Business Cycle Monitor

March 2023

Belgian economic activity is expected to expand by 0.4 % in the first quarter of 2023[1]

- The latest NAI statistics put Belgian real GDP growth at 0.1 % in the fourth quarter of 2022. While this constitutes a clear slowdown compared to the third quarter, it is in line with the NAI's January flash estimate and somewhat above our estimate in the December 2022 BCM.
- GDP growth benefited in particular from an unexpected expansion of private consumption and services. Indicators and hard data point to improved conditions for private consumption in the first quarter of 2023, while the indexation mechanisms have pushed up nominal incomes and price pressures are softening. All in all, household consumption is likely to continue to expand strongly.
- Business investment posted unexpected growth in the fourth quarter, despite rising (wage) costs and the uncertain economic outlook. Business sentiment and demand expectations have improved in recent months but remain at low levels. All in all, we expect business investment growth to come in close to zero in the current quarter. Housing investment is expected to continue to decline.
- Government consumption should grow very moderately in the first quarter, while the roll-out of investment plans should lead to positive growth in government investment.
- The contribution of net exports to growth is expected to be broadly neutral in the first quarter.
- The NBB's “BREL” nowcasting model currently estimates growth in the first quarter at around 0.4 %, while the “R2D2” model is clearly much more optimistic, predicting a growth rate of 1.3 %. It should be noted that these nowcasts are subject to substantial uncertainty as the massive shocks since the start of the COVID-19 crisis constitute a challenge for the estimation of standard time-series models.
- All in all, we currently expect economic activity to expand by 0.4 % in the first quarter of 2023. This is slightly below the median predictions of the one-indicator models and in line with the most downbeat of the two nowcasts. It should again be stressed that the uncertainty of this nowcast is high. While household consumption could once again surprise on the upside, a more abrupt decline in stock levels could detract more from GDP growth than currently accounted for. The balance of risks appears to be broadly neutral.

[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 8 March 2022. As all estimates and forecasts, it comes with a degree of uncertainty.

The euro area GDP remained stable in the fourth quarter and activity should pick up in the first quarter of 2023

Despite expectations of a contraction, **euro area GDP remained stable in the fourth quarter of 2022.** As regards the demand components, GDP growth in quarterly terms was mainly supported by net exports due to the substantial fall in real imports, while business investment and household consumptions detracted from growth. The remarkable economic resilience is at least in part due to the recent decline in natural gas prices, which pushed down inflationary pressures, and to high levels of direct and indirect government support for firms and households across the euro area, which shored up demand. In addition, fourth-quarter GDP growth may have been boosted by continued post-pandemic reopening dynamics, which offset some of the headwinds. The year-on-year growth rate reached 1.8 %.

Table 1

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

	Quarter-on-quarter change				Year-on-year change
	2022Q1	2022Q2	2022Q3	2022Q4	2022Q4
Euro area	0.6	0.9	0.4	0.0	1.8
Germany	0.8	0.1	0.5	-0.4	0.9
France	-0.2	0.5	0.2	0.1	0.5
Italy	0.1	1.0	0.4	-0.1	1.4
Spain	0.0	2.2	0.2	0.2	2.7
Netherlands	0.4	2.5	-0.2	0.6	3.4
Belgium	**0.6**	**0.5**	**0.2**	**0.1**	**1.4**
EU	0.7	0.7	0.4	-0.1	1.7
UK	0.5	0.1	-0.2	0.0	0.4
US	-0.4	-0.1	0.8	0.7	0.9
JP	-0.4	1.1	-0.3	0.2	0.6

Sources: EC, US Department of Commerce, Cabinet Office Japan.

Nonetheless, economic activity decelerated sharply in most major euro area economies in the previous quarter, with negative growth in Germany and, to a lesser extent, Italy. German GDP growth came in at -0.4 % according to revised statistics, which constitutes a strong deceleration compared to the surprisingly positive 0.5 % growth recorded in the third quarter. The decline was broad-based, with sharper falls in output in energy-intensive industries. The French and Spanish economies expanded slightly, by 0.1 % and 0.2 % respectively. The Netherlands was the only larger euro area country where economic activity grew more strongly in the past quarter, it being noted that the Dutch economy had posted negative GDP growth in the third quarter.

