BUSINESS CYCLE MONITOR

December 2019

Belgian activity growth is expected to edge down slightly to 0.2 % in the fourth quarter of 2019[1]

- Belgian GDP growth increased to 0.4 % (q-o-q) in the third quarter of 2019. The underlying growth momentum in Belgium was however slightly lower as about 0.1 pp of third-quarter growth was due to a specific transaction related to a wide-ranging R&D cooperation agreement which would not affect GDP growth in the following quarters. The Belgian growth rate was above that of the euro area, which remained modest at 0.2 %.
- Third-quarter growth was supported by positive contributions of private and public consumption and business investment, while public and housing investment as well as net exports contributed negatively to activity growth**.** Looking at the production side, the increase in value added was mainly driven by the business-related services and construction industries, while the value added in the manufacturing industry, which has declined over the past two years, only marginally edged up in the third quarter.
- In the fourth quarter, private consumption would slightly decelerate as fundamentals remain relatively strong but signals coming from survey indicators are mixed. Business investment growth would also lose some traction in the fourth quarter. While headline business confidence and demand expectations have recently partly recovered and financing conditions remain favourable, capacity utilisation has declined and the global outlook has worsened. We expect a rebound in housing investment as mortgage interest rates have further declined to historically low levels, income prospects remain strong and confidence indicators in the building industry remain at elevated levels. Finally, the contribution of net exports to GDP growth is expected to be negative again in the fourth quarter. The recent minor uptick in survey data on foreign demand only marginally offsets the very large decline over the past two years, such that export growth is likely to remain weak, while import growth is expected to be more robust, in line with domestic demand.
- While the median forecast of several one-indicator bridge models based on survey and financial data suggests that GDP growth in the fourth quarter would remain stable at 0.4 % and the prediction of the NBB's BREL nowcasting model even forecasts a slight increase to 0.5 %, the NBB's other nowcasting model R2D2 is markedly more pessimistic at -0.1 %. However, the latter model is particularly sensitive to developments in manufacturing, that are usually indicators of turning points in overall GDP growth, while, according to the current statistics, the weak growth in manufacturing still coincides with moderate overall real GDP growth. The lasting resilience in the services industry and domestic demand can still be expected to shore up GDP growth in the fourth quarter as well, even if, looking further, the Belgian economy may lose further steam if the dismal external and manufacturing outlook does not improve. All in all, a minor deceleration to a growth rate of 0.2 % appears to be the most plausible estimate for the fourth quarter at the current juncture, even though uncertainty remains particularly high.

[1] This is a short-term NBB estimate and should not be confused with the official statistics published by the National Accounts Institute (such as the flash GDP estimate, which is released one month after the quarter has ended). This NBB estimate is based on nowcasting models, as well as expert judgment and incorporates information up to 5 December 2019. As all estimates and forecasts, it comes with a degree of uncertainty.

Euro area GDP growth remained modest in the third quarter of 2019 and would not pick up strongly in the fourth quarter

Euro area GDP growth was stable at a modest rate of 0.2 % in the third quarter of 2019, with the year-on-year growth rate remaining at its six-year low of 1.2 %. While growth was broadly constant at 0.3-0.4 % in France, Spain and the Netherlands, it was much weaker in Italy, Austria and Germany. The latter country only narrowly avoided a recession after the contraction in the second quarter.

