incomes will be saved; consumption growth is determined primarily by labour income and replacement benefits. Private consumption will thus gather pace somewhat in 2017, but at the same time the private savings ratio is also likely to rise slightly.

Household investment in housing is also set to increase only moderately. According to the current quarterly statistics, that investment was down sharply in the first half of the year, albeit following strong growth in 2014. That fall may be due partly to anticipation effects following the announcement of a reduction in the housing bonus in the Flemish Region with effect from 1 January 2015, which prompted many households to bring forward their building plans or the purchase of an existing home in the Region. Secondary market transactions may influence the investment figures since the registration fees paid fall in that category in accordance with the ESA 2010 methodology. The current forecasts assume a very gradual return to normal followed by a recovery, so that year-on-year growth will be virtually zero in 2015, but will begin rising in the ensuing two years. That recovery will gain further support, especially in 2016, from the persistently low mortgage interest rates. However, at the end of 2017, this investment is still expected to be about 10 % below the peak prevailing before the great recession.

The growth of business investment is much stronger, even though it is distorted by some specific major purchases of foreign investment goods. Thus, the apparent fall in business investment in 2016 is due solely to one specific purchase in the pharmaceutical industry at the beginning of 2015. Excluding specific factors, business investment is expected to grow steadily during the projection period, reaching an annual growth rate in the region of 4 % by the end of 2017.

Business investment growth will be supported by the increase in corporate profit margins combined with firms' substantial cash reserves, the low interest rate environment and the easing of financing conditions. Moreover, capacity utilisation in manufacturing industry has been a little higher than the long-term average for some time now, so that the growth of demand will increasingly generate investment in expansion. At the beginning of 2016, business investment should regain the level prevailing before the great recession.

In the case of public expenditure, the volume growth of government consumption is likely to decline in 2016 and 2017, owing to the consolidation measures aimed partly at reducing the size of the workforce. The volume of public investment will accelerate sharply this year – in particular because school-building is being stepped up, principally in the Flemish Community – before growth slows somewhat in 2016 and 2017.

TABLE 3 GDP AND MAIN EXPENDITURE CATEGORIES

(seasonally 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	0.9	0.4	1.5	1.2	1.3
General government final consumption expenditure	–0.1	0.6	0.6	0.4	0.4
Gross fixed capital formation	–1.7	7.0	1.8	–0.4	3.0
general government	–3.7	4.0	5.6	1.6	3.1
housing	–4.1	5.7	0.2	0.9	1.6
businesses	–0.5	8.0	1.8	–1.2	3.5
p.m. Domestic expenditure excluding change in inventories	*0.0*	*1.9*	*1.3*	*0.6*	*1.5*
Change in inventories (1)	–0.7	–0.2	0.5	0.1	0.0
Net exports of goods and services (1)	0.7	–0.4	–0.5	0.6	0.2
Exports of goods and services	1.6	5.4	3.4	4.5	5.3
Imports of goods and services	0.8	5.9	4.0	3.9	5.3
Gross domestic product	0.0	1.3	1.4	1.3	1.6

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

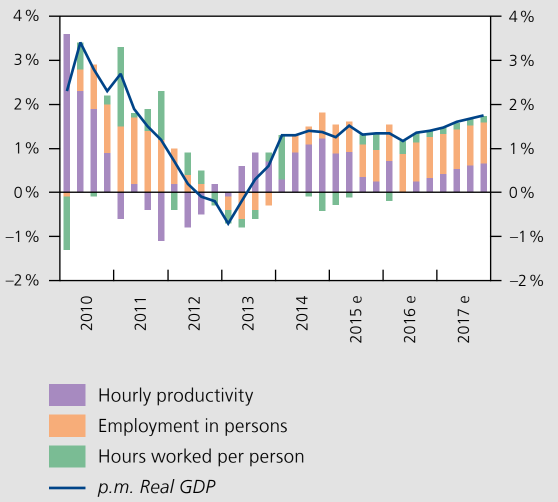
3. Labour market

The economic recovery from the second quarter of 2013 soon led to the expansion of employment, which grew quite steadily by around 0.1 to 0.2 % quarter-on-quarter, although at first that revival was offset by a slight reduction in average working time per person. During the projection period, demand for labour should continue to rise steadily and, according to the current forecasts, will hardly be affected by the slight slowdown in activity from the second half of 2015, due in particular to the various measures to reduce labour costs and make it cheaper for employers to take on staff. However, this implies that labour productivity will dip sharply at the start of the projection period and will improve only gradually as economic growth gains momentum. Since the number of hours worked per person will only increase slightly, the growing demand for labour will be almost entirely reflected in rising employment.

