

Economic projections for Belgium – Spring 2016

Introduction

For some time now, the world economy has regularly experienced phases of intense economic and financial turbulence which frequently originate from the situation in emerging countries. That was the case, for instance, in the summer of 2015, but also after the closure of the Bank's latest autumn projections, when the global economy again appeared to falter, reproducing a now familiar scenario. There was mounting concern over the scale of the growth slowdown and the level of debt in a number of emerging economies, headed by China. That situation triggered a renewed fall in commodity prices, particularly the prices of petroleum products. The growing fears about the world economy subsequently spread to the financial markets, where a more marked risk aversion, particularly at the beginning of the year, again resulted in relatively high volatility. While the emerging countries' currencies continued to depreciate, stock markets plunged worldwide, following a partial recovery in the autumn of 2015. Moreover, investors' search for secure assets reinforced the downward trend in interest rates on government bonds in the advanced economies. In the euro area, that financial volatility was further heightened by renewed concern over the resilience of certain financial institutions.

Fears of a further appreciation of the US dollar following the start of the process of normalising interest rate policy in the United States in December 2015 also cast a shadow over this picture: as emerging countries' debts are often denominated in dollars, some observers feared that a higher dollar would render that debt even more untenable, unleashing a severe debt crisis which could develop into another deep global recession. At the start of the year, confidence indicators therefore fell and growth estimates were revised downwards, as is evident for instance from

the update of the Eurosystem's December forecasts for the euro area, published by the ECB in March.

Furthermore, the trade intensity of world growth remained surprisingly low. Following a limited recovery in the third quarter, the growth of world trade – and hence the growth of foreign demand for European exporters – slowed sharply again at the end of 2015. Over 2015 as a whole, the euro area's foreign markets ultimately expanded by barely 0.6%, well short of the figure for world growth excluding the euro area. One reason being the marked decline in demand for imports from China, Russia, Brazil and other emerging countries. In the advanced countries, too, growth seemed to stall at the end of the year. According to the statistics for the first quarter of 2016, the US economy hardly expanded at all, while growth in Japan was particularly feeble and fragile, with a further contraction in the final quarter of last year.

However, the concern over global growth gradually subsided, and the financial markets and oil prices began to pick up from mid-February. In the euro area, the first monthly data, including those relating to industrial output and retail sales at the start of the year, suggested that the underlying economic situation was better than the financial markets and confidence indicators implied. That was borne out by the quarterly statistics published by Eurostat at the end of April: after losing ground during 2015, the growth of activity in the euro area strengthened in the first quarter of 2016 compared to the previous quarter, to reach 0.5%. For the first time in a long while, the euro area recorded stronger growth than most other developed economies, including the United States and the United Kingdom. According to initial indications, the strength of domestic demand was the main factor underpinning the European economies, compensating for the weak net exports. Moreover, there was a surge in consumption by both

households and governments, while in some countries, investment also recorded relatively vigorous growth.

Although the projections concerning foreign demand are relatively comparable, the Eurosystem's new spring forecasts comprise a significant upgrading of the interim estimates produced by the ECB in March 2016, partly on account of the good start to the year. The present projections are very similar to the latest Eurosystem autumn forecasts, certainly for 2016.

In Belgium, there has been little change in the policy environment since the autumn projections. The measures adopted at the time of the spring budget reviews were incorporated in these new projections, but generally have a relatively minor effect on the economy. The index jump ended as expected in the early spring, bringing the return of wage indexation in accordance with the system specific to each branch of activity. For the year 2018, included in the projection period for the first time, a further expansion of the tax shift measures was taken into account, and in particular the additional reduction in personal income tax and employers' social security contributions.

However, one of the main exogenous factors affecting activity in the short term concerns the threat of terrorism looming since the Paris attacks in November 2015 and culminating in the attacks on Belgium's national airport and the Brussels metro system on 22 March 2016. While it is not easy to quantify the precise impact of such factors on the economy, isolated terrorist attacks do not usually have any significant macroeconomic repercussions in the advanced countries. All the same, the terrorist threat which has been present for several months does seem to be affecting the Belgian economy in this instance. That is due mainly to the sharp decline in the number of foreign tourists and business travellers coming to Belgium since the Paris attacks, and the significant security measures implemented subsequently in the Brussels-Capital Region. That implies a substantial fall in revenue from tourism, particularly for firms in the hotel and restaurant sector. That diminished growth in the first quarter by an estimated 0.1 percentage point – putting Belgium's growth 0.2% below the euro area average – and could continue to depress activity in the second quarter.

Nonetheless, the present projections concluded on 19 May 2016 indicate annual growth of 1.3% in 2016, the same figure as in the latest autumn projections. That is because the negative impact of the terrorist threat and the slightly less favourable technical and external assumptions underlying the Eurosystem's estimates – the main ones being described in box 1 in this article – are offset by a favourable level effect due to the stronger growth in the final quarter

of 2015. Indeed, the NAI recently upgraded that figure in view of a marked expansion of activity in the energy sector which was not taken into account in the autumn projections or in previous editions of the NAI's quarterly accounts. In 2016, the Belgian economy should therefore expand at a rate very similar to that recorded in the two preceding years. According to the present projections, growth is set to remain modest in the current quarter, owing to the depleted flow of tourists, but is expected to pick up in the second half of the year partly thanks to the combined effect of rising global demand and better cost competitiveness resulting from the wage moderation policy. Annual growth is therefore estimated at 1.5% in 2017, much the same as in the autumn projections, and is put at a slightly higher figure in 2018. In that connection, attention should be drawn to the wide margin of uncertainty inherent in estimates for later years. Apart from the stronger export growth, increased investment and higher household consumption driven by rising incomes are likely to contribute to the acceleration of activity in the two subsequent years.

The labour market recovery remains robust, and is clearly due to the labour cost moderation policy and the structural reforms on the labour market. According to the latest statistics, the expansion of domestic employment will even exceed the estimates in the autumn projections, although that is offset by the average working time remaining somewhat below the figure in the projections. Over the three-year period from 2016 to 2018, the stronger growth should help to create almost 140 000 additional jobs. Although the participation rate is still rising and the population of working age continues to grow faster than expected owing to the relatively large number of asylum seekers, that job creation is still well in excess of the growth of the labour force. The unemployment rate should therefore decline gradually to around 7.8% in 2018, comparable to the rate prevailing just before the great recession.

Inflation continued to rise in the initial months of the year. The annual average inflation in 2016 will be much higher than last year's figure. Although that is due primarily to the upturn in oil prices, core inflation also remains surprisingly strong, despite the steady reduction in unit labour costs since 2013. While that increase partly represents a normal restoration of corporate profit margins, it also tempers the positive impact on growth of the improvement in cost competitiveness and employment. Moreover, given that the wage indexation mechanisms are now back in operation, the fact that Belgium has an inflation rate considerably higher than that of other euro area countries is liable to trigger a relatively steeper rise in labour costs in Belgium, and cause a renewed deterioration in competitiveness. According to the projections, inflation should continue rising to just below 2% in 2018, mainly as a result of higher

labour costs. As regards negotiated wages, in the absence of a central wage norm for the next two years, it was assumed that real growth would come to 1% in 2018, against the backdrop of strengthening growth and an increasingly tight labour market.

Turning to public finances, the budget deficit is unlikely to diminish before 2017. At the end of the projection period, the deficit is estimated at 2.4%, a long way from the targets set in the stability programme for the absorption of the nominal and structural deficits. In 2018, the public debt is expected to be almost as large as in the previous year. In this connection, it should be remembered that, in accordance with the rules applicable to the Eurosystem projection exercises, the forecasts only take account of measures which have been formally adopted by the government – or which are very likely to be approved – and are specified in sufficient detail on the cut-off date for the exercises. Moreover, the estimates of the budgetary impact of certain measures, such as those relating to fraud prevention, may deviate from the amounts included in the budget.

1. International environment and assumptions

1.1 World economy

During 2015, the world economy continued to recover, albeit in an uncertain environment; growth remained uneven and fragile, dropping to 3.0%, after 3.3% in 2014. In the advanced countries, activity continued to strengthen, yet it remained more vigorous in the Anglo-Saxon countries than in the euro area, and especially Japan. At the end of 2015, however, signs of weakening emerged: while the accommodative monetary policies and the fall in oil prices continued to support domestic demand, the increasing weakness of foreign demand ultimately had a greater impact on the ongoing recovery. In contrast, in the emerging countries, especially China, the economic slowdown was confirmed in 2015.

The loss of momentum in the Chinese economy constrained activity in the other emerging countries. In addition, the lower commodity prices and tighter financing conditions – due partly to the normalisation of American monetary policy – also hampered their activity. However, the situation was very heterogeneous. Russia and Brazil were in a deep recession, and several other commodity-exporting countries also encountered mounting difficulties. Conversely, growth remained more robust in other countries such as India. Throughout 2015, the financial markets suffered regular episodes of volatility, reflecting

concerns over the sluggish activity in the emerging economies, especially China. During the summer of 2015, there was a sudden surge in market jitters following the measures taken by the Chinese authorities to curb the risky investment behaviour in the shadow banking sector, and the announcement by the People's Bank of China of an adjustment to its exchange rate policy. Those fears triggered increasing volatility on the international financial markets, with falling share prices, declining capital flows to the emerging economies, a tightening of their financial conditions (against the decline in yields on government bonds in some advanced countries, considered as relatively safe investments) and a depreciation of the currencies of certain emerging countries. From the end of 2015 to mid-February 2016, a new period of intense volatility was sparked once again by growing fears of a disorderly and unexpectedly sharp slowdown in the Chinese economy, but also by the gloomier outlook for other economies and the persistently weak oil prices and their ensuing implications for the exporting countries, interpreted as a sign of a more anaemic world economy.

Fears of a further deterioration in the economic situation in the emerging countries continued to oppress the financial markets in the initial weeks of 2016, but those fears as yet appear to be unfounded. In the first quarter of 2016, China's growth likely remained more or less stable. That soft landing scenario is underpinned by the adoption of fiscal and monetary support policies. In Russia, thanks to the rise in commodity prices this year, the initial data indicate a diminishing contraction, whereas in Brazil the political uncertainty continues to erode confidence. Although vulnerabilities and persistent adverse winds are still hindering the emerging economies – China's high debt level remains a risk factor – it seems that the heightened fears at the beginning of 2016 were exaggerated; positive signs were therefore seen on the financial markets from mid-February 2016. Risk aversion diminished, the financial markets recovered and made up part of the earlier losses, and yields on government bonds of the advanced countries edged slightly upwards. Oil prices rose and the exchange rates of some emerging countries recovered. In China, the renminbi stabilised and the capital outflows eased, partly on account of the new macroeconomic data which reinforced the soft landing scenario.

