BUSINESS CYCLE MONITOR

December 2020

Belgian economic activity is expected to decline by 1 % in the fourth quarter of 2020[1]

- Belgian real GDP rebounded by 11.4 % in the third quarter of 2020 but the recovery lost traction at the end of the summer and the upsurge in the COVID-19 pandemic and the ensuing increase in containment measures are depressing economic activity again. Activity should contract in the fourth quarter of 2020, even if the direct negative impact of the second lockdown is clearly smaller than in the spring, in particular as the construction and manufacturing industries have remained operational.

- Private consumption will post the strongest decline. Household spending was again hampered by health fears and the closure of (non-essential) brick-and-mortar shops, even though the latter already ended on 1 December. More fundamentally, consumption is supported by robust purchasing power and a positive assessment of their financial situation by households, despite the unprecedented economic crisis. Nevertheless, overall consumer confidence remains low, which is likely to weigh on consumption growth until health fears have disappeared.

- We expect both business and housing investment to decline again in the fourth quarter, while government investment should continue to expand.

- Growth in exports of goods and services should remain in line with foreign demand and stay slightly positive. The decline in domestic demand, on the other hand, should limit import growth. All in all, the contribution of net exports to GDP growth is expected to be broadly neutral in the fourth quarter.

- The NBB nowcasting model “BREL” predicts a marginally negative quarterly growth rate of -0.15 % in the fourth quarter, while the “R2D2” model is more pessimistic and predicts a contraction of 1.4 %. The uncertainty of these nowcasting models is exceptionally large in the current circumstances, as the massive shocks since the start of the COVID-19 crisis constitute 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.

- All in all, we estimate that Belgian economic activity will decrease by about 1 % in the fourth quarter. This is a much smaller fall than during the first wave and would imply an annual growth of -6.6 % in 2020.

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

The continuing COVID-19 pandemic weighs on activity and keeps economic uncertainty high

After the economic recovery had lost traction over the summer, a surge in COVID-19 infections served as a stark reminder that the pandemic is far from over and triggered new lockdowns in Belgium and the euro area. This is likely to depress growth again in the fourth quarter.

Overall, uncertainty remains extremely high in the short run. Economic growth is bound to suffer from the consequences of the second wave (and the ensuing policy reaction) in the fourth quarter. Scenarios in which the health situation deteriorates again cannot be excluded at the current stage. This implies that any economic forecast, including our estimate for the short term, comes with particularly large margins of uncertainty. 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 are not designed to maintain their performance in the context of a shock like the current one. Hence, additional information and an increased reliance on judgment calls are currently necessary to estimate economic growth. In particular, we make use of a business survey that has been carried out since March by a number of Belgian federations and organisations of self-employed (BECI, Boerenbond, NSZ/SNI, 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 rebounded by 12.6 % in the third but should fall again in the final quarter of 2020

After having declined by a cumulative 15 % in the first half of 2020, euro area GDP recovered by 12.6 % in the third quarter of 2020, with the year-on-year growth rate reaching -4.4 %.