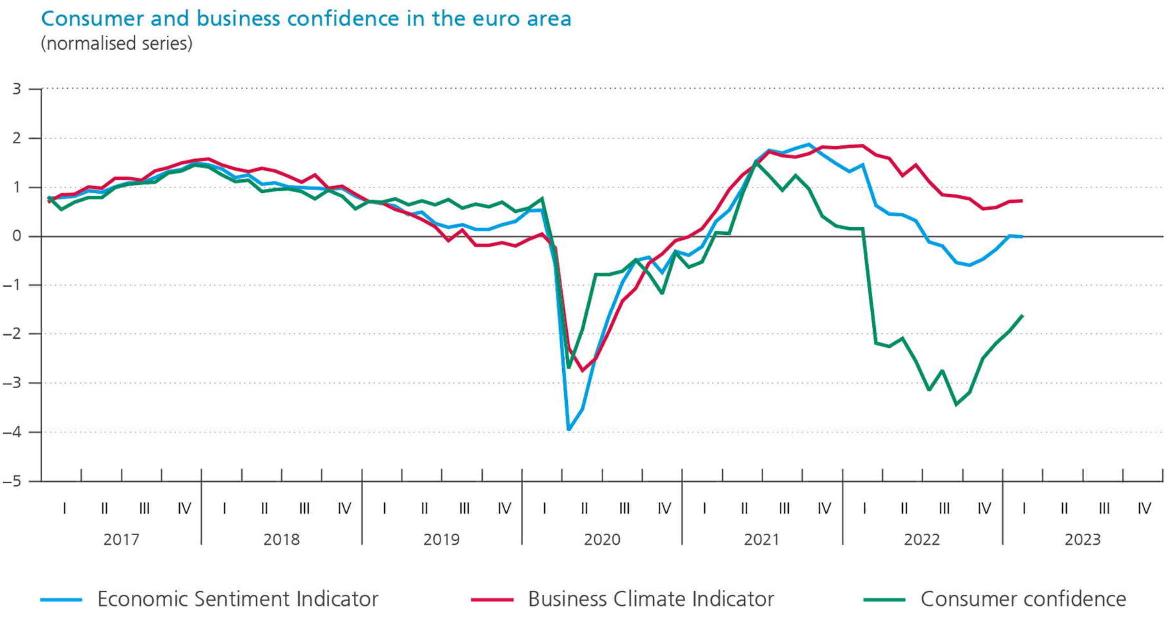
Among the major economies outside the euro area, the US nearly matched the pace it had set in the third quarter, while GDP growth in Japan rebounded from its third-quarter contraction and came in slightly positive. The UK economy stagnated in the final quarter of 2022, in line with already very weak performances in the second and third quarters.

Generally speaking, soft indicators for economic activity remain weak but improved markedly over the past months. An imminent, deep economic crisis looks increasingly unlikely. Consumer sentiment in the euro area, which had fallen to lows below those seen during the COVID-19 pandemic in 2022, remains downbeat but is now clearly trending up (see Chart 1). The labour market is easing but remains resilient. The EC's overall economic sentiment indicator (ESI), reflecting both consumer and producer sentiment in the euro area, stagnated in February after recovering in the preceding three months. The ESI sub-indicator related to overall consumer confidence improved slightly on account of a more positive outlook by households on their current and expected financial situation; this is likely related to the recent decline in gas prices and in headline inflation which provided some support for household purchasing power. This improvement appears mirrored in household intentions to make major purchases and led to an uptick in retail trade confidence. Confidence also edged up in the construction industry although the overall level remains much lower than in the first half of 2022.

However, confidence in both the manufacturing and services industries weakened slightly in February. After falling over the summer months due to surging energy prices, manufacturing sentiment tentatively improved in December and January, most likely due in part to cheaper natural gas in the final quarter of 2022. This upward trend came to a halt in February. Overall, the situation remains difficult for the manufacturing industry, with the latest survey of managers showing a decline in their assessment of production expectations and the level of order books, while stockbuilding accelerated again. The confidence indicator in services declined slightly as well, but remains quite resilient. Evidence of economic robustness can also be found in the Business Climate Indicator (BCI), which edged up marginally in February and remains firmly above both its long-run average and the pre-pandemic level.

