Economic projections for Belgium

June 2017

National Bank of Belgium
Eurosystem

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Economic projections for Belgium – Spring 2017

Introduction

As predicted in the autumn forecasts, the global economy bottomed out from the second half of last year. Despite the various – mainly political – uncertainties and shocks, it seems that growth in both the advanced and the emerging countries has at least stabilised. According to the latest statistics, world growth outside the euro area in 2016 actually slightly exceeded overall what was expected in the ECB's March 2017 forecasts. According to the first estimates, activity growth in the first quarter of 2017 in some major countries such as the United States, China and the United Kingdom fell somewhat short of expectations although – certainly in the case of the US – that could also be attributable to additional seasonal effects. However, those rather disappointing quarterly growth figures have little impact on the outlook for the medium term, as the short-term growth estimates remain favourable. As in the latest estimates by the leading international organisations, the common assumptions applied to these projections which were finalised on 17 May 2017 therefore also assume that global growth year-on-year will remain modest but continue to strengthen over the projection period.

The recent striking recovery of world trade is significant in that connection : at the end of 2016, import demand in the advanced and emerging countries recorded a marked increase which was stronger than expected. The initial figures for 2017 also indicate a continuing vigorous expansion of trade. Although recent trade statistics must always be interpreted with due caution, it is encouraging that estimates of world trade – which for a long time fell short of predictions – can now be revised upwards again. That may be due partly to a revival in investments, which are highly import-intensive, but may also indicate more generally that the improvement in world trade is accompanied by a recovery of the global production chains, making growth more robust and less dependent on the situation in some individual countries. Nevertheless, the common assumptions, the main ones being described in box 1, take account of a gradual decline in the trade intensity of growth to around 1, because some factors which have raised that intensity in the past – such as the progressive liberalisation of trade – are likely to have less influence during the projection period.

Calm has also been restored on the financial markets. Following the abrupt rise in interest rates at the time of the American presidential elections in November 2016, which mainly seemed to reflect rising inflation expectations against the backdrop of a probably more expansionary fiscal policy in the United States, but which also spread to other countries, market interest rates have ceased rising. In the past few weeks, they have also declined as market expectations concerning the future fiscal policy were gradually adjusted downwards. In the euro area, where the interest rate increase was more limited, rates remain close to the historical low. Share prices have risen more or less continuously since last year, bolstered partly by the still highly accommodative monetary policy, but also by the improving outlook for profits as economic activity gains momentum. Following the restrictions on production introduced by the oil-producing countries at the end of last year, after the autumn forecasts were finalised, oil prices surged but have since gradually subsided to a level that does not appear to be hampering global growth at present.

In the euro area, the economy also grew steadily at the beginning of 2017. While the German economy expanded slightly more strongly, and growth in Spain remained high, the French and Dutch economies slowed down somewhat. Moreover, the short-term indicators – such as those concerning business sentiment – still point to a very favourable outlook for the euro area in the second quarter of this year. According to the latest Eurosystem estimates, which include the spring forecasts described in this article, and which were finalised on 23 May, activity in the euro area will therefore continue to expand at roughly the same rate and strengthen somewhat on an annual basis to around 2 % in 2017. After that, growth is expected to decline slightly in the following two years as employment and domestic demand gradually lose momentum, and even more so as labour market supply constraints in some countries are likely to weigh more on growth. Although the common assumptions have been revised upwards overall, the growth outlook remains fairly close to the ECB's March 2017 forecasts. Inflation in the euro area is forecast to surge in 2017 before remaining more or less unchanged. The increasing domestic cost pressure is likely to be offset to some extent by declining energy inflation since oil prices should no longer be rising in the second half of the projection period. However, like real inflation, core inflation is also expected to remain below 2 % at the end of 2019.

Regarding Belgium, estimates have barely been revised compared to the autumn forecasts. Growth for 2017 was upgraded slightly, primarily on account of the better-than-expected start of the year, but is still somewhat lower than in the euro area, the main reason being the rather less vigorous domestic demand which is not offset by a stronger export performance. As in the autumn forecasts, year-on-year growth is expected to remain broadly constant thereafter.

Employment growth in 2016 slightly exceeded our autumn forecasts. There is little doubt that this growth was driven by the recent policy measures, particularly wage cost moderation, that makes labour relatively cheaper, and certain structural labour market reforms that broaden the effective labour supply. As in the autumn estimates, however, the current forecasts assume that this additional stimulus will fade away and that the ratio between employment expansion and the growth of activity will revert to a level closer to the historical averages. Indeed, in the past two quarters, there has already been a sharp fall in employment expansion. Although it was still strengthening slightly from the beginning of 2017, according to the current forecasts it should be clearly more moderate this year than in 2016. All in all, over the three years from 2017 to 2019, more than 115 000 new jobs are expected to have been created. Despite the somewhat slower growth of labour costs, due partly to the integration of the new wage agreement for 2017 and 2018, that amounts to a small downward revision compared to the autumn forecasts. This would be due mainly to the growing impact of supply shortages on the labour market, as is already apparent from the rising number of unfilled vacancies, with firms finding it increasingly difficult to find suitable staff. However, employment expansion should be supported by an increase in the participation rate, especially among older workers, fostered by the recent measures to impose further restrictions on early departure from the labour market. The unemployment rate is set to fall further to 7.2 %, a level which is still slightly higher than before the great recession.

Although inflation has risen somewhat faster than expected as a result of the higher oil price, core inflation was actually somewhat lower than estimated from the end of 2016. Despite the volatility due to calendar effects related to the date of the Easter holidays, which had a significant impact on the monthly figures for March and April, it would have nevertheless recently reverted to a level close to the estimates in the autumn forecasts. The current forecasts also expect limited changes in core inflation during the projection period : as in the past, the strong rise in labour costs should not be entirely passed on in prices, but should instead tend to squeeze profit margins. In comparison with the autumn forecasts, there was still a slight downward adjustment in core inflation. That is due partly to the expected impact of some measures designed to encourage effective competition in certain services industries with persistently high inflation, but it also reflects the somewhat slower rise in labour costs. These estimates take account of the new collective wage agreement from the beginning of this year for 2017 and 2018, and incorporate a slight downward adjustment in negotiated wage growth for 2019.

Finally, as regards public finances, the budget deficit declined more steeply than expected in 2016. That improvement is largely structural, and the estimates for the deficit over the projection period are also now lower than in the autumn forecasts. The deficit is expected to fall further this year to around 2 % of GDP, but remain virtually unchanged after that. The additional gains in interest charges, estimated at 0.3 % of GDP in 2018 and 2019, and the favourable impact of the economic situation should be offset by a further structural easing of fiscal policy, the main reason being that the additional reductions in charges planned in 2018 and 2019 under the tax shift are not yet fully financed. At the end of the projection period, the deficit is expected to exceed 2.0 % again, which is still a long way from the target of a structurally balanced budget. Although the gross public debt in relation to GDP should gradually fall, it is still estimated at around 104 % at the end of the projection period. In that connection, it should be borne in mind that, in accordance with the Eurosystem rules on the projection exercises, account is only taken of measures which, at the time of completion of the exercise, have been formally adopted by the government or which are very likely to be approved, and for which the details are sufficiently clear. Furthemore, 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

Although the year-on-year growth of the world economy dipped a little further in 2016, during that year – as predicted by the autumn forecasts – there was a marked turnaround in global activity. From the second half of last year, world growth picked up slightly in what remains a highly uncertain environment. The still relatively limited improvement in economic activity is evident in both emerging and advanced economies, but masks divergent developments in individual countries.

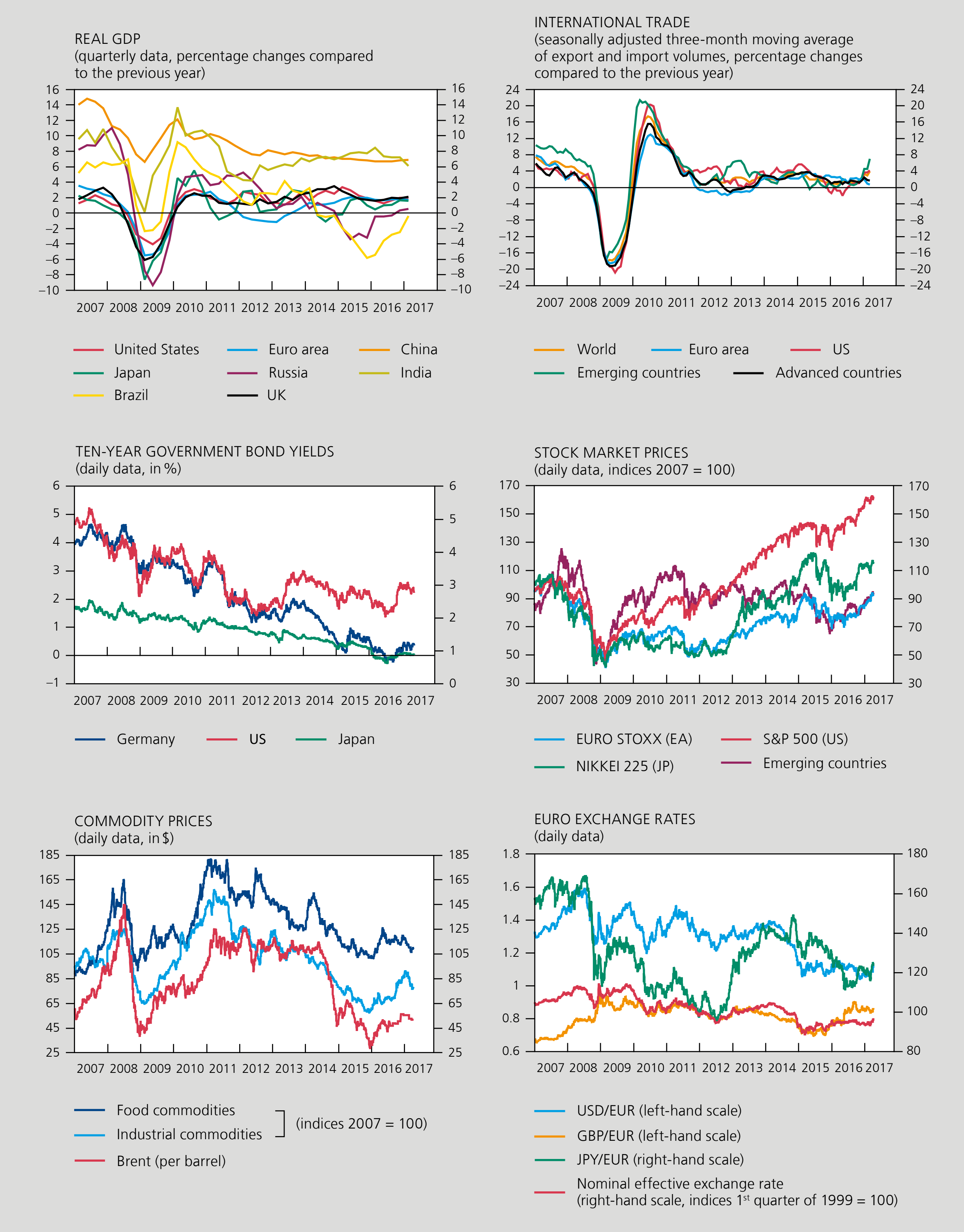
The strengthening growth in the emerging countries is attributable mainly to the Russian and Brazilian economies, which are gradually recovering from a deep recession caused by the slump in commodity prices but further exacerbated by western economic sanctions in the case of Russia and political instability in the case of Brazil. In China, despite the ongoing process of rebalancing from a growth model centred mainly on exports towards stronger domestic demand, the economy maintained vigorous growth which, though moderating slightly, remained in line with the official target of a growth rate between 6.5 % and 7 %. Apart from expanding foreign demand, growth was also underpinned by the dynamism of the property market and the accommodative fiscal policy, reflected primarily in major infrastructure projects. However, in the first quarter of this year, quarterly activity growth seems to have slackened pace again, and the slowdown was actually somewhat sharper than predicted in the previous forecasts. Furthermore, the recent tightening of monetary policy and banking supervision, and various administrative measures to prevent another property market bubble, have yet to be fully reflected in the real economy. In India, too, economic growth continues apace, partly as a result of radical structural reforms. The temporary slowing of the growth rate since the end of last year is due partly to certain monetary policy measures which have a negative but temporary impact on private consumption.