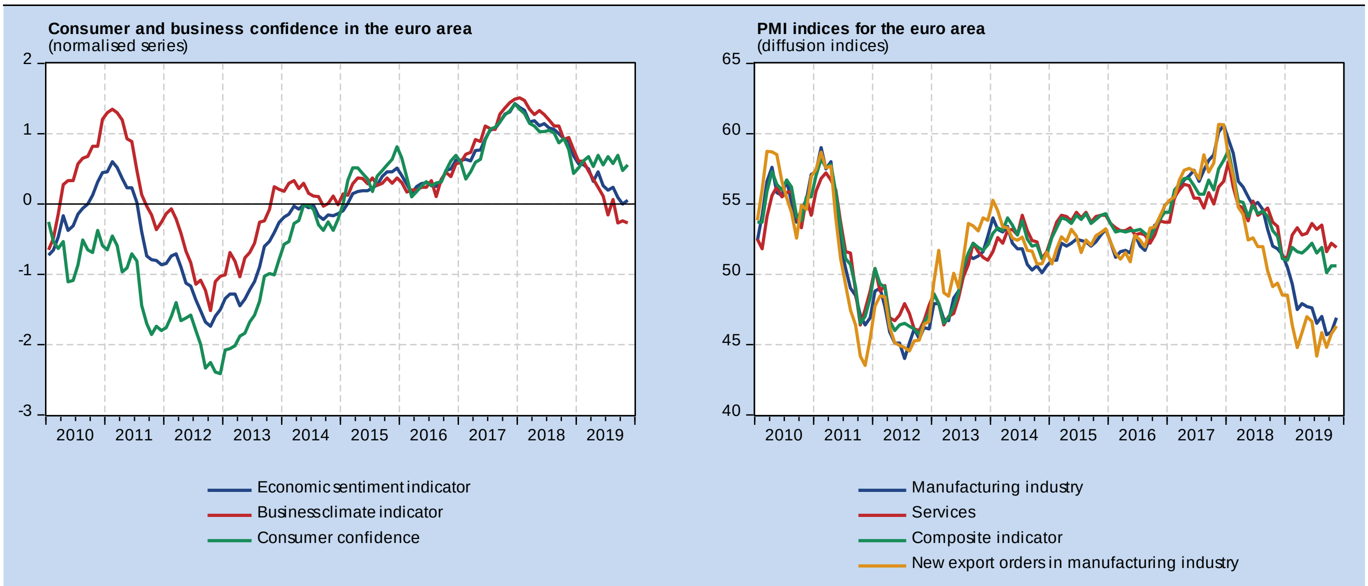
Table 1 Real GDP growth rate
(percentages, adjusted for seasonal and calendar effects)

	Quarter-on-quarter change				Year-on-year change
	2018 Q4	**2019 Q1**	**2019 Q2**	**2019 Q3**	**2019 Q3**
Euro area	0.3	0.4	0.2	0.2	1.2
Germany	0.2	0.5	-0.2	0.1	0.5
France	0.4	0.3	0.3	0.3	1.3
Italy	0.1	0.1	0.1	0.1	0.3
Spain	0.6	0.5	0.4	0.4	2.0
Netherlands	0.5	0.4	0.4	0.4	1.8
Belgium	**0.8**	**0.0**	**0.3**	**0.4**	**1.6**
Austria	0.7	0.5	0.1	0.1	1.5
EU	0.4	0.5	0.2	0.3	1.4
UK	0.3	0.6	-0.2	0.3	1.0
US	0.3	0.8	0.5	0.5	2.1
JP	0.4	0.5	0.4	0.1	1.4

Sources: EC, U.S. Department of Commerce, Cabinet Office Japan.

Looking forward, the recent survey and other high-frequency indicators suggest that the underlying growth momentum in the euro area would not pick up strongly in the fourth quarter of 2019. The EC's business climate indicator (see Chart 1, left graph) worsened further, falling to a six-year low in November. Consumer sentiment has been broadly stable this year after the steep fall in the course of 2018 and the overall economic sentiment indicator, that reflects both the business climate and consumer sentiment, dropped to a four-year low in October. The PMI indicators (see Chart 1, right graph) continue to point to a **strong divergence between the manufacturing and services industry**. After having plummeted in 2018 and having shown a further trend decline in the first nine months of 2019, the manufacturing PMI indicator and its new export orders component slightly edged up in October and November. While this may suggest that the manufacturing recession is bottoming out, the indicators still remain substantially below the 50 % threshold that marks zero growth. On the other hand, the services PMI indicator has held up much better since 2018 and remains well above the 50 % mark, even though it had weakened in September and has only marginally recovered since then. Against this background, euro area growth is not likely to rebound and it would remain subdued in the fourth quarter.

CHART 1 SENTIMENT INDICATORS FOR THE EURO AREA



Sources: Markit, EC.
Note: the original series in the left graph are normalised around their historical averages and divided by their standard deviation.

Outside the euro area, quarterly GDP growth remained relatively strong in the United States and it rebounded in the United Kingdom, while it decreased in Japan. Furthermore, due to the ongoing trade tensions, international organisations have further revised down their global growth and trade projections, which are projected to bottom out in 2019 and to pick up again in the course of 2020. All in all, growth would remain subdued in the next two years.

