# BUSINESS CYCLE MONITOR

June 2020

## Belgian economic activity is expected to shrink by a further 16 % in the second quarter of 2020[1]

- **The Covid-19 containment measures have caused an economic shock that is unprecedented in modern times.** Affected by two weeks of containment measures, Belgian real GDP already shrank by 3.6 % in the first quarter of 2020. This is only slightly better than in the euro area as a whole, where activity declined by 3.8 %. First-quarter growth was only supported by positive contributions from net exports and stockbuilding.
- **Belgian GDP growth should take an even steeper dive in the second quarter of 2020.**
- As regards the demand components, private consumption will plummet, as consumption possibilities have been constrained by several weeks of containment measures. Consumer confidence has plunged, despite the as yet limited impact of the crisis on household incomes. Government consumption growth is expected to be slightly positive due to extra covid-19-related spending. Business investment is likely to shrink even more: very weak business sentiment indicators reflect the large uncertainty about the global economic outlook, as well as the financial strains on companies. Also according to survey indicators, companies are massively postponing investment plans. Housing investment should decline as well, after real estate transactions fell and the building industry came to a temporary halt. Finally, the contribution of net exports to GDP growth is likely to be close to neutral in the second quarter, as the recent Covid-19 developments would depress both import and export growth.
- The NBB nowcasting model 'BREL' predicts a -2.3 % GDP growth in the second quarter, while the 'R2D2' model expects growth to come in at -2.0 %. However, **mechanical nowcasts are not reliable in these exceptional circumstances** and substantially overestimate growth. They need to be complemented with information gathered from other sources, such as the specific surveys conducted in the context of the Economic Risk Management Group, as well as expert judgment. **It should be stressed that forecast uncertainty is much higher than usual**.
- Survey information suggests a roughly 30 % loss in output in the private sector during the lockdown weeks and only a very gradual recovery thereafter. At the end of May, output loss was still reported to be about 25 %. As we currently expect no full recovery by the end of June (and assume that turnover losses will only decline to about 15 %), it seems increasingly likely that private sector value added, which accounts for over 80 % of total economy value added, will be down by about 20 % in the second quarter. Non-market output is expected to remain relatively stable.
- All in all, we estimate second quarter growth to come in at about -16 %.

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

# The Covid-19 containment measures have clobbered Belgian and euro area economic activity

**In the March 2020 Business Cycle Monitor, quarterly growth was estimated at 0.2 % GDP for Belgium in the first quarter. However, at the time of writing (early March) the Covid-19 impact in Europe was still limited to certain areas in northern Italy. It was explicitly indicated that given the uncertain further developments of the pandemic, the estimate was very uncertain and, in particular, conditional on no restrictive containment measures being taken in Belgium. Unfortunately, reality turned out very differently: since mid-March severe containment measures have been introduced elsewhere in the euro area, including in Belgium. The Covid-19 pandemic and the containment measures have essentially switched off a large part of the economy for several weeks and, hence, amount to an economic shock that is unprecedented in modern times.**

From an economic point of view, both supply and demand side channels were severely disrupted. Companies cut back or ceased activities due to forced closures, 'social distancing' measures and/or staff absenteeism. Domestic demand also fell, due to uncertainty or negative income effects while foreign demand suffered from lockdowns elsewhere that also disrupted global supply chains.

Even though the containment measures are gradually relaxed, in Belgium as in other countries, the uncertainty remains very high, in particular about the speed and the strength of the recovery, but also regarding additional policy measures that could be taken to support that recovery. In addition, scenarios in which the health situation deteriorates again and a second outbreak leads to new containment measures can not be excluded at the current stage. This implies that any economic forecast, including estimates for the short term, comes with particularly large uncertainty margins. A specific technical problem is that the traditional indicators and models used for forecasting are likely to give unreliable signals at the current stage. Models have typically been estimated on the basis of past observations and correlations and a shock like the current one has not been observed in the data set used to estimate these models. Hence, additional information and judgment calls become more necessary to estimate economic growth at the current juncture. For this Business Cycle Monitor, we also make use, in particular, of a regular business survey that has been carried out by a number of Belgian federations and organisations of self-employed (notably, BECI, Boerenbond, NSZ, UNIZO, UWE and VOKA). This initiative was set up in the context of the Economic Risk Management Group and is coordinated by the NBB and the FEB/VBO. It has the specific aim to assess the Covid-19 impact on economic activity in Belgium.

