September 2021

Belgian economic activity is expected to increase by 1.8 % in the third quarter of 2021[1]

- According to revised statistics Belgian GDP increased by 1.7 % in the second quarter. This is better than the estimate in the previous Business Cycle Monitor (+1.3 %).
- The breakdown into the demand components was in line with our expectations. Growth was supported by a rebound in domestic demand and private consumption in particular, while net exports constituted a drag to growth.
- Private consumption growth should be even higher in the third quarter, mostly because it was still weighed down by several containment measures in the early weeks of the second quarter. Most containment measures have been lifted gradually after Easter, as planned, and the final phase of the exit plan from the containment measures started in September.
- While the overall business sentiment indicator seems to have peaked, it remains well above its pre-crisis level. Moreover, capacity utilisation is on the rise. Business investment should accelerate again in the third quarter. Government and housing investment should also continue to expand.
- The contribution of net exports to GDP growth is expected to come in slightly negative again in the third quarter. Strong domestic demand is boosting import growth while decelerating manufacturing demand in particular should limit export growth in the near term.
- The NBB nowcasting model “BREL” predicts a quarterly growth rate of about 1.2 % in the third quarter of 2021, while the “R2D2” model is somewhat more optimistic with a growth rate of 1.4 %. The uncertainty of these nowcasting models is exceptionally large in the current circumstances: the massive shock 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.
- In that connection, the carry-over effect due to the steep increase in activity in the course of the second quarter should mechanically push up growth in the third quarter. Even if activity may actually already be decelerating in the second half of the summer, we estimate that this effect is important enough to keep the quarter-on-quarter growth at roughly the same rate as in the previous quarter.
- All in all, taking into account other information, we currently estimate that Belgian economic activity will increase by 1.8 % in the third quarter.

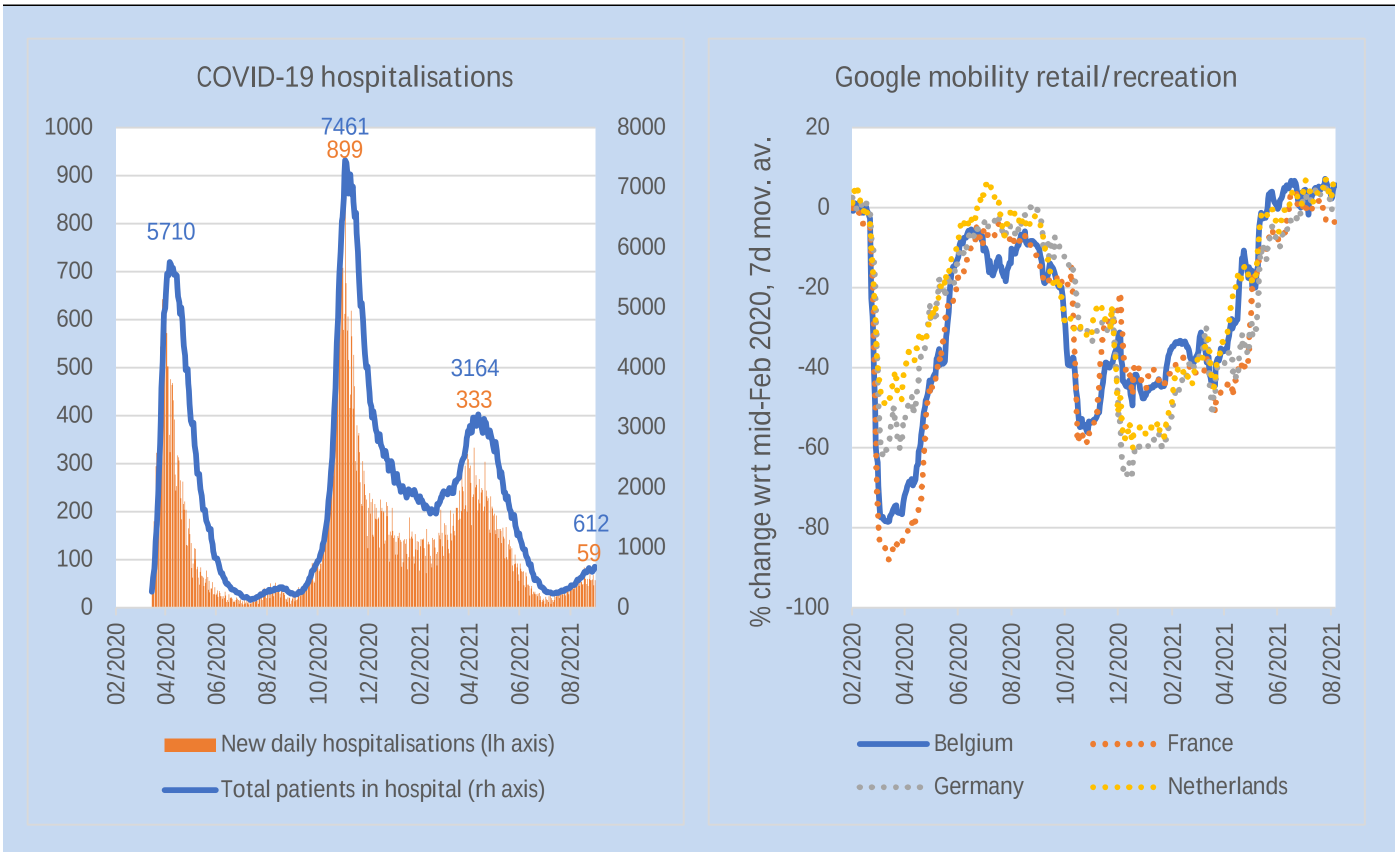
[1] This is a short-term NBB estimate and should not be confused with the official statistics published by the National Accounts Institute (such as the flash GDP estimate, which is released one month after the quarter has ended). This NBB estimate is based on nowcasting models, as well as expert judgment and incorporates information up to 3 September 2021. As all estimates and forecasts, it comes with a degree of uncertainty.

