

# Economic projections for Belgium – Autumn 2016

## Introduction

According to the latest estimates, the growth of the world economy weakened a little further in 2016, following the already modest rate recorded a year earlier. In addition, 2016 was characterised by a number of shocks, triggering periods of high volatility on the financial markets. One of the most significant ones was the unexpected outcome of the Brexit referendum in the United Kingdom on 23 June, immediately after the publication of the Bank's latest spring projections. The prospect of one of its largest economies leaving the EU prompted many national and international institutions to fear a sharp downgrading of the growth forecast for the United Kingdom, and – via trade and the heightened macroeconomic uncertainty – for other countries in the EU and across the world. Given the share in Belgian value added related to British final demand, Belgium is the euro area country most vulnerable, after Ireland, to a slowdown in growth in the United Kingdom.

Nonetheless, the global economy has proved surprisingly robust: world growth did not weaken further in the second half of the year, and actually seems to have picked up slightly since the summer. That is due primarily to the improving situation in the emerging economies and the easing concerns about them. Thus, some countries such as Russia and Brazil appear to be gradually emerging from the deep recession in which they were languishing. Moreover, according to the official statistics, the difficult process of rebalancing the Chinese economy is still accompanied by continuing vigorous and relatively stable growth, and the risk of a hard landing seems to have faded, even though that situation is due partly to credit expansion which may ultimately prove unsustainable. In addition, the signals from some advanced economies are

still favourable. In the United States, the economy and the labour market continue to pick up, now also clearly raising average wages, while the Japanese economy continues to record moderate positive growth, following the contraction at the end of 2015. In the euro area, the economy has maintained slow but steady growth of 0.3% per quarter, broadly in line with the Eurosystem's spring projections. It is also noteworthy that the growth dispersion between countries appears to be declining sharply. For example, in the third quarter of 2016, all the euro area countries were already recording positive growth rates.

Finally, even the Brexit referendum has had little impact on British growth so far, as is evident from the first statistics for the third quarter, showing that growth was hardly any lower after the referendum compared to the previous quarter, and is still outpacing that in the euro area. However, this must be viewed in the context of the monetary policy adjustment and the ensuing depreciation of the pound sterling, as well as the fairly rapid dissipation of the political uncertainty. Similarly, the current projections concerning the immediate future are now considerably less gloomy than they were just after the referendum. The uncertainty about the eventual new relationship between the United Kingdom and the EU is of course still justified, and there is little doubt that – all other things being equal – an effective exit from the EU accompanied by greater restrictions on trade and the free movement of persons will depress both actual and potential growth. That applies more generally to any shift towards increased protectionism and isolationism.

A positive factor that has widened and strengthened the basis of global growth in 2016 is the trade revival, albeit still modest. At the beginning of 2016, trade had fallen to a historically low level, with growth lagging far behind that

of global activity. That was attributable partly to cyclical factors, although the lower growth-elasticity of trade is also due to more structural developments, such as the increasing stake in the global economy of the emerging economies, which have a lower trade intensity, and the waning momentum generated by the lengthening of the global value chains and further trade liberalisation. Although the ratio between the growth of demand for imports and global GDP excluding the euro area is still well short of unitary elasticity, it nevertheless increased slightly in 2016, one factor being the relatively stronger demand for imports from a number of advanced economies. According to the current common assumptions for the Eurosystem estimates – the main ones concerning Belgium being presented in box 1 of this article – the trade intensity of growth is set to increase continuously, reverting to a more normal level of around 1 by 2018. That corresponds to the level prevailing from 2013 to 2014, but owing to the aforementioned structural factors, it is still well below the average level recorded in the preceding decades.

The latest Eurosystem estimates which incorporate the autumn projections covered by this article were finalised on 24 November, i.e. in the middle of a renewed period of volatility following the American elections at the beginning of November. There was mounting uncertainty surrounding future policy in the United States, particularly regarding the fiscal and trade policies. During November, interest rates rose sharply, not only in the United States but also in Europe, for example. Although this may, in principle, have an adverse impact on investment – and hence on growth – the rise here seems to originate primarily from market expectations that an expansionary fiscal policy in the United States will drive up inflation and growth, and that is likewise reflected in rising American stock markets. However, in accordance with the guidelines for the Eurosystem projection exercises, the baseline scenario cannot prejudge possible or probable future policy choices which, in this instance, might imply potential upside risks to world growth in the short term. At the same time, the political shocks and heightened uncertainty over the conduct of economic policy obviously increase any margin of error surrounding these estimates. Moreover, for the first time, the current Eurosystem estimates run until 2019. That corresponds to the time horizon used for the stress tests conducted for the purpose of the prudential supervision of financial institutions. However, it goes without saying that the further the macroeconomic projections look into the future, the greater their margin of uncertainty.

According to the new Eurosystem projections, activity in the euro area will continue to expand at a fairly moderate but steady pace of around 1.6% to 1.7% over the

projection period. Taking account of the ultimately quite minor adjustments to the common assumptions, the growth outlook therefore remains practically unchanged compared to the ECB's September 2016 forecasts. For the immediate future, the short-term indicators also continue to suggest that growth will pick up from the fourth quarter of 2016. Inflation in the euro area will also increase, driven by higher oil prices and growing domestic cost pressures, but will still remain below 2% in 2019.

For Belgium, the 2016 growth estimate has been revised down to 1.2%, a minor adjustment due solely to the NAI's downward adjustment of quarterly growth at the beginning of the year. As in previous years, growth in 2016 will lag behind that in neighbouring countries and the euro area in general. According to the current quarterly accounts, the main explanatory factor is the lower consumption pattern by government and households. The recent wage moderation policy forms part of a set of measures necessary to restore cost competitiveness and strengthen growth in the longer term, but it may depress spending in the short term. However, activity should regain momentum from 2017, as a result of a stronger rise in household consumption underpinned by solid income growth, and will thus move more in line with growth in the euro area. For the years 2017 and 2018, the growth estimates have undergone a very slight adjustment of less than 0.1 percentage point on average, compared to the latest spring projections. The negative effect of the less favourable common assumptions was in fact largely offset by a higher forecast for growth of private investment and a slightly bigger impact of increased competitiveness on exports in the course of 2017, in line with the latest available statistics.

The labour market is recovering further vigorously, and the employment growth in the first half of the year was actually slightly higher than predicted by the Bank's spring projections. This growth is undoubtedly propelled by the recent policy measures, in particular the wage moderation which is reducing the relative cost of labour, plus a number of structural labour market reforms. These measures are also reflected in a marked rise in the labour intensity of growth. However, the present projections assume that, despite the new labour market reforms announced in October, this additional stimulus will fade away and the ratio between employment growth and activity growth will gradually revert to a level closer to its historical average. As a result, productivity growth – which actually appears to be negative in 2016 – should also begin rising again. In general, during the three years from 2017 to 2019, more than 120 000 new jobs should be created. Despite the further expansion of the labour force, that will reduce the unemployment rate to 7.6%, though that is still slightly higher than the level prevailing just before the great recession.

Inflation has continued to rise in recent months, approaching 2% year-on-year, mainly as a result of the increase in energy prices. Although the monthly figures exhibit wider fluctuations, the current projections suggest that price increases will continue at an annual pace of 2% in the coming years. The expansion of corporate profit margins, which was particularly marked in 2015 and 2016, thus largely offsetting the downward impact of wage moderation on inflation, is likely to wane, but on the other hand labour costs are set to edge upwards. The index jump came to an end in the spring of 2016. In addition, in the absence of a central wage norm for the period 2017-2019, these projections – like those in the spring – adopt the technical assumption of collectively agreed wage growth of 1% in 2018 in the context of an increasingly tight labour market and rising productivity, an assumption which has now also been extended to 2019. In general, the inflation gap in relation to the rest of the euro area is expected to narrow but remain positive in 2019.

Finally, turning to public finances, the budget deficit is forecast at exactly 3% of GDP in 2016. It is expected to decline in 2017, but remain virtually unchanged thereafter. The additional interest charges gains, estimated at 0.4% of GDP from 2017 to 2019, are likely to be offset by a new structural easing of fiscal policy, the main reason being that the additional reductions in charges planned for 2018 and 2019 under the tax shift have not yet been fully financed. At the end of the projection period, the deficit is forecast at 2.3%, which is still a long way from the target of a structurally balanced budget. Even in 2019, the public debt will hardly dip below 2015's level. However, in that connection it should be remembered that, in accordance with the rules on the Eurosystem projection exercises, account is only taken of measures which have been formally adopted by the government or which are very likely to be approved, and for which the details are sufficiently clear at the time of completion of the exercise. Furthermore, the estimates of the budgetary impact of certain measures, such as those intended to combat fraud, may deviate from the amounts entered in the budget.

## 1. International environment and assumptions

### 1.1 World economy

During 2016, the growth of the world economy was moderate, overall, in an environment afflicted by many uncertainties. After a hesitant start, activity began to show some signs of picking up in the second half of

the year, notably due to vigorous private consumption. Supported by accommodative monetary policies and low energy prices, advanced economies displayed some resilience despite the fears triggered by Brexit. In emerging economies and commodity-exporting countries, activity gradually began to expand modestly again, after having bottomed out at the end of 2015. Nonetheless, wide variations between countries persist.

As expected, following the adoption of a new growth model considered to be more sustainable, the expansion of the Chinese economy slowed again slightly. However, it remained robust, stabilising at around 6.7%, well within the official target range of 6.5 to 7%. Stimulus measures and sustained credit expansion continued to bolster the growth of output. As is evident from the dynamism of consumption and the gradual shift in activity from industry to services, the rebalancing of the economy in favour of a domestic demand-led growth continued, without any major difficulties. Economic activity in the commodity-exporting countries in general was still adversely affected by the on-going transition of the Chinese economy and the low level of commodity prices. Brazil slid into a deep recession, further aggravated by a political crisis which seriously dented confidence. However, there seems to be an end in sight to the slowdown in activity, given the recent rise in commodity prices and a new boost to exports, thanks to the past depreciation of the real. The Russian economy, weakened by the international sanctions imposed in response to the conflict in Ukraine and by the fall in oil prices, displayed some signs of stabilisation following the recovery in crude oil prices. Finally, economic growth remained solid in India, backed by the improvement in the terms of trade, lower inflation and various reforms favourable to the business climate. The country still records the highest growth rate among the world's major economies.