Chart 1

Sentiment indicators for the euro area



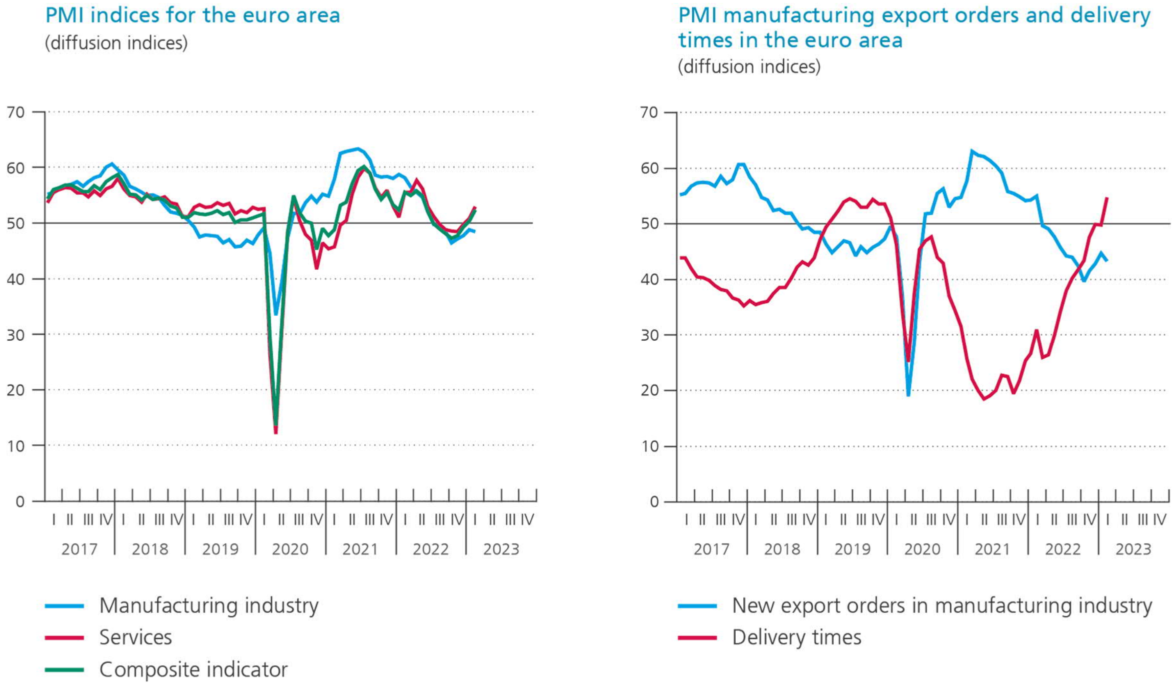
Source: EC.
Note: The original series are normalised around their historical averages and divided by their standard deviation.

A tentatively brighter outlook is also apparent in the PMI composite indicator for the euro area (see Chart 2, left-hand graph) which edged up again in February for the fourth consecutive month. The indicator has now firmly settled above 50, which in principle signals a mild expansion in economic activity, after having fallen slightly below 50 in the second half of 2022. Given the magnitude of the recent shocks and inflationary pressures, purchasing manager confidence has been remarkably robust. This is in line with the latest hard data; as indicated above, euro area growth declined significantly but remained in positive territory.

However, the indicators also point to some heterogeneity between industries. The upward trend in the composite indicator was driven mainly by improving confidence in the services industry, whereas purchasing managers in the manufacturing industry continued to indicate moderately contractionary conditions. Despite this recent relative improvement in conditions, as well as anecdotical evidence of certain firms increasing output again after cost-induced production stoppages, the competitiveness of European manufacturing firms remains under pressure. This can be seen in the new export orders index for the manufacturing industry (see Chart 2, right-hand graph), which has stagnated at a level quite far below the 50-point mark (pointing to negative growth). The significant easing of supply chain bottlenecks, as evidenced by the PMI supplier delivery times index reaching pre-crisis levels, is insufficient to counter the prevailing sentiment and is at least in part attributable to falling demand. All in all, the current level of the PMI composite indicator seems consistent with a moderate expansion of economic activity in the euro area in the first quarter of 2023.

Chart 2

PMI indices



Source: Markit.

The Belgian economy expanded by 0.1 % in the fourth quarter

Belgian GDP decelerated further in the final quarter of 2022, but – contrary to what was initially expected – activity did not contract. The latest quarterly statistics released by the NAI at the end of February indicate that fourth-quarter GDP grew by 0.1 % QoQ, in line with the NAI's January flash estimate and somewhat above our estimate in the December 2022 BCM (-0.1 %).

As was the case in previous quarters, GDP growth was boosted by stronger-than-expected household consumption which surprised on the upside, despite headwinds caused by high inflation. The NBB's consumer confidence indicator bottomed out in the fall – at an extremely low level, reminiscent of that reached at the start of the pandemic – and rebounded strongly in the fourth quarter. This development should be viewed against the backdrop of the spectacular decline in natural gas prices. In addition, although the impact on individual households varies depending on specific circumstances and consumption patterns, Belgian households have been on average well protected against price shocks through the indexation of nominal wages and a range of government measures such as the (extended) social tariff for natural gas and electricity.

