

Economic projections for Belgium – Autumn 2018

Introduction

Although world growth has been rather erratic in the past year, it has generally fallen well short of expectations. In the advanced countries, growth clearly picked up from the spring, but that was due mainly to specific developments in certain countries. For instance, the tax reforms and expenditure increases in the American budget gave the economy a strong boost, while Japan and the United Kingdom also recorded clearly positive growth again following a particularly weak first quarter. Since then, however, the global economy has slackened pace somewhat, and so far the short-term confidence indicators do not suggest any strong recovery in the months ahead. The same picture emerges from the substantial downward revisions that most international organisations have made to their forecasts during the autumn. In fact, there are various factors holding back world growth. For instance, world trade has slowed significantly since the beginning of the year against the backdrop of increasing trade barriers which, owing to the uncertainty that they generate and the interdependence of global production chains, often have a greater negative impact than just their direct effect on the countries and products concerned. In addition, the steady rise in interest rates resulting from increased inflation expectations in the United States is contributing to growing volatility on the financial markets. Moreover, it also leads to escalating financing problems for many emerging economies with current account deficits, due to a reallocation of international capital resulting from changes in relative yields.

In the euro area, too, activity has slowed sharply since the beginning of the year, mainly owing to a decline in the growth contribution of (net) exports. This deceleration in the euro area should not be considered solely in the context of the aforesaid global factors, such as the slight weakening of world growth and the trade slowdown, but could also be connected with the more expensive euro, given its appreciation until the first quarter of the year. According to the initial quarterly statistics, investment does not appear to have suffered too much as yet from the uncertainty surrounding world trade, but the growth of household consumption has lost momentum. The latter could be due to the steep rise in oil prices – and hence inflation – and the still relatively moderate increase in wages. During the third quarter, growth in the euro area weakened further, dropping to its lowest level in four years: in Italy and Germany, activity actually declined. However, this contraction in activity would be attributable partly to temporary production slowdowns in the (predominantly German) car industry as a result of new test procedures for environmental standards and the disappearance of this temporary factor should subsequently support growth in Germany and in Europe from the fourth quarter onwards, even though the relevant short-term growth indicators have not yet improved.

In general, the common assumptions for these projections, of which the main ones are described in the box, are based on a scenario in which the decline in world trade bottomed out in the second half of the year, so that the export markets relevant for the euro area will pick up somewhat in the coming years. In addition, according to these assumptions, the ongoing monetary tightening will cause only a gradual rise in euro area interest rates and the oil price will continue to subside steadily, following the sudden fall since October. It should be noted that the present projections for both the euro area and Belgium are largely based on these common assumptions. However, there are

significant, predominantly downside risks to this favourable baseline scenario. For instance, renewed disruption of international trade or rising interest rates in the euro area, fuelled by doubts over the sustainability of fiscal policy in certain countries, could erode growth to a greater extent than foreseen in the projections. On the other hand, oil prices have continued to decline since the cut-off date for these common assumptions, and that could have a favourable influence on the outlook.

According to the new Eurosystem estimates – of which the autumn projections presented in this article form part – activity growth in the euro area will weaken to 1.9% this year, representing a further downward revision compared to the September 2018 ECB estimates, mainly as a result of the disappointing growth in the third quarter. However, activity appears to have picked up from the fourth quarter, regaining a pace more in line with potential growth. After that, year-on-year growth is set to diminish gradually to reach 1.5% in 2021 owing to increasing labour market tensions and the waning impact of the easing of fiscal policy in certain countries in 2019. This year, as in 2017, inflation in the euro area was propelled by higher energy prices. After adjustment for these and other volatile components, core inflation rises throughout the projection period in line with increasing domestic cost pressure, to reach 1.8% in 2021.

For Belgium, the latest quarterly statistics on real GDP growth up to the third quarter of this year are broadly in line with the spring forecasts, and there has also been very little change in the growth estimate in the last quarter. The growth estimate for 2018 therefore still stands at 1.5%. Nonetheless, the pace of Belgian economic growth is weakening steadily to an average of around 0.3% per quarter, or annual growth of 1.2%. The corresponding storyline is more or less unchanged compared to the spring projection exercise, namely the cooling of the business investment cycle and a slowdown in exports which is only partly offset by the expected upturn in private consumption. The negative growth gap which has existed between Belgium and the euro area since 2015 is set to narrow slightly but will not be entirely eliminated over the projection period.

Employment growth slightly exceeded expectations once again during the first three quarters. However, as labour costs rise and activity slackens pace somewhat, the expansion of employment will gradually diminish. Similarly, the growing impact of supply constraints on the labour market – already evident from the rising number of vacancies – will make it increasingly difficult for firms to find suitable staff and will therefore also contribute to this slowdown. Nevertheless, partly on account of this labour market tension, the average number of hours worked – which has already risen lately – will continue to increase. The harmonised unemployment rate, which – on the basis of a survey – measures the number of people actually seeking work, has stabilised at an exceptionally low level not seen in this century except in 2001. Moreover, as the continuing expansion of the labour force – due partly to the measures aimed at limiting early departure from the labour market – is more or less keeping pace with job creation, the unemployment rate will remain particularly low throughout the projection period, despite the weakening activity growth.

The surge in energy prices gave a particularly strong boost to inflation this year. The rise in domestic electricity prices, triggered by fears over the shutdown of nuclear power plants, adds to these steep increases in gas and oil prices on the international markets up to October. However, in the months ahead inflation should begin subsiding again, judging by the price cuts already seen and the common assumptions concerning oil prices. While core inflation will pick up during the projection period, the sharp rise in labour costs will, just like in the past, not be fully reflected in prices, but lead to a contraction in profit margins which, after having increased considerably in recent years, should revert to a level only just above their long-term average by 2021.

Finally, turning to public finances, the budget deficit is set to decline a little further in 2018 to 0.8% of GDP. This improvement in the deficit compared to last year is due mainly to the strong rise in advance payments by businesses in the context of the further increase in the surcharge on any shortfall in advance payments. However, this is a temporary factor which will result in lower assessments when corporation tax is settled. The budget deficit will therefore deteriorate again during the projection period, despite the continuing decline in interest charges on the outstanding debt. By the end of the projection period, the deficit is expected to increase again to 2% of GDP, which is a long way from the target of a structurally balanced budget. Here it should be pointed out that, in accordance with the Eurosystem rules for these projection exercises, account is only taken of measures which, on the cut-off date for the estimates, the government has already specified in sufficient detail and has formally approved, or is very likely to approve. In addition, the estimates of the impact on the budget of certain measures, such as those to combat fraud, deviate from the amounts included in the budget.

1. International environment and assumptions

1.1 World economy

Following a strong performance in 2017, the world economy ran out of steam somewhat this year. On the basis of the known quarterly figures, world growth clearly fell short of the favourable spring forecasts. Moreover, world growth is less broad-based than last year, in an environment where risks and uncertainties have significantly increased. In this context, trade – which had expanded vigorously in 2017 – also decelerated sharply. At present, short-term indicators show no sign of strengthening economic growth or trade flows, and in autumn, international institutions systematically downgraded their forecasts for next year.

In the advanced countries, growth was rather volatile. An anaemic first quarter gave way to a vigorous recovery. However, that was attributable to specific factors in certain economies. For instance, the fiscal stimulus measures adopted in the United States triggered a – probably temporary – growth acceleration, supported by a substantial rise in consumption and investment. In these circumstances, unemployment fell to an historically low level, while inflation climbed to reach the 2 % target of the Federal Reserve, which continued to normalise its policy, raising interest rates on three occasions this year, by 25 basis points at a time, to a range of 2-2.25 %. A fourth interest rate hike is expected in December.

