Economic projections for Belgium – Spring 2018

Introduction

After having produced strong growth last year, the global economy seems to have lost some momentum around the turn of the year. According to the initial quarterly statistics, economic growth in many advanced countries declined sharply in the first quarter. Thus, the American economy slackened pace somewhat, though that is not unusual in a first quarter, and the British economy more or less stagnated. In Japan, activity actually recorded a clear contraction. In many countries, household consumption weakened. Although idiosyncratic factors played a role in some cases, a moderating growth cycle is not abnormal following a strong expansion in which unused production capacity has diminished. Furthermore, global growth was restrained by various factors. So far, announcements of protectionist measures only concern a small proportion of world trade, but they do raise doubts about the degree to which trade will continue to support global growth, and that uncertainty could weigh on investment. Also, commodity prices have increased, and rising inflation expectations, which also originate from the expansionary fiscal policy in an economy where capacity utilisation is already high, are driving up interest rates, especially in the United States. That rate rise is causing volatility on the financial markets. It also exacerbates the financing problems for various emerging economies with current account deficits due to shifts in international asset positions resulting from changes in relative returns.

In the euro area, following the vigorous expansion in 2017, activity also slackened pace, primarily as a result of weaker exports. Various analyses suggest that certain temporary factors, such as unusually inclement weather and strikes, may have held back growth to some degree, but the underlying growth rate also seems to have declined somewhat in comparison with the very strong quarterly average of 0.7 % in 2017. The slowdown in the euro area should not be viewed solely against the backdrop of the said global factors, such as the somewhat lower world growth and increasing trade restrictions, but may also be due to the more expensive euro, which continued to appreciate in the first quarter of this year.

The trend in confidence indicators and other short-term indicators in the second quarter, as known on 31 May when these estimates were completed, and the recent economic and geopolitical developments are difficult to interpret clearly. In April, the confidence indicators appeared to be bottoming out, but the relevant survey data deteriorated further in May. In addition, the risk of a major trade war between large economies seemed at first to have faded as a result of bilateral negotiations between the United States and China, but at the end of May additional economic sanctions and trade restrictions were announced, including for European exports, and that could depress international trade. The euro has also depreciated somewhat in the past few weeks, though that might equally reflect a downgrading of the relative growth prospects in the euro area. Finally, following the turbulence in the first quarter, the global financial markets are somewhat calmer again, but the oil price is still rising, which could, in the long run, erode household purchasing power and drive up the costs in energy-intensive industrial sectors.

Overall, the common assumptions adopted for these projections, of which the main ones are described in box 1, take the same view as most international institutions, i.e. they expect the global economy to continue growing strongly and trade to expand robustly, though in the coming years trade growth will gradually slow down compared to global GDP growth, as in the previous projections. In addition, according to these assumptions, the oil price rise will come to an end and interest rates will only edge up gradually in the euro area. However, the risks for this baseline scenario are mainly on the downside. Further disruption of international trade or turbulence on the European financial markets could have a downward impact on growth.

According to the Eurosystem's new estimates – of which the spring projections described in this article form part – activity growth in the euro area will drop back to 2.1 % this year. That is lower than the March 2018 ECB estimates but more or less in line with the Eurosystem's latest autumn projections which were less optimistic. This downward revision is due solely to the worse than expected start to the year. The further outlook is more or less unchanged, with activity continuing to slow gradually, as in the previous projections, giving growth of just 1.7 % in 2020. The main reason for that is the aforesaid loss of dynamism in world trade with a resulting gradual slowing of foreign demand, but it is also due to supply constraints on the labour market which will depress growth still further in some major countries. This year, as in 2017, inflation in the euro area is being fuelled by rising energy prices. After adjustment for these and other volatile components, core inflation rises throughout the projection period, in accordance with the increasing domestic cost pressure, to reach 2 % by the end of 2020.

In the case of Belgium, the macroeconomic estimates were revised downwards slightly in relation to the autumn forecasts. According to the revised NAI statistics, the 0.3 % growth in the first quarter was somewhat lower than expected, and on the basis of leading indicators, short-term models suggest that the growth rate will remain more or less unchanged in the second quarter. However, taking account of the aforesaid common assumptions, and as in the euro area as a whole, the cyclical downturn will not be accentuated in the second half of the year. In comparison with the autumn forecasts, the growth path remains broadly unchanged from then on. Over 2018 as a whole, Belgian growth comes to 1.5 %, subsequently declining a little further up to 2020, in line with the autumn estimates, the main reasons being the cooling of the corporate investment cycle and the slackening pace of exports, only partly offset by the expected revival in private consumption. The negative growth gap which has existed between Belgium and the euro area since 2015 narrows slightly but does not disappear altogether during the projection period.

Employment growth had been very vigorous in recent quarters, being driven by labour cost moderation which renders labour less expensive and by labour market reforms which expanded the effective labour supply, but according to the latest quarterly statistics it lost some momentum in the second half of 2017. As the effects of these policy measures fade away, year-on-year job creation will slow further. That is also due to the increasing impact of supply constraints on the labour market – as is already apparent from the rising number of unfilled vacancies – so that it will become increasingly difficult for firms to find suitable staff. That tension on the labour market is one reason why the average working time – which has increased again recently – will continue to rise. The harmonised unemployment rate, which measures the actual number of job seekers on the basis of a survey, fell even further than expected at the end of 2017 to a very low level not seen since the start of the century. During the projection period, the unemployment rate remains more or less unchanged year-on-year : the further rise in the labour force, resulting partly from the measures to restrict early departure from the labour market, will roughly keep pace with job creation.

Inflation, which is put at 1.8 % this year, will subside slightly over the next two years on the assumption that oil prices level out. Core inflation does edge upwards over the projection period, though as in the past the higher labour costs will not be entirely passed on in prices, but will instead be accompanied by a narrowing of profit margins.

Finally, as regards public finances, the 2018 budget deficit will again be smaller than originally expected, namely 1 % of GDP, the same as in 2017. The main factor here is the new, substantial increase in advance payments by companies, in the context of the further rise in the charge imposed if advance payments are insufficient. However, this is a temporary factor which will lead to lower assessments when corporation tax is settled. During the projection period the budget deficit will therefore worsen, despite the further reduction in interest payments on the debt, and is estimated at 1.8 % by the end of the projection period. It should be remembered that, in accordance with the Eurosystem rules for such 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. In addition, 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

On the back of flourishing trade, the world economy ended the year 2017 with an even higher than expected growth rate. However, in a climate of increased volatility on the financial markets and heightened geopolitical and commercial tensions, growth in most of the advanced economies was a little less vigorous in the first quarter of 2018. More generally, it is not unusual for the growth cycle to slow down after strong expansion during which unused production capacity has diminished.

In the advanced economies, the vigorous growth of activity in the United States subsided in the first quarter of this year, partly as a result of the slower pace of private consumption and exports and the decline in residential investment. Thanks to the steady job creation since October 2010, the unemployment rate was down to 3.8 % in May, its lowest level since April 2000. Against that backdrop of a tighter labour market, core inflation was running at 2 %. The Federal Reserve, which is normalising its monetary policy, increased its policy interest rates again in March. The impact on American growth of the easing of fiscal policy via increased expenditure and tax cuts for businesses and households is still very uncertain in view of the already very high level of capacity utilisation. However, most estimates, such as the one by the Congressional Budget Office, expect growth to accelerate temporarily to some degree, after which it will rapidly drop back, with inflation expectations increasing. That is also the scenario in the common international assumptions for these spring forecasts.

In Japan, following continuous growth in 2016 and 2017, the economy contracted again for the first time in the first quarter of this year. The main contribution to the loss of GDP came from negative changes in firms' inventories. Investment in housing also stagnated, after the Financial Services Agency had tightened the conditions for lending to households for the construction of apartments. More generally, the main factor supporting activity is exports rather than domestic demand, despite the continuously low unemployment rate.

The British economy more or less stagnated at the beginning of this year, but the bad weather in March was only a minor factor in that regard. Domestic demand was weak. Although unemployment is still very low, private consumption slowed further against the backdrop of high inflation, which is curbing purchasing power. Business investment declined, partly because of the uncertainty over the future relationship between the United Kingdom and the EU.

