BUSINESS CYCLE MONITOR

March 2021

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You left us way too soon, David,
but you will stay in our hearts
and remain an inspiration for all of us.

Rest in peace…

Belgian economic activity is expected to increase by 0.5 % in the first quarter of 2021[1]

– Belgian GDP declined marginally by 0.1 % in the fourth quarter. While this was somewhat better than expected, it is likely partly due to a temporary Brexit stockpiling effect pushing up exports. The reversal of this temporary effect should depress growth at the start of 2021.

– We expect private consumption to recover in the first quarter of 2021, but the rebound should remain very partial. While consumer confidence is approaching pre-COVID-levels and the fundamentals for private consumption, and the outlook for personal income in particular, remain solid, many restrictive measures limiting consumption are still in place. In addition, consumer demand is likely to still be depressed by remaining concerns about infection risks and some precautionary saving due to the uncertainty about the labor market situation after the removal of the government measures.

– Business investment growth is expected to remain positive in the first quarter of 2021, in line with the recent broad-based improvement in the overall business sentiment indicator. Government and housing investment should also continue to expand in the first quarter of 2021.

– The contribution of net exports to GDP growth is expected to be negative in the first quarter, despite the ongoing recovery in global trade. This mostly reflects a reversal of the aforementioned temporary UK stockpiling effect, but is also the result of the expected increase of import growth on the back of positive domestic demand growth.

– The NBB nowcasting model “BREL” predicts a quarterly growth rate of about 0.45 % in the first quarter of 2021, while the “R2D2” model is more pessimistic and estimates growth to be around zero. 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.

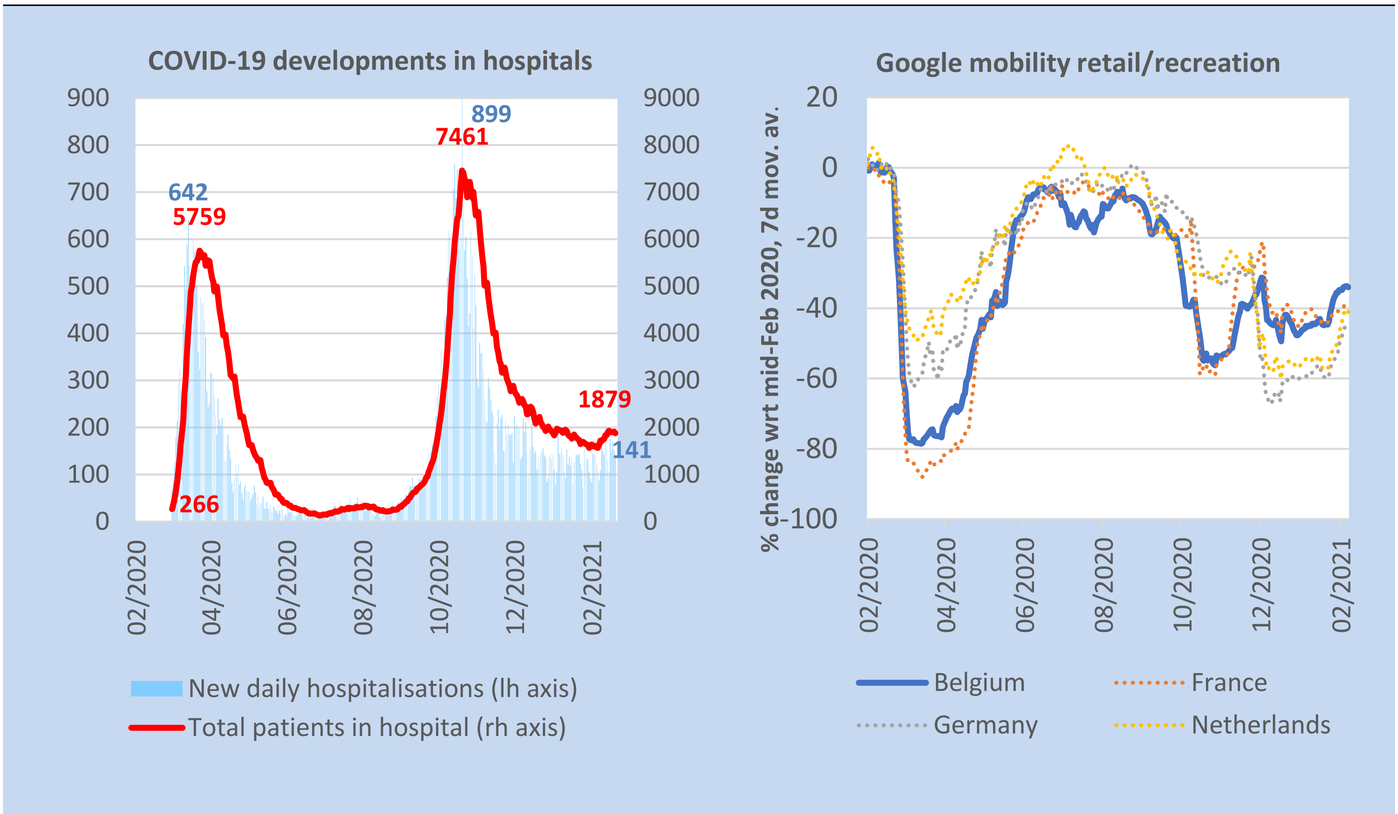
– All in all, we estimate that Belgian economic activity will increase by 0.5 % in the first quarter.