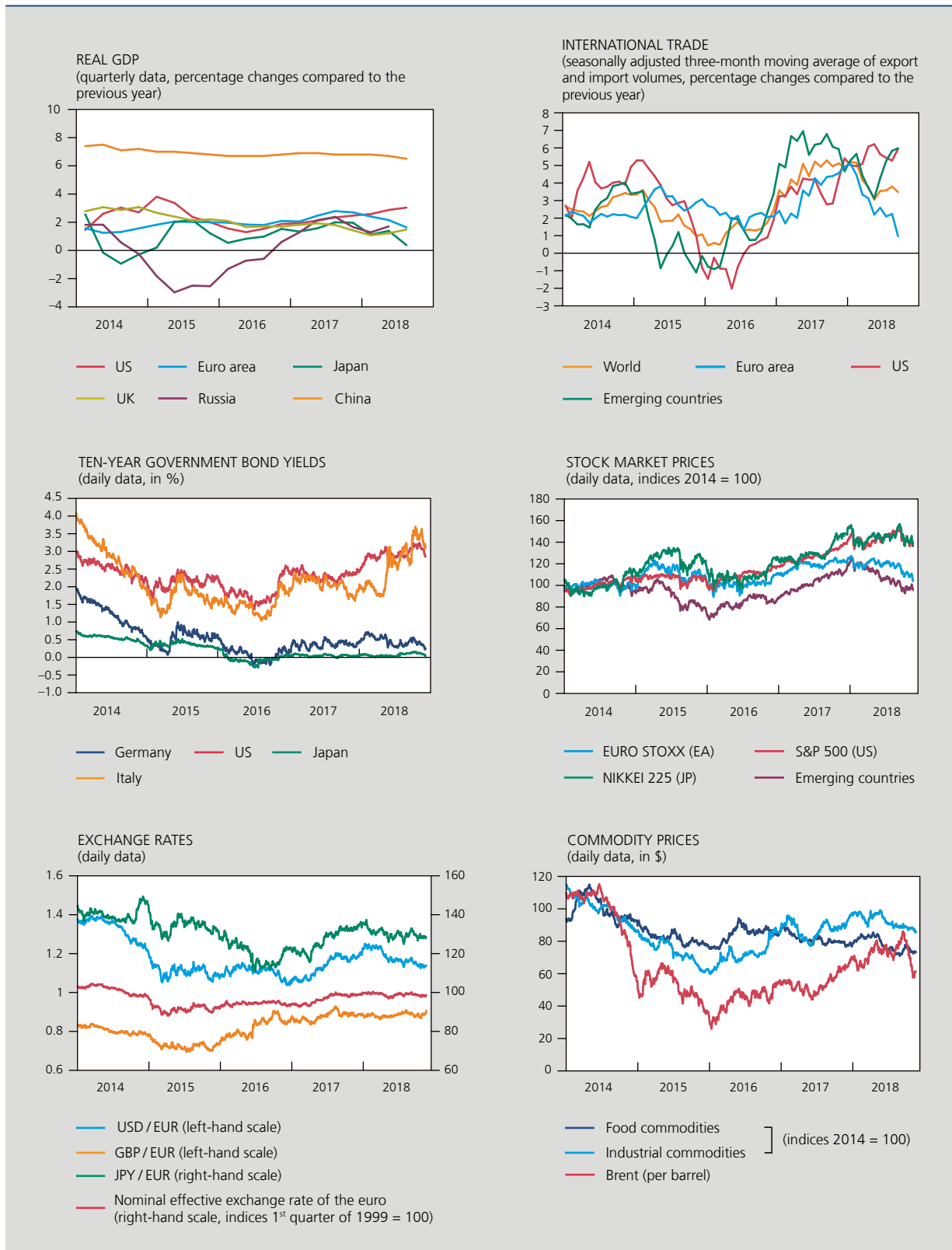
This year, the United Kingdom's growth figures were greatly influenced by unforeseen factors. While activity was hit by bad weather in the first quarter, it was supported by a revival in consumption growth in the second and third quarters. Nonetheless, the uncertainty over the outcome of the Brexit negotiations continued to weigh on investment and the outlook. Following negative growth in the first quarter, activity in Japan staged a temporary revival, driven by robust domestic demand. High profits revitalised investment and consumption was robust despite low pay rises. However, growth came to a halt again in the third quarter, as activity was hit by the impact of two natural disasters – floods in July and an earthquake in September.

Following last year's steady quarterly growth of 0.7 %, euro area growth lost momentum, dropping to 0.4 % in the first two quarters, and even 0.2 % in the third. The international trade slowdown and the euro's past appreciation weighed on euro area exports. Furthermore, temporary factors such as production interruptions in the car industry due to new emissions tests, curbed activity in the third quarter. Their impact was felt mainly in Germany, where GDP fell sharply in the third quarter, but growth also clearly cooled in Italy and the Netherlands. Conversely, activity picked up in France in the third quarter, following two weak quarters. Leaving aside the said temporary factors, domestic growth dynamics remained fairly strong in the euro area following an exceptional 2017, underpinned by substantial job creation and still favourable financing conditions.

Unemployment declined in most advanced countries this year, and even dropped to its lowest level in over 40 years in the United States and the United Kingdom. Among the major advanced economies, only in the euro area, the unemployment rate is still not below the level prevailing immediately before the crisis. Nevertheless, with the notable exception of the United States, growing labour market shortages have not yet generated sufficient wage growth to rekindle inflation as well. While the consumer price index has risen in most of the advanced economies, propelled by higher oil prices, core inflation has remained fairly stable at around, respectively below, 1 % in the euro area and Japan. In those countries, monetary policy has therefore remained highly accommodative. However, in view of the estimated rise in inflation, the ECB announced in June that it would terminate its programme for the purchase of public and private bonds by the end of the year. Nonetheless, the key interest rates are expected to remain at their present levels at least through the summer of 2019.

Like the advanced countries, emerging economies presented a fairly mixed picture this year. While the oil-exporting countries benefited from the rise in oil prices, and activity in China and India maintained a steady growth rate, the economy slowed down in certain oil-importing countries with substantial domestic and external imbalances. The appreciation of the US dollar since spring – against the backdrop of the further tightening of monetary policy and robust economic growth in the United States – raised questions about the resilience of a number of emerging countries which had borrowed heavily in US dollars in recent years. Although all the emerging economies were confronted to some degree by the reversal of investor sentiment – in the form of capital outflows and depreciation of the national currency – it was primarily certain particularly vulnerable countries, such as Turkey and Argentina, which were seriously

CHART 1 THE GLOBAL ECONOMY AND DEVELOPMENTS ON THE FINANCIAL AND COMMODITY MARKETS



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

affected. In those countries, the situation escalated during the summer months, but then stabilised somewhat as a result of more restrictive policy measures, including an IMF programme for Argentina.

Chinese growth weakened during the year, but, at 6.5 % in the third quarter, remained within the government's target range. Activity was supported by consumption, the accommodative macroeconomic policy and exports, which remained steady despite the mounting trade tensions with the United States. However, that could be a temporary phenomenon to the extent that firms anticipated the introduction of higher tariffs in January 2019 and therefore brought forward some of their exports. At the end of 2018, it nevertheless became clear that these new tariffs would not be imposed before March 2019, depending on the progress of the trade talks between the United States and China. In addition, the depreciation of the renminbi also bolstered exports. Conversely, investment in infrastructure slowed sharply following measures to restrict the activities of the shadow banks, which represent a major source of funding in that sector. In addition, excess capacities in a range of industrial sectors continued to depress investment. India's growth on the contrary peaked at 8.2 % in the second quarter before subsiding somewhat to 7.1 % in the third quarter. Higher oil prices, liquidity problems in the shadow banking sector, and less favourable financing conditions weighed on activity in the third quarter.

The recovery continued in Russia and Brazil. In Russia, consumption benefited from the rise in real wages and the credit expansion. Uncertainty over possible new American sanctions nevertheless impeded investment and fostered the depreciation of the rouble. Production interruptions as a result of strikes in the transport sector depressed Brazilian growth in the second quarter, but activity picked up in the third quarter, sustained mainly by a revival of investments.

Following last year's surge, international trade flows slowed down significantly in 2018. It is unclear to what extent the trade tensions between the United States and China have already affected international trade. The deceleration probably reflects a combination of factors, such as the decline in growth in the euro area and the more modest increase in trade-intensive investment following the marked revival in 2017, in an environment characterised by increased uncertainty. However, the existence of interlinkages between global production chains implies that the negative repercussions of protectionist measures often extend beyond the impact on the product groups and countries directly targeted.

After the worldwide upturn in the previous two years, financial markets experienced periods of intense volatility this year. Although American stocks underwent a substantial correction recently, it was mainly European stocks – and particularly bank shares – that showed a mediocre performance; the uncertainty over the impact of US trade policy on European exports played a role, as did the developments in Italy and Turkey. In the autumn, mounting concerns about world growth steadily began to dent the outlook for corporate profits, leading to a new global stock market sell-off from October. On the bond markets, the United States diverged further from the other advanced economies: while yields on US government bonds continued rising, they remained at historically low levels in Germany and Japan. That reflected the different monetary policy stance and the higher inflation expectations in the United States. In Italy, after rising in May, government bond yields climbed further in the autumn in the context of the budget discussions within the framework of the European regulations on the subject. However, contagion to other euro area countries remained limited so far.

The euro appreciated slightly in nominal effective terms from the middle of the year, following its rise against the currencies of a range of emerging countries. Conversely, the divergence between the monetary policy stance of the Federal Reserve and that of the ECB was reflected in a sharp depreciation of the euro against the dollar.

Oil prices maintained their upward trend of the preceding two years during the first three quarters of 2018, supported by fundamental factors but also by the US government's sanctions against Iran. At the beginning of October, the price per barrel reached around \$ 85, its highest level for four years. However, in the past two months the oil price has again fallen significantly owing to weaker demand expectations following the decline in world growth and ample supplies, also because some countries were granted temporary exemptions from the US sanctions on Iranian oil imports.

In general, in their baseline scenario, most international institutions currently expect world growth to be relatively stable in the coming years, though at a rate below previous forecasts. In that connection they systematically point out that the uncertainties and downside risks have increased.

TABLE 1 PROJECTIONS FOR THE MAIN ECONOMIC AREAS

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

	2017	2018 e	2019 e	2020 e
Real GDP				
World	3.7	3.7	3.5	3.5
of which:				
Advanced countries	2.6	2.4	2.1	1.9
United States	2.2	2.9	2.6	1.9
Japan	1.7	1.1	1.0	0.5
European Union	2.4	2.1	1.9	1.8
of which: United Kingdom	1.7	1.3	1.2	1.2
Emerging countries	4.5	4.7	4.7	4.7
China	6.9	6.6	6.2	5.9
India	6.2	7.4	7.5	7.5
Russia	1.5	1.7	1.6	1.8
Brazil	1.0	1.1	1.9	2.3
<i>p.m. World imports</i>	5.1	4.3	4.0	3.6
Inflation⁽¹⁾				
United States	2.1	2.5	2.4	2.2
Japan	0.5	0.8	1.0	1.3
European Union	1.7	2.0	2.0	1.8
of which: United Kingdom	2.7	2.6	2.0	1.9
Unemployment⁽²⁾				
United States	4.4	3.9	3.5	3.5
Japan	2.8	2.7	2.6	2.5
European Union	7.6	6.9	6.6	6.3
of which: United Kingdom	4.4	4.3	4.5	4.7

Source: EC.

(1) Consumer price index.

(2) In % of the labour force.

Box – Assumptions for the projections

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

In the projections, it is assumed that future exchange rates will remain constant throughout the projection period at the average levels recorded in the last ten working days before the cut-off date of the assumptions, i.e. 22 November 2018. In the case of the US dollar, the exchange rate then stood at \$ 1.14 to the euro.