# Euro area GDP declined by 3.8 % in the first quarter of 2020 and will decline much more in the second

**Euro area GDP fell by 3.8 % in the first quarter of 2020, with the year-on-year growth rate reaching -3.2 %.** France, Italy and Spain have taken draconian containment measures relatively early and are among the countries with the lowest growth rates: between -5.3 % and -5.2 %. Germany, the Netherlands and Austria were relatively less affected. Outside the euro area, economic activity contracted by 2.0 % and 1.2 % in the UK and the US, respectively, and by 0.9 % in Japan.

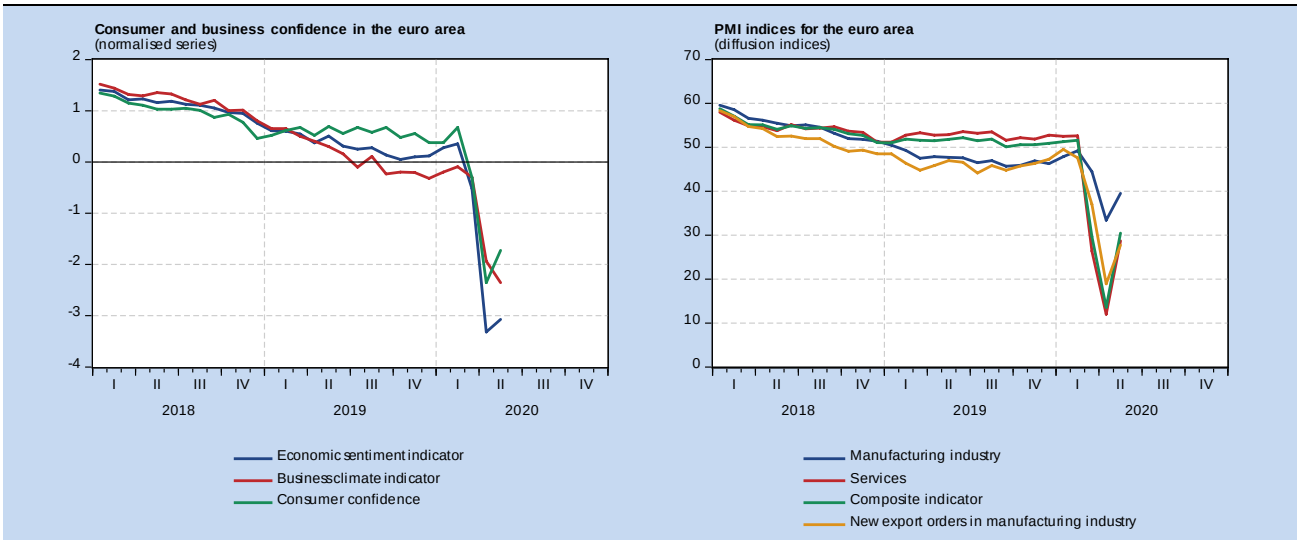
**Table 1 Real GDP growth rate**
(percentages, adjusted for seasonal and calendar effects)