The gradual lifting of the containment measures is fuelling the economic recovery even if certain health risks remain

After the Easter holiday weeks, the various containment measures affecting the Belgian economy were gradually lifted. The appointment-only regime for non-essential shops was dropped and bars and restaurants were allowed to first open their outdoor facilities and reopen completely on 9 June. The number of COVID-19 infections and hospitalisations continued to improve rapidly thereafter (see Chart 1, left-hand graph) and at the end of June the containment measures were loosened further; working from home was no longer mandatory when possible (but still recommended), for example.

By mid-July, however, COVID-19 infections were on the rise again throughout Europe (and elsewhere), as the more contagious 'Delta' variant spread among the population. Still, the health situation was considered manageable as the number of hospitalisations remained under control, and the government stuck to a roadmap that it announced in May. As envisaged, a number of the remaining restrictive measures, especially for events, were loosened in July and August. While certain measures (such as mandatory face masks in different situations) remain in place, life is gradually returning to normal, as witnessed by the fact that by the summer, mobility indicators had returned to a level last seen right before the pandemic (see Chart 1, right-hand graph). Although we lack pre-COVID-19 data, seasonal patterns are bound to affect mobility, so the 'normal' summertime level has probably not yet been attained.

CHART 1 COVID-19 HOSPITALISATIONS AND GOOGLE MOBILITY DATA



Sources: Google, Sciensano.

Any economic forecast, including our estimate for the short term, still 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 may be less accurate in this specific pandemic context. Hence, additional information and an increased reliance on judgment calls are necessary to estimate economic growth.

Euro area GDP increased by 2.2 % in the second quarter of 2021, and the recovery should continue in the third quarter

Following two quarters of negative growth, economic activity in the euro area has rebounded strongly in the second quarter, posting a quarterly growth rate of 2.2 %. The year-on-year growth rate reached 14.3 % and the gap with the pre-COVID-19 GDP level narrowed to some 2.5 %.

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

	Quarter-on-quarter change				Year-on-year change	Gap vs pre COVID 19 level[1]
	2020 Q3	**2020 Q4**	**2021 Q1**	**2021 Q2**	**2021 Q2**	**2021 Q2**
Euro area	12.4	-0.6	-0.3	2.2	14.3	-2.5
Germany	9.0	0.7	-2.0	1.6	9.4	-3.3
France	18.8	-1.0	0.0	1.1	18.7	-3.2
Italy	16.0	-1.8	0.2	2.7	17.3	-3.8
Spain	17.1	0.0	-0.4	2.8	19.8	-6.8
Netherlands	7.5	0.0	-0.8	3.1	10.0	-0.9
Belgium	**11.8**	**-0.1**	**1.1**	**1.7**	**14.9**	**-2.2**
Austria	11.6	-3.1	-1.1	3.6	11.9	-2.5
EU	11.6	-0.4	-0.1	2.1	13.8	-2.2
UK	16.9	1.3	-1.6	4.8	22.2	-4.4
US	7.5	1.1	1.5	1.6	12.2	0.8
JP	5.3	2.8	-0.9	0.3	7.6	-1.5

