March 2020

Belgian activity growth is expected to decline to 0.2 % in the first quarter of 2020[1]

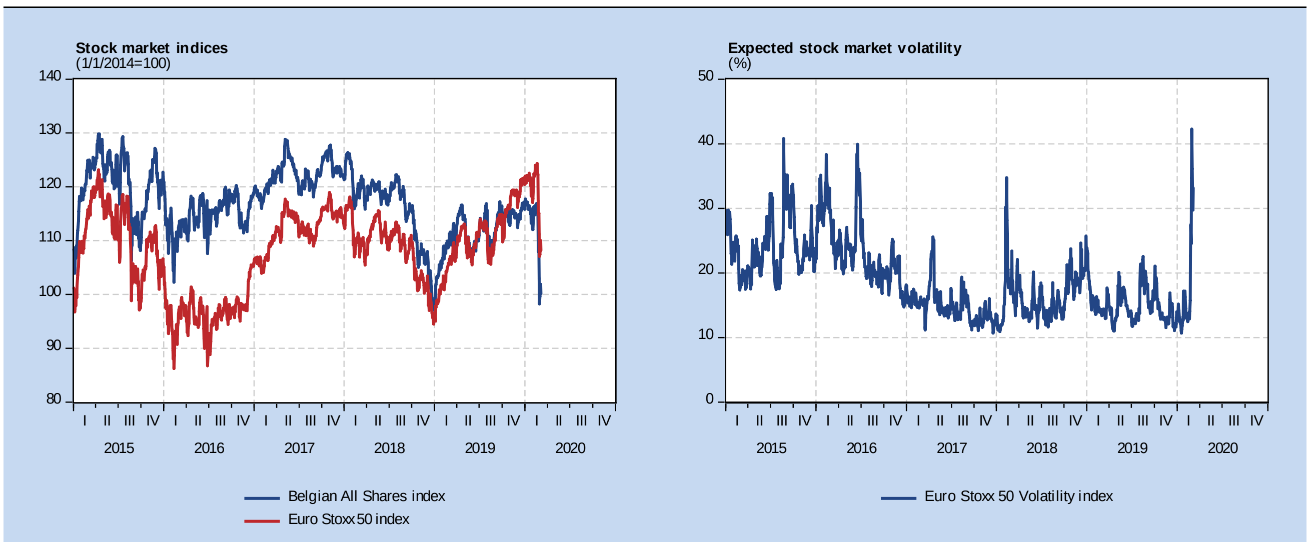
- **Belgian GDP growth would ease from 0,4 % in the last quarter of 2019 to 0,2 % in the first quarter of 2020. While business and housing investment should slow, private and public consumption are likely to remain resilient. Evaluating the economic effect of the Covid-19 is a difficult task as most available short-term indicators do not yet reflect the very recent outbreak in Europe. In the first quarter the negative growth impact is still assessed to be limited but it could worsen in the second quarter, in particular if severe containment measures are taken or if supply chain problems lead to production stops in the manufacturing industry.**
- Belgian real GDP growth remained stable at 0.4 % in the fourth quarter of 2019. This is well above the growth rate in the euro area as a whole, which declined to 0.1 %. Fourth-quarter growth was supported by positive contributions of private and public consumption as well as housing and business investment.
- The outbreak and the recent global spread of the new coronavirus disease (Covid-19) could potentially strongly negatively affect economic activity in Belgium, via both supply- and demand-side channels. These include disruptions in global supply chains, a reduction in global growth, travel and tourism, a decline in business and consumer confidence and, especially, the economic impact of possible severe containment measures, such as school and company closures, the cancellation of mass events and quarantine measures. In this Business Cycle Monitor, it is however assumed that the Covid-19 incidence will still worsen but that no such containment measures will be taken in Belgium in the remaining weeks of the quarter.
- We expect first-quarter private and government consumption growth to remain resilient as the survey indicators and purchasing power remain strong, while the negative impact of the recent Covid-19 developments on consumption would be partly offset by increased hoarding purchases and buoyant health care spending. Even though business sentiment further improved in the beginning of the year, business investment growth should moderate because of the Covid-19 related uncertainty and worsened global economic outlook, the reduced capacity utilisation and the discontinuation of the temporary increase in the tax allowance for investment for small businesses and self-employed. Housing investment growth should decline as well, after the surge in real estate transactions in the fourth quarter is likely to have been at least partly driven by the discontinuation of the so called ‘woonbonus’ in the Flemish Region. Finally, the contribution of net exports to GDP growth is likely to be negative again in the first quarter, as the recent Covid-19 developments would depress export growth.
- All in all, an estimate of 0.2 % for the quarterly growth rate in the first quarter appears to be most plausible, but the uncertainty is high. The NBB nowcasting models ‘BREL’ and ‘R2D2’ predict a growth deceleration in the first quarter, to 0.3 % and 0.2 %, respectively, but the indicators used by these nowcasting models do not yet reflect the very recent spread of Covid-19 in Europe. While specific industries, such as tourism-related activities or companies that export to China, are facing reduced demand, the overall Covid-19 impact however seems to remain limited at the current juncture as global supply chain problems do not yet lead to interruptions of production in the manufacturing industry. Still, depending on the further developments, also as regards containment measures, the growth impact can be larger.
- Finally, this Business Cycle Monitor was finalised on 6 March, i.e. before the Italian government announced further and unprecedented quarantine measures for a large part of the Italian economy in the weekend of 7 and 8 March. As Italy is Belgium’s sixth main trading partner directly accounting for close to 5 % of total exports, this is likely to further weigh on export demand and increases the downside risks for the first-quarter growth estimate. More importantly, it should be stressed that at the current juncture the outlook for the second quarter is much worse.

