

# Business Cycle Monitor

September 2023

## Belgian economy expected to grow by 0.2% in the third quarter of 2023<sup>1</sup>

- The latest NAI statistics place Belgian real GDP growth at 0.2% for the second quarter of 2023, somewhat below the estimate set out in the June 2023 BCM (0.4%) and the growth rate recorded in the first quarter of the year (0.4%).
- In the second quarter, GDP growth benefited once again from solid growth in private consumption and services. Household consumption is expected to continue to grow at a strong – but perhaps slightly more moderate – pace in the third quarter of 2023, as purchasing power rebounds sharply.
- Business investment in volume terms expanded very strongly once more in the second quarter and is expected to continue to increase in the third quarter, but to moderate somewhat. Residential investment clearly shrank in the second quarter and is likely to decline further in the third quarter.
- Government consumption surprised on the downside in the second quarter but should now return to (moderate) positive growth, while government investment is expected to accelerate, boosted by the roll-out of investment plans and the usual electoral cycle.
- The contribution of net exports to growth is expected to remain negative in the third quarter.
- The NBB's BREL nowcasting model currently estimates growth in the third quarter at 0.15%, while the R2D2 model remains clearly more optimistic, predicting a growth rate of 0.56%. 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 estimations based on standard time-series models.
- All in all, we currently expect economic activity to expand by 0.2% in the third quarter of 2023. This is slightly above the median predictions of the one-indicator models and the BREL nowcast, but clearly below the R2D2 outcome. The negative risks mostly relate to a stronger-than-expected slowdown in private consumption over the summer and are unlikely to have a substantial impact on overall growth.

<sup>1</sup> This is a short-term NBB estimate which 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 each quarter). This estimate is based on nowcasting models and expert judgment and incorporates information up to 8 September 2023. Like all estimates and forecasts, it is subject to a degree of uncertainty.

## Euro area growth came in stable in the second quarter of 2023 and is expected to remain around zero

The latest statistics indicate that second-quarter GDP growth in the euro area remained stable at 0.1%. While euro area growth rates are often affected by volatility in the Irish statistics<sup>2</sup>, the second vintage of the quarterly statistics suggests that Irish growth was more moderate than initially indicated. Excluding Irish GDP from the euro area aggregate shows growth has essentially been close to zero for several quarters. All in all, euro area GDP has expanded only very moderately over the past year, as evidenced by the fact that the year-on-year growth rate amounted to 0.5% in the second quarter.

Current statistics suggest that GDP growth in quarterly terms was mostly supported by inventory build-up. Smaller positive contributions to growth came from business investment and government consumption, while household spending stagnated. In line with expectations, net exports detracted from growth due to a substantial fall in real exports.

Table 1

### Real GDP growth

(%, adjusted for seasonal and calendar effects)

	Quarter-on-quarter change				Year-on-year change
	2022Q3	2022Q4	2023Q1	2023Q2	2023Q2
Euro area (EA)	0.3	-0.1	0.1	0.1	0.5
<i>p.m. EA excl. Ireland</i>	<i>0.2</i>	<i>0.0</i>	<i>0.2</i>	<i>0.1</i>	<i>0.5</i>
Germany	0.4	-0.4	-0.1	0.0	-0.1
France	0.3	0.1	0.0	0.5	1.0
Italy	0.3	-0.2	0.6	-0.4	0.4
Spain	0.4	0.4	0.5	0.4	1.8
Netherlands	-0.2	0.9	-0.4	-0.3	-0.1
<b>Belgium</b>	<b>0.3</b>	<b>0.1</b>	<b>0.4</b>	<b>0.2</b>	<b>0.9</b>
<i>p.m. Ireland</i>	<i>2.4</i>	<i>-0.9</i>	<i>-2.6</i>	<i>0.5</i>	<i>-0.7</i>
EU	0.3	-0.1	0.2	0.0	0.4
UK	-0.1	0.1	0.1	0.2	0.4
US	0.8	0.6	0.5	0.5	2.5
JP	-0.3	0.0	0.9	1.5	2.1

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

Growth performances of the individual member states diverged significantly. Germany has now recorded negative or zero growth for three consecutive quarters while the Dutch economy shrank for the second one. In both countries, the recession is mostly due to the weakness of household expenditure and net exports. However, other countries recorded strong second-quarter growth rates: French economic activity was shored up by a continued expansion of the contributions to growth from net exports and inventory building while Spanish GDP was boosted by robust domestic demand. In Italy, economic activity has been quite volatile of late and declined in the second quarter of 2023 following a renewed slump in domestic demand.

