Business Cycle Monitor

June 2023

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

- The latest NAI statistics put Belgian real GDP growth at 0.5% in the first quarter of 2023, clearly up from the near stagnation in the fourth quarter and even marginally above the 0.4% estimate in the March 2023 BCM and the NAI's April flash estimate.
- First-quarter GDP growth continued to benefit from a strong expansion of private consumption and services. Household consumption should grow at a broadly stable pace in the second quarter of 2023, with purchasing power rebounding strongly as inflation is falling rapidly.
- Business investment in volume terms surprised on the upside in the first quarter. Overall, we expect business investment growth to decline markedly but remain in positive territory in the second quarter. The slowdown partly reflects the disappearance of specific purchases that had pushed up investment in the previous quarter. Residential investment is expected to continue to decline in the second quarter.
- Government consumption should return to (moderate) positive growth in the second quarter, while government investment growth should continue to be boosted by the roll-out of investment plans and the usual electoral cycle.
- The growth contribution of net exports should turn slightly negative in the second quarter.
- The NBB's "BREL" nowcasting model currently estimates growth in the second quarter at around 0.45%, while the "R2D2" model is clearly more optimistic, predicting a growth rate of 0.85%. 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 second quarter of 2023. This is somewhat above the median predictions of the one-indicator models and roughly in line with the most downbeat of the two nowcasts. 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 June 2023. As all estimates and forecasts, it comes with a degree of uncertainty.

The euro area economy was in a technical recession in the past two quarters but activity should edge up again in the current

The latest statistics indicate that euro area first-quarter GDP decreased slightly. Technically, the euro area economy has experienced a recession in the past two quarters. However, the decline is mostly due to the very large negative contribution to euro area GDP coming from the notoriously volatile Irish activity growth: excluding Irish GDP from the euro area aggregate would result in a slightly positive growth for euro area GDP. Regardless of this technicality, the euro area economy has been quite resilient in the aftermath of the energy crisis, also thanks to the decline in natural gas prices, which reduced inflationary pressures, and to high levels of direct and indirect government support for firms and households across the euro area, which shored up domestic demand. In addition, as in previous quarters, continued post-pandemic reopening dynamics have probably still supported the remarkably robust services activity, thereby boosting GDP growth in the first quarter. As regards the demand components, the current statistics suggest that GDP growth in quarterly terms was mainly supported by net exports due to the substantial fall in imports, while business investment, inventories and household consumption reduced growth. The year-on-year growth rate reached 1.0%.

Table 1

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

	Quarter-on-quarter change				Year-on-year change
	2022Q2	**2022Q3**	**2022Q4**	**2023Q1**	**2023Q1**
Euro area	0.8	0.4	-0.1	-0.1	1.0
Germany	-0.1	0.5	-0.5	-0.3	-0.5
France	0.5	0.2	0.0	0.2	0.9
Italy	1.0	0.4	-0.1	0.6	1.9
Spain	2.5	0.4	0.4	0.5	3.8
Netherlands	2.6	-0.2	0.4	-0.7	2.1
Belgium	**0.5**	**0.3**	**0.1**	**0.5**	**1.4**
p.m. Ireland	*2.1*	*2.5*	*-0.1*	*-4.6*	*-0.3*
EU	0.7	0.4	-0.2	0.1	1.0
UK	0.1	-0.1	0.1	0.1	0.2
US	-0.1	0.8	0.6	0.3	1.6
JP	1.1	-0.2	0.0	0.7	1.8

