Business Cycle Monitor

December 2023

Belgian economy expected to grow by 0.3% in the fourth quarter of 2023[1]

- According to current statistics, Belgian economic activity accelerated slightly to 0.4% in the third quarter of 2023, up from 0.3% in the previous quarter. This constitutes a slight downward revision from the earlier flash estimate but is still 0.2 percentage points higher than the September Business Cycle Monitor (BCM) estimate, which was based on statistics up to the second quarter that have since been revised upwards.
- In the third quarter, GDP growth benefited from a moderate acceleration in private consumption and services. Household consumption growth is expected to edge up in the fourth quarter of the year, as consumer confidence is trending up, and purchasing power growth should remain positive.
- Business investment growth in volume terms moderated somewhat but remained strong in the third quarter. This gradual moderation should continue in the fourth quarter, but growth is expected to remain clearly positive. Residential investment shrank in the third quarter and is likely to decline further in the fourth.
- Government consumption returned to moderately positive growth in the third quarter and should maintain its current pace, while government investment is expected to continue to accelerate, boosted by the roll-out of investment plans and the regular electoral cycle.
- Net exports reduced activity growth in the third quarter, and this negative contribution may even become slightly more pronounced in the fourth quarter.
- The NBB's BREL nowcasting model currently estimates growth in the fourth quarter at 0.26%, while the R2D2 model is clearly more optimistic, predicting a growth rate of 0.51%.
- All in all, we currently expect economic activity to expand by 0.3% in the fourth quarter of 2023. This is just above the BREL nowcast but below the median predictions of the one-indicator models and clearly below the R2D2 outcome. Positive risks stem from potentially stronger-than-expected expansion of domestic demand, while negative risks mostly relate to the external environment.

[1] 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 December 2023. Like all estimates and forecasts, it is subject to a degree of uncertainty.

Euro area growth came in slightly negative in the third quarter of 2023 and is expected to remain near zero

The latest statistics indicate that third-quarter GDP in the euro area came in slightly negative, at -0.1%. In year-on-year terms, the growth rate amounted to zero in the third quarter, indicating that the euro area economy has stagnated over the past year. However, it should be noted that euro area growth rates are often affected by the highly volatile Irish statistics.[2] The first vintage of the third-quarter statistics suggests that Irish GDP growth was, once again, down quite sharply. Excluding Ireland shows that euro area GDP remained stable in the third quarter. Moreover, in year-on-year terms, euro area growth without Ireland was very moderately positive.

Current statistics suggest that the growth contribution of inventories was negative (which could point to a faster depletion or a slower build-up of stocks), while positive contributions to euro area growth came from household consumption expenditures and government consumption. Business investment and net exports made negligible contributions to growth.

Table 1

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

	Quarter-on-quarter change				Year-on-year change
	2022Q4	2023Q1	2023Q2	2023Q3	2023Q3
Euro area (EA)	0.0	0.0	0.1	-0.1	0.0
p.m. EA excl. Ireland	0.0	0.2	0.2	0.0	0.3
Germany	-0.4	0.0	0.1	-0.1	-0.4
France	0.0	0.1	0.6	-0.1	0.6
Italy	-0.2	0.6	-0.4	0.1	0.1
Spain	0.5	0.6	0.4	0.3	1.8
Netherlands	0.7	-0.5	-0.4	-0.2	-0.5
Belgium	**0.2**	**0.4**	**0.3**	**0.4**	**1.4**
p.m. Ireland	-1.6	-1.9	-0.4	-1.9	-5.6
EU	-0.1	0.1	0.0	0.0	0.0
UK	0.1	0.3	0.2	0.0	0.6
US	0.6	0.6	0.5	1.3	3.0
JP	-0.1	0.9	1.1	-0.5	1.4

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

The growth performances of member states converged somewhat in the third quarter. Domestic demand mostly weakened (further). A decline in business investment and inventory drawdowns led to a third consecutive quarter of negative growth for the Dutch economy while the small decline in German economic activity can be traced back to weaker household spending. Similarly, Italian GDP was barely positive, due solely to the fact that the negative contribution of domestic demand in the third quarter was offset by the positive contribution of net exports. Domestic demand held up marginally better in France and Spain, although Spanish GDP growth moderated somewhat, while the French economy shrank slightly, due to a large negative contribution of net exports, after strong performances in the second quarter.