[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 March 2021. As all estimates and forecasts, it comes with a degree of uncertainty.

Restrictive measures have been relaxed only partially and large swathes of economic activity remain constrained

While non-essential shops have been reopened in the beginning of December already – i.e. somewhat sooner than expected in the Bank's December 2020 macro projections –, most other restrictions that had been implemented in the final quarter of 2020 remain firmly in place. The only exception applies to the non-medical contact professions, most of which can now operate again: hairdressers were allowed to reopen on 13 February and most others followed suit on 1 March. At the same time, bars, restaurants and the event industry remain closed, working from home is still mandatory whenever it is possible, and non-essential international travel is not allowed. Curfews are still imposed, even if the one in the Walloon Region has been slightly relaxed. Overall, while the situation is by no means comparable to the spring lockdown, mobility data suggest that **mobility is still clearly below pre-crisis levels and, hence, domestic demand continues to be depressed by the pandemic context**.

CHART 1 COVID-19 HOSPITALISATIONS AND BELGIAN MOBILITY DATA



Sources: Google, Sciensano.

The health situation remains highly uncertain. The roll-out of the vaccination campaign in the EU is slower than in other parts of the world and the number of COVID-19 infections, as well as that of hospitalised patients remain at relatively high levels. At the time of writing, no additional restrictive measures were being discussed and there was growing social pressure to relax the existing ones. However, 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**.

As mentioned in earlier BCMs a specific technical problem is that the traditional indicators and models used for forecasting are currently likely to give unreliable signals. Models have typically been estimated on the basis of past observations and correlations and are not designed to maintain their performance in this pandemic context. Hence, additional information and an increased reliance on judgment calls are necessary to estimate economic growth. In particular, we make use of a business survey that has been carried out since March 2020 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 declined by 0.6 % in the fourth quarter of 2020 and growth will remain lacklustre at best in early 2021

After having recovered vigorously in the third quarter, surging infection numbers and renewed health-related restrictions in the fall of 2020 caused the euro area GDP to shrink by 0.6 % in the fourth quarter. The year-on-year growth rate reached -5.0 %. While the recovery was interrupted, the impact of the restrictive measures was generally much smaller than in the spring of 2020.

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

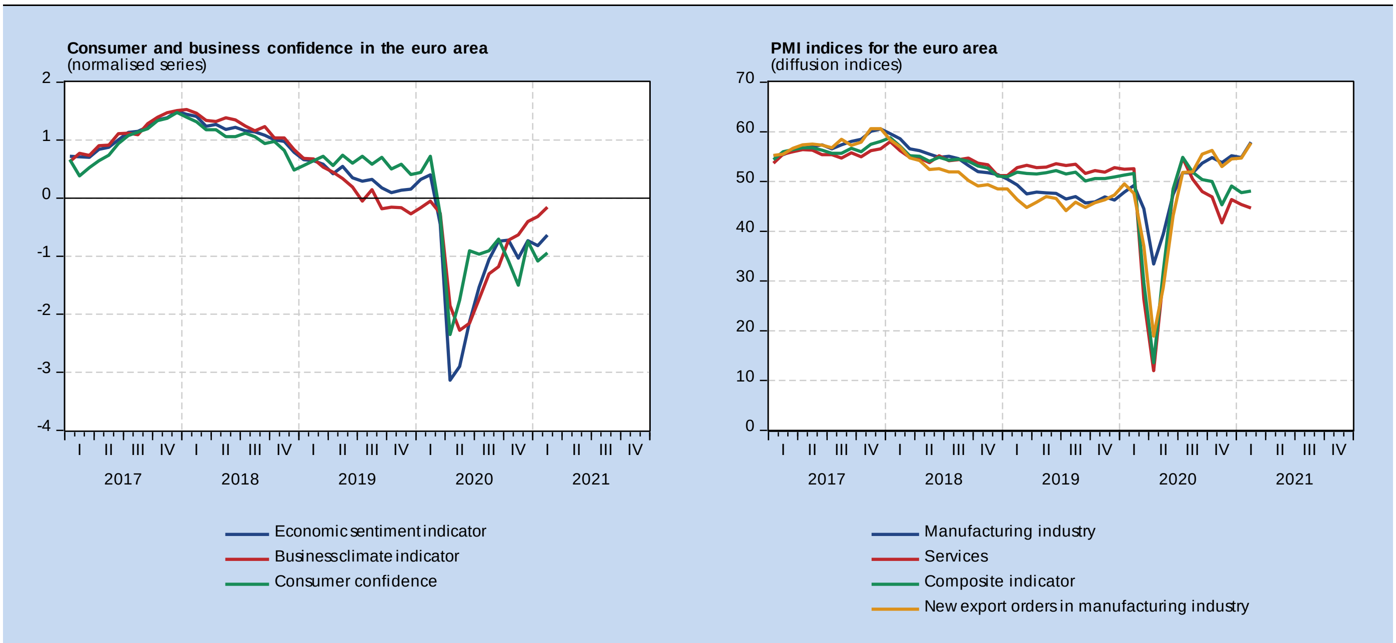
	Quarter-on-quarter change				Year-on-year change
	2020 Q1	**2020 Q2**	**2020 Q3**	**2020 Q4**	**2020 Q4**
Euro area	-3.7	-11.7	12.4	-0.6	-5.0
Germany	-2.0	-9.7	8.5	0.3	-3.6
France	-5.9	-13.5	18.5	-1.4	-4.9
Italy	-5.5	-13.0	16.0	-2.0	-6.6
Spain	-5.3	-17.9	16.4	0.4	-9.1
Netherlands	-1.5	-8.5	7.8	-0.1	-3.0
Belgium	**-3.4**	**-11.8**	**11.6**	**-0.1**	**-5.1**
Austria	-3.0	-10.7	11.8	-2.7	-5.9
EU	-3.3	-11.4	11.5	-0.4	-4.8
UK	-0.5	-8.0	5.5	2.5	-1.0
US	-1.3	-9.0	7.5	1.0	-2.4
JP	-0.6	-8.3	5.3	3.0	-1.1