Over 2015 as a whole, international trade in goods and services slackened pace, held back by declining imports on the part of several emerging countries. In China, the excess capacity in industrial production and in the property sector, and the beginnings of a shift in activity towards the services sector led to a slowdown in investment, which is relatively import-intensive. In other emerging countries, imports were curtailed by the currency depreciation and by weakening or even declining domestic demand, attributable

in particular to meagre investment. In the initial months of 2016, the growth of world trade seems to have stabilised at a relatively low level.

In contrast to the picture in the emerging economies, growth in the advanced countries strengthened somewhat in 2015. In the United States, growth remained vigorous, driven by domestic demand, particularly private consumption which remains anchored by sound fundamentals such as job creation, the rise in real wages and the increase in households' net assets. Conversely, the loss of price competitiveness due to the dollar's appreciation depressed exports. Moreover, investment in the energy sector declined. Since the end of 2015, growth has slowed sharply and, according to the latest quarterly statistics, it dropped to 0.8% year-on-year in the first quarter of 2016. Apart from the increase in the negative contribution of foreign trade, the loss of momentum is essentially attributable to domestic demand: while household expenditure – particularly investment in housing – has proved relatively resilient, investment excluding housing, relating to commodity extraction and productive investment in other sectors, depressed the growth pace.

In Japan, although the recovery seemed to be making progress from the beginning of 2015, activity ultimately contracted at the end of the year. The slowdown in China and in other Asian economies to which Japan has a substantial exposure had an adverse effect on the country's exports and hence on its manufacturing industry. Moreover, despite an extremely tight labour market, private consumption declined. But in the first quarter of 2016, growth surprisingly returned to slightly positive territory, thanks to a rebound in private consumption and exports.

During 2015, growth in the euro area showed signs of weakening as a result of the worsening external environment. Growth was again underpinned by domestic demand. The strengthening in private consumption was driven by the increased purchasing power of households, following the decline in energy prices and the improvement on the labour market. Conversely, the investment revival was rather hesitant overall. While highly favourable financing conditions were a supporting factor, the uncertainty and – in some Member States – the need for further debt reduction hindered investment decisions. Following a gradual slackening of the pace of economic growth in 2015, the initial data indicate an acceleration in the first quarter of 2016 (0.5% quarter-on-quarter). On the labour market, the situation continued to improve up to the beginning of 2016. Job creation increased in parallel with the growth recovery and was supported – in some countries – by fiscal and structural measures and wage moderation. The unemployment rate gradually subsided though it remained at a high level, comparable to the 2011 figure.

The recovery in the euro area in 2015 was geographically more broad-based. With the exception of Greece, which went back into recession in the middle of the year, it was mainly some of the peripheral countries that produced the strongest growth, bolstered by the improvement in the labour market and the recovery in other advanced economies outside the euro area, but also by the impact of the structural reforms and adjustment programmes which had been implemented. In the core euro area countries, growth in both Germany and France was driven by dynamic private consumption, while foreign trade did little to provide sound support for growth. In Germany, public consumption was also robust, partly thanks to the expenditure associated with the inflow of migrants, and investment spending as well. Conversely, in France the contraction in the construction industry offset the positive contribution from other investment.

Inflation in the euro area, which has been falling since 2011, reached a trough in January 2015, subsequently hovering erratically around slightly positive levels. Over 2015 as a whole, inflation thus stood at zero. From February 2016, inflation became negative again as a result of the persistent decline in oil prices and new negative base effects plus the recent appreciation of the euro.

In 2015 and up to the beginning of 2016, while the currencies of the advanced countries appreciated overall, those of various emerging countries and commodity exporters tended to depreciate. The currency movements in the advanced countries also reflected expectations regarding various new monetary policy measures. The euro depreciated further against the US dollar in the period preceding the monetary policy decisions taken on either side of the Atlantic in December 2015, with the first increase in the policy interest rate by the Federal Reserve and the six-month extension of asset purchases by the ECB. In March 2016, the ECB announced the adoption of new monetary easing measures. All key interest rates were cut again. The Governing Council also decided to increase the monthly purchases of assets under the Asset Purchase Programme (APP), raising them to € 80 billion (compared to the previous figure of € 60 billion) and to include in the eligible assets, from the end of the second quarter of 2016, certain bonds issued by non-financial corporations. Finally, a new series of four targeted longer-term refinancing operations (TLTRO II) will be launched between June 2016 and March 2017. In view of the troubled market climate, the uncertainty relating to the emerging countries, and the mixed macroeconomic data in the United States, the American monetary authorities urged a cautious approach to future interest rate rises, and opted to normalise their policy more slowly than expected. At its meeting on 27 April 2016, the Federal

Reserve therefore left its monetary policy unchanged, although it did not rule out an interest rate rise later in the year.

A reappraisal of the divergence between American and European monetary policies following the decisions taken since December 2015 seems to have contributed to the recent appreciation of the euro against the US dollar. The euro has besides clearly appreciated in effective terms since December 2015.

The Brent price, which had maintained a downward trend since mid-2014, reached a trough in January 2016 at just under \$ 30 per barrel and had subsequently climbed to almost \$ 48 at the end of May. While the oil supply is still in surplus, a number of factors have

tended to moderate it recently. Output has fallen as a result of the disrupted production in Iraq, Nigeria and the United Arab Emirates. In February, four of the leading OPEC countries – Saudi Arabia, Qatar, Russia and Venezuela – announced that they were freezing their production at January 2016 levels. In countries outside OPEC, such as the United States, Brazil and China, the provisional figures for January and February 2016 also indicate a decline in their output; moreover, in Canada, the forest fires in the Alberta region in May 2016 would also have affected almost half of its production capacity. Nevertheless, oil prices are still very jittery in view of the great uncertainty over future developments, such as the additional supply expected to come from Iran, the level of which is unknown. The prices of other non-oil commodities followed suit and likewise increased.

TABLE 1 PROJECTIONS FOR THE MAIN ECONOMIC REGIONS

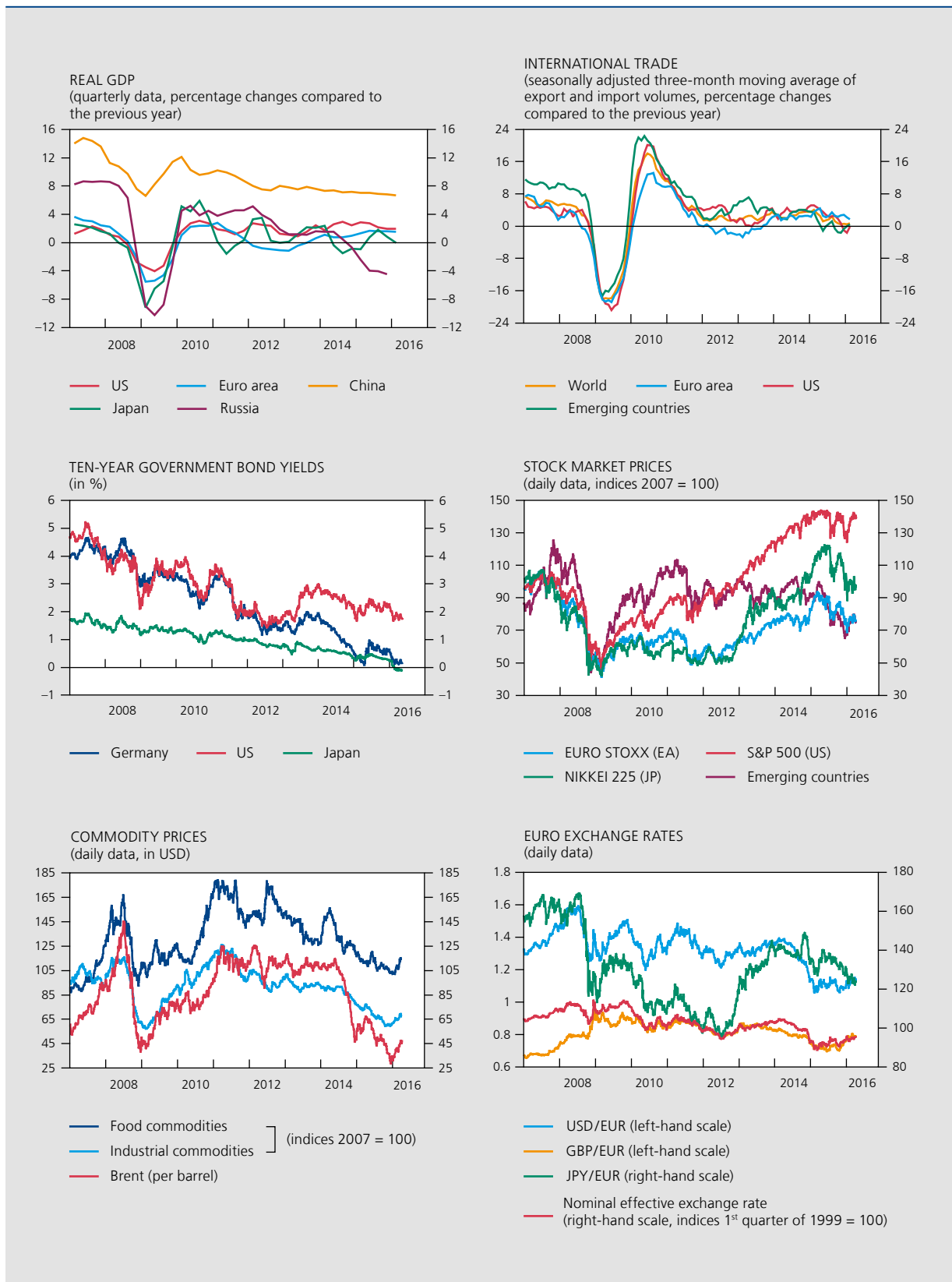
(percentage changes compared to the previous year, unless otherwise stated)

	2014	2015	2016 e	2017 e
	Actual figures		Projections	
Real GDP				
World	3.3	3.0	3.1	3.4
of which:				
Advanced countries	1.8	2.0	2.0	2.0
United States	2.4	2.4	2.3	2.2
Japan	0.0	0.5	0.8	0.4
European Union	1.4	1.9	1.8	1.9
Emerging countries	4.5	3.8	3.9	4.4
China	7.3	6.9	6.5	6.2
India	7.1	7.3	7.4	7.4
Russia	0.6	-3.7	-1.9	0.5
Brazil	0.1	-3.8	-3.7	0.3
<i>p.m. World imports</i>	3.4	2.3	2.9	4.0
Inflation⁽¹⁾				
United States	1.6	0.1	1.2	2.2
Japan	2.7	0.8	0.0	1.5
European Union	0.5	0.0	0.3	1.5
China	2.1	1.7	2.5	2.5
Unemployment⁽²⁾				
United States	6.2	5.3	4.8	4.5
Japan	3.6	3.4	3.4	3.3
European Union	10.2	9.4	8.9	8.5

Sources: EC, OECD.