Overall, domestic employment is projected to expand by 114 000 units during the period 2015-2017, driven not only by the activity revival but also by the policy of wage moderation. Both self-employed workers and employees will contribute to the jobs growth. In contrast to earlier

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.

TABLE 4 LABOUR SUPPLY AND DEMAND

(seasonally adjusted data; change in thousands of persons, unless otherwise stated)

	2013	2014	2015 e	2016 e	2017 e
Total population	57	55	53	58	56
Working age population	12	9	10	16	11
Labour force	6	29	13	27	24
Frontier workers	–1	–1	0	0	0
Domestic employment	–18	16	32	40	42
Employees	–24	9	23	31	32
Branches sensitive to the business cycle (1)	–25	–4	11	18	22
Public administration and education	3	5	–2	1	–3
Other services (2)	–1	7	14	12	13
Self-employed	6	7	9	9	10
Unemployed job-seekers	25	14	–18	–13	–18
p.m. Harmonised unemployment rate (3)(4)	*8.5*	*8.6*	*8.7*	*8.4*	*8.1*
Harmonised employment rate (3)(5)	*67.2*	*67.3*	*67.1*	*67.3*	*67.8*

Sources: FPB, EC, DGS, NAI, NBB.
(1) Agriculture, industry, energy and water, construction, trade, hotels and restaurants, transport and communication, financial services, real estate activities and business services.
(2) Health, welfare, community, social and personal services, and domestic services.
(3) On the basis of data from the labour force survey.
(4) In % of the labour force (15-64 years), gross data.
(5) Persons in work in % of the total working age population (20-64 years).

years, branches sensitive to the business cycle will be the main engine of that growth, followed by other services. As a result of the government's economy measures, the workforce in public administration and education will shrink, halting the upward trend of the past decade. The growth of the working age population has already been slowing down for some time owing to ageing, but the effect on the labour force is partly offset by the upward trend in the participation rate. That is supported by the increase in the participation rate of older workers as a result of the measures taken by the federal government to limit early departure from the labour market, such as the abolition of the status of older unemployed persons and the tougher criteria for access to the system of unemployment with employer top-up. In addition, the current higher net inflow of migrants, and particularly refugees, is slightly enlarging the working age population; the impact of that will only become clear in the average annual figures from 2016 onwards. It is therefore mainly from that year onwards that the growth of the population of working age and the labour force has been revised upwards compared to the spring forecasts.

Nonetheless, labour demand is still growing strongly enough to absorb that larger increase in the labour force. The number of unemployed should begin to fall from 2015, after having risen for three consecutive years. Although that fall will slow somewhat in 2016, the number of unemployed at the end of the projection period should still be around 49 000 lower than at the start of 2015. The harmonised unemployment rate determined on the basis of the labour force survey and the International Labour Office definitions, expressing the ratio between the number of unemployed persons available for the labour market and actively seeking work (regardless of whether they are registered with the NEO as unemployed and entitled to benefits) and the labour force, should consequently fall from 8.6 % in 2014 to 8.1 % in 2017.

4. Prices and costs

As in the spring projections, labour costs in the first part of the projection period are pushed down by the various measures taken by the federal government to reduce the wage gap with respect to the three main neighbouring countries and to improve the cost competitiveness of Belgian firms. Those measures include the freezing (in 2015) and the moderation (in 2016) of negotiated wage increases, the temporary suspension of the indexation mechanisms (index jump) and the further substantial reductions in levies on labour in 2016 (planned earlier as a part of the competitiveness pact) via, *inter alia*, additional reductions in employers' social security contributions and an increase in the payroll tax exemption for night and shift work.

TABLE 5 PRICE AND COST INDICATORS
(percentage changes compared to the previous year, unless otherwise stated)

	2013	2014	2015 e	2016 e	2017 e
Labour costs in the private sector (1)					
Labour costs per hour worked	2.5	0.6	0.2	0.2	1.9
of which indexation	1.9	0.8	0.1	0.4	1.1
Labour productivity (2)	0.4	0.9	0.6	0.3	0.5
Unit labour costs	2.1	–0.3	–0.4	–0.1	1.3
p.m. Labour costs per hour worked according to the national accounts (3)	*2.5*	*0.7*	*0.3*	*0.1*	*1.7*
Core inflation (4)	1.4	1.5	1.6	1.4	1.4
Energy	–4.6	–6.0	–7.7	4.0	3.2
Food	3.6	0.8	1.8	2.4	2.0
HICP	1.2	0.5	0.6	1.9	1.7
Health index	1.2	0.4	1.1	1.7	1.4

Sources: EC; FPS Employment, Labour and Social Dialogue; NBB.
(1) Labour costs per hour worked are not shown here according to the national accounts concept but according to a broader concept that also includes reductions in contributions for target groups and wage subsidies. That concept gives a better idea of the labour cost for firms.
(2) Value added in volume per hour worked by employees and self-employed persons.
(3) Excluding wage subsidies and reductions in contributions for target groups.
(4) Measured by the HICP excluding food and energy.