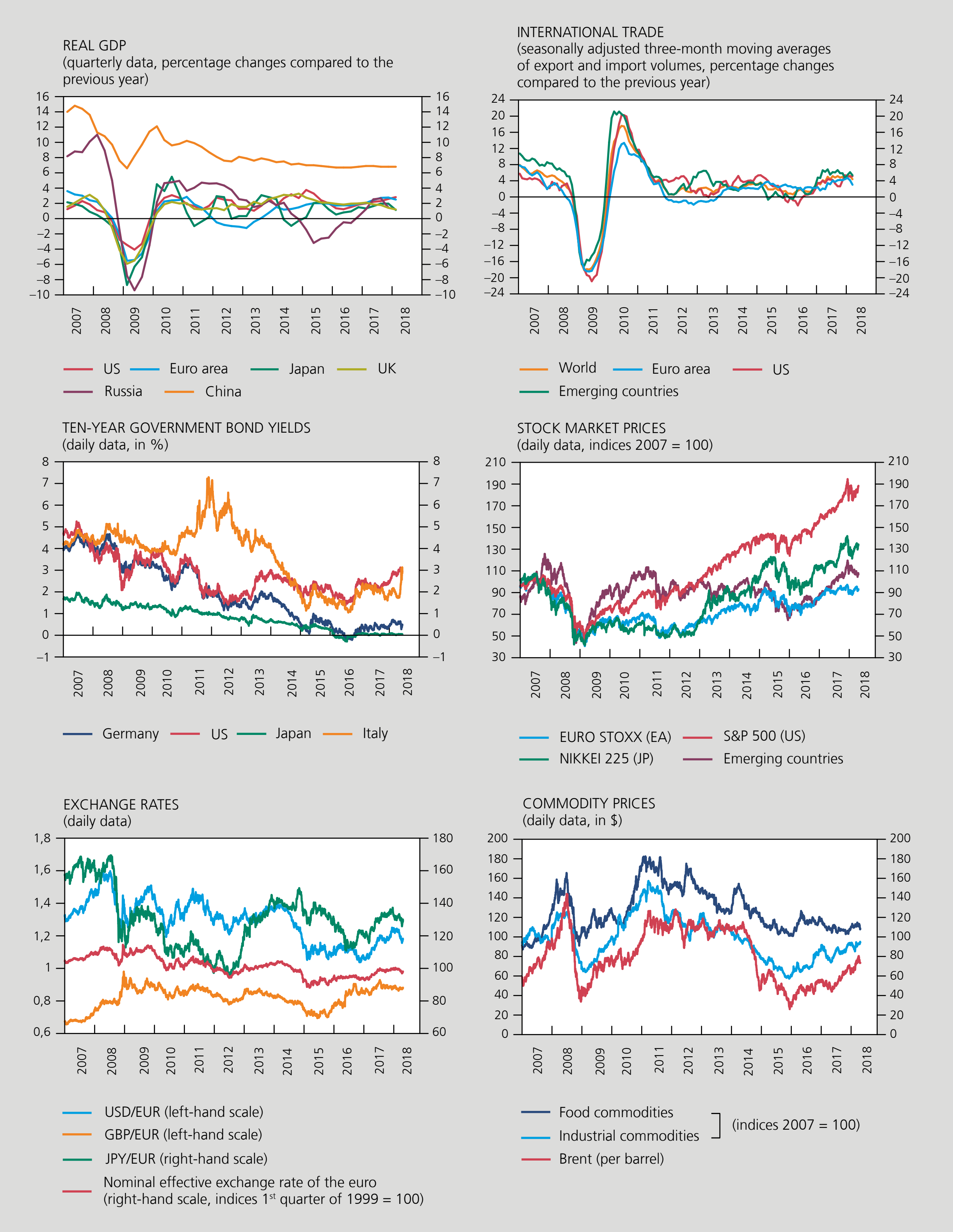
In the euro area, which performed strongly in 2017 with growth spreading across the various countries and sectors, activity also expanded less rapidly in the first quarter of 2018 (0.4 %, compared to 0.7 % in the preceding three quarters). Growth was down sharply in some major economies such as France, Germany and, to a lesser degree, the Netherlands, but remained strong in Spain. Adverse weather conditions, strikes, and other factors the impact of which is hard to quantify precisely depressed activity to some extent in certain countries, but cannot account for the whole of the decline. According to the first available statistics, that decline is due to a fall in exports, in which the strong appreciation of the euro may also have played a role in addition to the said global factors. Confidence indicators have generally weakened since the beginning of this year.

Strong job creation reduced unemployment in the euro area to 8.5 % in April, the lowest figure since the end of 2008. Inflation had remained very low for a long time, but in May it suddenly surged to almost 2 %. Although this is due mainly to higher oil prices, core inflation also increased, with a particularly steep rise in service sector prices.

The emerging economies were better able to hold their course: the oil-exporting countries benefited in particular from the higher oil prices. However, some countries with current account deficits, such as Argentina and Turkey, had to contend with increasing financing problems and a depreciation of their currency, partly as a result of the recent appreciation of the US dollar, leading to shifts in international asset positions. In that context, a more widespread capital flight will certainly weigh on the emerging countries' prospects.

Activity in the emerging countries was underpinned by vigorous growth in China and India and a continued gradual recovery in Brazil and Russia. The stronger than expected expansion of the Chinese economy in 2017, bolstered by robust export growth, continued during the first quarter of this year. With growth of 6.8 % year-on-year, activity in the first three months of this year continued to expand at the same pace as in the two preceding quarters, while also exceeding the

CHART 1 WORLD ECONOMY AND DEVELOPMENTS ON FINANCIAL AND COMMODITY MARKETS



Sources: CPB Wereldhandelsmonitor, OECD, Thomson Reuters.

government target of 6.5 %. Industrial output recovered following a relaxation of the measures to curb pollution during the winter months. In addition, investment in real estate remained strong despite measures by the authorities to cool the housing market. Although the People's Bank of China maintained a predominantly neutral stance, in the context of a high debt burden and continued credit expansion, the reserve requirements for banks were eased again at the end of April to facilitate access to credit for smaller businesses. In India, growth regained momentum from the end of the year, supported by a revival in investment and consumption, after the effects of the demonetisation (November 2016) and the harmonisation of taxes on goods and services (July 2017) had temporarily restrained growth during 2017.

In the commodity exporting countries the recovery from deep recessions continued. After a slowdown in the final quarter of 2017, the Russian economy picked up again in the first months of this year. Higher oil prices, increased confidence and the easing of monetary policy in the context of falling inflation underpinned both consumption and investment. However, the new American sanctions at the beginning of April triggered a further depreciation of the rouble and depressed the exports of large firms; which may induce a gloomier economic outlook. The Brazilian economy also continued to pick up in 2017 and the first months of 2018, despite the political tensions. Growth was driven by the dynamism of both foreign demand – in a favourable external environment – and domestic demand, with consumption benefiting in particular from the more relaxed monetary policy and better labour market conditions.

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

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

	2016	2017	2018 e	2019 e
Real GDP				
World	3.2	3.7	3.9	3.9
of which:				
Advanced countries	1.8	2.6	2.6	2.4
United States	1.5	2.3	2.9	2.7
Japan	0.9	1.7	1.3	1.1
European Union	2.0	2.4	2.3	2.0
of which: United Kingdom	1.9	1.8	1.5	1.2
Emerging countries	4.3	4.6	5.0	5.0
China	6.7	6.9	6.6	6.3
India	7.9	6.4	7.4	7.6
Russia	–0.2	1.5	1.7	1.6
Brazil	–3.5	1.0	2.4	2.6
p.m. World imports	*2.3*	*5.1*	*5.1*	*4.5*
Inflation (1)				
United States	1.3	2.1	2.2	2.2
Japan	–0.1	0.5	1.0	1.1
European Union	0.3	1.7	1.7	1.8
of which: United Kingdom	0.7	2.7	2.5	1.9
Unemployment (2)				
United States	4.9	4.4	4.0	3.5
Japan	3.1	2.8	2.7	2.6
European Union	8.6	7.6	7.1	6.7
of which: United Kingdom	4.8	4.4	4.4	4.6

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

World trade flows recorded strong growth last year, mainly reflecting the cyclical recovery in global demand and, more particularly, the revival of trade-intensive investment. Despite mounting trade tensions, the growth of world trade also seems to have continued at the start of this year, albeit at a somewhat slower pace. In the euro area in particular, exports declined against the backdrop of slower economic growth and the stronger euro.

On the financial markets, interest rates on government bonds in the United States continued rising to their highest level in four years, while in Germany and Japan interest rates are still at historically low levels. That mainly reflects the differing monetary policy stance, but is also due to the stronger rise in inflation expectations in the United States. In the euro area, however, interest rate differentials increased: uncertainty over the political situation and the announced budget plans significantly drove up the interest rate premium on Italian government bonds. While the rising interest rates, higher inflation expectations and uncertainty over the announced protectionist measures led to increased volatility on the stock markets, the steep falls, mainly in February, gave way to a recovery.

On the foreign exchange market, following a surge last year against the backdrop of the strong economic performance by the euro area and market expectations concerning a gradual tightening of monetary policy, the euro stabilised in effective terms this year. The somewhat larger movements in relation to the US dollar are due to the changing relative growth and inflation prospects for the United States and the euro area, in which the sharper growth slowdown in Europe recently was accompanied by a depreciation of the euro, whereas the euro had previously appreciated strongly. The recent financial turbulence over the political situation in Italy also depressed the exchange rate.

Finally, the oil price maintained the rise that had begun last year, actually climbing to around $ 80 per barrel in May, its highest level in more than three years. While the oil prices are buttressed by strong global demand, various factors on the supply side were also in play, such as the strict compliance with the supply restrictions announced by the OPEC and a number of non-OPEC countries, unplanned production outages in, amongst others, the North Sea, Libya and Venezuela and finally, the uncertainty over withdrawal by the United States from the nuclear agreement with Iran. At the end of May, however, the oil price dropped clearly, as some oil-producing countries suggested that they could step up their production in the future. Industrial commodity prices declined at the beginning of the year, partly because of the uncertainty over a possible trade war, but they subsequently recovered.

