BUSINESS CYCLE MONITOR

December 2021

Belgian economic activity is expected to increase by 0.2 % in the last quarter of 2021[1]

- According to revised statistics Belgian real GDP increased by 2.0 % in the third quarter. This is slightly better than the estimate in the previous Business Cycle Monitor (+1.8 %). Belgian growth stayed below that in the euro area (+2.2 %).

- The breakdown into the demand components was largely in line with our expectations. Growth was supported by a rebound in domestic demand, especially private consumption, while net exports constituted a drag to growth. However, business investment shrunk for the first time since the spring of 2020.

- Private consumption is expected to slow down sharply in the fourth quarter after the substantial rebound in the third. Strong headwinds come from weakening consumer confidence, the massive increases in energy prices as well as the worsening health situation.

- The overall business sentiment indicator has also come down from its peak, but it has stabilised at rather high levels in the last three months. However, to the extent that business investment was held back in the third quarter by rising input prices and supply-chain bottlenecks, the decline may continue in the current quarter. Housing investment should continue to expand on the other hand, but at a more modest pace than in the most recent quarters.

- Government consumption should again grow moderately. Government investment is more volatile and could shrink in the final quarter of 2021, mostly due to lower purchases of military aircraft.

- The contribution of net exports to GDP growth is expected to come in slightly negative again in the fourth quarter.

- The NBB nowcasting model “BREL” predicts a quarterly growth rate of close to zero in the fourth quarter of 2021, while the “R2D2” model is somewhat more optimistic with a growth rate of 0.8 %. 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, including surveys as well as expert judgment.

- In this connection, it should be stressed that in all likelihood activity was actually already decelerating in the course of the summer but the quarterly growth rate for the third quarter was pushed up by an important carry-over effect from the second quarter, when containment measures were gradually relaxed. Growth in the current quarter should in principle not benefit from such a carry-over effect. Taking recent pandemic developments into account, a growth rate of just 0.2 % in the fourth quarter seems the most likely scenario at the moment.

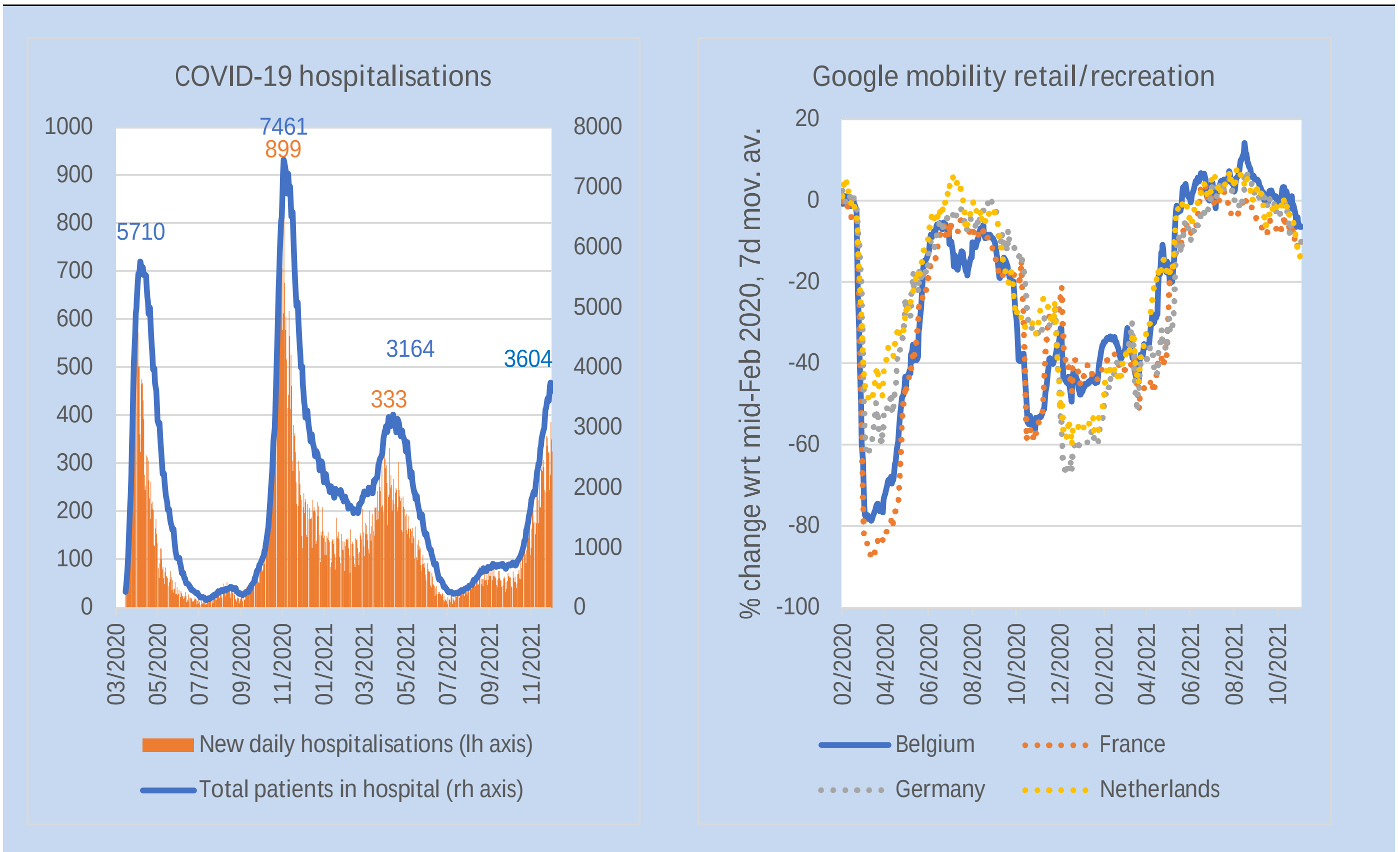
[1] This is a short-term NBB estimate and should not be confused with the official statistics published by the National Accounts Institute (such as the flash GDP estimate, which is released one month after the quarter has ended). This NBB estimate is based on nowcasting models, as well as expert judgment and incorporates information up to 6 December 2021. As all estimates and forecasts, it comes with a degree of uncertainty.