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

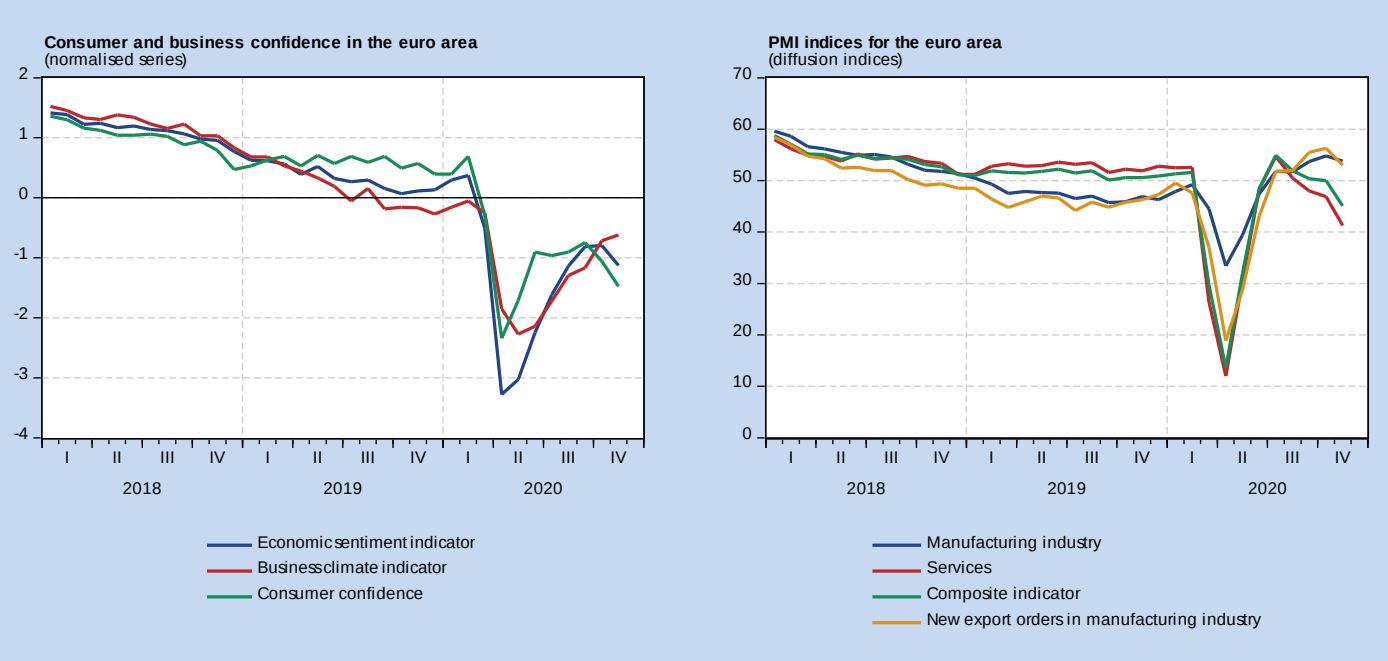
	Quarter-on-quarter change				Year-on-year change
	2019 Q4	2020 Q1	2020 Q2	2020 Q3	2020 Q3
Euro area	0.0	-3.7	-11.8	12.6	-4.4
Germany	0.0	-1.9	-9.8	8.5	-4.0
France	-0.2	-5.9	-13.7	18.2	-4.3
Italy	-0.2	-5.5	-13.0	16.1	-4.7
Spain	0.4	-5.2	-17.8	16.7	-8.7
Netherlands	0.5	-1.5	-8.5	7.7	-2.5
Belgium	**0.6**	**-3.4**	**-11.8**	**11.4**	**-4.5**
Austria	-0.5	-2.5	-12.1	11.1	-5.3
EU	0.1	-3.3	-11.4	11.6	-4.3
UK	0.1	-2.5	-19.8	15.5	-9.6
US	0.6	-1.3	-9.0	7.4	-2.9
JP	-1.8	-0.6	-8.2	5.0	-5.9

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

Cross-country variation in the recovery is significant. France, Spain and Italy registered the largest increases in the third quarter, with activity surging by 18.2 %, 16.7 % and 16.1 % respectively. Mirroring the more limited declines in the first half of 2020, growth rates were somewhat smaller in Austria, Germany and the Netherlands, with increases in real GDP of respectively 11.1 %, 8.5 % and 7.7 %. In all cases this still leaves activity way below the pre-crisis level. Outside the euro area, economic activity recovered by 5.0 % and 7.4 % in Japan and the US and surged by 15.5 % in the UK.

The relevant euro area survey indicators show that the recovery lost traction towards the end of the third quarter. The EC's overall economic sentiment indicator, reflecting both the business climate and consumer sentiment, registered a strong recovery since May, but stagnated at a level still well below its pre-crisis level in October and posted a new decline in November (see Chart 1, left-hand graph). Consumer confidence indicator levelled off in the third quarter and started to deteriorate again in October and November, driving the decline of the overall sentiment indicator. The business climate indicator, on the other hand, continued to improve, albeit at a slower speed in the last months. The PMIs indicate more clearly that the recovery remains incomplete and is beyond its peak already. All PMIs rebounded simultaneously in May but only reached about neutral levels (i.e. a diffusion index of 50) in June. The PMI for the manufacturing industry indicator, as well as the export orders indicator improved further over the summer and only started to decline in November. Their current level indicates an ongoing moderate expansion of activity (see Chart 1, right-hand graph). The PMI services indicator, on the other hand, is more tied to consumer behaviour and peaked in July. It has deteriorated to contractionary levels again since and this development accelerated in November, dragging the PMI composite indicator down as well. Obviously, **the decline is driven by the second COVID-19 wave, which is likely to have further depressed consumer spending.**