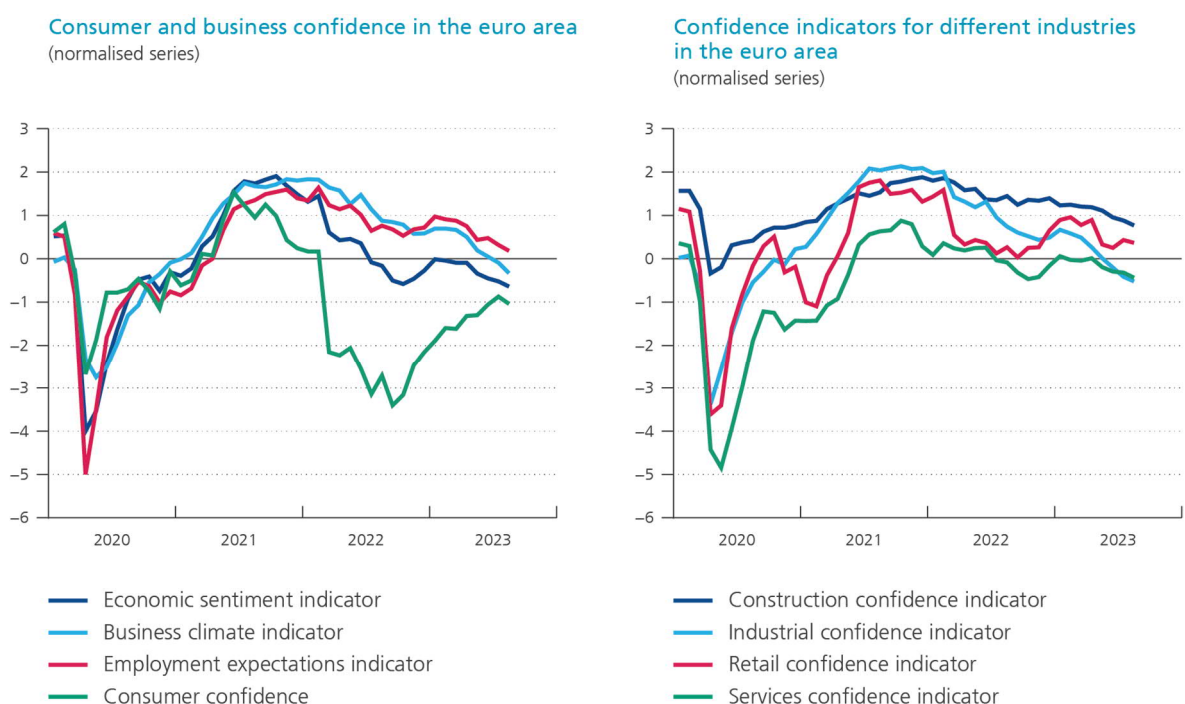
<sup>2</sup> The volatility in Irish GDP statistics is mostly due to operations involving intangible assets. These transactions usually do not reflect the Irish or euro area business cycle and are related to tax optimization by large foreign-owned multinationals. See [Andersson et al \(2023\)](#) for a detailed discussion.

Of the major economies outside the euro area, Japan experienced strong growth in the first half of the year with the quarter-on-quarter growth rate reaching 0.9 % in the first and 1.5% in the second quarter. US growth remained robust and broadly unchanged in the second quarter. In the UK, on the other hand, economic growth was anaemic once again. In volume terms, the UK economy has grown by only 0.4% over the past four quarters.