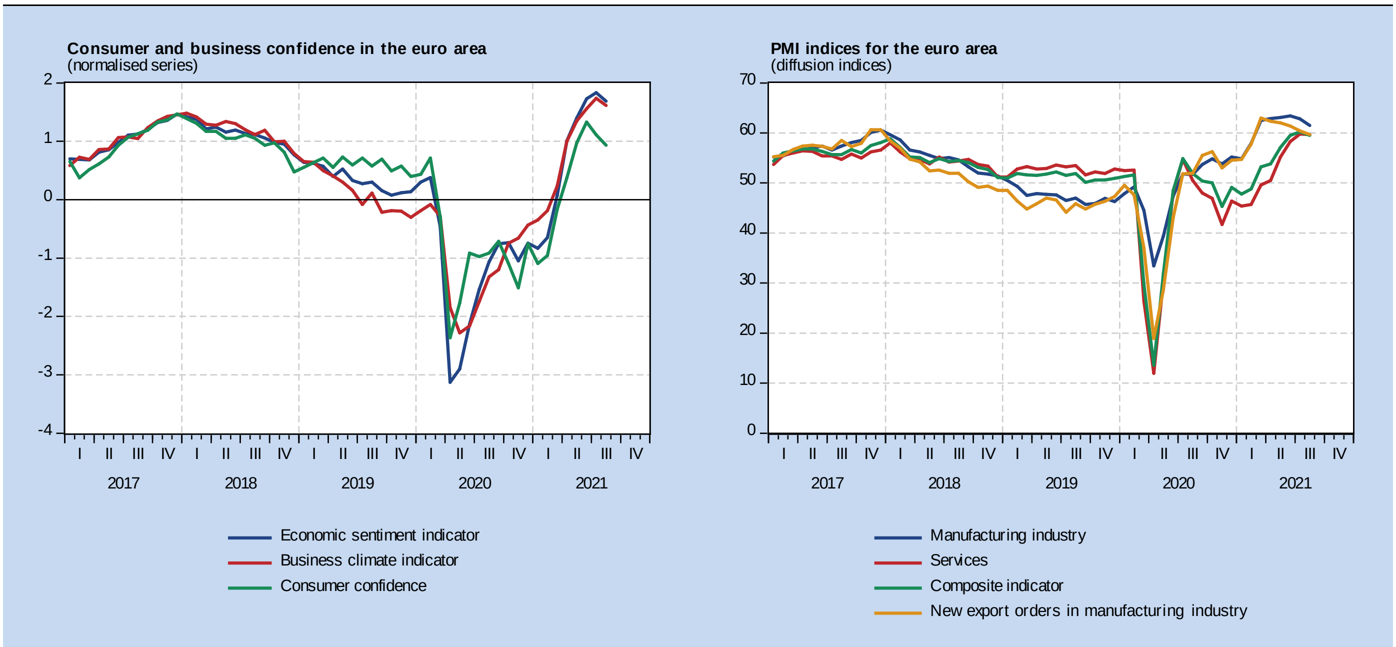
Sources: EC, U.S. Department of Commerce, Cabinet Office Japan.
[1] The pre-COVID-19 reference is 2019 Q4

Activity expanded strongly across the euro area countries, with the Italian, Spanish, Dutch and Austrian economies outpacing the euro area average. Belgium, Germany and France, on the other hand, recorded growth rates below 2.2 %. All in all, the euro area economy is still some 2.5 % below its 2019 level. All countries have yet to recover to their pre-crisis level, but the cross-country variation is significant. The Netherlands should close the gap soon, while Spain is at the other end of the spectrum at nearly 7 % below the pre-pandemic level. France and Germany still have a gap of slightly more than 3 %. Compared with major non-euro area developed economies, the recovery of the euro area is lagging the one of the US economy in particular, where the level of economic activity has fully recovered from the COVID-19 crisis. On the other hand, the euro area economy is doing somewhat better than the UK economy which still faces a gap of 4.4 % compared to its pre-COVID-19 level.