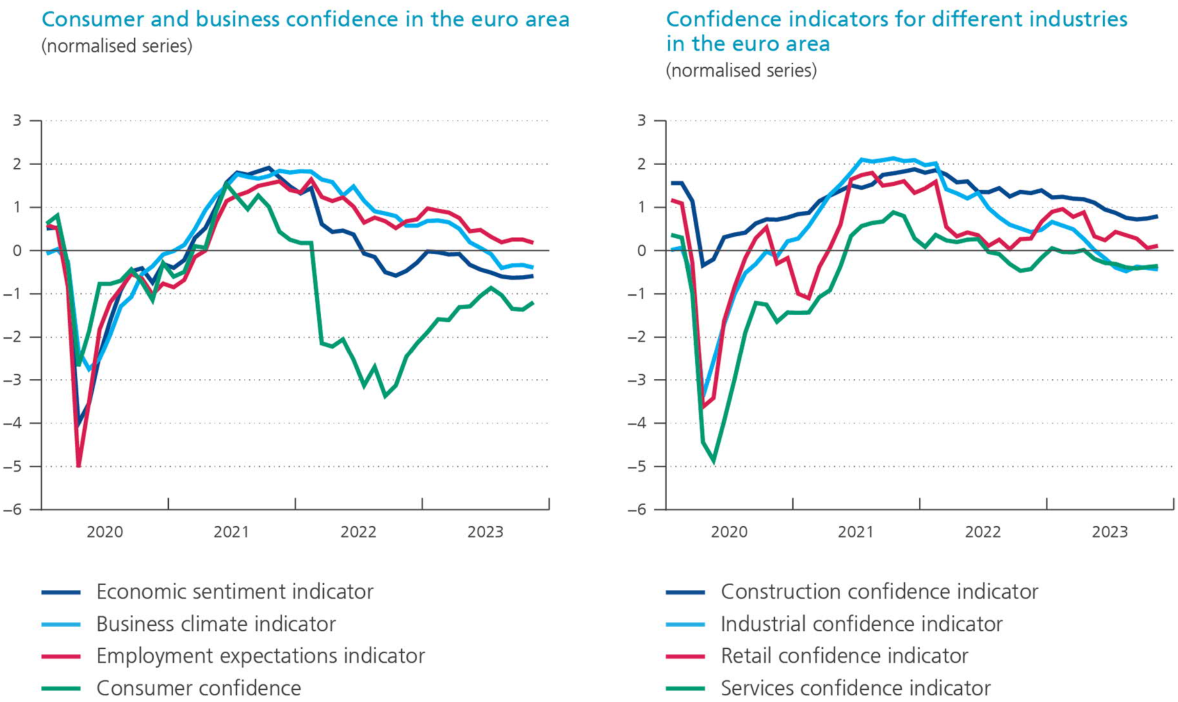
[2] The volatility in Irish GDP statistics is mostly due to operations involving intangible assets. These transactions usually do not reflect the Irish or euro area business cycle and are related to tax optimisation by large foreign-owned multinationals. See Andersson et al (2023) for a detailed discussion.

Among the major developed economies outside the euro area, the US economy accelerated, with third quarter GDP expanding by a whopping 1.3%. In volume terms, the US economy has now grown by nearly 3% over the past four quarters. On the other hand, third-quarter economic activity stagnated in the UK but, after substantial recent statistical revisions, annual growth is now 0.6%. GDP growth was negative for Japan in the third quarter, after very robust growth in the first half of 2023. All in all, growth is clearly lower in Europe than in other major advanced countries.

Soft indicators for economic activity in the euro area have worsened somewhat compared to the third quarter but could be bottoming out. The EC’s Economic Sentiment Indicator (ESI) for the euro area was up slightly in November, which can be attributed to higher consumer confidence. Euro area consumer confidence seems to have bottomed out in early autumn but remains well below its long-term average (see Figure 1). Certain business sentiment indicators suggest that firms remain cautious; the employment expectations index, reflecting employment plans of managers, edged down in November but has essentially flatlined since August. The same is true for the aggregate business climate indicator.

Figure 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.