[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 6 March 2020. As all estimates and forecasts, it comes with a degree of uncertainty.

The Covid-19 outbreak could potentially strongly affect Belgian and euro area economic activity but the uncertainty is large

The outbreak and the recent global spread of the new coronavirus disease (Covid-19) could potentially strongly negatively affect economic activity in Belgium and the euro area, via both supply and demand side channels. On the supply side, quarantine measures in China since the end of January have weighed on its manufacturing output and are already disrupting global supply chains, which could lead to shortages and lower production also in the euro area. In addition, the euro area labour supply and economic output could be affected, especially in case more severe containment measures, such as the lockdown of some municipalities and the general school closures already witnessed in Italy, would be taken in the euro area. On the demand side, euro area exports should be negatively affected by the reduced global economic growth, which according to the OECD may be lowered by 0.5 to 1.5 pp as a result of Covid-19. Exports may specifically be hit by a sharp drop in tourism and business travel, even if this would also reduce imports. Furthermore, certain forms of consumption may be affected by an increasing tendency to avoid public places or simply because mass events are cancelled. The negative direct impact on private consumption may be exacerbated by a decline in confidence or by wealth effects coming from the sharp decline in stock prices and the increased expected stock market volatility (see Chart 1) and these developments, together with the increased economic uncertainty and reduced demand prospects, could also weigh on business investment beyond the short term. At the same time, there is some anecdotal evidence of hoarding purchases of non-perishable items by households that could initially and partly counterbalance the negative Covid-19 impact somewhat.

CHART 1 EURO AREA AND BELGIAN STOCK PRICE INDICES AND STOCK MARKET VOLATILITY INDEX



Source: Thomson Reuters Datastream.

However, the economic impact of Covid-19 on Belgian and euro area economic growth greatly depends on the further spread of the disease and, in particular, on the containment measures that will be taken in the coming weeks, which are both very uncertain. **In this Business Cycle Monitor, where we forecast the first-quarter economic growth in Belgium, it is assumed that the Covid-19 incidence will still worsen but that no very restrictive containment measures such as company or school closures or quarantine measures will be taken in Belgium in the remaining weeks of the quarter**. However, if such containment measures are still implemented in the coming weeks, first-quarter growth could clearly be lower.

In addition to the uncertainty about future developments, a technical difficulty of producing short-term growth estimates at this stage is that the traditional indicators that are used in the nowcasting models do not yet reflect the recent spread of Covid-19 in Europe. The consumer and business confidence indicators that are available for February, for instance, are based on surveys that have taken place by mid-February at the latest, while the outbreak in northern Italy occurred in the second half of February. This implies that it is important to complement these model-based estimates with expert judgment in order to take into account the impact of these recent Covid-19 developments on economic growth.