Autumn brought a new wave of COVID-19 infections, adding to the downside risks to growth

Contrary to what was hoped earlier, the vaccination campaign did not bring about the end of the COVID-19 epidemic. After having declined in the spring of 2021, infections were on the rise again as of July, as the more contagious ‘Delta’ variant spread among the population. Still, the situation was considered manageable for the healthcare system and the government stuck to the roadmap that was announced in May. Restrictive measures, in particular for events, were eased further in July and August, to no discernible ill effect. The number of infections plateaued by mid-August and remained stable throughout September. The containment measures were loosened further on October 1st (face masks in the Flemish Region, nightlife) but by the end of that month the number of COVID-19 infections and hospitalisations accelerated again (see Chart 1, left-hand graph). By late November, rising pressure on hospitals and their staff led the government to re-impose some restrictive measures, mostly targeting nightlife and non-private social gatherings. In early December, a peak in the number of hospitalisations seemed near.

Households have adapted their behaviour in response to the news about rising infection rates. Even prior to the official restrictive measures, mobility indicators regarding retail and recreation fell back below their pre-pandemic levels (see Chart 1, right-hand graph).

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 third quarter of 2021, but the recovery should slow in the fourth quarter

After decreasing slightly in the final quarter of 2020 and the first quarter of 2021, economic activity in the euro area returned to positive growth in the second quarter of 2021 and the rebound continued over the summer. GDP increased by 2.2 % in volume terms in the third quarter. The year-on-year growth rate reached 3.7 % and the gap with the pre-COVID-19 GDP level narrowed to some 0.5 %.

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]
	2020Q4	2021Q1	2021Q2	2021Q3	**2021Q3**	**2021Q3**
Euro area	-0.4	-0.3	2.1	2.2	3.7	-0.5
Germany	0.7	-1.9	2.0	1.7	2.6	-1.1
France	-1.1	0.1	1.3	3.0	3.3	-0.1
Italy	-1.6	0.3	2.7	2.6	3.9	-1.3
Spain	0.2	-0.6	1.1	2.0	2.7	-6.6
Netherlands	0.0	-0.8	3.8	1.9	5.0	1.7
Belgium	**-0.1**	**1.2**	**1.7**	**2.0**	**4.9**	**0.5**
Austria	-2.0	-0.4	4.2	3.8	5.6	1.1
EU	-0.2	-0.1	2.0	2.1	3.9	-0.2
UK	1.1	-1.4	5.5	1.3	6.6	-2.1
US	1.1	1.5	1.6	0.5	4.9	1.4
JP	2.8	-1.1	0.4	-0.8	1.3	-2.2