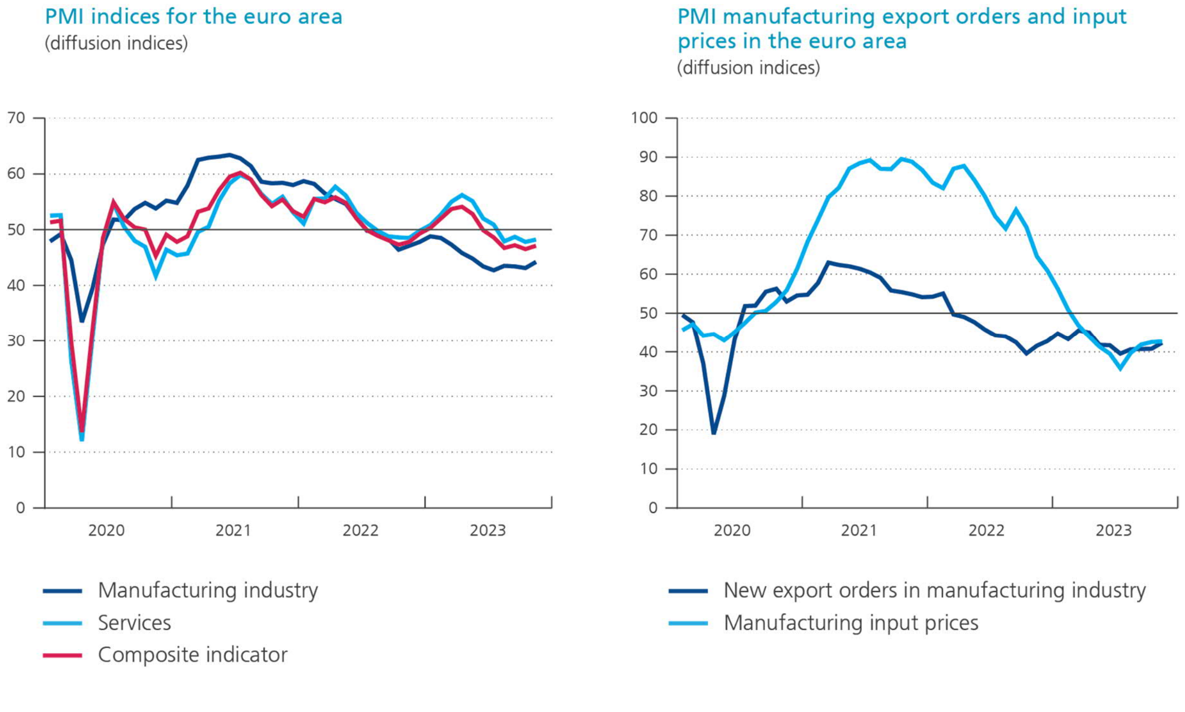
Zooming in on the synthetic business confidence indicators for the main euro area industries, confidence in the manufacturing industry has followed a downward trend since at least early 2022 but seems to have stabilised this autumn, although it edged down again in November. Overall, assessments of (export) orders in the manufacturing industry remain downbeat. The confidence indicator for the services industry bottomed out in September and has recovered somewhat since, mostly due to an improving outlook for demand. Likewise, stocks are up in the retail industry and while the recent business situation was assessed negatively, the outlook is reported to be brightening. Finally, confidence in the construction industry improved again due to higher employment expectations but managers’ assessments of order books in this industry remain bleak.

Turning to PMIs, the composite indicator for the euro area edged up slightly in November but has essentially flatlined since late summer (see Figure 2, left-hand graph). The indicator has remained at a level below 50 since June, signalling in principle that purchasing managers believe the euro area economy should continue to contract in the final quarter of 2023. This sentiment is mostly driven by feedback from purchasing managers in the manufacturing industry, with the manufacturing PMI pointing to contractionary conditions that have been reported since mid-2022 and that intensified in the first half of 2023. Sentiment in the services industries, on the other hand, continued to improve up to the summer, thereby diverging from the manufacturing industry. However, as sentiment in the services industries has eroded over the last few months, the gap between the two has narrowed substantially. Feedback from managers in the services industries currently points to a slight contraction of activity but remains much closer to neutral overall.