Euro area GDP growth declined in the fourth quarter of 2019 and could further decline in the first quarter

Euro area GDP growth declined to 0.1 % in the fourth quarter of 2019, with the year-on-year growth rate reaching a six-year low of 0.9 %. While quarterly GDP growth slightly increased in Spain and remained constant in the Netherlands and Austria, economic activity stagnated in Germany and it declined in France and especially in Italy. Outside the euro area, economic activity continued to strongly expand in the United States, but it stagnated in the United Kingdom and fell substantially in Japan following a consumption tax increase and a typhoon.

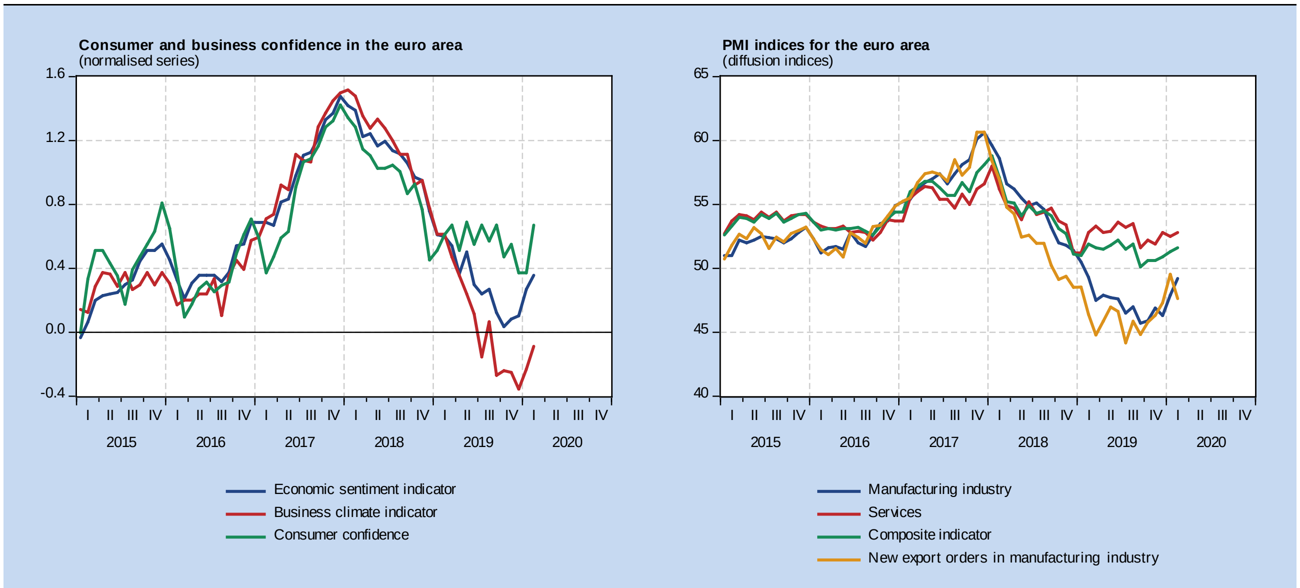
Table 1 Real GDP growth rate
(percentages, adjusted for seasonal and calendar effects)

	Quarter-on-quarter change				Year-on-year change
	2019 Q1	**2019 Q2**	**2019 Q3**	**2019 Q4**	**2019 Q4**
Euro area	0.4	0.2	0.3	0.1	0.9
Germany	0.5	-0.2	0.2	0.0	0.5
France	0.3	0.4	0.3	-0.1	0.9
Italy	0.2	0.1	0.1	-0.3	0.0
Spain	0.5	0.4	0.4	0.5	1.8
Netherlands	0.4	0.4	0.4	0.4	1.6
Belgium	0.0	0.3	0.4	0.4	1.2
Austria	0.5	0.1	0.2	0.2	0.9
EU	0.5	0.2	0.3	0.1	1.1
UK	0.6	-0.1	0.5	0.0	1.1
US	0.8	0.5	0.5	0.5	2.3
JP	0.6	0.5	0.1	-1.6	-0.4

