NationalBank OF BELGIUM
Eurosystem

BUSINESS CYCLE MONITOR

September 2020

Belgian economic activity is expected to rebound by 8 % in the third quarter of 2020[1]

- The Covid-19 pandemic and the containment measures have depressed Belgian economic activity. After having already declined by 3.5 % in the first quarter, Belgian real GDP plummeted by 12.1 % in the second quarter of 2020. This is in line with the euro area as a whole, where activity declined by respectively 3.7 % and 11.8 % in the first two quarters. Belgian second-quarter growth was only supported by positive contributions from net exports and inventories, while consumption and investment contracted sharply.

- Belgian GDP growth will rebound in the third quarter of 2020 mainly because containment measures are much less severe than in the first half of the second quarter, even though they continue to weigh on economic activity.

- Private consumption will rebound in the third quarter as it is no longer hampered by the closure of (non-food) brick-and-mortar shops and as it is may be supported further by pent-up demand. The recovery in private consumption will however only be partial due to the Covid-19 upsurge: the fear to catch the disease and the remaining or strengthened containment measures still hold back consumption. At the same time, the rebound of consumption will be supported by the fact that purchasing power has not been affected too much, despite the unprecedented economic crisis. The available data on car registrations as well as survey data seem to confirm the upswing in consumption in the third quarter, but the ultra-low consumer confidence could lead to more precautionary saving, which would weigh on consumption growth going forward. Also, government consumption should rebound in the third quarter as healthcare expenditures are expected to return to normal levels after having been substantially reduced in the second quarter due to the postponement of many non Covid-19-related operations and consultations.

- We expect business investment to only partially recover in the third quarter as companies are likely to continue to scale back their initial investment plans in a context of very large uncertainty. Revenues and profit margins of firms have been squeezed by the Covid-19 crisis and demand prospects are still subdued and highly uncertain, which is detrimental for investment. In addition, capacity utilisation in the manufacturing industry remained stable in July at its near-historic low and general conditions for access to bank credit have become considerably tighter since the Covid-19 crisis. Finally, according to the ERMG survey of mid-August, firms still indicate that investment is down by about one third due to the Covid-19 crisis. At the same time a rebound in the construction of new dwellings and renovations is expected in the third quarter and housing investment will in addition also be supported by the recent surge in real estate transactions and registration and notary fees. Finally, government investment should recover as well in the third quarter as certain government investment projects that were temporarily stopped in April and May have now resumed.

- The contribution of net exports to GDP growth is expected to be broadly neutral in the third quarter. While exports of goods and services should recover only partially in the third quarter as the rebound in foreign demand was relatively limited., the pick-up in import of goods and services is expected to be slightly faster, supported by the rebound in domestic demand. This would however be broadly offset by a positive “staycation effect” in the third quarter, as many Belgians have spent their holidays during the peak-summer period in Belgium.

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

– The NBB nowcasting model “BREL” predicts a quarterly growth rate of 4.1 % in the third quarter, while the “R2D2” model predicts 11.9 %. However, the uncertainty of these nowcasts is very large in these exceptional circumstances and they need to be complemented with information gathered from other sources as well as expert judgment. The developments in the weekly revenue loss reported by companies in the ERMG surveys suggest a very strong increase of private-sector output in the third quarter of about 28 %. However, as the current statistics seem to indicate that the ERMG surveys may have overstated the drop in private-sector activity in the second quarter, the upturn in the third quarter is also likely to be less vigorous. Furthermore, non-market output is also expected to strongly increase in the third quarter as government investment and consumption will rebound. Finally, taking the current statistics for the second quarter and the Bank’s June 2020 projections for the real GDP level in the third quarter as a benchmark, quarterly growth would be about 7 %.

– All in all, we estimate that the Belgian economy will increase by 8 % in the third quarter. This is equal to the average of the two model nowcasts and it would imply a slight upward revision of the June projections third quarter GDP level, which could be justified by the positive staycation effect in the third quarter. Finally, it should be stressed that the uncertainty of this nowcast is much higher than usual.