**Soft indicators for economic activity continued to worsen somewhat in recent months.** The EC's Economic Sentiment Indicator (ESI) for the euro area stagnated in the first quarter and has been declining ever since. This mostly reflects weakening business sentiment. Consumer confidence has generally improved since the trough reached in the autumn of 2022 but remains well below its long-term average (see Chart 1). In addition, in August, consumers were slightly more pessimistic about the general economic outlook as well as their own financial perspectives.

### Chart 1

#### Sentiment indicators for the euro area



Source: EC.

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

Business sentiment has weakened across euro area industries, even though certain forward-looking sub-indicators show some improvement. In the manufacturing industry, confidence has been on a downward trend since early 2022 with sentiment eroding further in the current quarter. The assessment of (export) orders worsened again against the backdrop of the slump in world trade but, remarkably, manufacturing firms' expectations regarding production, more generally, improved. The confidence indicators for the services and retail sectors declined due to a deteriorated appraisal of their *past* business activity. In the retail sector, weaker demand gave rise to reports of inventory accumulation. Nevertheless, managers in services and retail were more optimistic about their *expected* business situation. Confidence in the construction industry continued to slide as well, in this case due to deteriorating expectations (notably of order books and employment).

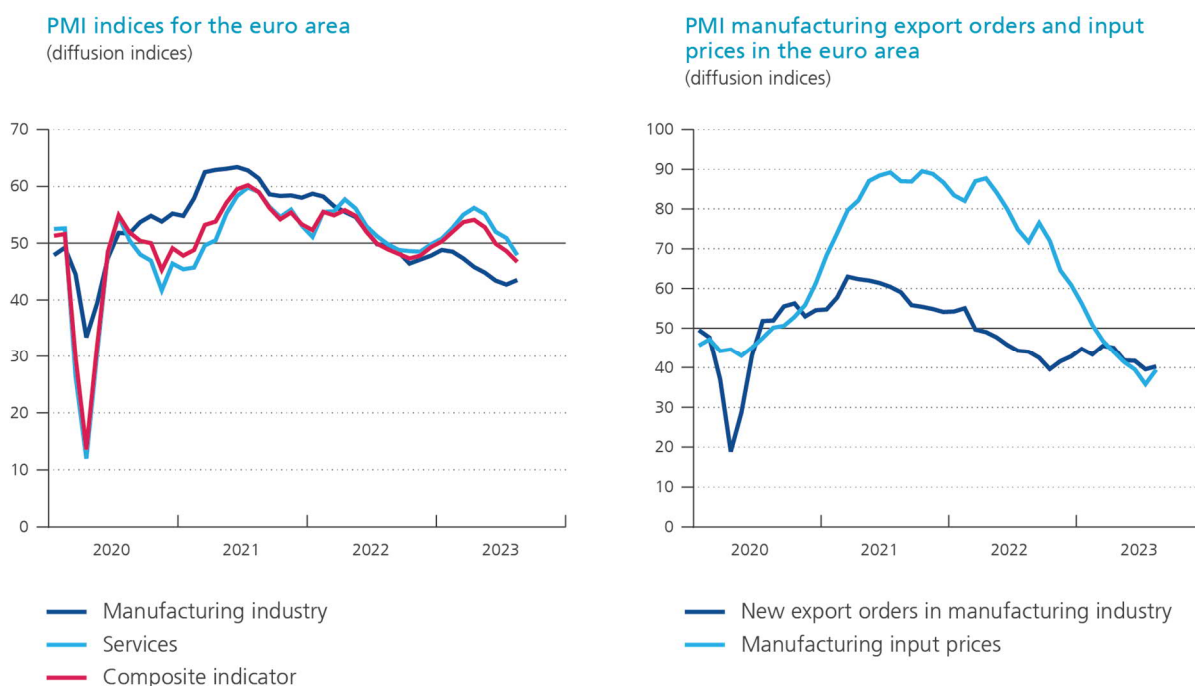
In August, the PMI composite indicator for the euro area, which has been on a downward trend since May, fell to its lowest point since 2020 (see Chart 2, left graph). The composite indicator has been below 50 since June, signalling in principle that purchasing managers increasingly believe the euro area economy is set to contract.