All in all, private consumption again expanded strongly, by 1.1 % on a quarterly basis. This increase was driven by both durables and non-durables, although the consumption of durable goods still remains well below the pre-COVID-19 level.

Turning to other demand components, according to current statistics housing investment fell markedly in the fourth quarter, even below our already pessimistic expectations. The positive outturn for business investment was surprising, as we projected a contraction in the December 2022 BCM. Public investment shrank markedly according to current quarterly statistics, which is probably linked to further delays in the roll-out of recovery plans. Public consumption, on the other hand, expanded at a moderate pace, in line with our estimate. Net exports came in close to neutral, whereas we expected a negative contribution to GDP growth in the fourth quarter. It should also be mentioned that stockbuilding, which is usually assumed to be growth-neutral in line with the long-term average, shaved off 0.5pp from GDP growth in the past quarter. While these quarterly statistics on demand components are subject to revision, the clearly negative contribution made by inventories may be consistent with the unexpectedly strong increase in domestic and foreign consumer demand for goods.

At the same time, the production approach to GDP shows that fourth-quarter growth was again driven mainly by services, in particular non-market services, which expanded by 0.7 %. On the other hand, growth in market services flatlined. Activity rose slightly in the construction industry but declined by 1.0 % in the manufacturing industry.

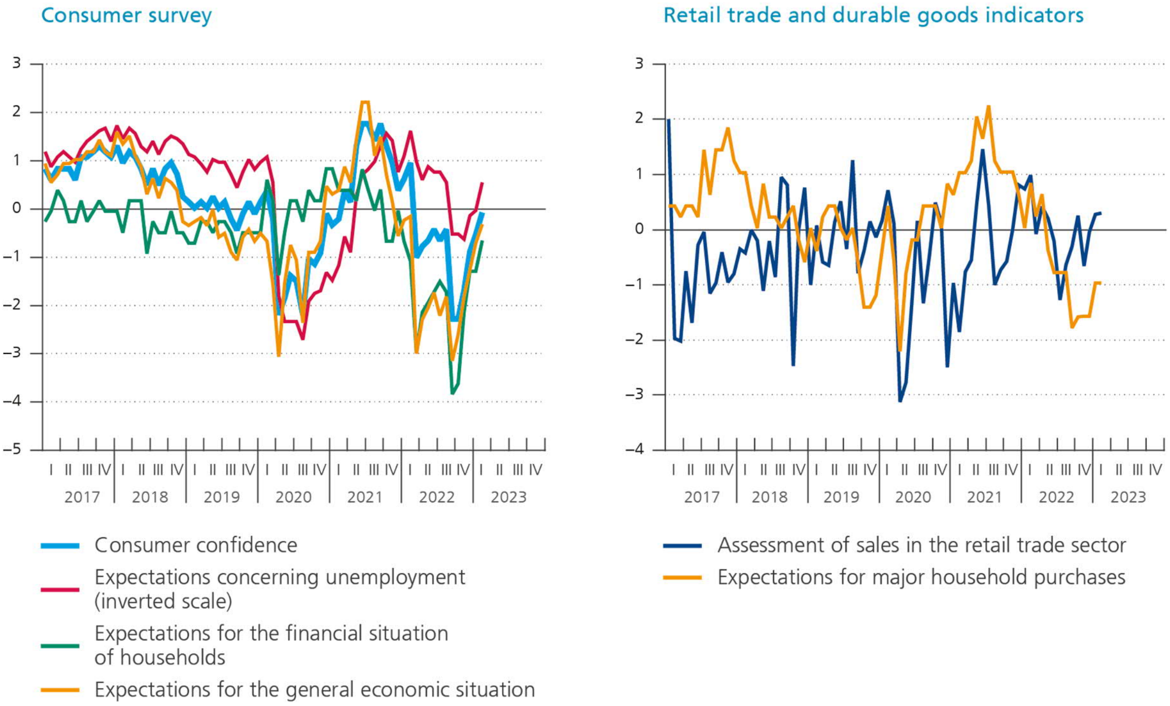
Household consumption should continue to expand strongly as purchasing power rebounds

The current statistics suggest that, despite difficult circumstances and plunging confidence, private consumption held up much better than expected in the second half of last year. Consumer confidence reached its highest level since the Russian invasion of Ukraine a year ago (see Chart 3, left-hand graph). While the overall level still remains below the historical average, the improvement of the headline indicator is broad-based: household expectations of their financial situation and the general economic situation improved, as did their expectations of the labour market situation. The only exception was household saving intentions over the next twelve months (not shown on the graph), which declined slightly. Given the usual ambiguity surrounding this question, this could mean that they plan to save less, as uncertainty is declining, or to purchase more durables.