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

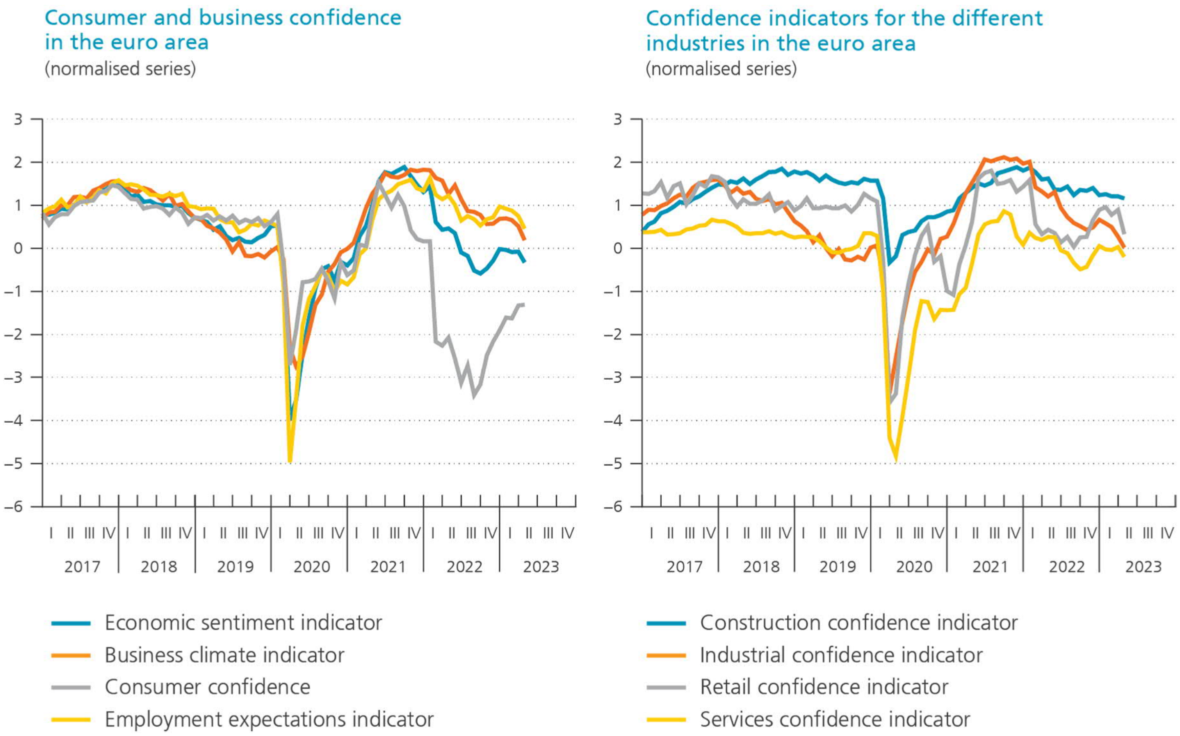
Behind the euro area aggregate lie heterogenous performances of the individual member states. Germany has clearly experienced a recession according to the newly revised statistics. The export-oriented German manufacturing industry in particular was hit hard by the energy crisis and is likely suffering from a decline in international competitiveness. On the other hand, economic activity is remarkably resilient in some other countries, such as Spain, that continues to benefit from a revival of tourism, but also Belgium. A third group of countries has had more volatile performances in terms of economic growth over the last quarters. Among these economies, Italian economic activity accelerated again to 0.6% in the first quarter of 2023 on the back of strong domestic and external demand after having nearly stalled in the preceding quarter. In the Netherlands, on the other hand, moderately positive fourth-quarter growth was followed by the most significant quarterly drop in activity since mid-2020 due to a decline in the trade balance and increased gas withdrawals from storage facilities.

Among the major economies outside the euro area, US growth moderated again but remained positive, while activity rebounded in Japan after stagnating in the second half of 2022. The UK economy, on the other hand, continued to post very weak growth. In volume terms, the UK economy nearly stagnated over the last 4 quarters.

Generally speaking, soft indicators for economic activity bottomed out early in the fourth quarter of 2022 and improved markedly thereafter but seem to level off now. The EC's aggregate Economic Sentiment Indicator (ESI) for the euro area worsened in May. This mostly reflects weakening business sentiment while consumer confidence is still gradually improving. The latter has rebounded sharply from the all-time lows in the fall of 2022 but remains well below its long-term average (see Chart 1). Overall, increased fears about a deterioration of the labour market situation were offset by households' improved assessment of the general economic situation. Consumers also expect price pressures to continue to ease over the coming months. This is consistent with the continued decline in energy prices and in headline inflation which supports the slight improvement in households' current and expected financial situation.

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.