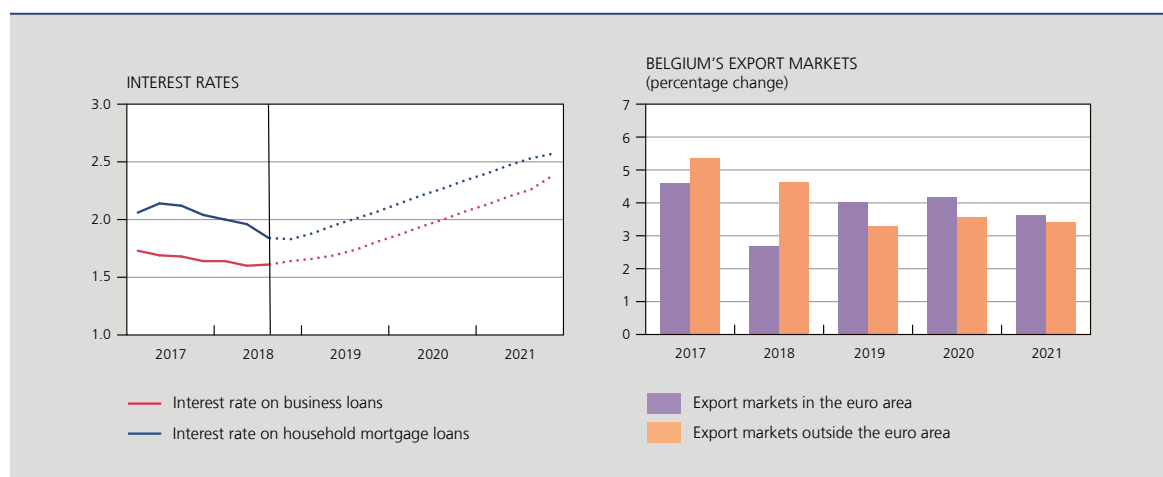
Although the euro has depreciated slightly since the spring, that still implies a modest appreciation of the euro compared to the average level in 2017.

As usual, the assumptions concerning future oil prices take account of market expectations as reflected in forward contracts on the international markets. While the oil price had risen sharply during 2018, it recorded a sudden, marked fall after the beginning of October. In mid-November 2018 the markets expected the price per barrel of Brent crude to continue declining gradually during the projection period.

The interest rate assumptions are likewise based on market expectations. The three-month interbank deposit rate has been stable for more than two years, at around –30 basis points, but is expected to edge upwards very slowly and become positive again during 2020. The level of long-term yields on Belgian government bonds is also projected to rise, from an average of 0.8 % in 2018 to 1.6 % in 2021.

INTEREST RATES AND VOLUME GROWTH OF EXPORT MARKETS

(in %)



Source: Eurosystem.

Bank interest rates on business investment loans and household mortgage loans are also expected to record a comparable rise. The average mortgage interest rate is currently still at an historically low level, on account of the ECB's extremely accommodative monetary policy and the resulting abundant liquidity. Nevertheless, it is expected to rise to an average of 2.4 % by 2021. The average interest rate on business loans, which is closer to the short-term segment, is also expected to rise gradually over the projection period: in 2021 it is forecast at an average of 2.2 %, i.e. about 0.6 percentage point above the 2018 figure.

As mentioned in chapter 1, the growth of world trade came under pressure this year following 2017's strong performance. The growth of Belgium's export markets will therefore slow sharply in 2018, compared to the spring projections. Nonetheless, the common assumptions predict that these markets for Belgian exporters will pick up slightly during the coming quarters, though after that their expansion will weaken again by the end of the projection period, in line with the spring forecasts.

The trend in Belgian exports is determined not only by the growth of those foreign markets but also by the movement in market shares, and consequently by Belgium's competitiveness. As regards the cost aspects of

competitiveness, fluctuations in the prices that competitors charge on the export markets are a key factor. In 2018, the more expensive euro is reflected in a relatively small increase in the prices of competing exporters outside the euro area. In subsequent years, assuming that exchange rates remain constant, rising inflation in the euro area – but also elsewhere – will gradually lead to renewed upward pressure on the prices of Belgian exporters' competitors.

EUROSYSTEM PROJECTION ASSUMPTIONS

(in %, unless otherwise stated)

	2018	2019	2020	2021
	(annual averages)			
EUR/USD exchange rate	1.18	1.14	1.14	1.14
Oil price (US dollars per barrel)	71.8	67.5	66.8	65.9
Interest rate on three-month interbank deposits in euro	-0.3	-0.3	0.0	0.3
Yield on ten-year Belgian government bonds	0.8	1.0	1.3	1.6
Business loan interest rate	1.6	1.7	1.9	2.2
Household mortgage interest rate	1.9	1.9	2.2	2.4
	(percentage changes)			
Belgium's relevant export markets	3.5	3.7	3.9	3.5
Export competitors' prices	0.4	2.9	2.1	2.0

Source: Eurosystem.

On balance, the adjustments to the assumptions compared to those in the latest spring projections have a fairly neutral impact overall on the medium-term growth forecasts for Belgium. Although the expansion of Belgium's relevant export markets has been clearly revised downwards since the spring projections, the largest revisions concern the recent quarters for which the NAI has already published GDP estimates.

1.2 Estimates for the euro area

The Eurosystem's current estimates for the euro area, like the previous ECB projections, continue to show a progressive slowdown in growth for the years ahead. Following the unexpected continued weakening in the third quarter of this year, attributable partly to temporary interruptions in production in the – predominantly German – car industry, activity in the euro area would nonetheless recover a little in the final quarter, bringing annual growth to 1.9% for 2018. The growth rate is then set to decline to 1.5% by 2021. That deceleration is due mainly to the increasing shortages on the European labour markets, a modest rebuilding of savings and the slightly less favourable financial environment following the rise in interest rate levels, but also the waning impact of the fiscal stimulus measures which are expected to support growth in certain countries in 2019. Growth in the euro area will be driven almost exclusively by domestic demand and, despite slowing down, will still exceed its potential level over the whole of the projection period.

Inflation accelerated sharply in the second half of 2018 to over 2%, mainly owing to higher energy prices. However, the marked reduction in those prices will cause inflation to edge downwards next year, though domestic cost pressure will gradually drive up core inflation over the projection period. The reason is that nominal wages are set to rise significantly

in view of the mounting pressures on the labour market and, during the period between 2019 and 2021, will increase by an average of almost 2.5 % per annum. The increased labour costs will gradually be reflected in prices, so that inflation will climb back to 1.8 % by the end of the projection period.

While the recent employment growth was very vigorous, it is likely to lose momentum over the projection period owing to the slowdown in activity, rising labour costs and the growing shortage of skilled labour. Nonetheless, labour productivity will increase quite considerably throughout the projection period. The labour force, too, will continue to expand, albeit more slowly. In that context, the impact of ageing will be moderated by increased labour market participation, notably among older workers, but also the continuing net immigration and the increasing integration of migrants on the labour market. However, the unemployment rate will maintain its downward trend, dropping to 7.1 % in 2021. That corresponds to around 12.3 million unemployed, broadly comparable to the figure recorded before the great recession.

The average budget deficit in the euro area will decline further in 2018, notably on account of the further fall in interest charges, to reach 0.5 % of GDP. However, that deficit will creep back up next year, essentially owing to the easing of fiscal policy in the form of reductions in charges or additional spending in certain countries with budget surpluses, such as Germany and the Netherlands, but also in Italy. The deficit will then gradually diminish again, reverting to roughly its 2018 level. The fall in the government debt ratio is expected to continue, supported by the low level of interest rates: in 2021 the debt ratio will have contracted by almost 13 percentage points compared to its 2014 peak.

TABLE 2 EUROSISTEM PROJECTIONS FOR THE EURO AREA
(percentage changes compared to the previous year, unless otherwise stated)

	2017	2018 e	2019 e	2020 e	2021 e
Real GDP	2.5	1.9	1.7	1.7	1.5
Household and NPI final consumption expenditure	1.7	1.4	1.7	1.6	1.4
General government final consumption expenditure	1.2	1.1	1.6	1.4	1.4
Gross fixed capital formation	2.9	3.5	3.3	2.6	2.1
Exports of goods and services	5.5	2.8	3.5	3.8	3.4
Imports of goods and services	4.1	2.7	4.2	4.2	3.6
Inflation (HICP)	1.5	1.8	1.6	1.7	1.8
Core inflation ⁽¹⁾	1.0	1.0	1.4	1.6	1.8
Domestic employment	1.6	1.4	0.9	0.8	0.6
Unemployment rate ⁽²⁾	9.1	8.2	7.8	7.5	7.1
General government financing requirement (–) or capacity ⁽³⁾ ...	–1.0	–0.5	–0.8	–0.7	–0.6

Source: ECB.

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

(2) In % of the labour force.

(3) In % of GDP.