(1) Consumer price index.

(2) In % of the labour force.



Sources: CPB Wereldhandelsmonitor, OECD, Thomson Reuters Datastream.

Box 1 – Assumptions adopted for the projections

The macroeconomic projections for Belgium described in this article form part of the joint Eurosystem projections for the euro area. That projection exercise is based on a set of technical assumptions and forecasts for the international environment drawn up jointly by the participating institutions, namely the ECB and the national central banks of the euro area.

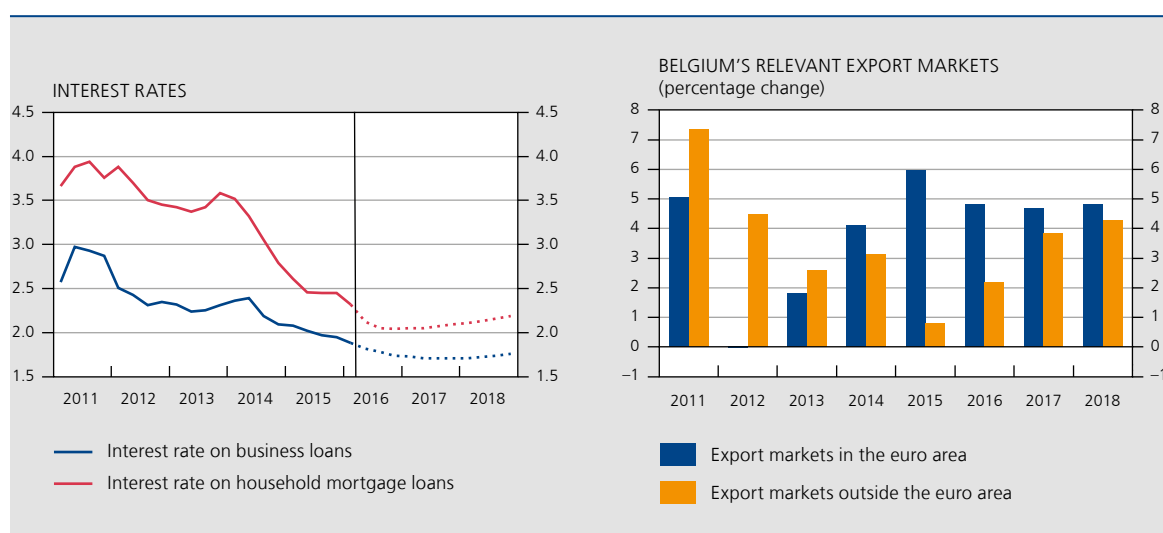
In the projections, it is assumed that future exchange rates will remain constant throughout the projection period at the average levels recorded in the last ten working days before the cut-off date of the assumptions, i.e. 11 May 2016. In the case of the US dollar, the exchange rate then stood at \$ 1.14 to the euro.

As usual, the assumptions concerning oil prices take account of market expectations as reflected in forward contracts on the international markets. In mid-May 2016, following the almost continuous decline which had begun in the autumn of 2014, the markets expected to see the price per barrel of Brent begin rising gradually over the projection horizon, from an average of \$ 35 in the first quarter of 2016 to around \$ 52 in the last quarter of 2018. Once again, this implies a substantial downward revision compared to the assumptions for the autumn 2015 projections.

The interest rate assumptions are likewise based on market expectations in mid-May 2016. The three-month interbank deposit rate is projected at –20 basis points in the first quarter of this year and is actually likely to dip a little further after that before gradually moving back up to around –20 basis points by the end of the projection period. The level of Belgian long-term interest rates is projected to rise more sharply from 0.6 % in the first quarter of this year to 1.1 % on average in 2018.

INTEREST RATES AND VOLUME GROWTH OF EXPORT MARKETS

(in %)



Source: Eurosystem.

However, the predicted movement in bank interest rates on business investment loans and household mortgage loans may diverge somewhat from the movement in market rates. For instance, the average mortgage interest rate is historically low, on account of the particularly accommodative monetary policy of the ECB and the resulting abundant liquidity and is unlikely to track the upward movement in long-term market rates and will probably remain fairly steady over the whole of the projection period. The average interest rate on business loans, which is closer to the short-term segment, is also expected to remain relatively constant over the projection period: at the end of 2018, it is forecast at below 1.8 %, which is actually lower than the current rate.

The outlook for global economic growth excluding the euro area has clearly worsened since the autumn projections published in December 2015, in both the advanced and the emerging economies. Moreover, the recent sluggishness of international trade mentioned above has led to a new downward revision of the trade intensity of world growth for 2016. That has a particularly adverse effect on the growth of foreign markets outside the euro area, which is therefore predicted to remain very weak in 2016, following the record low level in 2015. Overall, the growth of the foreign markets relevant for Belgian exports should continue to strengthen steadily over the projection period, to reach 4.6 % in 2018.

The trend in Belgian exports is determined not only by the growth of those markets but also by the movement in market shares, and consequently by Belgium's competitiveness. The prices that competitors charge on the export markets are a key factor in the cost aspects of that competitiveness. Partly as a result of the euro's recent appreciation, competitors' euro-denominated prices on the export markets are expected to fall by 2.9 % in 2016, whereas they had risen further in 2015 as the euro became cheaper. Assuming that the exchange rate remains constant, rising inflation in the euro area – but also elsewhere – will gradually lead to renewed upward pressure on the prices of Belgian exporters' competitors in the years ahead.

EUROSYSTEM PROJECTION ASSUMPTIONS

(in %, unless otherwise stated)

	2016	2017	2018
		(annual averages)	
EUR/USD exchange rate	1.13	1.14	1.14
Oil price (US dollars per barrel)	43.4	49.1	51.3
Interest rate on three-month interbank deposits in euro	-0.25	-0.30	-0.25
Yield on ten-year Belgian government bonds	0.6	0.8	1.1
Business loan interest rate	1.8	1.7	1.7
Household mortgage interest rate	2.1	2.1	2.1
		(percentage changes)	
Belgium's relevant export markets	3.7	4.3	4.6
Export competitors' prices	-2.9	2.2	2.1

Source: Eurosystem.

Overall, the adjustment of the assumptions compared to those of the latest autumn forecasts has a minor negative impact on Belgium's growth prospects, as the downward effect of the less favourable international environment and the more expensive euro is only partly offset by the slightly lower level of interest rates and the downward adjustment of oil prices.

1.2 Estimates for the euro area

The Eurosystem's spring forecasts for euro area growth in 2016 are considerably more optimistic than the ECB's March 2016 estimates. Given the strong start to the year, annual growth is predicted at 1.6%, equalling last year's figure. This new estimate is very similar to the Eurosystem's previous autumn projections. The less favourable external environment is the main reason why growth is likely to be slightly weaker than those projections predicted for next year. The economy of the euro area is expected to continue growing at more or less the same pace in 2018.

In that respect, the recovery is still supported by favourable basic conditions such as a relatively cheap euro and low interest rates encouraged partly by monetary policy. The weakening of external demand is likely to continue depressing net exports' growth contribution in 2016, but will be offset by a strong rise in domestic demand, driven not only by private consumption but also by investment. However, domestic demand is set to weaken somewhat during the projection period, partly as a result of rising oil prices. Taking account of the estimated global growth rate, that should nevertheless be offset by strengthening foreign demand. That should eliminate the negative growth contribution of net exports so that economic growth remains fairly stable.

Last year, annual inflation in the euro area dropped to zero. Over the projection period, the recent and expected movement in the oil price should have a major impact on inflation, which is expected to rise sharply from 2017. Core inflation, i.e. inflation excluding its volatile components, should also gradually rise, propelled mainly by the wage growth resulting from the continuing recovery of the economy and the labour market. In 2018, however, inflation excluding its volatile components should still remain well below 2%.

During the recent period, employment has expanded strongly: compared to the growth of activity, the recent labour market revival has actually exceeded expectations based on historical elasticities. Although cyclical shifts towards labour-intensive sectors of activity contributed to that recovery, the main factors are the structural reforms in certain countries and the continuing wage moderation. According to the estimates, employment should continue to expand by around 1% per annum during the projection period; however, the ratio between the growth of employment and the growth of activity should gradually revert to its historical level. For the euro area as a whole, the unemployment rate is forecast to continue falling, though it is still estimated at 9.5% in 2018, roughly the level reached in 2009.

TABLE 2 EUROSISTEM PROJECTIONS FOR THE EURO AREA

(percentage changes compared to the previous year, unless otherwise stated)

	2016 e	2017 e	2018 e
Real GDP	1.6	1.7	1.7
Household and NPI final consumption expenditure	1.9	1.7	1.5
General government final consumption expenditure	1.5	0.8	0.9
Gross fixed capital formation ...	3.2	3.4	3.3
Exports of goods and services ..	3.2	4.2	4.4
Imports of goods and services ..	4.7	4.7	4.8
Inflation (HICP)	0.2	1.3	1.6
Core inflation ⁽¹⁾	1.0	1.2	1.5
Domestic employment	1.1	0.9	0.9
Unemployment rate ⁽²⁾	10.2	9.9	9.5
General government financing requirement (–) or capacity ⁽³⁾ ...	–1.9	–1.7	–1.4

Source: ECB.

(1) Measured by the HICP excluding food and energy.

(2) In % of the labour force.

(3) In % of GDP.

The average budget deficit in the euro area is set to fall sharply to 1.4% of GDP in 2018. That improvement is due solely to the upturn in economic activity and the continuing fall in interest charges as a result of the unusually low interest rates. Conversely, the fiscal policy stance will ease slightly in 2016, though that is attributable largely to higher expenditure on taking in refugees. The public debt ratio is expected to continue falling, albeit slowly, dropping to 5.5 percentage points below its 2014 peak by the end of 2018.