The Covid-19 containment measures and the global recession have depressed Belgian and euro area economic activity

As of mid-March, very restrictive measures had been introduced in Belgium in order to contain the spread of Covid-19. Similar measures were taken elsewhere in the euro area and in the world. These containment measures have brought a large part of the economy to a halt for several weeks and amount to an economic shock that is unprecedented in modern times. **Even though the restrictive measures had been gradually relaxed since May, they continue to weigh on economic growth**, insofar as many industries still have to operate at a lower capacity. In addition, new restrictions had been imposed at the end of July following an upsurge of Covid-19, including the obligation to shop alone and to wear mouth masks in many public places, even though they have been relaxed again at the end of August.

The uncertainty remains extremely high, in particular about the speed and the strength of the recovery, but also regarding additional measures that could be taken to support that recovery or, alternatively, contain the virus. Scenarios in which the health situation deteriorates again and further outbreaks lead to new containment measures cannot 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 dataset used to estimate these models. Hence, additional information and judgment calls become more necessary to estimate economic growth at the current juncture. In particular, we also make use of a business survey that has been carried out since March by a number of Belgian federations and organisations of self-employed (notably BECI, Boerenbond, NSZ, UCM, 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 fell by 11.8 % in the second quarter of 2020 but will rebound in the third

After having already declined by 3.7 % in the first quarter, euro area GDP dropped further by a massive 11.8 % in the second quarter of 2020, with the year-on-year growth rate reaching -14.7 %. While economic activity collapsed in all euro area countries, there was again a lot of cross-country variation. As in the first quarter, Spain, France and Italy also registered the largest decline in the second quarter, with activity plummeting by respectively 18.5 %, 13.8 % and 12.8 %. On the other hand, the economic downturn in the second quarter was again somewhat smaller in Austria, Germany and the Netherlands, with declines of respectively 10.4 %, 9.7 % and 8.5 %. Outside the euro area, economic activity contracted by 7.9 % and 9.1 % in Japan and the US and by a massive 20.4 % in the UK.

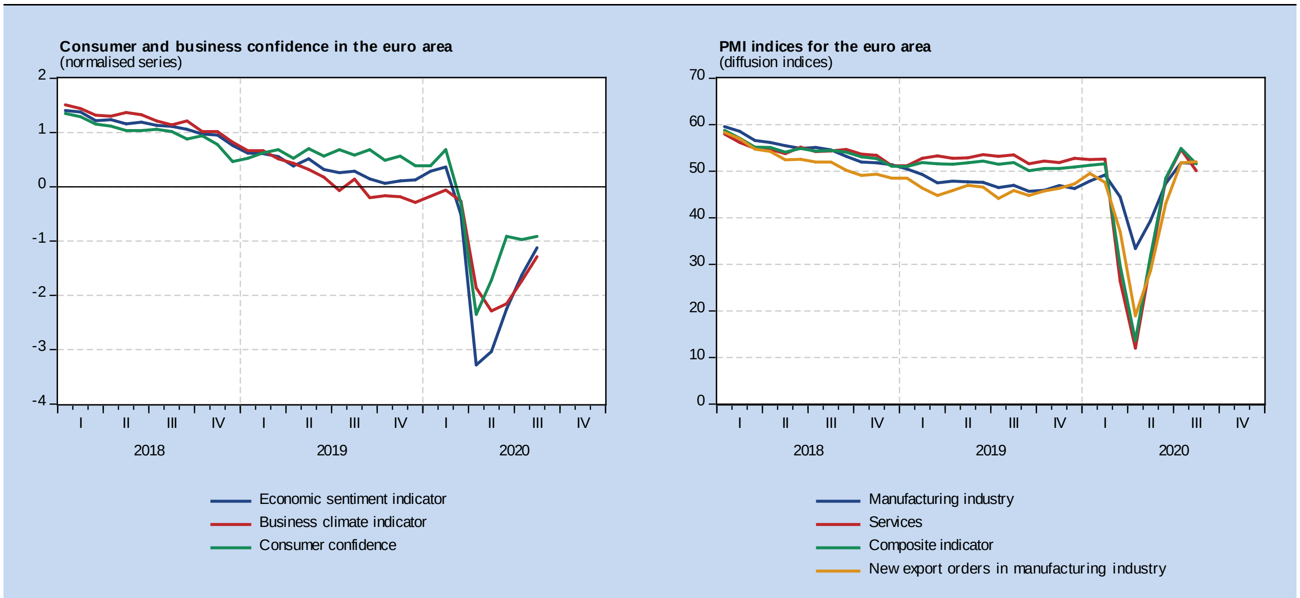
Table 1 Real GDP growth rate
(percentages, adjusted for seasonal and calendar effects)