Indicators related to household purchasing behaviour (see Chart 3, right-hand graph) are moderately positive for the current quarter. Managers' assessments of sales in the retail industry, as measured by the NBB's monthly Business Survey, suggest that sales improved in the latter half of the fourth quarter and in early 2023. However, hard data for retail sales up to December show sales volumes trending down. In addition, expectations of major household purchases in the next twelve months picked up slightly but remain very low overall, which could point to positive, yet subdued, durable goods consumption. All indicators taken together point to continued growth in private consumption in the first quarter of 2023.

Chart 3

Indicators of private consumption growth
(normalised series)



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

A fundamental factor supporting the robust growth of private consumption in the past quarters was the labour market, with both employment and hours worked contributing to the increase in purchasing power. However, employment stagnated in the fourth quarter of 2022, while unemployment started to rise. Despite this slackening, the labour market remains very tight, as evidenced by still historically high job vacancy rates. In addition, as the deceleration of the economy is now more widely considered to be temporary, employment should rebound beyond the near term.

Moreover, while geopolitical uncertainty remains significant, headline inflation is coming down and about one third of employees (those subject to annual indexation) saw their nominal wages adjusted in January, compensating for the rise in the health index over the past year. Taken together, this should significantly boost aggregate purchasing power. **All in all, we expect private consumption to continue to expand rather strongly in the first quarter of 2023.**

Total fixed investment should come in clearly less negative in the first quarter

Business investment in volume terms surprised on the upside in the fourth quarter. The supply situation improved further, and energy prices declined markedly. Nevertheless, the expansion was moderate at best at 0.5 % and, fundamentally, the business environment remains challenging for companies.

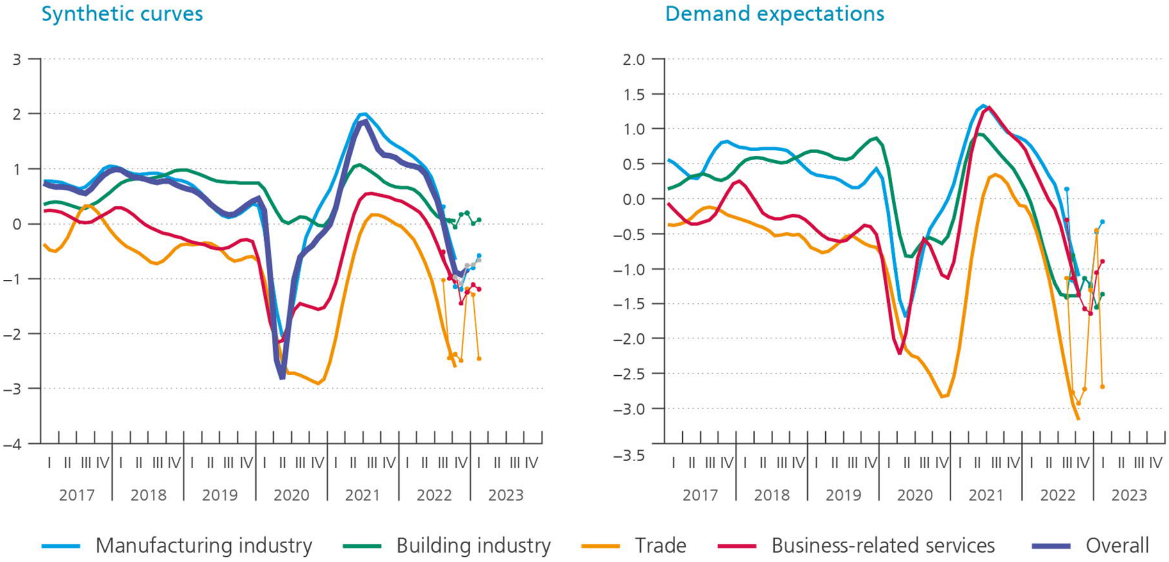
Business investment contracted rapidly in the second half of 2021 and has, broadly speaking, been flatlining since. The gap relative to the pre-pandemic level is around 5 %. The overall business sentiment indicator (see Chart 4, left-hand graph), on the other hand, reached an unprecedented peak in mid-2021 but then gradually trended down. In early 2022, Russia's invasion of Ukraine hastened the decline. By mid-2022, overall business confidence had fallen to well below its pre-pandemic levels and the long-term average, i.e. more in line with the national accounts data. The overall indicator stabilised in late 2022 and displayed some tentative signs of improvement in early 2023 but, all in all, remains very downbeat.