After a slowdown at the beginning of the year, the American economy recovered in the third quarter. The growth revival largely reflected the surge in exports and, to a lesser extent, the increased stock-building and the rise in federal public expenditure. Although the growth of consumption expenditure slowed down, it remained significant and is still the principal engine of activity. It was supported mainly by wage rises and the continuing expansion of employment. The unemployment rate in fact dropped below 5%, while towards the end of the year hourly wages recorded their strongest rise since 2009.

In Japan, activity grew strongly in the first quarter of 2016, but then decelerated. The economy nevertheless maintained moderate growth, underpinned by resilient consumption in the context of a gradual improvement

in employment and incomes. Japanese economic growth also benefited from very favourable financial conditions and government support measures. However, it was tempered by the reduced demand from emerging economies and the appreciation of the yen, two factors which inhibited exports.

In the United Kingdom, the unexpected outcome of the Brexit referendum on 23 June has so far had no significant impact on growth, which barely dipped in the third quarter. Similarly, the outlook for the immediate future is now already much less gloomy than indicated by the initial analyses presented by various institutions. That is evident, for instance, from the marked upward revision of the Bank of England's growth estimates for 2016 and 2017, unveiled in its November 2016 Inflation Report, compared to the August edition. Undoubtedly, that is partly due to the adjustment of monetary policy and the fairly rapid fading of the political uncertainty. This being said, the question of the longer-term macroeconomic effects remains. The uncertainty surrounding future relations between the EU and the United Kingdom could depress investment and job creation. The strong appreciation of the pound against the euro in the second half of the year also threatens to apply the brakes to the euro area's foreign demand, as the United Kingdom is one of its main trading partners. Finally, all other things being equal, the actual exit from the EU and the greater restrictions that will apply to trade and the free movement of people will inevitably depress both actual and potential growth of the United Kingdom and its trading partners.

In the euro area itself, activity surged at the beginning of the year, mainly thanks to some temporary effects, before contracting slightly as anticipated in the previous Eurosystem projections. Thus, quarterly GDP growth dipped from 0.5% in the first quarter to 0.3% in the two ensuing quarters. Private consumption, bolstered by a gradual improvement in the labour market situation, remained the primary engine of growth. Supported by favourable financing conditions, investment also made a significant contribution while exports were held back by the inertia of world trade.

With the possible exception of Greece, which saw a substantial fall in its net exports in the context of the continuing capital controls, all the euro area countries contributed to the area's economic growth in 2016. Moreover, the divergences between Member States generally diminished. Among the large countries, Germany still benefited from robust domestic demand and job creation, although growth slowed significantly during the year. In Italy and France, the economy stagnated after a strong start to the year. However, growth returned to positive territory in the third quarter. By contrast, Spain maintained a vigorous

recovery throughout the year, underpinned by domestic consumption and exports.

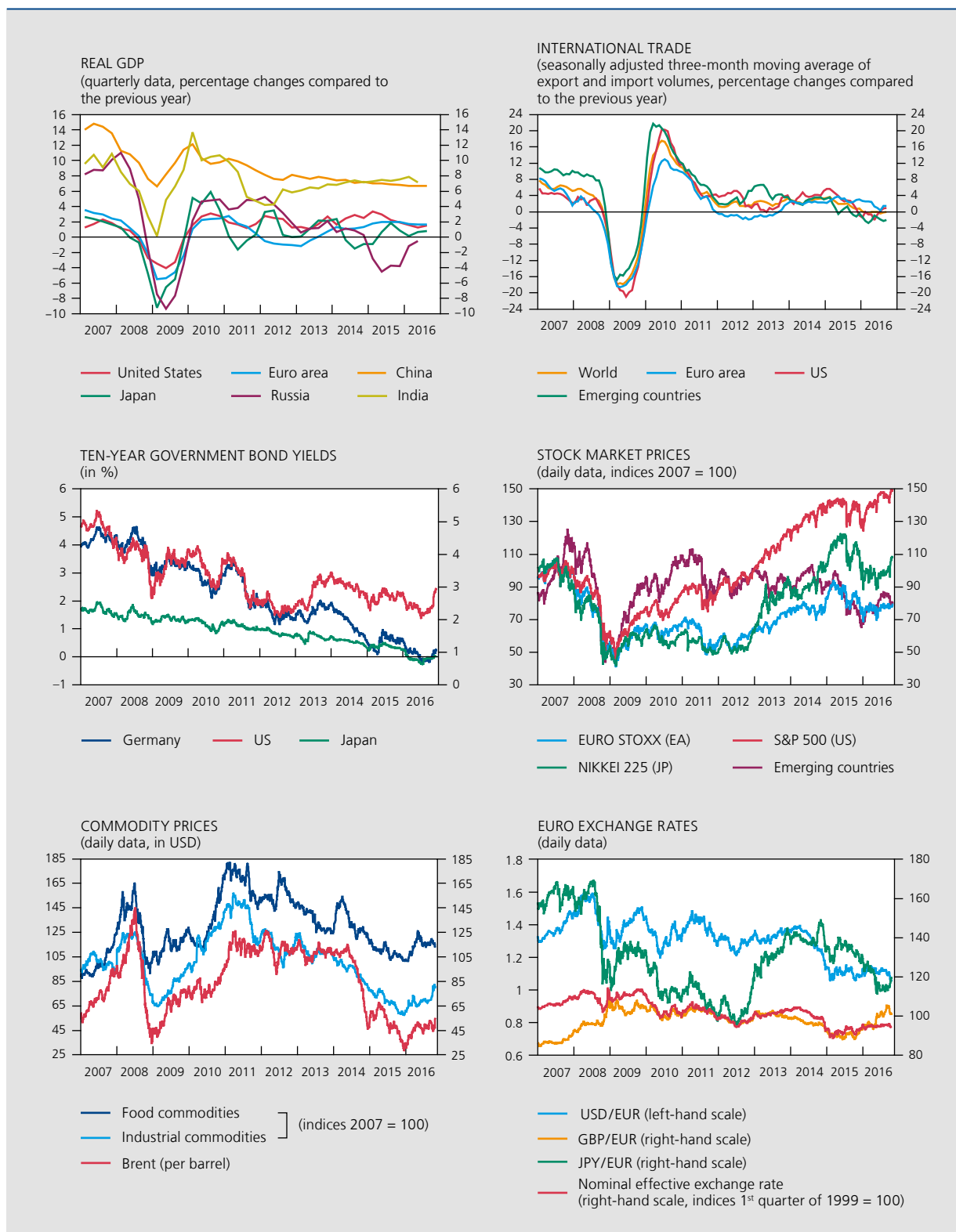
After reaching a low point in April, inflation in the euro area edged upwards. Although running at 0.5% in October, it remained well below the target of close to 2% defined by the ECB. The rise in inflation largely reflected the less negative energy price inflation, in line with the recovery of oil prices. Core inflation, i.e. excluding prices of food and energy, dipped slightly during the year, as a result of the still subdued growth of prices and wages. It stood at 0.8% in October, compared to 1.0% in January. In the coming months, headline inflation should continue to climb owing to positive base effects of energy prices.

World trade flows, also when expressed as a percentage of activity growth, declined to an absolute low point at the beginning of 2016. Apart from the increasing share of global GDP represented by emerging economies, which still exhibit a lower trade intensity, and other structural factors such as the waning momentum of trade liberalisation and of the extension of global value chains, that decline was also due to a number of specific cyclical factors. For instance, weak investment is regarded as a major factor behind this slump. China's transition to a more consumption and service-driven model – and hence less dependent on imports of commodities and machinery – and the fall in capital expenditure by countries exporting basic goods are likely to have played a significant role here. This being said, there were some signs of a trade revival in the second part of 2016, thanks in particular to the strengthening demand for imports in some advanced economies.

The financial markets were confronted with an initial wave of turbulence at the beginning of the year, caused by new fears over growth in emerging countries and the profitability of the banking sector. Nonetheless, in parallel with the improvement of the outlook for world growth, investors soon found a renewed appetite for risk. That reduced volatility, bolstered asset prices and lowered risk premiums. Sentiment regarding emerging economies also improved as a result of expectations of a long period of low interest rates in the advanced economies, easing of concerns about Chinese growth and a favourable movement in commodity prices. The return of capital flows to those countries was accompanied by a sharp stock market rise and an appreciation of their currencies. At the end of June, markets responded vigorously to the vote in favour of the United Kingdom's withdrawal from the European Union. While a wave of optimism had driven up asset prices in the preceding days, the unexpected referendum outcome sent stock markets tumbling and reduced risk-free yields. At the same time, the pound fell sharply while the US dollar and the Japanese yen appreciated.

CHART 1

WORLD ECONOMY AND DEVELOPMENTS ON FINANCIAL AND COMMODITY MARKETS



Sources: CPB World Trade Monitor, OECD, Thomson Reuters Datastream.

**TABLE 1** PROJECTIONS FOR THE MAIN ECONOMIC REGIONS

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

	2015	2016 e	2017 e	2018 e
<b>Real GDP</b>				
World .....	3.1	2.9	3.3	3.6
of which:				
Advanced countries .....	2.1	1.7	2.0	2.3
United States .....	2.6	1.5	2.3	3.0
United Kingdom .....	2.2	2.0	1.2	1.0
Japan .....	0.6	0.8	1.0	0.8
Euro area .....	1.5	1.7	1.6	1.7
Emerging countries .....	3.8	4.0	4.5	4.6
China .....	6.9	6.7	6.4	6.1
India .....	7.6	7.4	7.6	7.7
Russia .....	-3.7	-0.8	0.8	1.0
Brazil .....	-3.9	-3.4	0.0	1.2
<i>p.m. World imports</i> .....	2.6	1.9	2.9	3.2
<b>Inflation<sup>(1)</sup></b>				
United States .....	0.1	1.2	1.9	2.2
Japan .....	0.8	-0.3	0.3	1.0
Euro area .....	0.0	0.2	1.2	1.4
China .....	1.5	2.1	2.2	2.9
<b>Unemployment<sup>(2)</sup></b>				
United States .....	5.3	4.9	4.7	4.5
Japan .....	3.4	3.1	3.0	2.9
Euro area .....	10.9	10.0	9.5	9.1

Source : OECD.

(1) Consumer price index.

(2) In % of the labour force.

Although the initial reaction was very marked, the tumult subsided when the central banks declared their willingness to provide sufficient liquidity and, if necessary, to adopt new monetary easing measures. The tensions then continued to ebb away against the backdrop of a cautious recovery in the outlook for the global economy. Nonetheless, the pound remained low and, following reappraisal of the future path of monetary policies, yields on sovereign securities stayed close to their historical floor.