Turning to the advanced countries, from the third quarter of 2016, there was a surge in American economic activity, propelled by a strong export recovery, robust consumption growth and, primarily after the election of the new President, rising expectations of a more expansionary fiscal policy. Household consumption remains the principal engine of activity, and is in turn supported by the further improvement in the labour market situation. With unemployment at 4.3 % in May 2017, the labour market is close to full employment, curbing the prospects for further growth. The rise in hourly wages has also accelerated, and has already reached 2.5 % year-on-year. In those circumstances, the Federal Reserve continued to normalise its monetary policy. A year after the first interest rate hike since the crisis, the interest rate range was again increased by 25 basis points in December 2016, and that was followed by a further monetary tightening on the same scale in March 2017. According to current estimates, growth in the United States also declined more sharply than expected at the beginning of 2017, dropping to 0.3 % quarter-on-quarter. However, the American quarterly growth figures are rather volatile and are often lower in the first quarter. It is therefore possible that this low growth was due to an inadequately adjusted seasonal profile, or may be revised upwards later, as was already the case for the second estimate of the quarterly growth figures.

In contrast, in Japan, the economy achieved only sluggish growth in 2016, despite the supportive policy and the favourable financial conditions. Although the labour market situation is particularly tight, with unemployment currently at its lowest level since the 1990s, wage dynamics are still very weak and therefore insufficient to provide a significant stimulus for activity – and inflation. However, from the end of 2016, economic growth was increasingly buttressed by a strong export revival, due partly to the depreciation of the yen and the recovery of foreign demand.

In the United Kingdom, the outcome of the Brexit referendum did not immediately put the brakes on economic activity. In the third and fourth quarters of 2016, the economy continued to expand at the same pace as in the previous quarter, far exceeding the expectations of most institutions. Supportive policy measures, including the Bank of England's cut in interest rates in August and the easing of fiscal policy, were undoubtedly contributory factors. Nonetheless, the British economy clearly ran out of steam in the first quarter of this year. The depreciation of the pound sterling and higher inflation are beginning to dent household purchasing power in particular, and that has depressed private consumption. Exit from the

CHART 1 WORLD ECONOMY AND DEVELOPMENTS ON FINANCIAL AND COMMODITY MARKETS



Sources: CPB Wereldhandelsmonitor, OECD, Thomson Reuters Datastream.

European Union is still expected to cause a further decline in British growth in the medium term, although to a lesser extent than in earlier forecasts, as a result of more restrictions on exports and the impact on investment of the uncertainty over future relations with the European Union.

In all, the recent slowdown in some major countries such as the United States, China and the United Kingdom should not be seen as a break in the trend, and most forecasts still indicate that activity outside the euro area will continue to pick up gradually.

In the euro area itself, since the second half of last year, real GDP has been growing for the third consecutive quarter at a relatively constant rate of around 0.5 % per quarter. Private consumption remains the principal engine of growth, and is propelled mainly by a further improvement in the labour market. Although investment rebounded strongly at the end of last year after a weak third quarter, various factors such as uncertainty and corporate debt reduction are still curbing investment growth to some degree, despite the highly favourable financing conditions created by the accommodative monetary policy.

Last year, the recovery in the euro area clearly became stronger and more broadly based: growth differences between countries diminished though they have not yet disappeared. In the first quarter of this year, activity increased in all countries. Growth remained very vigorous in Spain, Portugal, and some smaller European countries, and gathered pace in Germany and especially in Finland. Conversely, the French and Dutch economies slowed down somewhat.

As in the other advanced countries, inflation in the euro area began rising steeply last year, reaching 1.4 % in May 2017 (first Eurostat flash estimate) compared to –0.1 % in the same month of last year. But that mainly reflects the rise in oil prices; core inflation is still fairly flat overall, primarily as a result of the continuing modest wage growth.

Although global trade flows reached a low point in 2016, growing by around 2 % year-on-year, they nevertheless showed clear signs of recovery in the second half of the year. That was due not only to strengthening global demand but also to certain composition effects and, in particular, the gradual revival of investment, for example in the Chinese infrastructure projects mentioned earlier, but also in American energy production, because investment usually generates higher demand for imports. More generally, the sharp upturn in trade intensity which was also evident at the beginning of 2017 could also be attributable to a modest recovery in global production chains against the backdrop of the improving situation in the emerging countries. Nonetheless, various structural factors continue to depress the trade intensity of growth, so that the pre-crisis level may not be regained in the near future. Apart from China's transition to an economy geared more to consumption and services, which thus generates weaker import demand for commodities and machinery, the main factor is the marked lack of progress in the liberalisation of trade, with the policy intentions of some countries actually suggesting a return to protectionism.

The financial markets have been particularly calm in the past few months. Share prices climbed steeply throughout the world, particularly after the American presidential elections, and there have been few interim corrections as is evident from the current low level of the volatility indices. Although the American stock markets lost some of their momentum recently as expectations of an expansionary fiscal policy and more deregulation in the United States were adjusted downwards, share prices elsewhere, and notably in the euro area, are still rising, driven by fundamental determinants such as the continuing very flexible monetary policy and rising corporate profit expectations as the economy picks up. Following a sharp increase in the autumn, bond yields have subsided somewhat and remain close to their historical floor in the euro area. Furthermore, since the French presidential elections, spreads have clearly narrowed again.

While the pound sterling had fallen sharply against the euro following the Brexit referendum, the announcement of an early parliamentary election recently caused the British currency to strengthen slightly. After appreciating in the wake of the presidential elections, the dollar recently lost ground against the euro. Factors which may have played a role include the change in the growth differential in relation to the United States, reflected in stronger growth figures for the euro area, the renewed confidence in the European economy following the French presidential elections, and the mounting uncertainty over American policy.

Oil prices began rising again last year, supported by the revival in activity and the agreement of 30 November between OPEC members and a number of other countries on restricting oil production. Against that backdrop, other commodity prices also increased, particularly as a result of the growing demand from the emerging countries. During the initial months of 2017, however, prices of oil and industrial commodities lost some of the gains made. Higher oil production in the United States triggered a further decline in oil prices, while industrial commodity prices fell in view of expectations concerning lower future demand from China, following the measures taken by the Chinese authorities this year to avoid a property market bubble.

TABLE 1 PROJECTIONS FOR THE MAIN ECONOMIC REGIONS

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

	2015	2016	2017 e	2018 e
Real GDP				
World	3.2	3.0	3.4	3.6
of which:				
Advanced countries	2.4	1.8	2.1	2.0
United States	2.6	1.6	2.2	2.3
United Kingdom	2.2	1.8	1.8	1.3
Japan	1.2	1.0	1.2	0.6
Euro area	2.0	1.8	1.7	1.8
Emerging countries	4.0	4.1	4.5	4.8
China	6.9	6.7	6.6	6.3
India	7.5	7.1	7.2	7.5
Russia	–2.8	–0.2	1.2	1.4
Brazil	–3.8	–3.6	0.5	1.8
p.m. World imports	*2.5*	*1.9*	*3.5*	*4.0*
Inflation (1)				
United States	0.1	1.3	2.2	2.3
Japan	0.8	–0.1	0.4	1.0
Euro area	0.0	0.2	1.6	1.3
China	1.4	2.0	2.4	2.3
Unemployment (2)				
United States	5.3	4.9	4.6	4.5
Japan	3.4	3.1	3.1	3.0
Euro area	10.9	10.0	9.4	8.9

Sources: EC, IMF.
(1) Consumer price index.
(2) In % of the labour force.

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.