Belgian growth surprised on the upside in the third quarter and was supported by consumption and business investment

According to the current estimate of the National Accounts Institute (NAI), **Belgian real GDP growth edged up to 0.4 % in the third quarter of 2019,** which is twice as high as the euro area average. It is also clearly above the September 2019 estimate of the Business Cycle Monitor (0.2 %). In a year-on-year comparison, real GDP growth increased to 1.6 %. However, the NAI flags that about 0.1 pp of third-quarter growth is due to a specific transaction related to a wide-ranging R&D cooperation agreement. As this transaction would not affect GDP growth in the following quarters, this implies that the underlying growth momentum is about 0.3 %.

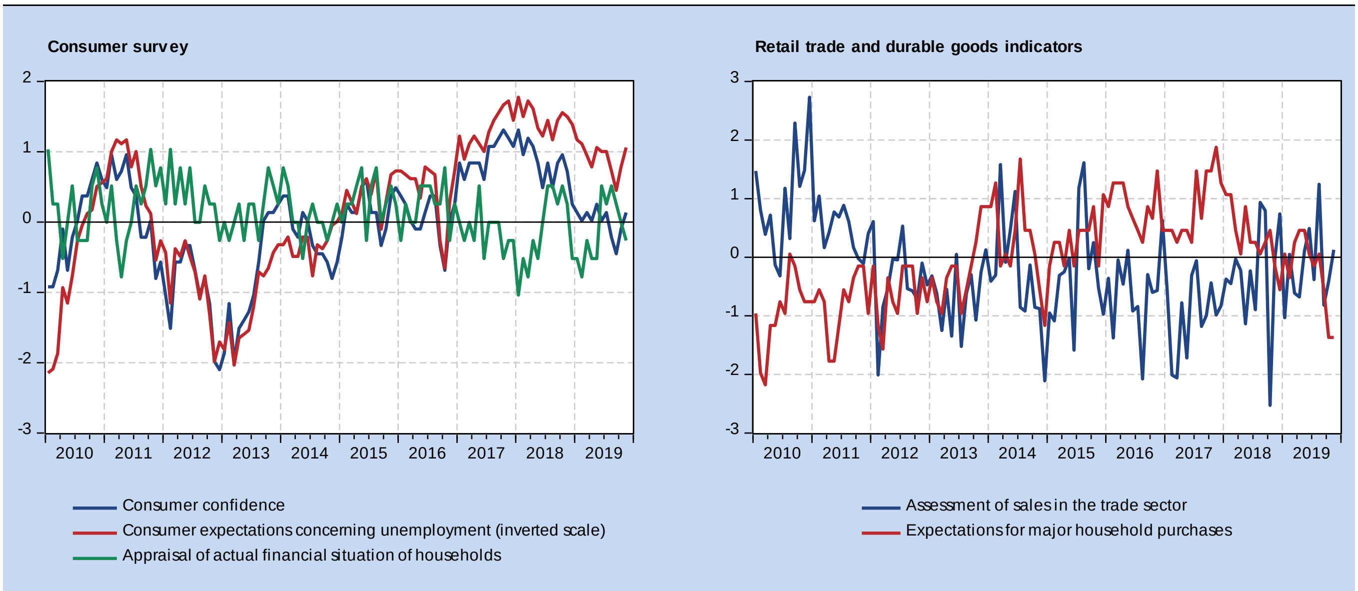
Third-quarter growth was supported by positive contributions of private and public consumption and business investment, while public and housing investment and net exports contributed negatively to activity growth**.** Looking at the production side, growth in value added was again buoyant in the construction (1.3 %) and services (0.4 %) industries. On the other hand, value added in the manufacturing industry grew only marginally in the third quarter (0.1 %) after having declined by 0.4 % in the previous quarter and by 2.2 % since early 2018.

Private consumption growth would slightly decelerate in the fourth quarter, as survey indicators are mixed

Private consumption strongly increased by 0.6 % in the third quarter of 2019, which puts the year-on-year growth rate at 1.5 %. Non-durable consumption, which accounts for the bulk of total private consumption, increased by 0.8 % and durable consumption strongly rebounded by 3.1 %[2].