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

Austria, Italy and France registered the largest contractions in the fourth quarter, with activity declining by 2.7 %, 2.0 % and 1.4 % respectively. GDP was essentially flat in Belgium and the Netherlands while Germany and Spain recorded mild expansions, with GDP growing by 0.3 % and 0.4 %, respectively. In all cases activity is still (far) below the pre-crisis level, but euro area cross-country variation is significant. The overall impact of the crisis, in year-on-year terms, has been much larger in Spain, Italy and Austria than in Germany or the Netherlands. When compared to important non-euro area developed economies, the recovery of the euro area is clearly lagging behind. Fourth-quarter economic activity grew by 1.0 % in the US, 2.5 % in the UK and 3.0 % in Japan, thereby further reducing the remaining gap of those economies with their pre-COVID output.

The relevant euro area survey indicators show that sentiment regained its upward trend in the first months of 2021, after a temporary interruption due to the flare-up in infections in the fourth quarter of 2020. The EC's overall economic sentiment indicator, reflecting both the business climate and consumer sentiment, posted a new uptick in February (see Chart 2, left-hand graph). In recent months, this composite indicator was subject to some volatility that can in particular be traced back to consumer confidence. After a partial recovery, the latter had levelled off over the summer and deteriorated again significantly in October and November as new restrictive measures were taken in many countries. Sentiment recovered in December, however, and now hovers around the levels seen in the third quarter of 2020 again. In stark contrast to this volatility, the business climate indicator has consistently shown a robust recovery in confidence among business leaders and is currently approaching pre-COVID-levels. The PMIs confirm this picture by pointing to a manufacturing-services divergence caused at least in part by the COVID-19 containment measures. All indexes have rebounded simultaneously in May and reached about neutral levels (i.e. a diffusion index of 50) in June. However, the PMI for the manufacturing industry, as well as the new export orders indicator have since moved further up into expansionary territory and are currently at three-year highs (see Chart 1, right-hand graph). The PMI services indicator, on the other hand, is much more affected by changes in domestic consumer demand. It quickly fell into contractionary territory again in the third quarter and has further deteriorated since, dragging the PMI composite indicator down. The maintaining of COVID-19 restrictions, the uncertainty about the economic fall-out and the slow vaccine roll-out are depressing consumer spending.

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 GDP declined by 0.1 % in the fourth quarter, as renewed restrictions depressed consumer spending

Falling infection numbers and the easing of restrictions have driven a strong economic rebound in the third quarter. However, the worsening health situation and the new restrictive measures in the autumn of 2020 have interrupted this recovery. All in all, Belgian GDP shrank by 0.1 % in the fourth quarter. Nevertheless, this was somewhat better than the estimate in the previous Business Cycle Monitor (-1 %). As expected on the basis of the ERMG survey, the second series of lockdown measures, as of mid-October 2020, depressed activity much less than those taken in the spring. However, substantial stockpiling by UK firms in the run-up to the Brexit deadline is likely to also have contributed to the better-than-expected outcome by temporarily boosting Belgian exports.