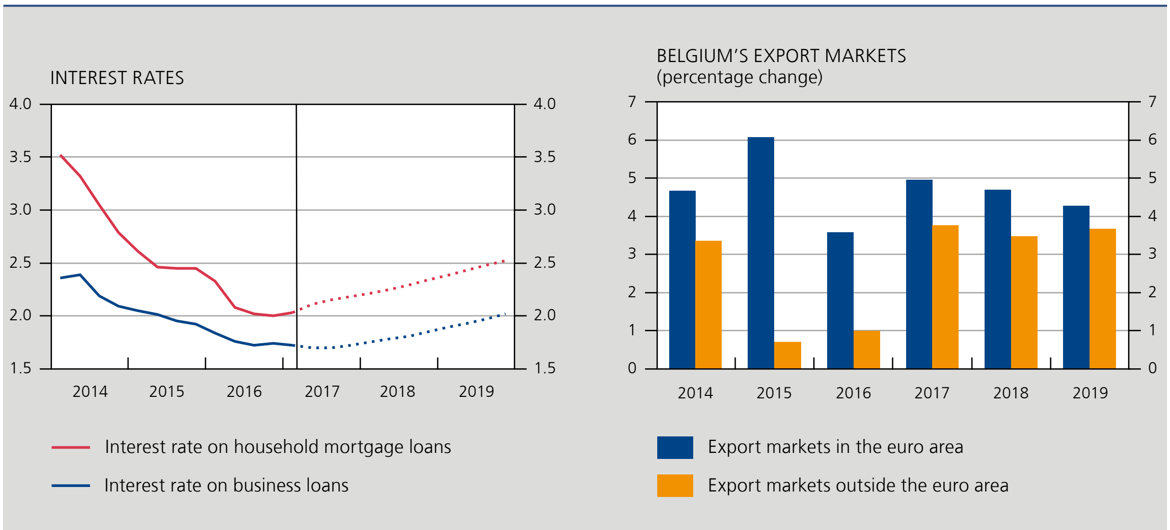
In the projections, it is assumed that future exchange rates will remain constant throughout the projection period at the average levels recorded in the last ten working days before the cut-off date of the assumptions, i.e. 17 May 2017. In the case of the US dollar, the exchange rate then stood at $ 1.09 to the euro.

As usual, the assumptions concerning oil prices take account of market expectations as reflected in forward contracts on the international markets. After the cut-off date for the autumn forecasts in November 2016, oil prices rose sharply as a result of the production restrictions announced by the oil-producing countries at the end of last year. Following widely fluctuating prices in recent years, the price of Brent crude is now set to become unusually stable: in mid-May 2017, the markets expected the Brent price to average roughly $ 51 on an annual basis over the projection period covering the years 2017 to 2019. That price implies an upward revision for 2017, but is still close to the assumptions made in the autumn forecasts for the end of the projection period.

The interest rate assumptions are likewise based on market expectations in mid-May 2017. In the first half of 2017, the three-month interbank deposit rate thus dropped below –30 basis points, but is expected to edge upwards very gradually and reach zero by the end of the projection period. The level of Belgian long-term interest rates is projected to rise more sharply from 0.8 % in the first quarter of 2017 to an average of 1.4 % in 2019.

INTEREST RATES AND VOLUME GROWTH OF EXPORT MARKETS

(in %)



Source: Eurosystem.

The predicted movement in bank interest rates on business investment loans and household mortgage loans may still diverge somewhat from the movement in market rates. For instance, the average mortgage interest rate is historically low, partly on account of the ECB’s particularly accommodative monetary policy and the resulting abundant liquidity, and it is unlikely to keep entirely in line with the upward movement in the long-term market interest rate: that rate is only projected to increase from around 2.1 % in 2017 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 remain relatively constant over the projection period: in 2019, it is forecast at an average of 2 %, which is barely 0.3 percentage points more than the 2017 average.

As stated in chapter 1, the international environment seems to have improved a little further compared to the situation at the time of the autumn forecasts. Global economic growth excluding the euro area has only undergone a modest upward revision, but the trade intensity of growth has been much higher than 1, exceeding the predictions forming the basis of the common assumptions in the autumn forecasts. In itself, that strong end to the year generates a substantial spillover effect for 2017, even though for the projection period it was still expected that there would be a gradual return to a unitary elasticity of global import demand in relation to growth. For 2017, the year-on-year growth of the Belgian export markets was revised upwards quite considerably compared to the autumn forecasts, but since that primarily concerns a spillover effect from the much larger-than-expected trade flows at the end of 2016, the impact on the actual estimates from 2017 onwards is rather limited. The upward revisions of the export markets for 2018 and 2019 are decidedly smaller. Overall, for the projection period as a whole, the growth of Belgium's export markets comes to at least 4 %, weakening slightly towards the end of the period.

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 trend in prices that competitors charge on the export markets is a key factor in the cost aspects of that competitiveness. In 2017, those prices have risen steeply, but that mainly reflects the aforesaid increase in the oil price. In 2018 and 2019, they are set to rise at a more moderate pace : assuming that the exchange rate remains constant, rising inflation in the euro area – but also elsewhere – will gradually lead to renewed, albeit weak, upward pressure on the prices of Belgian exporters' competitors in the years ahead.

EUROSYSTEM PROJECTION ASSUMPTIONS

(in %, unless otherwise stated)

	2016	2017	2018	2019
	(annual averages)			
EUR/USD exchange rate	1.11	1.08	1.09	1.09
Oil price (US dollars per barrel)	44.0	51.6	51.4	51.5
Interest rate on three-month interbank deposits in euro	–0.3	–0.3	–0.2	0.0
Yield on ten-year Belgian government bonds	0.5	0.8	1.1	1.4
Business loan interest rate	1.8	1.7	1.8	2.0
Household mortgage interest rate	2.1	2.1	2.3	2.5
	(percentage changes)			
Belgium's relevant export markets	2.5	4.5	4.2	4.0
Export competitors' prices	–3.0	4.0	2.0	2.0

Source : Eurosystem.

Overall, the adjustment of the assumptions compared to the latest autumn forecasts has a small, positive impact on Belgium's growth prospects, as the favourable effect of the more rapid export market growth and the cheaper euro is only partly offset by the somewhat higher oil prices.

1.2 Estimates for the euro area

The current Eurosystem growth estimates for the euro area have been revised upwards slightly compared to the ECB's previous projections (March 2017). As a result of the strong growth at the beginning of the year and the favourable short-term outlook, activity in the euro area is forecast to expand by almost 2 % this year. But that growth rate is likely to shrink in the following two years. That is due to the slight decline in the trade elasticity of world growth and, in particular, import demand from countries outside the euro area, plus the fact that supply constraints on the labour market will increasingly tend to hold back growth in certain countries, such as Germany.

Growth is underpinned by the favourable framework conditions such as the relatively cheap euro and low interest rates, brought about partly by monetary policy. Although

TABLE 2 EUROSYSTEM 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	1.9	1.8	1.7
Private consumption	1.9	1.5	1.6	1.4
Public consumption	1.8	1.2	1.2	1.1
Gross fixed capital formation	3.6	3.7	3.4	3.0
Exports of goods and services	2.8	4.8	4.3	4.1
Imports of goods and services	4.0	5.2	4.6	4.3
Inflation (HICP)	0.2	1.5	1.3	1.6
Core inflation (1)	0.9	1.1	1.4	1.7
Domestic employment	1.4	1.4	1.0	0.9
Unemployment rate (2)	10.0	9.4	8.8	8.3
General government financing requirement (–) or capacity (3)	–1.5	–1.3	–1.2	–1.0

Source: ECB.
(1) Measured by the HICP excluding food and energy.
(2) In % of the labour force.
(3) In % of GDP.

the growth of private and public consumption, like that of total investment, slackens pace slightly over the projection period, domestic demand remains vigorous overall. That will also boost imports from the euro area, offsetting the strong but diminishing growth of exports, so that the growth contribution of net exports should be virtually neutral over the projection period as a whole.

Inflation surged in the first quarter of this year. Although that was due mainly to the rise in the oil price at the end of 2016, core inflation – i.e. inflation excluding the volatile components – has also risen somewhat already, and should continue to edge upwards over the projection period. That is due mainly to rising wage costs in tightening labour markets where the influence of recent measures to moderate those labour costs in various countries – including Belgium – is fading away. Nevertheless, in the last quarter of 2019, both total and core inflation are still likely to be well below 2 %.

In the recent period, the labour market recovery has gained momentum. The labour intensity of growth has risen sharply, perhaps partly as a result of the aforesaid labour cost moderation. As that influence wanes, the scarcity of suitable labour increases and activity slows down, and job creation in the euro area should weaken somewhat, although employment expansion will remain quite strong at around 1 % year-on-year in the last two years of the projection period. The unemployment rate, which had already declined to 10 % last year, is projected tofall further and by 2019 should be back to around the immediate pre-crisis level of 7.5 % seen in 2007.

According to the forecasts, the average budget deficit in the euro area is expected to fall further to 1 % of GDP in 2019. However, that improvement is due mainly to the upturn in business activity and the further decline in interest charges as a result of the unusually low interest rates. Conversely, over the projection period as a whole, there should be hardly any change in the structural primary balance, which indicates the underlying fiscal policy. The fall in the public debt ratio is forecast to continue, thanks to the low level of interest rates: by 2019, the debt ratio is projected to have dropped by more than 7 percentage points below its 2014 peak.

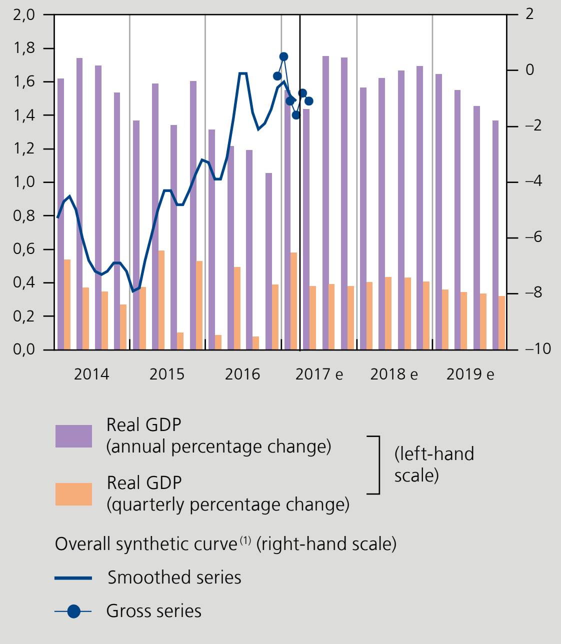
2. Activity and demand

In 2016, activity expanded by 1.2 % as predicted in the autumn forecasts. It should be noted that in the latest NAI statistics, the quarterly profile and the contributions of the expenditure components were revised slightly in comparison with the available statistics and estimates in those autumn forecasts. In that regard, the NAI has made a small upward adjustment to the contribution of private consumption to the growth of activity, particularly at the beginning of the year. Nevertheless, that growth is still supported to a significant degree – and more so than in other countries – by the expansion of investment, at least if an adjustment is made for the impact of specific major purchases of investment goods in other countries by large multinationals in the pharmaceuticals industry. On the production side, all the main branches contributed to the growth, although the principal factor was the expansion of activity in market services. The changed quarterly profile and, more specifically, the downward revision of growth in the third quarter compared to the previous NAI estimates, weakens the spillover effect for year-on-year growth in 2017.