Input prices continue to fall (see Figure 2, right-hand graph). Nonetheless, European energy prices remain higher than before the crisis, which has weakened the cost competitiveness of European manufacturing firms. Moreover, international trade remains subdued. The new export orders PMI for the manufacturing industry reflects these unfavourable conditions and is still exceptionally low: it has been below 50 (pointing to negative growth) for almost two years now. **Overall, despite signs of a stabilisation in recent months, the sentiment indicators point to continued weakness in euro area economic activity in the fourth quarter of 2023 and growth is expected to hover around zero.**

Figure 2

PMI indices



Source: HCOB.

The Belgian economy grew by 0.4% in the third quarter

According to current statistics Belgian economic activity accelerated slightly to 0.4% in the third quarter of 2023, up from 0.3% in the second. This constitutes a slight downward revision from the earlier flash estimate but is still 0.2 percentage points higher than the September BCM estimate, which was based, however, on a now revised set of statistics with lower GDP growth in the second quarter.

As regards the demand components, our expectations in the September BCM were quite accurate. Household consumption accelerated somewhat in the third quarter while business investment expanded strongly again, albeit at a slightly more moderate pace than in the second quarter: it grew by 2.1% on a quarterly basis, raising the year-on-year growth rate to around 10%. Housing investment, on the other hand, continued to decline sharply, as anticipated. Third-quarter GDP growth was dampened by both net exports and inventories.

Public spending was also as expected. Government investment growth turned positive in the third quarter, in line with the expected boost in the run-up to local elections. Government consumption normalised and expanded at a moderate pace. It should be noted, however, that quarterly statistics on government spending in particular are prone to significant subsequent revisions.

The production approach to GDP shows that activity growth in the third quarter was again mainly driven by services, which were up by 0.7% from the previous quarter. Both market and non-market services contributed positively, with the main contribution to growth again coming from the former. Activity expanded by 0.6% in the construction industry, a surprisingly vigorous pace. Value added in the manufacturing industry, on the other hand, declined once more, marking the fourth consecutive quarter of negative growth.

Household consumption growth should edge up again in the fourth quarter

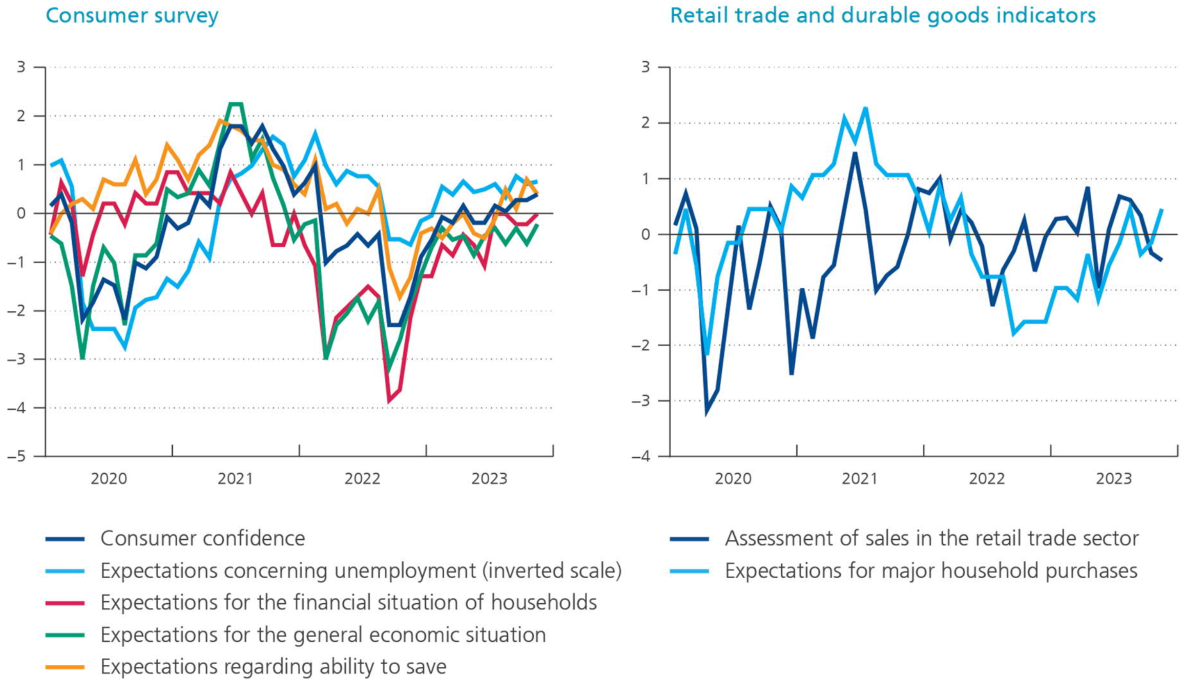
According to the latest statistics and apart from a temporary dip in the fourth quarter of 2022, household consumption has been quite buoyant since mid-2022. The growth rate moderated somewhat in the second quarter of 2023 but increased again to 0.3% in the third.