Since mid-2022, the PMI indicators revealed a diverging in confidence levels between the services sector, which had remained optimistic about the economic outlook, and the manufacturing sector in which purchasing managers have reported contractionary conditions. In recent months, it appears that this gap has started to narrow, as confidence in the services sector deteriorated more. In contrast, the manufacturing PMI bottomed out, but remains below 50.

While (input) price pressures have fallen (see Chart 2, right graph), the cost competitiveness of European manufacturing firms remains under pressure. This comes on top of the existing weakness in international trade. Against this background, the new export orders PMI for the manufacturing industry has remained distinctly below 50 (pointing to negative growth) since May. **Overall, the current level of the confidence indicators appears consistent with a continued slump in euro area economic activity in the third quarter of 2023: growth is expected to remain around zero. This is somewhat weaker than expected in the June 2023 Eurosystem projections.**

## Chart 2

### PMI indices



Source: HCOB.

## Belgian economy grew by 0.2% in the second quarter

According to current statistics Belgian growth moderated somewhat more than expected in the second quarter of 2023. The latest quarterly statistics released by the NAI at the end of August were in line with the July flash estimate and indicated that real GDP grew by 0.2% in the second quarter, which is 0.2 pp below both the June BCM estimate and growth in the first quarter (which was revised down slightly by the NAI).

In line with our expectations, household consumption continued to expand strongly, by 0.5% on a quarterly basis, and helped shore up GDP in the second quarter. In addition, GDP growth was boosted more than expected by a new surge in business investment, which increased by slightly more than 2% on a quarterly basis, following two already strong quarters. Housing investment, on the other hand, declined quite sharply once again, as anticipated in the previous BCM.

Current statistics suggest that in particular government spending came in below expectations. Government investment expanded, but stronger growth had been expected in the run-up to local elections. Government consumption, on the other hand, declined unexpectedly again, for the third quarter in a row. It should be noted that the first quarterly statistics on government spending in particular are often subject to significant subsequent revision.

In line with our expectations GDP growth was weighed down by a negative contribution from net exports. Inventories also reduced growth, suggesting that demand outpaced supply.

According to the production approach, activity growth in the second quarter was again mainly driven by services, which were up 0.5% from the previous quarter. Both market and non-market services contributed positively, with the main support coming from the former, as expected. Activity expanded slightly in the construction industry, whereas value added in the industrial sectors strongly declined, marking the fifth consecutive quarter of negative growth.

## Household consumption expected to continue to expand strongly in the third quarter although the growth rate could moderate slightly

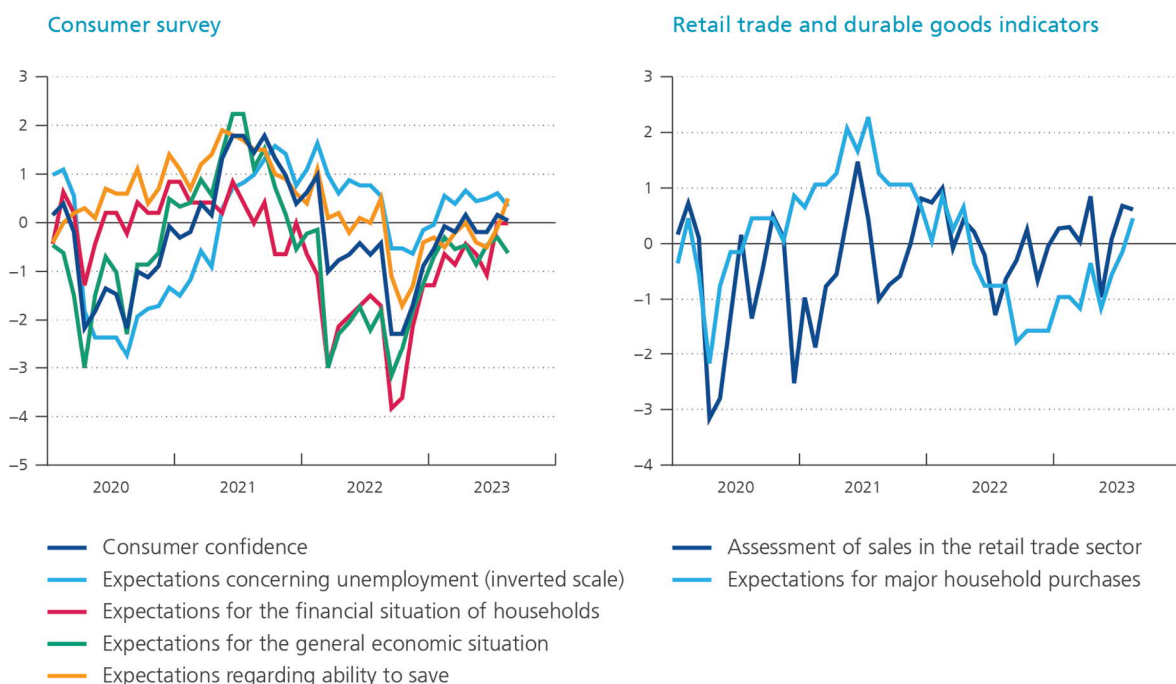
Following a buoyant 2022, household consumption continued to expand strongly in the first half of 2023, slowing only marginally in the second quarter (0.5% compared to 0.6% in the first).