The latter may be partly reflected in the strong positive growth contribution of net exports. Private and public investment categories also supported domestic demand and GDP growth, as was the case for domestic inventories. However private consumption growth was clearly negative due to the new restrictive measures in the fall, while public consumption also reduced GDP growth.

Not surprisingly, the production approach to GDP shows negative fourth-quarter growth in services (-0.9 %), which depends more on domestic consumer demand and has been affected most by the restrictive measures. On the other hand, growth was very robust in the manufacturing industry (5,5 %) and agriculture (4.4 %) and solid in the construction industry (1.4 %). On an annual basis, the National Accounts Institute (NAI) now estimates that **Belgian real GDP decreased by 6.3 % in of 2020**. This is still the biggest decline since World War II.

As COVID-19-related restrictions remain in place, first-quarter private consumption growth will remain subdued

After the spectacular, albeit partial, recovery in the third quarter, **private consumption declined again by 5.6 % in the fourth quarter** against the background of a new Covid-19 wave after the summer, as well as new restrictive measures from mid-October onwards. As was expected in the last BCM, several factors caused the fall-out of these measures to be much more limited than in the spring. The restrictions on activities were generally lighter and the construction and the manufacturing industries have remained fully operational. In addition, by the end of the summer, the economy had not yet fully recovered, which limited the additional loss in economic activity due to the second lockdown. Finally, several quarters into the pandemic, retailers and consumers have had time to adjust their behaviour and online and distance sales have replaced a larger part of on-site purchases when the latter were not possible due to closures. Nevertheless, consumption of both durables, which had increased markedly in the third quarter partly as a result of pent-up demand, and non-durable goods, constituting the bulk of consumer spending, were down. At the end of 2020, private consumption was about 10 % below the level recorded in the final quarter of 2019.

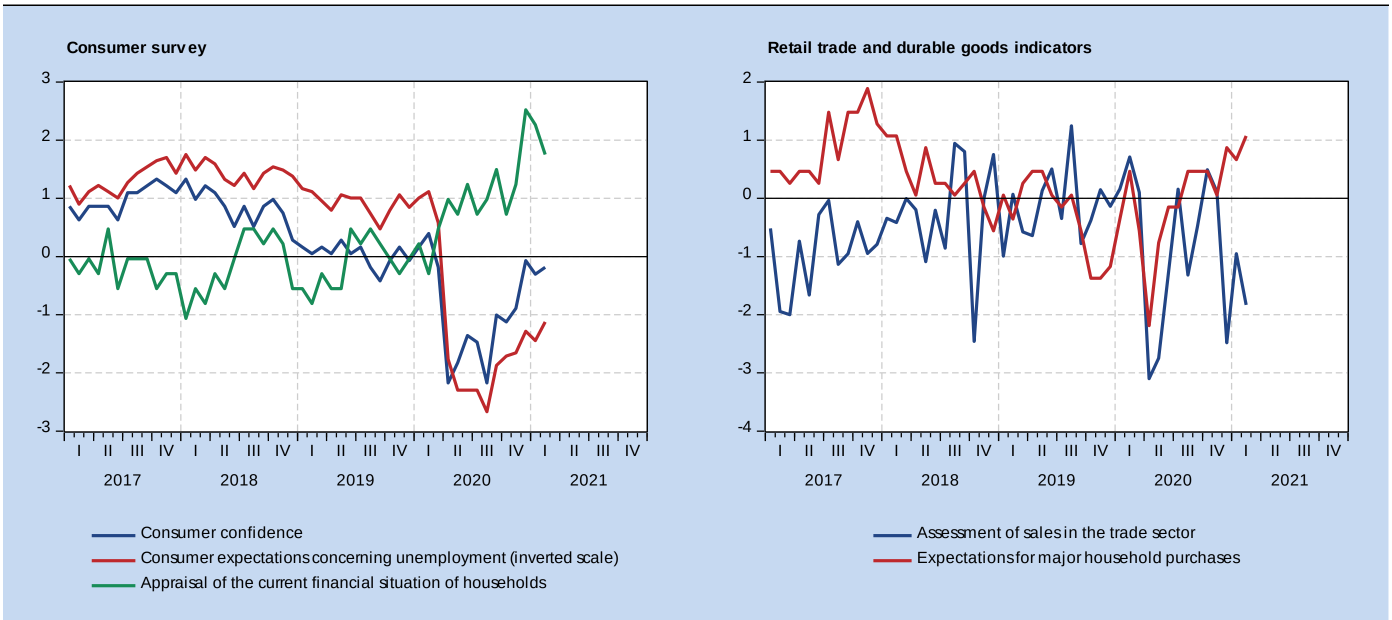
We expect private consumption to recover in the first quarter of 2021 but the rebound should remain quite subdued. Even though certain restrictions have been lifted before (the closure of brick&mortar non-essential shops) or during (most contact professions) the current quarter, many other restrictive measures remain in place and consumer demand is likely to still be depressed by remaining concerns about infection risks. As shown in Chart 1, mobility data related to retail and recreation have only slightly edged up since the fall and remained clearly below normal levels at the end of February.