Nevertheless, the impact of that is more than offset by the slight upward revision of the quarterly growth figures in the first half of the year. The autumn forecasts already assumed that the Belgian economy would accelerate considerably starting from the last quarter of 2016 to expand by around 0.5 % quarter-on-quarter, but according to the latest statistics, growth was even better in the first quarter: at the end of May, the NAI made a further upward adjustment to the first quarter's growth compared to the initial flash estimate, increasing it to 0.6 % quarter-on-quarter, slightly higher than the estimate in the autumn forecasts. The current short-term estimates of growth in the second quarter, based partly on specific nowcasting

CHART 2 GDP AND PRODUCER CONFIDENCE

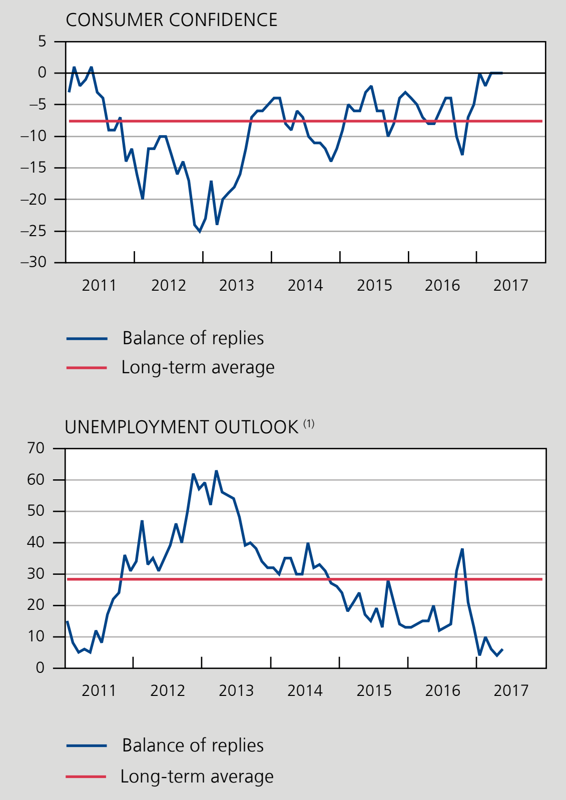
(data adjusted for seasonal and calendar effects, unless otherwise stated)



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

CHART 3 CONSUMER CONFIDENCE AND SUB-INDICATOR

(seasonally adjusted data)



Source: NBB.
(1) An increase indicates a less favourable trend, a decrease indicates a more favourable trend.

models, are also a little higher than those in the autumn forecasts. The higher model expectations are largely due to the confidence indicators, which have recently painted a very promising picture. Since the beginning of this year, Belgian producer and consumer confidence have both been close to or at their highest level in six years, and well above the long-term average. The sub-indicators particularly relevant for the nowcasting models – such as the section of the consumer survey that polls the respondents' expectations concerning unemployment, and the component of the producers' confidence relating to demand and employment expectations in manufacturing industry – also point to further strong growth. Conversely, the movement in certain factual indicators (hard data), such as industrial output and retail sales, looks less favourable for the moment. On the basis of the above factors, the current forecasts therefore take account of a small deceleration, putting growth at 0.4 % in the second quarter. That would mean that the Belgian economy's growth rate will then already have been relatively constant for three successive quarters at an average of 0.5 %. Mainly as a result of this stronger first half of the year, expectations for annual growth in 2017 are upgraded slightly to 1.6 %, despite the slightly weaker spillover effect resulting from the revision of the quarterly accounts for 2016.

Subsequently, year-on-year economic growth is expected to remain unchanged in 2018 and to dip to 1.5 % in 2019 as a result of the fairly flat profile of the growth of Belgium's export markets and the declining influence of the recent improvements in cost competitiveness, as labour costs begin rising faster again. In particular, towards the end of the projection period, economic growth could already be held back somewhat by supply constraints, notably on certain geographical or functional segments of the labour market. Nonetheless, compared to the autumn projections published in December, the current estimates for the last two years of the projection period remain unchanged. The impact of the revision of the assumptions, which is in principle slightly favourable, is largely negated by a somewhat lower estimate of the growth contribution of net exports during the projection period, based among other things on the latest statistics.

Over the projection period as a whole, just as in the recent past, domestic demand will be the main engine of growth. Over the next three years, the growth contribution of domestic demand (excluding changes in inventories) will average 1.6 percentage points. Conversely, net exports will make a negative contribution year-on-year averaging –0.1 percentage point.

Although exports were well up last year with a 6 % rise in volume, that was due largely to the reorganisation of the commercial activities of a multinational pharmaceutical company, which meant that more of its trade flows are imputed to its Belgium-based subsidiaries and which caused a roughly equivalent rise in imports. If adjusted for that statistical effect, export growth would have been much more in line with the expansion of the export markets, and the market share of Belgian exporters would have risen by 0.5 %. According to the forecasts, however, this small gain will be gradually eroded and will disappear altogether in 2018, since unit labour costs are expected to rise considerably from 2017 and cost competitiveness will then no longer improve (even though wages are also expected to rise strongly in other countries, such as Germany). In line with the relatively flat profile of world demand, quarterly export growth will decelerate slightly to average less than 1 % over the final two years of the projection period. Since imports rise a little faster, notably on account of the strong expansion of domestic demand, the growth contribution of net exports will remain slightly negative.

In 2017, stock-building is likely to continue making a positive contribution to growth, but that is due only to a spillover effect from the statistics up to the end of 2016. As usual, the technical assumptions for all the quarters in the projection period from the start of 2017 are based on a growth-neutral contribution from changes in inventories, particularly in view of the great statistical uncertainty surrounding that concept.

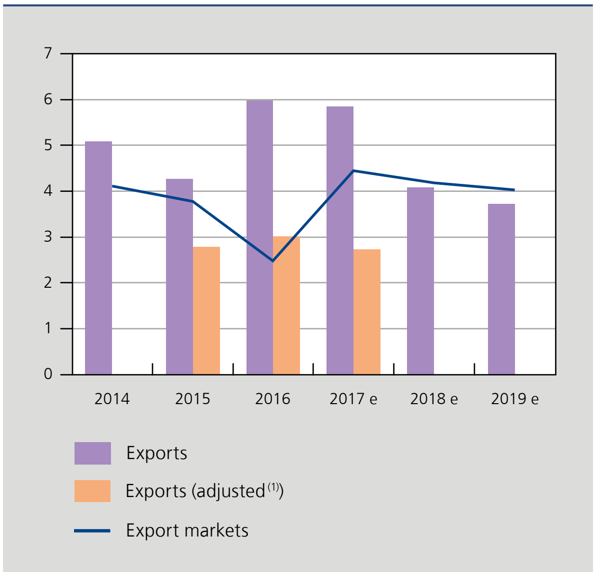
Among the domestic demand components, private consumption is the main growth engine. Although the latest NAI statistics imply a small upward adjustment to the 2016 figure, the growth is still relatively moderate in comparison with that in other countries. This relatively anaemic consumption growth is one of the main reasons why economic growth in Belgium has recently been weaker than the average in the neighbouring countries, and it primarily reflects the short-term negative impact of the wage moderation policy aimed at improving cost competitiveness.

Growth of household consumption is expected to pick up gradually to average around 0.5 % quarter-on-quarter from next year. The main factor stimulating the rise in consumption is income growth, and particularly the increase in earned incomes, which are going up significantly as a result of the substantial employment growth and the rise in real wages.

In the final two years of the projection period, incomes should also be supported by the additional tax cuts

CHART 4 EXPORTS AND EXPORT MARKETS

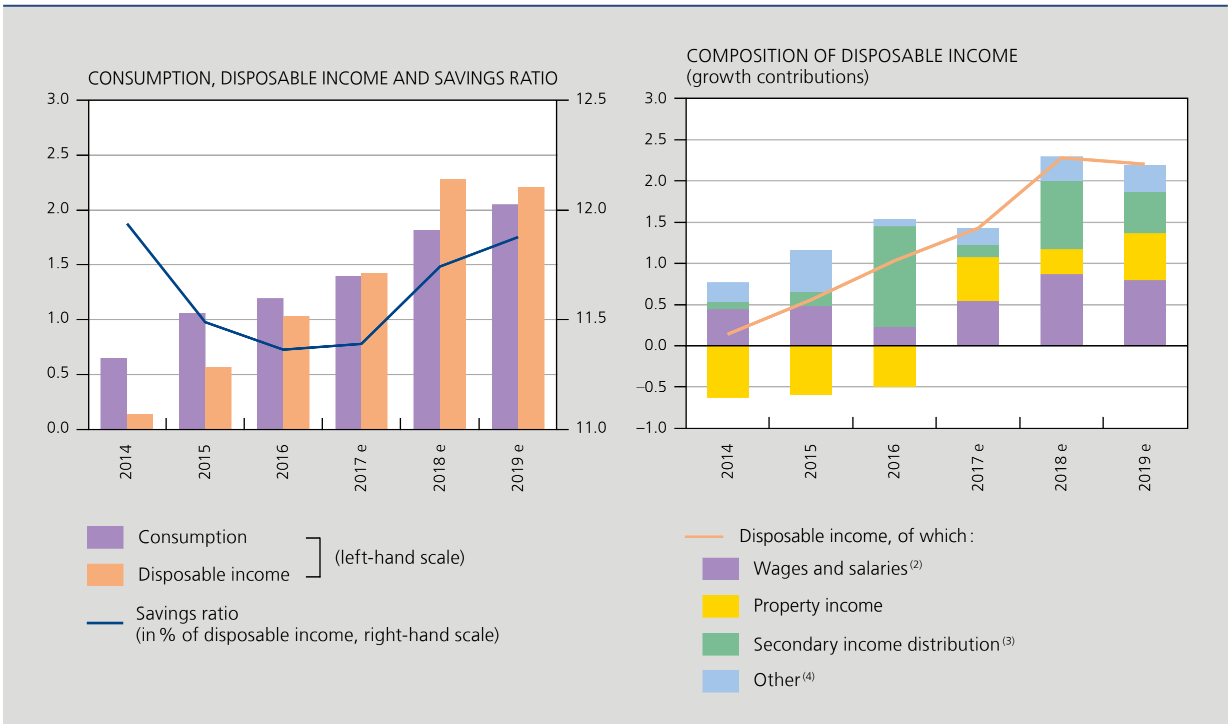
(volume data adjusted for seasonal and calendar effects, percentage changes compared to the previous year)



Sources: NAI, NBB.
(1) Export growth adjusted for expenditure resulting solely from the reorganisation of the commercial activities of a major pharmaceutical company.