Consumer confidence has recovered from the autumn 2022 lows and has been hovering around its long-term average for several months now (see Chart 3, left graph). The average confidence level was marginally higher in July and August than in the second quarter of 2023, mostly due to a slight improvement in July in the outlook for the general economic situation over the next twelve months (although August saw a new downturn). In addition, expectations of households' ability to save and their financial situation have improved markedly in recent months. On the other hand, their unemployment expectations for the next year have worsened somewhat compared to the second quarter. While this sub-indicator tends to have some predictive power in our nowcasting models, the worsening is limited and households have essentially been quite bullish on the labour market since the start of the year.

Households' saving intentions are not to the detriment of their willingness to spend, as the consumer confidence survey also indicates that households increasingly plan major purchases in the next 12 months (see Chart 3, right graph). Indicators related to household purchasing behaviour can be volatile but have shown a remarkable upward trend since the second half of 2022. The sharp drop observed in May in managers' assessments of sales in the retail industry, as measured by the NBB's monthly business survey, proved temporary and the indicator has bounced back to close to the high levels recorded in early spring. Despite some recent volatility, the gradual upward trend in the synthetic curve for the retail industry (see Chart 4, left graph) corroborates the relative strength of this sector.

### 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 sped up again. Employment growth in the second quarter surprised on the upside once more and the labour market is expected to remain robust in the near term. Together with the recent boost to nominal wages from the indexation mechanisms and the ongoing deceleration of inflation, household purchasing power growth is bound to remain solid. At the same time, the post-pandemic recovery dynamics should gradually lose some steam, while the bad summer weather may have dampened growth in certain hospitality services.

**All in all, we expect private consumption to continue to expand strongly in the third quarter of 2023, albeit possibly at a more moderate rate.**