On the foreign exchange markets, the euro was fairly stable, overall, in relation to the US dollar. After raising its key interest rates in December 2015, the Federal Reserve decided to keep rates on hold, and that kept the dollar from strengthening. Conversely, the euro edged upwards in effective terms, notably on account of its marked

appreciation against the pound, which more than offset the fall against other currencies.

Although oil prices had dropped below \$ 30 in mid-January, they climbed rapidly throughout the first half of the year, passing the \$ 50 mark during the summer. In the second half of the year, oil prices were more volatile. After peaking in early October, they dropped below \$ 50. Supplies remained abundant as a result of record production by the OPEC countries and an increase in Russian output, while demand contracted in both advanced and emerging economies. However, after the OPEC countries had agreed to cut production, prices began rising sharply again at the end of November. In general, commodity prices excluding energy displayed a modest rise in the first half of the year, before

stabilising. The price increase recorded is directly linked to the higher prices of energy, which is a major input in both industrial and agricultural production.

Towards the end of the year, the unexpected outcome of the American presidential elections on 8 November triggered various shocks, both on the financial markets and on the foreign exchange and commodity markets. The prospect of a major programme of investment in infrastructure and tax cuts favoured by the winning candidate was beneficial to the equity markets. American stock markets soared to new record levels. Conversely, investors turned away from the bond markets owing to the inflationary risk of such a fiscal stimulus plan in a situation of virtually full employment for the American economy, and hence the possibility that the Federal Reserve would raise its policy interest rates more quickly. Yields on US Treasuries staged a marked recovery during

the week following the election, with the 10-year rate gaining more than 40 basis points. That increase spread to other regions of the world, including the euro area and emerging economies. Taking account of the heightened risk of a capital flight, interest rates in those countries actually rose more steeply overall. On the foreign exchange markets, the dollar appreciated, particularly against certain emerging currencies such as the Mexican peso and the Brazilian real.

The unexpected outcome of the American elections therefore undoubtedly shocked the markets. More generally, there was mounting uncertainty, particularly concerning the future fiscal and trade policies in the United States. Any radical change of course in that respect could have a major impact on American and global growth, and therefore increase the margins of uncertainty concerning these autumn projections.

## Box 1 – Assumptions 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. 18 November 2016. The euro-dollar exchange rate then stood at \$ 1.09 to the euro. It should be noted that the dollar has continued to appreciate since then in the wake of the American elections.

As usual, the assumptions concerning oil prices are based on market expectations reflected in forward contracts on international markets. Following the significant decline which had begun in the autumn of 2014, the Brent price per barrel embarked on a clear upward trend from the beginning of 2016. In mid-November 2016, the markets expected that oil prices would rise gradually during the projection period, from an average of \$ 43 in 2016 to around \$ 55 in 2019. For the period 2017-2018, that is close to the assumptions in the spring projections.

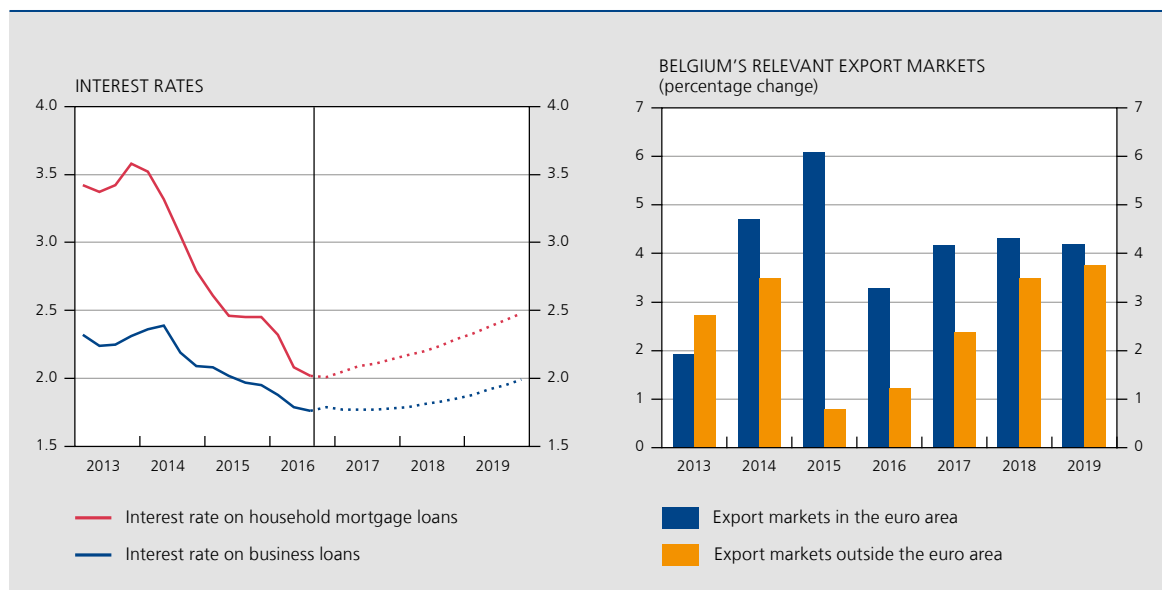
The interest rate assumptions are likewise based on market expectations in mid-November 2016. In the second half of 2016, the three-month interbank deposit rate stood at around –30 basis points; it would only return to positive territory at the end of the projection period. The level of long-term interest rates on Belgian government bonds is projected to rise more sharply, from 0.2% in the third quarter of 2016 to an average of 1.3% in 2019.

The predicted movement in retail banks' interest rates on corporate loans and household mortgage loans may however 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; alignment with the upward movement in long-term market rates will probably be only gradual. That rate is predicted to rise from around 2% in mid-2016 to 2.5% by the end of the projection period. The average interest rate on business loans, which is closer to the short-term segment, is also expected to rise more



INTEREST RATES AND VOLUME GROWTH OF EXPORT MARKETS

(in %)



Source: Eurosystem.

slowly over the projection period: an average rate of 1.9% is expected in 2019, which is hardly any higher than the 2016 rate.

Although the outlook for global economic growth excluding the euro area has not worsened greatly since the spring projections published in June 2016, the recent sluggishness of international trade mentioned above has led to a new downward revision of the trade intensity of world growth for 2016 and 2017. That has a particularly adverse effect on the growth of export markets outside the euro area, which is therefore predicted to remain very weak in 2016 and 2017, 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 an average of 4% in 2019.

The trend in Belgian exports is determined not only by the growth of those foreign markets but also by the movement in market shares, and consequently by Belgium's competitiveness. As regards the cost aspects of competitiveness, fluctuations in the prices that competitors charge on the export markets are a key factor. 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.

Overall, the adjustment of the assumptions compared to the latest spring projections for the period up to 2018 has a rather negative impact on the forecast for Belgium's growth, as the adverse effect of the less favourable export market situation is only partly offset by the cheaper euro.





## EUROSYSTEM PROJECTION ASSUMPTIONS

(in %, unless otherwise stated)

	2016	2017	2018	2019
	(annual averages)			
EUR/USD exchange rate .....	1.11	1.09	1.09	1.09
Oil price (US dollars per barrel) .....	43.1	49.3	52.6	54.6
Interest rate on three-month interbank deposits in euro .....	-0.26	-0.27	-0.18	-0.01
Yield on ten-year Belgian government bonds .....	0.5	0.8	1.1	1.3
Business loan interest rate .....	1.8	1.8	1.8	1.9
Household mortgage interest rate .....	2.1	2.1	2.2	2.4
	(percentage changes)			
Belgium's relevant export markets .....	2.4	3.4	4.0	4.0
Export competitors' prices .....	-3.3	2.1	2.1	1.9

Source: Eurosystem.

## 1.2 Estimates for the euro area

The growth estimates in the Eurosystem's autumn projections are very similar to the previous projections of both the ECB (September 2016) and the Eurosystem (June 2016). Over the projection period as a whole, the euro area's economy is expected to grow at a fairly steady rate of between 1.6 and 1.7%. The slight fall anticipated for the final two years is attributable in particular to a slowdown in the German economy, where a tight supply situation on the labour market is likely to gradually inhibit growth. Compared to the latest ECB estimates, these autumn projections incorporate a minimal upward revision of the growth estimate for the euro area for 2016 and 2017, despite the admittedly minor adjustment to the common technical and international assumptions which could, in principle, imply lower growth owing to the rise in long-term market interest rates and a slight weakening of foreign demand. In fact, the short-term outlook, based partly on confidence indicators, continues to suggest a marked revival of economic growth at the end of 2016 and in early 2017.

Growth is still supported by favourable initial conditions, such as a relatively cheap euro and low interest rates, fostered partly by monetary policy. Sluggish foreign demand is still depressing the growth contribution of net exports, but is offset by a surge in domestic demand driven not

only by private consumption but also by investment. As growth and trade pick up at a global level over the projection period, the euro area's exports also begin rising again, largely offsetting the slackening of household and government consumption.

During the projection period, inflation is set to increase sharply, although it should still remain slightly below 2% at the end of 2019. Although that rise is determined partly by the turnaround in the energy component, which – as a result of the recent and expected movement in oil prices – will cease to restrain price growth from 2017, core inflation – i.e. inflation excluding its volatile components – is also expected to increase: compared to its current level of less than 1%, core inflation is expected to virtually double by 2019. This mainly reflects wage acceleration in the context of improving labour markets.

During the recent period, employment has expanded strongly: compared to the growth of activity, the recent recovery on the labour market even exceeded expectations based on historical elasticities. Although trend shifts towards more labour-intensive sectors of activity have played a part in that recovery, the improvement is due primarily to the reduction in labour costs and structural reforms in certain countries. According to the estimates, the job intensity of growth is likely to diminish gradually as the impact of those recent measures on job

**TABLE 2** EUROSISTEM PROJECTIONS FOR THE EURO AREA

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

	2016 e	2017 e	2018 e	2019 e
Real GDP .....	1.7	1.7	1.6	1.6
Household and NPI final consumption expenditure .....	1.7	1.5	1.5	1.4
General government final consumption expenditure .....	2.0	1.3	1.1	1.1
Gross fixed capital formation .....	3.0	3.1	3.1	2.7
Exports of goods and services .....	2.7	3.7	3.9	4.0
Imports of goods and services .....	3.3	4.1	4.3	4.1
Inflation (HICP) .....	0.2	1.3	1.5	1.7
Core inflation <sup>(1)</sup> .....	0.9	1.1	1.4	1.7
Domestic employment .....	1.4	1.1	0.8	0.8
Unemployment rate <sup>(2)</sup> .....	10.0	9.5	9.1	8.7
General government financing requirement (–) or capacity <sup>(3)</sup> ...	–1.8	–1.6	–1.5	–1.2

Source: ECB.