Via the tax shift, the reduction in labour costs will be strengthened in 2016. The intention is to cut the average rate of employers' contributions to 25 % in 2018, with a specific focus on low and medium wages. Moreover, additional measures were taken to encourage job creation in SMEs, e.g. via specific reductions in labour costs which, since this is a target group measure, are also recorded as a subsidy according to the ESA 2010 methodology.

In order to cut the rate of the employers' contributions to 25 %, it was also decided to convert the existing linear exemption from payment of the payroll tax of 1 % in the profit sector into a reduction in employers' contributions. However, in contrast to the measures mentioned above, that decision does not imply any actual reduction in labour costs for employers, and therefore has no macroeconomic impact since it only represents a (statistical) shift between wage subsidies and social contributions.

However, wage subsidies are not included in the concept of labour costs as traditionally measured in the national accounts. Table 5 above shows both concepts, but it is mainly the broader definition – including wage subsidies – that is relevant for firms. It shows labour costs per hour worked in the period 2016-2017 rising slightly faster than according to the national accounts concept. The reason is that the amount of the accounting shift concerning the 1 % exemption of the payroll tax which distorts the latter concept exceeds the further extension of wage subsidies which are not included in the national accounts concept.

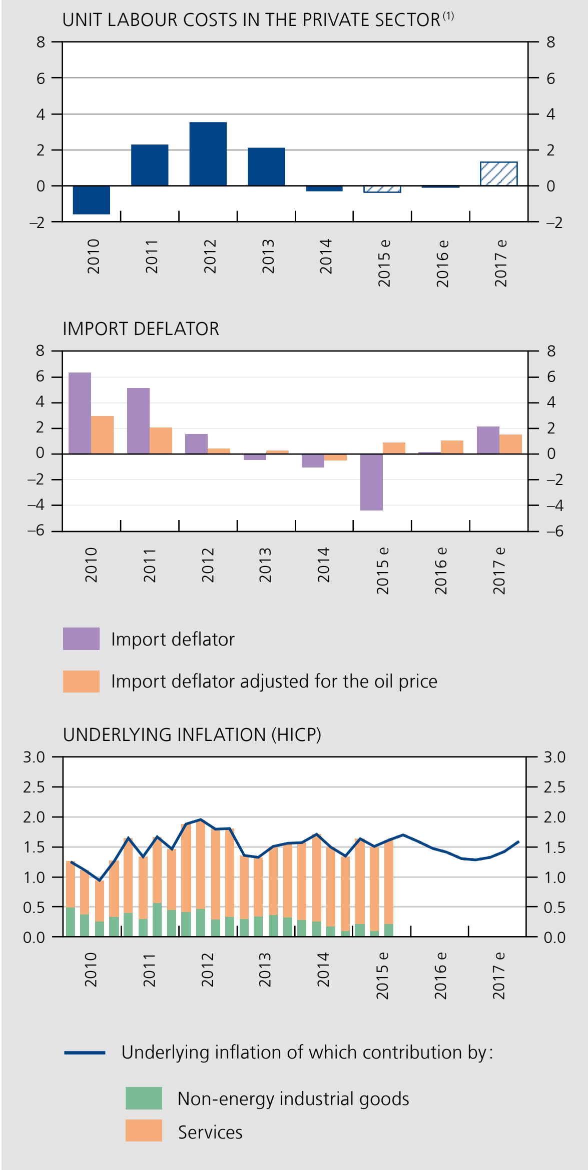
Overall, these reductions in charges on labour should cut labour costs per hour worked by around 1 % over the projection period, the main impact being felt in 2016. Owing to the tax shift, that represents roughly twice the estimated impact in the spring projections. Nevertheless, it is noticeable that unit labour costs have not been revised downwards to the same degree, the reason being that the impact of the larger reduction in charges on labour is largely offset by two other factors. On the one hand, the slower growth of productivity in 2016 drives up unit labour costs. Inflation also accelerates faster and some new indirect taxes, particularly those which increase the price of electricity, propel the health index higher. As a result, the effects of the index jump disappear sooner than foreseen in the spring projections, and the indexation mechanisms will be activated again by the end of the first quarter of 2016. Although this will naturally be a gradual process which depends on the specific indexation mechanisms in each branch of activity, it will already increase wage indexation in 2016, but particularly in 2017.