### Total fixed investment growth expected to weaken but to remain clearly positive in the third quarter

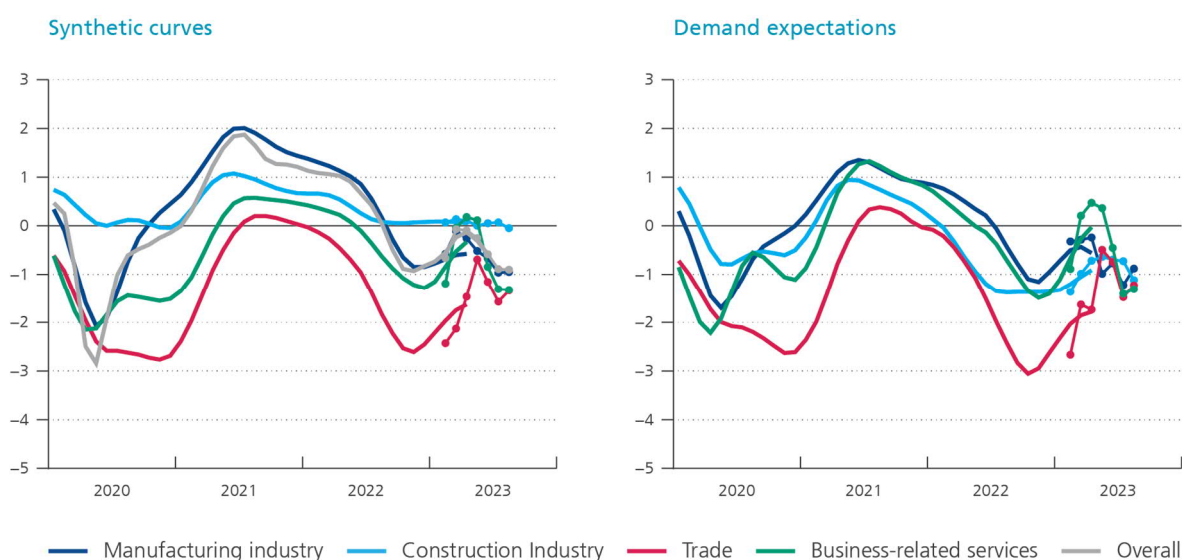
**Following a strong performance since the end of last year, business investment again surprised on the upside, expanding by more than 2% in volume terms in the second quarter.** This was despite the weakening of business confidence observed since April (see Chart 4, left graph). In the third quarter, business confidence continued to deteriorate; while the August reading was stable, it remains close to the trough recorded during the energy crisis of last autumn and below its long-term average and pre-pandemic levels.

At the sector level, business sentiment in both the manufacturing industry and services appears to have bottomed out after worsening in recent months. Confidence in trade is traditionally highly volatile but is trending up. Sentiment in the building industry edged down but, overall, has been virtually flat since mid-2022.

The stabilisation of business sentiment in the manufacturing industry is the result of a marked improvement in demand expectations which made up for a gloomier assessment of current order books and the employment outlook. The demand outlook also improved in services and trade, but deteriorated in the building industry (Chart 4, right graph). All in all, this could suggest that in most sectors the economic situation is expected to gradually improve beyond the very near term.

## 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.

Capacity utilisation in the Belgian manufacturing industry, as reported by the quarterly NBB survey on production capacity, fell to 75.3% again in July following a brief improvement in April. This is clearly below the long-run average of around 80%. Lower capacity utilisation in principle signals a lesser need for investment. However, the NBB’s business intelligence network has indicated that investment in digitalisation, automation and greening is still a clear priority. This should remain the case for the foreseeable future as firms work to reduce their exposure to energy price volatility and adjust their production facilities to a tightening regulatory framework.

Turning to financial conditions, the NBB’s quarterly survey on the assessment of financing conditions shows that the percentage of businesses that perceive current credit conditions as “constrained” edged down in July, to just over 37%, but remains high overall. Current levels are comparable to those last seen in the aftermath of the global financial crisis.

All in all, following three quarters of (unexpectedly) vigorous growth, **we expect business investment growth to moderate somewhat in the third quarter.**

According to current statistics, residential investment in volume terms fell by 1.2% on a quarterly basis, with the short-term indicators not signalling a clear rebound. As indicated, demand expectations in the construction industry remain rather bleak. 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. **On the whole, we expect residential investment to fall again in the third quarter of 2023.**

Government investment increased by just 0.5% in the second quarter, following strong growth of 5.8% 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, with the growth rate expected to pick up pace in the third quarter.**

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

## Government consumption expected to expand moderately

Government consumption in real terms surprised on the downside again. The currently available NAI statistics indicate a drop of 0.6% in the second quarter, while moderately positive growth was expected. It should again be stressed that the quarterly statistics on demand components, and for government spending in particular, are often revised. **Nonetheless, we expect government consumption growth to normalise and turn positive in the rest of 2023.**

## Contribution of net exports to growth should remain negative

**In the second quarter, both exports and imports fell, but the latter less strongly, resulting in a negative contribution of net exports to GDP growth, in line with our expectations.**