Looking at gross data, sentiment in the manufacturing industry edged up in early 2023, driving the recent small improvement in the overall indicator. Confidence in the building industry and business-related services, on the other hand, came in flat again. Confidence in trade is traditionally very volatile. This industry was particularly hard hit by the pandemic and the resulting restrictions and is again a negative outlier in the current downturn. **Overall, business confidence appears to have bottomed out but remains at a low level.**

Capacity utilisation in the Belgian manufacturing industry, as reported in the quarterly NBB survey on production capacity, fell further to 75.3 % in January, down from over 80 % in the first half of 2022 and clearly below the historical average. According to the NBB's monthly Business Survey, demand expectations have plummeted in all industries, most notably since Russia's invasion of Ukraine, although a trough may have been reached recently (see Chart 4, right-hand graph). The outlook has even brightened a bit in business-related services and the manufacturing industry, although the latter's demand expectations, in absolute terms, remain well below their pre-pandemic level. As regards trade, demand expectations have fallen back to pandemic lows, while the outlook in the building industry has stabilised at a historically low level, far below the COVID-19 low point. The building industry is indeed under pressure, as costs have soared in the wake of the energy crisis, while demand is faltering as mortgage rates are on the rise and households are revising their investment plans, while the economic outlook remains uncertain.

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.

The volatile geopolitical situation and continued pipeline cost-pressures have led companies to re-evaluate their investment plans. The seemingly structural erosion of the cost competitiveness of the European manufacturing industry, in particular energy-intensive industries, is leading to reports of multinationals shifting their investment focus to other continents. Although Belgium has a relatively services-heavy economy, Belgian firms are deeply embedded in European value chains and such a shift would have knock-on effects on investment activity. In addition, the strong increase in wage costs, due to automatic indexation, has been particularly challenging for Belgian firms. Moreover, financial conditions are tightening, which could further reduce investment plans. At the same time, a recent NBB analysis[2] shows that very large firms are weathering the cost crisis much better than others and we know that these firms are the main drivers of investment. This may explain why business investment began to recover slightly at the end of 2022.

Overall, we expect business investment growth to come in close to zero in the first quarter. The unfavourable climate is likely to weigh on firm investment in the first half of 2023, in particular recent increases in labour costs. However, the outlook for business investment beyond the near term is more positive. Productivity-enhancing investments and digitalisation efforts, for example, are reported to have been maintained or stepped up to counter the effects of rapidly rising wage costs and a structurally tight labour supply. The same goes for energy-efficiency investments to counter probably structurally more expensive energy supplies in Europe. Finally, companies are pushing forward with the “greening” of their production processes in order to comply with regulatory requirements.

Residential investment fell by 2.4 % in the fourth quarter, more than our already pessimistic estimates. In volume terms, residential investment is back below its pre-crisis level. All signs point to continued muted developments for the housing market in 2023. The aforementioned indicator related to demand expectations in the building industry has stagnated at a historically low level and, despite recent improvement, consumer confidence remains quite low. Mortgage rates are on the rise, eroding household borrowing capacity. On the positive side, the labour market remains structurally tight and should only slacken temporarily, while wage indexation is boosting purchasing power. **All in all, we expect residential investment to continue to decline in the first quarter of 2023, albeit at a more moderate pace.**

Government investment fell by 5.4 % in the fourth quarter. Although the timing remains difficult to nail down and many projects are facing delays, **the roll-out of recovery plans should boost government investment spending in the near term.**

Finally, the contribution of stock adjustments to growth, which was strongly negative in the fourth quarter, should be more neutral in the current quarter. As supply chains have now normalised for the most part, we expect any further stock drawdowns to be more gradual.

All in all, we expect total fixed investment to come in clearly less negative in the current quarter.

Government consumption is expected to expand moderately

According to current NAI statistics, government consumption in real terms increased by 0.9 % in the fourth quarter, in line with expectations. The stagnation in the preceding quarters was mostly due to a normalisation of public consumption after the unwinding of COVID-19-related spending. This effect has now faded and additional spending (e.g. in the context of the refugee crisis) has replaced temporary COVID-19 outlays. **Hence, we expect government consumption to continue to grow at a relatively similar pace in the first quarter of 2023.**

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[2] For more information, please see the January 2023 article by G. Bijnens and C. Duprez, “Bedrijven, prijzen en marges”, available at Bedrijven, prijzen en marges | nbb.be.