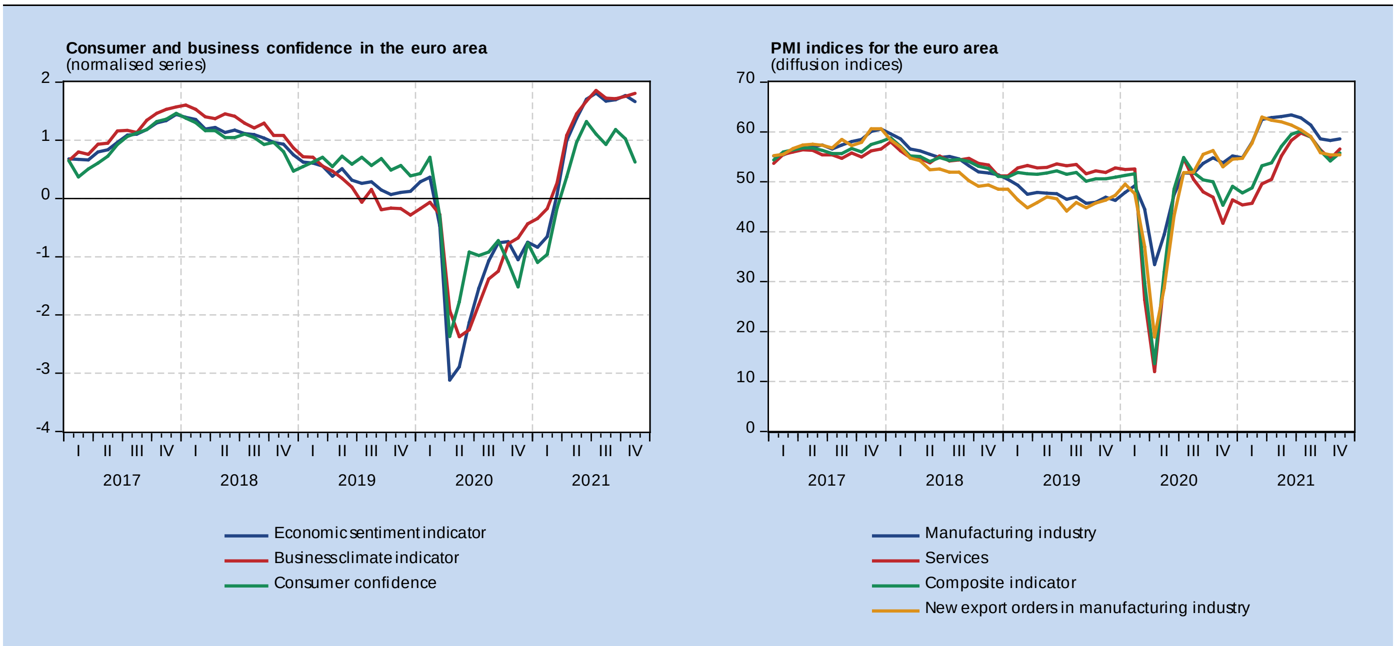
Sources: EC, U.S. Department of Commerce, Cabinet Office Japan.
[1] The pre-COVID-19 reference is 2019Q4

Euro area growth was broad-based and particularly strong in Austria, France and Italy, which outpaced the euro area average. Spain, Belgium, The Netherlands and Germany, on the other hand, recorded below-average growth rates. While the euro area economy as a whole is still some 0.5 % removed from its 2019 level, Austria, Belgium and the Netherlands have already recovered to their pre-crisis output levels. France is close to that point. Italy and Germany have a remaining gap of 1.3 % and 1.1 %, respectively, while Spain is at the other end of the spectrum with output still 6.6 % below the pre-pandemic level. Among the major economies outside the euro area, the US economy lost some traction in the third quarter but compared to the pre-crisis level, its recovery remains ahead of that in the euro area. The opposite holds for the UK and Japan with growth even turning negative again in the third quarter for the latter country.

Turning to the soft indicators, the EC's overall economic sentiment indicator, reflecting both the business climate and consumer sentiment, worsened slightly in November. In general, it has been quite stable at a very high level since July, when it reached a historic maximum (see Chart 2, left-hand graph). The main driver is the business climate indicator which improved further in November, albeit slightly. Current levels suggest continued strong growth of activity and this appears to be broad-based. The increase in business sentiment was driven by an uptick in retail trade confidence, construction sentiment and, to a lesser extent, services, while industrial confidence remained unchanged at its second-highest level on record. The decline of the overall economic sentiment indicator was caused by the drop in consumer confidence in November. The latter decrease was reflected in all major components of the consumer confidence indicator and is likely the result of the steep increase in COVID-19 infections as the epidemic gained traction again in many euro area countries.