Turning to the soft indicators, the EC's overall economic sentiment indicator, reflecting both the business climate and consumer sentiment, reached an all-time high in July. Even though it eased slightly in August, sentiment remained at very high levels (see Chart 2, left-hand graph). The business climate indicator shows a similar pattern and its current level points to very strong growth. Consumer confidence peaked in June and fell slightly in July and again in August, mostly on account of declining intentions to make major purchases and deteriorating expectations about the general economic situation. More generally, the minor worsening in consumer confidence is likely to reflect renewed COVID-19 fears that have led to new restrictive measures, in particular for unvaccinated people, in certain countries.

The PMI composite indicator for the euro area (see Chart 1, right-hand graph) levelled off in the third quarter, although the index remained in very expansionary territory (i.e. at a level far above 50), remaining close to a fifteen-year high. Confidence in the services industry retained momentum, whereas sentiment fell back slightly in the manufacturing industry, most likely reflecting capacity constraints and supply chain issues. Indeed, the supplier delivery times index still points to significant delays. However, supply issues may not be the only cause for concern as demand for manufactured goods seems to have passed its peak: the manufacturing industry's new export orders index has been cooling down gradually over the past six months. All in all, the current level of the PMI composite indicator remains consistent with a further strong rebound of the euro area economy in the third quarter.

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.

The Belgian economy expanded strongly in the second quarter

The gradual relaxation of restrictive measures and the corresponding improvement in economic sentiment have pushed up Belgian economic growth in the second quarter to a whopping 1.7% according to revised NAI statistics. This is well above the 1.3 % estimate in the previous Business Cycle Monitor but also constitutes a significant upward revision from the NAI's earlier flash estimate of 1.4 %.

Growth was supported by domestic demand, while net exports and changes in inventories reduced it. Private consumption expanded vigorously as several containment measures, such as those for non-essential shops and bars and restaurants, were loosened in the course of the second quarter. Households mainly spent more on non-durable goods. Consumption of durables was weak, which could be related to the supply chain issues such as the global shortage of semiconductor chips plaguing the production of durable goods. In addition, public spending also remained buoyant and both private and public investment grew in line with expectations.

Complementing the demand components, the production approach to GDP shows second-quarter growth to be broad-based across industries. Posting 1.7% growth in quarterly terms, services were the strongest growing production component, reflecting increased consumer demand for non-durables. Still, the sector's level of activity remains more than 3 % below its pre-crisis level. The construction industry grew by 0.5 % and has now exceeded its pre-pandemic level of activity. The manufacturing industry continued to expand albeit at a slower pace (1.0 %) than in the previous quarters, mostly due to supply-side constraints. At the same time, the manufacturing industry has already exceeded its pre-crisis output level and, hence, a deceleration is not abnormal.

The gradual lifting of the containment measures will keep consumer spending growth very high

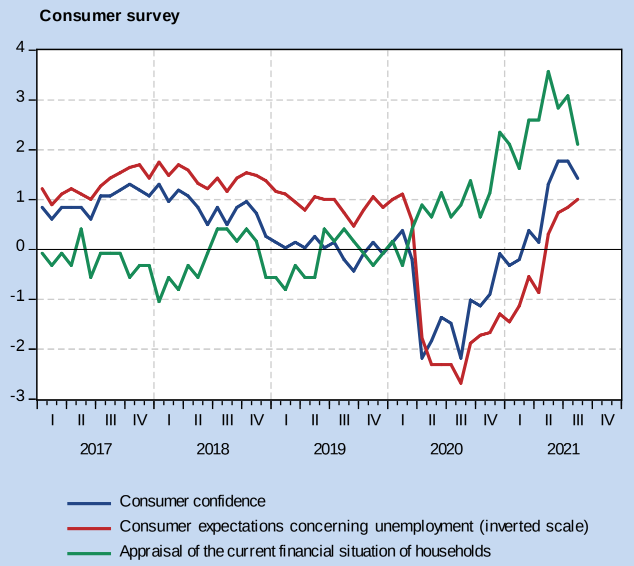
A Private consumption expanded by a solid 3.5 % in the second quarter, thanks to the tailwinds coming from the further easing of containment measures with the two-stage opening of bars and restaurants on 8 May and 9 June in particular. However, this still leaves consumer spending some 6% below its pre-crisis level. The rebound should continue and possibly gain further traction in the third quarter, as more containment measures have been lifted but also due to a mechanical effect: consumption was in all likelihood still subdued in the first weeks of April due to the restrictive measures around Easter so the return to normal in May and June automatically pushes up growth in the third quarter via a level effect.