In regard to the other elements of wage growth, it is assumed – as in the spring projections – that the maximum scope of 0.67 % for collectively agreed wage increases according to the wage norm imposed by the federal government will be used in full in 2016 following three years without any real negotiated increases and in a context of a steady labour market recovery. The estimates for the wage drift are also largely unchanged.

Generally speaking, unit labour costs are forecast to decline in 2016 for the third consecutive year. In 2017,

CHART 7 LABOUR COSTS AND UNDERLYING INFLATION

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



Sources: EC, NBB.
(1) Including wage subsidies and target group reductions.

labour costs are likely to rise quite sharply again. On the one hand, rising inflation means that the indexation effect will already exceed 1 %. On the other hand, negotiated wage increases are likely to accelerate. The scope for real negotiated increases in 2017 is not yet known since the outcome of the negotiations for a central agreement for that year will only become clear in 2016. As in the spring forecasts, however, the current estimates are based on the technical assumption of negotiated wage growth of 0.9 %. This slight acceleration of agreed wages compared to the growth in 2016 takes account of both the continued labour market recovery and the expected further narrowing of the wage gap in relation to neighbouring countries, which will gradually create more scope for real pay increases.

In principle, the very moderate rise in labour costs should be reflected – after a certain time lag – in prices, and more particularly in the underlying inflation rate, which excludes the prices of volatile components, namely food and energy. However, in recent years, that underlying inflation has remained practically unchanged, especially on a annual basis. In the final quarter of 2015, underlying inflation is still estimated at around 1.7 %. As regards the foreign components of the cost structure, import prices rose as a result of the fall in the euro after the summer of 2014, which was connected with (expectations concerning) monetary policy easing in the euro area. That considerably increases the price of imported goods, in particular, or goods requiring imported intermediate inputs. That applies particularly to non-energy industrial goods, and to a lesser extent to services. On the other hand, imported oil has become much cheaper, so that energy costs for Belgian firms have fallen, and average import prices actually declined in 2015.

Furthermore, underlying inflation in Belgium has hitherto remained relatively high in Belgium, compared to the euro area and the main neighbouring countries, despite the very favourable trend in labour costs. In the services sector in particular, price rises have remained persistent up to now, possibly because of certain structural factors such as a relatively low level of competition on certain services markets and fairly small productivity gains. The existence of various indexation mechanisms which determine pricing on many markets and which lead to only partial or delayed adjustment of prices in line with the underlying cost structure may also play a role.

However, the current inflation forecasts indicate that the very modest domestic cost pressure and the disappearance of the impact of the euro's depreciation will gradually bring down underlying inflation, although the reduction will be very small. By the end of 2016, underlying inflation is forecasted to fall to around 1.3 % before rising again as a result of increasing labour costs. Expressed as an annual average, underlying inflation will therefore remain relatively stable over the projection period, albeit at a slightly lower level than at present.

Headline inflation is determined not only by underlying inflation but also by the prices of the volatile components, namely energy and food prices, and the influence of exogenous factors such as indirect taxation.

The various increases in levies on consumption will have a significant direct impact on the inflation figure. For instance, the excise duty on diesel, alcohol, tobacco and soft drinks will increase (or has already done so), and the VAT on household electricity consumption went up again in September from 6 % to 21 %. Apart from these measures introduced by the federal government in order to fund the tax shift, the Flemish government has also adopted certain measures which increase prices, notably the electricity price. For instance, from 2016, a levy is being introduced which aims to eliminate the historical debt accumulated by the electricity distribution network operators, due to the compulsory granting of subsidies to Flemish households that produce energy themselves. In addition, some regulated prices, such as higher education registration fees, are being increased. Although these and other measures by the Flemish government only increase prices in the Flemish Region, they drive up the average Belgian inflation and, in so far as they are included in the health index – which is the case here – they lead to higher indexation of Belgian wages and replacement incomes.