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

Euro area survey indicators have improved over the previous months, but as the surveys were conducted before the Covid-19 outbreak in Italy, they do not yet incorporate the recent developments and are therefore overoptimistic for the first-quarter growth. After having fallen substantially since the end of 2017 to multi-year lows at the end of 2019, the EC's business climate indicator, the consumer confidence indicator and the overall economic sentiment indicator, that reflects both the business climate and consumer sentiment, have rebounded in January and February (see Chart 2, left graph). Also the PMI indicators have improved since the end of 2019 and they seem to suggest that the strong divergence between the manufacturing and services industry observed in 2019 is narrowing (see Chart 2, right graph). After having plummeted in 2018 and the first nine months of 2019, the manufacturing PMI indicator and its new export orders component have bottomed out at the end of 2019 and picked up in January and February to just below the 50 % threshold that marks zero growth. However, it should be noted that the February improvement in the manufacturing PMI indicator is somewhat misleading as it is driven to a large extent by the lengthening of delivery times due to the Covid-19-related supply chain disruptions. In this particular case, this does not reflect buoyant demand but rather problems on the supply side, which should not be correlated positively with GDP growth. The services PMI indicator, which had declined to a lesser extent since 2018, has remained relatively constant since 2019 and is well above the 50 % mark.

CHART 2 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.

Belgian growth remained stable in the fourth quarter, supported by consumption and business and housing investment

According to the current estimate of the National Accounts Institute (NAI), **Belgian real GDP growth remained stable at 0.4 % in the fourth quarter of 2019**, which is well above the growth rate in the euro area as a whole. It is also above the estimate of the December 2019 Business Cycle Monitor (0.2 %). However, the fourth-quarter underlying growth momentum is slightly lower, at 0.3 %, as about 0.1 pp of the GDP growth is reported to be accounted for by the surge in real estate activity that is likely to have been at least partly brought about by the announced discontinuation of the tax abatement for mortgage loans in the Flemish Region (the so-called 'woonbonus') as of January 2020.

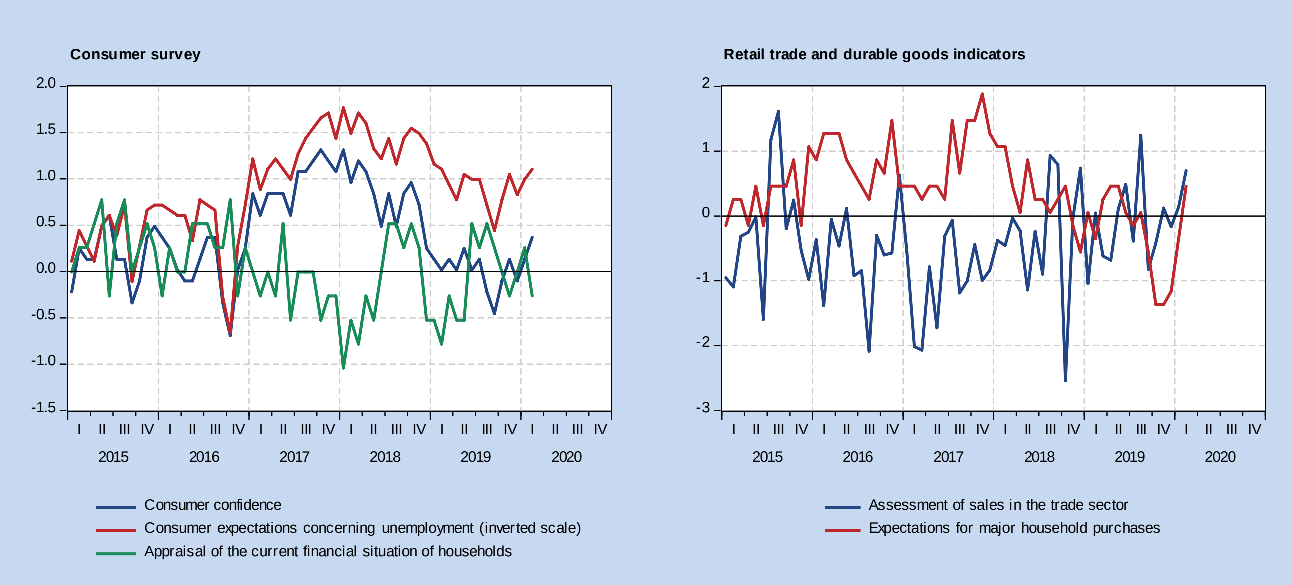
Fourth-quarter growth was supported by positive contributions of private and public consumption and housing and business investment, while net exports and public investment contributed negatively to activity growth. Looking at the production side, growth in value added was broad-based across sectors: it remained especially buoyant in the construction industry (1.1 %), while it marginally declined in the services (0.3 %) and manufacturing (0.4 %) industries.