	Quarter-on-quarter change				Year-on-year change
	2019 Q3	**2019 Q4**	**2020 Q1**	**2020 Q2**	**2020 Q2**
Euro area	0.3	0.0	-3.7	-11.8	-14.7
Germany	0.3	0.0	-2.0	-9.7	-11.3
France	0.2	-0.2	-5.9	-13.8	-18.9
Italy	0.0	-0.2	-5.5	-12.8	-17.7
Spain	0.4	0.4	-5.2	-18.5	-22.1
Netherlands	0.3	0.5	-1.5	-8.5	-9.2
Belgium	0.4	0.5	-3.5	-12.1	-14.4
Austria	-0.2	-0.2	-2.4	-10.4	-12.9
EU	0.4	0.1	-3.3	-11.4	-13.9
UK	0.5	0.0	-2.2	-20.4	-21.7
US	0.6	0.6	-1.3	-9.1	-9.1
JP	0.0	-1.8	-0.6	-7.9	-10.1

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

After having rebounded since May from their historic lows, the euro area survey indicators lost traction again in August and they do not point to a full recovery in the near term. First, the EC's overall economic sentiment indicator, that reflects both the business climate and consumer sentiment, has been improving gradually since May, but still remains well below its pre-crisis level, indicating a still negative year-on-year growth rate in August (see Chart 1, left-hand graph). While the EC's consumer confidence indicator strongly rebounded in May and June but remained about constant in July and August, the business climate indicator has been increasing since June. Second, after having strongly rebounded since May, the PMI indicators have again declined in August and are now only slightly above the 50 % threshold that marks zero monthly growth. The services PMI indicator, which had fallen back much more in April, declined again to 50 % in August, while the manufacturing PMI indicator as well as the export orders indicator remained about constant in August at 52 % (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.

Belgian GDP plunged by 12.1 % in the second quarter as consumption and investment contracted sharply

According to the current estimate of the National Accounts Institute (NAI**), Belgian real GDP plummeted by 12.1 % in the second quarter of 2020 after having already declined by 3.5 % in the first quarter**. This is very similar to the recent euro area growth. While net exports and inventories contributed slightly positively to Belgian second quarter GDP growth (the latter suggesting that firms have recently increased their stock-building and probably reflecting depressed demand), consumption and investment contributed strongly negatively to activity growth. Looking at the production approach to GDP, while economic activity increased in agriculture, it collapsed in all other industries, with the manufacturing industry (-14.3 %) and the construction industry (-13.4 %) being slightly more affected than the services industry (-11.5 %). According to the current statistics, the out-turn for second-quarter growth is somewhat less negative than the estimate in the previous Business Cycle Monitor (-16 %), that was mostly anchored to the ERMG business surveys.

Private consumption will rebound in the third quarter thanks to the loosening of containment measures

Private consumption plummeted by 12.7 % in the second quarter, which puts the year-on-year growth rate at -17.1 % after having already declined by 6.4 % in the first quarter. Durable and non-durable consumption fell by about the same extent, while spending of Belgians abroad dropped more than expenditure of foreign tourists in Belgium.

Consumption will rebound in the third quarter because of the less stringent containment measures relative to the second quarter. Unlike the first half of the second quarter, consumption is no longer hampered by the closure of (non-food) brick-and-mortar shops and **it may be supported further by pent-up demand in the third quarter**, i.e. necessary purchases that had to be postponed due to shop closures in the first half of the second quarter. However, this pent-up demand was likely already partly fulfilled in the second half of the second quarter and, in addition, not all consumption that would had taken place will be recovered due to the nature of non-durable consumption. Also, the recovery in private consumption will only be partial due to the continued fear of contagion and due to the remaining or strengthened containment measures in the third quarter, including the social distancing measures in bars and restaurants, the restrictions on events and the obligation imposed at the end of July to shop alone and to wear mouth masks in shopping streets.