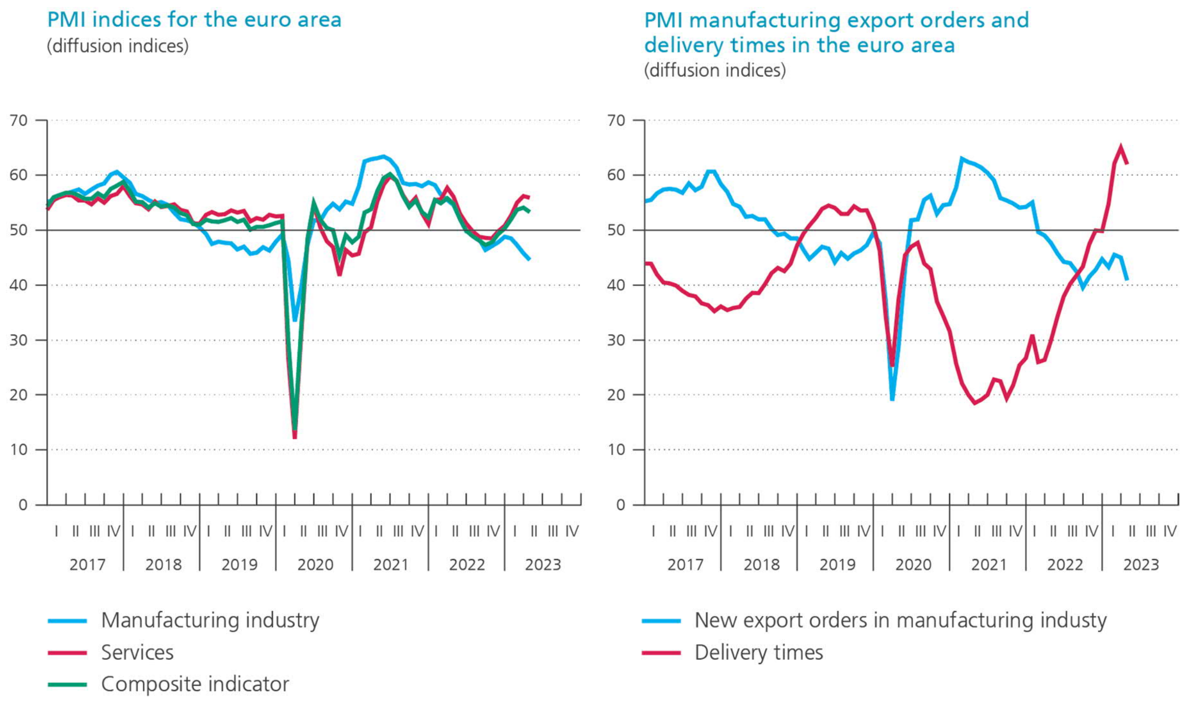
The decline in business sentiment was broad-based across euro area industries. Overall, confidence is still most gloomy for the manufacturing industry and the uptick in sentiment in December and January has proven temporary. The latest survey shows assessments of (export) orders and production expectations in the manufacturing industry down while stock building has accelerated. The specific, manufacturing-focussed Business Climate Indicator (BCI) has fallen below its long-run average but is still above the pre-pandemic level. The confidence indicator for services declined on account of lower demand expectations and a deteriorated business situation but is proving more resilient. The sub-indicator related to retail trade in the euro area weakened abruptly in May due to a worse perception of the current and expected business situation, which seems somewhat at odds with the further increase in consumer sentiment. Confidence in the construction industry reached a two-year low, but the moderation has been quite gradual and overall levels are still above their long-term average. Turning to the labour market outlook, employment expectations weakened again in May but remain broadly stable since the second half of last year.

The PMI composite indicator for the euro area also seems to level off somewhat in May (see Chart 2, left-hand graph), after improving in the fourth quarter of 2022 and the first quarter of 2023. Up until now, purchasing managers' confidence had been remarkably resilient given the magnitude of the shocks and inflationary pressures in the past quarters. The composite indicator edged down in May but remains firmly above 50, which in principle still points to a mild expansion in economic activity.