2. Activity and demand

The growth of activity in Belgium strengthened significantly during the final quarter of 2015. While the previous quarterly statistics tallied entirely with the Bank's autumn projections, a substantial increase in the energy sector's activity prompted the NAI to revise quarterly growth upwards (to 0.5%) at the end of April. As the autumn projections had anticipated, economic growth came to 1.4% for 2015 as a whole.

However, the upward revision of the growth figure in the last quarter of last year had a positive level effect on the current year, thus offsetting the weaker growth recorded

in the first half of 2016. In fact, growth in the first half of the year was held back not only by the fragility of the external environment but also by the adverse impact of the terrorist threat prevailing since the Paris attacks in November 2015 and exacerbated by the March 2016 attacks in Brussels. The NAI's initial estimates confirm that situation, indicating that economic growth in the first quarter was very moderate at around 0.2%, well below the euro area average.

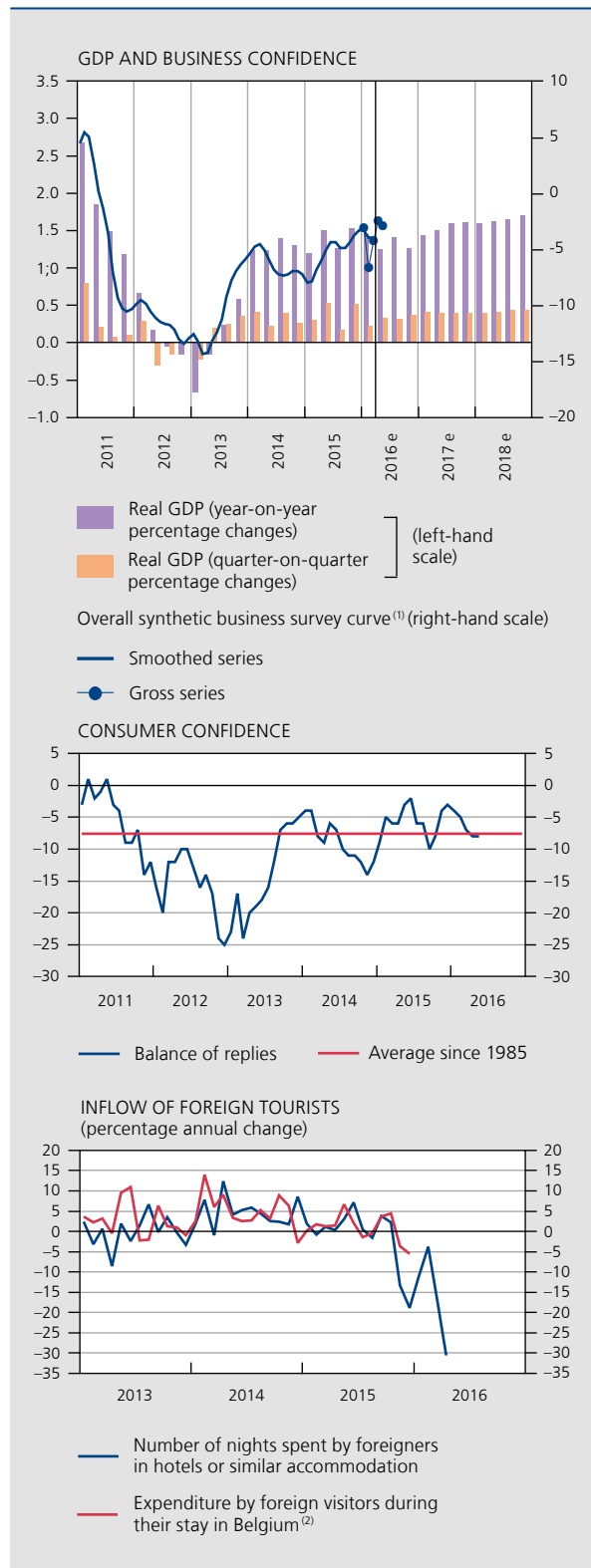
Since the attacks in Brussels did not occur until the end of the first quarter, their impact on the economy is still likely to be felt in the second quarter; it is mainly tourism that will be affected, and only to a lesser extent private consumption. Consumer confidence has dipped again since April, even falling for a time below its long-term average. However, comparison with the confidence indicators of other countries similarly affected by terrorist attacks (such as Spain in 2004, the United Kingdom in 2005 and France in 2015) shows that consumer confidence generally recovers very quickly after the attacks. Moreover, Belgian business confidence strengthened further after the attacks. Much more than domestic demand, exports, and more particularly income from tourism, have suffered from the attacks which have furthermore also caused prolonged disruption to activity at the national airport, a key point of entry to Belgium. Since the Paris attacks in November 2015 and the ensuing heightened terrorist alert leading to major security measures in the Brussels-Capital Region, the number of tourists and business travellers coming to Belgium has fallen significantly. The decline in the number of tourists is also reflected in the relatively low hotel occupancy rate, especially in Brussels, in the first half of the year.

In these circumstances, current estimates predict very slow quarterly growth in the second quarter of 2016. However, as a result of the 2015 level effect, year-on-year growth should still reach 1.3% in 2016, in line with the autumn projections. On an annual basis, economic growth is expected to continue rising to 1.5% and 1.6% in 2017 and 2018 respectively.

As in the recent past, and as expected until a short while ago, domestic demand will be the main engine of growth, but not the only one, during the rest of the projection period. In 2017 and 2018, the growth contribution from domestic demand (excluding the change in inventories) will rise further to 1.5 and 1.6 percentage points respectively. Although it is possible that, in the immediate future, firms may reduce their stocks more slowly or speed up their stock-building, in accordance with the technical assumptions made for all the quarters in the projection period, changes in inventories are as usual assumed to be growth-neutral, particularly in view

CHART 2 GDP, CONFIDENCE INDICATORS AND INFLOW OF FOREIGN TOURISTS

(data adjusted for seasonal and calendar effects, unless otherwise stated)



Sources: Eurostat, NAI, NBB.
 (1) Non calendar adjusted data.
 (2) Nominal data.

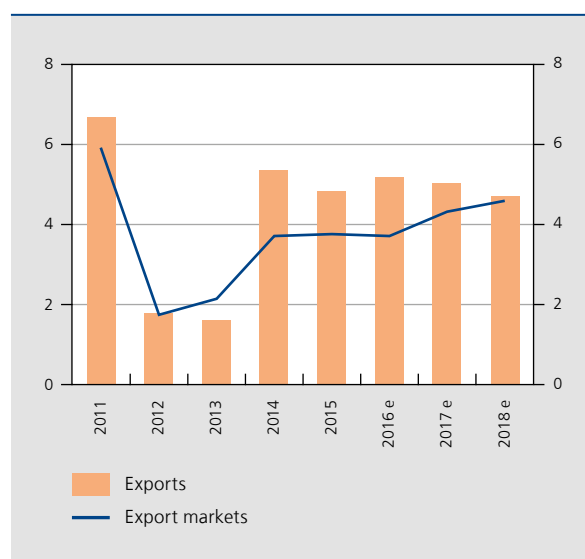
of the great statistical uncertainty surrounding that concept. Overall, the contribution of net exports to GDP growth is likely to be negligible.

Although the 2015 spillover effect still means significant year-on-year gains in market share in 2016, the decline in exports of tourism services is likely to depress exports in the first half of 2016. According to the projections, export growth should nevertheless pick up again thereafter owing to the expected recovery of the inflow of tourists, and especially the increase in global demand associated with the improvement in cost competitiveness. Overall, however, the growth contribution of net exports is likely to be relatively modest over the projection period. For one thing, the favourable effect of the euro's depreciation since the summer of 2014, which has provided a substantial boost for exports lately, is fading away as the euro has recently strengthened again slightly and, as regards the projection period, the technical assumption of a constant exchange rate applies (see box 1). Also, the resolute wage moderation seems to have had little impact so far on Belgium's export performance. Over the recent period, other euro area countries have achieved stronger (increased) gains in market share than Belgium. The reason may be that the lower labour costs have yet to be fully reflected in exporters' prices – although the recent and expected movement in the Belgian export deflator seems considerably more moderate than in the euro area as a whole – but it could also be that the price elasticity of Belgian exports is lower. Indeed, those exports consist of semi-finished products and intermediate inputs for global value chains to a greater extent than the exports of other euro area countries, which could imply lower sensitivity to changes in price. Also, as mentioned in section 4, unit labour costs are likely to rise sharply from 2017, impairing cost competitiveness and limiting the gains of export market shares at the end of the projection period.

As already stated, domestic demand is set to be the main engine of economic growth, being largely supported by private consumption and business investment. In the first half of 2016, the growth of household consumption is forecast to remain very moderate, as expected, owing to declining consumer confidence and a marked acceleration in inflation. According to the initial quarterly statistics, private consumption in volume expanded very little in the first quarter of 2016. However, from the second half of 2016, and over the projection period as a whole, this expenditure component is predicted to grow at a relatively steady rate of around 0.3% in volume per quarter. The steady expansion of the labour market and especially the bigger real pay rises from 2017 will bring an acceleration in labour incomes, the primary determinant

CHART 3 EXPORTS AND EXPORT MARKETS

(volume data adjusted for seasonal and calendar effects, percentage changes compared to the previous year)

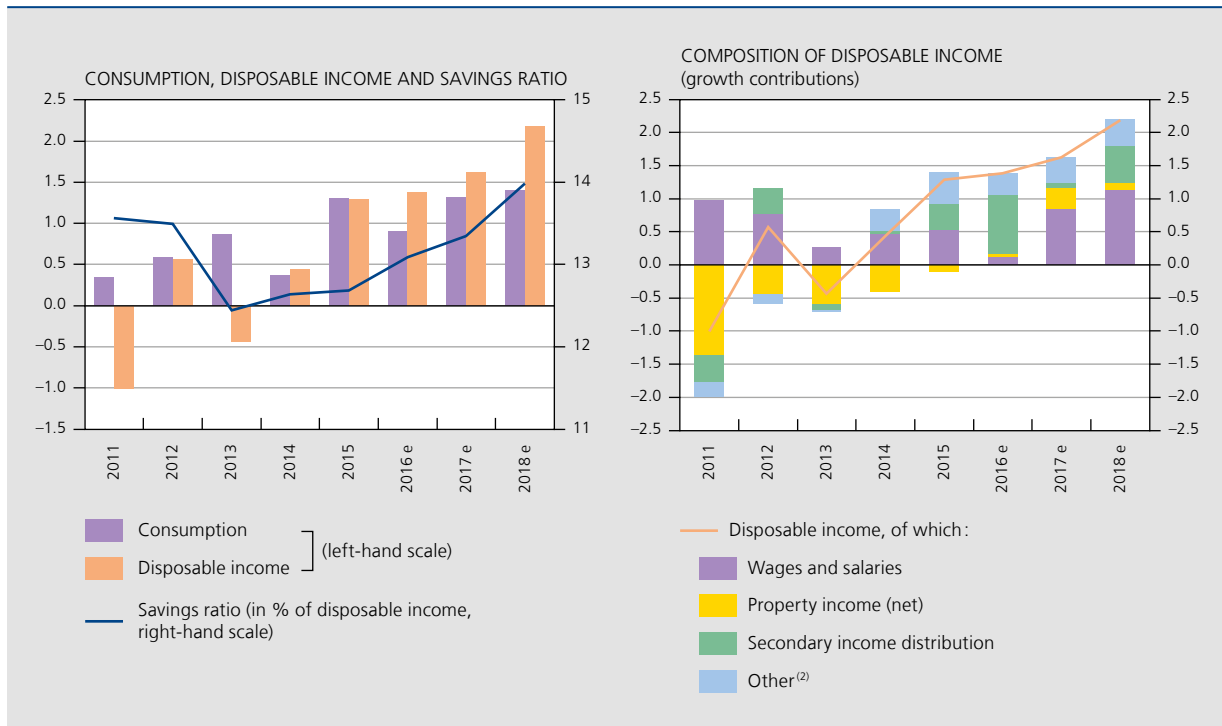


Sources: NAI, NBB.