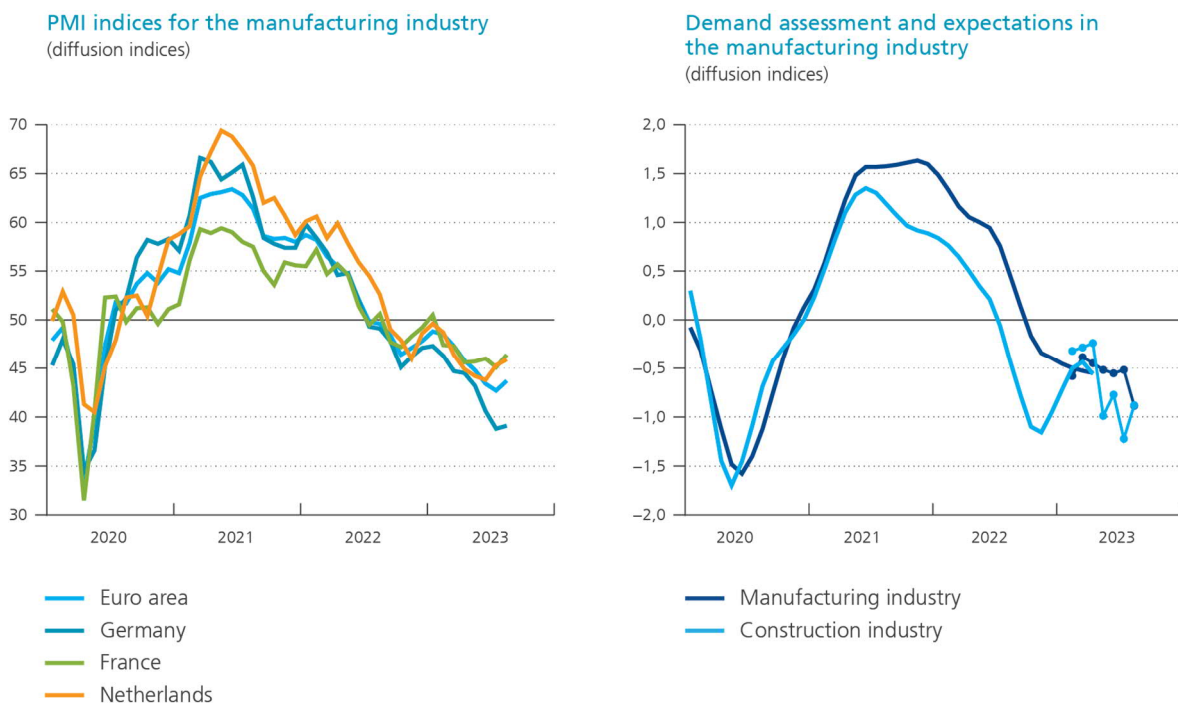
The PMI manufacturing index for the country's main trading partners (see Chart 5, left graph) can be used as a proxy for foreign demand for Belgian exports. Confidence levels of purchasing managers in the manufacturing industry in Belgium's neighbouring countries and the euro area average have been well below 50 for some time now, indicating a prolonged contraction of activity. However, a broad-based uptick was recorded in August, with confidence among managers in the hard-hit German manufacturing industry also edging up marginally. This matches the information from the NBB's business survey according to which demand expectations in the manufacturing sector also appear to have bottomed out in August. Manufacturing firms' appraisal of export orders, on the other hand, is at a three-year low. The ongoing slump in export orders probably also reflects the reduced cost competitiveness of Belgian exporting firms. **All in all, the outlook for exports in the third quarter remains rather weak.**

As the outlook for domestic demand is holding up better, import growth is likely to once again outpace export growth in the near term. Hence, **the contribution of net exports to GDP growth should remain negative in the current quarter.**



## Chart 5

### PMI indicators in neighbouring countries and export orders in manufacturing



Sources: Markit, NBB.