| | Quarter-on-quarter change | | | | Year-on-year change |
|---|---|---|---|---|---|
| | **2019 Q2** | **2019 Q3** | **2019 Q4** | **2020 Q1** | **2020 Q1** |
| Euro area | 0.1 | 0.3 | 0.1 | -3.8 | -3.2 |
| Germany | -0.2 | 0.3 | -0.1 | -2.2 | -2.3 |
| France | 0.3 | 0.2 | -0.1 | -5.3 | -5.0 |
| Italy | 0.1 | 0.0 | -0.2 | -5.3 | -5.4 |
| Spain | 0.4 | 0.4 | 0.4 | -5.2 | -4.1 |
| Netherlands | 0.3 | 0.4 | 0.4 | -1.7 | -0.6 |
| **Belgium** | 0.3 | 0.4 | 0.5 | **-3.6** | **-2.5** |
| Austria | -0.1 | 0.0 | 0.0 | -2.6 | -2.6 |
| EU | 0.2 | 0.4 | 0.2 | -3.3 | -2.6 |
| UK | -0.2 | 0.5 | 0.0 | -2.0 | -1.6 |
| US | 0.5 | 0.5 | 0.5 | -1.2 | 0.3 |
| JP | 0.5 | 0.0 | -1.9 | -0.9 | -2.2 |

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

**Euro area survey indicators have all plunged to (near) historic lows since they incorporated the recent developments.** 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, registered their strongest monthly declines on record (since 1985) in April. The improvement in the headline indicator in May was exclusively driven by a small recovery in consumer confidence that is perhaps related to the reopening of shops in a number of countries. Business sentiment continued its decline (see Chart 1, left-hand graph). PMI indicators suggest that services have been hit hardest. Manufacturing seems to be somewhat less severely affected overall, although the sub-component of new export orders in this industry paints a more pessimistic picture as regards the future recovery (see Chart 1, right-hand graph).

**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.

## The Belgian economy shrank by 3.6 % in the first quarter

According to the current estimate of the National Accounts Institute (NAI**), Belgian real GDP growth fell to - 3.6 % in the first quarter of 2020**, which is slightly better than the growth rate in the euro area as a whole.

**The only positive contributions to Belgian GDP growth came from net exports and stockbuilding by companies** (probably reflecting rapidly falling demand). All other demand components contributed negatively to activity growth. Looking at the production approach to GDP, growth in value added was especially negative in the construction industry (-5.1 %), where 'social distancing' measures were difficult to implement. Activity declined somewhat less on average across services (-3.2 %), although losses in specific services branches, such as the one involving food services and accommodation, are much more heavily affected. The manufacturing industry was hit least on average (-2.7 %). Companies in the latter branch were more likely to be classified as 'essential activities', thereby being exempted from forced closings if social distancing could not be guaranteed.

## Private consumption will post a steep decline in the second quarter

**The COVID-19 crisis and the resulting lockdown has put a sudden stop to the continued expansion of private consumption**. Consumption possibilities have been constrained with (non-)food brick and mortar shops closed for several weeks, while purchasing power remained relatively intact due to massive government transfers and the expansion of employment protection schemes such as temporary unemployment. **Consumers thus entered a state of 'forced saving' as of mid-March and this was maintained in the first half of the second. Due to the nature of non-durable consumption, it is certain that some consumption that would have taken place over the past few months will not be recovered in the remainder of the second quarter or thereafter.**