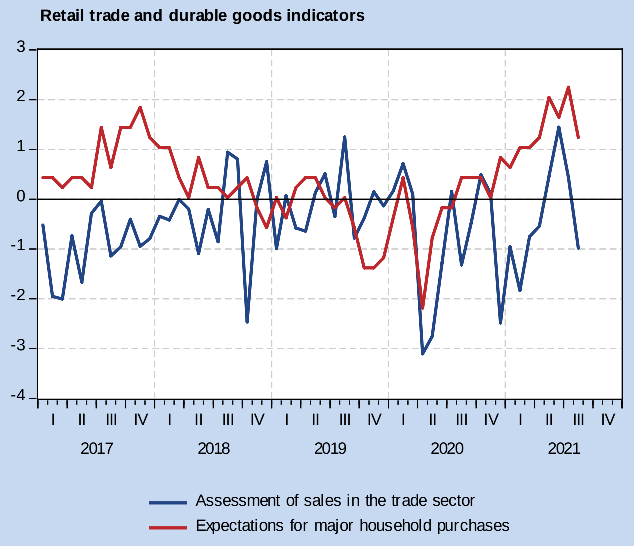
As regards the soft indicators, consumer confidence clearly remained above pre-crisis levels (see Chart 3, left-hand graph), although it appears to have reached a peak. With most businesses allowed to reopen and consumer mobility back at pre-crisis levels, unemployment expectations have continued to improve. Although remaining at high levels, households' appraisal of their current financial situation, on the other hand, came down from record highs in August. Similarly, expected major household purchases in the next twelve months declined somewhat (see Chart 3, right-hand graph). Company managers' assessment about sales in the trade sector has been quite volatile recently. Reflecting a wave of optimism as containment measures were loosened, the indicator jumped to a high level in June, but it has since declined again. This fall in sentiment seems somewhat at odds with the recovery of the abovementioned indicator on mobility (although its current level is probably still below 'normal' summer mobility) but is corroborated by reports from retail associations citing disappointing summer sales due to bad weather and remaining containment measures.

Zooming in on durable goods, seasonally-adjusted car registrations as reported by Febiac took another hit in July and are far from regaining their pre-crisis levels. In this connection, it should be kept in mind that the car industry has continued to experience supply chain troubles in recent months, leading to ongoing delivery delays.

Despite some indicators levelling off, the fundamentals for private consumption and the outlook for personal income in particular remain very solid. The labour market surprised on the upside again, with domestic employment posting a 0.7 % quarter-on-quarter expansion in the second quarter of 2021. As a consequence, employment has already regained its pre-COVID-19 level. The use of the system of temporary unemployment has declined, with some 7 % of the salaried workforce still affected in June (against 18 % in June 2020). At the same time the number of unemployed jobseekers has not recorded a corresponding increase; suggesting that the workers leaving the system of temporary unemployment have mostly returned to regular employment (either in their existing jobs or in new ones) The rapidly tightening labour market is already leading to bottlenecks, as evidenced by survey questions on hiring expectations and Eurostat data on vacancy rates. Meanwhile, temporary work remains only about 2 % below pre-crisis levels.

CHART 3 INDICATORS FOR PRIVATE CONSUMPTION GROWTH
(normalised series)





Source: NBB.
Note: the original series are normalised around their historical averages.

All in all, private consumption is on track for another strong expansion in the third quarter of 2021. Sentiment indicators are at very high levels, although they have softened a bit recently, suggesting that the consumption boom is already losing some traction. This reinforces our assessment that the ‘excess savings’ amassed in 2020 will not turn into consumption spending in 2021 and beyond. Still, consumer spending should remain the main growth engine beyond the very near term as well. The mere normalisation of the saving ratio, coupled with favourable purchasing power prospects should continue to provide enough impetus to consumption growth going forward.

Government consumption growth should moderate somewhat in the third quarter

Government consumption increased by 3.5 % in the second quarter. This increase was driven by additional health care spending related to the vaccination campaign and the normalisation in non-COVID-19 medical treatments that had been postponed in 2020. As these elements are likely to wear off in the second half of the year, **government consumption growth should moderate already in the third quarter**. It should be stressed that uncertainty is particularly large for this demand component as the early statistics for government consumption are sometimes difficult to interpret and prone to quite large revisions.