CHART 5 HOUSEHOLD CONSUMPTION AND DISPOSABLE INCOME [1]

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



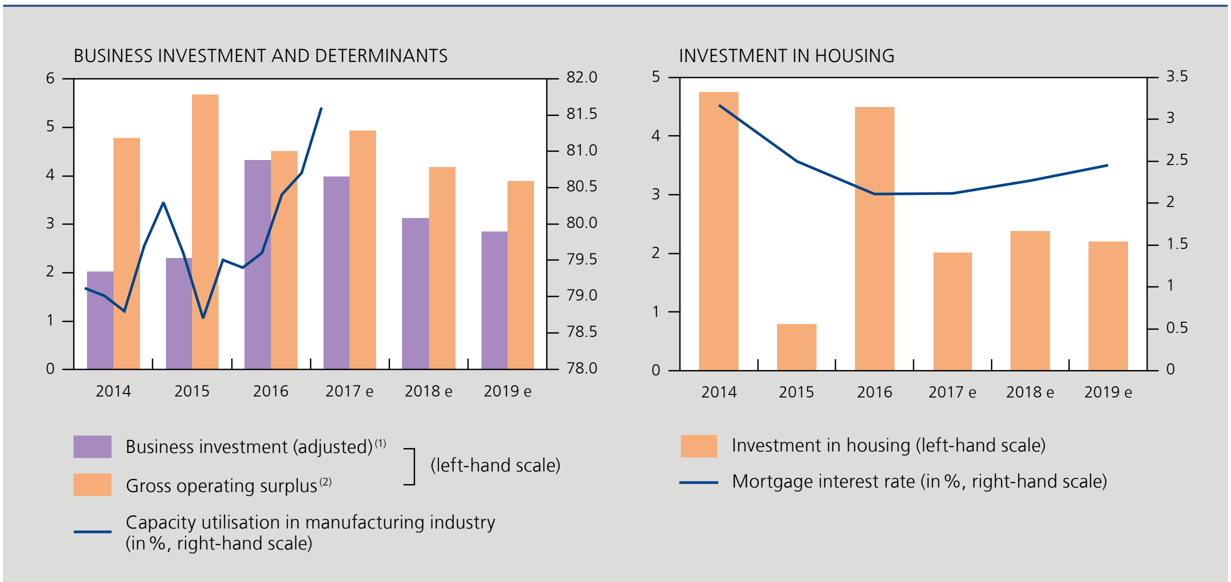
Sources: NAI, NBB.
(1) Data deflated by the household consumption expenditure deflator.
(2) Excluding employers' social contributions.
(3) Including employers' social contributions.
(4) 'Other' comprises the gross operating surplus and gross mixed income (of self-employed persons).

planned in those years as part of the tax shift, which would in turn boost household purchasing power. In that regard, it should be borne in mind that any additional consolidation measures designed to fund the tax shift over the next two years have not been taken into account in this analysis, in accordance with the rules on the Eurosystem forecasting exercises. Moreover, the fact that both wages and tax scales are indexed to inflation after a small time lag provides further support for real disposable incomes in 2018, since inflation should ease compared to 2017 and the indexation in 2018 is in fact likely to exceed inflation in that year. Finally, in the years ahead, and for the first time in a long while, property incomes should once again make a positive contribution to the growth of private incomes owing to the expected rise in the level of interest rates and the increase in dividends paid out by companies.

According to the forecasts, the quickening growth of private consumption should be slightly outpaced by the rise in incomes. This year, the savings ratio is predicted to remain stable as the growth of consumption remains in line with income growth, but it is expected to increase again from 2018. As usual, households will take time to adjust their consumption to the steep rise in earned incomes and the tax cuts. Moreover, the share of disposable income represented by property income, of which relatively more is saved, will increase again.

Private investment should also make a significant contribution to growth in the coming years. As regards business investment, the annual growth for 2017 is still slightly distorted by specific factors relating to substantial purchases of investment goods abroad which boosted investment (and imports) in the preceding years. If these specific factors are excluded, the volume of business investment increased strongly in 2016 by around 4.3 %. Although the underlying determinants remain favourable and increasing capacity utilisation will lead to further investment in expansion, the forecasts still predict that investment growth will gradually subside in the years ahead, reverting to a more normal growth rate. This notwithstanding the fact that business investment will continue to be supported by favourable financing conditions, and more specifically by the sizeable liquidity reserves, the rising gross operating surplus, and the persistently low interest rates. Investment of households

CHART 6 BUSINESS INVESTMENT AND INVESTMENT IN HOUSING
(volume data, percentage changes compared to the previous year, unless otherwise stated)



Sources: NAI, NBB.
(1) Adjusted to take account of exceptional, substantial purchases of investment goods abroad.
(2) In nominal terms.

in real estate – either in the form of new building or renovation projects – is likewise still being stimulated by the low interest rate environment. In that regard, there are clear signs that property is increasingly becoming an alternative form of investment for households in search of yield. Here, too, the forecasts suggest that the growth rate will gradually return to normal, in view of the expected rise in mortgage interest rates. While business

TABLE 3 GDP AND MAIN EXPENDITURE CATEGORIES
(seasonally adjusted volume data; percentage changes compared to the previous year, unless otherwise stated)

	2016	2017 e	2018 e	2019 e
Household and NPI final consumption expenditure	1.2	1.4	1.8	2.0
General government final consumption expenditure	−0.1	0.2	0.4	0.6
Gross fixed capital formation	1.9	2.5	3.2	2.3
general government	0.7	1.7	5.2	−1.2
housing	4.5	2.0	2.4	2.2
business	1.2	2.8	3.1	2.8
p.m. Domestic expenditure excluding change in inventories (1)	1.0	1.3	1.8	1.7
Change in inventories (1)	0.1	0.4	0.0	0.0
Net exports of goods and services (1)	0.1	−0.1	−0.1	−0.2
Exports of goods and services	6.0	5.8	4.1	3.7
Imports of goods and services	6.0	6.1	4.3	4.0
Gross domestic product	1.2	1.6	1.6	1.5

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

investment had already surpassed its pre-crisis level some time ago, investment in housing is still well below that level, and that gap will barely have been filled by the end of the projection period.

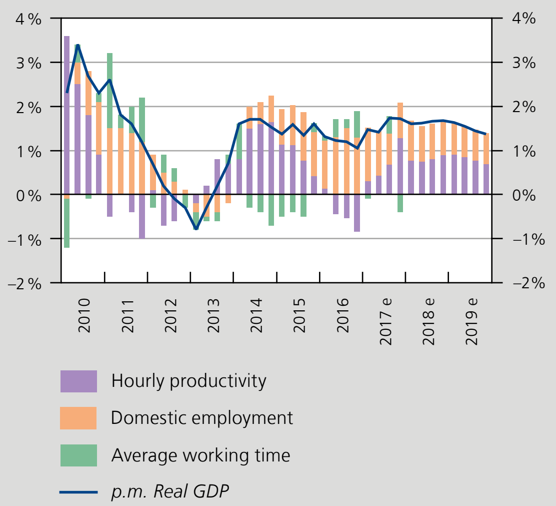
In regard to public investment, local authority expenditure was ultimately lower than expected so that there was only a very small rise in the volume of public investment in 2016, and the figure fell short of that projected in the autumn forecasts. Additionally, public investment follows the pattern of the electoral cycle, with a decline in 2019 following the strong growth in the run-up to the local elections in 2018. Growth of public consumption is set to remain extremely modest throughout the projection period.

3. Labour market

Despite the moderate activity growth in 2016, averaging 1.2 % over the year, net job creations came to 59 000 units, or considerably more than in previous years, when economic growth was actually higher. The greater job intensity of growth – roughly 1 in 2016 – is brought about by the wage moderation policy which makes labour relatively less expensive and boosts

CHART 7 DOMESTIC EMPLOYMENT, WORKING TIME AND PRODUCTIVITY

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



Sources: NAI, NBB.

TABLE 4 LABOUR SUPPLY AND DEMAND

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

	2013	2014	2015	2016	2017 e	2018 e	2019 e
Total population	57	55	59	62	63	58	54
Working age population	12	9	16	21	17	8	4
Labour force	**9**	**32**	**22**	**33**	**28**	**29**	**30**
Domestic employment	**−15**	**19**	**42**	**59**	**43**	**39**	**33**
Employees	**−21**	**12**	**31**	**45**	**31**	**25**	**20**
Branches sensitive to the business cycle (1)	−25	−1	16	29	20	16	12
Public administration and education	3	6	1	2	−2	−3	−3
Other services (2)	1	7	14	14	13	12	11
Self-employed	**6**	**7**	**11**	**14**	**12**	**14**	**13**
Unemployed job-seekers	**25**	**14**	**−19**	**−26**	**−15**	**−10**	**−3**
p.m. Harmonised unemployment rate (3) (4)	*8.5*	*8.6*	*8.6*	*7.9*	*7.5*	*7.3*	*7.2*
Harmonised employment rate (3) (5)	*67.2*	*67.3*	*67.2*	*67.7*	*69.2*	*69.7*	*70.2*

Sources: DGS, FPB, NAI, NEO, NBB.
(1) Agriculture, industry, energy and water, construction, trade, hotels and restaurants, transport and communication, financial activities, real estate 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).