Private and government consumption growth would remain resilient in the first quarter

Private consumption continued to expand strongly in the fourth quarter of 2019, by 0.5 %, which puts the year-on-year growth rate at 1.8 %, a two-year high. Non-durable consumption, which accounts for the bulk of total private consumption, increased by 0.7 %, while durable consumption declined by 1.1 %.

Survey indicators for private consumption growth improved in January and February, but they do not yet reflect the latest Covid-19 developments, as the surveys are taken in the beginning of the month**.** Consumer sentiment increased in January and February to a fifteen-month high, driven by an improvement in the consumers' expectations regarding unemployment, their financial situation and their savings (see Chart 3, left graph). However, the assessment by households of their current financial situation in the consumer survey, which is not included in the headline index, remained about constant. Furthermore, the assessment of sales by company managers in the trade sector and the survey indicator related to forecasts of major purchases of households for the next twelve months have strongly increased in January and February, which suggests that consumption growth would remain solid and that purchases of durables could pick up in the near term (see Chart 3, right graph). However, based on the seasonally adjusted data until February of the automobile federation Febiac, new car registrations are expected to slightly decline in the first quarter.[2]

CHART 3 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.

Consumption would be supported by increases in purchasing power: disposable income has strongly increased in 2019 and is likely to continue growing, though at a more moderate pace. Employment would still grow at a healthy pace and purchasing power is also boosted by the decline in electricity and especially gas prices over the past year, the latter being at a ten-year low. More generally, consumption growth remained below that of

[2] Please 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.

purchasing power over the past years and in 2019 in particular, because consumption tends to react to income shocks with some delay. However, we now expect consumption growth to outpace income developments in the coming years.

The immediate impact of the Covid-19 developments on private consumption is uncertain. A relatively strong downward impact could come from the cancellation of mass events and a greater tendency to avoid public places. This may be exacerbated by adverse confidence effects. At the same time, these effects on first-quarter growth could be offset by hoarding purchases, which seem to already take place according to anecdotical evidence from retail chains.

Finally, **government consumption growth should continue to be fuelled by buoyant health care spending.** This is due to the fact that no specific measures seem to be taken to bring its growth in line with the 1.5 % norm, as the federal government acts in a caretaker capacity, and health care spending may in addition be higher due to the Covid-19 outbreak.

All in all, we expect first-quarter private and government consumption growth quarter to remain relatively solid as the survey indicators and purchasing power remain strong, while the negative impact of the recent Covid-19 developments on consumption could be partly offset by increased hoarding purchases and buoyant health care spending.