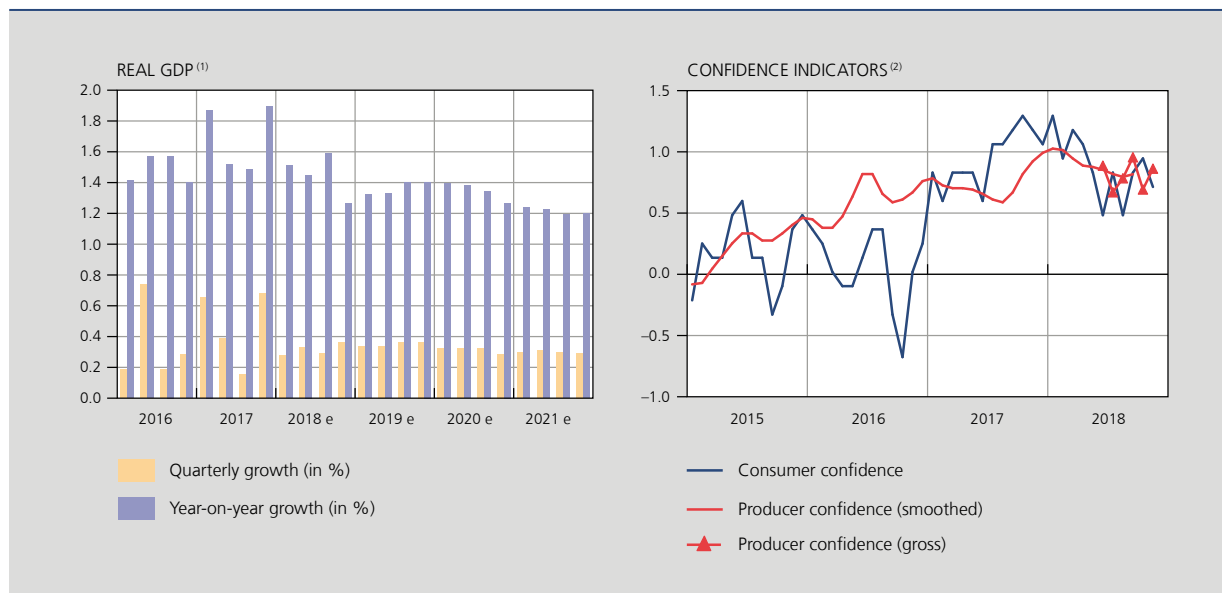
2. Activity and demand

In the first nine months of 2018 the Belgian economy grew at an average rate of 0.3 % per quarter, broadly in line with the spring projections. On the expenditure side, that growth was largely supported by net exports. On the production side, the main factor contributing to growth was the increased activity in services, while value added in the manufacturing industry was virtually unchanged.

However, quarterly growth averaging 0.3 % is well below the 2017 figure, and the same applies in other euro area countries. This weakening mirrors the trend in the confidence indicators, which have come down since the beginning of

the year. Despite this deterioration, the confidence of both producers and consumers in Belgium remains at a high level, exceeding the long-term average. In recent months, the indicators also appear to be slightly more robust than some of those in the euro area as a whole. The immediate forecasting (nowcasting) models used by the Bank therefore show fairly stable growth in the last quarter, rising slightly to just below 0.4 %.

CHART 2 GDP AND BUSINESS CONFIDENCE



Sources: NAI, NBB.

(1) Data adjusted for seasonal and calendar effects.

(2) Data normalised on the basis of the long-term average and the standard deviation.

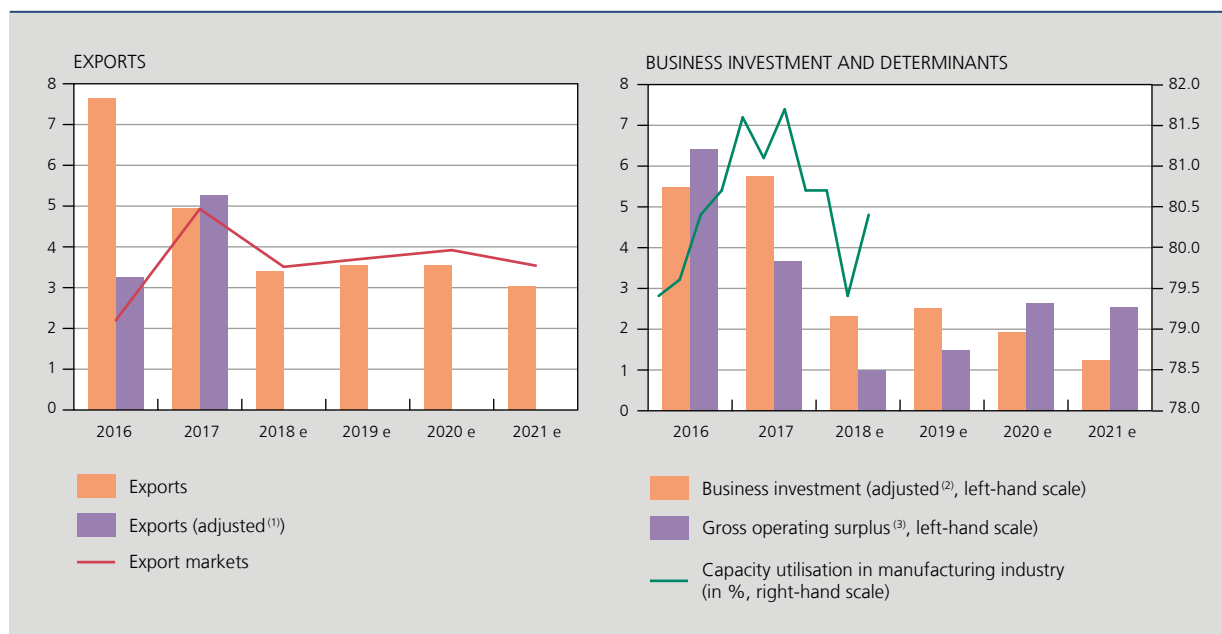
During the rest of the projection period, growth will continue to hover around 0.3% to 0.4% per quarter. As in the previous projections, Belgium's annual growth is still set to slacken pace slightly to 1.2% in 2021, reflecting a normalisation of the expansion of business investment and a deceleration of exports. In addition, and particularly at the end of the projection period, economic growth will also be curbed to a greater extent by supply constraints, especially on certain geographical or functional segments of the labour market.

Over the projection period as a whole, activity growth will be driven mainly by domestic demand. In fact, although net exports will continue to make a positive contribution to year-on-year growth in 2018, mainly as a result of the surprisingly good performance in the first three quarters of the year (at least in comparison with the figures for the euro area in general), export growth will nevertheless gradually lose momentum towards the end of the projection period. While the expansion of Belgium's export markets will be more stable, Belgian exporters will gradually suffer an increasing loss of market shares. Between 2014 and 2017, those shares had remained more or less unchanged, on average, partly thanks to the substantial improvement in cost competitiveness. Now that the pressure of domestic labour costs has begun rising again, Belgium's competitiveness in relation to other countries is no longer improving, so that market shares will drop by more than 1% over the 2019-2021 period. As the slowdown in imports is a little less marked, the growth contribution of net exports is set to become slightly negative. In addition, according to the technical assumptions adopted for all the quarters covered by the projection period, as usual, the growth contribution of the changes in inventories is considered neutral, particularly in view of the great statistical uncertainty surrounding this concept.

However, domestic demand will also weaken slightly during the projection period, as a result of two opposing forces. While the share of private consumption will rise as incomes increase, investment will slow sharply. Excluding the impact of certain specific transactions in investment goods with other countries, the expansion of business investment was in

CHART 3 EXPORTS AND BUSINESS INVESTMENT

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



Sources: NAI, NBB.

(1) Export growth adjusted to take account of expenditure due solely to the reorganisation in 2016 of the commercial activities of a large pharmaceutical company in favour of its subsidiaries based in Belgium so that, from the second quarter of 2016, the statistics show more trade flows to and from Belgium. However, since the upward impact is fairly similar for both imports and exports, there is no net effect on GDP. Nonetheless, an adjustment should be made to take account of this statistical effect when considering the movement in market shares.

(2) Adjusted to take account of major transactions in specific investment goods with other countries.

(3) In nominal terms.

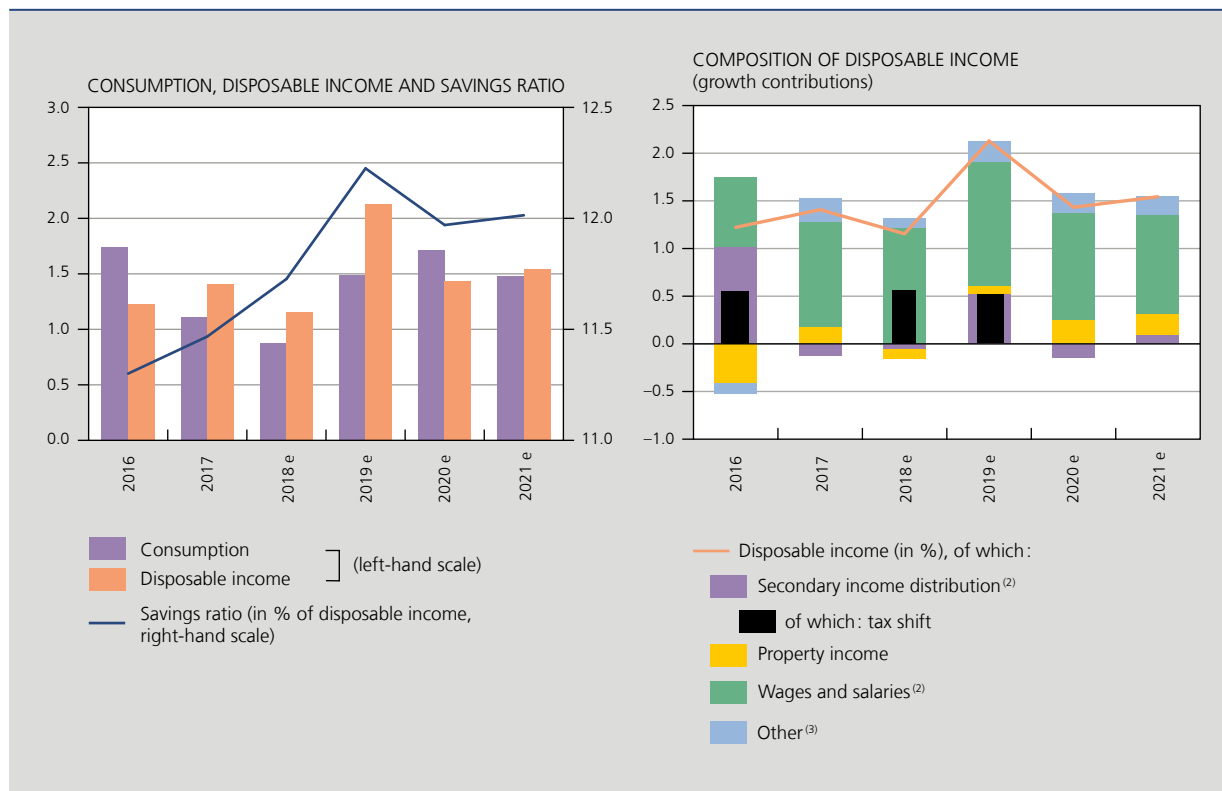
fact particularly marked in both 2016 and 2017, exceeding 5% in volume during each of those two years. Nevertheless, that growth rate is considered untenable, and that appears to be borne out by the recent quarterly data for 2018. Thus, the autumn projections foresee more moderate business investment growth in line with the expected trend in the underlying investment determinants, namely a slowdown in final demand, a rise in interest rates, and an increase in costs which will only partially be passed on (selling) prices, thus causing firms' profit margins to shrink, as explained in the chapter 4.