Box – Assumptions adopted for the projections

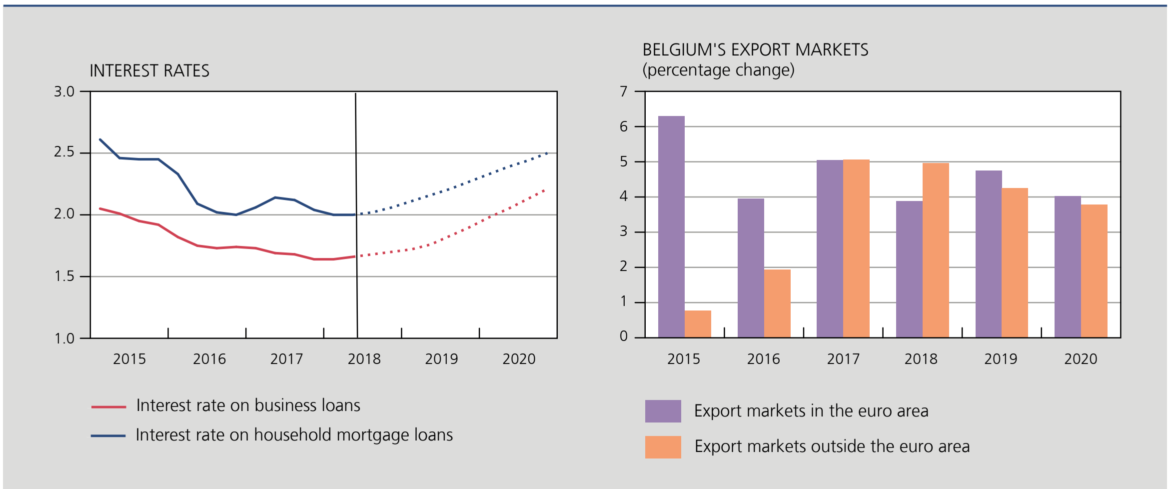
The macroeconomic projections for Belgium described in this article form part of the joint Eurosystem projections for the euro area. That projection exercise is based on a set of technical assumptions and forecasts for the international environment drawn up jointly by the participating institutions, 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. 23 May 2018. In the case of the US dollar, the exchange rate then stood at $ 1.18 to the euro. That implies that the euro has appreciated considerably compared to its average level in 2017.

As usual, the assumptions concerning oil prices take account of market expectations as reflected in forward contracts on the international markets. After the recent steep price rise, the markets in mid-May 2018 were expecting the price per barrel of Brent crude to continue edging upwards in the third quarter of the year, but to fall steadily thereafter.

The interest rate assumptions are likewise based on market expectations. The three-month interbank deposit rate has been stable for almost two years now at around –30 basis points, but is expected to climb very gradually and become positive again in 2020. The level of Belgian long-term interest rates is also projected to rise from an average of 0.9 % in 2018 to 1.4 % in 2020.

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 diverge somewhat from the movement in market rates. For instance, the average mortgage interest rate is still very low, and it is unlikely to keep entirely in line with the upward movement in the long-term market interest rate : that rate is projected to increase from an average of 2.0 % in 2018 to 2.4 % towards 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 relatively slowly over the projection period : in 2020, it is forecast at an average of 2.1 %, which is roughly 0.4 percentage points higher than the 2018 average.

As stated in chapter 1, the global economy produced a strong growth performance in 2017, with a particularly vigorous recovery in trade flows, which considerably outstripped GDP growth. According to the common assumptions, that gap will gradually narrow and world import growth will revert to a pace more in line with the expansion of global activity. Nevertheless, the annual growth of trade flows will remain very robust this year, partly as a result of the favourable spillover effect of the strong end to the year 2017. In 2018, the markets for Belgian exporters are predicted to expand by over 4 %. However, that growth will gradually weaken over the ensuing two years.

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 2018, the more expensive euro was reflected in a relatively small price rise among rival exporters outside the euro area. In the years ahead, assuming that the exchange rate remains constant, rising inflation in the euro area – but also elsewhere – will again exert stronger pressure on the prices of Belgian export competitors.

EUROSYSTEM PROJECTION ASSUMPTIONS
(in %, unless otherwise stated)

	2017	2018	2019	2020
	(annual averages)			
EUR/USD exchange rate	1.13	1.20	1.18	1.18
Oil price (US dollars per barrel)	54.4	74.5	73.5	68.7
Interest rate on three-month interbank deposits in euro	–0.3	–0.3	–0.2	0.2
Yield on ten-year Belgian government bonds	0.7	0.9	1.2	1.4
Business loan interest rate	1.7	1.7	1.8	2.1
Household mortgage interest rate	2.1	2.0	2.2	2.4
	(percentage changes)			
Belgium's relevant export markets	5.1	4.3	4.5	3.9
Export competitors' prices	2.0	0.3	2.3	2.0

Source: Eurosystem.

Overall, the adjustment of the assumptions compared to the latest autumn forecasts has a small, negative impact on Belgium's growth prospects. The small upward revision concerning the export markets is favourable to growth, but that beneficial effect is more than offset by the higher oil price and the somewhat more expensive euro, despite the recent depreciation.

1.2 Estimates for the euro area

The Eurosystem's current growth estimates for the euro area were downgraded in comparison with the March ECB forecasts. In many countries, including the biggest economies (Germany and France), activity growth fell short of expectations, particularly at the beginning of this year. According to the initial statistics on the subject, the growth slowdown is due mainly to a decline in exports.

However, except for this lower starting point, which will probably depress annual growth in 2018, the outlook for the euro area has remained more or less unchanged, as the international assumptions have only altered slightly. This year, the euro area's economy is predicted to grow by 2.1 % and to lose some of its momentum in the ensuing years. That slowdown is due to the presumed gradual weakening of the trade intensity of world growth, implying that import demand from countries outside the euro area will rise more slowly, but also to the fact that labour market supply constraints will increasingly hold back growth in certain countries. Despite the slowdown, however, activity growth is still expected to continue to outpace potential growth at the end of the projection period. In regard to the demand components, household consumption – which has risen since the beginning of 2018 and will barely slacken pace in the years ahead – is still providing substantial support for growth, as household incomes are increasing steadily, not only as a result of the continuing strong job creation, but also because real wages are picking up. However, in most countries that income growth is used to a somewhat greater degree to supplement reserves of savings, driving the saving ratio back up after its further fall in 2017.

According to the projections, inflation will accelerate a little more this summer to just over 2 %. That is due mainly to the higher oil prices. The presumed levelling out and gradual fall in those prices from the third quarter cause a sharp drop in energy price inflation. However, that is offset by the rising domestic cost pressure. Thus, labour costs are set to rise, partly as a result of the disappearance of certain measures which previously moderated the growth of those costs in some countries, but more generally, as a result of mounting labour market tensions. Overall, inflation therefore remains at 1.7 % in each year of the projection period, though that masks a strong rise in core inflation, which will reach 2 % by the end of 2020.

The recent jobs growth was very vigorous, but as the shortage of suitable labour increases and activity slackens pace, job creation in the euro area will gradually lose momentum. Against the backdrop of increasing labour market tensions, the downward trend in average working time will be suspended temporarily, with a rise in the average number of hours worked helping to support the expansion of output in various countries. The labour force is still expanding, with the impact of ageing being moderated by increasing labour market participation, including among older workers. Nonetheless, the unemployment rate will also decline further to 7.3 %, its lowest level this century.

According to the forecasts, the euro area's average budget deficit, which had fallen to less than 1 % of GDP last year, will diminish further to 0.5 % of GDP in 2020. However, that improvement is due mainly to the cyclical upturn and the further decline in interest charges as a result of the unusually low level of interest rates. In contrast, the cyclically adjusted primary surplus will decrease slightly during the projection period, primarily because of the easing of fiscal policy in the form of reductions in charges or additional spending in various countries. The public debt ratio will continue to fall, thanks to the low interest rates: in 2020, the debt ratio will already have declined by more than 11 percentage points below its 2014 peak.