This expansion seems to be in line with the developments in overall consumer confidence, which continues to improve gradually after having recovered from the lows of autumn 2022 (see Figure 3, left-hand graph). From a quarterly perspective, the observations for October and November suggest that confidence in the fourth quarter will come in clearly higher than the third-quarter average. The overall consumer confidence reading for November shows a broad-based improvement, driven by a brightening of the consumer outlook on the general economic situation for the next twelve months and, to a lesser extent, expectations regarding unemployment and their own financial situation. Household saving expectations were the only sub-component to deteriorate in November, but were still markedly up compared with a few months ago.

The gradual improvement in consumer confidence is fuelling households' willingness to spend, as expectations of major purchases in the next 12 months are trending up (see Figure 3, right-hand graph). Survey data and business intelligence from the supply side tend to be somewhat less upbeat: in the NBB's monthly business survey, managers' assessments of retail industry sales have been softening since August. However, it should be noted that the latter indicator is particularly volatile and the synthetic curve for retail trade points to a stabilisation (see Figure 4, left-hand graph). Information from managers in retail and logistics, gathered from interviews conducted for the latest issue of NBB Business Echo (published on 4 December), also points to a slowdown in activity and some inventory build-up in non-food retail. Moreover, consumers were said to have become increasingly price-conscious. However, respondents also mentioned that at least part of the slowdown in retail is the result of a shift in spending away from goods towards services, as some post-pandemic effects continue to linger.

Figure 3

Indicators of household consumption growth
(normalised series)



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

At the same time, consumer confidence and household consumption continue to be supported by robust fundamentals. Employment growth has moderated since late 2022 but remains near its long-term average, and job creation is generally expected to continue at its current pace in the coming quarters. Moreover, households are, on average, still benefiting from the boost to their nominal income resulting from the (delayed) impact of wage indexation mechanisms, while inflation has come down rapidly. Household purchasing power growth should remain positive in the near term.

All in all, we expect household consumption growth to edge up again in the fourth quarter of 2023.

Total fixed investment growth is expected to moderate further but should remain clearly positive in the fourth quarter

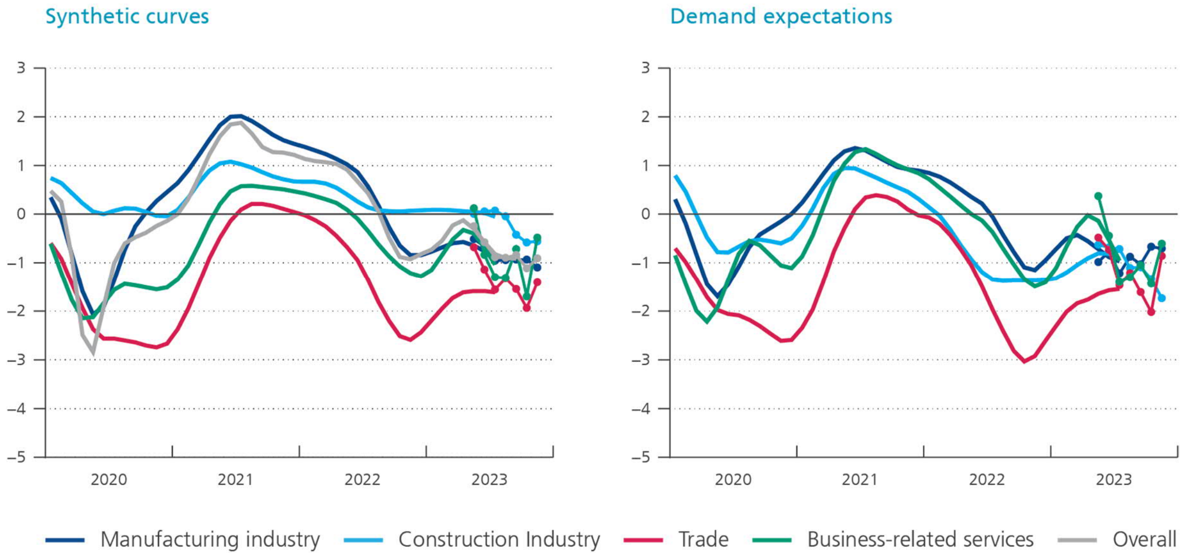
According to the most recent statistics, business investment has surged since the second half of 2022. This strong expansion is remarkable given the weakening of business confidence observed since mid-2022 (see Figure 4, left-hand graph). However, it is fully in line with business intelligence: firms report having ramped up their investment in automation and digitalisation in response to higher wage costs and a structurally tight labour market for qualified personnel, while energy price volatility and an increasingly strict regulatory environment have prompted (energy-intensive) firms to intensify the ‘greening’ of their production processes.