In contrast, the other private investment category, namely household investment in new building or renovation projects, has recorded relatively meagre growth in recent years. Following the decline since the great recession, investment remains well below the peak recorded more than ten years ago. Nonetheless, the current forecasts predict a relatively small rise in investment in housing, averaging 0.4% quarter-on-quarter over the projection period. While the expected rise in interest rates will also penalise these investments, that effect will still be partly offset by the increase in household incomes.

Household incomes are derived largely from labour. In the coming years, thanks to the expansion of employment – which though decelerating, will remain robust for some time – and above all to the rise in real wages, income earned by labour will increase. In addition, household purchasing power will also benefit from the new tax cut planned for 2019 as part of the tax shift. Similarly, during the projection period, property incomes will contribute positively again to the growth of private incomes, mainly as a result of rising interest rates.

Over the next three years, the cumulative increase in individuals' purchasing power will exceed 5%. Taking account of the expected population growth, that will correspond to an extra 3.6% per person. The trend in incomes, particularly labour incomes, also plays a decisive role in household consumption behaviour. In fact, private consumption should maintain a steady expansion during the projection period, with a quarter-on-quarter increase averaging 0.4%.

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 social contributions payable by employers.

(3) 'Other' comprises the gross operating surplus and gross mixed income (of self-employed persons).

However, as usual, households will only gradually adjust their spending in line with the bigger rise in their incomes, so that annual consumption growth will generally lag slightly behind the growth of incomes, enabling households to save more. This should be clearly apparent in 2019, with household incomes being temporarily bolstered not only by the tax shift but also by a marked indexation effect, with a fairly strong rise in the savings ratio. In 2021, the increase in that ratio will also be due to the small rise in the part of disposable income comprising property incomes, because there is tendency to allocate a larger proportion of those incomes to savings.

Finally, as regards public expenditure, the growth of public consumption will remain relatively moderate throughout the projection period. Conversely, public investment will, as usual, mirror the profile of the electoral cycle: following the sharp acceleration in 2018, local investment growth will be considerably lower in 2019. For 2020, and especially for 2021, account is taken of more substantial spending on a number of major public investment projects, e.g. in connection with the Oosterweel link.

TABLE 3 GDP AND MAIN EXPENDITURE CATEGORIES

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

	2017	2018 e	2019 e	2020 e	2021 e
Household and NPI final consumption expenditure	1.1	0.9	1.5	1.7	1.5
General government final consumption expenditure	0.6	0.8	0.9	1.0	1.0
Gross fixed capital formation	1.8	1.8	2.3	1.7	1.7
general government	2.1	5.7	-2.1	0.5	5.7
housing	0.0	0.5	1.7	1.6	1.3
business	2.3	1.6	3.2	1.9	1.2
<i>p.m. Domestic expenditure excluding change in inventories</i> ⁽¹⁾ ..	1.1	1.1	1.5	1.5	1.4
Change in inventories ⁽¹⁾	0.0	-0.4	-0.2	0.0	0.0
Net exports of goods and services ⁽¹⁾	0.6	0.8	0.0	-0.2	-0.2
Exports of goods and services	5.0	3.4	3.5	3.5	3.0
Imports of goods and services	4.3	2.5	3.5	3.7	3.2
Gross domestic product	1.7	1.5	1.4	1.3	1.2

Sources: NAI, NBB.

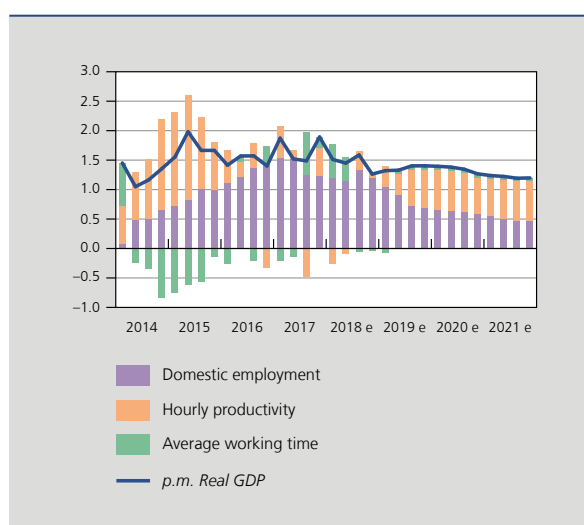
(1) Contribution to the change in GDP compared to the previous year, in percentage points.

3. Labour market

In recent years, growth in Belgium has been very labour intensive, but during the projection period the expansion of activity will gradually derive more support from increased productivity. Strong job creation should persist in 2018, albeit on a smaller scale than in the two preceding years. Following the substantial increases in 2016 and 2017, the number

CHART 5 DOMESTIC EMPLOYMENT, WORKING TIME AND PRODUCTIVITY

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



Sources: NAI, NBB.

of persons in work is expected to rise by a further 58 000 units this year. Employment dynamics are set to weaken over the projection period. Between 2018 and 2021, 153 000 jobs will be created.

This picture reflects the expected decline in activity growth to 1.2 % in 2020. Another factor curbing job creation is the gradually waning impact of the policies introduced in recent years to stimulate net job creation, particularly labour cost moderation. In addition, at this stage of the cycle, after years of strong job creation combined with a steep fall in unemployment, labour shortages affecting certain occupations and some segments of the labour market are holding back the expansion of employment.

This situation also contributes to the upward pressure on average working time. After having fallen until 2016 despite the economic recovery, the average hours worked again displayed a slight upward trend.

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	2021 e
Total population	55	59	57	54	54	56	60	59
Working age population ⁽¹⁾	9	16	16	12	9	7	6	5
Labour force	33	21	33	37	29	30	20	15
Domestic employment	19	40	59	65	58	40	30	24
Employees	14	30	46	52	48	32	23	17
Branches sensitive to the business cycle ⁽²⁾ ..	0	18	29	38	35	20	11	5
Public administration and education	7	3	3	2	1	1	2	2
Other services ⁽³⁾	7	9	14	13	12	12	10	10
Self-employed	6	10	13	12	10	8	8	7
Unemployed job-seekers	14	-19	-26	-28	-29	-10	-11	-10
<i>p.m. Harmonised unemployment rate^{(4),(5)}</i>	<i>8.6</i>	<i>8.6</i>	<i>7.9</i>	<i>7.1</i>	<i>6.3</i>	<i>6.3</i>	<i>6.3</i>	<i>6.3</i>
<i> Harmonised employment rate^{(4),(6)}</i>	<i>67.3</i>	<i>67.2</i>	<i>67.7</i>	<i>68.5</i>	<i>69.6</i>	<i>70.1</i>	<i>70.5</i>	<i>70.8</i>

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

(1) Population aged 15-64 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).

In 2018, for the fourth consecutive year, most of the jobs were created in branches sensitive to the business cycle. Only financial and insurance activities continue to record a decline in their workforce. The sectors making the biggest contribution are business services, and the branches comprising trade, transport and hotels and restaurants. However, the market sector's contribution to net job creation is likely to decline over the projection period. Within employment, the growth of the number of employees will decelerate more sharply than the growth of the number of self-employed persons. That is due mainly to the said waning impact of labour cost moderation, which did much to support the expansion of paid employment. In addition, the sustained interest in self-employed status is underpinned in particular by the improvements made to the social security scheme for the self-employed and by the opportunities for retired persons to engage in professional activity under this scheme while drawing a pension.

The growth of the working age population is slowing down as a result of ageing, but the participation rate is still rising significantly. This is to do with cohort effects concerning the participation of women in the labour market, but it is due mainly to the reforms restricting early retirement. Overall, the labour force will expand more slowly during the projection

period. The harmonised unemployment rate, which measures actual availability for the labour market on the basis of a survey, will decline this year to an historically low level of 6.3 %, but will remain fairly constant thereafter as employment growth matches the increase in the labour force. Since the unemployment rate has dropped below its structural level, it is hard to reduce it further without a change of policy. The number of unemployed job seekers has fallen a little more than the harmonised unemployment rate owing to the gradual departure of a large cohort of unemployed persons aged 63 and over entering retirement. However, their exit from the group of unemployed job seekers has no impact on the harmonised unemployment rate since most of them did not state in the surveys that they were actively looking for work. In 2021, there will still be around 466 000 unemployed job seekers, or about 30 000 fewer than this year.

4. Costs and prices

4.1 Labour costs

Labour costs, which had risen steeply last year, are set to maintain an upward trend in 2018, despite new reductions in social security contributions. The main reason lies in the acceleration of negotiated pay rises, though they are limited and smaller than expected, and in the somewhat stronger increase in the wage drift.