The PMI composite indicator for the euro area (see Chart 2, right-hand graph) improved in November, after three months of decline, and remains firmly in expansionary territory (i.e. at a level above 50). The improvement is mainly linked to recovering sentiment in services, whereas it remained more or less stable in the manufacturing industry. The new export orders index also stabilised and remain near its lowest point since early 2021. Moreover, constraints and supply chain issues remain a significant cause for concern, as evidenced by the elevated PMI supplier delivery times index. All in all, the current level of the PMI composite indicator remains consistent with further, but more moderate growth of the euro area economy in the fourth 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 returned to its pre-pandemic output level in the third quarter

The gradual reopening of the economy and the corresponding improvement in economic sentiment have supported Belgian economic growth. It reached 2.0 % in the third quarter according to revised NAI statistics, thereby also bringing Belgian GDP to above its pre-pandemic output level. This growth rate is just above the 1.8 % estimate in the September Business Cycle Monitor, that was identical to the NAI's flash estimate of 28 October.

GDP growth was driven by strong domestic demand. Private consumption in particular expanded much more than expected. Household spending mainly rose for non-durable goods. Consumption of durables was also up, but to a much lesser extent, which is likely partly related to the continuing and sometimes even intensifying supply chain issues that particularly affect the production of durable goods. In addition, public spending and investment remained buoyant. Business investment, on the other hand, declined. Investment plans may be postponed due to the aforementioned supply chain issues and caution in a context of rapidly rising input prices, while the rapidly tightening labour market presents an additional challenge in the form of worker shortages. Finally, net exports and changes in inventories also reduced GDP growth.

In line with the picture of a consumer-driven recovery coming from the demand components, the production approach to GDP shows third-quarter growth to be mainly driven by market services, which posted 2.2 % growth in quarterly terms and now exceeds its pre-crisis level by 0.2 %. Non-market services accelerated to 3.2 % growth but have not yet fully recovered from the crisis. Activity in the manufacturing and construction industries decreased by 0.4 % and 0.8 % respectively in the third quarter, likely due to supply-side constraints. Both industries and manufacturing in particular remain above pre-crisis levels, though.

The resurgence of the pandemic and new containment measures will limit consumer spending growth in the fourth quarter

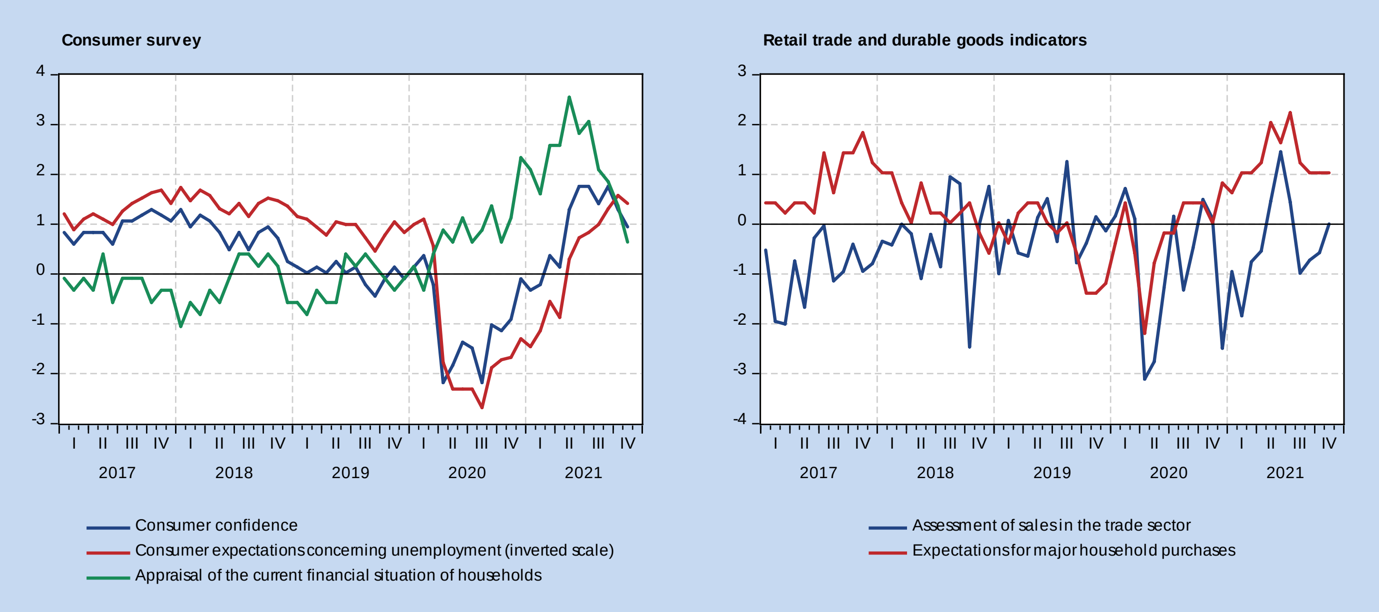
Private consumption expanded by a massive 6.3 % in the third quarter, thereby fully closing the remaining gap with the pre-crisis level. Household consumption growth was mechanically boosted by the carry-over effect coming from the gradual unwinding of containment measures in the course of the second quarter: the restrictions on activities that still limited consumer spending in part of the second quarter, did not affect the third to the same degree. Consumption growth in the fourth quarter will not benefit from a similar boost. Meanwhile, the health situation has worsened again and new restrictions have been introduced in an attempt to safeguard the healthcare system. Although the direct economic impact of those restrictions should remain limited, more cautious consumer behaviour in general will dampen consumer spending growth again in the fourth quarter. Moreover, energy prices have increased sharply in the second half of the year, prompting warnings for higher household energy bills, which could lead to an increase in precautionary saving among households and erode purchasing power, at least temporarily, of the more vulnerable households.