of private consumption. Nevertheless, taking account of the smoothing of consumption over time, there will be some delay before households adjust their consumption in line with this increase in their income. The private savings ratio will therefore rise somewhat during the last two years of the projection period. Another factor being that the share of property income – more of which tend to be more saved – will increase slightly, mainly as a result of the rise in dividend income. More generally, households can be expected to use part of the increase in their disposable income to replenish their reserve savings to some extent, following serious erosion in recent years. Nonetheless, even in 2018 the savings ratio will still be well below its long-term average of 15% recorded overall between 2000 and 2015.

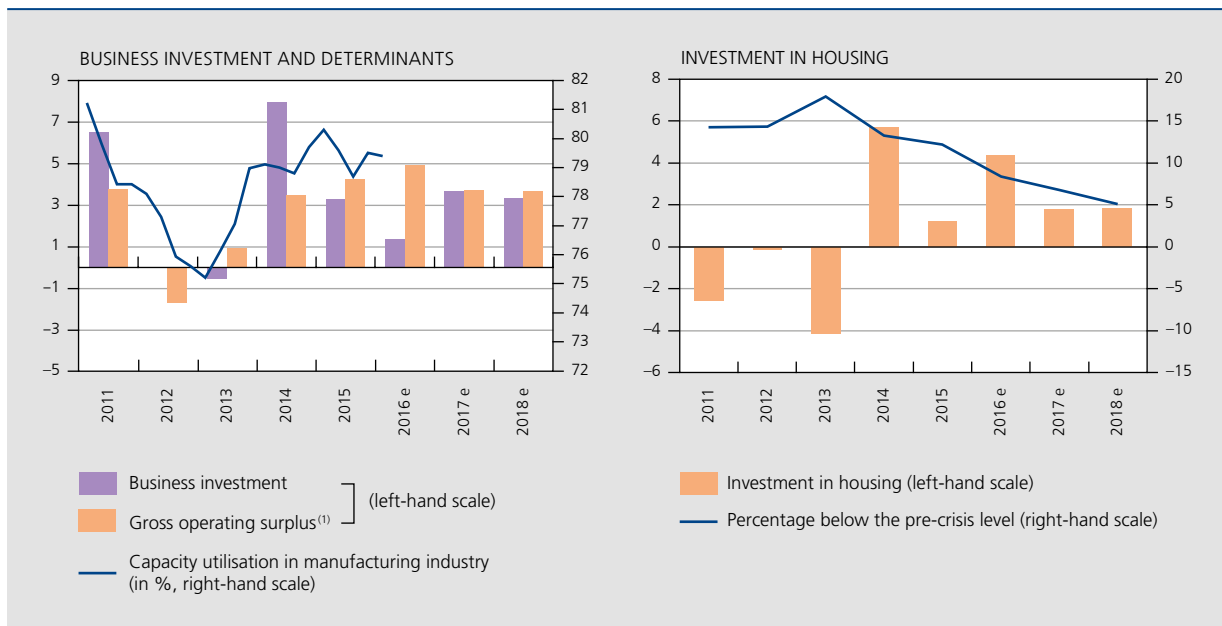
The underlying growth rate of business investment is likewise relatively steady, although it is still slightly distorted – mainly in 2016 – by specific factors which have driven up investment (and imports) in the past two years. Leaving aside those factors, business investment is set to rise gradually at an annual average rate of just under 4% in volume during the projection period. The size of the liquidity reserves, the increase in the gross operating surplus and the low interest rates and easing of financing conditions are contributing to this investment revival. In addition, capacity utilisation in manufacturing industry was recently restored to a rate close to its long-term average, so that the rise in demand will increasingly generate expansion investment.

CHART 4 HOUSEHOLD CONSUMPTION AND DISPOSABLE INCOME⁽¹⁾
 (volume data, percentage changes compared to the previous year, unless otherwise stated)



Sources: NAI, NBB.
 (1) Data deflated by the household consumption expenditure deflator.
 (2) Other⁽²⁾ comprises the gross operating surplus and gross mixed income (of self-employed persons).

CHART 5 BUSINESS INVESTMENT AND INVESTMENT IN HOUSING
 (volume data, percentage changes compared to the previous year, unless otherwise stated)



Sources: NAI, NBB.
 (1) In nominal terms.

TABLE 3 GDP AND MAIN EXPENDITURE CATEGORIES

(seasonally adjusted volume data; percentage changes compared to the previous year, unless otherwise stated)

	2014	2015	2016 e	2017 e	2018 e
Household and NPI final consumption expenditure	0.4	1.3	0.9	1.3	1.4
General government final consumption expenditure	0.3	0.2	0.8	0.5	0.6
Gross fixed capital formation	7.0	2.3	2.3	2.9	3.0
general government	3.2	-0.6	3.5	0.0	3.5
housing	5.7	1.2	4.4	1.8	1.8
businesses	8.0	3.3	1.4	3.7	3.4
<i>p.m. Domestic expenditure excluding change in inventories</i>	1.8	1.3	1.2	1.5	1.6
Change in inventories ⁽¹⁾	-0.2	0.4	0.0	0.0	0.0
Net exports of goods and services ⁽¹⁾	-0.4	-0.3	0.2	0.1	0.1
Exports of goods and services	5.4	4.8	5.2	5.0	4.7
Imports of goods and services	5.9	5.2	5.1	5.1	4.7
Gross domestic product	1.3	1.4	1.3	1.5	1.6

Sources: NAI, NBB.

(1) Contribution to the change in GDP compared to the previous year, percentage points.

While business investment exceeded its pre-crisis level some time ago, investment in housing is still well below that level. During the projection period, that shortfall is unlikely to be made up, despite strengthening growth. The strong annual rise in investment in housing in 2016 is due mainly to a spillover effect of the sharp rise in 2015. Although mortgage interest rates also remain low in real terms, while household incomes are rising and unemployment is falling steadily, the recovery of investment in housing is expected to continue being restrained somewhat by the supply shortage. The rise in demand for housing will therefore continue to focus largely on the secondary market where prices are forecast to maintain their marked upward trend.

Regarding government expenditure, the growth of public investment should receive a further substantial boost in 2016 from expenditure relating to the “*Scholen van Morgen*” project. The decline in these specific investments explains why the volume of government investment will remain practically unchanged in 2017. After that, investment is expected to begin rising again in the run-up to the forthcoming local elections. Finally, the growth of public consumption will be slightly inflated this year, notably by the exceptional expenditure incurred in addressing the terrorist threat.

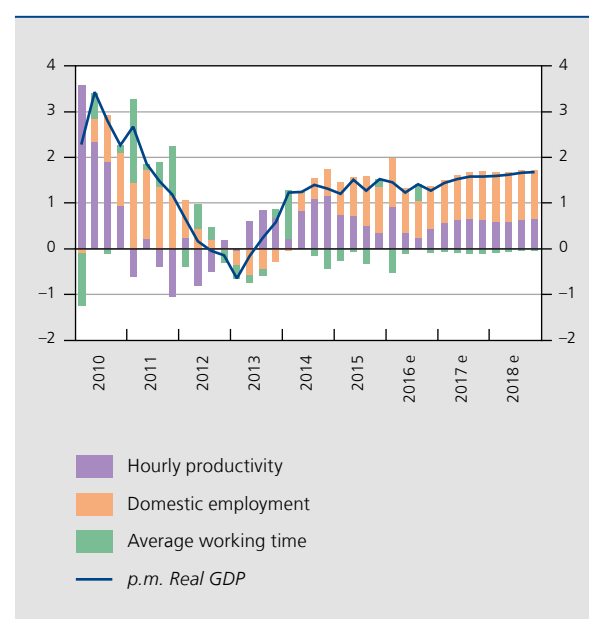
3. Labour market

Lagging slightly behind the restoration of economic growth, the employment revival which began in 2014 was

confirmed in 2015, with net job creation of more than 41 000, slightly exceeding the estimates in the latest autumn projections. The expansion of employment, likewise supported by the growth of activity, is clearly connected

CHART 6 DOMESTIC EMPLOYMENT, WORKING TIME AND PRODUCTIVITY

(contributions to annual GDP growth, in percentage points; data adjusted for seasonal and calendar effects)



Sources: NAI, NBB.

with the wage moderation policy which is making the production factor labour relatively cheaper and stimulating recruitment, but it is also due to the recent labour market reforms, including unemployment insurance.

The strong employment growth is accompanied by the recent decline in average working time, which is due to both temporary and structural factors. As regards temporary factors, the abolition in 2015 of allowances for time credit without a specific reason undeniably played a role, as anticipation effects probably led to an increase in this form of time credit in the first half of 2015. The number of persons receiving a time credit, with or without an allowance, thus rose by 7.3 % in 2015. Most of that rise concerned 20 % reductions in working time. The security measures in response to the terrorist threat, and especially the lock-down following the November 2015 attacks in Paris, also depressed output, primarily via a reduction in productivity and average working time. However, the reduction in working time is also due to structural factors, such as increased flexibility on the labour market, with an ever growing proportion of part-time work and short-term contracts. Changes in the employment structure have also played a part. While employment is declining in industry, it is expanding in

both market and non-market services. These last two sectors employ a higher proportion of part-timers, exerting a downward influence on the general trend in average working time. Another factor concerns the growing proportion of workers aged 55 and over who scale down their activity at the end of their career.