Consumer sentiment recovered in October and November from its summer drop and it is now again at its level of the first half of 2019, which is also close to its historical average (see Chart 2, left graph). The recovery is mainly driven by an improvement in the expectations regarding the economic situation and unemployment. On the other hand, the assessment by households of their current financial situation in the consumer survey has declined since September. Finally, the assessment of sales by company managers in the trade sector partly recovered in October and November but this follows a strong decline in September (see Chart 2, right graph).

CHART 2 INDICATORS FOR PRIVATE CONSUMPTION GROWTH
(normalised series)



Source: NBB.
Note: the original series are normalised around their historical averages and divided by their standard deviation.

Durable consumption growth is likely to decline in the fourth quarter of 2019. Based on the seasonally adjusted data until November of the automobile federation Febiac, new car registrations are expected to remain broadly stable in the fourth quarter[3]. Moreover, the survey indicator related to forecasts of major purchases of households for the next twelve months declined to a seven-year low in October and remained at this level in November (see Chart 2, right graph).

[2] Private consumption mainly consists of durable and non-durable consumption in Belgium, but it also includes tourism spending of Belgians abroad as well as consumption by non-profit institutions serving households and it excludes spending of foreign tourists in Belgium. That is why total private consumption growth is not just a weighted average of the growth in durable and non-durable consumption.

[3] Note that the link between the Febiac data on new car registrations and private consumption is partly blurred because of the substantial share of new car registrations by companies, including car dealers.

Turning to the fundamentals, consumption is likely to be supported by increasing purchasing power. First and foremost, real wage growth is robust in 2019 and will continue to be strong in the following years. In addition, a new phase of the tax shift has increased take-home pay as of January 2019 and, while expected to slow gradually, employment growth would remain solid for some time. Finally, oil prices have remained about constant since their further decline in September and they are well below the highs reached in May of this year and in October of last year.

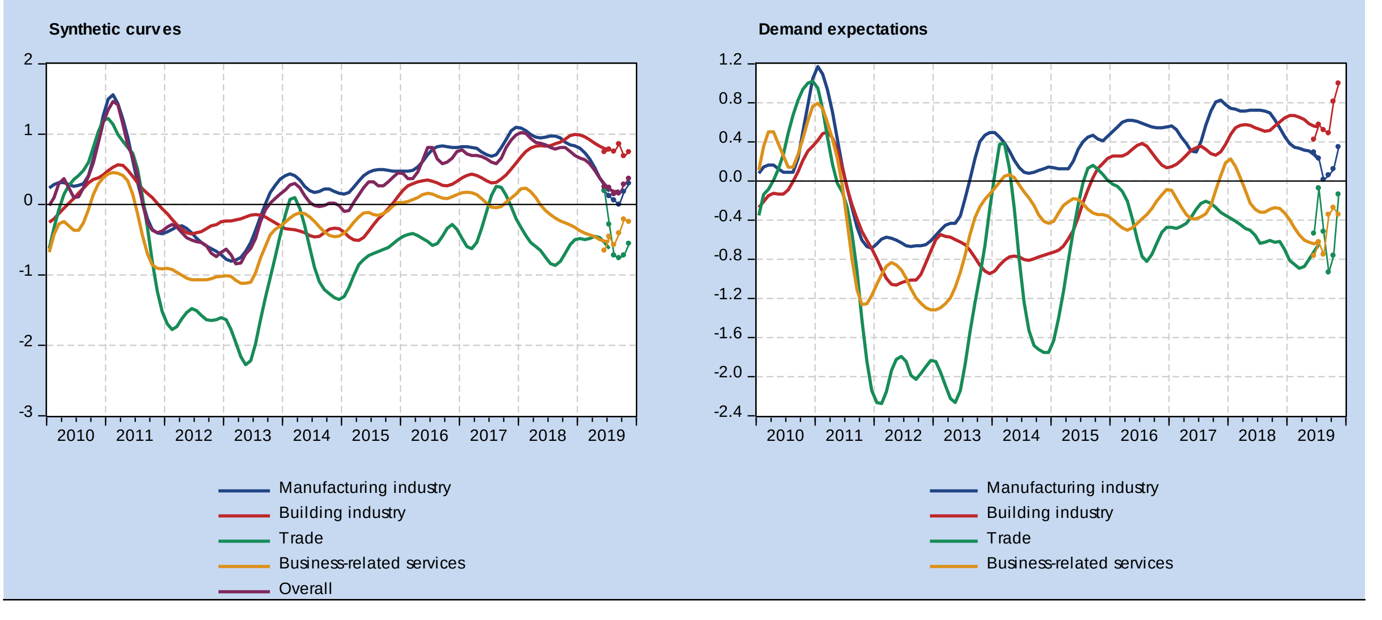
All in all, we expect private consumption growth in the fourth quarter to remain strong – but to decelerate somewhat compared to the large increase in the previous quarter – as fundamentals remain relatively strong but signals coming from survey indicators are mixed.