The movement in energy and food prices also drives inflation higher during the projection period. In view of the oil price assumptions presented in Box 1, the negative impact of the movement in energy prices on headline inflation should gradually diminish and turn into a positive contribution from 2016. Together with the expected sharper rise in food prices, that will lead to a clear increase in inflation despite the initially flat and then falling underlying inflation trend. Although inflation this year will be barely higher, on average, than last year's figure, the annual average will increase to 1.9 % from 2016 and only dip slightly to 1.7 % in 2017. About a third of the relatively high inflation in 2016 will be attributable to the federal and Flemish measures concerning indirect taxes and regulated prices. The health index, which is determined by the national consumer price index excluding alcohol, tobacco and motor fuels, is also forecast to increase from 1.1 % in 2015 to 1.7 % in 2016 and 1.4 % in 2017.

5. Public finances

5.1 General government balance

According to the latest estimates, the public finances should end the year 2015 with a deficit of 2.9 % of GDP. In the macroeconomic context described in this article, that deficit will again equal 2.9 % of GDP in 2016 before declining to 2.5 % in 2017.

The deficits are likely to be concentrated mainly on the federal government, but the Communities and Regions will also record further – albeit smaller – deficits during the projection period. Conversely, the social security accounts should be more or less in balance.

The reduction in the general government deficit between 2014 and 2017 is due solely to the decline in interest charges. The expectation is that public loans maturing can be refinanced at interest rates favourable to the government. Primary expenditure is set to fall by 1.5 percentage points of GDP, as a result of the index jump and other economy measures adopted by the various governments and local authorities. The revenue ratio is predicted to fall by roughly the same amount. Consequently, the primary balance which was in equilibrium in 2014 should remain fairly stable over the projection period.

These projections take account of all the budget measures which have already been announced and are specified in sufficient detail, including the tax shift introduced by the federal government to alleviate the heavy tax burden on labour incomes and transfer it to other tax bases. The expenditure included in the estimates is likely to be higher than the budget figures because of the lack of detail concerning a number of measures, such as those relating to social security expenditure and the redesign of the federal authorities, and the assumption that the under-utilisation of appropriations will be slightly less than the government expects. The estimated government revenue is also lower than the budget figures as a result of the expectation that VAT revenues will rise more slowly, the fact that (owing to an agreement within the Eurosystem) the proceeds of the measures to combat tax evasion cannot be taken into account, and a lower estimate of the yield from some measures. The projections indicate that additional consolidation measures are needed in order to attain the budget targets aimed at achieving a structural balance in 2018.

5.2 Revenue

Public revenues expressed as a percentage of GDP are projected to fall by 0.9 percentage point in 2015 and by a further 0.3 percentage point in both 2016 and 2017. This means that the decline in the revenue ratio which began

TABLE 6 GENERAL GOVERNMENT ACCOUNTS
(in % of GDP)

	2014	2015 e	2016 e	2017 e
General government				
Revenue	52,0	51,1	50,8	50,4
Primary expenditure	52,0	51,2	51,0	50,5
Primary balance	0,0	–0,1	–0,2	–0,1
Interest charges	3,1	2,8	2,6	2,4
Financing requirement (–) or capacity	**–3,1**	**–2,9**	**–2,9**	**–2,5**
Overall balance per sub-sector				
Federal government (1)	–2,5	–2,5	–2,5	–2,0
Social security	0,0	0,1	0,0	0,0
Communities and Regions (1)	–0,4	–0,3	–0,3	–0,3
Local authorities	–0,2	–0,2	–0,1	–0,2

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.

TABLE 7 PUBLIC REVENUES [1]

(in % of GDP)

	2014	2015 e	2016 e	2017 e
Fiscal and parafiscal revenues	44.8	44.2	43.9	43.6
Levies applicable mainly to labour income	26.2	25.8	24.7	24.4
Personal income tax [2]	11.6	11.3	10.7	10.6
Social contributions [3]	14.5	14.5	14.0	13.8
Taxes on corporate profits [4]	3.2	3.3	3.5	3.5
Levies on other incomes and on assets [5]	4.4	4.2	4.3	4.3
Taxes on goods and services	11.1	10.9	11.4	11.5
of which:				
VAT	6.9	6.8	7.0	7.1
Excise duty	2.1	2.1	2.2	2.2
Non-fiscal and non-parafiscal revenues [6]	7.2	6.8	6.9	6.9
Total revenues	52.0	51.1	50.8	50.4

Sources: NAI, NBB.

(1) In accordance with the ESA 2010, total revenue of general government does not include the proceeds of customs duties which the government transfers to the EU, nor the revenues collected directly by the EU.

(2) Mainly payroll tax, advance payments, assessments and the additional percentages on personal income tax.

(3) Including the special social security contribution and the contributions of persons not in work.

(4) Mainly advance payments, assessments and withholding tax on movable property incomes.