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 recovered by 11.4 % in the third quarter, mostly driven by a strong recovery of consumer spending

As economic activity in the neighbouring countries and the euro area as a whole, Belgian GDP rebounded strongly after the unprecedented hit in the second quarter. The National Accounts Institute (NAI) now estimates that **Belgian real GDP in the third quarter of 2020 grew by 11.4 %** (a significant upward revision compared to their earlier flash estimate of 10.7 %). Government investment, private consumption and housing investment posted by far the largest growth rates, followed by government consumption and business investment. Net exports and inventories contributed negatively to Belgian third-quarter GDP growth. The production approach to GDP reveals that the rebound in the third quarter was broad-based, with particularly fast growth in the construction industry (18.9 %) and above-average growth in manufacturing (11.6 %) and market services (also 11.6 %). The agricultural sector 'only' grew by 9.8 % in the third quarter but did not post a decline in the first half of 2020. Third-quarter growth thus even exceeded the estimate in the previous Business Cycle Monitor (8 %).

Renewed containment measures will cause private consumption to decline in the fourth quarter

Private consumption shot up by 16.4 % in the third quarter, which brings it to within 4 percent of the level recorded in the final quarter of 2019**.** As was expected, pent-up demand (from necessary purchases that had to be postponed due to shop closures in the first half of the second quarter) played a role in the robust rebound. While non-durable consumption, constituting the bulk of consumer spending, did not yet recover its pre-crisis level, third quarter statistics indicate that spending on durable goods surged to a peak of about 10 % above end of 2019 levels.

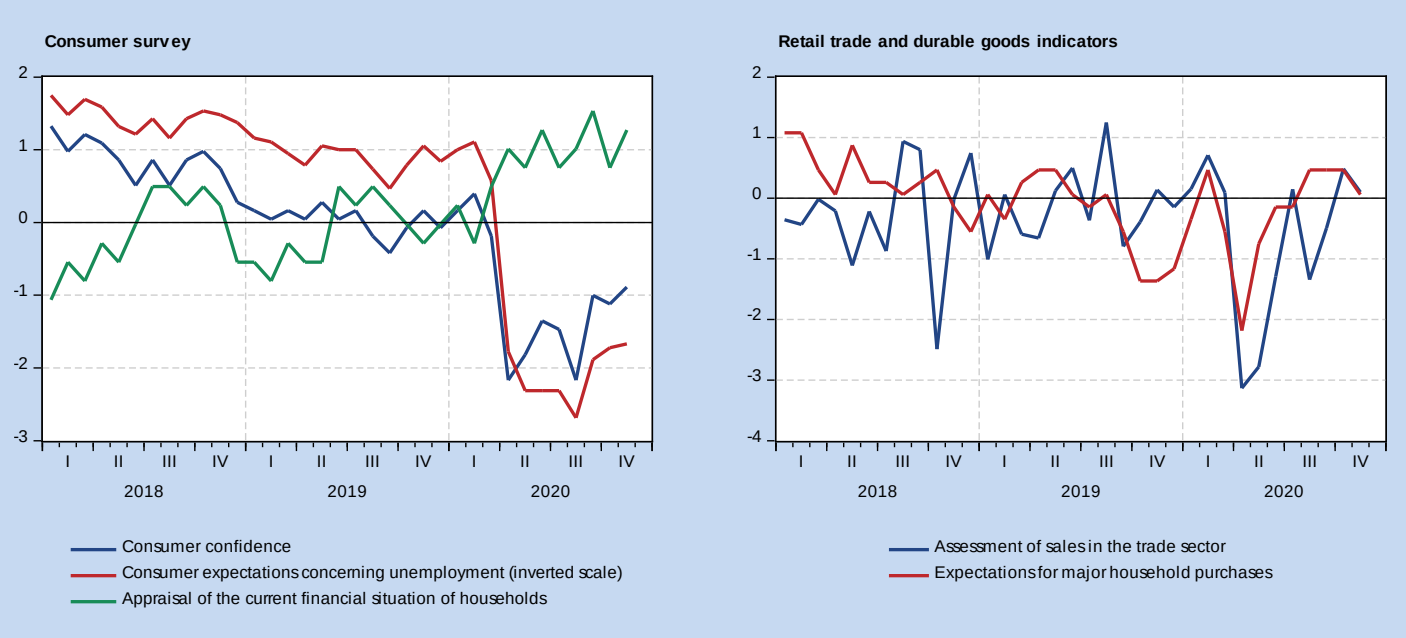
This recovery should not continue in the fourth quarter. The accelerating second wave of infections in early autumn led to renewed fears among consumers and ultimately triggered the implementation of new containment measures in order to safeguard the healthcare system. In addition to the still existing restrictions on activities, bars and restaurants were closed on 19 October (which was already the case in the Brussels Capital Region before) and a nationwide curfew was imposed. A more generalised lockdown followed on 3 November, when most recreative indoor activities were banned and non-essential physical retail stores were closed again, further hampering household consumption. Seasonally-adjusted car registrations as reported by Febiac, a typical indicator for consumption of durable goods, were down in October and especially November. Nevertheless, compared to the situation in the second quarter, **we expect the economic fallout to remain more limited this time around.** First, the economy was still below its normal level prior to the lockdown, which means that the activity loss due to the lockdown is smaller. Second, the restrictions on activities have been slightly less strict compared to the first lockdown (pick-up points were allowed and a larger number of shops remained open) and barely affect the construction and the manufacturing industries (in contrast to the production stops in the spring). In addition, adaptation and learning-effects (e.g. organising take-aways and sales from a distance) among retailers and consumers has limited the damage somewhat. As the number of infections and hospitalisations has steadily declined in November, brick&mortar retail stores were reopened already as of 1 December. A (modest) holiday season sales boost could further limit the damage in the fourth quarter.