Business investment expected to decelerate slightly, while housing investment would rebound

Total investment expanded by 0.3 % in the third quarter of 2019. While business investment increased by 1.0 %, public investment and especially housing investment decreased, by respectively 0.2 % and 1.5 %.

Headline business sentiment edged up in October and November, after having been on a downward trend since early 2018 (see Chart 3, left graph). Sentiment partly recovered in the business-related services and the manufacturing industry, which are the two sectors where sentiment had fallen strongly since early 2018. On the other hand, sentiment remained broadly stable in the building and trade industries. As regards the sub-indicators, demand expectations rebounded in the trade, the business-related services and the manufacturing industries and they continued to further increase to a fourteen-year high in the building industry (see Chart 3, right graph).

CHART 3 BUSINESS SENTIMENT AND DEMAND EXPECTATIONS
(normalised series)



Source: NBB.
Note: the original series are normalised around their historical averages and divided by their standard deviation.

Turning to fundamentals, business investment in the fourth quarter will continue to be supported by the favourable financing conditions. In addition, the discontinuation of the temporary increase in the tax allowance for investment for small businesses and self-employed as from January 2020 may have brought forward certain investments that were initially planned for the coming years. On the other hand, the worsened international economic outlook is expected to weigh on investment, which may also decline due to increasing labour costs that dampen profit growth. In addition, capacity utilisation in the manufacturing industry decreased to 79.4 % in October and is now substantially below its peak level reached in 2017, which, together with the worsened global outlook, should make expansion investment less urgent. **Overall, we expect business investment growth to decelerate slightly in the fourth quarter of 2019.**

After having expanded strongly since the beginning of 2018, housing investment declined by 1.5 % in the third quarter of 2019. **We expect a rebound in housing investment in the fourth quarter of 2019,** as the environment remains very supportive for real estate investment. Mortgage rates have slightly declined further to historically low levels and income prospects remain strong in the medium term, while monetary policy accommodation has increased. The favourable outlook for residential investment is also in line with the aforementioned elevated business confidence and demand expectations in the building industry.

All in all, investment is expected to provide slightly stronger support for GDP growth in the fourth quarter of 2019, even though business investment may decelerate somewhat.