Turning to the soft indicators, consumer confidence has been declining markedly since September (see Chart 3, left-hand graph). The fall was driven by households' assessment of the economic situation over the next 12 months, which deteriorated further in November. Unemployment expectations also declined in November, for the first time since April. The steep increase in energy prices probably also contributed to the decline in the assessment of the current financial situation since the summer, which had long been very high but is now fast approaching pre-crisis levels.

Strikingly, company managers' assessment about sales in the trade sector has been rising somewhat over the same period and has now recovered after the disappointing turnover in late spring and early summer (see Chart 3, right-hand graph). Caution is warranted, however: the trade indicator is quite volatile and the recovery in sentiment is at odds with the new downturn in the abovementioned indicator on mobility, which could signal worse times ahead for (retail) trade. Expectations for major household purchases in the next twelve months stagnated in November and have come down from their summer peak. This is likely to negatively affect consumption of durable goods, which comprises goods such as cars, furniture, appliances, etc. Observations up to the third quarter show lacklustre growth for consumption of durables. Vehicle sales in particular, which account for over 40 % of durable goods consumption, have suffered from supply chain troubles in the past year, leading to continuing delivery delays. Seasonally adjusted car registrations as reported by Febiac took another hit in October and continued their gradual downward trend.

While uncertainties and price pressures may be weighing on households' consumption at the moment, the fundamentals for private consumption and the outlook for personal income in particular remain solid. Domestic employment now already exceeds the pre-COVID-19 level by about 1.5 %, after posting another solid 0.7 % quarter-on-quarter expansion in the third quarter of 2021, which is again more than was expected. At the same time, the use of temporary unemployment is declining. According to the most recent figures for October 2021, about 4 % of salaried workers were still in the system and often on a part-time basis. The workers leaving the system of temporary unemployment seem to mostly return to regular employment (either to their existing jobs or to new ones). In fact, the number of unemployed decreased again in November, continuing a downward trend which has been present since the end of 2020. The labour market is tight, as evidenced by survey questions on hiring expectations and Eurostat data on vacancy rates, and shortages of workers are increasingly limiting production increases. 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 will slow down significantly in the fourth quarter of 2021. The increase in COVID-19 infections, renewed restrictions and more cautious consumer behaviour, in particular, are bound to weigh on growth. Sentiment indicators have passed their peak and higher energy prices could lead to more precautionary saving and erode purchasing power. In addition, recent survey indications corroborate the assumption that the 'excess savings' built up in 2020 will not be used for extra consumption spending in the near term.