These developments are expected to persist throughout the projection period against the backdrop of steady growth following the slight dip at the beginning of 2016. Average working time will continue to decline gradually while the rise in employment should accelerate a little further.

The expansion of employment – namely 140 000 additional jobs between 2016 and 2018 – is due mainly to market activities. Nonetheless, a contrasting picture is evident within the branches sensitive to the business cycle, where job creation is driven by market services, and especially by business services. Self-employment continues to gain ground, with 31 000 more self-employed workers during the projection period. Conversely, owing to fiscal consolidation, the public sector is no longer driving employment growth, even though the expected job losses are relatively limited.

TABLE 4 LABOUR SUPPLY AND DEMAND

(calendar adjusted data; change in thousands of persons compared to the previous year, unless otherwise stated)

	2014	2015	2016 e	2017 e	2018 e
Total population	55	55	71	85	61
Population of working age	9	12	27	33	9
Labour force	29	22	24	38	24
Frontier workers	-1	0	0	0	0
Domestic employment	16	41	43	47	50
Employees	9	31	32	37	40
Branches sensitive to the business cycle ⁽¹⁾	-4	15	17	25	29
Public administration and education	5	1	1	-1	-3
Other services ⁽²⁾	7	15	14	14	14
Self-employed	7	10	10	10	11
Unemployed job-seekers	14	-19	-19	-9	-26
<i>p.m. Harmonised unemployment rate⁽³⁾⁽⁴⁾</i>	8.6	8.6	8.6	8.3	7.8
<i>Harmonised employment rate⁽³⁾⁽⁵⁾</i>	67.3	67.2	67.2	67.5	68.2

Sources: DGS, FPB, NAI, NEO, NBB.

(1) Agriculture, industry, energy and water, construction, trade, hotels and restaurants, transport and communications, financial activities, property services and business services.

(2) Health, welfare, community, public social services, personal services and domestic services.

(3) On the basis of data from the labour force survey.

(4) Job-seekers in % of the labour force aged 15-64 years.

(5) Persons in work in % of the total population of working age (20-64 years).

Population ageing is reflected in a fairly small increase in the population of working age. However, in 2016 and 2017, that factor is partly offset by the influx of refugees, who are very young compared to the Belgian population. This influx will have only a gradual, minor impact on the labour force, in view of the time involved in accessing the labour market and the barriers hampering integration.

Since labour demand is growing faster than the labour force, the number of unemployed job-seekers should continue to fall throughout the projection period. At the end of 2018, the number unemployed should be down by 54 000 compared to 2015. The harmonised unemployment rate should reflect this trend, falling from 8.6 % in 2015 to 7.8 % in 2018.

4. Prices and costs

As in 2015, hourly labour costs should hardly increase in 2016. In contrast, in 2017 and 2018, they are forecast to rise, on average, by around 2 % per annum. The trend in labour costs is influenced by the measures taken in recent years to reduce the wage gap in relation to the three main

neighbouring countries and to strengthen the cost competitiveness of Belgian firms. Those measures include the freeze in the growth of negotiated wages imposed in 2015 and the maintenance of the moderation policy in 2016, the temporary suspension of the indexation mechanisms (index jump) and substantial cuts in the levies on labour.

Some of those cuts, already scheduled under the Pact for Competitiveness, Employment and Recovery in 2014, lead to reductions in employers' social security contributions and an increase in the payroll tax exemption for night work and shift work in 2016. Under the tax shift, the reductions in charges were increased in order to lower the average rate of employers' contributions to 25 % in 2018, focusing particularly on low and medium wages. It was also decided to convert the 1 % linear exemption from payment of the payroll tax in the market sector into a cut in employers' contributions. In contrast to the measures mentioned above, that decision does not actually imply an additional reduction in labour costs for employers, and therefore has no macroeconomic impact since it represents a (statistical) shift between wage subsidies and social contributions. Moreover, additional measures were taken to stimulate job creation in SMEs, notably via specific reductions in labour costs.

TABLE 5 PRICE AND COST INDICATORS
(percentage changes compared to the previous year, unless otherwise stated)

	2014	2015	2016 e	2017 e	2018 e
Labour costs in the private sector ⁽¹⁾					
Labour costs per hour worked	0.6	0.4	0.2	2.0	2.5
of which indexation	0.8	0.1	0.5	1.2	1.7
Labour productivity ⁽²⁾	0.9	0.7	0.5	0.6	0.6
Unit labour costs	-0.3	-0.3	-0.3	1.4	1.9
<i>p.m. Labour costs per hour worked according to the national accounts⁽³⁾</i>	<i>0.7</i>	<i>0.5</i>	<i>0.1</i>	<i>1.8</i>	<i>2.5</i>
Core inflation ⁽⁴⁾	1.5	1.6	1.8	1.6	2.0
Energy	-6.0	-8.0	-2.7	3.3	1.2
Food	0.8	1.8	2.9	1.6	2.0
Total inflation (HICP)	0.5	0.6	1.6	1.8	1.9
<i>p.m. Inflation according to the national consumer price index (NCPI)</i>	<i>0.3</i>	<i>0.6</i>	<i>1.8</i>	<i>1.7</i>	<i>1.9</i>
Health index ⁽⁵⁾	0.4	1.0	1.9	1.5	1.8

Sources: EC; FPS Economy, SMEs, Self-Employed and Energy, FPS Employment, Labour and Social Dialogue, NAI, NBB.

(1) Labour costs per hour worked are not shown here according to the national accounts concept but according to a broader concept that also includes reductions in contributions for target groups and wage subsidies. That concept gives a better idea of the true labour cost for firms.

(2) Value added in volume per hour worked by employees and self-employed persons.

(3) Excluding wage subsidies and reductions in contributions for target groups.

(4) Measured by the HICP excluding food and energy.

(5) Measured by the national consumer price index excluding tobacco, alcohol and fuel.

Altogether, these reductions in charges on labour should cut labour costs per hour worked by around 1.3% over the projection period, most of the impact occurring in 2016, and to a lesser extent in 2018. That assessment is the same as in the autumn projections – except, of course, for the account taken of the measures planned for 2018.

The temporary suspension of indexation ended in April – a month later than expected last December – but core inflation and the health index were revised upwards for the rest of the year so that, as the two factors offset one another, the impact of indexation in 2016 remained the same as in the autumn forecasts. Taking account of the specific phasing of the many mechanisms, indexation will make a growing, but gradual, contribution to wage increases from 2016, but primarily in 2017 and 2018.

On the subject of real negotiated wages (excluding indexation) in 2016, the available statistics for the first quarter seem to indicate that the rise will be less than the maximum 0.67% margin resulting from the wage norm that the government imposed at the beginning of 2015 in the absence of agreement between the social partners. Consequently, an average 0.5% increase is now expected. For 2017 and 2018, the margins for negotiated adjustments will only be known once the central agreement negotiations have ended; those negotiations are due to start at the end of the year. For those two years, the effect of indexation is forecast at 1.2% and 1.7% respectively, owing to the rise in core inflation. Taking account of both the continuing labour market improvements and the expected movement in wages in neighbouring countries, a technical assumption was made whereby real negotiated wages will rise by 0.8% and 1% respectively in 2017 and 2018.

Overall, unit labour costs should decline further in 2016, for the third consecutive year. Conversely, they are likely to rise again from 2017, mainly on account of the increase in hourly labour costs but also because of the projected weak productivity gains.

Although unit labour costs have been falling since 2014, core inflation in Belgium has remained relatively high and persistent, with monthly rates rarely below 1.5%. Core inflation has actually risen year-on-year since 2014, and in the period 2014-2015 it came to between 1.5% and 1.6%, or about twice the average for the euro area, where labour costs have increased significantly. Moreover, in recent months, core inflation appears to have continued rising, once again in contrast to the euro area average, to reach an average of almost 1.9% in the first quarter of 2016. The very moderate cost pressure should therefore lead to only a minor dip in core inflation during the coming months.

The movement in profit margins also shows that the lower costs have not been fully reflected in selling prices: profit margins clearly recovered last year, and taking account of downward price rigidities and the persistent decline in labour costs, that trend is likely to continue in 2016. For the following two years, the projections take account of a much more modest increase in profit margins. However, the more marked rise in labour costs from 2017 should gradually increase the pressure on prices, and core inflation is expected to resume an upward trend in the course of 2017.

The terms of trade are another factor influencing prices: the fall in oil prices led to a marked improvement in the terms of trade in 2015, contributing to low inflation that year despite the relative persistence of core inflation. For the projection period, the terms of trade are expected to display a more neutral picture, notably on the basis of the assumptions described in box 1 for oil prices and exchange rates.

Overall, headline inflation measured by the harmonised index of consumer prices (HICP) is estimated at an average of 1.6% in 2016. That is therefore much higher than the euro area's inflation rate (0.2% pour 2016), but it is only partly influenced by the basic components of price-setting. In 2016, the price rises triggered by government decisions are likely to represent more than half of total inflation. In Belgium, inflation is projected to reach 1.8% in 2017 and 1.9% in 2018.

Regarding the components of core inflation, the growth of prices of non-energy industrial goods remains relatively stable, rising by around 1% per annum. The euro's tendency to appreciate in 2016 will exert downward pressure on external costs (imported goods and goods involving foreign intermediate inputs). On the other hand, the gradual rise in oil prices will put up energy costs for Belgian firms. These movements will help to stabilise the rise in prices of non-energy industrial goods. However, the recovery of unit labour costs apparent from the end of 2016 will also drive up prices of these goods, albeit after a certain time lag.