Investment spending, by firms in particular, is likely to accelerate again in the third quarter

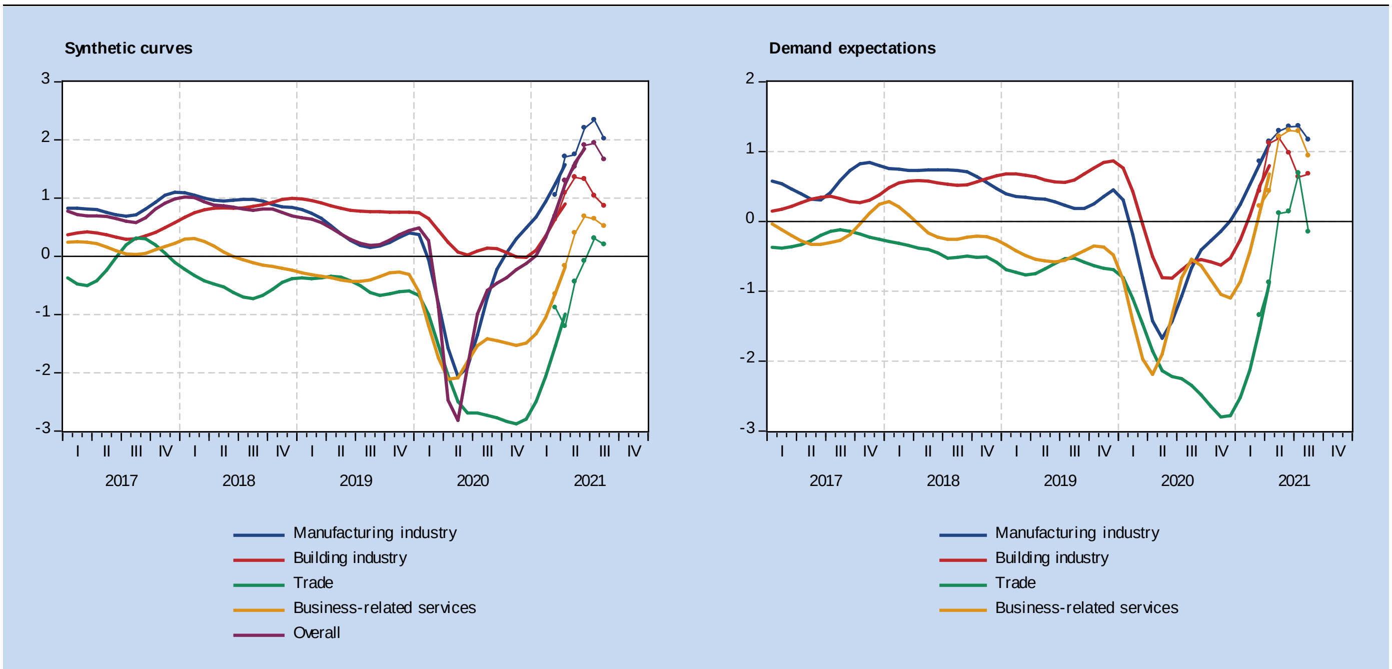
Quarterly volume growth in total investment amounted to 1.6 % in the second quarter of 2021, following the recovery in investment that started in the summer of 2020. **Total investment is now already some 2 % above its pre-crisis level.** Government investment posted the largest quarterly increase, shooting up by 5.2 %. Housing and business investment expanded by a more moderate 0.8 % and 1.2 % respectively. However, as some extraordinary purchases of ships abroad drove up business investment in the first quarter of the year, the quarterly expansion rate in the second quarter does not fully reflect the underlying investment dynamics.

Business investment has shown a remarkably strong recovery and has by now cleared its pre-pandemic level. This is in line with developments in the headline business confidence indicator, that quickly rebounded from the historically low levels in April and May of last year on the back of the surging sentiment in the manufacturing industry (see Chart 4, left-hand graph). The upward trend in business confidence accelerated and became more broad-based in 2021 as the outlook for an exit to the crisis brightened. **Although results for August show a minor deterioration, confidence levels of all industries remain high**.