The recent upward trend in the PMI composite indicator was driven by improving confidence in the services industry, whereas purchasing managers in the manufacturing industry have been signalling contractionary conditions since mid-2022 and their assessment has worsened since the turn of the year. Supply chain bottlenecks have been resolved, as evidenced by the PMI supplier delivery times index being well above pre-crisis levels (see Chart 2, right-hand graph) and price pressures are falling. Nevertheless, cost competitiveness of European manufacturing firms remains under pressure. This is by and large reflected in the outlook for exports that also suffer from the current weakness in international trade: the new export orders PMI for the manufacturing industry dropped further below the 50-point mark (pointing to negative growth) in May. **All in all, taking in account the recent upward surprises, the current level of the PMI composite indicator seems consistent with a mild expansion of economic activity in the euro area in the second quarter of 2023.**

Chart 2

PMI indices



Source: Markit.

The Belgian economy expanded by 0.5% in the first quarter

As expected, Belgian GDP rebounded sharply in the first quarter of 2023. The latest quarterly statistics released by the NAI at the end of May indicate that first-quarter GDP grew by 0.5% QoQ, 0.1pp higher than both the NAI's April flash estimate and our estimate in the March 2023 BCM.

In line with our expectations, strong household consumption boosted GDP growth in the first quarter. Consumer confidence continued to rebound in the first quarter, as aggregate household purchasing power was supported by falling prices for natural gas, robust job creation, the indexation of nominal wages for about one third of private-sector employees, the indexation of personal income tax brackets, as well as the still-active government support measures such as the "Basic Energy Package" and the (extended) social tariff for natural gas and electricity. All in all, private consumption again expanded strongly, by 0.6% on a quarterly basis; this is only due to non-durables, as consumption of durable goods fell slightly.

Turning to the other demand components, the positive outturn for business investment beat expectations; we projected a contraction in the March 2023 BCM. However, there are some indications that business investment may have been boosted by specific one-off transactions. According to current statistics housing investment also surprised on the upside: the slightly positive growth is better than the decline expected in the previous BCM. Public investment expanded markedly according to current quarterly statistics, which is linked to the roll-out of recovery plans and the traditional electoral cycle in public investments. Public consumption, on the other hand, decreased unexpectedly. The contribution of net exports to GDP came in neutral, as was expected.

First-quarter statistics according to the production approach to GDP show that growth was again mainly driven by services, which expanded by 0.9% compared to the previous quarter. Both market and non-market services contributed positively, with the main support coming from market services. Activity rose slightly in the construction industry, but value added in the manufacturing industry declined for the fourth consecutive quarter and is now down 2.5% in year-on-year terms. It should be stressed that the manufacturing contraction was smaller than in the previous quarter.

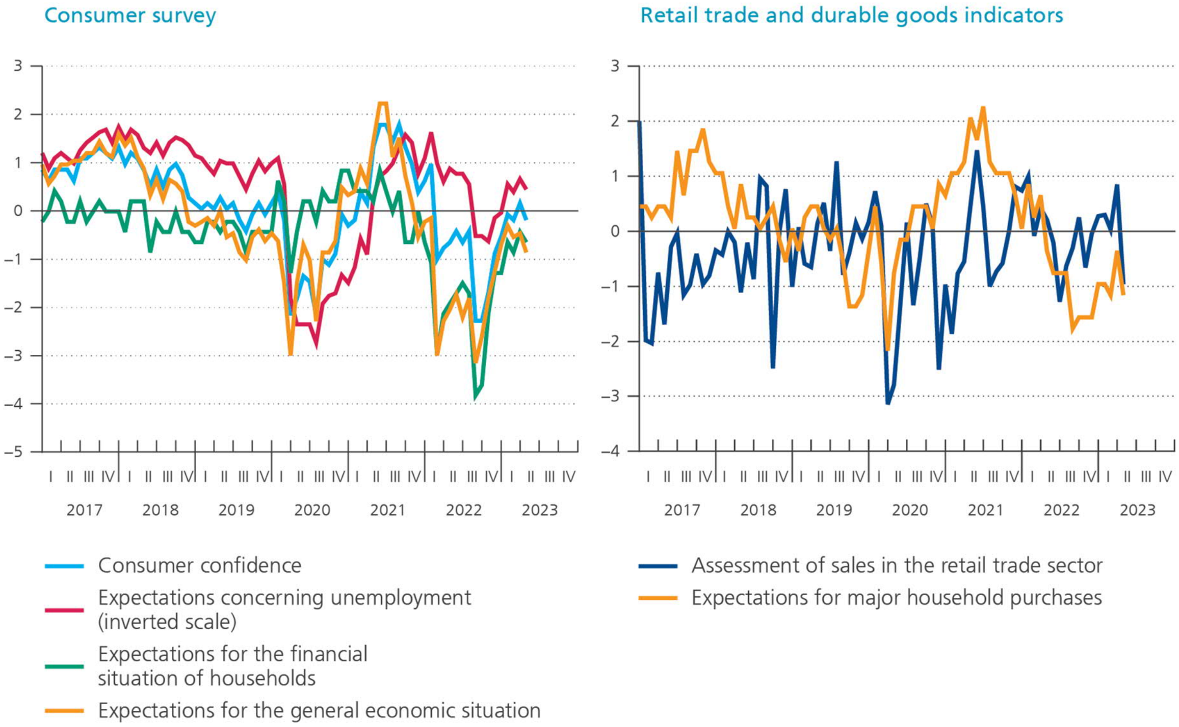
Household consumption should continue to expand at a broadly stable pace