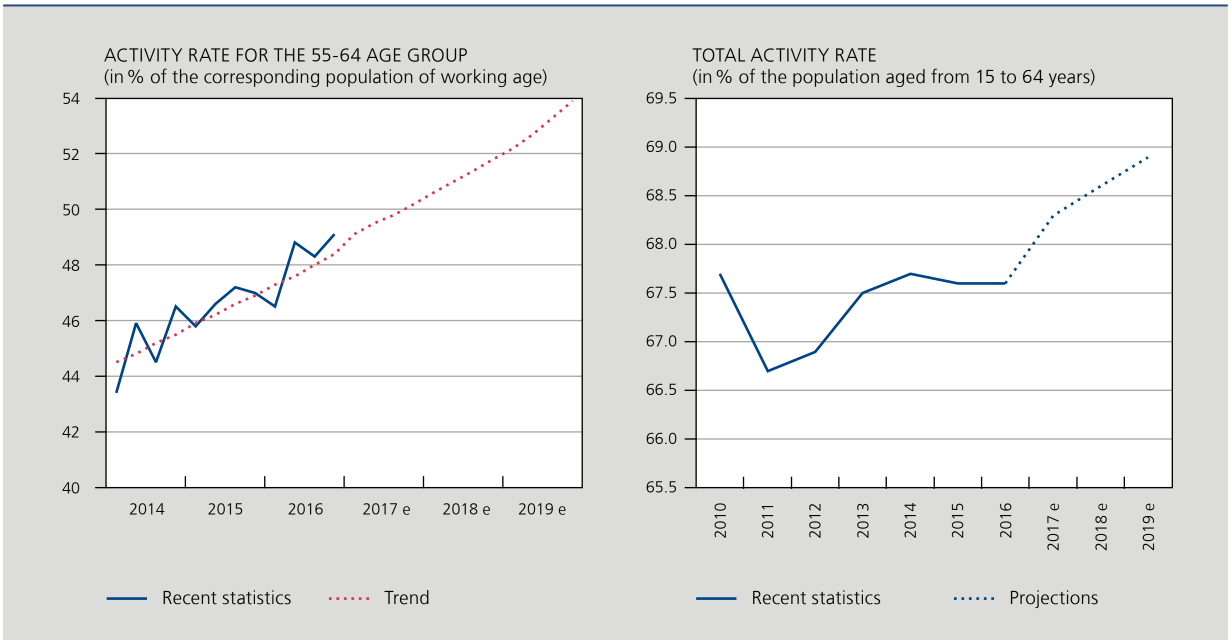
demand for labour, and by the various structural reforms which increase the actual labour supply. The strong expansion of employment against the backdrop of relatively modest activity growth has nevertheless held back the growth of labour productivity, which declined last year.

The expansion of employment slowed down from the last quarter of 2016 to reach an average of 0.15 % quarter-on-quarter. It should remain moderate throughout the projection period, as the policies introduced in recent years which greatly influenced net job creation should gradually have less impact. Moreover, the latest reforms such as the Law on Feasible and Manageable Work passed by Parliament in March 2017 are likely to have an impact on job quality indicators rather than on net job creation. All the same, the additional numbers of people in work will remain substantial at around 115 000 over the projection period.

This increase is expected to be accompanied by higher hourly productivity, which will begin rising again from 2017. Average working time, which is very volatile from one quarter to the next, should decline only slightly over the projection period. The increase in the proportion of part-time workers is causing a slight downward trend, but the average working time of part-time workers is tending to increase : the average number of hours worked per week by part-timers was up from 22.5 in 2000 to 24.1 in 2016. The switch to a services economy is also having a negative influence on average working time. In the short term, the increase in average working time in the fourth quarter of 2016 reflects the abolition of the allowances for time credit granted for no specific reason. That reform, which was announced in January 2015, had triggered an anticipation effect among many workers who were able to use the scheme up to 1 July 2015 to reduce their working time. The opposite effect applies now, since those workers are gradually leaving the non-specific time credit scheme. During the projection period, the average working time should revert to the long-term trend and remain virtually unchanged.

Employment growth in 2016 was particularly marked in the case of employees in branches sensitive to the business cycle, with an increase of 29 000 compared to 2015. The main factor here was a significant rise in the business services branch (+20 000) and in trade, transport and hotels and restaurants (+7 000). Compared to the preceding years, employment in industry and construction did not decline further. In the branches sensitive to the business cycle, only financial and insurance activities continued to record a fall, with 1 000 fewer jobs than in 2015. Over the projection period, salaried employment in the cyclical branches is likely to maintain its upward trend, albeit at

CHART 8 LABOUR MARKET PARTICIPATION



Sources : DGS, EC, FPB, NBB.

a more modest pace. As in previous years, non-market services also share in the expansion of employment, but only in the case of other services (+36 000 over the period 2017-2019). Over the projection period as a whole, employment in public administration and in education is expected to fall by 8 000 persons.

The number of self-employed workers continued rising, to reach 781 000 in 2016, or 14 000 more than a year earlier. In that regard, the growth of self-employment has clearly outpaced the increase in the number of employees recently (averaging 1.8 % year-on-year, compared to 1.2 % for employees). The projections assume that this trend will continue, and put the number of additional self-employed persons at 39 000 by 2019.

Although the latest demographic forecasts indicate that the population will continue to grow, that is increasingly less so in the case of the population of working age, which will virtually stop expanding in 2019 in view of ageing. On the other hand, the participation rate – especially in the case of older workers – has risen recently and will continue to do so according to the forecasts. Apart from cohort effects whereby the younger generations participate to a greater extent in the labour market, that mainly reflects the reforms aimed at discouraging older workers from taking early retirement. The rising participation rate is supporting the expansion of employment.

Following very dynamic job creation in 2016, the first signs of tension are beginning to emerge on the labour market, particularly in certain regions and for some occupations. Consequently, it is taking longer to find appropriate staff to fill vacancies – which have already risen significantly in recent months – and that will increasingly hamper employment growth in the final quarters of the projection period unless the current reforms aimed, in particular, at getting job-seekers back to work and seeing lifelong training produce results.

Against that backdrop, the unemployment rate – which fell sharply in 2016 by 0.7 percentage point to less than 8 % – will continue falling, albeit more slowly. According to the current forecasts, the unemployment rate is expected to be down to 7.2 % in 2019, corresponding to around 525 000 job-seekers. We are thus gradually approaching the unemployment levels of 2008, prior to the great recession, at around 500 000 people.

4. Prices and costs

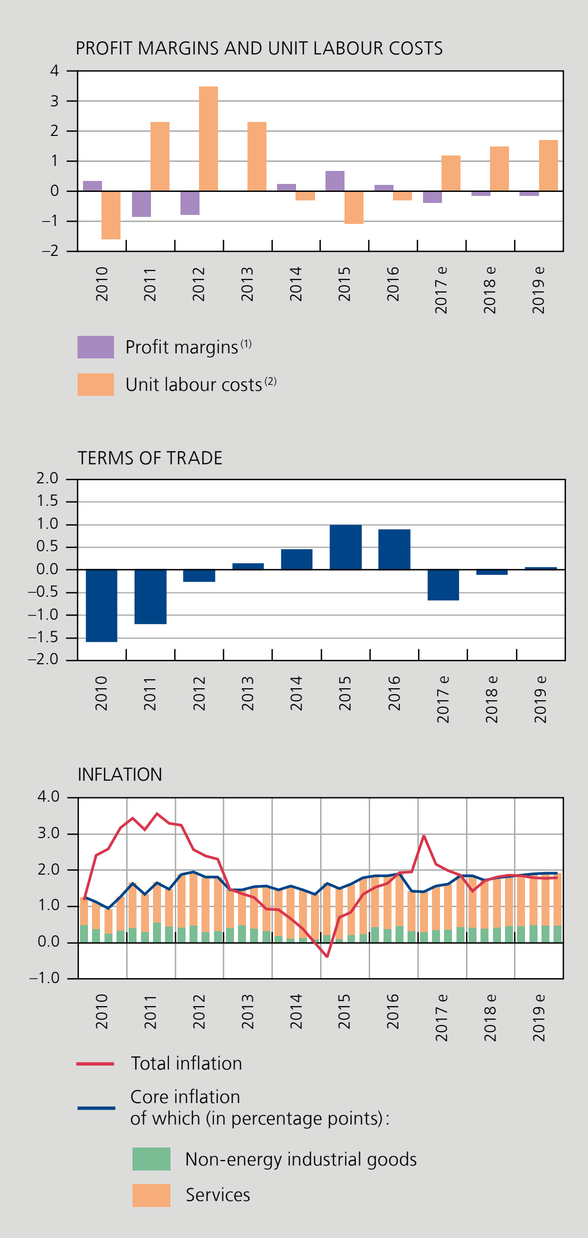
Since 2014, unit labour costs have fallen as a result of various measures to improve the cost competitiveness of Belgian firms. That was still the case in 2016, despite the above-mentioned drop in labour productivity, as hourly labour costs fell even more sharply than productivity. That was due primarily to the new reductions in employers' contributions which took effect on 1 January and 1 April. Also, April 2016 brought the end of the temporary suspension of the indexation mechanisms, but owing to the delays inherent in the indexation method of some sectors, the index jump continued to have an impact for the rest of the year. Finally, it is noticeable that collectively agreed wage increases also remained well below expectations, and below the permitted maximum (0.5 % of the gross wage bill including all charges, and 0.3 % of the net wage bill excluding additional expenses) : on the basis of the data currently available, it seems that in reality virtually no sectoral negotiated wage increases were granted, while the wage drift was also very limited.

However, hourly labour costs are set to rise considerably from 2017 as the effect of the index jump has almost completely worn off this year. Furthermore, in contrast to the autumn forecasts, the current estimates take account of the wage norm set by the social partners at 1.1 % for real collectively agreed wage adjustments in 2017 and 2018. Those agreed wage increases are lower than the technical assumption made in the autumn forecast when the wage norm was still unknown. Moreover, this wage norm is based on a new method of calculating the maximum margin for the increase in labour costs set by the CEC following revision of the 1996 Law. Taking account of the very strong wage moderation in recent years, it is assumed that the permitted margin will be fully used in 2017 and 2018, and will drive up negotiated wages by 0.3 % this year and 0.8 % in 2018. The new collective labour agreements will only be concluded in the course of 2017 and will therefore comprise a bigger annual pay rise in 2018. For 2019, the margin for real negotiated adjustments will not be discussed until a collective agreement is negotiated at the end of 2018. In the absence of any official wage norm and in the context of the continuing recovery of the labour market and the decline in the unemployment rate, the technical assumption here is based on stabilisation of negotiated wage growth between 2018 and 2019. If, at the end of 2018, it emerges that labour costs are again rising faster than in the main neighbouring countries, that technical assumption could be adjusted downwards.