(5) Mainly withholding tax on income from movable property of individuals, withholding tax on income from immovable property (including the proceeds of additional percentages), and inheritance taxes and registration fees.

(6) Property income, imputed social contributions, current transfers and capital transfers from other sectors, plus sales of goods and services produced.

in 2014 will persist, with a particularly sharp reduction in the levies on earned incomes.

The contraction of revenues in 2015 is due to both a decline in fiscal and parafiscal revenues and a reduction in other revenues. Personal income tax and social contributions are depressed by the reduction in the share of wages in GDP resulting from the index jump and the freezing of real negotiated wages. In the case of personal income tax, that effect is augmented by the increase in flat-rate deductible business expenses taken into account in calculating the payroll tax. The withholding tax on income from movable property will also decline as a result of the change in the law concerning liquidation surpluses, whereby the withholding tax was increased from 10 to 25 % in October 2014, causing a temporary rise in these revenues. Taxes on goods and services are also down, mainly because of the decline in VAT revenues resulting from a marked increase in refunds. Taxes on corporate profits have risen following the imposition of corporation tax on some intermunicipal associations and the reduced impact of the notional interest deduction resulting from the lower reference interest rate and a restriction on the use of that system by the banks. Since the effect of these measures will only be partially apparent in the advance payments in 2015, revenues from the assessments can be expected to rise further in subsequent years. The fall in non-fiscal and non-parafiscal revenues is due partly to the decline in the income that the State receives from various financial institutions. In addition, the transfer of responsibility for family allowances to the Communities under the sixth State reform has led to a shift from imputed to actual social contributions in the case of benefits paid to public sector workers.

In 2016, personal income tax is likely to be further depressed by a new rise in the flat-rate deductible business expenses and the adjustment of the tax scales aimed at boosting purchasing power, particularly for workers on low and middle incomes. In addition, employers' social security contributions are being cut from 1 April 2016 in order to improve the competitiveness of firms and stimulate employment. Taxes on goods and services will rise sharply as a result of the increase in the rate of VAT on electricity and higher excise duty on diesel, tobacco and alcohol.

In 2017, most of the revenue categories should remain fairly stable in relation to their 2016 level. However, social contributions are likely to fall slightly because the full impact of the cut in employers' contributions will then be felt.

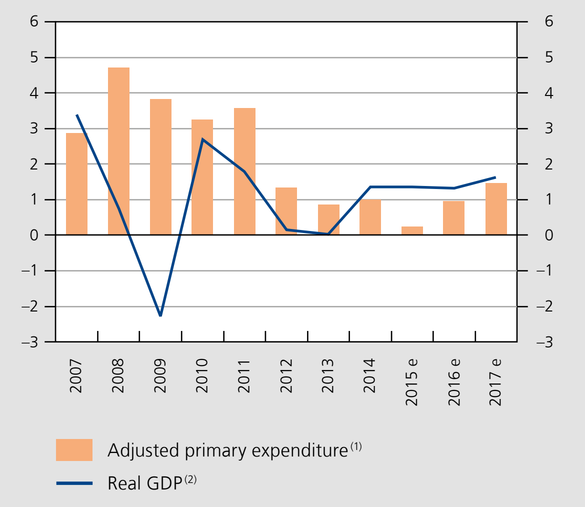
5.3 Primary expenditure

Primary expenditure as a ratio of GDP are expected to fall sharply in 2015, and – if there is no change of policy – in the two ensuing years. In nominal terms, public expenditure should therefore expand more slowly than economic activity, so that the primary expenditure ratio should fall from 52 % of GDP in 2014 to 50.5 % in 2017.

These developments largely reflect the economy measures of the governments formed after the May 2014 elections. The principal effect is due to the index jump which will significantly curb the growth of social benefits and wages in 2015 and 2016 in all government sub-sectors. The federal government is also endeavouring to reduce its operating expenses by cutting the size of the public workforce and moderating purchases of goods and services. However, the impact of those measures will be partly offset by the new expenditure likely to be allocated to the refugee crisis, which was taken into account in the estimates. The growth of social security expenditure will also be curbed by a number of measures aimed, among other things, at keeping down the cost of health care. The Communities and Regions have also taken economy measures, notably concerning operating expenses in administration and education, and subsidies. Finally, the local authorities have likewise had to introduce cuts in order to maintain sound finances.

Following adjustment for non-recurring and cyclical factors and the effect of indexation, real primary expenditure should edge upwards by 0.2 % in 2015, which is 1 percentage point below real GDP growth. In 2016 and 2017, adjusted expenditure is forecast to increase again somewhat, by 1 and 1.5 % respectively, while remaining below real GDP growth.