Supporting consumer spending is the fact that purchasing power still has not been affected much, despite the unprecedented economic crisis. The containment measures for the second wave were accompanied by a new series of government income transfers to businesses and employment protection schemes, such as temporary unemployment, were prolonged. Additionally, after two negative quarters and against all expectations, the latest employment statistics indicate domestic employment actually slightly increased in the third quarter, as did the number of self-employed throughout 2020. In annual terms, the decline in purchasing power per person should remain very limited in 2020. As a result, on average, households have been building up excess savings. Even though precautionary saving may remain higher than usual for long, a normalisation of the saving ratio should

support consumption in December and the first quarters of next year. The situation of forced saving and strong income protection mechanisms has led to a marked improvement of the assessment of households' current financial situation in 2020. Furthermore, the expectations regarding major household purchases for the next twelve months have strongly increased since May and the recent lockdown seems to have had only a very limited impact in November (see Chart 2, right hand graph). Similarly, sales in the trade sector may be slightly down in November, but company managers reported a strong recovery in sales after the first lockdown. This pattern is likely to be repeated again in December, as restrictions are being eased again.

The recovery on the labour market was reflected in a continued improvement of the expectations concerning unemployment and led to an uptick of the overall consumer sentiment indicator (see Chart 2, left-hand graph). **Nevertheless, the recovery of consumer sentiment is only gradual and remains near historically low levels. A full normalisation of confidence is likely to take longer, i.e. until a more permanent solution to the health crisis has been found.**

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 growth should remain positive due to additional healthcare spending in the fourth quarter

Government consumption increased by 8.3 % in the third quarter, more or less erasing the 8 % cumulative fall in the first two quarters of the year. The recovery was mainly driven by additional COVID-19 related spending and expenditures for healthcare services which had been postponed in the first wave, notably in order to create additional capacity in hospitals for COVID-19 patients. Despite new postponements in the fourth quarter, we still expect that additional spending will have driven up government consumption growth. It should be stressed that uncertainty is particularly large for this demand component as the current statistics for government consumption are difficult to interpret and prone to volatile revisions.

Housing and business investment will decline again, while government investment will continue to expand