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

(2) In % of the labour force.

(3) In % of GDP.

creation fades away. Nonetheless, those measures will have a lasting effect on the level of employment, which is set to grow by an average of almost 0.9 % per annum, even after 2016. That also implies a steep decline in unemployment, although in 2019 it will still be slightly higher than before the great recession.

The average budget deficit in the euro area is set to fall sharply to 1.2 % of GDP in 2019. That improvement is attributable solely to the upturn in economic activity and, especially, to the further reduction in interest charges resulting from the exceptionally low interest rates. The fiscal policy stance is expected to remain relatively neutral, following the easing in 2016, which was largely due to increased expenditure for hosting refugees in some countries. The public debt ratio will continue to fall, albeit slowly: by the end of 2019, it should be more than 6 percentage points below its 2014 peak.

## 2. Activity and demand

According to the current quarterly statistics, the pattern of economic activity was rather erratic in 2016. Compared to an earlier NAI estimate taken as the basis for the spring projections, quarterly growth in the first three months of the year was revised downwards recently, to barely 0.1 %. In the second quarter, however, growth gathered pace to 0.5 %, which was higher than estimated in the spring projections. Growth then slowed again in the third quarter to

0.2 %, a sharper fall than predicted in the spring projections. Over the three quarters considered, growth was essentially driven by a strong expansion of business and housing investment, while household consumption was less buoyant. From the production side, all the main branches of activity contributed to growth, although the key driving sector was market services.

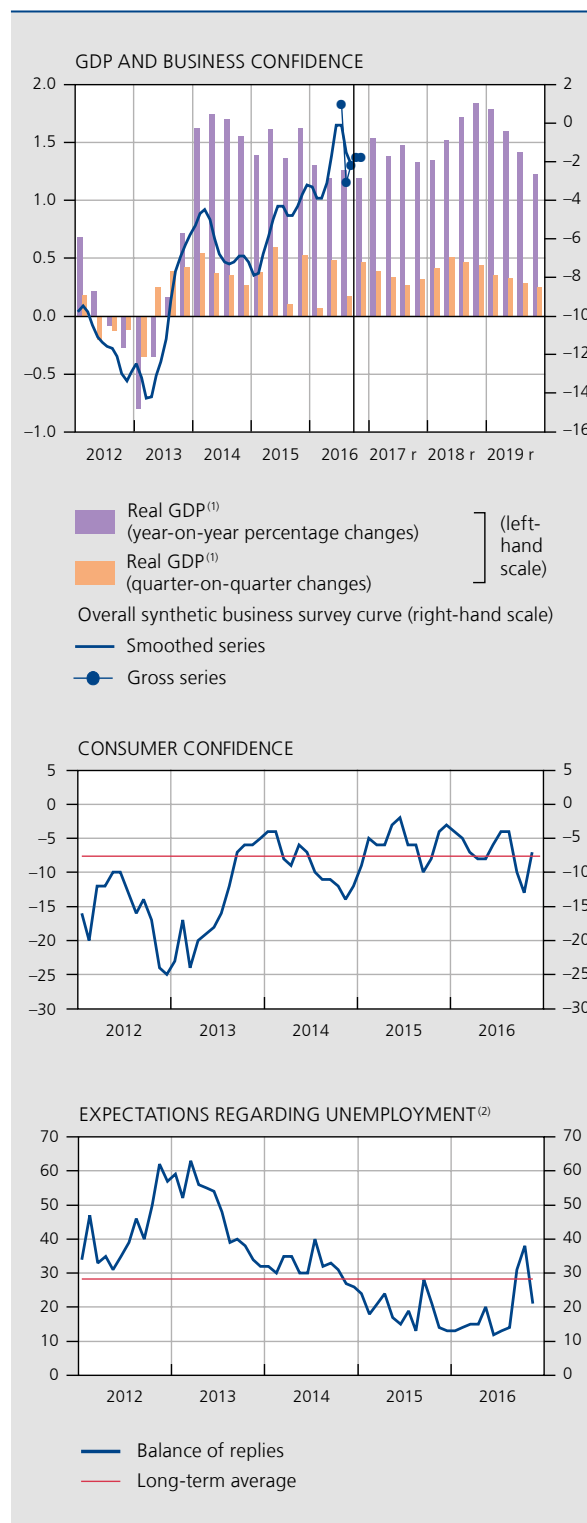
Turning to the short-term growth estimate, the situation outlined by the confidence indicators is not so evident at first sight. While the confidence of Belgian producers weakened somewhat during the summer – though it remained above its long-term average and has recovered since September – consumer confidence initially fell much more sharply this autumn, dropping to its lowest level for about two years. That decline was due mainly to the consumer survey component that asks about the respondents' expectations concerning unemployment, and must therefore be considered in the context of the numerous announcements of corporate restructuring and closures, implying multiple job losses in September and October, and the associated media attention. However, the pessimism of households is at odds with the actual labour market situation, because job creation outstrips the job losses announced. Moreover, there is nothing to suggest any sharp deterioration in the labour market since the summer, as demonstrated by the employment growth that remained vigorous in the third quarter of 2016. Furthermore, as expected, the latest figures show that consumer confidence revived strongly in November. The “nowcasting” models used by the Bank

therefore show a growth surge in the final quarter of 2016. In that context, the short-term estimate for that quarter consequently remains close to 0.4%, in line with the spring projections, so annual growth for 2016 should ultimately reach 1.2%. Compared to the spring projections, the downward revision of annual growth is due entirely to the aforementioned statistical revision for the first quarter.

Economic growth should then rise to 1.4% in 2017 and 1.6% in 2018 on an annual basis. Compared to the spring projections, that is a small downward adjustment for 2017, attributable partly to the common assumptions which are less favourable to growth, as explained in box 1. More specifically, the assumptions concerning the international environment, and hence Belgium's export markets, are less favourable than expected in June. Moreover, certain fiscal measures announced recently weigh on the growth forecasts for 2017, essentially on account of lower government consumption. However, the impact of these factors is partly negated by the short-term outlook which is still relatively favourable, particularly thanks to the strong growth of private investment. In addition, the estimate of gains of export market shares has been slightly upgraded on the basis of the latest statistics. For the first time, the current autumn projections also include an estimate for 2019, which must of course be interpreted with due caution owing to the great uncertainty inherent in longer-term macroeconomic estimates. In 2019, growth should not rise further but weaken marginally to 1.5%, owing to the relatively flat profile of Belgium's export markets growth and the waning impact of the recent improvements in cost competitiveness, as wages start to rise more strongly. In that year, the post-election fall in local investment will also curb growth to some extent. Furthermore, economic growth is likewise expected to slow somewhat at the end of the projection period on account of supply side constraints, notably on certain labour market segments.

Domestic demand will be the main engine of growth in the coming years, as it has been in the recent past. The growth contribution of domestic demand (excluding changes in inventories) will be virtually stable for the next three years, at 1.5 percentage points. The contribution of net exports to growth is rather small over the projection period, although this year is an (apparent) exception. In 2016, net exports should contribute 0.9 percentage point to growth, but this is essentially derived from the data already available for the first three quarters. The current quarterly accounts in fact indicate that exports in that period were bolstered by substantial market share gains on foreign markets, mostly outside the euro area. However, these large gains will gradually diminish over the projection horizon, even disappearing completely in 2018, since unit wage costs are expected to rise again more noticeably from next year, therefore reducing cost

CHART 2 GDP AND CONFIDENCE INDICATORS



Sources: NAI, NBB.

(1) Data adjusted for seasonal and calendar effects.

(2) A rise indicates a less favourable movement while a fall indicates a more favourable movement.

**CHART 3 EXPORTS AND EXPORT MARKETS**

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



Sources: NAI, NBB.

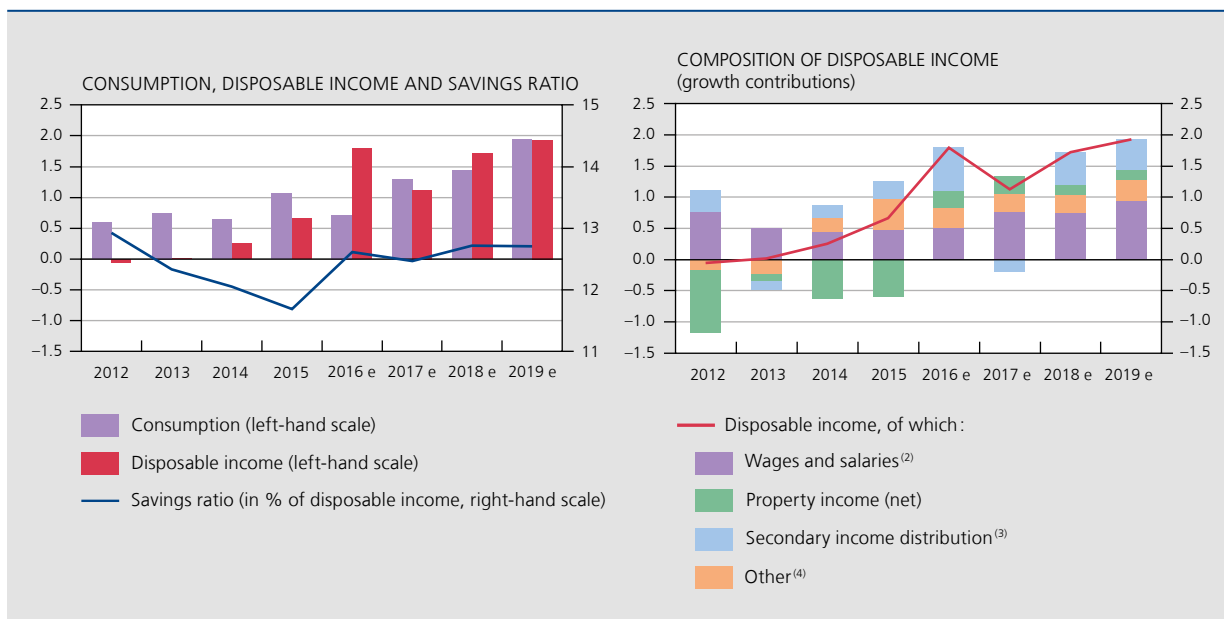
competitiveness. According to the projections, export growth should nevertheless increase until 2018 in parallel with the expansion of global demand, while imports are likely to rise at more or less the same pace, thus maintaining the growth contribution of net exports close to zero.