Service prices prove somewhat more volatile over the projection period. Prices of certain services have surged recently, continuing to exert an influence on inflation. That applies, for example, to higher education, where registration fees were increased in Flanders in October 2015, and in telecommunications where operators' tariffs were raised at the beginning of 2016. Finally, the hotel and restaurant sector is still seeing exceptional increases, as prices there went up by more than 3% in the first quarter of 2016. Over 2017 as a whole, however, inflation in services should ease slightly, owing to the delayed effect

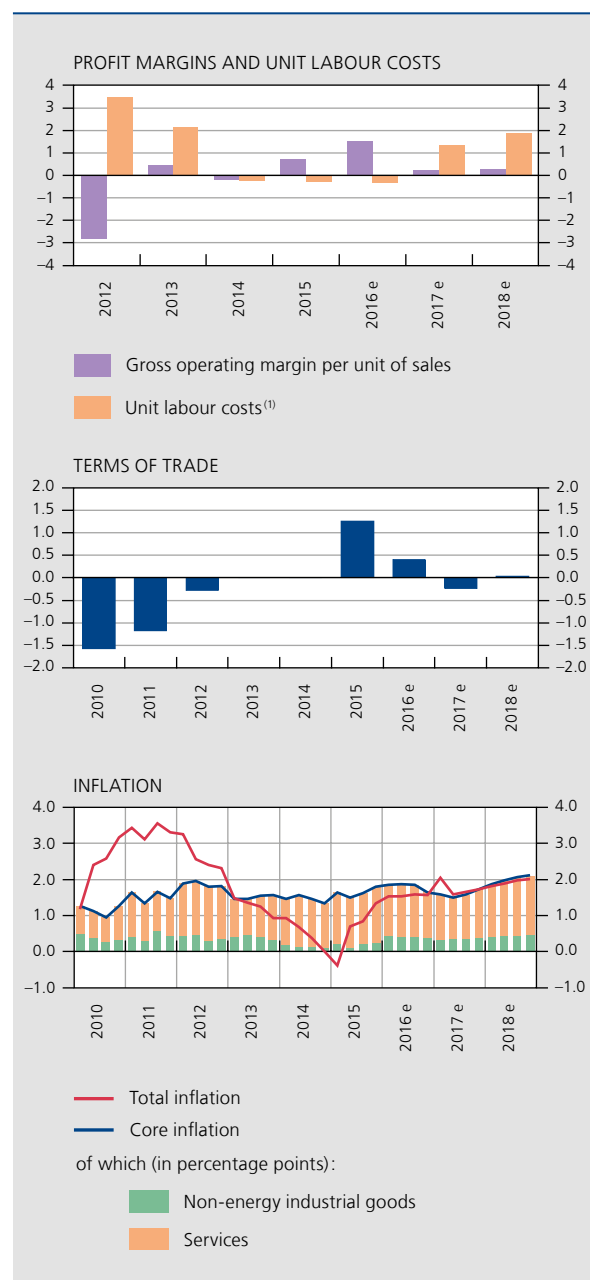
of the wage moderation pursued in preceding years. Conversely, in 2018, services prices are expected to increase more sharply as a result of the faster transmission of the renewed rise in labour costs.

The volatile components, namely food and energy, also exert upward pressure on inflation over the projection period. Numerous measures, particularly concerning taxation, drove prices higher in 2015 and in early 2016, as is still evident from the annual inflation rate.

As regards energy products, the fading-out in the negative contribution of energy, that was caused by the steep fall in the price per barrel of Brent between mid-2015 and early 2016, originates mainly from the “electricity” component. The year-on-year change in electricity prices in 2016 reflects the increase in VAT from 6% to 21% in September 2015, and the fact that intermunicipal associations (to which the distribution network companies belong) have been subject to corporation tax since mid-2015. Furthermore, the Flemish government adopted a series of additional measures which have caused a significant rise in electricity prices in the Flemish Region. For instance, August 2015 saw the introduction of the “Prosumer” tariff. As well as that, there is the “energy fund” contribution which increased sharply in Flanders in March 2016, from € 3 to around € 100 per annum for the average household, in order to eliminate the debt accumulated in the past by the distribution network companies. The abolition of free electricity from May 2016 onwards will also be reflected in the index, likewise exerting upward pressure on electricity prices. Altogether, these measures concerning electricity – whether introduced by the federal government or the Flemish Region – are expected to drive up inflation by around 0.6 percentage point in 2016. Moreover, the tax shift introduced by the federal government to reduce the charges on labour is influencing fuel prices, the latest ratchet system having led to a rise in the total fuel price. These increases are expected to persist at the same rate in 2017 and 2018, as the government has scheduled a fixed annual rise. Taking account of these government measures and a gradual increase in prices of Brent per barrel, energy’s negative contribution to headline inflation is expected to turn into a positive contribution from December 2016. Similarly, inflation in the other volatile component, notably food, has been propelled upwards lately as a result of a number of measures adopted by the government, such as the increase in excise duty on alcohol and tobacco and the introduction of a “health tax” in the context of the tax shift. Conversely, the estimates of this inflation for the coming years mainly reflect the expected movement in food prices in Europe.

The above analysis concerns the harmonised index of consumer prices (HICP), which permits comparison of inflation across all European countries. Inflation measured according to the Belgian national consumer price index (NCPI) may deviate from that figure, on account of differences in the composition of the household consumption basket and also – for some components – owing to methodological differences. Thus, for 2016, the NCPI

CHART 7 INFLATION AND DETERMINANTS
(percentage changes compared to the previous year, unless otherwise stated)



Sources: EC, FPS Economy, SMEs, Self-Employed and Energy, NBB.
(1) Including wage subsidies and reductions for target groups.

figures diverge from those of the HICP mainly because the NCPI attributes a much bigger weight to the “electricity” component, which increased sharply in price. The NCPI is used to calculate the health index, i.e. the national index excluding tobacco, alcoholic beverages and fuel. That health index, which forms the basis of wage indexation, is forecast to rise by an average of 1.9 % in 2016, 1.5 % in 2017 and 1.8 % in 2018.

5. Public finances

5.1 General government balance

According to the data published by the NAI in April 2016, the Belgian government recorded a deficit of 2.6 % of GDP in 2015. In the macroeconomic context described above, the deficit is set to increase to 2.8 % of GDP in 2016, before subsiding to 2.4 % of GDP in 2017 and remaining at that level in 2018.

The general government budget balance is expected to deteriorate sharply in 2016, even though interest charges are well down since public loans maturing are refinanced at favourable interest rates for public authorities. The primary balance is expected to become negative again following a contraction in revenues and an increase in primary expenditure, which is rising because of the additional spending connected with the refugee crisis and

security measures. In 2017, the budget balance should improve again since the share of primary expenditure and interest charges in GDP is expected to decline. In 2018, the budget balance is set to stagnate because the impact of the continuing fall in interest charges and primary expenditure is likely to be offset by a decline in revenue owing to the measures concerning the tax shift.

The deficits will be concentrated mainly at federal government level. Social security should record a balanced budget as the appropriation which it receives from the federal government is specifically intended to achieve that. The Communities and Regions and the local authorities are expected to record small deficits during the projection period.

These projections only take account of budget measures which have already been announced and specified in sufficient detail. The impact of future decisions, notably concerning the preparation of the budgets for 2017 and 2018, has not yet been incorporated. The April 2016 stability programme foresees a structural budget balance in 2018. The present projections show that additional consolidation measures will be necessary to achieve that.

5.2 Revenue

Public revenues are expected to contract by 0.3 percentage point of GDP in 2016 and to continue declining

TABLE 6 GENERAL GOVERNMENT ACCOUNTS⁽¹⁾
(in % of GDP)

	2015	2016 e	2017 e	2018 e
General government				
Revenue	51.4	51.1	50.9	50.5
Primary expenditure	51.1	51.3	50.9	50.6
Primary balance	0.3	-0.2	0.0	-0.2
Interest charges	2.9	2.6	2.4	2.2
Financing requirement (-) or capacity	-2.6	-2.8	-2.4	-2.4
Overall balance per sub-sector				
Federal government ⁽¹⁾	-2.4	-2.5	-2.2	-1.9
Social security	0.1	0.0	0.0	0.0
Communities and Regions ⁽¹⁾	-0.3	-0.3	-0.2	-0.3
Local authorities	0.0	-0.1	-0.1	-0.2

Sources: NAI, NBB.

(1) These figures include the advances on the regional additional percentages on personal income tax although, according to the methodology of the ESA 2010, those advances are regarded as purely financial transactions and the regional additional percentages are only taken into account at the time of collection.

TABLE 7 PUBLIC REVENUES
(in % of GDP)

	2015	2016 e	2017 e	2018 e
Fiscal and parafiscal revenues	44.7	44.3	44.1	43.8
Levies applicable mainly to labour incomes	26.0	25.1	24.9	24.5
Personal income tax	11.5	11.0	10.9	10.6
Social contributions	14.6	14.1	13.9	13.8
Taxes on corporate profits	3.4	3.6	3.5	3.6
Levies on other incomes and on assets	4.2	4.3	4.3	4.3
Taxes on goods and services	11.0	11.4	11.4	11.5
of which:				
VAT	6.7	6.9	7.0	7.0
Excise duty	2.1	2.2	2.2	2.2
Non-fiscal and non-parafiscal revenues	6.7	6.8	6.8	6.7
Total revenues	51.4	51.1	50.9	50.5

Sources: NAI, NBB.

in 2017 and 2018 by 0.2 and 0.4 percentage point respectively. The reduction in the revenue ratio which began in 2014 is therefore set to continue over the projection period. It is mainly the levies on labour incomes that will be down sharply, the aim being to enhance business competitiveness, trigger a recovery on the jobs market and boost household purchasing power.

In 2016, the revenues generated by personal income tax and social security contributions are forecast to diminish by 0.5 percentage point of GDP in both cases. The reduction in personal income tax is due to adjustment of the tax scales in order to increase purchasing power, particularly for employees on low and medium incomes, and the increase in deductible business expenses. Social contributions are forecast to fall owing to the reduction in the rate of employers' contributions from 1 April 2016.

This decline in revenues should be partly offset by an increase in taxes on goods and services and higher corporation tax revenues. VAT revenues are expected to rise owing to the entry into force on 1 September 2015 of the increase in VAT on electricity, which will take full effect in 2016. Excise revenues are set to rise owing to several increases in duty on diesel, tobacco and alcohol. Corporation tax revenues should expand because advance payments will probably increase owing to the favourable trend in corporate profits and because the notional interest allowance will have a smaller downward impact as a result of the lower reference interest rate.

In 2017, most revenue categories are expected to remain relatively stable in relation to their 2016 level. Social contributions are likely to contract slightly as the reduction in employers' contributions exerts its full impact.