Robust government consumption growth should continue, but will moderate somewhat in the fourth quarter

Government consumption increased by 3.8 % in the third quarter. This increase was driven by additional healthcare spending related to the vaccination campaign and the normalisation in non-COVID-19 medical treatments that had been postponed in 2020. **Government consumption growth should moderate in the fourth quarter:** the initial vaccination campaign has been wound down and the new booster campaign has started but is only expected to pick up speed in the next quarter. Meanwhile, new postponements for medical treatments (suppressing healthcare expenditures) have been reported in recent days and weeks. 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 is likely to decrease again in the fourth quarter

Gross fixed capital formation in the Belgian economy decreased by 0.2 % in the third quarter of 2021 but remains some 2.4 % above its pre-crisis level. Government investment contributed positively and shot up by nearly

10 %. Housing investment also expanded by 1.5 %. The largest component, however, business investment, decreased by 2.4 %.

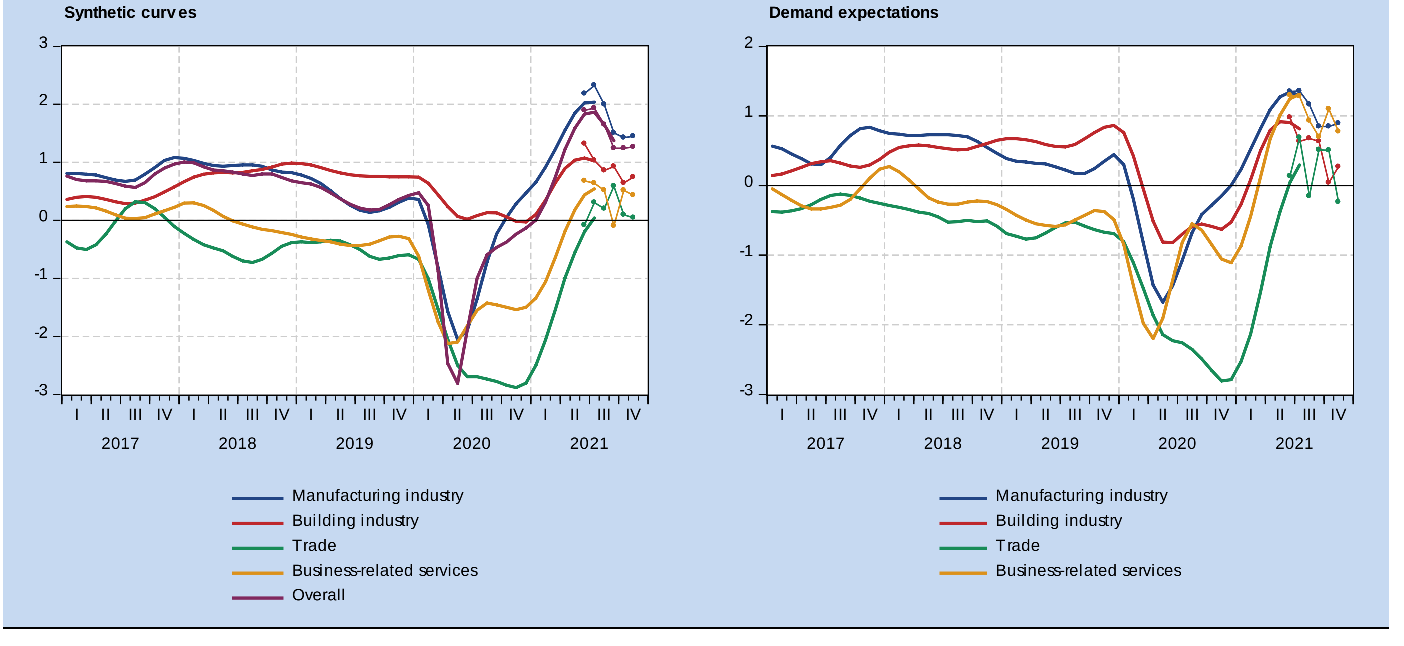
The impressive recovery of business investment that started after the second quarter of 2020 came to a halt in the third quarter of 2021, as investment by firms fell back slightly below the pre-pandemic level. This decrease was unexpected but is in line with the worsening of business confidence in the third quarter. The headline business confidence indicator has trended down, mainly driven by weaker sentiment in the capital-intensive manufacturing industry (see Chart 4, left-hand graph). Results for October and November have shown some tentative signs of stabilizing sentiment, but **confidence levels have clearly passed their peak early in the summer in all industries**.