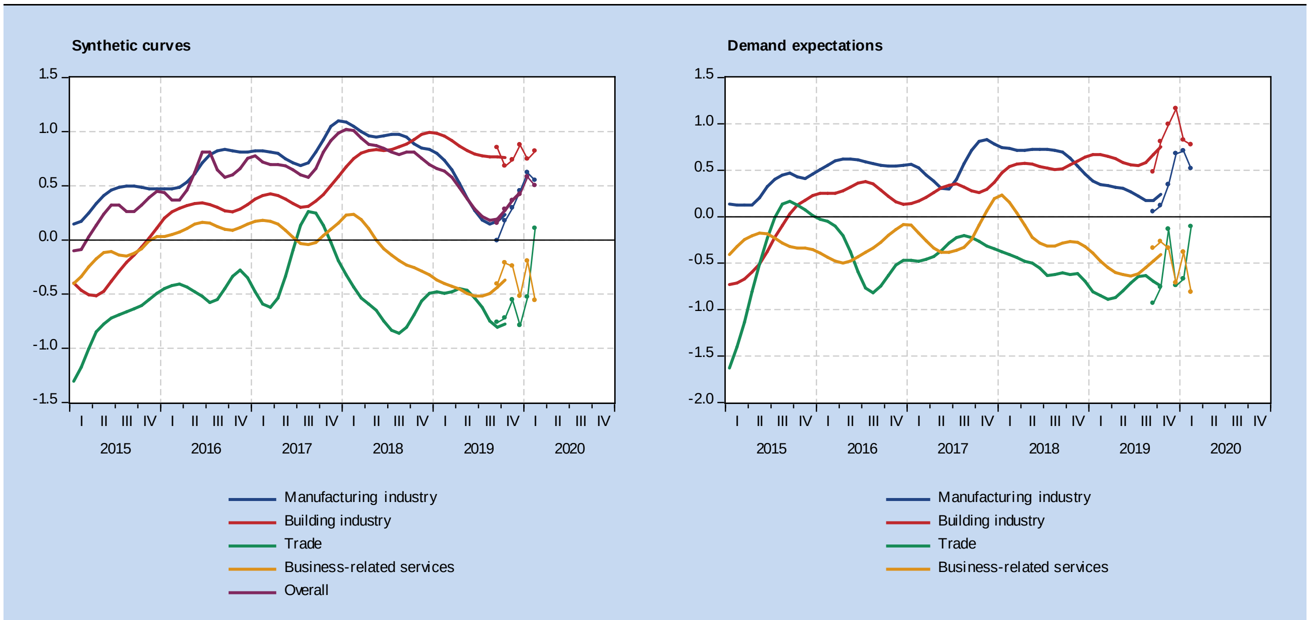
Business and housing investment growth are expected to decline in the first quarter

Volume growth in total investment decelerated to just 0.1 % in the fourth quarter of 2019. Government investment plunged by 7.3 %, while housing investment rebounded by 1.3 % and growth in business investment remained stable at 0.9 %. However, without the specific transactions in the shipping industry related to the sale of several large vessels abroad in the fourth quarter, business investment growth would in fact have accelerated to 2.4 %.

The headline business sentiment indicator improved in January for the fifth consecutive month and only slightly receded in February (see Chart 4, left graph)**, but it does not yet reflect the recent Covid-19 developments.** Sentiment increased in the manufacturing industry and especially in the trade industry and remained broadly stable at elevated levels in the building industry, while it slightly decreased in the business-related services. As regards the sub-indicators, demand expectations in the business-related services, manufacturing and building industries slightly came down from the high levels reached at the end of last year, while they further increased in the trade industry (see Chart 4, right graph).

Turning to fundamentals, the increased economic uncertainty and the reduced demand prospects related to the recent Covid-19 developments are expected to negatively affect business investment, even though the negative impact could materialise only gradually as it takes time to adjust investment plans. In addition, capacity utilisation in the manufacturing industry further decreased to 78.6 % in January and is now slightly below its historical average, which, together with the worsened global outlook should make expansion investment less urgent. Finally, the discontinuation of the temporary increase in the tax allowance for investment for small businesses and self-employed as from January 2020 could negatively impact first-quarter business investment growth in particular, because certain investments that were initially planned for this year could have been brought forward. **Overall, we expect (underlying) business investment growth to weaken in the first quarter of 2020.**

CHART 4 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.

Housing investment increased by 1.3 % in the fourth quarter of 2019. The underlying growth was lower as the registration and notary fees were boosted by the spike in the number of real estate transactions, which is likely to have been at least partially driven by the discontinuation of the tax abatement for mortgage loans ('woonbonus') in the Flemish Region as of January 2020. There are currently no indications that real estate transactions are plummeting as of the beginning of 2020; real estate investors, that did not benefit from the mortgage tax deduction in the first place, seem to make up for the reduced demand of single-home buyers. Still, even if real estate transactions would return to normal levels, the unwinding of the high fourth quarter level means that first-quarter growth will be negatively affected. Therefore, **we expect housing investment growth to edge down in the first quarter**, even if the historically low mortgage rates, solid income prospects and the elevated business confidence and demand expectations in the building industry remain supportive for real estate investment.