The substantial contribution of net exports to growth in 2016 is largely offset by the negative growth contribution of inventories, suggesting that firms have recently curbed their stock-building or, on the contrary, increased the rate of their stock reduction. That will still generate a spillover effect in 2017, although for all quarters of the projection period the usual technical assumption holds that changes in inventories have a neutral impact on growth, in view of the great statistical uncertainty surrounding that concept.

As already stated, domestic demand will therefore be the main engine of economic growth, being largely supported by private investment at the start of the projection period (as it was in the preceding quarters). On the basis of the available quarterly figures, private consumption recorded rather weak growth in 2016, despite the large wage increase amounting to almost 2% in real terms. That increase resulted from the rise in labour incomes and the fall in personal income tax in the context of the tax shift. Dividends received by households also listed strong growth, so property incomes made a positive contribution to households' income growth again, for the first time in a long while. However, a large proportion of those property incomes

**CHART 4 HOUSEHOLD CONSUMPTION AND DISPOSABLE INCOME<sup>(1)</sup>**

(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) Excluding social contributions payable by employers.
- (3) Including social contributions payable by employers.
- (4) "Other" comprises the gross operating surplus and gross mixed income (of self-employed persons).

is saved, and that explains – albeit only partly – the sharp rise in the savings ratio in 2016.

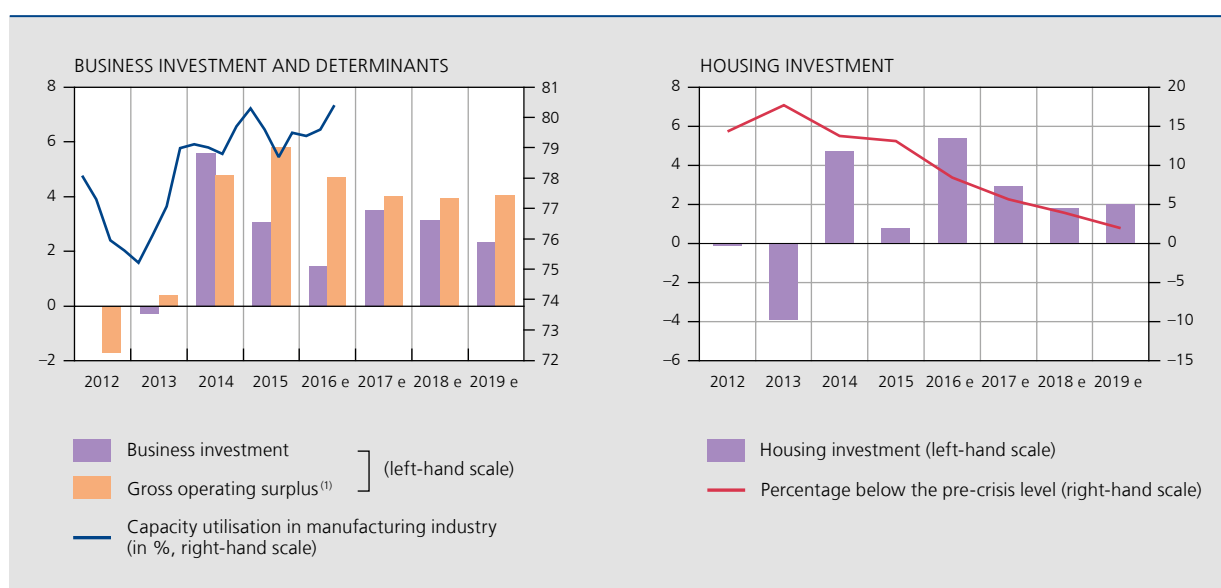
The growth of household consumption is expected to remain relatively moderate in 2017, averaging around 0.3% per quarter; income growth is likely to subside again since no new tax cuts are planned for that year. However, taking account of the usual inertia of consumption habits, households will make hardly any adjustment to their consumption pattern so that the slowdown in disposable income mainly influences the savings ratio, which is expected to dip slightly. Over the final two years of the projection period, income growth is set to rise again, driven mainly by the steady increase in labour incomes, in particular as a result of the strengthening wage growth, and the additional tax cuts planned as part of the tax shift, which will create extra scope in household budgets. Households should thus smoothly adapt their consumption to this higher income growth, but the time lag inherent in that process will again lead to a small rise in the savings ratio.

As regards business investment, the annual growth for 2016 is somewhat biased by specific factors relating to substantial purchases of investment goods abroad, which raised the level of investment (and imports) in the past two years. If we exclude these specific factors (in 2015), the volume of business investment is estimated to rise by more than 5% in 2016, largely as a result of exceptionally strong figures in the first half of the year.

Moreover, the statistics currently available show that both business investment and housing investment have surprised on the upside in the first two quarters of 2016, but they are both likely to revert to a “more normal” growth rate during the projection period. In the case of business investment, that corresponds to an annual growth averaging 3% over the last three years of the projection period. The continuing business investment revival is linked to positive underlying determinants: firms have large liquidity reserves, the operating surplus is increasing and interest rates remain low. In addition, capacity utilisation in manufacturing industry has been above its long-term average for some time, so that the rise in demand will generate ever-increasing expansion investment. The low interest rate environment is also stimulating investment in housing, in the form of both new building and renovation projects. In that regard, there are clear signs that property is increasingly becoming an alternative form of investment for individuals in their search for yield. However, the projections indicate here, too, a gradual return to a normal growth rate in view of the expected rise in mortgage interest rates. Nonetheless, it should be noted that while business investment surpassed its pre-crisis level some time ago, investment in housing is still well below that level, and that gap is barely closed by the end of the projection period.

Regarding public expenditure, investment is estimated to have risen significantly in 2016, driven by substantial

**CHART 5 BUSINESS AND HOUSING INVESTMENT**  
(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

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

	2015	2016 e	2017 e	2018 e	2019 e
Household and NPI final consumption expenditure .....	1.1	0.7	1.3	1.4	1.9
General government final consumption expenditure .....	0.5	0.2	0.5	0.3	0.5
Gross fixed capital formation .....	2.4	2.6	3.2	3.2	1.7
general government .....	1.9	3.6	1.8	6.6	-2.6
housing .....	0.8	5.4	3.0	1.8	2.0
business .....	3.1	1.5	3.5	3.1	2.3
<i>p.m. Domestic expenditure excluding change in inventories</i> <sup>(1)</sup> ..	1.2	1.0	1.5	1.5	1.5
Change in inventories <sup>(1)</sup> .....	0.3	-0.7	-0.2	0.0	0.0
Net exports of goods and services <sup>(1)</sup> .....	0.0	0.9	0.2	0.1	0.0
Exports of goods and services .....	4.3	4.0	4.1	4.3	4.1
Imports of goods and services .....	4.3	3.0	4.1	4.4	4.3
Gross domestic product .....	1.5	1.2	1.4	1.6	1.5

Sources: NAI, NBB.

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

amounts related to the building of schools in the Flemish Community. The decline in these specific investment projects explains why the increase in the volume of government investment will be only very small in 2017. Furthermore, in accordance with the pattern of the electoral cycle, public investment is set to decline in 2019 following strong growth in the run-up to the 2018 elections. The growth of public consumption in 2016 appears weaker than expected, despite some exceptional expenditure incurred in addressing the heightened terrorist threat. The adoption of some consolidation measures which have just been announced for the 2017 budgets will likewise slow the growth of public consumption somewhat in 2017, compared to the June projections.

### 3. Labour market

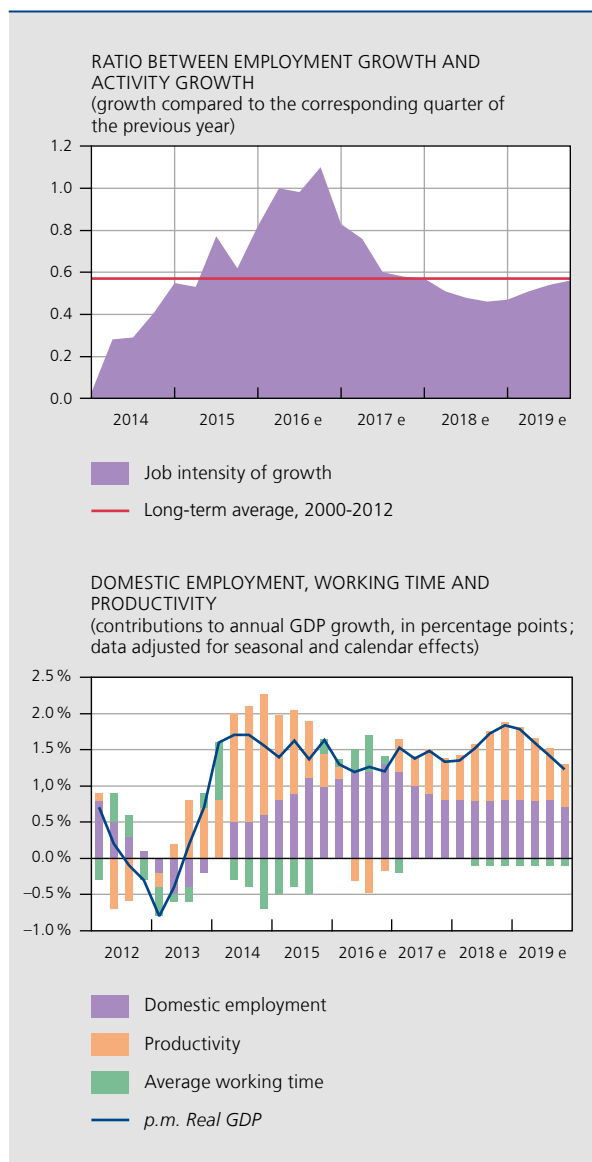
Since the start of the economic recovery in 2013, activity growth in Belgium has become increasingly job-intensive. That is due partly to structural factors, such as the growing importance of labour-intensive services branches, but also reflects the normal pattern typical of the start of an economic recovery. In that case, productivity, and to a lesser extent average working time, are the first variables to increase; employment expansion comes only later. However, there is little doubt that the strong job creation seen lately is also attributable to the favourable impact of the wage moderation policy, which reduces the relative cost of the production factor labour, and more especially

that of new recruits, and to a series of structural reforms aimed at boosting the effective labour supply. The downside to this rising employment growth is that it inhibits productivity growth – which actually became negative in 2016 – because activity is expanding at a rather moderate pace.