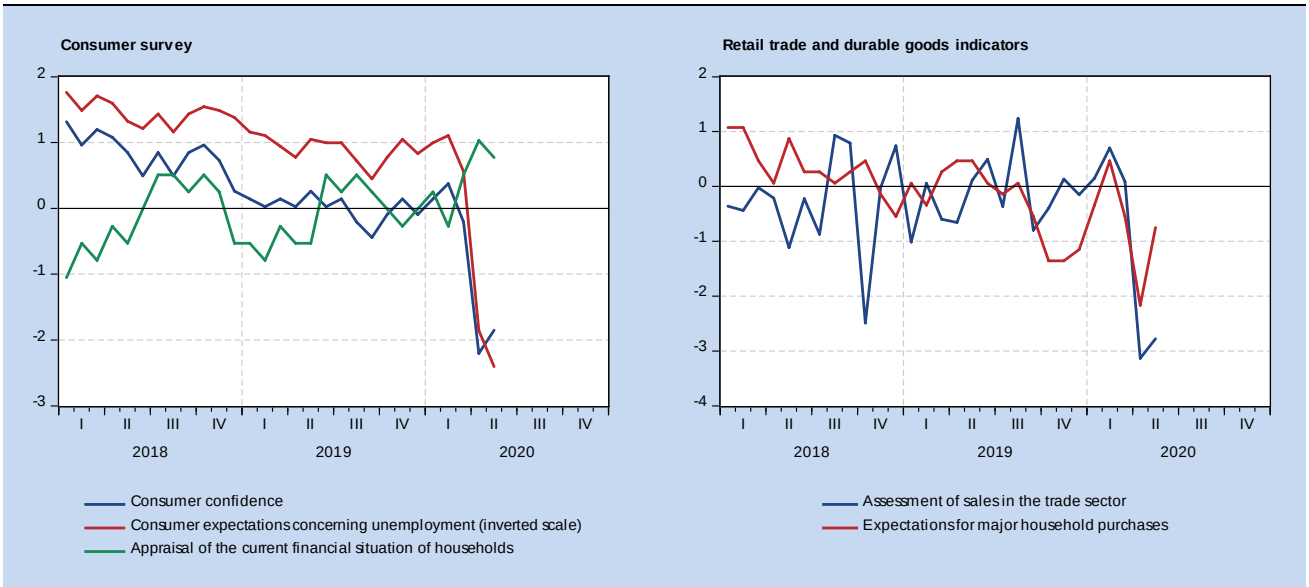
For other goods and services, a certain degree of pent-up demand may exist: a significant improvement of the expectations regarding major household purchases for the next 12 months was reported in May (see Chart 2, right-hand graph). However, for now and despite the stepwise relaxation of containment measures in May, this does not (yet) seem to be showing up in companies' sales figures. **ERMG survey results indicate that turnover loss was around 30 % during the lockdown weeks and only reached 25 % at the end of May. 'Lack of demand' is a persistent problem for companies in most industries.** Reports by company managers in the trade sector show a large fall in sales in April and a stabilization at a low level in May. Based on data for April and May reported by the automobile federation Febiac, new car registrations, for example, can be expected to shrink by over 50 % in the second quarter.[2] Demand prospects could be further dampened by developments on the labour market, which seem to be turning negative fast and which could further weigh on consumer confidence.

**Household survey indicators show that the fall in consumer sentiment in April was mainly driven by households' appraisal of the economic situation and the spike in concerns about their future (un)employment situation.** Although not included in the headline index, the situation of forced saving and strong income protection mechanisms has also led to a marked improvement of the assessment of households' current financial situation (see Chart 2, left-hand graph). The slight improvement in consumer confidence in May was driven by a somewhat less pessimistic appraisal of the economic situation. However, unemployment concerns kept worsening.

**Not surprisingly, we expect second quarter private consumption to shrink dramatically.**

[2] Please note that the link between the Febiac data on new car registrations and private consumption is blurry because of the substantial share of new car registrations by companies, including car dealers.

**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.

## Government consumption should rebound slightly in the second quarter

Given the nature of the crisis, intuitively, government consumption growth would be expected to be fuelled by buoyant healthcare spending and other extra covid-19-related expenditures. However, in order to contain the outbreak and to create additional capacity for the intensive care units, many non-urgent healthcare services were also postponed, effectively decreasing government consumption. Additionally, in line with new Eurostat guidelines in the context of the Covid-19 crisis, wages of non-active government workers (even though paid) are not taken into account. This correction was not applied to education, however, as it is assumed that teachers continued to work from home. All in all, this led to a -3.1 % growth of government consumption.