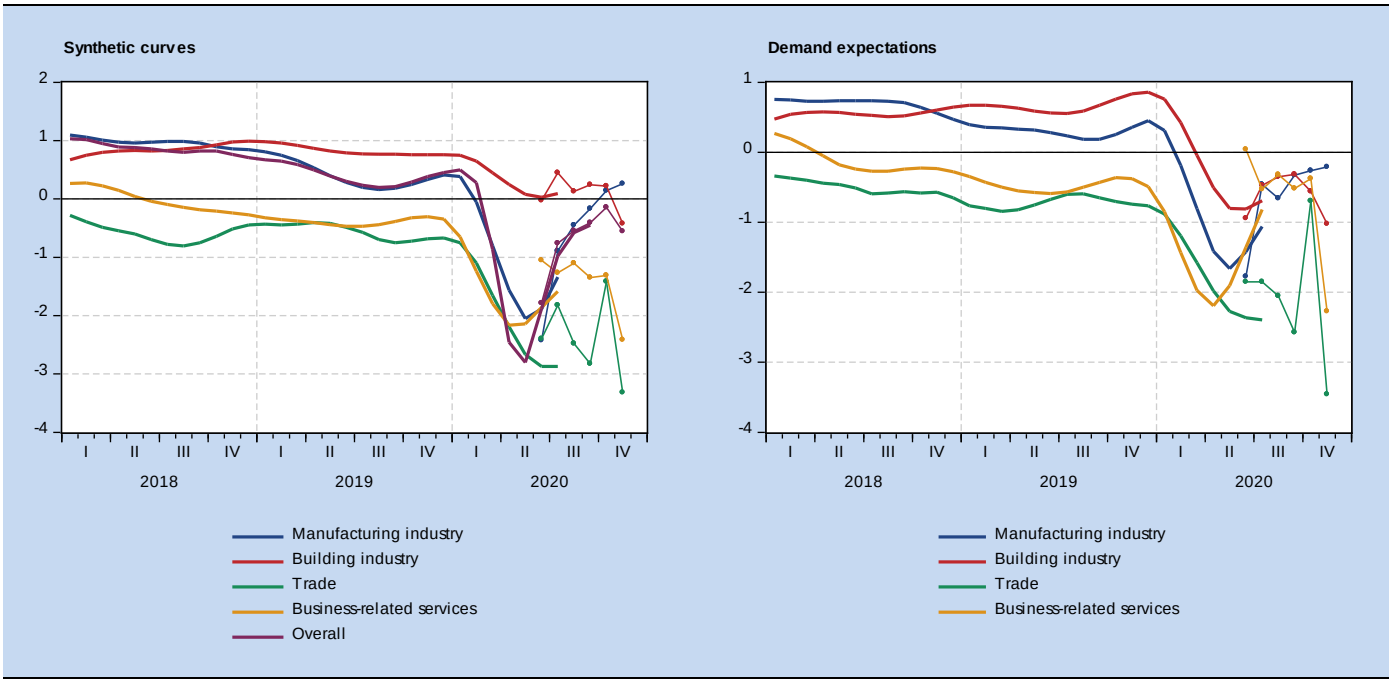
Volume growth in total investment increased by 10.7 % in the third quarter of 2020. Housing investment and government investment posted particularly large increases, with 15.8 % and 20.7 % respectively. As expected, business investment recovered much less, by 7.3 %.

Revenues and financial buffers declined and profit margins have been squeezed by the COVID-19 crisis while demand prospects remain subdued, all of which is detrimental to firms' investment plans. **The headline business sentiment indicator** rebounded from its historically low levels in April and May, but lost traction in late summer, as elsewhere in Europe. It **remains substantially below its pre-crisis level and the second wave of the pandemic resulted in a new decline in November** (see Chart 3, left-hand graph). This decline was especially strong in the trade industry and business services, which remain by far the most pessimistic branches of activity. Confidence in the building industry also deteriorated in November, interrupting a steady recovery. The manufacturing industry, on the other hand, continued on its upward trajectory thanks to increasing demand and employment prospects in November. The manufacturing industry is, according to the results of the October Bank lending survey, also the sole branch of activity to report an easing in the general conditions for access to bank credit.

As regards the near-term outlook, the sub-indicators regarding demand expectations remain quite weak and worsened again in November, especially in the trade industry (see Chart 3, right-hand graph) and business-related services. In addition, the capacity utilisation in the manufacturing industry remained below average in October, at 76.7 %, which signals little current need for investment in additional production equipment. According to the ERMG survey in mid-November, firms still indicate that, on average, planned investment is down by about 25 % in 2020 due to the COVID-19 crisis. On the other hand, while the second wave may lead to the pausing or cancelling of some ongoing investments in the fourth quarter, **the recent positive news regarding viable vaccine candidates is opening up perspectives on a post-COVID-19 economy.** Lead times for the execution of business investment plans are often quite long though, suggesting that even after the crisis has been contained, the recovery of this particular demand component will anyway take some time.