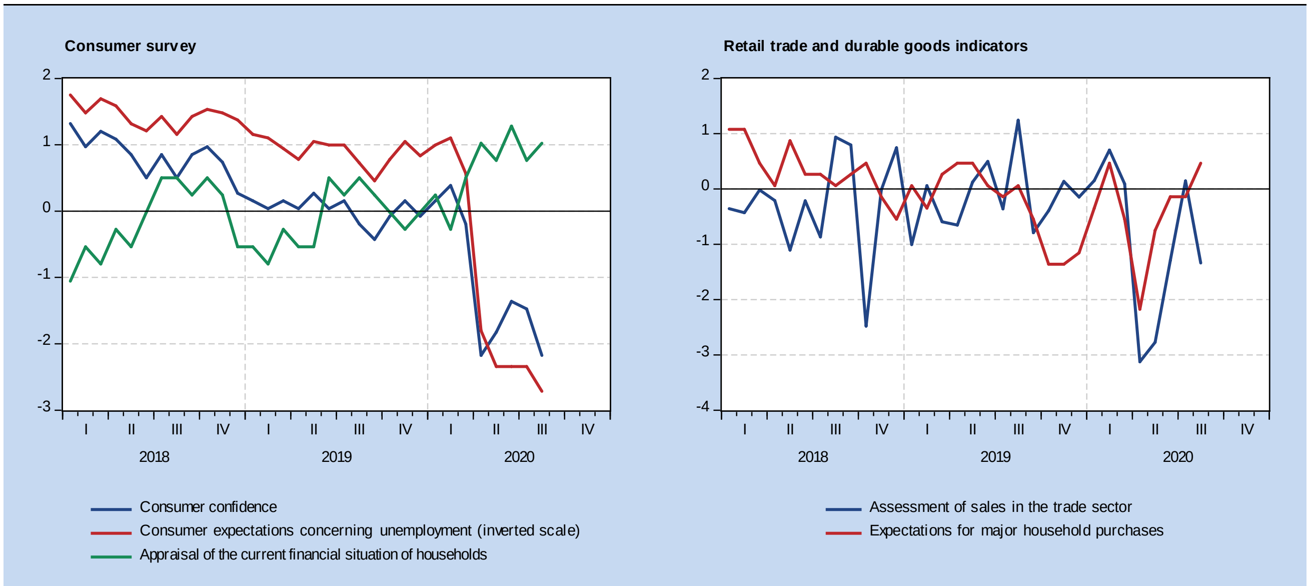
This rebound of consumption will be supported by the fact that purchasing power has not been affected too much, despite the unprecedented economic crisis. In annual terms, purchasing power per person should remain virtually stable in 2020 compared to last year and is expected to grow by a cumulative 2.2 % in 2021-2022, according to the Bank's June 2020 projections. While household disposable income growth was definitely lowered due to the crisis, the loss was on average relatively limited due to massive government transfers and the expansion of employment protection schemes such as temporary unemployment. As a result, households had been temporarily "forced" to save in excess of their needs in the second quarter, which implies that they can tap into those excess savings to support consumption in the second half of the year. 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 available data on car registrations as well as survey data seem to confirm the upswing in consumption in the third quarter. Based on data for July and August reported by the automobile federation Febiac, new car registrations seem to have recovered to pre-crisis levels, after having declined by more than 50 % over the first half of the year.[2] Furthermore, the expectations regarding major household purchases for the next twelve months have strongly increased since May (see Chart 2, right-hand graph). In addition, reports by company managers in the trade sector show a strong recovery in sales to pre-crisis levels in July, but the indicator deteriorated again in August, which is likely due to the new stringent restrictions on shopping imposed at the end of July. Finally, the results of the ERMG surveys show that non-food retail sales show a strong recovery, from on average 46 % below the normal level in the second quarter to just 6 % off-par at the end of June and 9 % in the middle of August, while food retail was much less affected by the Covid-19 crisis.

However, the ultra-low consumer confidence could lead to more precautionary saving, which would weigh on consumption growth going forward. After having only slightly recovered in May and June, the headline consumer confidence fell again in July and especially in August and it is again at the near-historic low reached in April. The collapse in consumer confidence can be traced back to the very pessimistic consumer expectations regarding the economic situation and unemployment, with both sub-indicators at or near historic lows.