Household consumption growth was particularly buoyant in 2022, notwithstanding the unprecedented drop in consumer confidence. The latter hit rock bottom in the fall but has rebounded strongly and reached a 14-month high in April. However, consumer confidence, which is anchored to four forward-looking sub-indicators, seems to level off somewhat; it edged down again to below its long-term average in May (see Chart 3, left-hand graph). Overall, households' outlook regarding the labour market situation and the general economic situation over the next twelve months deteriorated, as did their expectations regarding their ability to save and their financial situation, albeit minimally. While consumers' outlook may be souring slightly, households' appraisal of the *current* situation was actually quite solid. There was an improvement in the assessment of the current economic situation and consumers felt more inclined to make major purchases, although both of these indicators still remain well below their historical averages.

Indicators related to household purchasing behaviour (see Chart 3, right-hand graph) are often volatile, but have in general been trending up since the second half of 2022. However, the latest results for May show a sharp drop, in particular for managers' assessments of sales in the retail industry, as measured in the NBB's monthly business survey. Expectations of major household purchases in the next twelve months deteriorated as well, albeit to a lesser degree. At the same time, the synthetic curve for the trade industry (see Chart 4, left-hand graph), continued to rebound in May. Anecdotical information from company managers in retail and logistics, gathered in the context of the new NBB Business Echo published on 5 June, still points to robust consumer spending, although some slowdown in activity was noted in non-food retail.

Chart 3

Indicators of private consumption growth
(normalised series)



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

Strong fundamentals continue to support consumption growth. After a brief slowdown in the fourth quarter of 2022, job creation accelerated again in the first quarter of 2023, with the vigorous growth in employment contributing to the rise in purchasing power. As activity growth rebounded strongly and any deceleration of the economy is expected to be gradual at the current juncture, employment growth should remain robust in the near term. Moreover, while the government support measures in the context of the energy crisis are discontinued, household purchasing power is expanding strongly this year, as inflation is now falling rapidly.

All in all, we expect private consumption to continue to expand at a broadly stable pace in the second quarter of 2023. Consumption growth should moderate gradually in the coming quarters.