All in all, business investment growth should come in slightly negative in the fourth quarter.

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 increased by 15.8 % in the third quarter of 2020 and is expected to decline somewhat in the fourth quarter. Pent-up demand after the second quarter lockdown drove a surge in real estate transactions in the third quarter. Even on the secondary market this supported housing investment via the resulting registration and notary fees (that are recorded as investment). This surge in demand was short-lived however and notaries reported that the number of transactions was already down substantially in October. In addition, starting from November, property visits in the presence of others such as a real estate agent or occupants were banned due to the need to maintain a social distance. This will have further limited the number of transactions. Declining business confidence and demand expectations in the building industry also point to a decrease in the current quarter. Nonetheless, the decline should prove limited. Fundamentals for housing investment remain solid, as mortgage rates remain historically low and income prospects remain sound.

Finally, **government investment should grow robustly in the fourth quarter.** Investment projects can continue unhindered this time around and investment is still catching up from the delays caused by the first lockdown.

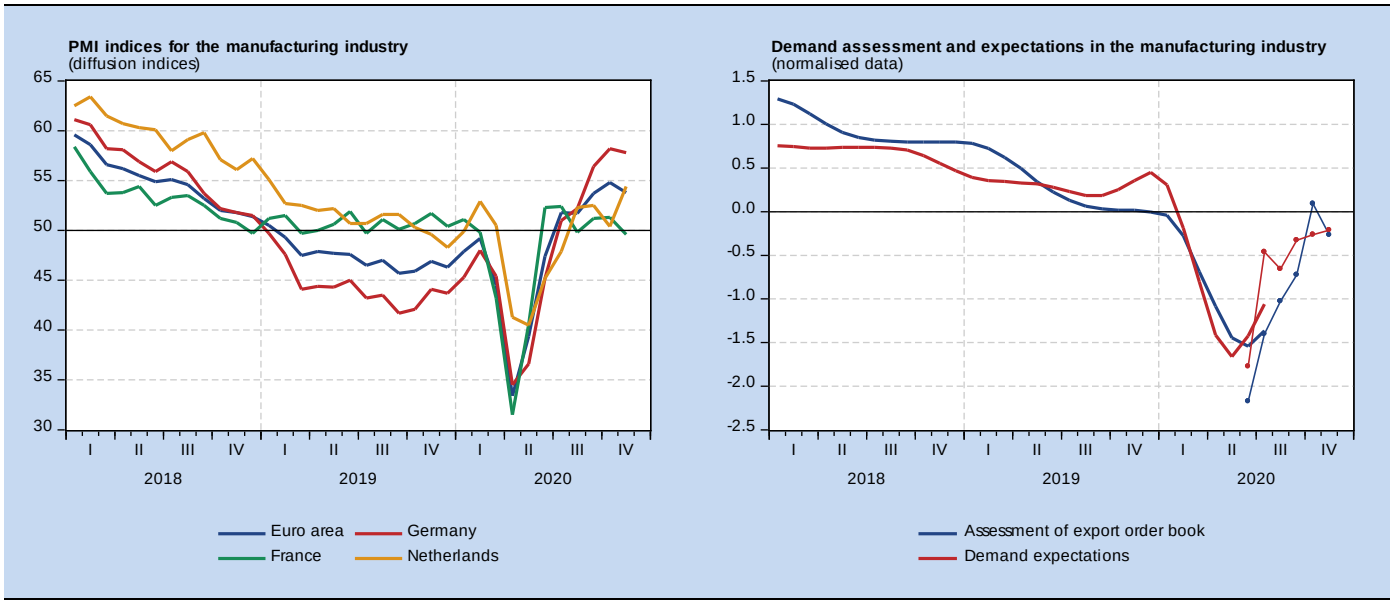
Net exports should have a broadly neutral impact on GDP growth in the fourth quarter

Third quarter exports increased by 13.3 % and imports even by 14.3 %, resulting in a -0.6 percentage point contribution of net exports to GDP growth.