[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 strongly rebound in the third quarter as healthcare expenditures return to normal levels

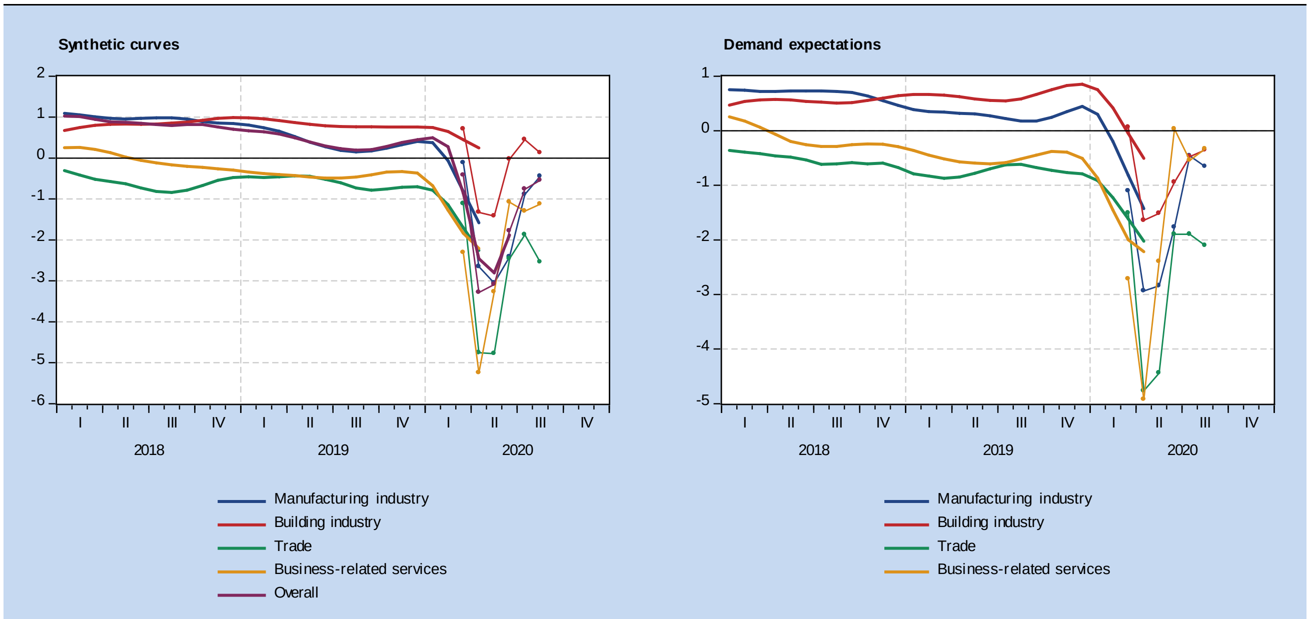
Government consumption plummeted by 8.3 % in the second quarter, after having already declined by 3.5 % in the first quarter. This decline is mainly driven by reduced expenditures for healthcare services such as non-Covid-19 related operations and consultations, which had been postponed in order to contain the outbreak and to create additional capacity in the intensive care units for Covid-19 patients. As these other healthcare services are expected to return to normal levels in the third quarter, government consumption should strongly rebound.

Housing and government investment will rebound, while business investment will recover more gradually

Volume growth in total investment declined by 18.2 % in the second quarter of 2020. Business investment, housing investment and government investment plummeted by respectively 19.9 %, 15,7 % and 11.7 %.