Demand prospects have weakened slightly since July in all industries except construction. The deterioration was most significant for the trade industry. In the manufacturing industry, the shortage of stocks has started to normalise, but other constraints may be starting to bite. The latest quarterly survey on production capacity indicates that the degree of capacity utilisation in the manufacturing industry increased further towards the second half of the year, to 81.1 %, somewhat exceeding the pre-crisis level, as well as the historical average.

As demand prospects remain high and capacity utilisation is on the rise, business investment should continue to post solid growth in the third quarter. The ERMG surveys, including the last edition of June, have consistently shown that the level of firms' planned investments in 2021 is still negatively affected by the crisis but actual business investment statistics have consistently surprised on the upside.

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.

Residential investment growth dropped off somewhat in the second quarter. This moderation did not come unexpectedly, considering how residential investment had already closed the gap compared to its pre-crisis level at the start of this year. Still, fundamentals for future housing investment remain strong: mortgage rates are still historically low and households' income prospects are robust. Residential investment should continue to expand in the third quarter, even though a further deceleration may occur.

Finally, taking into account the roll-out of recovery plans, **government investment should continue to increase in the coming quarters.**

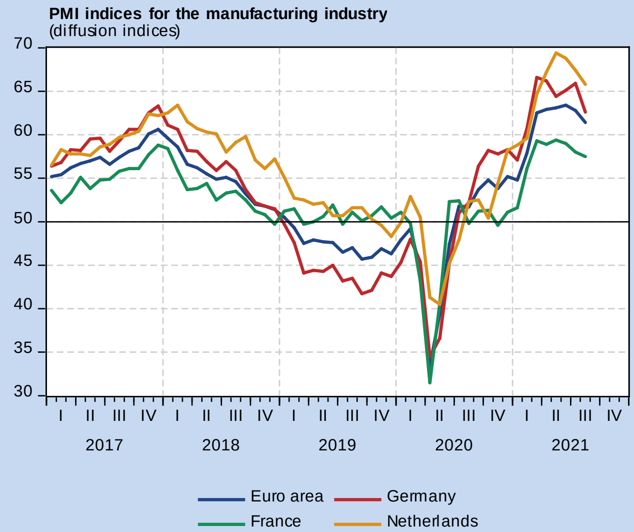
Net exports should reduce GDP growth in the third quarter

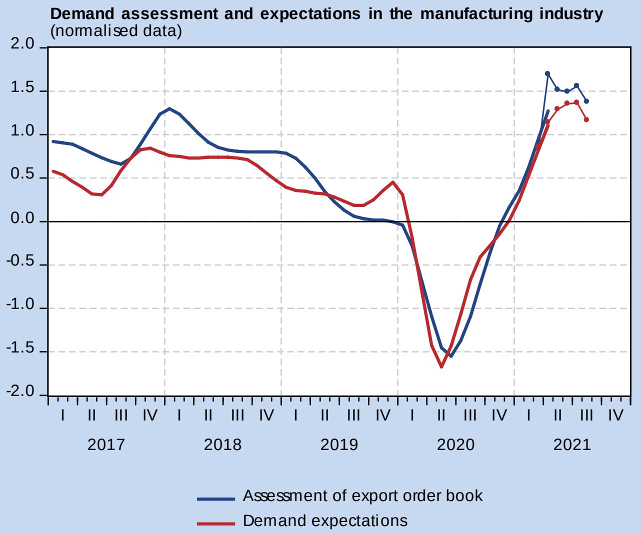
In the second quarter, exports grew by 2.7 %, but import growth was even stronger at 3.1 %[2], resulting in a 0.3 percentage point negative contribution of net exports to GDP growth, in line with expectations.

Foreign demand has continued to recover in recent months, driving up exports of goods and services. Although the outlook remains favourable, demand for Belgian exports has probably passed its peak. Purchasing managers in the manufacturing industry in Belgium's neighbouring countries remain upbeat, but the degree of optimism is declining. **The PMI manufacturing index for the euro area was at a six-month low in August** (see Chart 5, left-hand graph).

A similar picture emerges when looking at the business survey data for the Belgian manufacturing industry. Since the spring of 2020 up until very recently, demand expectations and the assessment of the export order book improved steadily, but their simultaneous – though still limited – decline in August suggests that the peak may be behind us (see Chart 5, right-hand graph). **All in all, export growth should still be strong in the third quarter of 2021**, but is likely to lose some traction compared to the second quarter.