Taking account of a return to full wage indexation based on the health index, the growth of hourly labour costs for firms is already forecast to reach 1.9 % in 2017 and rise further to 2.6 % in 2019. Throughout the projection period, that labour cost growth is still tempered by the additional cuts in employers' contributions (as well as the

CHART 9 INFLATION AND DETERMINANTS

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



Sources: EC, NAI, NBB.
(1) Difference between annual growth of unit selling prices and unit production costs.
(2) Including wage subsidies and reductions for target groups.

residual effect of the cuts introduced on 1 April 2016) as a result of the tax shift, but those cuts are much smaller than in 2016: overall, they are expected to reduce hourly labour costs by less than 0.2 % per annum on average between 2017 and 2019, compared to 0.9 % in 2016.

From 2017, labour productivity reverts to normal, slightly positive growth, so that the rise in unit labour costs is somewhat smaller than the rise in hourly labour costs. But unit labour costs are set to increase strongly again from 2017, rising by around 1.7 % at the end of the projection period.

Nonetheless, this increase in labour costs should have only a partial and delayed effect on inflation. In fact, what has happened in the past, when strong labour cost increases were often partially absorbed in the variation of business profit margins, indicates that pricing in Belgium exhibits some upward rigidities. According to the current forecasts, there should be no further steep increase in profit margins as a percentage of selling prices, as there was in past years when the decline in labour costs was not entirely passed on in those prices; instead, the share of profit margins is actually projected to diminish slightly.

Apart from the usual inertia in passing on costs in prices, some specific factors may also curb inflation. For instance, the last quarter of 2016 saw a marked fall in core inflation, and services inflation in particular, owing to the disappearance of the upward influence on year-on-year inflation of the substantial increase in higher education registration fees in the Flemish Community on 1 October 2015. That lower level of services inflation was maintained in the first quarter of 2017, mainly as a result of a calendar effect caused by the Easter holidays falling entirely in April, which was not the case in the previous year. Thus, in March, there was a year-on-year decline in the prices of package holidays and hotel rooms. At the same time, inflation in telecommunications also moderated. From the second quarter of 2017, services inflation begins rising again. The strong increase in April 2017 was still largely temporary since it was due mainly to the reversal of the said calendar effects, and particularly the steep increases in the prices of package holidays and hotel rooms during that year's Easter holidays. Overall, core inflation in 2017 is projected to be down slightly, as an annual average, compared to last year.

In the two ensuing years, core inflation is expected to rise again to 1.9 % in 2019, owing to the albeit limited impact of higher labour costs on prices. However, core inflation and especially the services inflation thus estimated is lower than in the autumn forecasts. The main reason for that is the downward adjustment to the movement in labour costs, but also the expected effects of the recent regulations concerning restaurants and cafés – in this case the end of the brewery contracts imposing strict sales conditions – and telecommunications, notably the opening up of the cable networks in 2016 and the greater ease of switching between fixed operators from July 2017. These changes should enhance

TABLE 5 PRICE AND COST INDICATORS

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

	2014	2015	2016	2017 e	2018 e	2019 e
Labour costs in the private sector [1]						
Labour costs per hour worked	1.0	0.0	−0.8	1.9	2.3	2.6
of which: indexation	0.8	0.1	0.6	1.5	1.7	1.6
Labour productivity [2]	1.3	1.1	−0.5	0.7	0.8	0.8
Unit labour costs	−0.3	−1.1	−0.3	1.2	1.5	1.7
p.m. Labour costs per hour worked according to the national accounts [3]	*1.1*	*0.0*	*−0.9*	*1.7*	*2.3*	*2.5*
Core inflation [4]	1.5	1.6	1.8	1.6	1.8	1.9
Energy	−6.0	−8.0	−0.6	9.1	0.9	1.0
Food	0.8	1.8	3.1	1.3	1.7	1.8
Total inflcation (HICP)	0.5	0.6	1.8	2.2	1.7	1.8
p.m. Inflation according to the national consumer price index (NCPI)	*0.3*	*0.6*	*2.0*	*2.1*	*1.6*	*1.8*
Health index [5]	0.4	1.0	2.1	1.9	1.5	1.7

Sources: EC, 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 the self-employed.

(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 motor fuels.

competition and influence the prices charged. In view of the importance of these two sectors in household consumption, these measures are expected to have a moderating impact on inflation.

Apart from core inflation, energy and food also contribute to the movement in total inflation over the projection period. Thus, total inflation is forecast to rise to 2.2 % in 2017, notably on account of energy prices, which are expected to increase by 9.1 % whereas they had fallen by 0.6 % in 2016. The reason for this turnaround lies in the recent and expected movement in the Brent price expressed in euros, which is anticipated to be 19 % more expensive in 2017 than in 2016. The change in the price of gas should also become positive. The movement in imported energy prices is likewise a major determinant of the terms of trade which, after a marked improvement during recent years, are deteriorating again in 2017, thus driving up inflation. Conversely, the disappearance during the first half of 2017 of a number of base effects which had influenced the increase in electricity prices should keep that rise down to 7 % in 2017, whereas the increase came to 28 % in 2016. After that, energy prices should become relatively stable in 2018 and 2019, reflecting a fairly flat profile for petroleum products, gas and electricity.

In 2016, food prices had risen particularly steeply, partly as a result of increases in the excise duties on alcohol and tobacco, plus a methodological effect on alcoholic beverage prices due to the expanded use of scanner data from the beginning of 2016. In 2017, the level of increases should be much lower again with the rate of inflation in processed foods ‘returning to normal’, and inflation in unprocessed foods expected to be very low. An upward trend in inflation is subsequently predicted for both types of products.

Thus, as a result of the scale of the price fluctuations on the energy markets, the total inflation rate in Belgium is set to fall in 2018, in contrast to the expected movement in core inflation. The inflation gap in relation to the euro area which stood at 1.6 percentage points in 2016, should narrow substantially over the projection period.

The above analysis concerns the HICP, which permits comparison between the inflation rates of all European countries. Inflation measured according to the Belgian national consumer price index (NCPI) may deviate from the former, owing to methodological differences. The NCPI is used to calculate the health index, i.e. the national index which excludes tobacco, alcoholic beverages and motor fuels. The increase in the health index, which forms the basis of wage indexation, is set to slow down somewhat in 2017 (1.9 %) compared to the previous year, and decelerate further in 2018 (1.5 %), ending at 1.7 % in 2019.

5. Public finances

5.1 General government balance

According to the data published by the NAI in April 2017, the Belgian government recorded a deficit of 2.6 % of GDP in 2016. In the macroeconomic context described above, the deficit should fall to 2 % of GDP in 2017. In 2018 and 2019, the budget deficit is set to remain fairly stable at 2.1 % of GDP.

The general government budget balance is expected to improve in 2017, since expenditure should fall sharply in relation to GDP while there will only be a small decline in revenue. Primary expenditure is projected to fall as a result of the budgetary policy aimed at curbing its growth. Interest charges should continue to fall since public loans maturing are refinanced at favourable interest rates for public authorities. In 2018 and 2019, primary expenditure and interest charges are likely to decline further, but the reduction in interest charges should diminish towards the end of the projection period. The favourable impact of the two factors on the budget balance should nevertheless be offset by the fall in revenues resulting from a reduction in the levies on labour under the tax shift.

The deficits are expected to be concentrated mainly at federal government level. Social security should record a balanced budget since it receives an appropriation from the federal government intended to achieve that. The Communities and Regions are expected to record small deficits during the projection period, while the local authorities' finances will be more or less in balance.

As usual, these projections assume that there will be no change in policy. They therefore only take account of budget measures which have already been announced and specified in sufficient detail. The estimates show that additional consolidation measures will be necessary to achieve a structurally balanced budget in 2019, that being the target set in the April 2017 stability programme.

5.2 Revenue

Public revenues are expected to contract by 0.1 percentage point of GDP in 2017 and to continue declining in 2018 and 2019 by 0.6 and 0.4 percentage point

TABLE 6 GENERAL GOVERNMENT ACCOUNTS
(in % of GDP)

	2016	2017 e	2018 e	2019 e
General government				
Revenue	50.8	50.7	50.1	49.6
Primary expenditure	50.5	50.1	49.8	49.5
Primary balance	0.2	0.6	0.2	0.1
Interest charges	2.9	2.5	2.3	2.2
Financing requirement (–) or capacity	**–2.6**	**–2.0**	**–2.1**	**–2.1**
Overall balance per sub-sector				
Federal government (1)	–2.7	–1.8	–1.8	–1.8
Social security	0.0	0.0	0.0	0.0
Communities and Regions (1)	–0.1	–0.2	–0.3	–0.3
Local authorities	0.2	0.0	0.0	0.1

Sources: NAI, NBB.
(1) These figures were produced 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.

TABLE 7 PUBLIC REVENUES
(in % of GDP)

	2016	2017 e	2018 e	2019 e
Fiscal and parafiscal revenues	43.9	43.8	43.2	42.9
Levies applicable mainly to labour income	25.1	24.8	24.2	23.9
Personal income tax	11.1	11.0	10.5	10.3
Social contributions	14.0	13.8	13.7	13.6
Taxes on corporate profits	3.4	3.5	3.5	3.5
Levies on other incomes and on assets	4.2	4.2	4.2	4.1
Taxes on goods and services	11.2	11.3	11.3	11.4
of which:				
VAT	6.8	6.9	6.9	6.9
Excise duty	2.2	2.3	2.3	2.3
Non-fiscal and non-parafiscal revenues	6.9	6.9	6.8	6.8
Total revenues	50.8	50.7	50.1	49.6

Sources: NAI. NBB.

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 are likely to be down sharply, as a result of the measures introduced via the tax shift in order to enhance business competitiveness, encourage employment and boost household purchasing power.