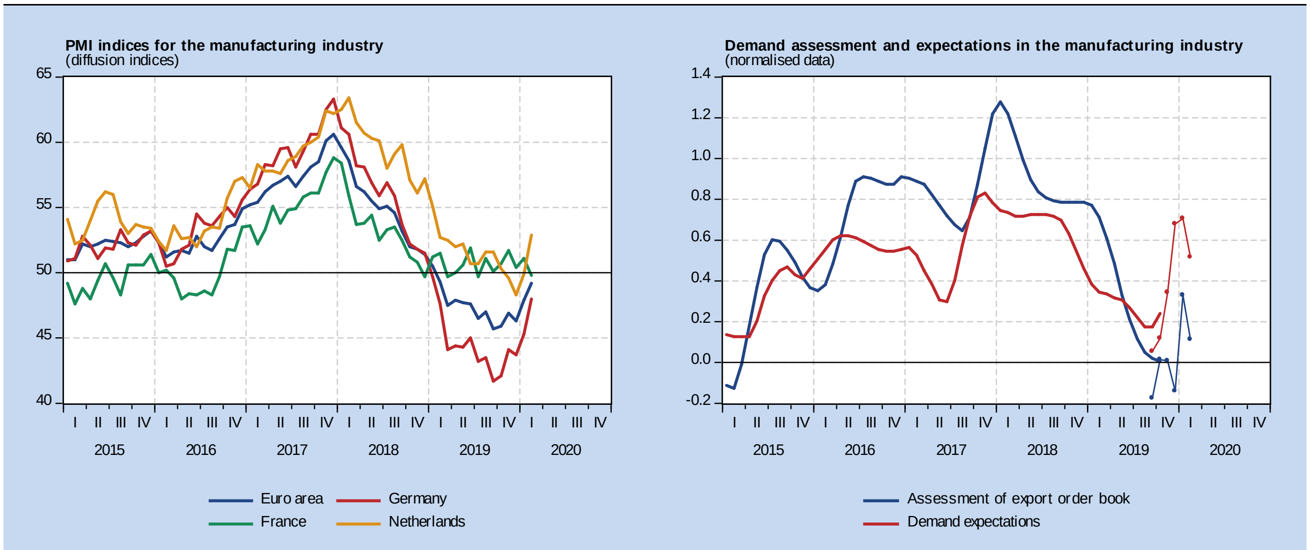
Net exports would again weigh on growth in the first quarter due to weaker foreign demand including from tourism

Exports increased by 0.6 % and imports grew by 0.9 % in the fourth quarter of 2019, resulting in a negative contribution of net exports to GDP growth of -0.2 percentage point. However, excluding the impact of the aforementioned specific shipping transactions related to sale of large vessels abroad, the contributions of net exports would have been more negative at -0.5 pp.

The surveys conducted among purchasing managers in the manufacturing industry in several key partner countries for Belgium indicate that potential demand for Belgian exports has improved in January and February (see Chart 5, left graph). After large declines throughout 2018 and 2019, the PMI manufacturing index picked up in the euro area, Germany and the Netherlands, while it remained broadly stable in France, and it is now close to the 50 % level that marks zero-growth in these countries. These improvements are reflected by a strong rebound in demand expectations and the assessment of export orders in the Belgian manufacturing industry in January and February (see Chart 5, right graph). However, these survey indicators will likely substantially worsen in March when they will reflect a stronger Covid-19 impact. In addition, as argued above, the February improvement in the manufacturing PMI indicator is a bit misleading as it is partly driven by the lengthening of delivery times due to the supply chain disruptions. Furthermore, declining tourism inflows (from China in particular) reduce exports. Finally, accelerating wage growth and the waning impact of past cost competitiveness gains could weigh on Belgian export growth.

All in all, the contribution of net exports to GDP growth is expected to be negative again in the first quarter. The improvement in survey data on foreign demand does not yet reflect the recent Covid-19 developments, which will likely depress export growth in the first quarter, while import growth is expected to be more resilient.