Business sentiment should remain broadly stable in the fourth quarter, at a level close to the trough recorded when energy prices escalated in 2022 and below both its long-term average and pre-pandemic levels. At industry level, manufacturing sentiment edged down again in November, after several stable months. Sentiment in the services industries has been volatile of late, in both business-related services and trade. The significant worsening in October was offset by a substantial improvement in November. Overall, looking beyond the volatility, sentiment in the services industries has not noticeably deteriorated in recent months. This differs from the situation in the construction industry, where sentiment came in virtually flat in November but has deteriorated markedly since mid-2023.

Turning to firms' demand expectations, the outlook in the manufacturing industry has been trending up since early autumn. The demand outlook also improved in services and trade, but deteriorated in the construction industry (Figure 4, right-hand graph). All in all, this could suggest that in most industries the economic situation is expected to improve gradually beyond the very near term. This is fully in line with information gleaned from NBB Business Echo interviews, although conditions in the current quarter were said to remain challenging.

Figure 4

Business sentiment and demand expectations
(normalised series)



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

Despite the ongoing investment drive in automation, digitalisation and the greening of production processes, business leaders interviewed for the NBB Business Echo stressed that they remained cautious regarding investments to expand production capacity. This squares with the observation from the quarterly NBB survey that production capacity utilisation in the Belgian manufacturing industry fell to 74.4% in October, its lowest level since 2020 and clearly below the long-run average of around 80%.

As regards financial conditions, the NBB's quarterly survey on the assessment of financing conditions shows that nearly 42% of businesses now perceive current credit conditions as "constrained", up from 37% in July and much higher than the figure of 10% recorded in early 2022. Current levels are in fact comparable to those last seen in the aftermath of the global financial crisis. However, although external financing conditions have become tighter, macroeconomic statistics indicate that firms generally have large cash balances (see e.g. Piette and Tielens, 2023) from which they can draw to finance investment projects. Interviews conducted for the NBB Business Echo confirm that, overall, current financing conditions are not impeding investment, except in a few specific (capital-intensive) industries, such as real estate development.

In general, **business investment growth has been remarkably buoyant recently, although we expect it to moderate in the fourth quarter while remaining clearly positive.**

According to current statistics, residential investment fell by 1.2% in volume terms on a quarterly basis. In annual terms, residential investment is down 5.5% and the short-term indicators suggest that more is to come. As noted above, demand expectations in the construction industry continue their downward trend. The November reading was at a level not seen since the aftermath of the global financial crisis and the early 1990s. Mortgage lending has plummeted. Respondents in the construction industry confirm the gloomy outlook, despite strong fundamentals for household income. **Overall, we expect residential investment to fall further in the fourth quarter of 2023.**

All in all, the expected further moderation of firm investment activity and the continued weakness in residential investment should lead total private fixed investment growth to lose some traction in the current quarter, while clearly remaining in positive territory.