Following the 0.2 % rise granted in the private sector in 2017, real negotiated pay increases are not expected to exceed 0.4 % this year. Over the two years of the 2017-2018 central agreement, they will therefore remain well below the 1.1 % wage norm negotiated by the social partners. This moderate rise in negotiated wages is similarly evident in other

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

	2016	2017	2018 e	2019 e	2020 e	2021 e
Private sector labour costs ⁽¹⁾						
Labour costs per hour worked	-0.1	1.4	1.8	3.0	2.5	2.9
of which: Indexation	0.5	1.6	1.7	2.2	1.6	1.8
Real increases	0.7	0.1	0.6	0.7	1.0	1.0
Social contributions	-1.5	-0.4	-0.6	0.0	-0.2	0.0
<i>p.m. Labour costs per hour worked according to the national accounts</i> ⁽²⁾	-0.2	1.4	1.7	2.9	2.5	2.9
Labour productivity ⁽³⁾	-0.2	0.0	-0.2	0.6	0.7	0.7
Unit labour costs	0.1	1.5	2.0	2.5	1.9	2.2
Total inflation (HICP)	1.8	2.2	2.4	2.0	1.6	1.8
Core inflation ⁽⁴⁾	1.8	1.5	1.3	1.6	1.9	2.0
of which:						
Services	2.2	1.9	1.6	2.0	2.3	2.4
Non-energy industrial goods	1.0	0.8	0.9	1.0	1.2	1.3
Energy	-0.6	9.9	9.1	3.6	-1.1	0.0
Food	3.1	1.4	2.8	2.4	1.9	1.8
<i>p.m. Inflation according to the national index (NCPI)</i>	2.0	2.1	2.1	2.1	1.6	1.8
Health index ⁽⁵⁾	2.1	1.8	1.8	2.1	1.6	1.9

Sources: DGS, 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) Excluding wage subsidies and reductions in contributions for target groups.

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

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

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

euro area countries. Meanwhile, as a result of higher inflation, the indexation effect is slightly more important than in 2017 and the wage drift has also intensified. The latter is due partly to structural factors – for instance, the recent reforms slowed the departure of older workers whose earnings are relatively higher – but it may also be due to more individualised pay for workers in the context of growing labour market tensions. For firms, however, the rise in labour costs has been reduced by the additional cuts in social security contributions under the tax shift. Thus, hourly labour costs will rise by 1.8%, or almost half a percentage point more than in 2017. As labour productivity is down slightly, unit labour costs will rise by 2% in 2018.

The wage norm for 2019-2020 will only be negotiated at the end of the current year. The technical assumption adopted in these projections reflects the increasing pressure on certain labour market segments: it is assumed that negotiated adjustments excluding indexation will increase to 1.3% for this two-year period, with a slightly bigger rise in the second year in view of the stylised facts concerning the implementation of those agreements. With considerably higher indexation in 2019 as a result of the rise in energy prices, among other things, and a modest increase of the wage drift throughout the projection period, the growth of gross hourly wages will accelerate in 2019 to 2.9%, before softening somewhat in line with the outlook for indexation.

Apart from the latest package of tax shift measures which will apply in 2020 and will bring labour costs growth down by 0.2 percentage point to 2.5%, the profile of labour costs per hour worked is similar to the profile of gross pay. Owing to the weak recovery of productivity growth from 2019, the rise in unit labour costs will be outpaced by the increase in labour costs and will amount to 2.5% in 2019 and 1.9% in 2020 before edging back up in line with the movement in hourly labour costs.

4.2 Prices

The accelerating growth of labour costs exerts upward pressure on core inflation, which will rise gradually to 2% by the end of the projection period. In 2018, it slowed to 1.3%, mainly as a result of lower inflation in services due to the smaller increase in the prices of telecommunication services and hotel and restaurant prices since the end of 2017, and the abolition of the radio and television licence fee in the Walloon Region last January. However, from 2019 onwards the stronger rise in labour costs will gradually drive services inflation higher again to reach 2.4% by the end of the projection period. Inflation in non-energy industrial goods will also rise steadily to 1.3% in 2021.

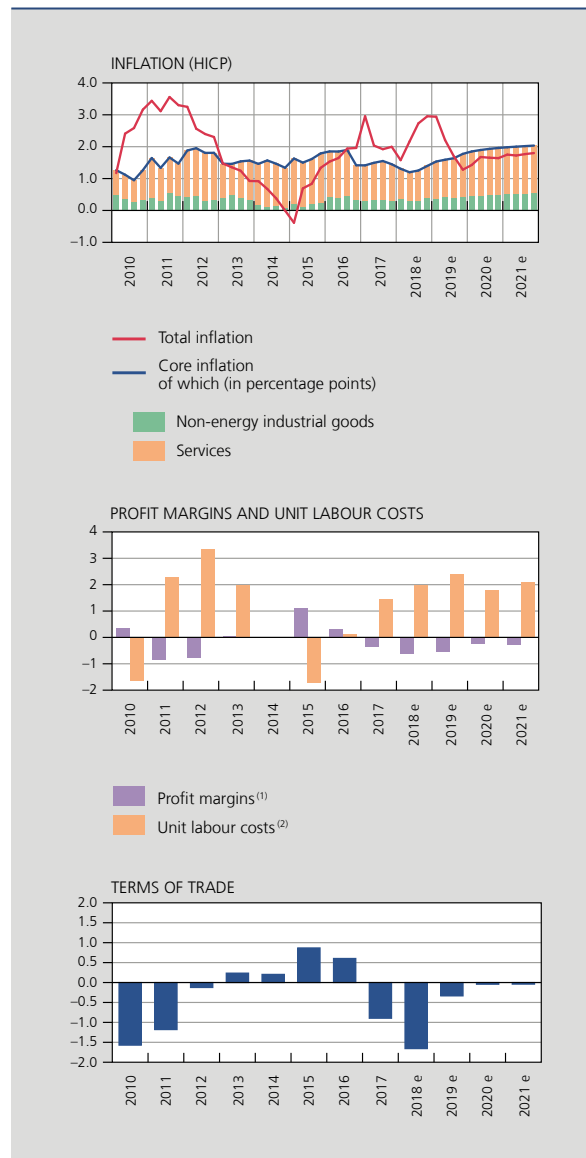
In line with the correlations seen in the past, however, the increasing domestic cost pressure will only partially get passed on in final prices. The rise in core inflation will therefore be smaller than the rise in labour costs, as firms' profit margins also absorb part of the cost pressure. In recent times, those profit margins had expanded because the reduction in labour costs had not been passed on in full, but according to the forecasts they should continue to contract throughout the projection period, reverting to a level close to the average prevailing since 2005.

In the case of products with more volatile prices, the expected stabilisation of energy inflation at a high level in 2018 conceals divergences within its components: in annual average terms, a continuing steep rise in oil prices – causing a deterioration in the terms of trade – , a stronger rise in gas prices and a considerably weaker increase in electricity prices. This last point is due mainly to the abolition of the tax on electricity consumption in the Flemish Region in January 2018. However, owing to the risks of shortages following the shutdown of most of the nuclear power plants in Belgium, there was a surge in electricity prices from October, and that is likely to persist at the end of 2018 and especially in early 2019. There is uncertainty over additional supply capacity owing to technical obstacles (such as delays in the work being done on the power stations, the limited import capacity, and congestion problems) and because winter demand is equally great in the neighbouring countries (so that reserves are limited). In 2020, with prices reverting to levels close to those prevailing before the autumn of 2018, electricity will make a negative contribution to energy inflation. However, over the projection period, energy inflation is influenced mainly by the Eurosystem's common assumptions, which foresee a gradual decline in oil prices.

Food prices in 2018 were considerably higher than in the previous year. That applied to both unprocessed and processed foods. In the case of processed food, the steeper increase in prices of dairy products, alcohol, tobacco and soft drinks was a major factor, particularly owing to the higher excise duty on tobacco and the increase in the "soft drink" tax at the beginning of the year. A return to "normal" is expected from 2019 onwards, with excise duty no longer rising so steeply. In the case of unprocessed food, the end of the decline in fruit prices is the main reason for the average rise in inflation, which is expected to continue increasing in 2019 before subsiding over the rest of the projection period.

CHART 6 INFLATION AND DETERMINANTS

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



Sources: EC, NAI, NBB.

(1) Difference between the year-on-year rise in unit selling prices and unit production costs.

(2) Including wage subsidies and reductions for target groups. Unit labour costs in the private sector.

Overall, driven by food prices, total inflation is expected to rise from 2.2 % in 2017 to 2.4 % in 2018. It will weaken significantly in 2019 and 2020 as a result of movements in energy inflation. After that, total inflation will only edge up slowly to reach 1.8 % at the end of the projection period.

The above analysis concerns the HICP, which permits comparison of inflation rates across the EU member countries. Inflation measured according to the Belgian national consumer price index (NCPI) may deviate slightly from that figure owing to methodological differences. The NCPI is used to calculate the health index, which excludes tobacco, alcoholic beverages and motor fuel. Following the stabilisation of its growth rate in 2018, the increase in this index will accelerate in 2019 before slowing down again. It is expected that the pivotal index will next be exceeded in April 2019.

5. Public finances

5.1 Budget balance

According to the latest estimates, the public finances will end the year 2018 with a deficit of 0.8 % of GDP, representing a small improvement over 2017. However, in the macroeconomic context described above, the general government budget deficit will increase in the coming years.