Exports of goods and services recovered swiftly, driven by the rebound in foreign demand. Surveys conducted among purchasing managers in the manufacturing industry the neighbouring countries indicate that potential demand for Belgian exports has improved markedly since the first COVID-19 wave hit the European economies. **The PMI manufacturing index for the euro area has been solidly in expansionary territory since July,**

despite some weakening in November (see Chart 4, left-hand graph). Purchasing managers in the Netherlands signalled a strong improvement in activity, while the index for Germany declined slightly but remains at its highest level since April 2018. The latest results from France are weaker and now point to a slight contraction in November. Robust foreign demand contributed to the optimism emanating from the business survey results for the Belgian manufacturing industry over the past months (see Chart 4, right-hand graph). The assessment of the export order book in this industry has nearly recovered from the COVID-19 blow, although November saw a small deterioration. Of note here may be that foreign demand in the fourth quarter may be boosted to some degree by pre-Brexit stockpiling, out of fear of (temporary) supply chain disruptions as the less favourable WTO rules will apply from 1 January 2021 onwards for trade between the UK and the EU in case no deal is reached. **Overall, demand expectations in November continued their gradual recovery, but have not yet reached pre-crisis levels.** In the ERMG surveys "lack of demand" was still cited as an important factor in explaining revenue losses among manufacturing companies, which are heavily reliant on foreign demand.

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.

Import of goods and services in the third quarter picked up even faster than exports, supported by the rebound in domestic demand. **Imports are expected to fall again in the fourth quarter, on the back of a decline in domestic demand, although a shift of household consumption towards (often foreign) online purchases could provide some support for imports.**

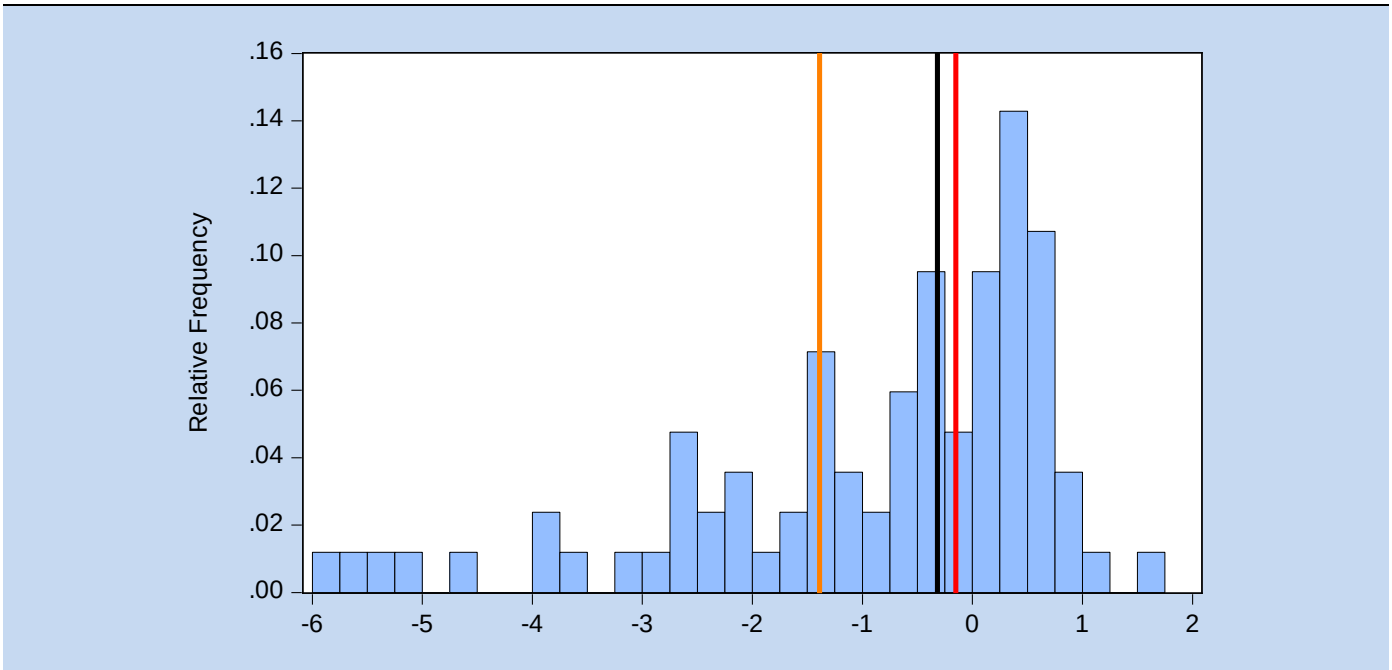
All in all, the contribution of net exports to GDP growth is expected to be broadly neutral in the fourth quarter.