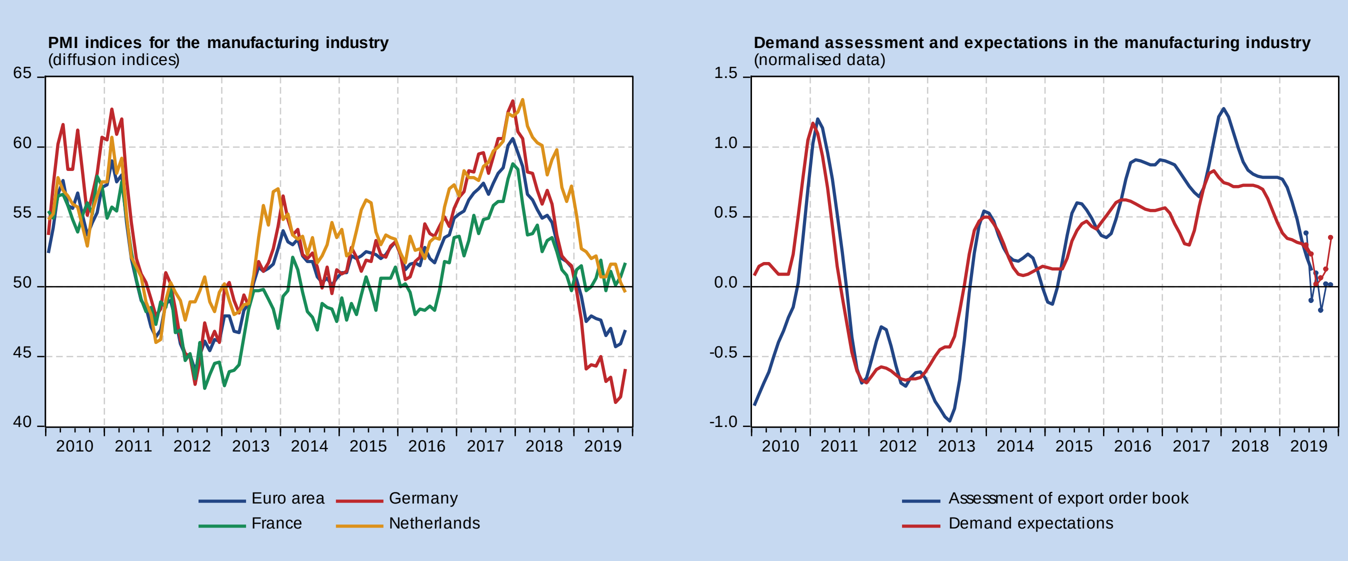
Net exports could again weigh on growth in the fourth quarter due to weaker foreign demand

Exports decreased by 0.9 % and imports fell by 0.8 % in the third quarter of 2019, resulting in a negative contribution of net exports to GDP growth of 0.1 percentage point.

Surveys conducted among purchasing managers in the manufacturing industry in several key partner countries for Belgium suggest that potential demand for Belgian exports may not pick up strongly (see Chart 4, left graph). After large declines throughout 2018 and the first nine months of 2019, the PMI manufacturing index again weakened in the Netherlands in October and November, but slightly edged up in the euro area, Germany and France. While the index remains close to 50 % for France and the Netherlands, it continues to be substantially below that zero-growth threshold for the euro area and especially for Germany, pointing to a continuation of the manufacturing recession. Furthermore, accelerating wage growth and the waning impact of past cost competitiveness gains could weigh on Belgian export growth. Finally, the worsened prospects for exports are confirmed by a sharp fall in demand expectations and the assessment of export orders in the Belgian manufacturing industry since early 2018, even though they slightly edged up since October (see Chart 4, right graph).

All in all, the contribution of net exports to GDP growth is expected to be negative again in the fourth quarter. The recent minor uptick in survey data on foreign demand only marginally offsets the very large declines over the past two years, such that export growth is likely to remain weak, while import growth is expected to be more robust, in line with domestic demand.

CHART 4 PMI INDICATORS IN NEIGHBOURING COUNTRIES AND EXPORT ORDERS IN MANUFACTURING



Sources: Markit, NBB.

While the one-indicator models based on financial and survey data predict a stable growth in the fourth quarter…

The information content in the most recent survey and financial data can be summarised by looking at the range of mechanical GDP predictions using one-indicator bridge models, even if the forecast performance of these simple models suggests that the individual predictions should be interpreted with caution. The histogram in Chart 5 shows the distribution of the GDP growth nowcasts of these different one-indicator bridge models.

The different one-indicator bridge model predictions point to a stable GDP growth in the fourth quarter of 2019. The predictions have a distribution which is roughly symmetric and most frequently lie in the [0.3;0.6] % range, with a median estimate equal to 0.4 %.

…The unusual divergence in the two NBB nowcasting models points to a large uncertainty of the nowcasts