Since the effect of the wage moderation and structural reforms will gradually ebb away, the ratio between employment growth and activity growth is expected to revert to a level closer to the long-term average, according to the current autumn projections, even though labour costs will begin rising again from 2017. A number of new labour market reforms were announced in October 2016, including more flexible working times, but they are likely to have less of a positive impact on the job intensity of growth compared to the previous measures, according to the initial estimates.

Against that backdrop, the expansion of domestic employment is estimated at around 55 000 jobs in 2016, a figure which is ultimately a little higher than expected in the spring projections. Although job creation has been even more vigorous at certain times in the past, for example in the years preceding the great recession, the situation is rather exceptional as this job creation is currently accompanied by overall moderate activity growth. One point worth mentioning here is that average working time is displaying a slight downward trend. That is taking place in an increasingly flexible labour market,

**CHART 6** JOB INTENSITY OF GROWTH



Sources: NAI, NBB.

where part-time work and short-term contracts are more common. The expansion of the economy's tertiary sector is another contributory factor, as the services branches employ a higher proportion of part-time workers than the industrial branches, and that is driving down the general trend in average hours. The increased participation of workers aged 50 years and over, who are more commonly employed part-time, is also a factor reducing the average working time.

Mainly as a result of the estimated decline in labour intensity, employment is expected to slow down somewhat in the future. That also implies the recovery of labour productivity, forecast to grow by around 1% over the

last two years of the projection period. During the period from 2017 to 2019, net job creation totalling around 120 000 units is supported mainly by market activities. In the branches sensitive to the business cycle, however, the pattern is variable, with the main job creation taking place in market services, and particularly in business services. Following the fiscal consolidation measures, jobs in general government are expected to fall slightly between 2017 and 2019, by 6 000 persons, for the first time in almost 20 years. Conversely, the number of self-employed people is set to continue rising, increasing by 40 000 workers during that same period.

Population ageing is reflected in the ever-diminishing growth of the population of working age, which is already set to decline by 5 000 units by 2019, while the total population will continue to expand rapidly. However, in 2016 and 2017, ageing is partly offset by the arrival of numerous refugees in the second half of 2015; the impact on the labour force takes time to become apparent as their integration into the labour market is very gradual. Moreover, these projections are based on continuation of the structural rise in the participation rate, which reflects both longer-term tendencies and recent reforms to the schemes for early retirement from the labour market. Consequently, the labour force continues to expand throughout the projection period.

Since demand for labour is growing faster than the labour force over the whole of the projection period, the number of unemployed job-seekers should continue to fall. At the end of 2019, it is estimated at 56 000 fewer unemployed than in 2015. The harmonised unemployment rate will reflect those developments, dropping from 8.6% of the labour force in 2015 to 7.6% in 2019.

## 4. Prices and costs

In recent years, there have been a number of measures such as the restrictions on collectively agreed wage increases, reductions in employers' social security contributions, and the index jump, in order to eliminate the wage handicap in relation to the three main neighbouring countries and to boost the cost competitiveness of Belgian firms. In consequence, unit labour costs declined in both 2014 and 2015.

In 2016, the growth of hourly labour costs will remain slightly negative. First, the wage moderation was still in force, and although the government authorised collectively agreed wage increases in 2016 – in contrast to 2015 – , a limit of 0.67% was imposed. Furthermore, collectively agreed wage growth seems to have remained

**TABLE 4** LABOUR SUPPLY AND DEMAND

(seasonally adjusted data; change in thousands of persons, unless otherwise stated)

	2014	2015	2016 e	2017 e	2018 e	2019 e
Total population .....	55	59	61	71	61	44
Working age population .....	9	16	18	21	9	-5
Labour force .....	32	22	29	36	30	24
Domestic employment .....	19	42	55	46	38	37
Employees .....	12	31	41	31	25	25
Branches sensitive to the business cycle <sup>(1)</sup> ..	-1	16	24	19	15	16
Public administration and education .....	6	1	0	-1	-2	-2
Other services <sup>(2)</sup> .....	7	14	17	14	12	11
Self-employed .....	7	11	14	15	13	12
Unemployed job-seekers .....	14	-19	-26	-10	-8	-12
<i>p.m. Harmonised unemployment rate<sup>(3)(4)</sup> .....</i>	<i>8.6</i>	<i>8.6</i>	<i>8.2</i>	<i>8.0</i>	<i>7.8</i>	<i>7.6</i>
<i>  Harmonised employment rate<sup>(3)(5)</sup> .....</i>	<i>67.3</i>	<i>67.2</i>	<i>67.4</i>	<i>67.9</i>	<i>68.3</i>	<i>68.9</i>

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

(1) Agriculture, industry, energy and water, construction, trade, hotels and restaurants, transport and communication, 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).

under that limit for now, according to indications for the first three quarters of 2016: in fact, it seems that few negotiated pay rises were decided at sectoral level. The index jump ended in April 2016, but taking account of the delays inherent in the way in which indexation operates in some of the joint committees, the effect of the index jump will still be felt in 2016 as the effect of indexation on wage growth is significantly below inflation. In general, nominal gross wages should therefore increase only slightly, on average, in 2016. However, that modest rise is more than offset by the new substantial cuts in employers' social contributions applied in 2016. With effect from 1 January 2016, the first employee recruited by SMEs or self-employed workers was granted exemption from employers' social contributions, and the system of reduced charges applicable from the first to the fifth recruit in 2015 now applies from the second to the sixth. On 1 April, the so-called facial rate of social contributions was cut to 30 % (from 32.4 % previously). The flat-rate reduction in social contributions was cut (from € 462.6 to € 438), while at the same time the threshold for the structural reduction in contributions for low wages was raised and the calculation parameter was adjusted so that a larger proportion of wages would qualify for a structural reduction in contributions for low wages.

Despite the reduction in hourly labour costs and contrary to what the June projections predicted, unit labour costs are estimated to have more or less stabilised in 2016; that is due entirely to the fall in labour productivity mentioned above.

According to the present projections, hourly labour costs will rise sharply again from 2017, with the increase actually reaching 3 % in 2019. That is due to the steady increase in indexation linked to the health index, but also – and above all – to an acceleration in collectively agreed wages. For 2017 and 2018, the agreed norm for real negotiated adjustments will only become known on conclusion of the collective agreement negotiations that will start at the end of 2016. The norm applicable for 2019 will not be known until after the negotiations at the end of 2018. Also, a draft Law revising the 1996 Law on the Promotion of Employment and the Preventive Safeguarding of Competitiveness is currently under consideration and aims to modify the method of calculating the maximum margin available for negotiation. In accordance with the Eurosystem rules, however, the projections can only take account of laws which have already been passed or which have been specified in sufficient detail. In view of the continuing labour market recovery and the expected movement in wages in the neighbouring countries, the technical assumption adopted here is broadly the same



as that in the spring projections, namely real negotiated wages increasing by 0.7 % in 2017 and 1 % in 2018. This last assumption was extended to 2019. Depending on the specific projections relating to the three main neighbouring countries and in view of the aforementioned impending revision of the legal framework, it is still possible that wage growth may deviate from these forecasts.

For 2018 and 2019, account is also taken of additional measures under the Competitiveness Pact and the tax shift, which curb the growth of labour costs. For instance, the nominal rate of employers' social security contributions will be further reduced to 25 % in 2018, the flat-rate reduction will be abolished in that same year and the method of calculating the structural reduction in employers' contributions will be adjusted again in 2018 and 2019. From 2018 onwards, there will be no further cuts in employers' contributions on high wages, but in 2018 and in 2019 a bigger proportion of lower wages will be granted a structural reduction in employers' social security contributions.

In all, the reductions in the burden of charges on labour should reduce labour costs per hour worked by around

1.4 % between 2016 and 2019, the effects of that being felt mainly in 2016 and to a lesser extent in 2018. That assessment is unchanged compared to the spring projections except – obviously – for the incorporation of the effect of the measures planned for 2019, since that year was not included in the projection period at that time. Although the increased productivity will somewhat restrain the rise in unit labour costs, those costs will rise faster during the projection period to reach annual growth in the order of 2 % by 2019.

Despite the significant wage moderation efforts, core inflation in Belgium remained relatively high in 2016, at 1.8 %. That is due partly to certain government measures which drove up core inflation, the main one being the October 2015 increase in higher education fees in the Flemish Community. Furthermore, it seems that selling prices barely reflect the moderate movement in labour costs. At macroeconomic level, that is clear from the movement in corporate profit margins which rose sharply in 2016, as in the previous year. Yet, core inflation has eased a little recently, but the main reason is that the said effect of the increased higher education fees in the Flemish Community is no longer reflected in the monthly

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

	2014	2015	2016 e	2017 e	2018 e	2019 e
Labour costs in the private sector <sup>(1)</sup>						
Labour costs per hour worked .....	1.0	-0.1	-0.2	2.0	2.5	3.0
of which: indexation .....	0.8	0.1	0.6	1.3	1.6	1.8
Labour productivity <sup>(2)</sup> .....	1.3	1.1	-0.3	0.4	0.9	0.8
Unit labour costs .....	-0.3	-1.1	0.1	1.6	1.6	2.1
<i>p.m. Labour costs per hour worked according to the national accounts<sup>(3)</sup> .....</i>	<i>1.1</i>	<i>0.0</i>	<i>-0.4</i>	<i>1.9</i>	<i>2.5</i>	<i>2.9</i>
Core inflation <sup>(4)</sup> .....	1.5	1.6	1.8	1.6	2.0	2.0
Energy .....	-6.0	-8.0	-1.0	5.5	2.1	1.8
Food .....	0.8	1.8	3.2	1.8	2.1	2.0
Total infclation (HICP) .....	0.5	0.6	1.8	2.0	2.0	2.0
<i>p.m. Inflation according to the national consumer price index (NCPI) .....</i>	<i>0.3</i>	<i>0.6</i>	<i>2.0</i>	<i>1.9</i>	<i>1.9</i>	<i>1.9</i>
Health index <sup>(5)</sup> .....	0.4	1.0	2.1	1.5	1.8	1.8

Sources: EC, DGS, 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 targeted reductions in social security contributions.