After the unexpected decline in the second quarter, government investment grew by 1.8% in the third quarter. **The further roll-out of recovery plans and the regular electoral cycle should continue to boost government investment in the near term.**

Government consumption should continue to expand moderately

Government consumption growth in real terms turned positive again in the third quarter, in line with expectations. As always, it should be stressed that the quarterly statistics on demand components, for government spending in particular, are often subject to subsequent revision. **Nonetheless, we expect government consumption growth to continue its moderate expansion in the fourth quarter of 2023.**

The contribution of net exports to growth should remain negative

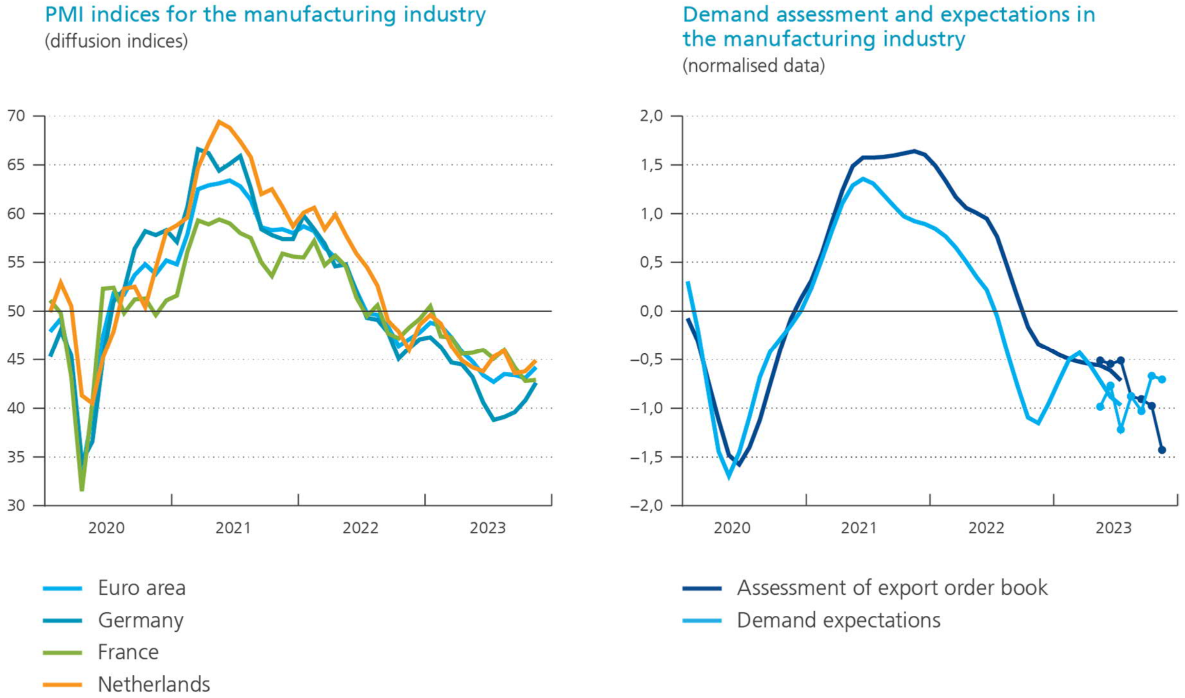
In the third quarter, both exports and imports fell markedly, the former somewhat more than the latter, resulting again in a slightly negative contribution of net exports to GDP growth, in line with our expectations.

The external environment has deteriorated in recent quarters, implying weaker foreign demand for Belgian exports. The PMI manufacturing indices for Belgium’s neighbouring countries (and main trading partners) and the euro area show a near-continuous decline since early 2021 (see Figure 5, left-hand graph). These indices entered contractionary levels around mid-2022 and hit fresh lows in the second half of 2023. Sentiment may have finally started bottoming out, as some tentative signs of improvement can be seen for the hard-hit German manufacturing industry from August onwards, while manufacturing sentiment in the Netherlands and the euro area as a whole also improved in November. Managers in the French manufacturing industry, however, were less optimistic; the index for France stagnated at its lowest level since 2020. These tentative improvements are reflected in the recent uptick in demand expectations for the manufacturing industry in the NBB’s monthly business survey (see Figure 5, right-hand graph), as well as in the information gathered from Business Echo interviews. Nevertheless, caution is warranted as manufacturing firms’ assessments of export orders remain on a downward trend and have now nearly reached the trough seen in 2020. **All in all, the outlook for exports in the fourth quarter remains weak.**