CHART 8 PRIMARY EXPENDITURE OF GENERAL GOVERNMENT AND GDP
(percentage changes compared to the previous year)

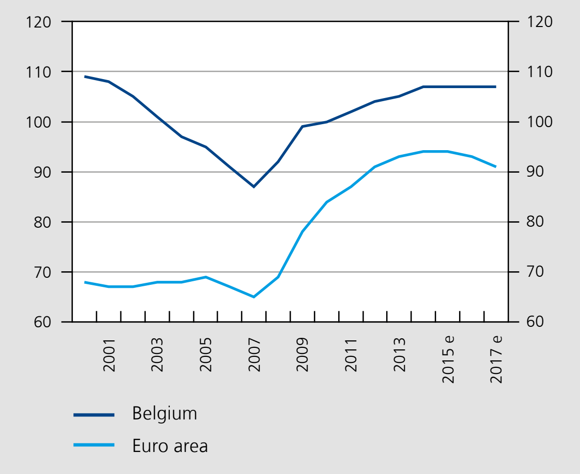


Sources: NAI, NBB.
(1) Primary expenditure deflated by the GDP deflator and adjusted for cyclical, one-off and fiscally neutral factors, and for the effect of indexation. The latter is due to the difference between the actual indexation (or the theoretical figure for 2015 and 2016, as a result of the approved index jump) of civil service pay and social benefits and the increase in the GDP deflator.
(2) Calendar adjusted data.

5.4 Debt

The debt ratio has risen steadily since 2008, reaching 106.7 % of GDP at the end of 2014. In 2015, the public debt is projected to rise further to 106.9 % of GDP. That expansion is due to the endogenous increase in the debt amounting to 0.2 % of GDP. The reason is that the implicit interest rate is slightly higher than real GDP growth, and that is combined with a slightly negative primary balance. The impact on the debt of exogenous factors, so called because they influence the debt but not the overall balance, should be virtually neutral. Management of the public debt should reduce the debt ratio slightly, mainly as a result of the favourable effect of substantial issue premiums. The repayment of government loans and participations should also exert slight downward pressure on the debt ratio. That applies, for instance, to the repayment by KBC and Greece’s repayment of part of the loan which

CHART 9 CONSOLIDATED GROSS DEBT OF GENERAL GOVERNMENT
(in % of GDP)



Sources: EC, NAI, NBB.

that country received from the European Financial Stability Facility. Conversely, a number of factors, such as the expected increase in loans granted in connection with the social housing policy, will drive up the debt ratio.

In 2016, the public debt is forecast to climb further to 107.3 % of GDP. Despite an endogenous decline in the debt of 0.4 % of GDP brought about by rising nominal GDP, it will increase by 0.8 % of GDP as a result of exogenous factors. The latter are connected mainly with the management of the public debt and the expected further rise in social housing loans.

In 2017, owing to endogenous factors, the debt ratio is set to fall to 106.8 % of GDP, as nominal GDP growth is expected to considerably exceed the implicit interest rate on the public debt. The public debt should thus begin falling again for the first time since the outbreak of the financial crisis.

6. Conclusion and risk factor assessment

These autumn projections continue to present a scenario of gradual recovery which is largely in line with the previous estimates. However, the somewhat sharper-than-expected slowdown in the second half of 2015 and in particular the weaker outlook for world trade have resulted in a slight downward adjustment to the growth forecasts for 2016 and 2017 compared to the spring projections.

These projections are very similar – at least as regards growth – to those of the other institutions, such as the recent autumn forecasts issued by the EC. Some international institutions, such as the OECD and the IMF, are currently still expecting slightly stronger growth in 2016. When comparing the various estimates, it is necessary to bear in mind the different dates of the estimates and the information available when they were produced. For instance, the FPB's September 2015 estimate for the Economic Budget, which also puts growth at 1.3 % in 2016, was not able to take account of the measures relating to the tax shift. The divergences are greater in the case of the inflation forecasts. However, that is partly because the older forecasts taken no account of the various new indirect taxes which increase certain prices, nor of the latest slightly higher-than-expected monthly inflation figures.

The close convergence of the macroeconomic forecasts should not mask the fact that such forecasts are always subject to great uncertainty. In the international environment, downside risks still predominate. For instance, a further heightening of the geopolitical tensions could yet have a detrimental impact on European growth. There is also still a risk that the growth slowdown in China and in other emerging countries may be sharper or more prolonged than the international assumptions currently predict. In that case, Belgian growth could be inhibited in particular via indirect channels, such as growth in the partner countries, confidence effects, or increased financial market volatility. In addition, the impending normalisation of US monetary policy could also influence the financial markets. On the other hand, a relative depreciation of the euro due to a widening divergence between American and European monetary policy could support growth in Europe. Finally, the recovery in the euro area is still fragile and vulnerable to negative confidence effects and specific factors which could depress growth in certain countries or branches of activity.