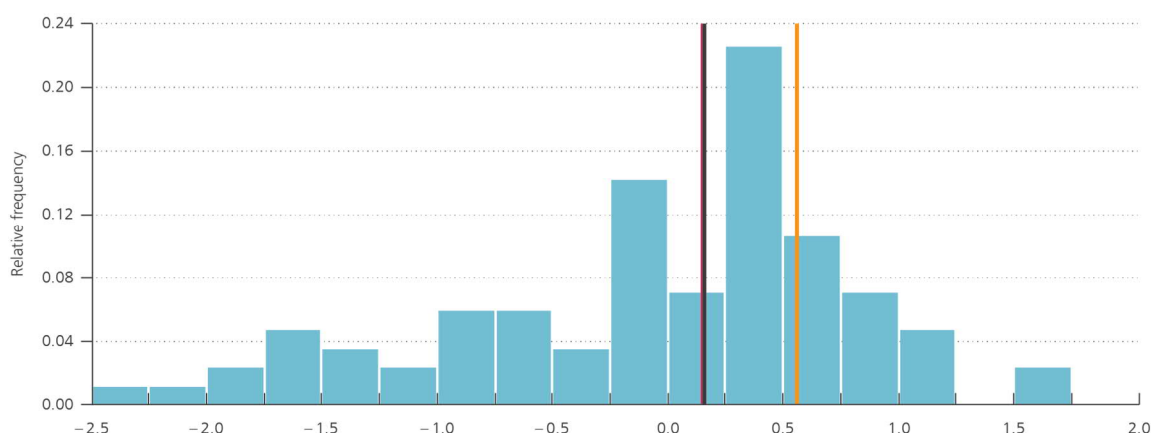
Note: The series in the right graph are normalised around their historical averages and divided by their standard deviation.

## Median value of the mechanical nowcasts points to moderately positive GDP growth in the third 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 various predictions points to positive growth of 0.16% in the second quarter of 2023** (see Chart 6). The range is substantial at [-2.5;1.5] and skewed to the negative end, which may indicate the presence of downside risks and relatively high levels of uncertainty. It should be noted that the past forecast performance of these simple models suggests that 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 percentage terms.



Source: NBB.

Note: The black line corresponds to the median of the one-indicator bridge model predictions of current quarter GDP growth, while the red and orange lines correspond to the predictions by the BREL bridge model and the R2D2 dynamic factor model, respectively.

## Economic activity should continue to expand moderately in the third quarter

Of the NBB's more elaborate standard nowcasting models, BREL predicts positive quarterly growth of 0.15% in the third quarter, while R2D2 estimates growth at around 0.56%. 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 by standard time-series models. Moreover, indicators and coefficients used in these models may not fully capture the fallout from the reaction of economic activity to the large inflationary shock. In that regard, a preliminary estimate using an improved BREL model<sup>3</sup>, intended to be more resilient to such shocks, indicates a somewhat higher growth estimate than the original vintage (but it remains 0.2% in rounded numbers). As always, these model-based estimates should be complemented by information gathered from other sources, as well as expert judgment.

**The broader context of this nowcast is an increasingly gloomy external environment with a more uncertain economic outlook for the euro area and increasingly tight monetary policy.** However, the recent performance of the Belgian economy has been more robust than that of the euro area and some neighbouring countries due to solid domestic demand. Despite second-quarter growth coming in somewhat below our previous estimates according to current statistics, the short-term outlook for the Belgian economy does not point to a further deceleration. The probability of a recession is still very low and it should be stressed that most forward-looking survey indicators are actually improving, which could point to higher growth in the last quarter of the year.

**All in all, we currently expect economic activity to expand in the third quarter at more or less the same pace as in the previous quarter, i.e. 0.2%.** This is slightly above the median nowcast of the one-indicator models but at the lower end of the range provided by the two nowcasting models. Negative risks, pertaining mostly to a stronger-than-expected slowdown in private consumption over the summer (due to weaker employment expectations as well as exogenous factors such as the impact of relatively bad weather on certain services industries) are unlikely to have a substantial impact on overall growth.

<sup>3</sup> Further analysis on the robustness of this improved model is needed. We currently expect a technical Working Paper to be published in the first half of 2024.