Consumer confidence is now approaching pre-crisis levels (see Chart 3, left-hand graph) but this is mostly due to households' appraisal of their current financial situation. This suggests that lack of purchasing power is not the key element holding back consumption. However, while the impact of the crisis on the labour market has so far been limited, partly due to unprecedented government measures, unemployment expectations remain far worse than before the crisis despite a recent improvement. Precautionary saving could then still keep the saving ratio higher than usual for a longer period and, hence, delay the full recovery of private consumption.

Against this background, sales in the trade sector as reported by company managers are disappointing and currently at very low levels. Seasonally-adjusted car registrations as reported by Febiac, a typical indicator for consumption of durable goods, were down in January and February.

At the same time, the fundamentals for private consumption and the outlook for personal income in particular remain solid, even if government support will be gradually withdrawn. Employment has increased again in the final quarter of 2020 and the ERMG surveys suggest that, overall, the negative impact on the labour market could remain subdued in 2021 as well, in particular if labour mobility between industries can be guaranteed. Hence, a permanent improvement in the health situation (which may be dependent on the successful implementation of the vaccination campaign) will almost certainly boost private consumption later in the year. One leading indicator of additional pent-up demand may be the expectations regarding major household purchases for the next twelve months that have strongly increased since May and are currently near a three-year high (see Chart 3, right hand graph). All in all, a rebound in private consumption similar to the one seen in the summer of 2020 is not expected for the current quarter but may just be a matter of time.

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.

Government consumption growth should come in positive due to additional healthcare spending in the first quarter

Government consumption decreased by 3.1 % in the fourth quarter, thereby underperforming compared to our expectations. The decline was mainly driven by the postponement of certain health care treatments. This phenomenon, should not gain further traction in the first quarter of 2021, which is consistent with higher government consumption growth, that may turn positive again. 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 quite large revisions.

Business, housing and government investment will continue to expand at a moderate pace

Volume growth in total investment amounted to 4 % in the fourth quarter of 2020, continuing the recovery in investment that started over the summer. Business and government investment posted the largest increases, with 4.6 % and 4.0 % respectively. Housing investment recovered by 2.1 %.

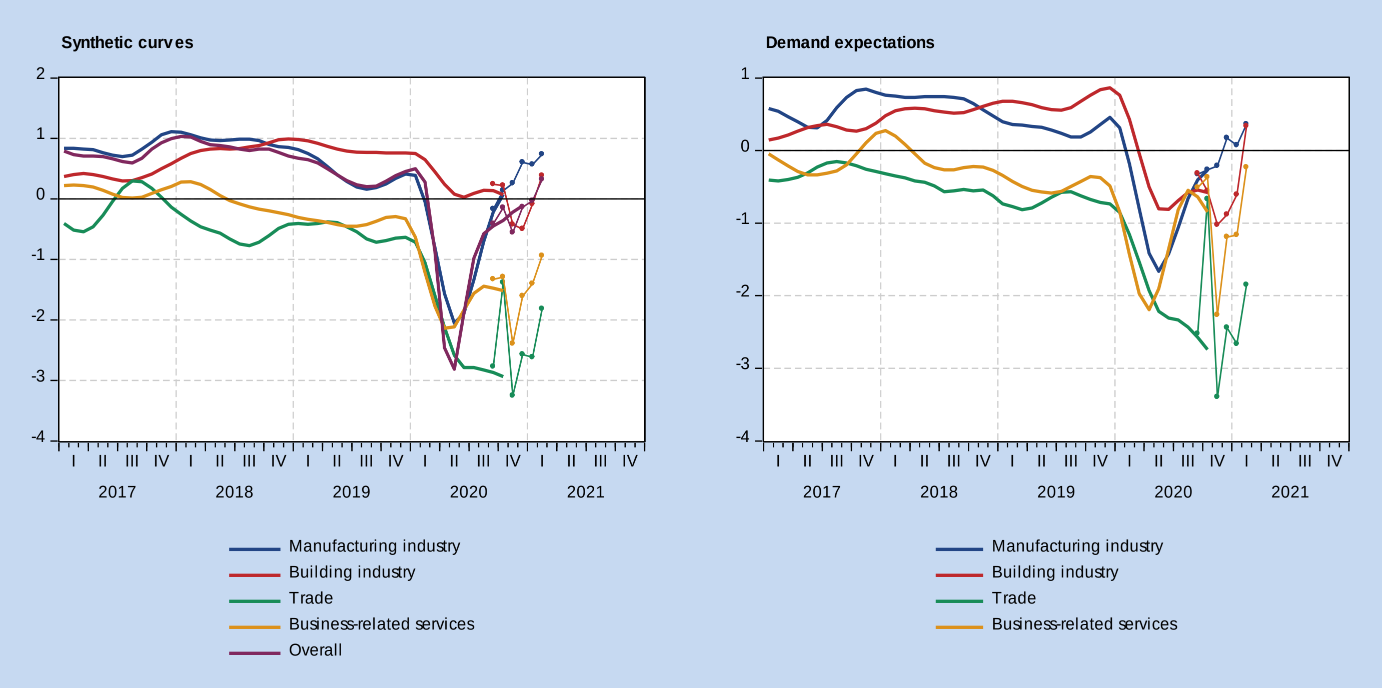
NAI statistics on business investment growth in 2020 have been revised up substantially since the last BCM. After having fallen to nearly one fourth below pre-crisis levels, business investment has recovered to within 4 % of pre-crisis levels in the fourth quarter. This brings business investment growth more in line with developments of the synthetic business confidence indicator but is at odds with the findings of the ERMG survey that points to two-digit cuts in firm investment. Headline business confidence, which quickly rebounded from its historically low levels in April and May, showed a gradual upward trend over the second half of 2020 (see Chart 4, left-hand graph) and continued to improve in the first months of 2021. The main driver behind this recovery has been sentiment in the (capital-intensive) manufacturing industry, which remained unaffected by the restrictions in the second wave of the pandemic and which was supported by the recovery in world demand and some catching-up from the effect of the first lockdown. These positive elements appear to have been enough to counter the impact of negative factors, such as the Brexit and the recent supply chain disruptions in certain industries such as car manufacturing. Overall, confidence levels in the manufacturing industry are currently above their pre-crisis level and have continued to improve in February. The latest quarterly survey on production capacity indicates that the degree of capacity utilisation in the manufacturing industry increased further at the start of 2021, to 78.9 %, and is now at pre-crisis levels and near the historical average.