TABLE 8 COMPARISON WITH ESTIMATES OF OTHER INSTITUTIONS
(in %)

Institution	Publication date	Real GDP growth			Inflation (HICP, unless otherwise stated)		
		2015	2016	2017	2015	2016	2017
Federal Planning Bureau	September 2015 (1)	1.2	1.3		0.6	1.7	
IMF	October 2015	1.3	1.5	1.5	0.7	1.1	1.3
Consensus Economics	November 2015	1.2	1.4		0.5	1.5	
EC	November 2015	1.3	1.3	1.7	0.6	1.7	1.5
OECD	November 2015	1.3	1.5	1.6	0.6	1.3	1.4
NBB	December 2015	1.4	1.3	1.6	0.6	1.9	1.7

(1) Economic Budget 2015-2016. However, the inflation figures are the NCPI figures as estimated in the December 2015 inflation forecast.

In regard to the domestic risks, attention should be drawn to the way in which the recent government measures to improve competitiveness were incorporated in the projections. As in the previous estimates, it was again assumed that the slower growth of hourly labour costs will feed through into prices to a significant extent, albeit after some delay. If that process is faster or slower, or more or less incomplete 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, the movement in activity, employment, the budget balance or inflation could deviate from these autumn projections. Generally speaking, the domestic risks to growth seem to be on the upside overall. Certainly in the short term, the likelihood of a stronger confidence revival and somewhat higher quarterly growth in the second half of 2015 and in early 2016 appears to prevail. In addition, these forecasts take no account of the macroeconomic impact of redistribution aspects of the various government measures, particularly in connection with the tax shift. Insofar as the higher purchasing power will tend to favour low- and middle-income earners who generally have a lower savings ratio, private consumption could expand faster than these forecasts predict. Conversely, however, other government measures such as those taxing consumption could have a relatively bigger impact on the purchasing power of low and middle income households.

Next, it should be remembered that these estimates naturally take no account of any new budget measures that may be taken in the future.

Finally, it is also difficult at present to estimate the short- and longer-term economic impact of the heightened terrorist threat following the attacks in Paris and the associated tight security measures in Belgium. In the short term, it seems that the main adverse effect will be on activity in a few specific sectors such as hotels and restaurants, while public consumption will presumably exceed the estimates as a result of the additional expenditure on security. In the longer term, the repercussions of these terrorist attacks and their geopolitical implications are much more uncertain.

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	1.3	1.4	1.3	1.6
Contributions to growth:				
Domestic expenditure, excluding change in inventories	1.9	1.3	0.6	1.4
Net exports of goods and services	–0.4	–0.5	0.6	0.2
Change in inventories	–0.2	0.5	0.1	0.0
Prices and costs				
Harmonised index of consumer prices	0.5	0.6	1.9	1.7
Health index	0.4	1.1	1.7	1.4
GDP deflator	0.7	1.2	1.8	1.7
Terms of trade	0.0	2.9	0.3	0.1
Unit labour costs in the private sector (1)	–0.3	–0.4	–0.1	1.3
Hourly labour costs in the private sector (1)	0.6	0.2	0.2	1.9
Hourly productivity in the private sector	0.9	0.6	0.3	0.5
Labour market				
Domestic employment (annual average change in thousands of persons)	15.6	31.6	40.4	42.0
Total volume of labour (2)	0.5	0.7	1.0	1.1
Harmonised unemployment rate (in % of the labour force aged 15-64 years)	8.6	8.7	8.4	8.1
Incomes				
Real disposable income of individuals	0.5	1.3	1.1	1.3
Savings ratio of individuals (in % of disposable income)	12.6	12.4	12.4	12.5
Public finances				
Public sector financing requirement (–) or capacity (in % of GDP)	–3.1	–2.9	–2.9	–2.5
Primary balance (in % of GDP)	0.0	–0.1	–0.2	–0.1
Public debt (in % of GDP)	106.7	106.9	107.3	106.8
Current account (according to the balance of payments, in % of GDP)	0.1	0.8	1.4	1.7

Sources: EC, DGS, NAI, NBB.
(1) Including wage subsidies (mainly reductions in payroll tax) and targeted reductions in social contributions.
(2) Total number of hours worked in the economy.