Similarly, demand prospects stabilized in the most recent months, but had weakened in all industries in the third quarter. Manufacturing and the construction industry, in particular, have been hard hit by the bottlenecks in international supply chains. In addition, rising European energy prices have affected certain energy-intensive segments of the manufacturing industry, in particular those that compete on the global level. The latest quarterly survey on production capacity indicates that the capacity utilisation in the manufacturing industry decreased in October, to 79.1 %, somewhat below the pre-crisis level and the historical average.

Moreover, the labour market has been tightening rapidly, as evidenced by the historically high vacancy rate. Firms are also reporting that the shortage of workers is negatively affecting current production and hampering plans to expand their capacity. Even though these conditions may limit investment plans in the short run, they could lead to investments in worker productivity down the line.

All in all, conditions do not seem more conducive to business investment than was the case in the third quarter. **We expect business investment to decrease slightly in the fourth 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.

Residential investment accelerated in the third quarter and currently exceeds pre-crisis levels by about 3 %. Fundamentals for future housing investment remain strong: mortgage rates are still historically low and households' income prospects are robust. Residential investment should therefore continue to expand in the fourth quarter.

Finally, taking into account the roll-out of recovery plans, government investment should continue to increase in the coming quarters. However, the third quarter figure was boosted by the delivery of two military transportation aircraft, whereas apparently only one is foreseen for the last quarter, so **fourth-quarter government investment could fall in quarter-on-quarter terms. Please note that, as these planes are imported, there is no impact on GDP.**

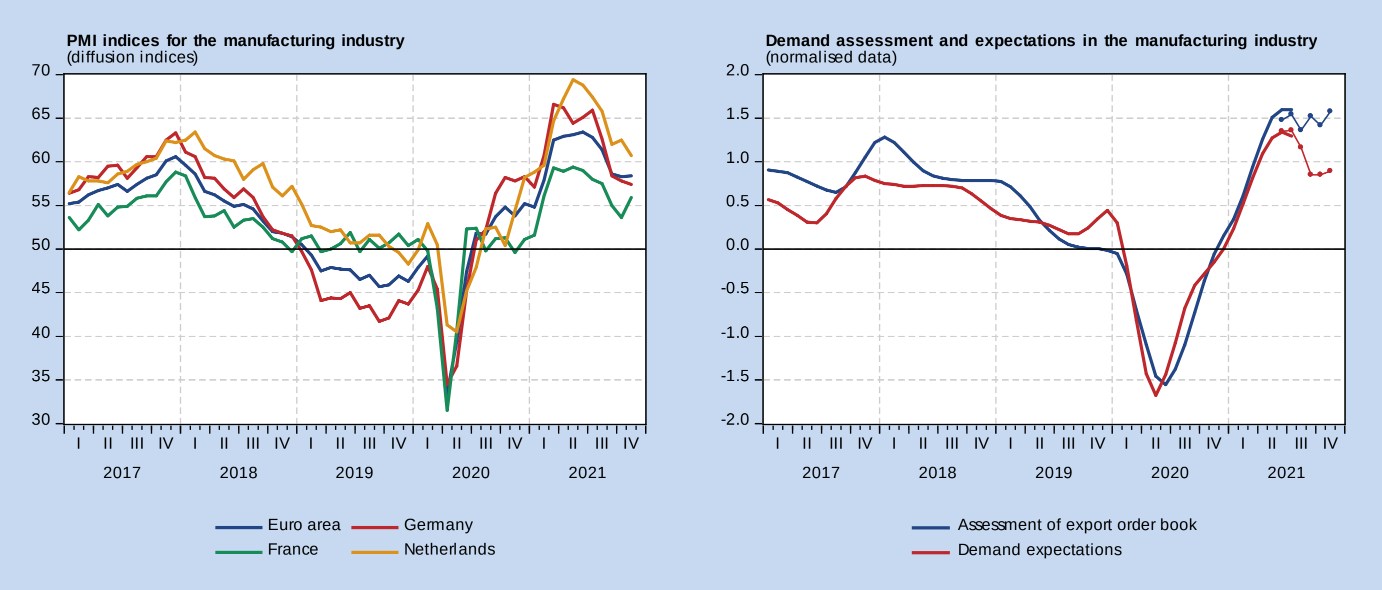
Net exports should reduce GDP growth in the fourth quarter

In the third quarter, exports declined by 1.1 %, but import growth held up better and declined by 0.2 %, resulting in a 0.8 percentage point negative contribution of net exports to GDP growth.