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





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

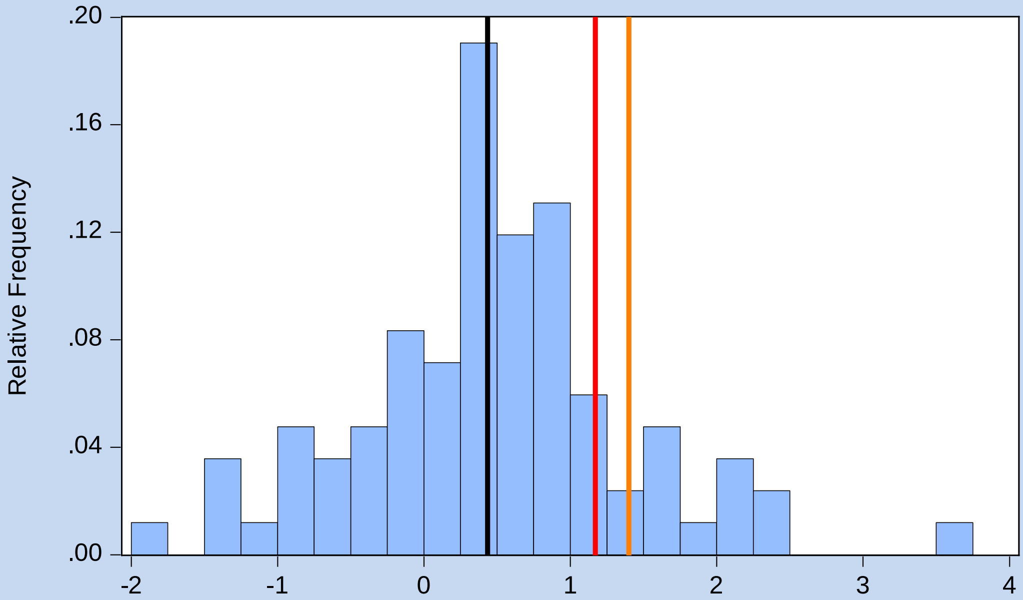
Meanwhile, the ongoing expansion of domestic demand should continue to boost import growth in the short run. In addition, with tourism and leisure travel picking up again and Belgium normally being a net importer of tourism: imports should be held back less by a staycation effect (that also boosts private consumption and GDP) in the third quarter. This is likely to **push the contribution of net exports to GDP growth into negative territory again in the third quarter.**

2 The same remark as for business investment applies as the extraordinary purchases of ships in the first quarter of the year pertained to imports.

The median value of the mechanical nowcasts points to very moderate GDP growth in the third quarter of 2021 …

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 median of the different predictions points to a moderately positive growth in the third quarter of 2021** (see Chart 6). The distribution is very wide [-2; 3.5] %, but skewed towards positive territory, with a median estimate equal to 0.4 %. 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 6 HISTOGRAM OF ONE-INDICATOR BRIDGE MODEL PREDICTIONS USING A BROAD SET OF SURVEY AND FINANCIAL DATA AND NBB NOWCASTING MODEL PREDICTIONS FOR REAL GDP GROWTH IN THE THIRD 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.

… While the two NBB nowcasting models are more upbeat but probably still underestimate third-quarter growth

Of the more elaborate standard NBB nowcasting models, "BREL"[3] predicts a quarterly growth rate of 1.2 % in the third quarter, while "R2D2"[4] estimates growth at around 1.4 %. However, as indicated above, the uncertainty of these nowcasting models is exceptionally large as the massive shocks since the start of the COVID-

[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.

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.

In this connection, the aforementioned carry-over effect of the steep increase in activity in the course of the second quarter (as containment measures started to be lifted after the Easter holiday) should mechanically push up growth in the third quarter. Even if activity may actually already be decelerating in the second half of the summer, we estimate that this effect is important enough to keep the quarter-on-quarter growth at roughly the same rate as in the previous quarter. **All in all, the most plausible point estimate for growth in the third quarter would appear to be 1.8 %. This is in line with the NBB's June 2021 macroeconomic projections** but somewhat above the range provided by the two model nowcasts. It should again be stressed that the uncertainty of this nowcast is much higher than usual. The biggest risk to the outlook is related to stronger supply-side restrictions (with respect to both the labour market and intermediate inputs), which put a speed limit on the recovery.