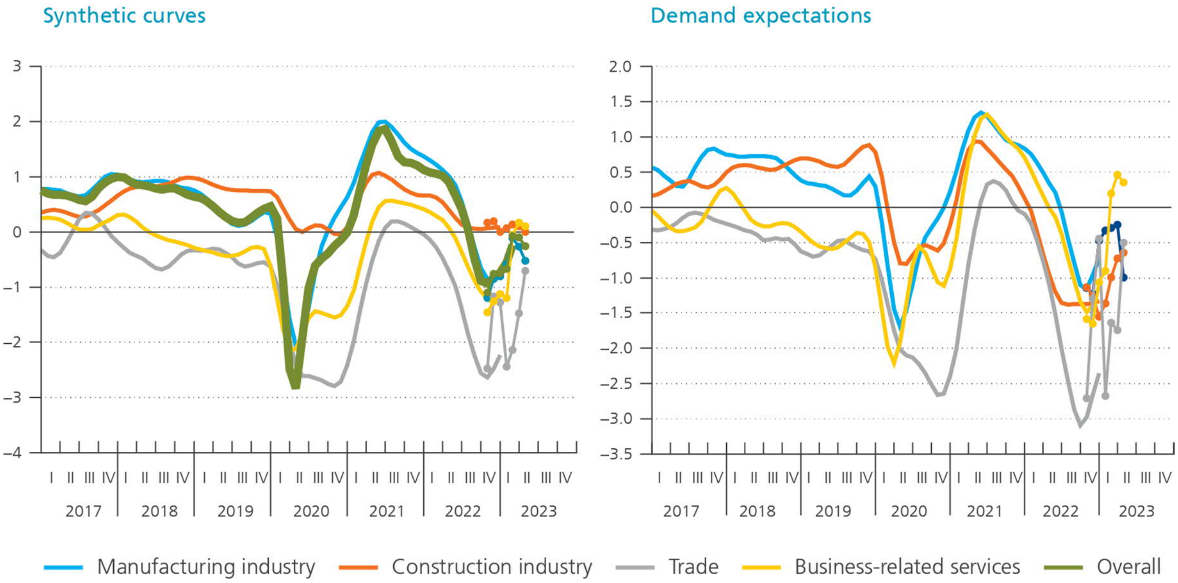
Total fixed investment growth should moderate, but remain positive in the second quarter

Business investment in volume terms surprised on the upside in the first quarter but the improvement in sentiment has been interrupted recently with business confidence softening in May (see Chart 4, left-hand graph)**.** The headline confidence indicator remains below the long-term average and pre-pandemic levels. However, the **recent decline is almost exclusively caused by the manufacturing industry**, which is overweighted in the headline indicator compared to its actual share in GDP. Sentiment in the trade industries is traditionally very volatile but has been improving consistently since the turn of the year. Sentiment in the business services industries also rebounded in March and has now stabilised above the pre-pandemic level, with May showing a slight decrease. Confidence in the building industry edged down and has been virtually flat since mid-2022.

The worsening sentiment in manufacturing can be mostly traced back to a more gloomy outlook on sales: demand expectations in the manufacturing industry were improving gradually over the past months but have plummeted in May to just above the trough reached in 2022 at the height of the energy crisis (see Chart 4, right-hand graph). The outlook is much more upbeat for the other industries. While demand expectations are back above their long-term average for services, they remain somewhat more subdued in the construction industry. Higher costs of building materials, as well as significantly higher interest rates and less lending hold back investment in dwellings in particular.

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 strong worsening of demand expectations in manufacturing could in principle point to a slowdown in investment as activity in that industry is particularly capital-intensive. However, a broader range of business intelligence, including the analysis in the aforementioned NBB Business Echo, suggests that the outlook among manufacturing firm actually remains quite robust. The recorded decline in sentiment in the May business survey is likely to reflect some monthly volatility rather than an actual turning point. The Business Echo interviews suggest that investment plans have generally not been curtailed (except for real estate development). Firms in the pharmaceutical industry, which accounts for a sizeable share in Belgian manufacturing, for instance, reported continued investments in new products and facilities. More generally, Business Echo interviewees pointed to rising investment related to the greening of production processes, as well as digitalisation efforts and productivity-enhancing investments in view of labour shortages.

In addition, capacity utilisation in the Belgian manufacturing industry, as reported in the quarterly NBB survey on production capacity, increased to 77.7% in April. This is the highest level since the summer of 2022, albeit still clearly below the historical average.

Overall, we expect business investment growth to cool down markedly but remain in positive territory in the second quarter and to rebound thereafter. The slowdown partly reflects the disappearance of the specific purchases that had pushed up investment in the previous quarter while the resilience of the economy and the aforementioned business intelligence points to investment gaining traction beyond the near term. In that connection, it should be stressed that business investment has still not recovered to its pre-pandemic level, contrary to economic activity.