**The second quarter will be affected by the continued postponement of healthcare services in April, but should also be boosted by additional government spending due to the organisation of the 'exit strategy' (e.g. setting up contact tracing) and because the bulk of the costs related to the procurement of personal protective equipment falls in this quarter. A downward effect may still come from the statistical guideline on the accounting of government wages during the current crisis but all in all, government consumption is expected to be up slightly in the second quarter.**

## Business and housing investment growth are expected to register the largest declines in the second quarter

**Volume growth in total investment came to -3.7 % in the first quarter of 2020.** Government investment fell by just 0.7 %. Much more significant contractions were found for housing investment (-5.4 %), mostly due to the interruptions of most construction work, and business investment (-3.6 %).

The Covid-19 outbreak has caused economic uncertainty to spike, which is detrimental for business investments. **The headline business sentiment indicator crashed in April and seems to have more or less stabilized at a very low level in May** (see Chart 3, left-hand graph)**, with the trade industry now being by far the most pessimistic branch of activity.** Business-related services seem to be an exception, as they reported a marked improvement in May. These developments were mirrored in the sub-indicator for demand expectations (see Chart 3, right-hand graph).

In addition, and as mentioned, 'lack of demand' remains a key concern for companies in all industries according to the ERMG survey results. Up to two thirds of companies have already postponed their investment plans. For half of these companies, plans have even been shelved 'indefinitely'. Financial reserves have been eroded and around 8 % of companies in the ERMG survey indicate that they may not survive the crisis. Furthermore, capacity utilisation in the manufacturing industry decreased to 73 % in April, a level last seen during the Great Recession. Overall, fundamentals for business investment are all (strongly) negative.

**We expect business investment to post the largest fall of all demand components in the second quarter of 2020 and to only recover very gradually thereafter.**

**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.

Housing investment decreased by 5.4 % in the first quarter of 2020. Survey results confirm that firms in the construction industry were heavily affected by the need to implement 'social distancing' measures and in many cases construction work came to a complete halt until the beginning of May, well into the second quarter. Similarly, real estate transactions have plummeted due to the lockdown and the need for 'social distancing'. Therefore, **we expect housing investment growth to decrease sharply as well in the second quarter**.

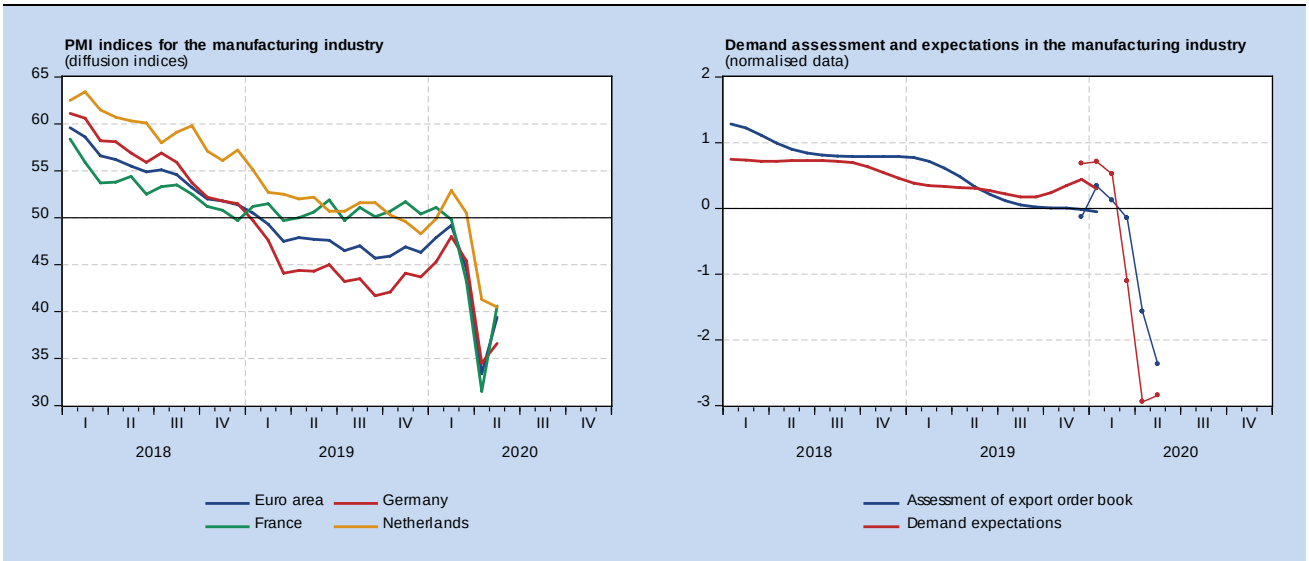
# Net exports should not contribute much to GDP in the second quarter