TABLE 2 EUROSYSTEM PROJECTIONS FOR THE EURO AREA

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

	2016	2017	2018 e	2019 e	2020 e
Real GDP	1.8	2.5	2.1	1.9	1.7
Private consumption	1.9	1.7	1.6	1.7	1.5
Public consumption	1.8	1.2	1.3	1.3	1.2
Gross fixed capital formation	4.5	3.3	4.2	3.3	2.8
Exports of goods and services	3.3	5.4	4.2	4.4	3.8
Imports of goods and services	4.8	4.6	4.1	4.7	4.0
Inflation (HICP)	0.2	1.5	1.7	1.7	1.7
Core inflation (1)	0.9	1.0	1.1	1.6	1.9
Domestic employment	1.4	1.6	1.4	1.1	0.8
Unemployment rate (2)	10.0	9.1	8.4	7.8	7.3
General government financing requirement (–) or capacity (3)	–1.5	–0.9	–0.7	–0.8	–0.5

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

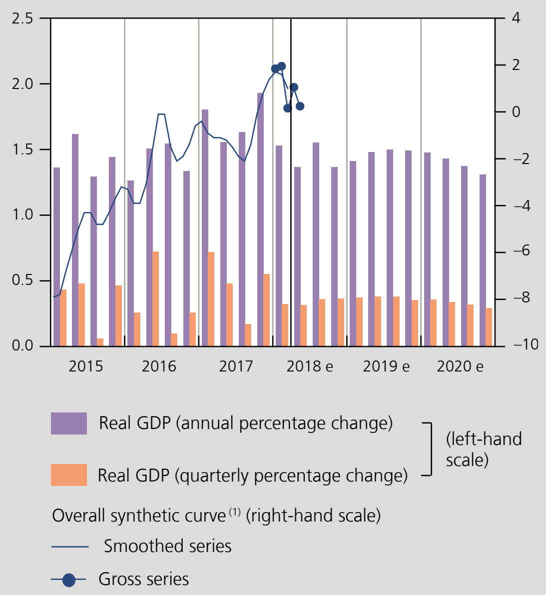
2. Activity and demand

In 2017, the Belgian economy's growth rate increased to 1.7 %, clearly exceeding the figure for recent years and outpacing potential growth. On the expenditure side, growth was significantly boosted by the underlying expansion of investment, at least if an adjustment is made for the impact of specific major purchases of investment goods abroad by large multinationals at the end of 2016. On the production side, increased activity in services was the main contributor to growth, while added value in manufacturing industry was virtually unchanged.

In the first quarter of this year, growth dipped slightly as in other euro area countries, dropping to 0.3 % on a quarterly basis. The gradual decline in quarterly growth mirrors the trend in business confidence, which weakened at the beginning of the year in more or less all sectors. Consumer confidence was rather volatile, but also seems to have been eroded somewhat since the end of the year. Overall, the leading indicators available at the cut-off date of the projections do not suggest any revival in the second quarter. The nowcasting models used at the Bank indicate that the growth rate will remain unchanged in that quarter, at 0.3 %. This implies that growth in the first half of the year will fall slightly short of the autumn forecasts, albeit to a lesser extent than in Germany and France, for example.

CHART 2 **GDP AND BUSINESS CONFIDENCE**

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



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

On the basis of the common assumptions, the decline in the confidence indicators in the first half of the year is expected to be temporary, with no worsening of the growth slowdown. From the third quarter on, growth is predicted to strengthen somewhat to around 0.4 % on a quarterly basis. As in the previous forecasts, however, Belgium's annual growth is set to slow down a little to around 1.4 % in 2020. That reflects the deceleration in Belgium's export markets and normalisation of the growth of business investment. In addition, certainly towards the end of the projection period, economic growth will be held back by supply constraints, particularly in certain geographical or functional segments of the labour market.

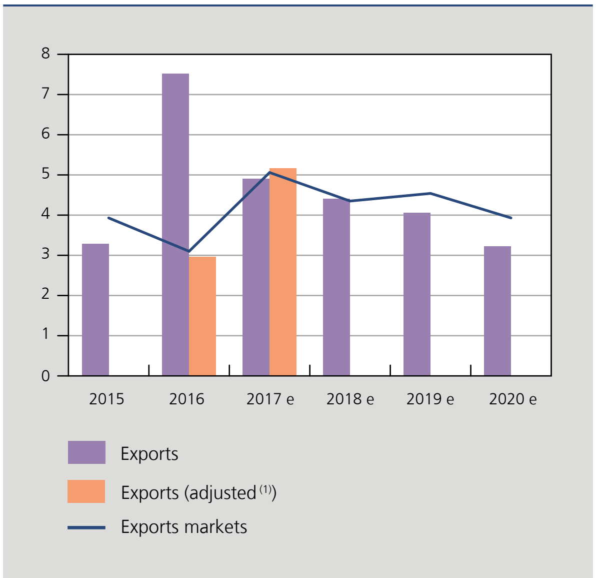
Over the projection period as a whole, just as in recent years, growth is still clearly supported by domestic demand, given that the growth contribution of net exports will be slightly negative on average. As usual, the technical assumptions for all quarters in the projection period are based on a growth-neutral contribution from changes in inventories, particularly in view of the great statistical uncertainty surrounding that concept.

Thanks partly to the strong improvement in cost competitiveness, the market shares of Belgian exporters remained more or less unchanged, on average, during the period from 2014 to 2017. According to the forecasts, exports will gradually trail behind the export markets during the projection period, so that market shares over the three years together will shrink by more than 1 %. That is due mainly to the domestic labour cost pressure which has now begun rising again, preventing any further improvement in cost competitiveness compared to other countries. Taking account of the recent appreciation of the euro, the loss of market shares for Belgian firms will be somewhat greater outside the euro area than within it.

The weakening of global demand is another factor causing a dip in export growth quarter-on-quarter, down to an average of 0.8 % in the final year of the projection period. On average, imports hold up somewhat better, underpinned by robust domestic demand, so that the growth contribution of net exports becomes slightly negative on a quarterly basis.

CHART 3 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 2016 reorganisation of the commercial activities of a large pharmaceutical company, in favour of subsidiaries based in Belgium, so that from the second quarter of 2016 more trade flows to and from Belgium are visible in the statistics. Since the upward effect is much the same for both imports and exports, there is no net impact on GDP but an adjustment is necessary for this statistical effect in order to examine the change in market shares.

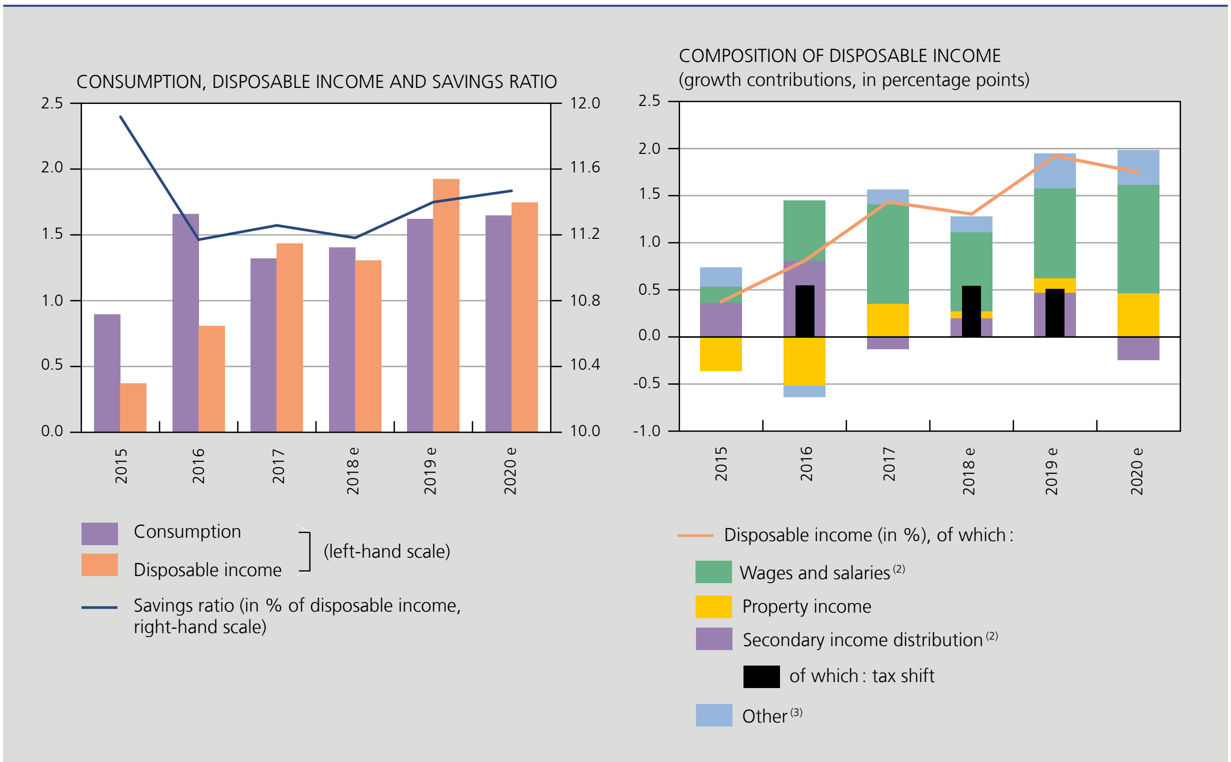
While exports thus gradually decelerate, the real growth of domestic demand remains fairly constant over the projection period, although the share represented by private consumption increases. However, the quarterly profile of household consumption is highly volatile, so that according to the current quarterly statistics, zero growth in the final quarter of 2017 was followed by strong expansion, particularly in the case of consumer durables, at the beginning of this year. After that, household consumption maintains relatively strong growth throughout the projection period, at an average of 0.4 % quarter-on-quarter. The main determinant here is the acceleration of labour incomes, driven by the growth of employment which, though losing some momentum, remains strong for quite some time, and – above all – the rise in real wages. Furthermore, household purchasing power is also bolstered by the additional tax cuts under the tax shift. In that connection, secondary income distribution drives up income growth particularly in 2019. In 2018, the favourable impact of the tax shift is still partly offset by such factors as the increase in certain federal levies on financial transactions and incomes.