Given expectations of robust growth in consumption and investment, import growth is likely to outpace export growth once again. Hence, **net exports should continue to drag down GDP growth in the current quarter, possibly even slightly more than in the previous one.**

Figure 5

PMI indicators in neighbouring countries and export orders in manufacturing



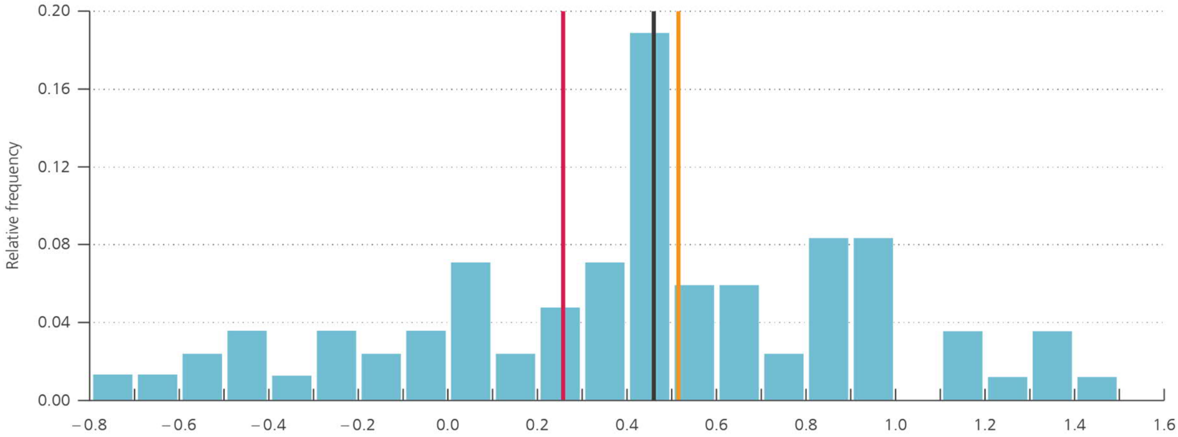
Sources: Markit, NBB.
Note: The series in the right-hand graph are normalised around their historical average and divided by their standard deviation.

The median value of the mechanical nowcasts points to broadly stable GDP growth in the fourth 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 0.46% in the fourth quarter of 2023** (see Figure 6). The range has narrowed at [-0.8;1.5] but remains skewed to the lower end, indicating that uncertainty has decreased but that downside risks predominate. 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.

Figure 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 fourth 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 could moderate but should continue to expand in the final quarter of 2023

Of the NBB's more elaborate standard nowcasting models, BREL predicts positive quarterly growth of 0.26% in the fourth quarter, while R2D2 estimates growth at around 0.51%. A preliminary estimate using an improved BREL model,[3] recalibrated to take into account the unusual volatility of the pandemic period, indicates a slightly higher growth estimate than the original vintage (but remains 0.3% in rounded numbers). As always, these model-based estimates should be complemented by information gathered from other sources, as well as expert judgment.

Despite the gradual deterioration of the external environment and higher interest rates, the recent performance of the Belgian economy has been remarkably robust. Up to the third quarter, robust domestic demand in the form of household consumption and buoyant investment spending by firms were the key drivers of solid GDP growth. The outlook for the current quarter suggests that activity should continue to expand, albeit possibly at a slightly more moderate pace as stronger household consumption growth is likely to be more than offset by further moderation in firm investment and, possibly, a more negative contribution from net exports.

All in all, we currently expect economic activity to grow by 0.3% in the fourth quarter. This is slightly below the median nowcast of the one-indicator models and near the lower end of the range provided by the two nowcasting models. The upside risks to this nowcast are mainly related to possible positive surprises from domestic demand, such as business investment maintaining its current pace or households spending more as the fall in inflation boosts their purchasing power. A stronger (impact of the) worsening in the economic situation in neighbouring countries constitutes a – limited – downside risk. Beyond the near term, it should be stressed that certain forward-looking survey indicators are bottoming out or improving, which could point to higher growth as from the beginning of 2024. A recession in the near term still seems highly unlikely based on current information.

[3] Further analysis on the robustness of this improved model is needed. We expect a technical Working Paper on this subject to be published in the first half of 2024.