**Exports decreased by 3.8 % and imports even by 4.7 % in the first quarter of 2020, resulting in a 0.8 percentage point positive contribution of net exports to GDP growth.**

On the export side, a further decrease seems all but certain. Surveys conducted among purchasing managers in the manufacturing industry in several key partner countries for Belgium indicate that potential demand for Belgian exports fell sharply in April and improved only slightly in May. Indices remain far below the 50 % level that marks zero-growth in these countries (see Chart 4, left-hand graph). Demand expectations and the assessment of export orders in the Belgian manufacturing industry (see Chart 4, right-hand graph) show no sign of improvement. 'Lack of demand' as taken from the ERMG surveys is most often cited in the 'transport and storage' branch and among manufacturing companies. Both are heavily reliant on foreign demand. As regards tourism, given the lockdown, both in- and outflows have virtually disappeared and this will in all likelihood only gradually change over the summer. However, imports are likely to decline to roughly the same extent due to the expected fall in private consumption and (import-intensive) business investment.

**All in all, the contribution of net exports to GDP growth in the second quarter is expected to be broadly neutral.**

**CHART 4 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.

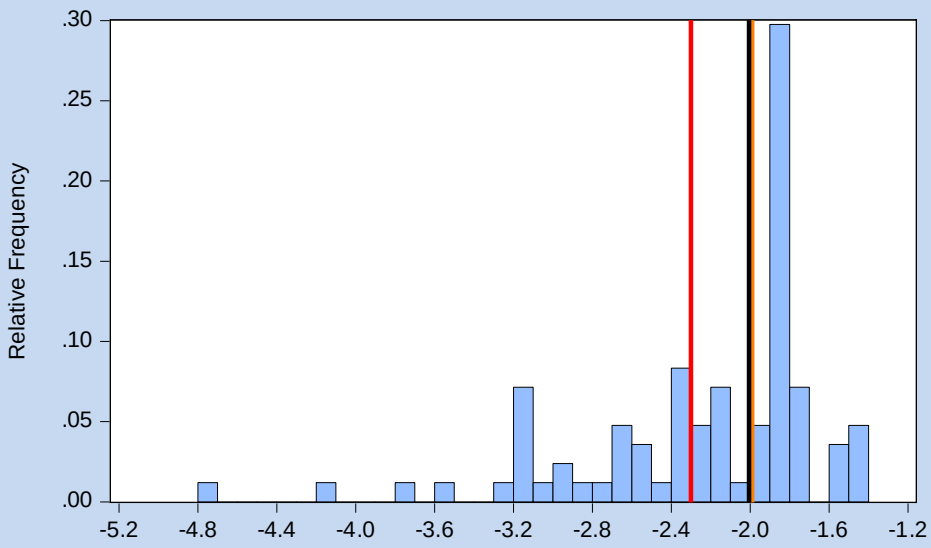
# Mechanical nowcasts are not reliable in these exceptional circumstances and substantially overestimate second-quarter growth …

The informational 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. **The different predictions point to slightly negative growth in the second quarter of 2020 (see Chart 5).** The predictions have a downward-skewed distribution and most frequently lie in the [-1.5;-3.5] % range, with a median estimate equal to -2.0 %. Note that the past forecast performance of these simple models suggests that the individual predictions should be interpreted with caution even in normal times.