The improvement in the overall business sentiment indicator was broad-based. Apart from manufacturing, confidence also improved in the hard-hit trade industry and business-related services, mainly due to more positive demand expectations. Sentiment in the building industry has also increased markedly. Looking at the sub-components of the headline indicator, the underlying driver of the recent upturn has mainly been the significant improvement in demand expectations, which point to a more positive near-term outlook (see Chart 4, right-hand graph).

Nevertheless, overall confidence in the hardest-hit branches is still very low. On average, respondents indicate in the ERMG survey that the level of their planned investments will only slightly improve in 2021. Even if there seems to be a divergence between the survey results and the current NAI statistics, this suggests that any further recovery is likely to be quite weak, in particular as the health crisis in worsening again in most European countries. The latter and the ensuing restrictive measures (including full lockdowns in many cases) may be a temporary factor that is not (yet) adequately reflected in the demand outlook and, hence, may delay investment plans to some extent.

All in all, business investment growth should be quite limited in the first quarter.

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.

After the surge in the third quarter and despite the restrictions on real estate activities, **housing investment** increased by 2.1 % in the fourth quarter of 2020 and **can be expected to continue its upward trend in the first quarter of 2021.** Fundamentals for housing investment remain solid, as mortgage rates remain historically low (despite the current uptick in sovereign yields) and income prospects are robust. Additionally, business confidence and demand expectations in the building industry are up in the current quarter.

Finally, **government investment should also continue to expand in the first quarter of 2021.** The construction industry can continue to function unhindered and investment is still catching up from the delays caused by the first lockdown.