Since last year, property incomes have also made a positive contribution to private income growth once again. In view of the relatively substantial financial assets of Belgian households, on average, the rise in interest rates will give a further boost to property incomes during the projection period. In 2020, however, income growth subsides somewhat, mainly because there will be no additional tax shift measures in that year and the positive contribution from secondary income distribution therefore disappears. Over the next three years, consumer purchasing power increases by a cumulative total of around 5 %. Taking account of the expected population growth, that corresponds to almost 3.5 % per person.

In 2018, year-on-year consumption growth still slightly outstrips the rise in incomes, which in real terms is also limited by the increase in oil prices. As a result, the savings ratio falls a little further, but in the ensuing years households will,

CHART 4 HOUSEHOLD CONSUMPTION AND DISPOSABLE INCOME [1]

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



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

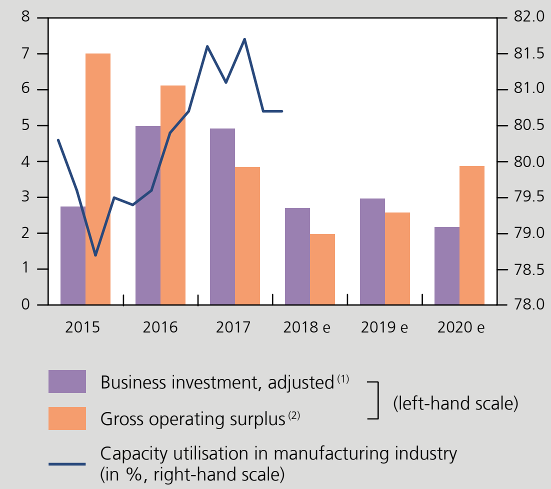
as usual, take time to adjust their expenditure in line with stronger income growth. In those years the rise in the savings ratio is also due to the limited increase in the share of disposable income represented by property income, of which relatively more is normally saved.

Apart from private consumption, private investment also continues to support growth, albeit to a diminishing degree. Excluding the distortion caused by certain specific purchases of investment goods abroad, which had driven up the 2016 investment figures, the expansion of business investment was particularly vigorous in 2017, with a volume rise of around 5 %. According to the initial quarterly statistics, however, business investment lost some momentum at the beginning of this year. The underlying investment determinants are still favourable in the future, thanks to the relaxed financing conditions, substantial cash reserves, a growing operating surplus, low interest rates and high capacity utilisation necessitating investment in expansion. The low growth figure in the first quarter is therefore not an indication: the current forecasts point to higher growth in the rest of the year. Nonetheless, the growth of business investment is expected to moderate gradually thereafter, reverting to a more normal pace closer to what is usually seen in this phase of the business cycle.

Household investment – either in the form of new building or renovation projects – should in theory still be stimulated by the low interest rate environment. Nonetheless, since mid-2016 the available quarterly statistics indicate that growth of such investment has been strikingly low (or even negative). That could be due to the declining influence of portfolio shifts, in view of the fairly stable level of market interest rates prevailing for some time. However, the current projections indicate a modest revival in investment in housing: over the projection period, that investment is set to rise by an average of 0.5 % on a quarterly basis.

CHART 5 BUSINESS INVESTMENT AND DETERMINANTS

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



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

Finally, as regards public expenditure, the growth of public consumption will be rather modest over the projection period as a whole. In contrast, public investment will, as usual, follow the pattern of the electoral cycle: after the acceleration in 2018, local investment will then subside rapidly in 2019. For 2020, account is taken of the launch of some major public investment projects, such as those concerning the Oosterweel link.

TABLE 3 GDP AND MAIN EXPENDITURE CATEGORIES

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

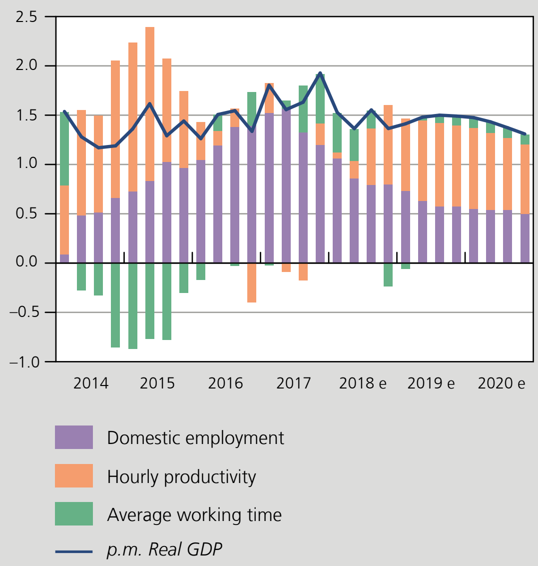
	2016	2017	2018 e	2019 e	2020 e
Household and NPI final consumption expenditure	1.7	1.3	1.4	1.6	1.6
General government final consumption expenditure	0.2	1.3	0.9	0.7	0.7
Gross fixed capital formation	3.8	0.7	2.6	2.3	2.3
general government	−1.5	2.0	6.6	−1.9	4.0
housing	2.6	0.3	0.7	2.2	1.9
business	4.9	0.7	2.7	3.0	2.2
p.m. Domestic expenditure excluding change in inventories (1)	*1.8*	*1.2*	*1.5*	*1.5*	*1.6*
Change in inventories (1)	0.2	0.1	−0.3	0.0	0.0
Net exports of goods and services (1)	−0.6	0.5	0.2	−0.1	−0.2
Exports of goods and services	7.5	4.9	4.4	4.1	3.2
Imports of goods and services	8.4	4.4	4.2	4.2	3.4
Gross domestic product	1.4	1.7	1.5	1.5	1.4

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

3. Labour market

CHART 6 **DOMESTIC EMPLOYMENT, WORKING TIME AND PRODUCTIVITY**

(contribution to GDP growth, percentage points, data adjusted for seasonal and calendar effects)



Sources: NAI, NBB.

In the past two years the growth of employment has been very vigorous, certainly in relation to GDP growth, with most jobs being created in the private sector, and particularly in the branches of activity sensitive to the business cycle. Within those branches, only financial activities and insurance saw their workforce decline in 2017, while industry and construction supported job creation. The sectors making the biggest contribution were business services, on the one hand, and trade, transport, hotels and restaurants, on the other hand. However, during the projection period the expansion of activity will gradually gain increasing support from renewed productivity growth and a steady rise in average working time.

In 2018, job creation is accordingly set to be weaker than in the two preceding years. Following a rise in the number of persons in work of 58 000 in 2016 and 65 000 in 2017, this year that figure is expected to increase by 41 000 units, and then by fewer each year up to 2020. That trend is due to the waning impact over the projection period of the policy measures introduced in recent years to stimulate net job creation, particularly wage moderation. In addition, GDP growth is expected to decelerate over the whole of the projection period, since it will decline to 1.4 % in 2020. Moreover, after three years of strong net job creation and falling unemployment, labour shortages in certain geographical and functional segments of the labour market could inhibit employment growth. During the period 2018-2020, 97 000 jobs are likely to be created.

The more moderate rise in the number of persons in work is expected to be accompanied by an increase in hourly productivity, which will again rise steadily from the second half of the current year, approaching the average recorded outside of the crisis period. The increase in average working time will also contribute to the deceleration of job creation. Despite the economic revival, average working time declined up to 2016, and is set to rise as a result of such factors as the abolition of allowances for time credit granted for no specific reason (introduced at the beginning of 2015), which had prompted many workers to reduce their working time temporarily before that scheme was abolished. In addition,

TABLE 4 LABOUR SUPPLY AND DEMAND

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

	2014	2015	2016	2017	2018 e	2019 e	2020 e
Total population	55	59	57	58	58	56	60
Working age population (1)	9	16	16	14	11	7	6
Labour force	33	21	32	38	15	24	22
Domestic employment	20	40	58	65	41	30	25
Employees	14	30	44	54	30	20	16
Branches sensitive to the business cycle (2)	–1	19	29	38	19	10	7
Public administration and education	8	2	2	4	1	0	0
Other services (3)	7	9	13	12	10	10	10
Self-employed	6	10	13	11	11	10	9
Unemployed job-seekers	14	–19	–26	–28	–26	–6	–4
p.m. Harmonised unemployment rate (4) (5)	*8.6*	*8.6*	*7.9*	*7.1*	*6.7*	*6.7*	*6.8*
Harmonised employment rate (4) (6)	*67.3*	*67.2*	*67.7*	*68.5*	*69.5*	*69.9*	*70.2*

Sources: DGS, FPB, NAI, NEO, NBB.
(1) I.e. the population aged from 15 to 64 years.
(2) Agriculture, industry, energy and water, construction, trade, hotels and restaurants, transport and communication, financial activities, property services and business services.
(3) Health, welfare, community, public social services, personal services and domestic services.
(4) On the basis of data from the labour force survey.
(5) Job seekers in % of the labour force aged 15-64 years.
(6) Persons in work in % of the total population of working age (20-64 years).

rising labour market tensions could further drive up average working time via the pressure to work more overtime or to reduce part-time working.