**Of the more elaborate standard NBB nowcasting models, 'BREL' predicts a quarterly growth rate of -2.3 % in the second quarter and 'R2D2' predicts -2.0 % GDP growth**.

Given the extent of the containment measures in the second quarter and the fact that only two weeks of measures were enough to send first quarter GDP growth significantly below these model estimates, it is clear that these results underestimate the depth of the decline that is expected for the second quarter. These model-based estimates need to be complemented with information gathered from other sources, as well as expert judgment.

**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 SECOND QUARTER OF 2020**




Sources: Markit, 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.

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

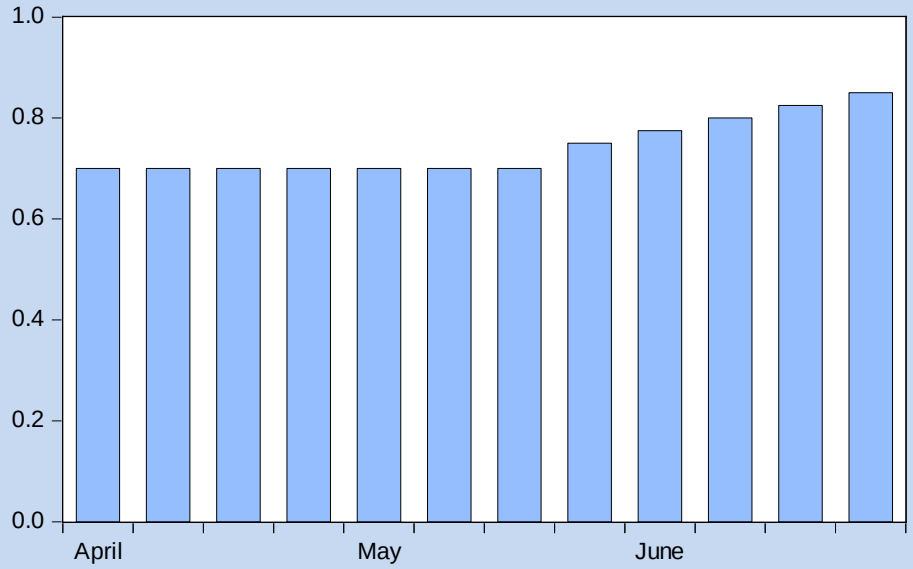
[4] Basselier, R., De Antonio Liedo, D. and Langenus, G. (2018) Nowcasting real economic activity in the euro area: assessing the impact of qualitative surveys, NBB Working Paper 331. The R2D2 model is estimated using the JDemetra+ software, which is publicly available at www.nbb.be/jdemetra. A new version of the R2D2 dynamic factor model that includes additional Belgian-specific variables is used as of this issue of the Business Cycle Monitor.

## ...But survey information can help us bridge the informational gap

**Uncertainty on the overall impact of Covid-19 and subsequent containment measures on the economy is very high, as traditional indicators and models fail to accurately capture the effects of the crisis. Results from the surveys carried out in the context of the ERMG can help bridge that gap.**

Taking company size and the weight of the different industries in value added into account, a persistent loss in turnover of about 30 % was reported since the start of the survey at the end of March. This number only started to improve somewhat in the final week of May, i.e. after the gradual relaxation of the containment measures and the restart of economic activity. As we currently expect no full recovery by the end of June (and assume that turnover losses will only decline to about 15 %), it seems increasingly likely that private sector value added, which accounts for over 80 % of total economy value added, will be down by about 20 % in the second quarter.

**CHART 6 ESTIMATED WEEKLY PRIVATE SECTOR OUTPUT LEVELS IN THE SECOND QUARTER OF 2020 RELATIVE TO A NORMAL QUARTER**




Sources: ERMG surveys, NBB.

Non-market output is expected to remain relatively stable in the second quarter.

**Against this background the Belgian economy should shrink by a further 16 % in the second quarter. As for the first-quarter estimate in the previous Business Cycle Monitor, this is anchored to the information that we currently have regarding further developments in containment measures in particular.**