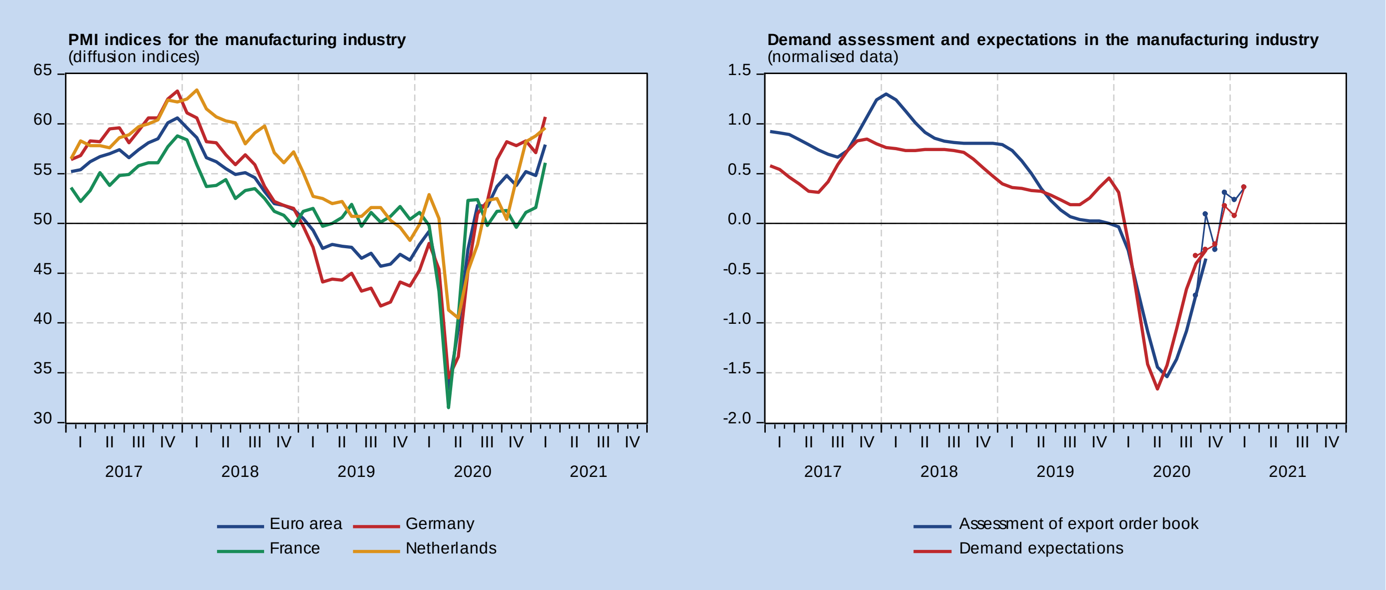
Net exports should reduce GDP growth in the fourth quarter

Fourth-quarter exports increased by 3.8 % with imports growing by only 2.0 %, resulting in a 1.4 percentage point contribution of net exports to GDP growth.

Foreign demand has shown a significant recovery, driving up exports of goods and services. The outlook remains positive for a further trend improvement. Purchasing managers in the manufacturing industry in Belgium's neighbouring countries indicate that potential demand for Belgian exports continues to increase. **After briefly losing traction in autumn 2020, the PMI manufacturing index for the euro area moved further into expansionary territory in the first months of 2021 and is currently at its highest level since early 2018** (see Chart 5, left-hand graph). Purchasing managers in the Netherlands and Germany continued to report an improvement in activity, while the index for France, which had lagged the euro area average and hovered around neutral territory in the second half of 2020, has rapidly improved since December.

Helped by the recovery of foreign demand, the business survey results for the Belgian manufacturing industry continued their steady improvement over the past months (see Chart 5, right-hand graph). However, export growth has likely been boosted by important stockpiling of UK firms ahead of the Brexit deadline. The reversal of this temporary element should depress growth somewhat in the first quarter of 2021. In addition, even though a last-minute trade agreement between the EU and the UK has been reached in December that exempts the goods trade from tariffs, non-tariff barriers, possibly exacerbated by temporary frictions in the first weeks of the year, should clearly reduce cross-Channel trade flows as of 2021. **Hence, despite the upbeat assessment of the export order books, export growth should actually weaken in the first quarter of 2021**.

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.

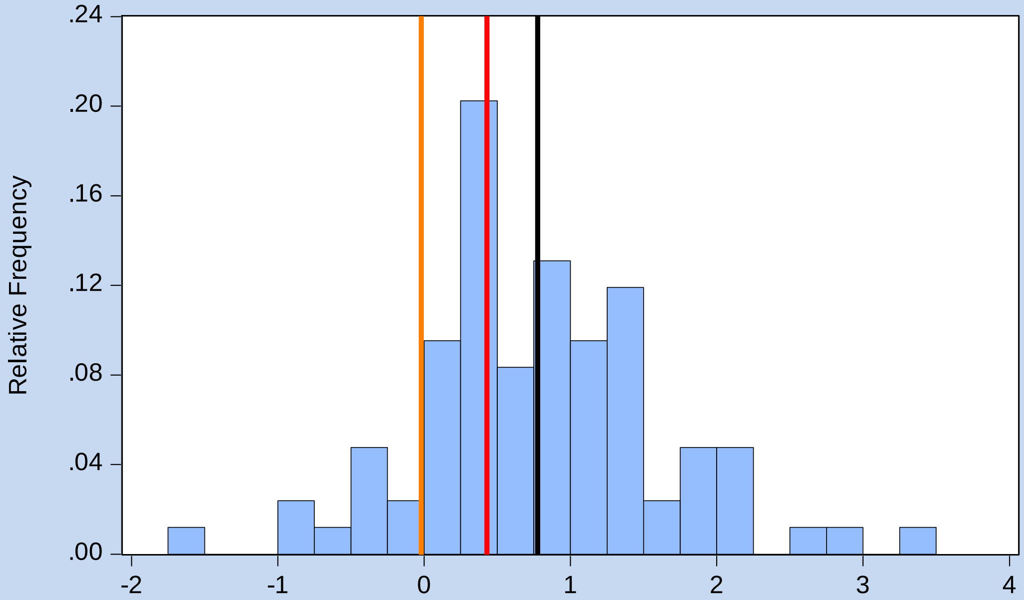
Imports of goods and services in the fourth quarter picked up more slowly than exports due to the fall in Belgian domestic demand. **Imports are expected to increase again in the first quarter of 2021, on the back of positive domestic demand growth.**

All in all, the contribution of net exports to GDP growth is expected to be negative in the first quarter, despite the ongoing recovery in global trade. This mostly reflects a reversal of the temporary UK stockpiling effect that is likely to have boosted growth at the end of 2020.