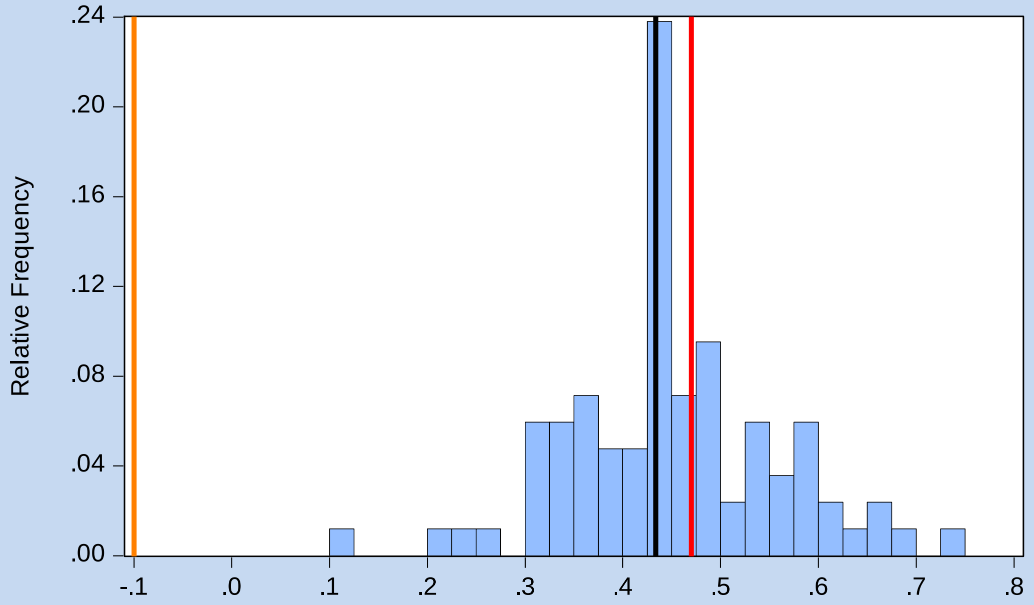
Estimates for activity growth in the fourth quarter of 2019 produced with the more elaborate standard NBB nowcasting models show an unusually large divergence, as was also the case for the nowcast of the third quarter growth in the previous version of the business cycle monitor. **While the BREL model predicts a slight increase in growth to 0.5 %,** which is slightly above with the median of the one-indicator bridge model predictions, **the R2D2 dynamic factor model forecasts a negative growth of -0.1 %**[4]. This reflects the current economic situation with the marked divergence between, on the one hand, the weak growth in external demand and the manufacturing industry and, on the other hand, the greater resilience in domestic demand and the services industry. The R2D2 dynamic factor model is particularly sensitive to developments in

[4] Another version of the R2D2 dynamic factor model that includes more Belgian-specific variables however points to a positive growth rate of 0.1 %.

manufacturing, that are typically indicators of turning points in overall GDP growth, while, according to the current statistics, the weak growth in manufacturing still coincides with modest real GDP growth. The lasting resilience in the services industry and domestic demand can still be expected to shore up GDP growth in the fourth quarter as well, even if, looking further, the Belgian economy may lose further steam if the dismal external and manufacturing outlook does not improve. Finally, the Federgon index on the work volume of temporary agency work has been broadly stable since August after it had substantially declined since mid-2018, which could be another indication of decelerating growth[5].

All in all and taking into account the fact that growth in the third quarter was increased by a specific operation that would have no impact on growth in the current quarter, an estimate of 0.2 % for the quarterly growth rate in the fourth quarter appears to be most plausible for now even though uncertainty remains high.

CHART 5 HISTOGRAM OF ONE-INDICATOR BRIDGE MODEL PREDICTIONS USING A BROAD SET OF SURVEY AND FINANCIAL DATA AND NBB NOWCASTING MODEL PREDICTIONS FOR REAL GDP GROWTH IN THE FOURTH QUARTER OF 2019



Source: NBB.
Note: The black line corresponds to the median of the one-indicator bridge model predictions for the current quarter GDP growth, while the red and the orange lines respectively correspond to the predictions from the bridge model 'BREL'[6] and the dynamic factor model 'R2D2'[7], respectively.

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5 The decline in the Federgon index since mid-2018 could also have been driven by an increased use of permanent contracts, given the current labour market shortages and the reduction in May 2018 of the notice periods applicable at the start of the period of employment.

6 Piette, C. (2016), Predicting Belgium's GDP using targeted bridge models, NBB Working Paper 290.

7 Basselier, R., De Antonio Liedo, D. and Langenus, G. (2018) Nowcasting real economic activity in the euro area: assessing the impact of qualitative surveys, NBB Working Paper 331. The R2D2 model is estimated using the JDemetra+ software, which is publicly available at www.nbb.be/jdemetra.