TABLE 6 GENERAL GOVERNMENT ACCOUNTS
(in % of GDP)

	2017	2018 e	2019 e	2020 e	2021 e
General government					
Revenue	51.3	51.6	50.7	50.5	50.5
Primary expenditure	49.7	50.1	50.1	50.1	50.5
Primary balance	1.6	1.5	0.6	0.4	0.0
Interest charges	2.5	2.3	2.1	2.0	2.0
Financing requirement (–) or capacity	–0.9	–0.8	–1.6	–1.7	–2.0
Overall balance per sub-sector					
Federal government ⁽¹⁾	–1.2	–0.3	–1.4	–1.5	–1.7
Social security	0.2	0.0	0.0	0.0	0.0
Communities and Regions ⁽¹⁾	0.0	–0.5	–0.2	–0.2	–0.2
Local authorities	0.1	0.0	0.1	0.1	0.0

Sources: NAI, NBB.

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

Both revenue and primary expenditure will rise in 2018, while interest charges have fallen. The increase in the deficit from 2019 onwards will be due to the erosion of revenue, as primary expenditure will remain more or less stable and interest charges will continue to decline. Corporation tax revenues are set to diminish owing to the decline in revenues collected from the assessments, that being the corollary to the switch to increased advance payments in 2017 and 2018. The tax burden on labour is further reduced via the tax shift, which aims to improve firms' competitiveness and promote employment; the final phase of the tax shift is scheduled for 2020.

The deficits will occur mainly at the level of the federal government, but the subsector comprising the Communities and Regions will also continue to record a small deficit during the projection period. In contrast, the local authority and social security accounts should remain in balance overall. In 2018, the downward revision of the autonomy factor for determining the regional additional percentages on personal income tax results in a one-off adjustment for the excess taxes paid to the Regions since 2015; that will have a negative impact on the budget balance of the Communities and Regions and a positive impact on the federal government budget.

As usual, the projections are based on the assumption of no change in policy. Consequently, they only take account of budget measures which have already been announced and specified in sufficient detail.

5.2 Revenues

In 2018, government revenues will increase by 0.3 percentage point of GDP before declining in 2019 and 2020 respectively by 0.9 and 0.2 percentage point of GDP. In 2021 they should remain stable.

The growth of government revenues in 2018 is due to the increase in corporation tax revenues resulting from the higher advance payments, which had already risen strongly in 2017. The explanation for that lies in the further increase in the basic rate of tax surcharge applied to inadequate advance payments, which goes up to 6.75 % from the 2018 tax year. It therefore makes sense for firms to step up their advance payments, generating a temporary revenue boost in 2017 and 2018, since the amount collected via the assessments will decline in the years ahead. This accounts for the expected sharp fall in corporation tax revenues in 2019. Despite that fall, revenues will still match the highest level recorded before the financial and economic crisis.

TABLE 7 PUBLIC REVENUES
(in % of GDP)

	2017	2018 e	2019 e	2020 e	2021 e
Fiscal and parafiscal revenues	44.3	44.5	43.6	43.5	43.7
Levies applicable mainly to labour income	24.9	24.9	24.8	24.9	25.0
Personal income tax	11.1	11.1	10.9	10.9	11.1
Social contributions	13.9	13.9	13.9	13.9	14.0
Taxes on corporate profits	4.1	4.3	3.6	3.5	3.5
Levies on other incomes and on assets	4.1	4.1	4.1	4.0	4.0
Taxes on goods and services	11.1	11.2	11.2	11.1	11.1
of which:					
VAT	6.8	6.8	6.8	6.9	6.9
Excise duty	2.2	2.2	2.2	2.2	2.1
Non-fiscal and non-parafiscal revenues	7.0	7.1	7.0	7.0	6.9
Total revenues	51.3	51.6	50.7	50.5	50.5

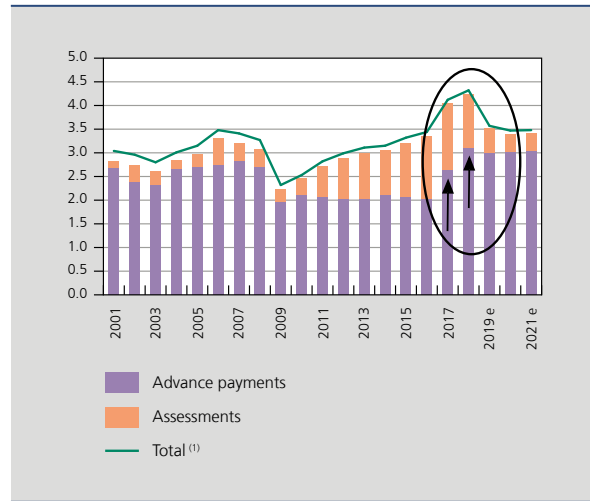
Sources: NAI, NBB.

As regards corporation tax revenues, the estimate differs from the assumption made by the federal government in drawing up the 2019 budget, whereby half of the strong rise in advance payments in 2017 and 2018 is due to a structural increase in corporation tax, so that in 2019 those revenues will roughly equal the 2018 figure. The EC also makes the same assumption in its estimates. This factor is the main reason for the divergence between the Bank's estimates and the target deficit of 1 % of GDP planned in the 2019 budget.

Moreover, as mentioned earlier, the measures relating to the tax shift result in a further reduction in the tax burden on labour incomes. In 2018 and 2019 the main cuts concern personal income tax, followed by a reduction in social contributions in 2020. However, the decline in revenues from personal income tax and social contributions should be relatively small owing to the high labour intensity of economic growth, and hence the strong expansion of employment.

Finally, 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 the tax on stock market transactions, but in 2019 the measures taken concerning the activation of savings will reduce those levies.

CHART 7 CORPORATION TAX REVENUES
(in % of GDP)



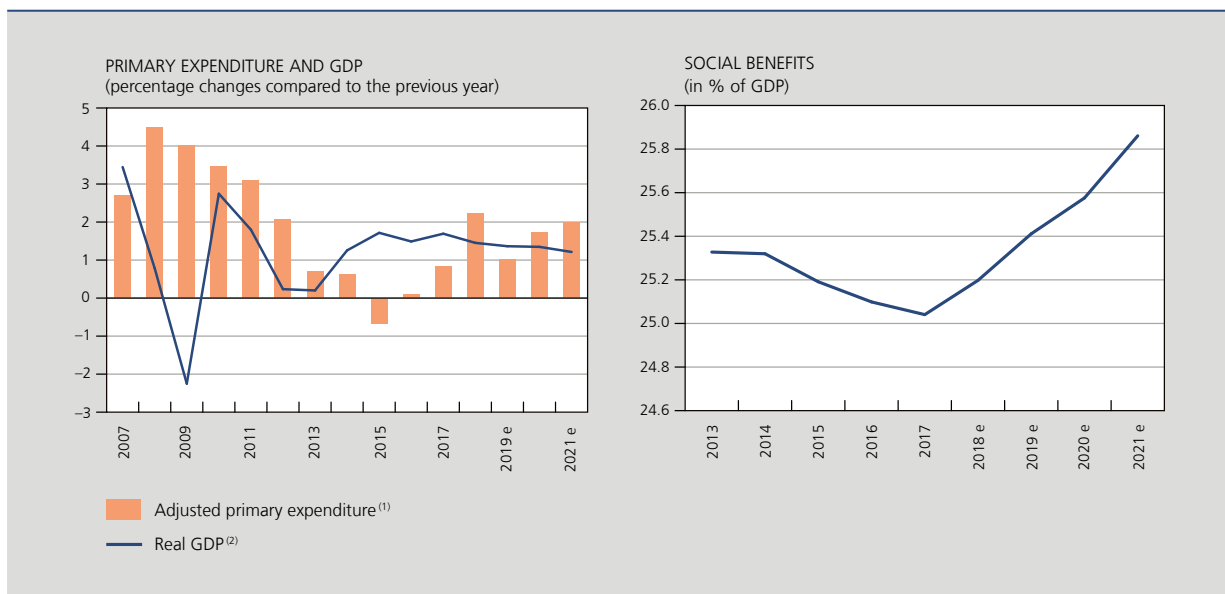
Sources: NAI, NBB.

(1) Including other taxes, primarily the withholding tax on income from movable property.

5.3 Primary expenditure

The downward trend in primary expenditure as a percentage of GDP is expected to come to a halt in 2018. Thus, the expenditure ratio is estimated at 50.1 % of GDP for the current year. After that, expenditure will increase, rising to 50.5 % of GDP in 2021.

CHART 8 PRIMARY EXPENDITURE OF GENERAL GOVERNMENT



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.

Following adjustment for both temporary factors and the influence of the business cycle, and for the time-lag between inflation and actual indexation, real primary expenditure is forecast to go up by 2.2 % in 2018. Thus, in contrast to the preceding years, that increase will slightly exceed real GDP growth. The main reasons for that excess lie in increased social benefits and the boost to public investment ahead of the local and provincial elections.

For 2019, the budgets announced by the federal government and the federated entities imply managed expenditure growth. In 2020 and 2021, if there is no change of policy, the structural trend in public expenditure will again exceed real GDP growth.

This situation is due mainly to the drift in social benefits resulting from population ageing. The natural increase in the budgets for pensions and, to a lesser extent, for health care will place a heavy burden on public finances, especially in view of the welfare adjustments. In recent years it has been possible to neutralise the demographic pressure on social security expenditure, in particular by strict control of spending on health care, the 2015 index jump, and the fall in unemployment.

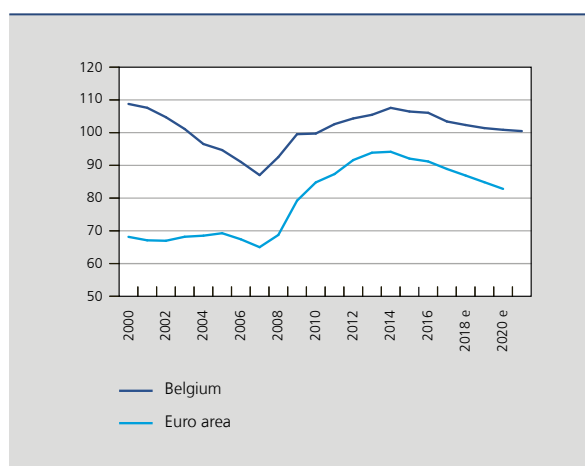
5.4 Debt

The modest reduction in the debt expressed as a percentage of GDP, expected during the projection period, will gradually slow down towards the end of that period.