Mechanical nowcasts indicate a slightly positive GDP growth in the first 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 moderately positive growth in the first quarter of 2021** (see Chart 5). The distribution is quite even and most frequently lies in the [-1; 3] % range, with a median estimate equal to 0.8 %. 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 FIRST QUARTER OF 2021



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 close to 0.45 % in the first quarter, while "R2D2"[3] is less positive and estimates growth around 0 %. 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.

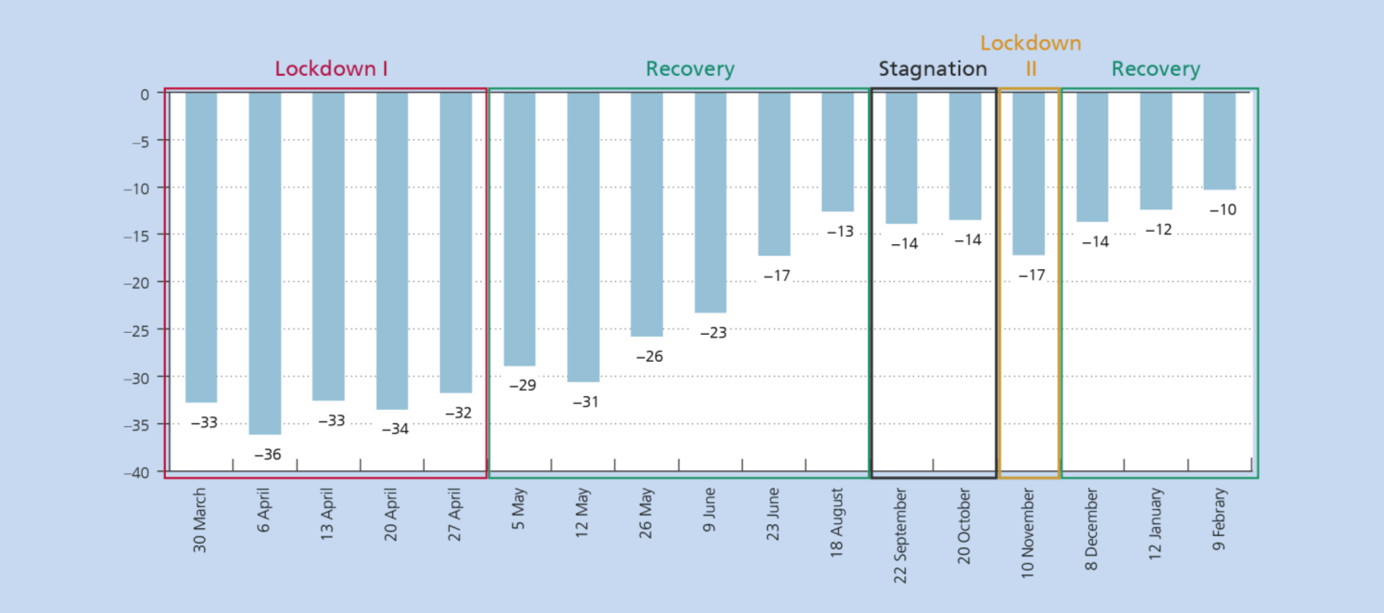
...Which is confirmed by gradual improvements in turnover in the most recent ERMG surveys

Sales developments reported by companies in the ERMG surveys suggest a further, but limited increase in turnover in the first quarter. Taking company size and the weight of the different industries in value added into account, an average loss in weekly turnover of about 15 % was reported in the fourth quarter, while the most recent survey indicates private-sector revenue losses gradually narrowing to levels that are slightly lower than those seen prior to the second COVID-19 wave (see Chart 7). **Non-market output, too, is expected to increase, in line with government consumption and investment**.

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.

CHART 7 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 increase by 0.5 % in the first quarter. This is at the high end of the range given by the two model nowcasts but significantly more moderate than the first-quarter growth rate (2 %) in the Bank’s December 2020 macro projections. The latter was conditional on far more restrictions being lifted as of mid-December, which did not happen. In addition, growth in the final quarter of 2020 has been somewhat better than expected, but this may be partly due to a temporary Brexit stockpiling effect pushing up exports. The reversal of this temporary effect is likely to depress growth at the start of 2021. 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 or setbacks regarding the vaccination campaign that could lead to additional or longer containment measures.