We expect business investment to only partially recover in the third quarter as companies are likely to continue to scale back their initial investment plans in a context of very large uncertainty. First, revenues and profit margins of firms have been squeezed by the Covid-19 crisis and demand prospects are still subdued and highly uncertain, which is detrimental for investment. According to the ERMG survey, the revenue decline of firms was still at about 13 % in mid-August and lack of demand is cited as a key reason for this revenue decline by 56 % of the responding firms and even by 62 % of the responding manufacturing firms. This is also reflected in the business sentiment indicator, which has only partly recovered and with the rebound clearly losing traction in August, as elsewhere in Europe. While the headline business sentiment indicator has strongly rebounded from its historically low April-level, it still remains substantially below its pre-crisis level (see Chart 3, left-hand graph). The business services and especially the trade industry remain the most pessimistic branches of activity and their sentiment remains well below the pre-crisis levels, while the manufacturing and especially the building industry have recovered to a larger extent. The demand expectations sub-indicators, in particular, remain very weak, especially in the trade industry (see Chart 3, right-hand graph). **In addition, capacity utilisation in the manufacturing industry remained stable in July at its near-historic low** of 73 %, which together with the worsened and highly uncertain global economic outlook diminishes the need for expansion investment. Furthermore, according to the Bank lending survey, companies say that **general conditions for access to bank credit have become considerably tighter since the Covid-19 crisis**. In particular, the percentage of firms viewing credit conditions as restrictive increased from 5.0 % in January to 16.3 % in April and it fell back only slightly to 14.9 % in July. This percentage is nevertheless still well below that observed in the wake of the financial crisis at the end of 2008. Finally, **according to the ERMG survey in mid-August, firms indicate that investment is still down by about one third due to the Covid-19 crisis**, a figure that is similar to the one reported in the ERMG surveys of June.

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 15.7 % in the second quarter of 2020 and is expected to rebound in the third quarter. First, we expect a **rebound in the construction of new dwellings and renovations**. The ERMG 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, after which it had recovered fast. While their reported Covid-related revenue loss amounted to close to 30 % for the second quarter, this loss had been reduced to 5 % by the end of June but was up again to 11 % in the mid-August ERMG survey. Second, we expect a **rebound in registration and notary fees** in the third quarter, which are a component of the housing investment, **as real estate transactions have strongly picked up** from June onwards after having been very low due to the lockdown and the need for social distancing. Finally, housing investment is still supported by the historically low mortgage rates and solid income prospects. The rebound in business confidence and demand expectations in the building industry also points to a recovery in the current quarter.

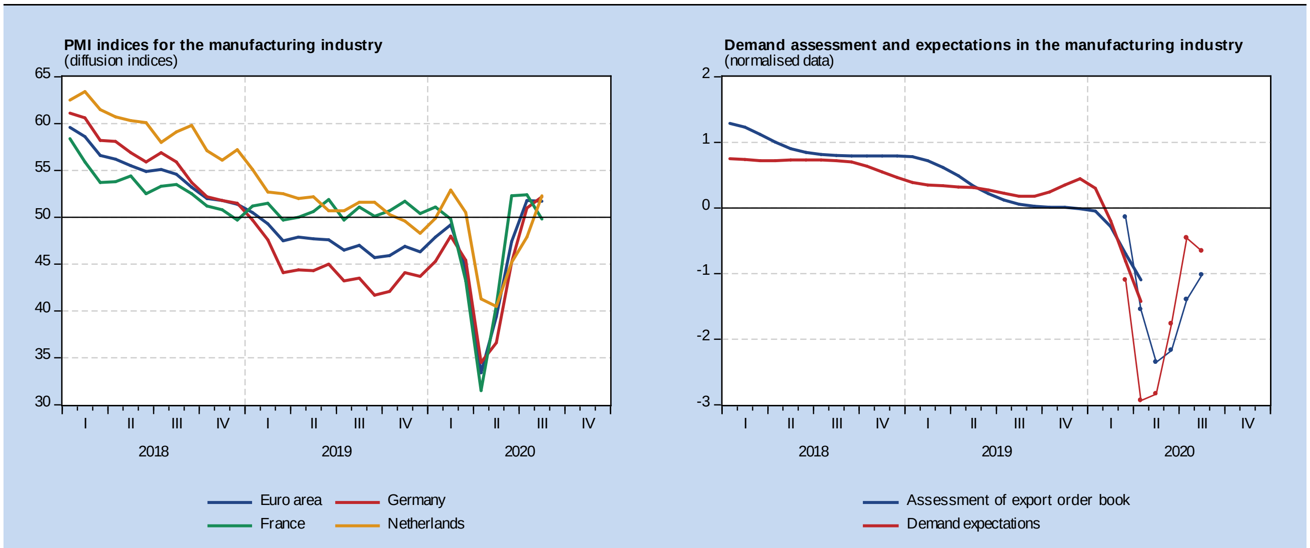
Finally, **government investment should recover as well in the third quarter**. As for other construction projects, certain government investment projects had to be temporarily stopped in April and May, but activity has now resumed.