Foreign demand weakened in the third quarter due to continued supply chain issues and escalating energy prices driving down exports of goods and services. Demand growth for Belgian exports probably passed its peak in the second quarter. Optimism among purchasing managers in the manufacturing industry in Belgium's neighbouring countries declined over the summer months, and recent signs of stabilisation seem tentative at best. **Although the PMI manufacturing index for the euro area actually increased slightly in November** (see Chart 5, left-hand graph), this was mainly driven by improving sentiment in France. Confidence declined again in Germany and The Netherlands.

Nevertheless, signs of some 'bottoming-out' appear when looking at the most recent business survey data for the Belgian manufacturing industry. Demand expectations and the assessment of the export order book peaked simultaneously in late spring. Export orders have since remained stable at a high level, while demand expectations fell back somewhat, but have now also stabilised far above pre-crisis levels (see Chart 5, right-hand graph). **All in all, export growth should turn positive again in the fourth quarter of 2021**.

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



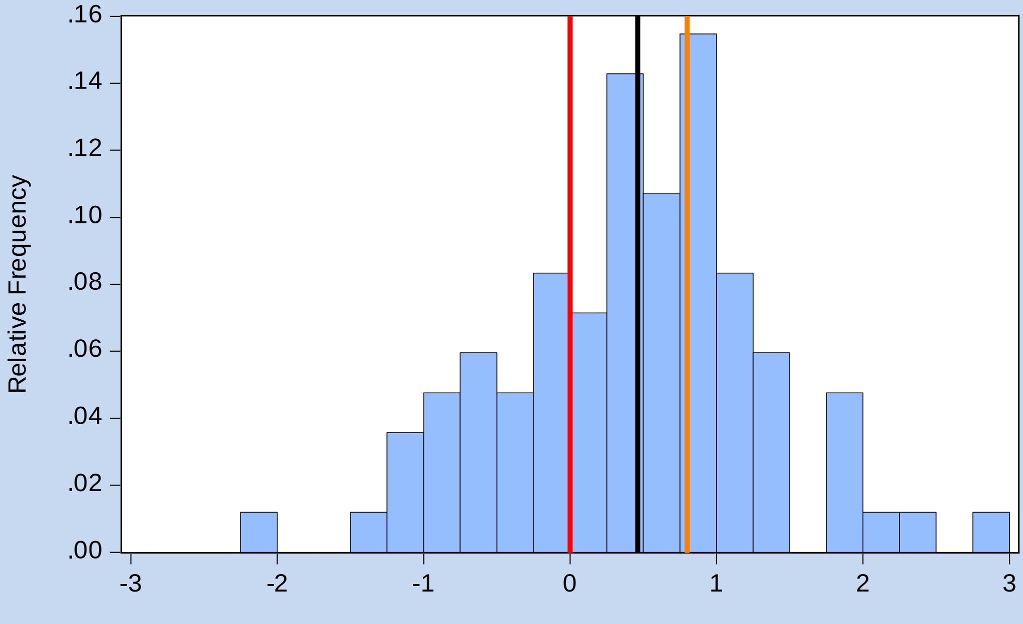
Sources: Markit, NBB.
Note: the series in the right graph are normalised around their historical averages and divided by their standard deviation.

Meanwhile, import growth in the fourth quarter is supported by domestic demand, even if the delivery schedule of the aforementioned specific purchases of military aircraft should reduce it somewhat. All in all, we expect **the contribution of net exports to GDP growth to remain in negative territory in the fourth quarter.**

The median value of the mechanical nowcasts points to very moderate GDP growth in the fourth 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 fourth quarter of 2021** (see Chart 6). The distribution is less wide than it has been in recent quarters, but still significant at [-1.5; 1.5] % and skewed towards positive growth, with a median estimate equal to about 0.46 %. 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 FOURTH 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.

… In line with the two NBB nowcasting models which probably still overestimate fourth-quarter growth

Of the more elaborate standard NBB nowcasting models, "BREL"[2] predicts zero quarterly growth in the fourth quarter, while "R2D2"[3] estimates growth at around 0.8 %. 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

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.

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 disappearance of the aforementioned carry-over effect that boosted growth in the third quarter and the resurgence of COVID-19 infections and associated changes in consumer behaviour are likely to depress growth somewhat more than anticipated, on average, by the models. **All in all, the most plausible point estimate for growth in the fourth quarter would appear to be 0.2 %.** This is towards the lower end of 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 quite unpredictable pandemic developments.