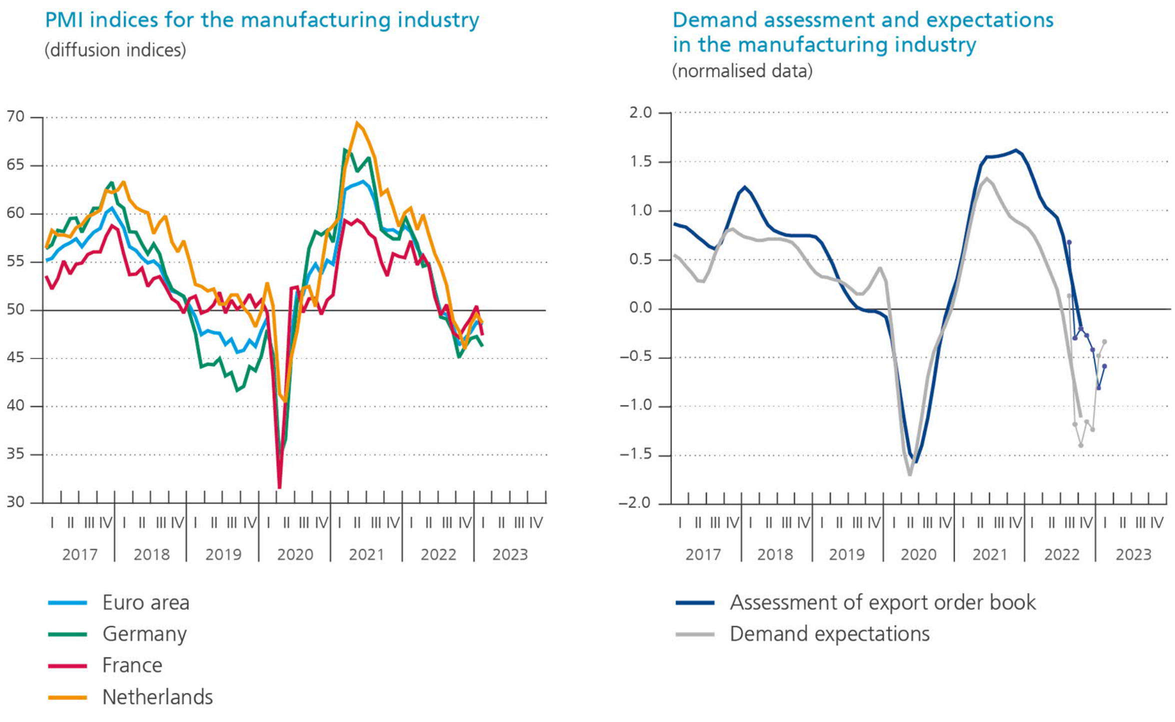
The growth contribution of net exports should remain close to zero

Fourth-quarter exports and imports both fell by around 0.7 %, resulting in a very moderate 0.1 pp positive contribution of net exports to GDP growth.

Using the PMI manufacturing index as a proxy for foreign demand (see Chart 5, left-hand graph), demand for Belgian exports peaked in the second quarter of 2021 and then weakened in the following quarter due to rising energy prices and COVID-19-related supply chain problems affecting international trade. After a brief stabilisation, Russia’s invasion of Ukraine and an unprecedented surge in natural gas prices brought about a new deterioration. Sentiment stabilised early in the fourth quarter of 2022 and was followed by a moderate uptick, but the improvement was cut short by the downturn in February 2023. The overall picture remains quite weak. The euro area average index has been hovering at a level below 50 since July, indicating a continued contraction of economic activity. The confidence of purchasing managers in the manufacturing industry in Belgium’s neighbours (and main trading partners) reveals a very similar picture, although sentiment in France briefly entered positive territory in January, before falling back again in February. Indicators related to demand in the manufacturing industry (see Chart 5, right-hand graph) seem to confirm that the situation improved in recent months, although the outlook remains weak overall. Both demand expectations and export orders have recovered from the lows reached in the last quarter of 2022.

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.

While both the downward trend in demand expectations after the peak in mid-2021 and the upturn in the latest observations are EA-wide phenomena, Belgian firms are facing an additional challenge in the form of worsening competitiveness due to rapidly rising wage costs. The pass-through of these higher costs to sales prices erodes the competitiveness of Belgian firms. However, we expect this to mostly curtail growth in the medium term in a gradual manner, while the short-term impact may be more limited.