Net exports should not contribute much to GDP in the third quarter

Exports decreased by 13.3 % and imports even by 13.9 % in the second quarter of 2020, resulting in a 0.4 percentage point positive contribution of net exports to GDP growth.

Exports of goods and services should recover only partially in the third quarter as the rebound in foreign demand was relatively limited. Surveys conducted among purchasing managers in the manufacturing industry in several key partner countries for Belgium indicate that potential demand for Belgian exports has only slightly improved in the third quarter relative to the second quarter. The PMI manufacturing indices are only slightly above the 50 % level that marks zero monthly growth in these countries in July and August (see Chart 4, left-hand graph). While the PMI manufacturing index has kept increasing in August in the Netherlands and Germany, it worsened in France and was flat in the euro area. The weak recovery in foreign demand is also reflected in the demand expectations and the assessment of export orders in the Belgian manufacturing industry (see Chart 4, right-hand graph), which have only partially recovered. As indicated above, “lack of demand” is most often cited in the ERMG survey as a reason for the revenue among manufacturing companies, which are heavily reliant on foreign demand. Finally, also the recent appreciation of the euro should weigh on exports.

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.

At the same time, import of goods and services are expected to pick up slightly faster than exports, supported by the rebound in domestic demand.

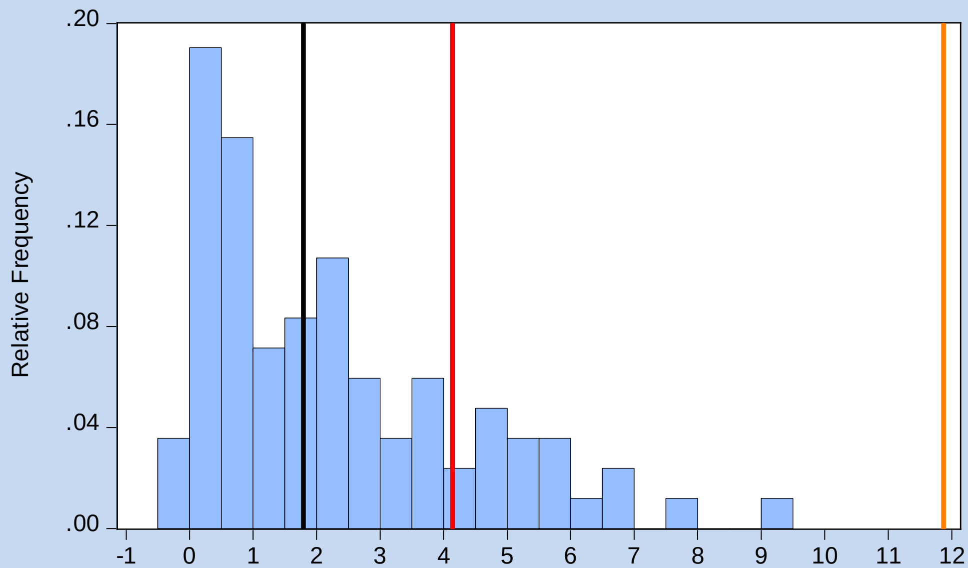
Tourism in- and outflows, which declined by respectively 40 % and 50 % in the second quarter, seem to have partly recovered after the opening of the borders as of mid-June and many Belgians have travelled abroad during the summer. Still, due to the combination of travel restrictions and caution, many tourists that normally would have gone abroad for their holidays during the peak-summer period have spent their holidays within their country. In contrast to southern European countries, this **“staycation effect” is likely to have had a positive impact on Belgian net exports**, as in normal times outbound tourism expenditures of Belgians are more than twice as high as expenditures of foreigners in Belgium.

All in all, the contribution of net exports to GDP growth is expected to be broadly neutral in the third quarter. While net exports are supported by a positive staycation effect in the third quarter, exports should generally recover more slowly than imports and net exports will likely be a drag on growth in the coming quarters.