According to the current statistics, residential investment in volume terms stabilised in the first quarter, after falling by nearly 2% in the previous quarter. It is likely to recover only gradually. As indicated, demand expectations in the building industry are improving gradually but remain low overall. Mortgage rates have increased significantly and are eroding household borrowing capacity. Mortgage lending has plummeted in recent months. Strong fundamentals such as employment growth and purchasing power should provide some support but the near-term outlook is clearly not favourable. **All in all, we expect residential investment to decline moderately in the second quarter of 2023.**

Government investment increased by a whopping 6.4% in the first quarter of 2023. **The roll-out of recovery plans and the traditional 'electoral cycle' should continue to boost government investment spending in the near term, even though the growth rate could decline somewhat in the second quarter.**

All in all, we expect total fixed investment growth to moderate significantly but to remain in positive territory in the current quarter.

Government consumption is expected to expand moderately

Contrary to our expectations, government consumption in real terms decreased by 0.7% in the first quarter according to the first NAI statistics. It should be stressed that the quarterly statistics on demand components and for government spending in particular, are often revised. **We expect government consumption growth to normalise and turn positive again as of the second quarter of 2023.**

The growth contribution of net exports should become moderately negative

First-quarter exports and imports both fell by around 1%, resulting in a zero contribution of net exports to GDP growth, in line with our expectations.

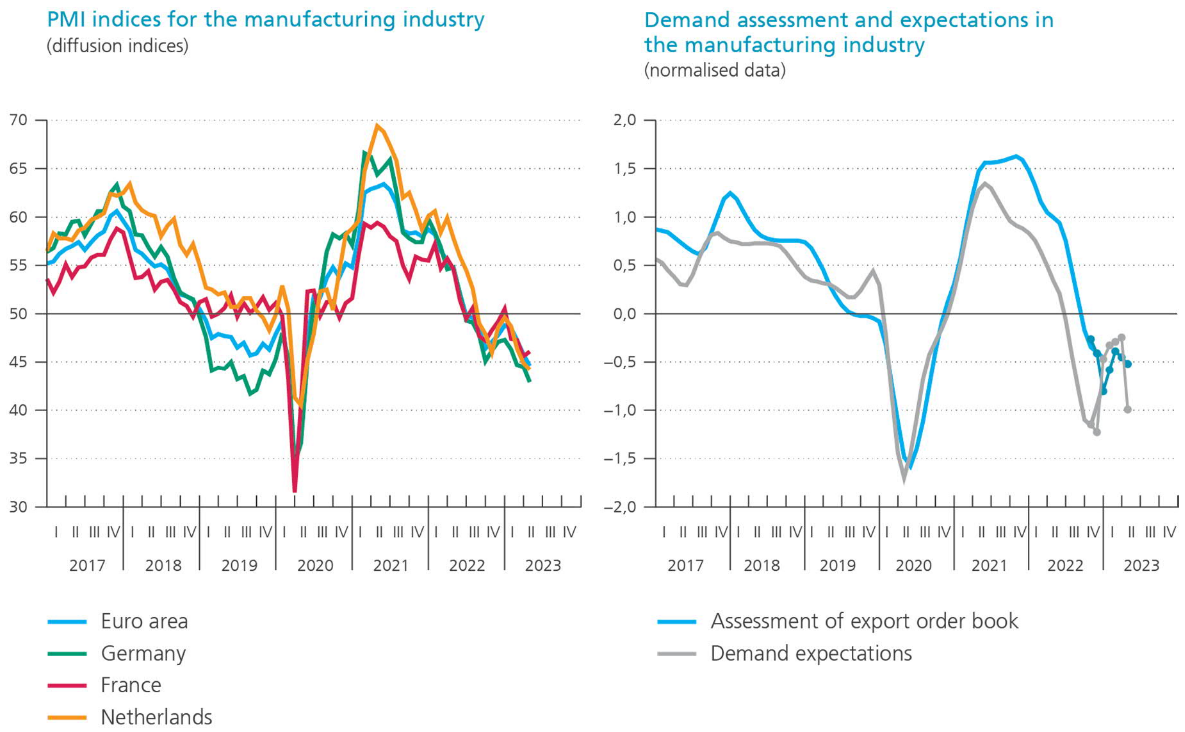
The PMI manufacturing index for the main trading partners (see Chart 5, left-hand graph) can be used as a proxy for foreign demand for Belgian exports. Business sentiment in manufacturing had improved somewhat at the turn of the year, as the energy crisis waned and supply chains normalised, but PMIs reverted to a downward trend again as of February. Confidence levels of purchasing managers in the manufacturing industry in Belgium's neighbouring countries and the euro area average are now well below 50, indicating a continued contraction of activity. In addition, cost competitiveness of Belgian exporters has worsened due to the surge in labour costs. **Overall, the picture remains quite weak as regards the outlook for exports in the second quarter.**