Mechanical nowcasts indicate a slightly negative GDP growth in the fourth quarter but 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 slightly**

negative growth in the fourth quarter of 2020 (see Chart 5). The distribution is negatively skewed and most frequently lies in the [-3; 1] % range, with a median estimate equal to -0.3 %. 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 FOURTH 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"[2] predicts a quarterly growth rate of -0.15 % in the fourth quarter, while "R2D2"[3] is more negative and predicts -1.39 % 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 constitute 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.

... And the most recent ERMG survey also points to a decline in turnover in the fourth quarter

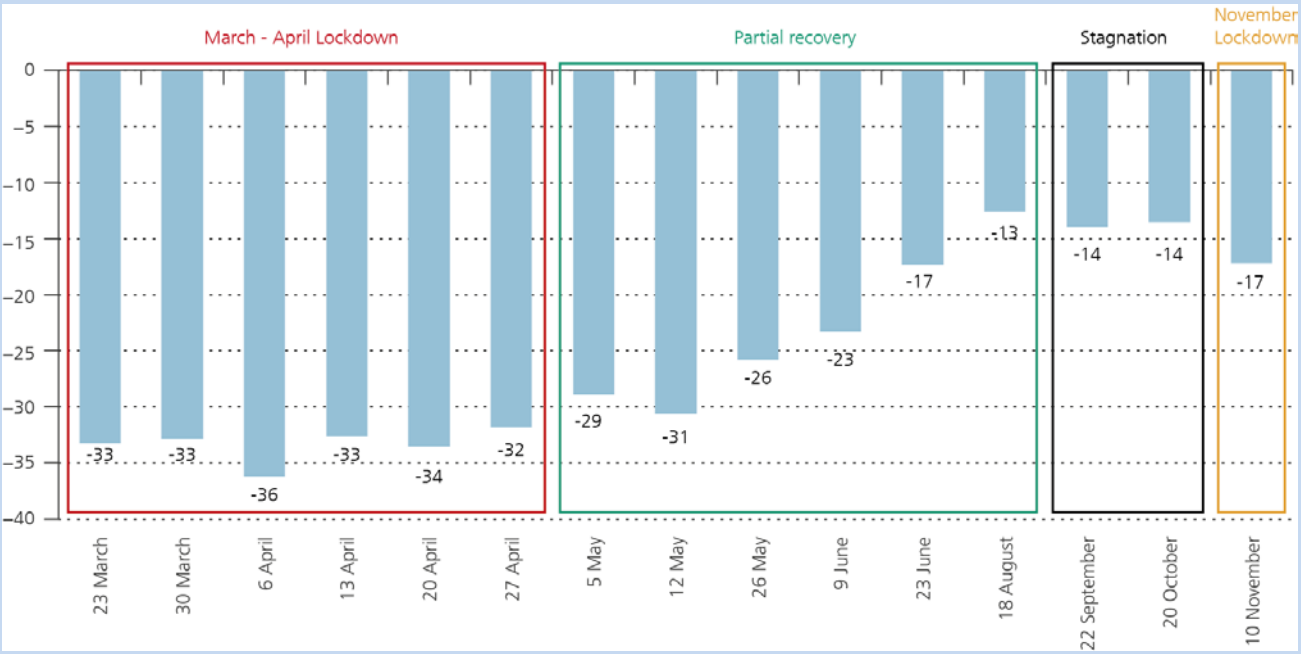
Sales developments reported by companies in the ERMG surveys suggest a decline in the fourth quarter. Taking company size and the weight of the different industries in value added into account, an average loss in

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

[3] 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.

weekly turnover of about 13 % was reported for the end of third quarter, while the most recent survey in the fourth quarter indicates private sector revenue losses of about 17 % (see Chart 6). **Non-market output, on the other hand, is expected to increase further, in line with government consumption and investment**.

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 Belgian economic activity will decrease by 1 % in the fourth quarter. This is slightly below the average of the two model nowcasts. This is a more moderate drop than we would have estimated up until very recently, but an upward revision is warranted by the earlier-than-expected reopening of retail stores and signs of some pre-Brexit stockpiling. It should again be stressed that the uncertainty of this nowcast is much higher than usual. The biggest risk to the outlook is the worsening of the epidemiological situation that could lead to renewed containment measures, although an unexpectedly large boost to sales in December might be an upward risk.