Within domestic employment, the growth in the number of employees is expected to weaken more rapidly than the growth in the numbers of self-employed, as the increase in the latter group is not curbed by the waning effect of wage moderation. Moreover, an increasing number of workers seem to be choosing that status, notably as a result of the improvements made in recent years to the self-employed social security scheme and to the scope for retired persons to combine their pension with a self-employed occupation.

Ageing is to some degree slowing the increase in the working age population, but the participation rate is still rising, partly on account of the measures to discourage early departure from the labour market which are boosting the growth of the labour force. However, that growth is being outpaced by employment expansion, so that the number of unemployed job seekers is still falling. In 2018 the figure will be 26 000 lower, on average, than a year earlier. Nevertheless, that decline will diminish greatly during the projection period, despite the contribution made by a large cohort of older unemployed persons gradually entering retirement. In 2020, the number of unemployed job seekers is put at 490 000 for the country as a whole. The harmonised unemployment rate, which measures actual availability for the labour market on the basis of survey data, and which may therefore deviate slightly from the number of unemployed job seekers registered with the RVA, has fallen very steeply in recent quarters. That rate is expected to fall further year-on-year in 2018 to 6.7 %, a level similar to that recorded at the beginning of the 2000s. It will thus approach its structural level, which can be regarded as an unemployment rate which is difficult to reduce further without a change in policy. Thereafter, the unemployment rate will remain fairly stable and rise slightly in 2020, as job creation loses momentum and the labour force continues to grow strongly.

4. Labour costs and prices

4.1 Labour costs

On the basis of the available information, real negotiated pay increases in 2017 did not exceed 0.2 %. In 2018 they are expected to rise to 0.8 %, which means that during the two years of the 2017-2018 central agreement they will remain a little below the 1.1 % wage norm agreed by the social partners. Taking account of the indexation effect which has risen very slightly, gross pay will therefore increase by more than last year. However, labour costs are moderated by the additional reductions in social contributions under the tax shift, but will still increase more than in 2017 with a rise of over 2 %.

The wage norm for 2019-2020 will not be negotiated until the end of this year. The technical assumption adopted in these projections reflects the rising tensions in certain labour market segments, predicting that the increase in the negotiated adjustments excluding indexation will accelerate to 1.7 % for this two-year period, and be slightly higher in the second year in view of the stylised facts concerning the implementation of such agreements. With more or less stable indexation and a small increase in the wage drift over the projection period as a whole, attributable mainly to older workers remaining in employment for longer, and to the tensions resulting from the shortage of workers in some branches, gross hourly pay in 2019 is set to accelerate in 2019 and then stabilise in 2020. Since there are no plans for any significant new reductions in social contributions, the same applies to labour costs per hour worked.

Thanks to the gradual restoration of productivity growth, the increase in unit labour costs will be slightly lower and remain relatively constant over the projection period. Although domestic cost pressure therefore diminishes somewhat in comparison with 2017, it remains much stronger than in the preceding years when labour cost moderation was more marked.

TABLE 5 COST AND PRICE INDICATORS

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

	2015	2016	2017	2018 e	2019 e	2020 e
Labour costs in the private sector (1)						
Labour costs per hour worked	0.1	–0.6	1.8	2.2	2.9	2.8
of which: Indexation	0.1	0.5	1.6	1.7	1.8	1.7
Labour productivity (2)	1.7	–0.6	–0.3	0.3	0.8	0.8
Unit labour costs	–1.6	0.1	2.1	1.8	2.0	2.0
p.m. Labour costs per hour worked according to the national accounts (3)	*0.2*	*–0.7*	*1.7*	*2.1*	*2.7*	*2.7*
Core inflation (4)	1.6	1.8	1.5	1.3	1.7	1.8
Energy	–8.0	–0.6	9.9	7.4	2.2	–1.0
Food	1.8	3.1	1.4	2.5	2.1	1.9
Total inflation (HICP)	0.6	1.8	2.2	2.1	1.9	1.6
p.m. Inflation according to the national consumer price index (NCPI)	*0.6*	*2.0*	*2.1*	*1.9*	*2.0*	*1.6*
Health index (5)	1.0	2.1	1.8	1.6	1.9	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 self-employed persons.

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

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

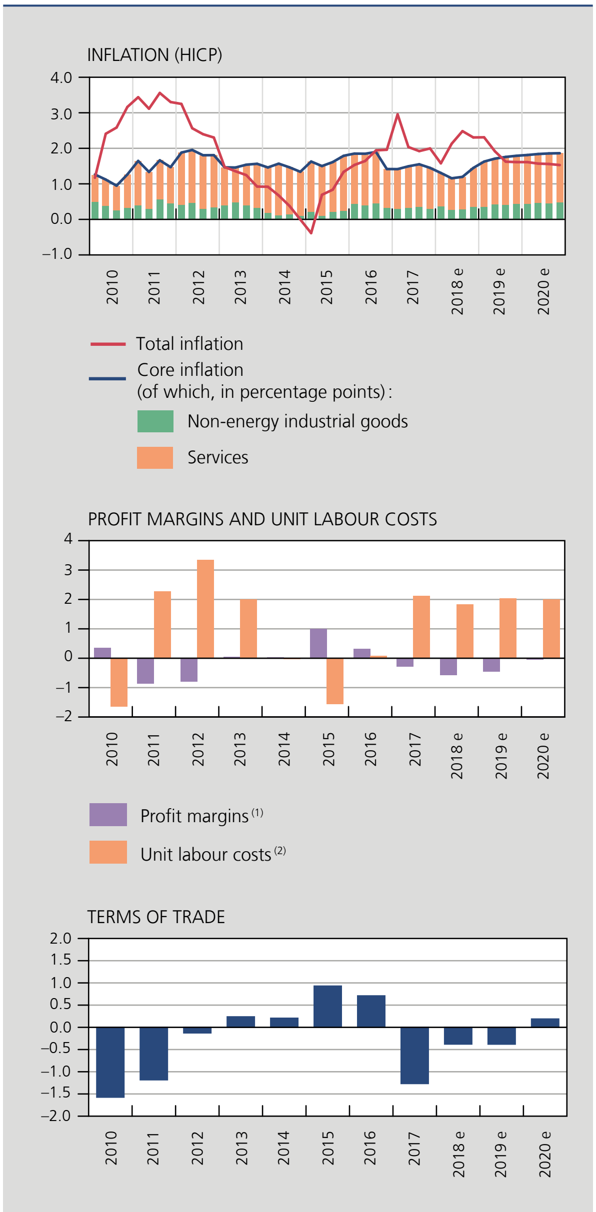
(5) Measured by the national consumer price index excluding tobacco, alcohol and motor fuel.

4.2 Prices

However, this increased cost pressure will only drive inflation up to a limited extent, as fluctuations in the growth of labour costs are generally partially absorbed in firms' profit margins and not passed on entirely in selling prices. That is also likely to be the case during the projection period: after profit margins had received a substantial boost in past years, since the lower labour costs were only very partially reflected in pricing, they are expected to be slightly negative up to 2019 and then to remain unchanged in 2020. The increase in core inflation, which excludes volatile components such as energy and food prices, therefore remains small during the projection period.

CHART 7 **INFLATION AND DETERMINANTS**

(percentage changes 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. This concerns unit labour costs in the private sector.

In 2018, core inflation is actually predicted to weaken a little further. The main factor here is inflation in services, which is expected to fall to 1.6 %, its lowest level since 2010. That deceleration is largely due to one specific measure, namely the abolition of the radio and television licence fee in the Walloon Region in January of this year. However, other service categories have also recorded more modest price rises lately. For instance, since the end of last year the price movements of telecommunication services have clearly decelerated. The measures to boost competition between the various suppliers (such as the "Easy Switch" principle which makes it easier to switch between telecom operators) and the abolition of roaming charges in the European Union, both measures dating from the summer of 2017, doubtless made a contribution here. From 2019 onwards, rising labour costs will gradually propel services inflation higher again, to around 2.3 % in 2020. Inflation in non-energy industrial goods will also pick up gradually. Apart from the rising domestic cost pressure, the expected increase in inflation in other countries and among trading partners also plays a role. It makes imports more expensive and also enables Belgian firms to gear their prices to the higher prices charged by foreign competitors.

The terms of trade are set to deteriorate further this year and next, indicating a relatively larger price increase among the trading partners, caused mainly by the steep rise in oil prices.

That rise is only one factor influencing energy product prices. In 2018, energy inflation is actually expected to be slightly lower than last year, the main reason being the abolition – pursuant to a Constitutional Court judgment – of the energy tax on electricity consumption in the Flemish Region with effect from January. In addition, taking account of the Eurosystem's common assumptions mentioned earlier, the rate of oil price increases is set to slow down in 2018, mainly because oil prices are expected to start falling again from the summer. Consequently, energy inflation will be very low in 2019 and actually negative in 2020.

Conversely, food inflation will rise steeply in 2018 compared to the previous year. That applies to both processed and unprocessed foods. Tax is the main factor in the case of processed foods. First, the excise duty on tobacco increased more this year than in 2017. Also, in January, the tax on soft drinks – known as the "sugar tax" – was increased. That tax was introduced in January 2016 as part of the tax shift. From 2019, excise duties should no longer increase to the same degree and the rate of food inflation is expected to subside gradually.