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

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

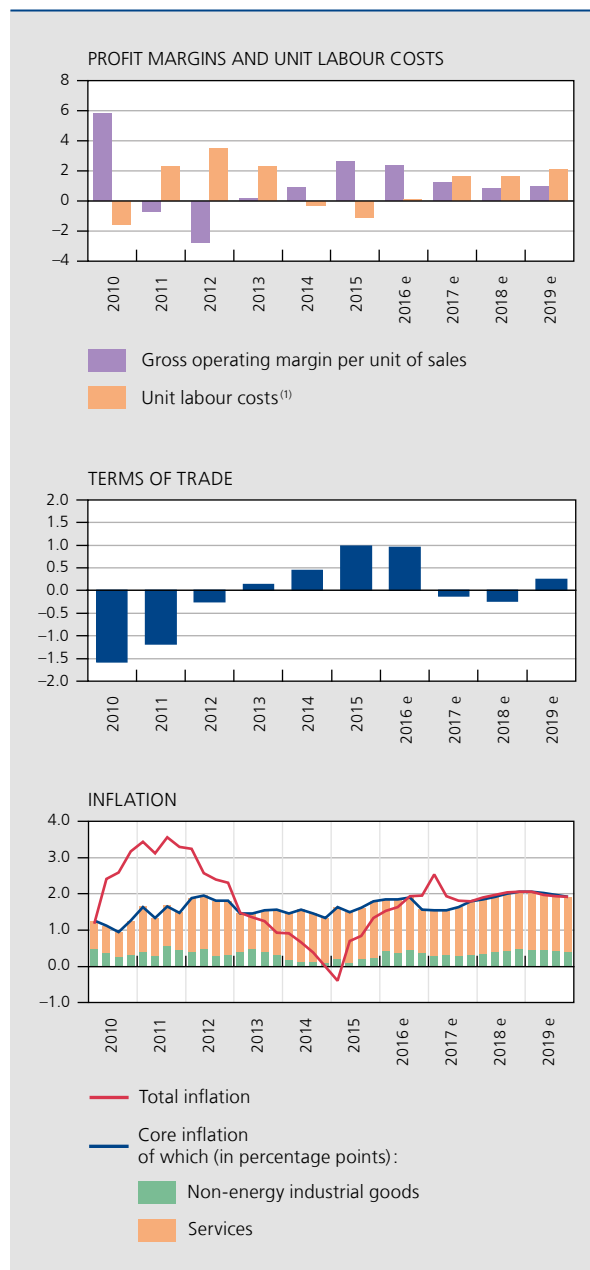
inflation statistics from October onwards. According to the current projections, core inflation should fall in the first half of 2017 – as a result of other base effects too, such as the disappearance from the statistics of the marked rise in the tariffs charged by telecommunications operators at the beginning of 2016 – before gathering pace to reach around 2 % in mid-2018.

This picture is defined by the steady rise in labour costs described above, which will increase the price of labour-intensive services, in particular. Similarly, during the projection period, the rise in prices of non-energy industrial goods – forming the other (less important) component of core inflation – will accelerate, even though their prices are also determined by competitors’ prices on the international markets where growth is expected to slow down slightly at the end of the projection period, according to the common assumptions. The impact of the higher wage costs is also greatly tempered by a weakening in profit margins, the annual growth of which is expected to fall to less than 1 % from 2018. That decline should be viewed partly as a return to a more normal growth rate. Past developments in which steep wage cost increases were often offset by a narrowing of margins suggest that in Belgium there is also a degree of upward rigidity in pricing.

In addition to core inflation, energy and food prices also influence headline inflation over the projection period. The sharp fall in oil prices, leading to an improvement in the terms of trade up to 2016, is part of the reason why headline inflation remained below core inflation up to then. However, oil prices, like the prices of other commodities, began rising again during 2016. More generally, as a result of various factors, the negative contribution of the energy component to observed inflation turned into a positive contribution from the third quarter of 2016. The slower pace of the rise in electricity prices is due essentially to the disappearance of various effects connected with the September 2015 increase in the VAT rate, the introduction of a “prosumer” distribution tariff in Flanders in July 2015 and the imposition of a rate of “corporation tax” on intermunicipal associations in the three Regions between March and August 2015. However, electricity inflation remains high owing to the increase in other charges (essentially the larger contribution to the Energy Fund introduced in the Flemish Region in March 2016) and the abolition of the free kWh in Flanders. Prices of road fuel and heating oil should rise from the final quarter of 2016 throughout the projection period, mainly as a result of the expected movement in oil prices. Gas prices should stabilise from 2017. The widely oscillating energy inflation figure, varying from –1.0 % in 2016 to 5.5 % in 2017, then subsiding to an average of 2.1 % in 2018,

**CHART 7 INFLATION AND DETERMINANTS**

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



Sources: EC, NBB.

(1) Including wage subsidies and reductions for target groups.

clearly influences the overall inflation rate. That is largely why real inflation will exceed core inflation in 2017, contrary to what has been the case in previous years, and will only revert to a level close to core inflation from 2018. The movement in the terms of trade is also projected to flatten out from 2017, as a result of the expected modest rise in oil prices and slightly slower price increases on the international markets.

Food prices were driven up in 2016 by a number of government measures, such as the increase in excise duty on alcohol (November 2015) and tobacco (January 2016), and the introduction of a "health tax" on sugary drinks as part of the tax shift. The rate of food inflation is thus expected to increase to 3.2% in 2016 before dropping thereafter. All the measures already known – such as the increase in excise duty – have been taken into account.

Altogether, inflation is estimated at 1.8% in 2016. As already mentioned, numerous measures have contributed to this general price increase: 0.4 percentage point is attributable to the tax shift and 0.4 percentage point is due to the measures concerning electricity, with the exception of the VAT increase (which forms part of the tax shift). The increase in prices significantly exceeds that in the euro area (0.2%), the main reason for that difference being the services category, where prices are rising much faster in Belgium than elsewhere. Inflation is then set to accelerate somewhat to reach 2% during 2017-2019, and the gap with the euro area average would become considerably smaller.

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 owing to methodological differences. The NCPI is used to calculate the health index, i.e. the national index which excludes tobacco, alcoholic beverages and road fuel. That health index, which forms the basis of wage indexation, is forecast to rise more slowly and remain below 2% from 2017.

## 5. Public finances

### 5.1 Budget balance and debt

According to the latest estimates, the public finances should end the year 2016 with a deficit of 3% of GDP, a 0.5 percentage point deterioration compared to 2015. In the macroeconomic context described above, the general government budget deficit is expected to fall to 2.3% of GDP in 2017 and remain at that level for the ensuing two years.

The deficits will be concentrated mainly at federal government level, but the sub-sector comprising the Communities

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

	2015	2016 e	2017 e	2018 e	2019 e
<b>General government</b>					
Revenue .....	51.3	50.7	50.6	50.2	49.8
Primary expenditure .....	50.9	51.0	50.6	50.4	50.1
Primary balance .....	0.5	-0.3	0.1	-0.2	-0.3
Interest charges .....	3.0	2.7	2.4	2.1	2.0
<b>Financing requirement (-) or capacity</b> .....	<b>-2.5</b>	<b>-3.0</b>	<b>-2.3</b>	<b>-2.3</b>	<b>-2.3</b>
<i>p.m. Structural budget balance</i> .....	-2.5	-2.7	-2.1	-2.2	-2.1
<b>Overall balance per sub-sector</b>					
Federal government <sup>(1)</sup> .....	-2.4	-2.9	-2.1	-2.0	-2.0
Social security .....	0.1	0.0	0.0	0.0	0.0
Communities and Regions <sup>(1)</sup> .....	-0.3	-0.2	-0.3	-0.3	-0.4
Local authorities .....	0.1	0.1	0.0	-0.1	0.1
<b>Consolidated gross debt</b> .....	<b>105.8</b>	<b>106.5</b>	<b>106.3</b>	<b>106.0</b>	<b>105.6</b>

Sources: NAI, NBB.

(1) These figures were drawn up in accordance with a budgetary approach. They 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. The adjustment for these advances was handled in accordance with the provisions of the Special Finance Act.

and Regions will also record a deficit – albeit smaller – during the projection period. Conversely, the local authority and social security accounts will be more or less in balance.

The increase in the budget deficit in 2016 is due to a sharp fall in revenue and a small rise in primary expenditure as a ratio of GDP, causing the primary balance to become negative again. Interest charges will be down by 0.3 percentage point of GDP, as maturing government loans can be refinanced at interest rates favourable for public authorities.

The expected improvement in the budget balance in 2017 is due to a reduction in both primary expenditure and interest charges as a ratio of GDP, while revenues should remain practically unchanged.

In 2018 and 2019, primary expenditure and interest charges are set to continue falling, but the decline in interest charges will weaken at the end of the projection period. The favourable impact of these two factors on the budget balance is likely to be offset by a fall in revenues owing to the measures taken via the tax shift.

The public debt is forecast to rise in proportion to GDP in 2016, but the debt ratio should fall slightly from 2017 until the end of the projection period. However, that reduction is smaller than the decline for the euro area as a whole, so the gap between Belgium's debt ratio and that of the euro area will widen.

These projections take account of all the budget measures which have been announced and specified in sufficient detail. Measures which have been insufficiently specified include the measures to combat fraud and those concerning tax regularisation, while the under-utilisation of spending appropriations and certain economy measures concerning social security are also expected to generate a lower yield. The potential impact of the planned reforms or the harmonisation of corporation tax in the European Union Member States has not been taken into account. The projections show that additional consolidation measures will be necessary to achieve a structurally balanced budget.

## 5.2 Revenue

Government revenues are forecast to fall by 0.6 percentage point of GDP in 2016 and should remain at much the same level in 2017. In 2018 and 2019, the revenue ratio will fall again by 0.5 and 0.4 percentage point of GDP respectively.

This marked decline in the revenue ratio is due to the tax shift which considerably reduces the levies on labour incomes, in order to boost firms' competitiveness, stimulate employment and increase household purchasing power.