Indicators related to demand in the manufacturing industry (see Chart 5, right-hand graph) confirm the weakness in the outlook. Demand expectations improved in early 2023 but, as indicated, fell back markedly in May while the downward trend in export orders in the manufacturing industry continues, although at a more moderate pace as it has pulled out of the steep decline seen in the second half of 2022. Business Echo interviewees from the manufacturing industry by and large confirmed the uncertain outlook and the concerns about competitiveness.

All in all, exports may recover somewhat in the first quarter of 2023 but are likely to remain subdued. As domestic demand remains vigorous, import growth is likely to outpace export growth in the near term. Hence, **the contribution of net exports to GDP growth should turn moderately negative in the current quarter.**

Chart 5

PMI indicators in neighbouring countries and export orders in manufacturing



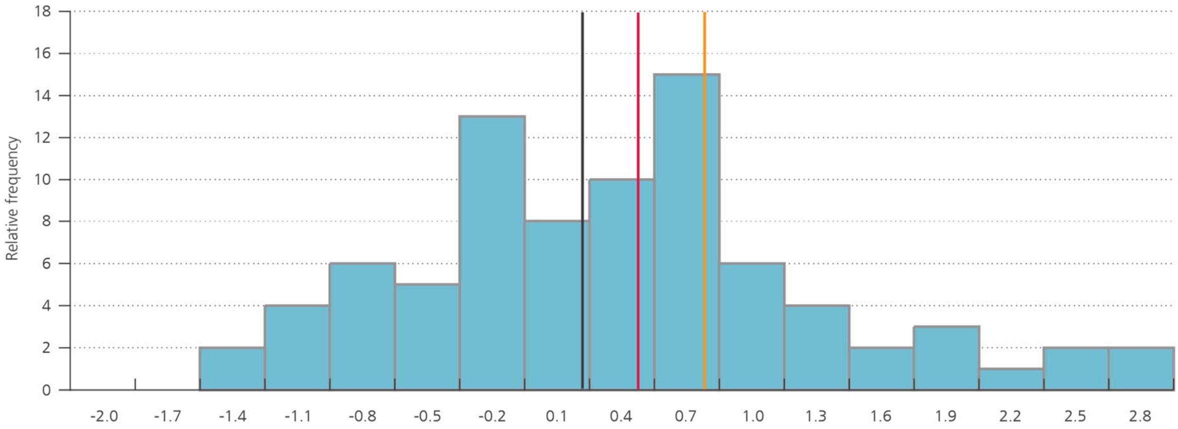
Sources: Markit, NBB.
Note: The series in the right graph are normalised around their historical averages and divided by their standard deviation.

The median value of the mechanical nowcasts points to slightly positive GDP growth in the second 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 positive growth of 0.2% in the second quarter of 2023** (see Chart 6). The range is large, with over half of the results falling outside the [0.0;1.0]% range, indicating that 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 second 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.

Economic activity should continue to expand quite vigorously in the second quarter

Of the NBB's more elaborate standard nowcasting models, "BREL" predicts positive quarterly growth of 0.45% in the second quarter, while "R2D2" estimates growth at around 0.85%. 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 large shock 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.

Short-term indicators and business intelligence mostly points to broadly stable growth in the near term. At the same time, the Belgian economy has clearly outpaced that of the euro area and, in particular, of the neighbouring countries and the main trading partners in the previous quarters. The outlook for the euro area remains quite weak in the near term and a very large positive growth difference solely based on the strength of Belgian domestic demand may not be sustainable for very long. Some gradual convergence due to the weakness in exports seems plausible.

All in all, we currently expect economic activity to marginally slow down and expand by 0.4% in the second quarter. This is above the median of the one-indicator models but at 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 economic outlook beyond the short term is increasingly uncertain and business confidence is still down while financial conditions are tightening further, which could weigh more than currently expected on gross fixed capital investment. All in all, the balance of risks appears broadly neutral for the current quarter.