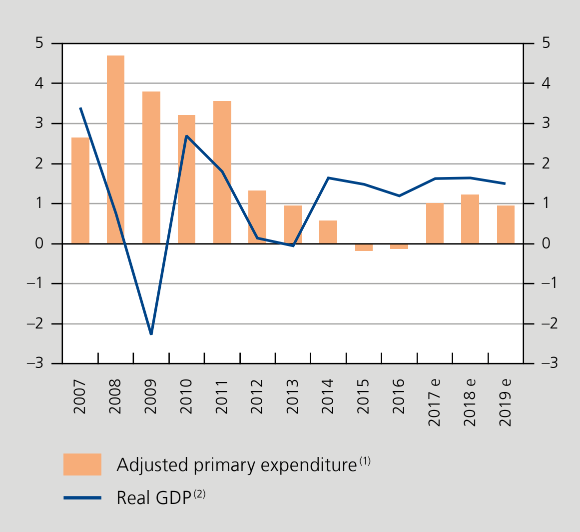
The slight fall in the revenue ratio projected in 2017 is due to the reduction in levies on labour incomes. Those incomes, which are relatively heavily taxed, should in fact rise more slowly than GDP. In addition, personal income tax is also expected to fall because the tax scales are index-linked on the basis of the previous year's consumer price index, and that exceeds the wage indexation planned for 2017, thus lessening the tax pressure. Social contributions will also decline since the full impact of the reduction in the rate of employers' contributions has been felt since 1 April 2016. However, the resulting fall in revenues is mostly offset by the higher taxes on goods and services, notably as a result of the rise in excise duties. Levies on other incomes and on assets should remain more or less stable in relation to GDP, although the withholding tax on income from movable property will rise as a result of the increase in the general rate from 27 % to 30 % with effect from 1 January 2017.

In 2018 and 2019, revenues are projected to contract further as a result of the measures under the tax shift. The reductions apply mainly to personal income tax, but social contributions are also expected to decline further.

5.3 Primary expenditure

The downward trend in primary expenditure as a ratio of GDP is set to continue in 2017 and in subsequent years.

CHART 10 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.

In nominal terms, the increase in that expenditure may therefore be outpaced by the expansion of economic activity during the projection period.

The moderation of expenditure expected this year is likely to continue to reflect the federal government's aim of limiting its operating expenses and keeping social security spending under control. It should also benefit from the weakening effect or disappearance of a range of unexpected factors that had an adverse impact on the budget balance in 2016. They included substantial tax rebates resulting from court rulings, and the exceptional efforts involved in managing the influx of asylum-seekers.

Conversely, a new indexation of social benefits and public sector pay, coming exactly a year after the previous one, will drive up the corresponding expenditure in 2017. That concerns all levels of the State: the federal government, the Communities and Regions, local authorities and social security.

Following adjustment for temporary and cyclical factors, and the time lag between inflation and indexation, real primary expenditure is projected to rise by 1% in 2017, which – as in previous years – is a modest increase outpaced by real GDP growth.

Control of primary expenditure will probably be less marked in 2018, notably on account of the usual public investment revival in the run-up to the local and provincial elections. However, it should be back on course in 2019.

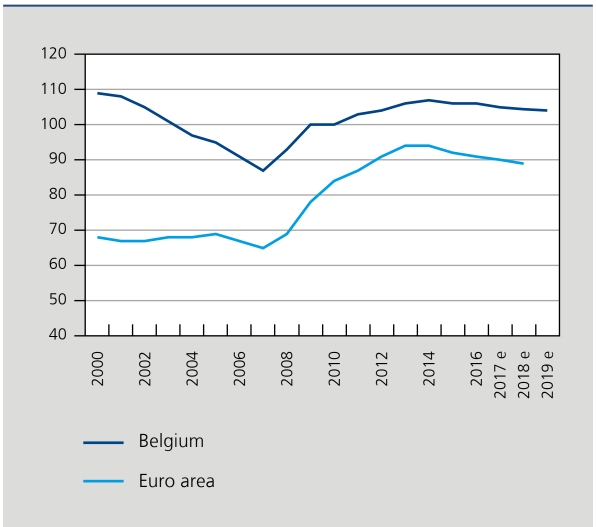
5.4 Debt

The debt ratio was stable in 2016, at 106% of GDP. However, as a ratio of GDP, the public debt should gradually decline over the projection period.

In 2017, the debt is projected to be down to 105% of GDP, despite the upward influence of exogenous factors. The sale of part of the federal government's stake in BNP Paribas will not outweigh the upward impact on the debt of the increased lending in connection with the social housing policy and a number of factors relating to debt management. The dip in the debt ratio will therefore be due solely to the downward influence of endogenous factors. Nominal GDP growth is expected to exceed the implicit interest rate on the public debt, and the primary budget balance should be slightly positive.

The debt ratio is subsequently set to continue falling, again as a result of endogenous factors, since nominal GDP growth is expected to be well above the implicit

CHART 11 CONSOLIDATED GROSS DEBT OF GENERAL GOVERNMENT
(in % of GDP)



Sources: EC, NAI, NBB.

interest rate on the public debt. Thanks to this favourable interest rate/growth dynamic combined with a (small) primary budget surplus, the debt ratio should fall to 104.4% of GDP in 2018 and 103.9% in 2019.

6. Conclusion and risk factor assessment

The Eurosystem's spring projections for the period from 2017 to 2019 show slightly stronger growth than was expected in the December 2016 autumn projections and the ECB's March 2017 forecasts. In Belgium's case, the growth outlook was revised upwards to a smaller degree, and only on account of a slightly more favourable start to the year 2017, as indicated by the NAI's revised quarterly statistics for the first quarter and the current short-term forecasts for the second quarter. The short-term inflation forecast was also revised upwards compared to the December projections. However, that is due mainly to the recent steep increase in energy prices. The profile for core inflation was in fact adjusted downwards slightly.

Despite the differences in cut-off dates and the resulting differences in the statistics used, if the economic growth forecasts are compared with the latest estimates by other institutions, a relatively broad consensus emerges. For 2017, the latest estimates, such as those by the OECD, the FPB and the Bank, seem to be at the top of the range. However, that essentially reflects the fact that

TABLE 8 COMPARISON WITH ESTIMATES OF OTHER INSTITUTIONS

(in %)

Institution	Publication date	Real GDP growth			Inflation (HICP, unless otherwise stated)		
		2017	2018	2019	2017	2018	2019
Belgian Prime News	March 2017	1.4	1.5		2.3	1.8	
IMF	April 2017	1.6	1.5	1.5	2.0	1.7	1.7
Consensus Economics	May 2017	1.5	1.6		2.1	1.8	
EC	May 2017	1.5	1.7		2.3	1.5	
Federal Planning Bureau (1)	June 2017	1.6	1.6	1.5	2.1	1.5	1.7
OECD	June 2017	1.6	1.7		2.5	1.8	
NBB	June 2017	1.6	1.6	1.5	2.2	1.7	1.8

(1) Economic budget (June 2017) for 2017 and 2018. Medium-term projections (March 2017) for 2019. However, inflation corresponds to the HICP for 2017 and 2018.

those institutions have already been able to incorporate the upward revision of growth in the first quarter, published by the NAI on 31 May, whereas the earlier forecasts were still based on a slightly weaker "flash" estimate. Although the differences are still small, they appear to be somewhat greater for the inflation projections because the latter are greatly influenced by expectations concerning the oil price, and given its volatility, by the exact cut-off date.

Notwithstanding the high degree of convergence between the various macroeconomic estimates, there are still risks on both the upside and the downside which need to be taken into account. Externally, the risks concern among other things the level of vigour and sustainability of the recent revival of international trade. A more persistent return to more trade-intensive world growth could in fact strengthen the latter's fundamentals and also reinforce growth in Europe and in Belgium via increased import demand. On the other hand, the uncertainty over the policy stance in a number of countries such as the United States remains high. A more protectionist policy or a less expansionary fiscal policy than envisaged by the current Eurosystem forecasts could in fact put further restraints on growth.

At national level, the risks concerning growth, inflation and the labour market seem fairly evenly spread. In regard to the labour market, a higher-than-expected participation rate as a result of a stronger or speedier impact of the labour market reforms limiting the early retirement options is an upside risk which could nevertheless be offset by a possible scarcity of labour in certain labour market segments. Wage-setting in 2019 is another specific risk, since no wage norm has yet been defined for the year in question. If the current estimates imply the re-emergence of divergences in relation to the growth of labour costs in Belgium's three main neighbouring countries, according to the definition of that concept in the 1996 Law on the Promotion of Employment and the Preventive Safeguarding of Competitiveness, the increase in wages in 2019 could ultimately prove smaller than foreseen by these estimates. But that will depend on what happens in neighbouring countries, as the macroeconomic impact of perhaps lower labour costs could be fairly limited at the level of growth and inflation in 2019 since the repercussions are normally only felt after a certain time lag.

Annex

PROJECTIONS FOR THE BELGIAN ECONOMY: SUMMARY OF THE MAIN RESULTS

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

	2016	2017 e	2018 e	2019 e
Growth (calendar adjusted data)				
Real GDP	1.2	1.6	1.6	1.5
Contributions to growth:				
Domestic expenditure, excluding change in inventories	1.0	1.3	1.8	1.7
Net exports of goods and services	0.1	–0.1	–0.1	–0.2
Change in inventories	0.1	0.4	0.0	0.0
Prices and costs				
Harmonised index of consumer prices	1.8	2.2	1.7	1.8
Health index	2.1	1.9	1.5	1.7
GDP deflator	1.6	1.7	1.6	1.7
Terms of trade	0.9	–0.7	–0.1	0.0
Unit labour costs in the private sector (1)	–0.3	1.2	1.5	1.7
Hourly labour costs in the private sector (1)	–0.8	1.9	2.3	2.6
Hourly productivity in the private sector	–0.5	0.7	0.8	0.8
Labour market				
Domestic employment (annual average change in thousands of persons)	59.2	43.3	38.6	33.1
Total volume of labour (2)	1.6	0.9	0.8	0.7
Harmonised unemployment rate (in % of the labour force aged 15 years and over)	7.9	7.5	7.3	7.2
Incomes				
Real disposable income of individuals	1.0	1.4	2.3	2.2
Savings ratio of individuals (in % of disposable income)	11.4	11.4	11.7	11.9
Public finances				
Primary balance (in % of GDP)	0.2	0.6	0.2	0.1
Budget balance (in % of GDP)	–2.6	–2.0	–2.1	–2.1
Public debt (in % of GDP)	106.0	105.0	104.4	103.9
Current account (according to the balance of payments, in % of GDP)	–0.4	–0.3	–0.1	–0.1

Sources: EC, DGS, NAI, NBB.
(1) Including wage subsidies (mainly reductions in payroll tax) and targeted reductions in employers' contributions.
(2) Total number of hours worked in the economy.