CHART 5 PMI INDICATORS IN NEIGHBOURING COUNTRIES AND EXPORT ORDERS IN MANUFACTURING



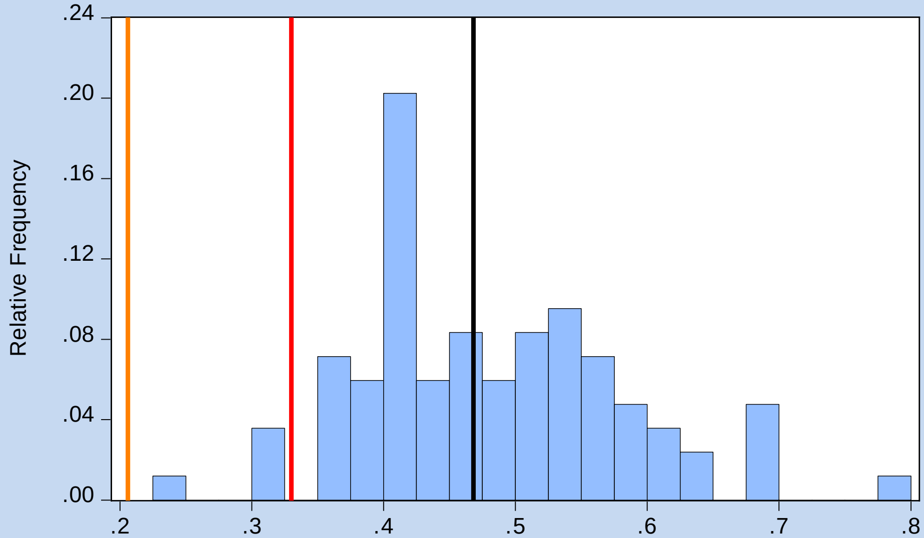
Sources: Markit, NBB.
Note: the series in the right graph are normalised around their historical averages and divided by their standard deviation.

The nowcasting models likely overestimate first-quarter growth as they do not reflect the recent Covid-19 developments…

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. However, the recent Covid-19 developments since the end of February are not at all reflected in the survey indicators, as the surveys took place in the beginning of the month, and they are only partly reflected in the financial indicators, which are computed as monthly averages. **The different one-indicator bridge model predictions point to a broadly stable or even marginally increasing GDP growth in the first quarter of 2020 (see Chart 6), but they are likely an overestimation as they do not take into account the recent Covid-19 developments.** The predictions have a distribution which is roughly symmetric and most frequently lie in the [0.3;0.7]% range, with a median estimate equal to 0.5 %.

The more elaborate standard NBB nowcasting models ‘BREL’ and ‘R2D2’ predict a growth deceleration, forecasting first quarter growth at 0.3 % and 0.2 %, respectively. However, these nowcasting models do not yet take into account the very recent spread of Covid-19 in Europe, as most of the indicators are based on surveys that took place before the end of February outbreak in Italy. Hence, it is important to complement these model-based estimates with expert judgment in order to take into account the impact of the recent Covid-19 development on economic growth.

CHART 6 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 FIRST QUARTER OF 2020



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'[3] and the dynamic factor model 'R2D2'[4], respectively.

...But the overall impact of covid-19 on first-quarter growth is expected to remain limited

While uncertainty is very high, the overall Covid-19 impact on first-quarter growth seems to remain limited at the current juncture, such that an estimate of 0.2 % for the quarterly growth rate in the first quarter appears to be most plausible. While specific industries, such as tourism-related activities or companies that export to China, are facing reduced demand, general supply chain problems do not yet lead to interruptions of production in the manufacturing industry. However, depending on the further developments, also as regards containment measures, the growth impact may be larger, especially in the second quarter.

Our nowcast of 0.2 % for the first-quarter growth is based on the assumption that the Covid-19 incidence will still worsen but that this will not lead to very restrictive containment measures in terms of company or school closures or quarantine measures in Belgium. If such containment measures are implemented in the coming weeks, first-quarter growth could clearly be lower.

Finally, this Business Cycle Monitor was finalised on 6 March, i.e. before the Italian government announced further and unprecedented quarantine measures for a large part of the Italian economy in the weekend of 7 March. As Italy is Belgium's sixth main trading partner directly accounting for close to 5% of total exports, this will likely further weigh on export demand and increases the downside risks for the first-quarter growth estimate. More importantly, it should be stressed that at the current juncture the outlook for the second quarter is much worse.

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

[4] 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. A new version of the R2D2 dynamic factor model that includes additional Belgian-specific variables is used as of this issue of the Business Cycle Monitor.