All in all, total inflation is therefore expected to ease a little in 2018 and 2019 and decline further to 1.6 % in 2020. The reason is that the – albeit slow – increase in core inflation is entirely offset by the negative energy inflation and the moderation of food price rises.

The above analysis concerns the harmonised index of consumer prices (HICP), which permits comparison of inflation in European Member States. Inflation according to the national consumer price index (NCPI) may deviate slightly from the HICP 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. After stagnating in 2018, the health index is expected to rise in 2019 before decelerating again towards the end of the projection period. It is predicted that the threshold will next be exceeded in August 2018.

5. Public finances

5.1 General government balance

According to the data published by the NAI in April 2018, the Belgian government recorded a budget deficit of 1 % of GDP in 2017, a 1.4 percentage point improvement compared to 2016. Against the macroeconomic background described above, the general government budget deficit is expected to remain at that level in 2018 but will start rising again in 2019 and 2020.

The expected stabilisation of the budget balance in 2018 is due to the further decline in interest charges, while primary expenditure will edge upwards in relation to GDP. Revenue will remain more or less stable as a ratio of GDP, given that the reduction in charges on labour will be offset by a temporary increase in corporation tax revenues, because firms are paying a larger proportion of the tax due in advance.

TABLE 6 GENERAL GOVERNMENT ACCOUNTS
(in % of GDP)

	2017	2018 e	2019 e	2020 e
General government				
Revenue	51.3	51.4	50.4	50.2
Primary expenditure	49.9	50.1	50.1	50.0
Primary balance	1.4	1.3	0.3	0.2
Interest charges	2.5	2.2	2.1	2.0
Financing requirement (–) or capacity	**–1.0**	**–1.0**	**–1.8**	**–1.8**
Overall balance per sub-sector				
Federal government [1]	–1.2	–0.5	–1.7	–1.7
Social security	0.1	0.0	0.0	0.0
Communities and Regions [1]	0.0	–0.5	–0.1	–0.2
Local authorities	0.1	0.0	0.1	0.1

Sources: NAI, NBB.
(1) These figures include, from 2015, 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 approach used here corresponds to that used for formulating the budget targets in the recommendations of the High Council of Finance's "Public Sector Borrowing Requirement" section or in the stability programmes.

In 2019 and 2020, the decline in interest charges will not counterbalance the drop in revenues, while primary expenditure will virtually stagnate. The main reason for the lower revenues is the reduction in corporation tax income resulting from lower assessments, which are the corollary to the shift in favour of advance payments in preceding years.

The deficits are expected to occur mainly at federal government level, but the Communities and Regions sub-sector will also continue to record a small deficit during the projection period. Conversely, the accounts of local government and social security should be more or less in balance. The downward revision of the "autonomy factor" for determining the regional additional percentages on personal income tax results in a one-off correction in 2018 for the excess taxes paid to the Regions since 2015, with a negative impact on the budget balance of the Communities and Regions and a positive impact on the federal government balance.

As usual, the projections assume that there will be no change in policy, and therefore only take account of budget measures which have already been announced and specified in sufficient detail.

5.2 Revenue

Public revenues will be more or less stable in 2018, but in 2019 and 2020 the fiscal and parafiscal pressure will decline by 0.9 and 0.2 percentage points of GDP respectively.

The tax burden on labour is declining as a result of the reduction in personal income tax in relation to GDP. In addition, a further cut in employers' contribution rates will lead to a decline in social contributions during the projection period.

In 2018, the steep rise in corporation tax revenues will offset the impact on public revenues of the lower levies on labour incomes. The advance payments by companies on the first due date of 10 April 2018 were up by 58 % against the first due date in 2017, when there had already been a substantial increase. The reason for this big rise is that the basic rate of the tax surcharge imposed in cases of insufficient advance payments was raised to 6.75 % from the 2018 income year. It therefore makes sense for companies to step up their advance payments, and to make the payments earlier in

TABLE 7 PUBLIC REVENUES
(in % of GDP)

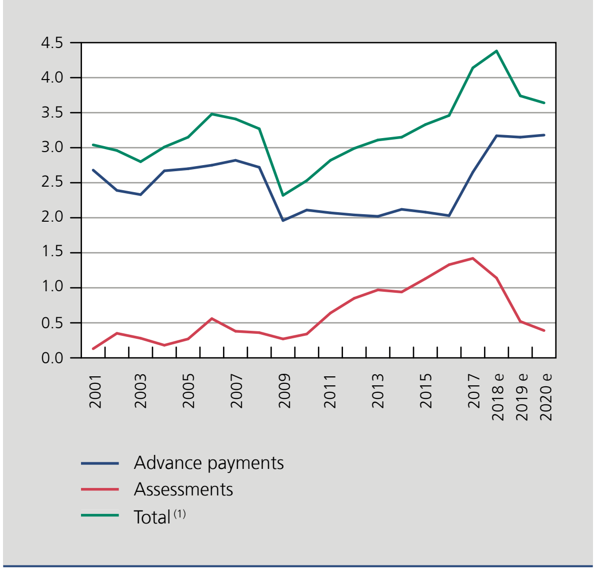
	2017	2018 e	2019 e	2020 e
Fiscal and parafiscal revenues	44.4	44.4	43.5	43.3
Levies applicable mainly to labour income	25.0	24.7	24.5	24.5
Personal income tax	11.1	10.9	10.7	10.8
Social contributions	13.9	13.8	13.8	13.7
Taxes on corporate profits	4.1	4.4	3.7	3.6
Levies on other incomes and on assets	4.1	4.2	4.1	4.1
Taxes on goods and services	11.2	11.2	11.1	11.1
of which:				
VAT	6.8	6.8	6.8	6.8
Excise duty	2.2	2.2	2.2	2.2
Non-fiscal and non-parafiscal revenues	6.9	6.9	6.9	6.8
Total revenues	51.3	51.4	50.4	50.2

Sources: NAI. NBB.

the year. The surge in advance payments leads to a temporary increase in revenues in 2018, since the amount collected via the assessments will decline in the years ahead. That explains the fall in corporation tax revenues in 2019 and 2020.

Finally, the levies on other incomes and on assets will increase in 2018 as a result of the entry into force of the tax on securities accounts and the increase in the rates of tax on stock market transactions, but in 2019 it will be depressed by the measures taken to activate savings.

CHART 8 CORPORATION TAX REVENUES
(in % of GDP)



Sources: NAI, NBB.
(1) Including other taxes, the main one being the withholding tax on income from movable property.

5.3 Primary expenditure

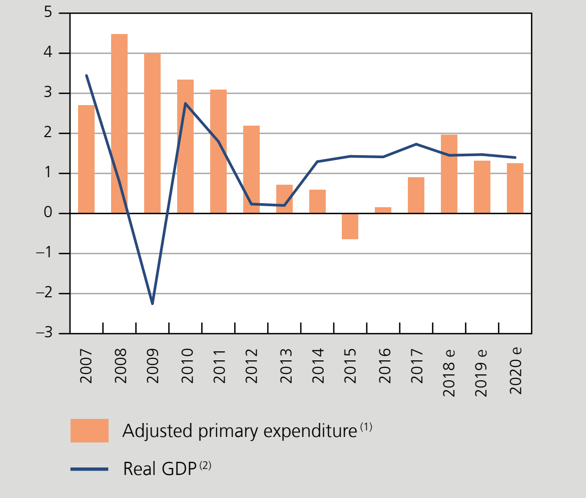
In the absence of new economy measures, the downward trend in primary expenditure as a ratio of GDP will come to a halt in 2018. The expenditure ratio will therefore hover around 50 % of GDP throughout the projection period. Consequently, expenditure will increase in nominal terms in line with economic activity.

Following adjustment for temporary factors, the cyclical impact and differences between inflation and indexation, real primary expenditure will rise by 2 % in 2018. In contrast to preceding years, that increase will therefore slightly exceed real GDP growth, partly because of public investment which will rise in the run-up to the impending municipal and provincial elections.

In 2019 and 2020, if there is no change of policy, the structural trend in public expenditure will closely track the trend in real GDP.

CHART 9 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.

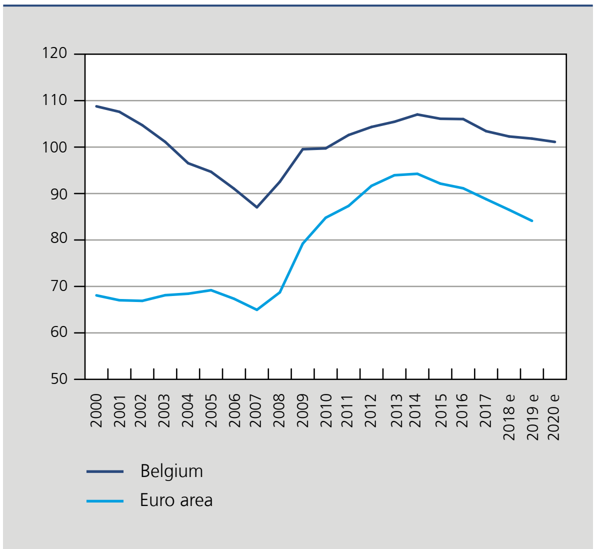
5.4 Debt

In 2017, the public debt declined to 103.4 % of GDP. The debt ratio will gradually decline further during the projection period.