In 2016, the revenues originating from personal income tax and social contributions are set to fall by 0.4 and 0.5 percentage point of GDP respectively. In the case of

**TABLE 7** PUBLIC REVENUES  
(in % of GDP)

	2015	2016 e	2017 e	2018 e	2019 e
Fiscal and parafiscal revenues	44.5	43.8	43.8	43.4	43.0
Levies applicable mainly to labour income	26.0	25.1	24.9	24.5	24.1
Personal income tax	11.5	11.1	11.0	10.7	10.4
Social contributions	14.5	14.0	13.9	13.8	13.7
Taxes on corporate profits	3.4	3.2	3.2	3.2	3.3
Levies on other incomes and on assets	4.2	4.2	4.3	4.3	4.2
Taxes on goods and services	10.9	11.3	11.3	11.4	11.4
of which:					
VAT	6.7	6.9	6.9	7.0	7.1
Excise duty	2.1	2.2	2.2	2.2	2.1
Non-fiscal and non-parafiscal revenues	6.8	6.9	6.9	6.8	6.7
Total revenues	51.3	50.7	50.6	50.2	49.8

Sources: NAI, NBB.

personal income tax, the fall is due to the adjustment of the tax scales aimed at boosting purchasing power, particularly for low and middle incomes, and the increase in deductible business expenses. Social contributions should 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. In 2016, VAT revenues are set to rise by 0.2 percentage point of GDP, mainly owing to the entry into force on 1 September 2015 of the increase in VAT on electricity consumption, which will take full effect in 2016. In addition, successive increases in the excise duty on diesel, tobacco and alcohol have generated a rise of around 0.1 percentage point of GDP in the revenues derived from excise duties.

Corporation tax revenues should fall by 0.2 percentage point of GDP owing to a reduction in advance payments. The shift away from advance payments towards collection via the assessments, apparent since the financial crisis, therefore seems to be continuing.

Revenues generated by the withholding tax on income from movable property are likely to remain more or less stable, despite the increase in the standard rate from 25 % to 27 %, applicable since 1 January 2016. The reason lies in a smaller yield from lower interest rates and the use of existing liquidation reserves, so that the withholding tax is no longer due on dividends.

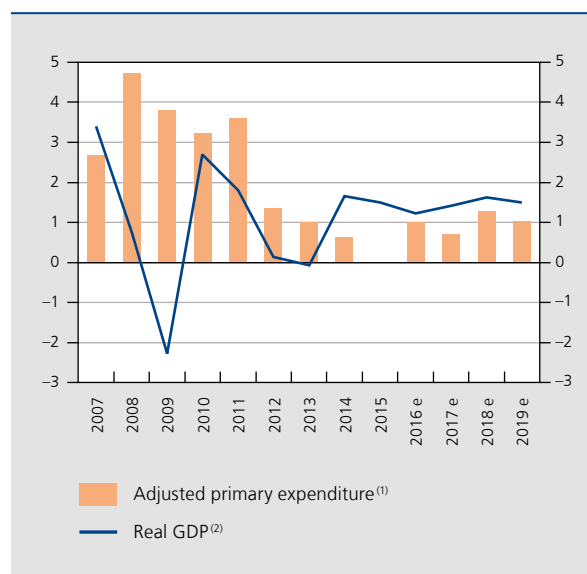
In 2017, most revenue categories are expected to remain relatively stable in relation to their 2016 level. Social contributions are set to contract slightly as the reduction in employers' contributions exerts its full impact.

In 2018 and 2019, revenues are forecast to fall further as a result of the measures adopted in relation to the tax shift. Thus, in both of these two years, personal income tax revenues are expected to fall by 0.3 percentage point of GDP. Moreover, a further cut in the employers' rates should reduce social contributions by 0.2 percentage point of GDP in 2018.

### 5.3 Primary expenditure

The fall in primary expenditure as a ratio of GDP will be suspended in 2016 before resuming its downward trend in the ensuing two years. In nominal terms, the increase in that expenditure will therefore be outpaced, during the projection period, by the expansion of economic activity. That picture largely reflects the economy measures adopted by the governments formed after the May 2014 elections.

**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.

The federal government is endeavouring to reduce its operating expenses considerably, e.g. by cutting the size of the public workforce and reducing purchases of goods and services. 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 have likewise decided to cut back their expenditure. Finally, the local authorities also had to implement restrictions to maintain sound finances, but these budget cuts will probably be offset by the revival of public investment in the run-up to the 2018 municipal and provincial elections.

In 2016, however, a number of unforeseen factors thwarted the moves to control expenditure. They included the exceptional efforts made to combat terrorism and to manage the influx of asylum-seekers, while various one-off factors also entailed additional expense.

Following adjustment for these temporary factors, the impact of the business cycle and the time lag between inflation and indexation, real primary expenditure will rise by 1 % in 2016, which is somewhat less than the forecast real GDP growth. In 2017, 2018 and 2019, adjusted expenditure growth will be more clearly below the increase in real economic activity.

## Conclusion and risk factor assessment

The present autumn projections produced by the Eurosystem – both for the euro area and for Belgium – are still very close to the June 2016 spring projections and the ECB’s September 2016 estimates. In the case of Belgium, the growth estimates have remained virtually unchanged compared to the spring projections. However, in that regard, the recent rise in employment, which has been significant and has exceeded expectations, strengthens the foundations of economic growth. The short-term outlook therefore continues to point to growth picking up in late 2016 and early 2017. Conversely, the estimates for inflation have been revised upwards slightly, though that increase is due mainly to the sharper rise in energy prices, as the core inflation profile has remained more or less unchanged.

These growth estimates are quite similar to the latest projections by other institutions, despite possible divergences in the dataset owing to the different periods in which they were produced. The growth projections issued before November, such as the FPB’s Economic Budget (September) and the latest IMF forecasts (October), did not take account of the revisions of the quarterly accounts published by the NAI at the end of October (which included the downward revision of growth for the first quarter of 2016), so that the estimated growth in 2016 is too high. The fact that the Bank’s projections for the years ahead are at the top of the range is probably also due in part to the more recent cut-off date so that, on the basis of the short-term models, they take more account of the slightly more favourable outlook for the immediate future. For inflation, too, these projections are in the upper part

of the range of other available estimates, although that may equally be due to different assumptions for the exchange rate and the oil price.

The convergence of macroeconomic projections should not mask the fact that such forecasts are always subject to great uncertainty. For instance, although the concerns over the emerging countries have waned somewhat, the heightened political uncertainty in the developed economies implies a considerable increase in the overall risks surrounding these specific projections. The extent to which American policy will change course is indeed particularly hard to determine at the current juncture, although the financial markets now seem to anticipate higher nominal and real growth, on account of substantial infrastructure projects. A significant rise in public spending at the beginning of 2017 should in all probability revitalise growth, but it may also encourage a new rise in inflation expectations and long-term interest rates, not only in the United States but also on other markets, which could depress private investment. A new appreciation of the US dollar could similarly boost the cost competitiveness of European exporters, but major downside risks also exist in the medium term, due to possible protectionist measures which would limit trade and the free circulation of persons. This would imply a reduction in the labour supply, a deterioration in international competition, and a decline in household purchasing power.

However, the political uncertainty also concerns the euro area. Although the recent turmoil in Italy following the referendum rejecting constitutional change has so far caused only moderate turbulence on the financial markets, national elections are scheduled in other large countries in 2017. Fundamental changes of course in the economic

**TABLE 8** COMPARISON WITH FORECASTS FROM OTHER INSTITUTIONS  
(in %)

Institution	Publication date	Real GDP growth				Inflation (HICP, unless otherwise stated)			
		2016	2017	2018	2019	2016	2017	2018	2019
Federal Planning Bureau <sup>(1)</sup>	September 2016	1.4	1.2			2.0	1.6		
IMF	October 2016	1.4	1.4	1.4		2.0	1.6	1.7	
EC	November 2016	1.2	1.3	1.5		1.7	1.7	1.8	
OECD	November 2016	1.2	1.3	1.5		1.7	1.7	1.7	
Consensus Economics	December 2016	1.3	1.4			1.8	1.7		
NBB	December 2016	1.2	1.4	1.6	1.5	1.8	2.0	2.0	2.0

(1) Economic Budget. The inflation rates correspond to the NCPI.

policy of those countries would naturally have a direct impact on the growth outlook for all euro area countries.

As regards the purely domestic risks, the forecast trend in the job intensity of growth might be mentioned: regardless of any prolonged beneficial impact of labour cost moderation and structural reforms, employment growth may also be largely underpinned by more persistent factors such as a new upward trend in the importance of the labour-intensive services branches. Moreover, taking account of the divergence between the budget estimates and the official targets for the

budget deficit, additional consolidation measures may be needed when budget reviews or the preparation of new budgets for 2018 and 2019 are drawn; this would obviously have an impact on the macroeconomic outlook. Finally, the assumptions concerning real wage growth and profit margins, based on past observations, are somewhat uncertain: if the future wage norm indicated a different path for wages, or if the impact of the wage increase on selling prices were to diverge from that foreseen in these estimates, the picture concerning activity, employment, the budget balance or inflation could differ from the current autumn projections.

## 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	2019 e
<b>Growth</b> (calendar adjusted data)					
Real GDP .....	1.5	1.2	1.4	1.6	1.5
Contributions to growth:					
Domestic expenditure, excluding change in inventories .....	1.2	1.0	1.5	1.5	1.5
Net exports of goods and services .....	0.0	0.9	0.2	0.1	0.0
Change in inventories .....	0.3	-0.7	-0.2	0.0	0.0
<b>Prices and costs</b>					
Harmonised index of consumer prices .....	0.6	1.8	2.0	2.0	2.0
Health index .....	1.0	2.1	1.5	1.8	1.8
GDP deflator .....	0.9	1.6	1.7	1.7	1.9
Terms of trade .....	1.0	0.9	-0.1	-0.2	0.2
Unit labour costs in the private sector <sup>(1)</sup> .....	-1.1	0.1	1.6	1.6	2.1
Hourly labour costs in the private sector <sup>(1)</sup> .....	-0.1	-0.2	2.0	2.5	3.0
Hourly productivity in the private sector .....	1.1	-0.3	0.4	0.9	0.8
<b>Labour market</b>					
Domestic employment (annual average change in thousands of persons) .....	42.1	55.0	45.8	38.0	36.6
Total volume of labour <sup>(2)</sup> .....	0.6	1.4	0.9	0.7	0.7
Harmonised unemployment rate (in % of the labour force aged 15 years and over) .....	8.6	8.2	8.0	7.8	7.6
<b>Incomes</b>					
Real disposable income of individuals .....	0.7	1.8	1.1	1.7	1.9
Savings ratio of individuals (in % of disposable income) .....	11.7	12.6	12.5	12.7	12.7
<b>Public finances</b>					
Primary balance (in % of GDP) .....	0.5	-0.3	0.1	-0.2	-0.3
Budget balance (in % of GDP) .....	-2.5	-3.0	-2.3	-2.3	-2.3
Public debt (in % of GDP) .....	105.8	106.5	106.3	106.0	105.6
<b>Current account</b> (according to the balance of payments, in % of GDP) .....					
	0.4	1.4	1.6	1.8	2.2

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.