In 2018, the debt ratio is estimated at 102.3 % of GDP, representing a 1.1 percentage point decline against the previous year. After that, the debt ratio should continue falling but much more slowly, and is forecast at 100.5 % of GDP in 2021. The favourable impact of the primary balance will gradually fade over the projection period, so that the 2018 surplus will become much smaller in 2019 and 2020, and disappear in 2021.

This picture contrasts with the EC forecasts for the euro area, where the debt ratio will decline faster, so that the discrepancy in relation to Belgian public finances will increase.

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



Sources: EC, NBB.

6. Differences compared to the previous projection exercise

Although GDP growth – particularly from next year – has again been adjusted downwards slightly, the broad outline derived from the economic context of the forecasts remains unchanged compared to the situation in June. However, larger adjustments were made in respect of prices and the labour market.

The outlook for the very near term has barely changed. According to the latest figures, economic activity growth was in line with expectations in the second quarter of this year, but fell somewhat short of the June forecast and the NAI's initial estimates in the third quarter. On the basis of the Bank's short-term models, among other things, and certain leading indicators that point to a degree of resilience in the Belgian economy, the expected growth for the final quarter has remained unchanged, so that annual growth in 2018 will be only just below the spring forecast, putting it at 1.5% in round figures. However, combined with the revised assumptions on the growth of Belgium's export markets, the slightly modified pattern for growth in 2018 is a factor in the small adjustment to the 2019 growth figure.

Inflation measured by the harmonised index of consumer prices (HICP) was revised upwards for both this year and next. That is due mainly to energy prices, which are traditionally a major cause of volatility in HICP inflation. Energy inflation was affected by the steeper than expected rise in oil prices on the international markets up to the autumn, but also by specific domestic factors which exert an upward influence on electricity prices. From the spring of 2019, and as a result of the expected moderation of oil prices, the expected inflation lies closer to the June estimates. However, taking account of recent, lower than expected observations and the gradual, albeit incomplete, pass-through in prices of this exercise's somewhat stronger rise in labour costs, the underlying price increase over the projection period will be a little steeper than expected in the spring forecasts.

Estimated unit labour costs have indeed been revised upwards, particularly in 2019, even though the relevant indicators show that the negotiated wage increases will again be smaller than expected in the short term, and more particularly below the available 1.1% margin that stems from the wage norm for 2017-2018. Against that backdrop, the technical assumptions for negotiated wage adjustments have also been revised for the coming years compared to the June estimates. In contrast, the estimate for the wage drift has been adjusted upwards slightly, and – owing to the delayed impact of inflation via the indexation effect – inflation is predicted to drive up nominal wage growth, particularly next year. Taking the projection period as a whole, labour costs per hour worked have been adjusted downwards by roughly 0.5 percentage point overall, compared to the spring forecast. Nevertheless, unit labour costs have been adjusted upwards because labour productivity is likely to fall well short of previous expectations, particularly in 2018.

While economic growth in the coming years looks set to be slightly less dynamic than was forecast in June, the growth of the volume of labour or domestic employment is stronger again, especially in the short term. That results in lower growth of labour productivity over the projection period as a whole. The estimated number of hours worked per person remains more or less unchanged. The more positive assessment for the labour market is due partly to observations in the first three quarters of the year, showing that job creation exceeded expectations, but it is also due to a technical adjustment: with effect from the present exercise, the Bank has detailed data from the Regions on the number of jobs created under the subsidy scheme. That volume is evidently considerably greater – and in particular, is rising more sharply – than was assumed in June. After adjustment for this factor, however, the underlying trend in the residual volume of labour in the private sector is less dynamic than in the spring forecasts, in line with the lower expectations regarding economic activity and in accordance with the finding that pressures on the labour market are still increasing, as is evident from the published vacancy and unemployment figures. According to the latest findings, the harmonised unemployment figures are again considerably lower than expected, and are likely to remain relatively flat up to the end of the horizon.

Conclusion and risk factor assessment

The Eurosystem's autumn forecasts again show that Belgium and the euro area have passed the peak of the current business cycle, and indicate a steady weakening in the expansion of activity from 2018. This year, the Belgian economy will grow by a further 1.5%, followed by 1.4% in 2019; thereafter, growth continues to decline to 1.2% in 2021, as a result of the slower growth of business investment and a negative contribution from net exports. Throughout the

projection period, Belgium thus lags well behind the average growth rate for the euro area, which comes to 1.9% for this year. In both Belgium and the euro area, domestic demand is the main factor supporting growth in the years ahead.

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

Institution	Publication date	Real GDP growth				Inflation (HICP, unless otherwise stated)			
		2018	2019	2020	2021	2018	2019	2020	2021
Federal Planning Bureau ⁽¹⁾	September 2018	1.5	1.5			2.0	1.9		
Belgian Prime News	September 2018	1.6	1.5			2.1	1.9		
IMF	October 2018	1.5	1.5	1.5	1.5	2.2	1.8	1.8	1.9
EC	November 2018	1.5	1.5	1.4		2.3	2.1	1.6	
Consensus Economics	December 2018	1.5	1.5	1.3		2.1	1.9	1.8	
NBB	December 2018	1.5	1.4	1.3	1.2	2.4	2.0	1.6	1.8

(1) Economic budget for 2018-2019. The inflation rates are the NCPI figures.

From 2019 onwards, these growth estimates are therefore slightly lower than the latest forecasts by other institutions. In its projections, the Bank was able to take account of the GDP and labour market figures for the third quarter of 2018. In comparison with those other institutions, it also had more recent economic indicators for the final quarter of this year, which currently present a fairly sturdy picture overall.

In the medium term, the situation depends largely on developments in the international environment, and especially the trade flows resulting from the economic activity on Belgian export markets. Despite the much weaker than expected performance in the past few quarters, a gradual recovery is predicted for 2019. The main uncertainties surrounding this forecasting exercise also concern trade, as protectionist tendencies have become evident in the past year which could curb the growth of world trade. For the time being, the impact on Belgium and the euro area seems to be fairly minor and is exerted mainly via indirect channels, but a further (direct or indirect) increase in trade barriers or an unexpectedly substantial effect caused by the existing measures is a clear downside risk factor for these forecasts. Mounting tension on the financial markets, e.g. as a result of internal political uncertainty for some major Belgian trading partners, could also have an adverse effect on the real economy. Finally, there is the possibility that geopolitical tensions intensify and lead to (further) disruption of international trade flows or higher commodity prices. If these risks materialise, it could prove necessary to revise the framework in which these estimates were produced.

On the domestic front, the risks to growth also seem to be predominantly downside risks. There is still great uncertainty over the demand components. For instance, it is possible that business investment will moderate more slowly than assumed in the current baseline scenario. Just as in the June estimates, the current forecasts are based partly on the ratios and patterns of such investment in past economic cycles. However, Belgian business confidence is still fairly robust at present, and financing conditions remain accommodative, suggesting that investment could remain strong for longer. In addition, in view of the recent weaker than expected figures, there is again the risk that the growth of private consumption will recover less strongly or more slowly than predicted at present. Also, a technical assumption is currently used to give a macroeconomic interpretation to the wage margins for the coming years (2019-2020 and 2021), but that is very likely to differ from the real margin. Finally, given the clear deterioration in the budget balance, the next government may need to take measures that could curb domestic demand.

Annex

PROJECTIONS FOR THE BELGIAN ECONOMY: SUMMARY OF THE MAIN RESULTS

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

	2017	2018 e	2019 e	2020 e	2021 e
Growth (calendar adjusted data)					
Real GDP	1.7	1.5	1.4	1.3	1.2
Contributions to growth:					
Domestic expenditure, excluding change in inventories	1.1	1.1	1.5	1.5	1.4
Net exports of goods and services	0.6	0.8	0.0	-0.2	-0.2
Change in inventories	0.0	-0.4	-0.2	0.0	0.0
Prices and costs					
Harmonised index of consumer prices	2.2	2.4	2.0	1.6	1.8
Health index	1.8	1.8	2.1	1.6	1.9
GDP deflator	1.7	1.1	1.9	1.5	1.7
Terms of trade	-0.9	-1.7	-0.3	0.0	0.0
Unit labour costs in the private sector ⁽¹⁾	1.5	2.0	2.5	1.9	2.2
Hourly labour costs in the private sector ⁽¹⁾	1.4	1.8	3.0	2.5	2.9
Hourly productivity in the private sector	0.0	-0.2	0.6	0.7	0.7
Labour market					
Domestic employment (annual average change in thousands of persons)	64.5	57.9	40.2	30.4	24.3
Total volume of labour ⁽²⁾	1.5	1.4	0.9	0.7	0.5
Harmonised unemployment rate (in % of the labour force aged 15 years and over)	7.1	6.3	6.3	6.3	6.3
Incomes					
Real disposable income of individuals	1.4	1.2	2.1	1.4	1.5
Savings ratio of individuals (in % of disposable income)	11.5	11.7	12.2	12.0	12.0
Public finances					
Primary balance (in % of GDP)	1.6	1.5	0.6	0.4	0.0
Budget balance (in % of GDP)	-0.9	-0.8	-1.6	-1.7	-2.0
Public debt (in % of GDP)	103.4	102.3	101.4	100.9	100.5
Current account					
(according to the balance of payments, in % of GDP)	0.7	-0.1	-0.4	-0.6	-1.0

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.