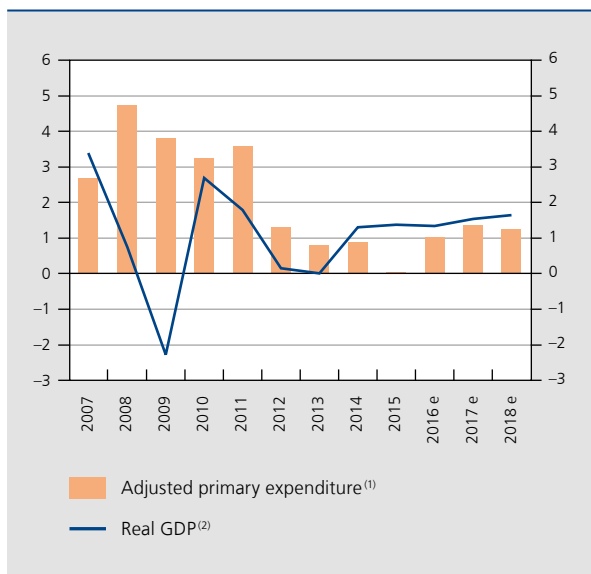
In 2018, revenues are forecast to fall as a result of the measures adopted in relation to the tax shift. This fall mainly concerns personal income tax, though social contributions will also decline further.

5.3 Primary expenditure

Primary expenditure as a ratio of GDP is likely to rise slightly in 2016 before resuming its downward trend in the ensuing two years. In nominal terms, that expenditure will therefore be outpaced, on average, by the expansion of economic activity.

That picture largely reflects the economy measures adopted by the governments formed after the May 2014 elections. The federal government is endeavouring to reduce its operating expenses by cutting the size of the public workforce and reducing purchases of goods and services. In 2016, however, the impact of those measures will be offset by new expenditure relating to security and to the arrangements for the influx of asylum seekers. The growth of social security expenditure will be moderated by a range of measures designed to curb the rise in health care costs, among other things. The Communities and Regions likewise decided to cut back their expenditure, notably in regard to operating

CHART 8 PRIMARY EXPENDITURE OF GENERAL GOVERNMENT AND GDP
(percentage changes compared to the previous year)



Sources: NAI, NBB.

(1) Primary expenditure deflated by the GDP deflator and adjusted for cyclical, one-off and fiscally neutral factors, and for the effect of indexation. The latter is due to the difference between the actual indexation (or the theoretical figure for 2015 and 2016, as a result of the approved index jump) of civil service pay and social benefits and the increase in the GDP deflator.

(2) Calendar adjusted data.

costs in administration and in education and subsidies. Finally, the local authorities also had to implement restrictions to maintain sound finances, but these budget cuts will probably be moderated by the revival of public investment in the run-up to the 2018 municipal and provincial elections.

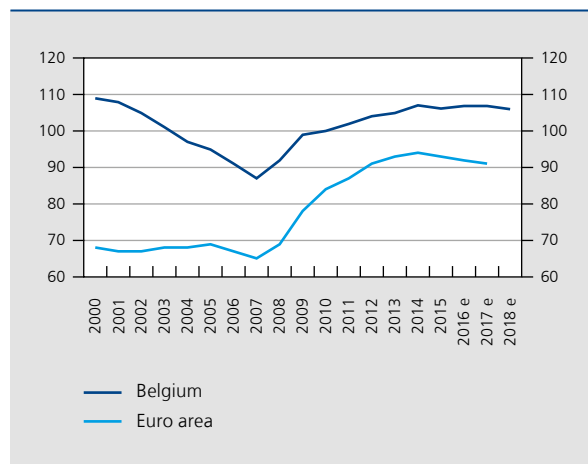
Following adjustment for non-recurring and cyclical factors and the effect of indexation, real primary expenditure will rise by 1% in 2016, which is somewhat less than real GDP growth. In 2017 and 2018 also, adjusted expenditure growth will be outpaced by the real increase in economic activity.

5.4 Debt

In 2015, the debt ratio declined for the first time since the outbreak of the financial crisis in 2008, contracting to 106.1% of GDP. That fall is due partly to the repayment by KBC of the remainder of the capital that the Flemish Community had injected in the wake of the financial crisis.

However, in 2016, the debt ratio is projected to rise again to 106.9% of GDP. Most of the increase in the debt ratio – namely 0.8% of GDP – is due to exogenous factors, so called because they influence the debt but not the budget

CHART 9 CONSOLIDATED GROSS DEBT OF GENERAL GOVERNMENT
(in % of GDP)



Sources: EC, NAI, NBB.

balance. Those factors include a new expected rise in lending under the social housing policy, and the impact of debt management. In regard to this last factor, the favourable effect that issue premiums have on the debt will be more than offset by payment of a relatively high coupon rate compared to market interest rates and by the costs incurred in the interest rate swaps concluded in the autumn of 2014 to permit the issuance of government bonds in 2015 and 2016 on the interest terms prevailing at that time. Conversely, endogenous factors will have a neutral impact on the debt ratio.

In 2017, the debt ratio is expected to edge downwards to 106.8% of GDP. While exogenous factors will exert some upward pressure on the debt, mainly owing to the payment of a coupon rate which is again relatively high compared to market interest rates, the downward effect of the endogenous factors will be slightly greater. Nominal GDP growth will exceed the implicit interest rate on the public debt, and the primary budget should be in balance.

In 2018, the endogenous factors will cause the debt to subside further to 106% of GDP, as nominal GDP growth will far exceed the implicit interest rate on the public debt.

6. Conclusion and risk factor assessment

These spring projections still describe a scenario of continuing recovery which is largely in line with previous forecasts. The slightly stronger-than-expected growth at the end

of 2015 should have led to a small upward adjustment of the annual growth expected for 2016, compared to the autumn forecasts. However, that effect was attenuated by a more cautious growth estimate in the first half of 2016, primarily on account of the negative impact of the terrorist threat and the recent attacks in Paris and Brussels. In the short term, it is mainly tourism and a few specific branches of activity such as hotels and restaurants that seem to be affected, while public consumption will increase in 2016 as a result of the additional expenditure on security.

The current spring projections are very similar to those of the other institutions, at least where growth is concerned. In comparing the various forecasts, it is necessary to bear in mind the different periods when they were produced and the information available at that time. For example, the EC's recent spring projections were unable to take account of the NAI's upward revision of growth in the last quarter of 2015 and hence of the higher level effect for year-on-year growth in 2016. The differences are slightly greater in the case of the inflation estimates by the various institutions. The Bank's forecasts are among the highest, but that is perhaps largely because they take account of the recent increase in oil prices.

The close convergence of the macroeconomic estimates should not mask the fact that such forecasts are always subject to great uncertainty. In the international environment, downside risks still predominate. For instance, there is still a risk that the growth slowdown in China and other emerging countries may be sharper or more prolonged than the international assumptions currently predict. Moreover, growth in the advanced economies is still rather fragile, as is evident from the recent slackening of activity in the United States and Japan. The

mounting uncertainty over the outcome of the Brexit referendum on the United Kingdom's membership of the EU, scheduled for 23 June, is an additional risk. Apart from the potential downward influence on exports to that country, it could also have a negative impact on Belgian growth via indirect channels, such as heightened financial market volatility in the run-up to the referendum, or in the event of the United Kingdom leaving the EU. In addition, a further heightening of the geopolitical tensions could yet have a detrimental impact on world growth. On the other hand, the very accommodative monetary policy and, above all, the measures to support lending announced by the ECB in March 2016, could have a bigger impact on investment by households and businesses, thanks to the more favourable credit conditions.

Apart from the possibly longer-lasting adverse effect of the terrorist threat, there are other risks at domestic level. In that connection, attention should be drawn to the way in which the government measures to improve competitiveness were incorporated in the projections. On the basis of the recent observations concerning the persistence of (core) inflation, it seems that the reduction in unit labour costs has not yet been fully reflected in prices. The estimates take account of a continuation of that trend. If that process were to change in the future (if the cost reduction were to be passed on more quickly or more slowly, or to a greater or lesser degree) or if the economic agents, such as employers, investors and foreign customers for Belgian exports, were to respond differently to wages and prices lower than those assumed in these projections, the movement in activity, employment, the budget balance or inflation could diverge from these spring forecasts.

TABLE 8 COMPARISON WITH ESTIMATES OF OTHER INSTITUTIONS
(in %)

Institution	Publication date	Real GDP growth			Inflation (HICP, unless otherwise stated)		
		2016	2017	2018	2016	2017	2018
Federal Planning Bureau ⁽¹⁾	March 2016	1.2	1.5	1.6	1.3	1.5	1.6
IMF	April 2016	1.2	1.4		1.2	1.1	
Consensus Economics	May 2016	1.3	1.7		1.3	1.8	
EC	May 2016	1.2	1.6		1.7	1.6	
OECD	June 2016	1.2	1.5		2.0	1.8	
NBB	June 2016	1.3	1.5	1.6	1.6	1.8	1.9

(1) Economic Outlook 2016-2021.

Annex

PROJECTIONS FOR THE BELGIAN ECONOMY: SUMMARY OF THE MAIN RESULTS

(percentage changes compared to the previous year, unless otherwise stated)

	2015	2016 e	2017 e	2018 e
Growth (calendar adjusted data)				
Real GDP	1.4	1.3	1.5	1.6
Contributions to growth:				
Domestic expenditure, excluding change in inventories	1.3	1.2	1.5	1.6
Net exports of goods and services	-0.3	0.2	0.1	0.1
Change in inventories	0.4	0.0	0.0	0.0
Prices and costs				
Harmonised index of consumer prices	0.6	1.6	1.8	1.9
Health index	1.0	1.9	1.5	1.8
GDP deflator	0.9	1.4	1.6	1.8
Terms of trade	1.3	0.3	-0.3	0.0
Unit labour costs in the private sector ⁽¹⁾	-0.3	-0.3	1.4	1.9
Hourly labour costs in the private sector ⁽¹⁾	0.4	0.2	2.0	2.5
Hourly productivity in the private sector	0.7	0.5	0.6	0.6
Labour market				
Domestic employment (annual average change in thousands of persons)	41.4	42.8	46.5	50.3
Total volume of labour ⁽²⁾	0.8	0.8	0.9	1.0
Harmonised unemployment rate (in % of of the labour force aged over 15 years)	8.6	8.6	8.3	7.8
Incomes				
Real disposable income of individuals	1.3	1.4	1.6	2.2
Savings ratio of individuals (in % of disposable income)	12.7	13.1	13.4	14.0
Public finances				
Primary balance (in % of GDP)	0.3	-0.2	0.0	-0.2
Financing requirement (-) or capacity (in % of GDP)	-2.6	-2.8	-2.4	-2.4
Public debt (in % of GDP)	106.1	106.9	106.8	106.0
Current account				
(according to the balance of payments, in % of GDP)	0.0	0.1	0.4	0.7

Sources: EC, DGS, NAI, NBB.

(1) Including wage subsidies (mainly reductions in payroll tax) and targeted reductions in social contributions.

(2) Total number of hours worked in the economy.