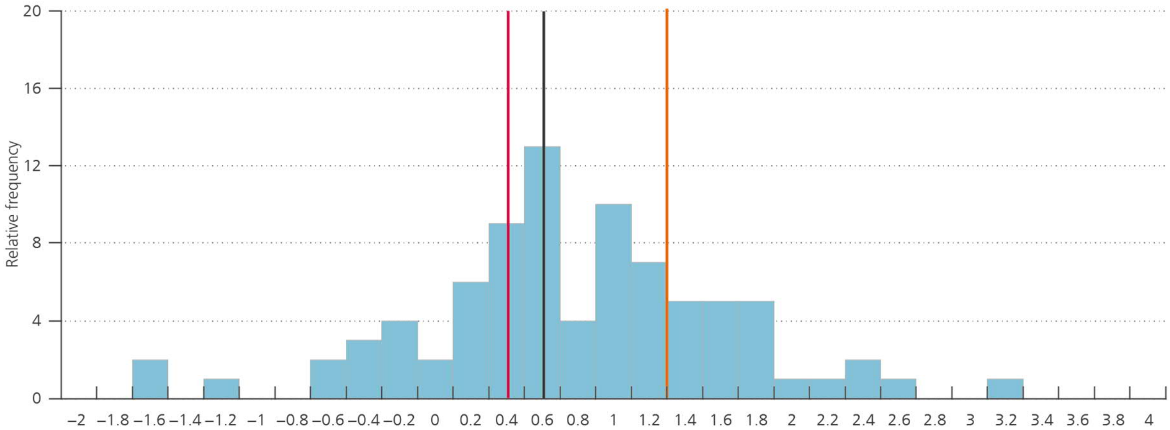
All in all, exports should recover somewhat in the first quarter of 2023. As domestic demand remains vigorous, it will likely fuel import growth. **We expect the contribution of net exports to GDP growth to remain broadly neutral in the current quarter.**

The median value of the mechanical nowcasts points to moderately positive GDP growth in the first quarter of 2023

The informational content of 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 clearly positive growth of 0.6 % in the first quarter of 2023** (see Chart 6). The range is still large at [-1.0; 2.0] % but certainly narrowing compared to the recent past, when reopening dynamics still caused significant volatility. Nevertheless, the level of uncertainty remains high. It should be noted that the past forecast performance of these simple models suggests that these individual predictions should be interpreted with caution, even under normal circumstances.

Chart 6

Histogram of one indicator bridge model predictions using a broad set of survey and financial data and NBB nowcasting model predictions of real GDP growth in the first quarter of 2023. Relative frequency in percentages.



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 orange lines correspond to the predictions of the “BREL” bridge model and the “R2D2” dynamic factor model, respectively.

A very moderate expansion of economic activity seems the most plausible scenario for the first quarter

Of the NBB’s more elaborate standard nowcasting models, “BREL” predicts positive quarterly growth of 0.4 % in the first quarter, while “R2D2” estimates growth at around 1.3 %. However, as indicated above, the uncertainty of these nowcasting models remains exceptionally high as the massive shocks since the start of the COVID-19 crisis constitute a challenge for the estimation of standard time-series models. Moreover, the fallout from the reaction of economic activity to the peak in inflation may not be fully captured by the indicators and coefficients used in these models. Therefore, these model-based estimates should be complemented by information gathered from other sources, as well as expert judgment.

Two issues can be raised in this regard. The first is the continued strength observed in household consumption. The combination of indexation of nominal incomes and government measures may have actually overcompensated a significant portion of households and, hence, boosted their purchasing power. Given that about one third of all employees only saw their wages indexed in January and headline inflation has been falling while government support measures are still in place, private consumption should continue to drive GDP growth in the near term. A second issue is the contribution of stockbuilding to growth, which was strongly negative in the last quarter of 2022. While the level of stocks is still above average, according to the current statistics, we expect any further drawdown to be more gradual, as supply chains have now normalised. Hence, inventories should weigh on GDP growth to a clearly lesser degree in the current quarter.

All in all, we currently expect economic activity to expand by 0.4 % in the first quarter. This is below the median of the one-indicator models and in line with the lower end of the range provided by the two model nowcasts. It should again be stressed that the uncertainty of this nowcast is high. Given the recent positive surprises in terms of household consumption and the labour market, a more positive outcome is definitely possible. On the other hand, the recovery in confidence is still fragile, demand expectations remain at relatively low levels and financial conditions are tightening further, which is likely to be a particular challenge for residential investment and construction activity. Moreover, a larger further decline in the level of stocks than currently assumed could weigh on growth. All in all, the balance of risks appears broadly neutral for the current quarter.