In 2018, the debt ratio will fall by 1.1 percentage points. That is due solely to the downward impact of the endogenous factors, as nominal GDP growth will exceed the implicit interest rate on the public debt and the primary balance will remain decidedly positive. Exogenous factors are likely to exert an upward influence in view of the debt-increasing effect of the expansion of lending in connection with the social housing policy, and a number of factors relating to debt management.

Thereafter, the debt ratio will continue to gradually decline, again as a result of favourable interest rate-growth dynamics combined with – albeit small – primary surpluses. In 2020, towards the end of the projection period, the debt ratio is predicted at 101.1 % of GDP.

CHART 10 CONSOLIDATED GROSS DEBT OF GENERAL GOVERNMENT
(in % of GDP)



Sources: EC, NBB.

6. Differences compared to the previous projection exercise

Compared to the 2017 autumn forecasts, the current estimates have undergone various minor adjustments, even though there has been little change in the basic picture and the medium-term outlook. The estimates still point to a gradually cooling economy in which accelerating income growth nevertheless supports household consumption and core inflation is gradually driven up by domestic cost pressure. As in the previous estimates, the budget deficit also rises in the final projection years.

Economic growth was only revised in the short term. In 2017, growth was totally in line with our estimates, but in the first quarter of this year, following the adjustment of the flash estimate by the NAI at the end of May, it ultimately fell a little short of expectations. According to the nowcasting models, the same should apply for the second quarter. Thereafter, the growth rate was again close to the figure in the autumn forecasts, since the revision of the common assumptions by the Eurosystem had only a very limited impact on activity overall. The higher oil price will dampen purchasing power, but the effect on household consumption remains small. In all, annual growth has been adjusted downwards slightly for both 2018 and 2019.

Taking the projection period as a whole, the growth of domestic employment is also slightly weaker. That is due to the somewhat lower growth of activity, but is also partly connected with the upward revision of the trend in average working time: the number of hours worked per person is now set to edge upwards until the end of the projection period. That is in line with the recent trends in the revised labour market statistics, in which the slightly weaker than expected job creation is accompanied by an increase in average working time, possibly due to the mounting tensions on the labour market. The weaker job creation combined with labour market participation that is still rising, notably as a result of the recent reforms, means that the unemployment rate remains somewhat flatter in the first half of the projection period, albeit at a low level. Nevertheless, unemployment is well below the level in the autumn forecast owing to the latest observations which were (much) lower than expected.

In nominal terms, the inflation estimates for this year and for 2019 have undergone marked upward revision, but that is due almost entirely to the much higher oil price compared to the autumn forecasts. Conversely, core inflation has hardly been revised at all: the upward effect of higher oil prices on core inflation is virtually negated by the lower imported inflation as a result of the euro's appreciation. In the short term, core inflation for 2018 has actually been adjusted downwards slightly, partly because of the recent monthly figures, which were lower than expected. Leaving aside the impact of indexation, the estimates for hourly pay are more or less unchanged.

The most striking change in this projection exercise concerns the budget figures, with the overall balance for 2018 showing a deficit of 1 % of GDP, the same as last year; that is 0.3 percentage points better than expected in the autumn projections. Once again, the reason lies in the (much) higher advance payments by companies as a result of the renewed increase in the tax surcharge imposed in cases of insufficient advance payments. However, much of that improvement is considered temporary, and will therefore disappear in later years. In addition, the estimates for pension benefits were also revised upwards on the basis of new data. Combined with the limited changes in the macroeconomic framework, that leads to a deterioration in the financing requirement in 2019 and 2020, compared to the autumn projections.

7. Conclusion and risk factor assessment

For Belgium, as indeed for the euro area, the Eurosystem's spring forecasts indicate a slight dip in growth in the years ahead. That is due to the cooling investment cycle and the deceleration of exports, the impact of which will not be entirely offset by the strengthening annual growth of household consumption.

That slower growth is also depicted in the forecasts of most other institutions. However, the spring projections are well below the latter forecasts. In comparing the various estimates, account must also be taken of their cut-off date and the information that could be included. In that respect, only the Federal Planning Bureau's Economic Budget of 7 June was able – like the current spring projections – to incorporate the first complete quarterly growth figures for the first quarter, and more particularly, the downward revision of growth compared to the earlier NAI flash estimate. In contrast to the growth estimates, the inflation forecasts are rather higher than those of other institutions. However, the main reason for that is that those older estimates had taken no account of the recent surge in the oil price.

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

Institution	Publication date	Real GDP growth			Inflation (HICP, unless otherwise stated)		
		2018	2019	2020	2018	2019	2020
Belgian Prime News	March 2018	1.9	1.6		1.7	1.7	
IMF	April 2018	1.9	1.7	1.5	1.6	1.8	1.8
Consensus Economics	May 2018	1.8	1.7		1.7	1.6	
EC	May 2018	1.8	1.7		1.6	1.6	
OECD	May 2018	1.7	1.7		1.8	1.8	
Federal Planning Bureau (1)	June 2018	1.6	1.6		2.0	1.7	
NBB	June 2018	1.5	1.5	1.4	2.1	1.9	1.6

(1) Economic budget for 2018-2019. The inflation figures refer to the NCPI.

As usual, the Eurosystem's spring forecasts are based on certain common assumptions. Since political and financial developments are often hard to predict, the uncertainty surrounding those assumptions may be greater than usual.

At international level, the risks to growth seem mainly on the downside. Apart from a possible continuing increase in the oil price, the main risk concerns the exacerbation or escalation of trade barriers which could dampen global growth. In addition, taking account of the latest short-term indicators, there is a possibility that the slowdown in the euro area could last longer than can be expected on the basis of the common assumptions. Of course, a less favourable international environment would also mean lower growth for the Belgian economy. In contrast, the purely domestic risks to the growth estimates seem to be rather neutral overall. On the labour market, additional coordinated efforts to match the existing labour supply more closely to the unfilled vacancies could boost job creation to some degree, thus providing support for growth. There is also the possibility that business investment could maintain its current growth rate for a bit longer. In that respect, the estimates take account of the slight weakening of business confidence and the assumed narrowing of profit margins as a result of higher costs, but they also consider the business investment cycles seen in the past. However, a tight labour market combined with high capacity utilisation and continuing favourable financing options could lead to more labour-saving investment.

On the other hand, private consumption could be lower than currently expected, as the recent rise was weaker than suggested by the high level of consumer confidence and substantial jobs growth. It is possible, especially in a context of mounting uncertainty, that households may top up their reserve savings a little more, after the clear decline in the past year, so that consumption will trail further behind the estimated income growth. Finally, there is the risk that, now that labour costs have risen again since last year, the (structural) loss of market share is somewhat underestimated, so that the growth contribution of net exports could be slightly lower during the projection period. Of course, that also depends on international developments, and – more specifically – on world demand.

As regards inflation, too, the balance of purely domestic risks (i.e. excluding the possible impact of oil prices different from those foreseen in the common assumptions) looks fairly neutral.

Annex

PROJECTIONS FOR THE BELGIAN ECONOMY: SUMMARY OF THE MAIN RESULTS

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

	2016	2017	2018 e	2019 e	2020 e
Growth (calendar adjusted data)					
Real GDP	1.4	1.7	1.5	1.5	1.4
Contributions to growth:					
Domestic expenditure, excluding change in inventories	1.8	1.2	1.5	1.5	1.6
Net exports of goods and services	−0.6	0.5	0.2	−0.1	−0.2
Change in inventories	0.2	0.1	−0.3	0.0	0.0
Prices and costs					
Harmonised index of consumer prices	1.8	2.2	2.1	1.9	1.6
Health index	2.1	1.8	1.6	1.9	1.7
GDP deflator	1.6	1.7	1.3	1.5	1.8
Terms of trade	0.7	−1.3	−0.4	−0.4	0.2
Unit labour costs in the private sector (1)	0.1	2.1	1.8	2.0	2.0
Hourly labour costs in the private sector (1)	−0.6	1.8	2.2	2.9	2.8
Hourly productivity in the private sector	−0.6	−0.3	0.3	0.8	0.8
Labour market					
Domestic employment (annual average change in thousands of persons)	57.7	65.3	41.4	29.9	25.5
Total volume of labour (2)	1.3	1.7	1.1	0.7	0.6
Harmonised unemployment rate (in % of the labour force aged 15 years and over)	7.9	7.1	6.7	6.7	6.8
Incomes					
Real disposable income of individuals	0.8	1.4	1.3	1.9	1.7
Savings ratio of individuals (in % of disposable income)	11.2	11.3	11.2	11.4	11.5
Public finances					
Primary balance (in % of GDP)	0.4	1.4	1.3	0.3	0.2
General government balance (in % of GDP)	−2.5	−1.0	−1.0	−1.8	−1.8
Public debt (in % of GDP)	106.0	103.4	102.3	101.8	101.1
Current account (according to the balance of payments, in % of GDP)	0.1	−0.2	−0.3	−0.7	−0.7

Sources: DGS, EC, 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.