Mechanical nowcasts indicate a rebound of GDP growth in the third quarter but the uncertainty is very large…

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 a positive growth in the third quarter of 2020** (see Chart 5): they have an upward-skewed distribution and most frequently lie in the [0; 6] % range, with a median estimate equal to 1.8 %. Note that the past forecast performance of these simple models suggests that these individual predictions should be interpreted with caution, even in normal times.

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 THIRD 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" and the dynamic factor model "R2D2", respectively.

Of the more elaborate standard NBB nowcasting models, "BREL"[3] predicts a quarterly growth rate of 4.1 % in the third quarter, while "R2D2"[4] predicts a much larger 11.9 % growth. However, as indicated above, the uncertainty of these nowcasting models is exceptionally large as the massive shocks since the start of the Covid-19 crisis constitutes a challenge for the estimation of standard time-series models. Therefore, these model-based estimates need to be complemented with information gathered from other sources, as well as expert judgment.

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 version of the R2D2 dynamic factor model that includes additional Belgian-specific variables is used in the Business Cycle Monitor.

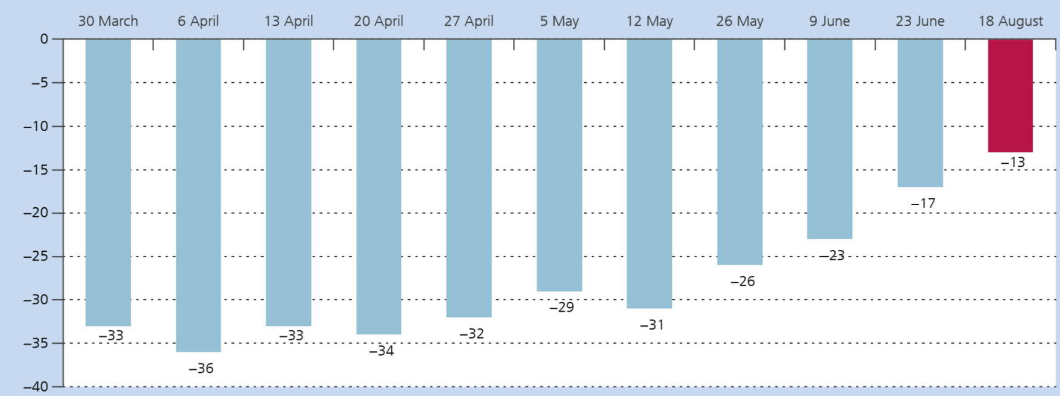
... And also the ERMG surveys and the June projections point at a rebound and large uncertainty

Results from the ERMG surveys carried out in the context of the ERMG as well as the broad macroeconomic projection exercise of June provide additional indications about third quarter growth.

The developments in the weekly revenue loss reported by companies in the ERMG surveys suggest a very large rebound in the third quarter. Taking company size and the value added weight of the different industries into account, an average loss in weekly turnover of about 28 % was reported for the second quarter, while the mid-August survey projects a revenue loss of on average 13 % for the third quarter (see Chart 6). This would suggest that the private sector output would increase by up to 22 % in the third quarter. **Non-market output is also expected to rebound in the third quarter, in line with government consumption and investment**.

However, as the current statistics seem to indicate that the ERMG surveys may have overstated the drop in private sector activity in the second quarter, the upturn in the third is also likely to be less vigorous. Taking the current statistics for the second quarter and the real GDP level in the Bank's June 2020 macroeconomic projections for the current quarter as a benchmark, quarterly growth would be about 7 %.

CHART 6 ERMG SURVEY REPORTED COVID-19 IMPACT ON WEEKLY TURNOVER
(in %, weighted average based on revenues and industry value added)



Sources: ERMG surveys, NBB.

All in all, we estimate that the Belgian economy will increase by 8 % in the third quarter. This is equal to the average of the two model nowcasts and it would imply a slight upward revision of the June projections third quarter GDP level, which could be justified by the positive staycation effect in the third quarter. It should be stressed that the uncertainty of this nowcast is much higher than usual and that it is anchored to the information that we currently have regarding further developments in containment measures in particular. The biggest risk to the outlook is the worsening of the epidemiological situation that could lead to additional containment measures.