

Economic projections for Belgium – Spring 2019

Introduction

Since the last quarter of 2018 and the finalisation of the Bank's previous projections, the external environment has clearly become less supportive. While growth outside the euro area has so far, all in all, held up well according to the most recent indicators and statistics, this was not the case for international trade: rather than accelerating slightly, as previously foreseen in the common Eurosystem assumptions, it slowed down sharply and actually started to decline at the end of 2018. The downward revision of trade growth, in particular in the first half of the projection period, obviously weighs on euro area foreign demand, as well as on the exports of its individual countries, and is the key change in this set of projections. It explains why the Belgian growth outlook, for 2019 and 2020 in particular, is revised down slightly, after the ECB had already significantly lowered the growth estimates for the euro area in its March 2019 projections.

The global economy has shifted down a gear in the course of last year but the current indicators point to a bottoming-out. Outside the euro area, growth in the advanced countries now seems to be more resilient, with strong first-quarter growth in the United States, for instance. As regards the emerging economies, the slowdown in China continues to be quite gradual and is largely offset by an acceleration for other emerging economies. In the first months of the year, global financial markets have rebounded strongly after the significant correction in the final quarter of 2018. The rebound was partly based upon the expectation that the trade tensions between the US and China would subside. When this turned out to be wrong and further tariff increases were announced in May, volatility immediately returned to the financial markets and headwinds and downside risks for global growth again intensified.

In the euro area, economic activity slowed down throughout last year but has rebounded somewhat in the first quarter of 2019. However, this partly reflects temporary factors. Stockpiling in the UK ahead of the 29 March deadline, when a no-deal Brexit could have occurred, seems to have supported demand for exports in several countries. In addition, construction activity in Germany, in particular, was boosted by the mild winter weather. These factors are likely to support growth to a lesser extent in the second quarter. All in all, most short-term and forward-looking indicators currently suggest that euro area growth will soften again in the near term.

In general, the common assumptions for the Eurosystem projections, of which the main ones are described in the next chapter, are still based on a scenario in which the decline in world trade bottoms out in the second half of the year, so that growth in euro area foreign demand will recover somewhat in the coming years. In addition, according to these assumptions, market interest rates will rise only gradually, while the oil price levels off in the second quarter of 2019 and slowly declines throughout the projection period. It should be noted that the present projections for both the euro area and Belgium are largely conditioned by these common assumptions. However, there are significant, predominantly downside risks to this baseline scenario. Renewed disruptions of international trade, in particular, as well as a further supply-driven increase in oil prices could erode growth to a greater extent than foreseen in the projections.

According to the new Eurosystem estimates – of which the spring projections presented in this article are part – activity growth in the euro area will drop further to 1.2 % this year. This slightly exceeds the March 2019 ECB estimate, mainly due to the impact of the aforementioned better-than-expected outcome for the first quarter, which is not entirely offset by the downward revision of the growth rates in the remaining quarters of the year. The assumed recovery in world trade would fuel euro area exports and gradually bring activity growth back to a level that is closer to the potential rate. In 2019 inflation is lowered by the deceleration in energy prices. However, underlying domestic cost pressures, related to relatively high wage growth in particular, will gradually increase inflation in the projection period, although it will still fall clearly short of 2 % at the end of 2021.

Turning to Belgium, growth in the two previous quarters was fully in line with the December 2018 projections according to the revised NAI statistics. While the same applies to our short-term estimate for the second quarter of 2019, quarterly growth rates have been revised down slightly for the second half of 2019 due to the weaker foreign trade assumptions. All in all, annual activity growth is broadly stable at around 1.2 % throughout the projection period. As in previous projection exercises, business investment is still expected to decelerate while export market shares are set to decline slightly again (following the acceleration in wage costs). However, these elements should be broadly offset by the acceleration in foreign demand, in line with the common assumptions, and the expected pick-up in private consumption supported by stronger growth in purchasing power. All in all, Belgian growth is expected to be below that in the euro area again from next year.

Despite the deceleration in activity, recent employment statistics, including the initial data for the first quarter of 2019, have continued to exceed expectations. This year the employment intensity of growth is projected to continue rising slightly, which also implies that labour productivity will decline marginally again. Going forward, increases in activity will be supported more by a recovery of productivity, as employment growth slows. This is mostly due to the recent and projected acceleration in labour costs, but also because the still important impact of supply constraints on the labour market, as witnessed by the high level of vacancies, will make it increasingly difficult for firms to find suitable staff. The harmonised unemployment rate, which – on the basis of a survey – measures the number of people actually seeking work, has fallen to an exceptionally low level not seen since the 1970s. 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.

Inflation will be lowered this year by the strong deceleration in energy prices. The projected gradual decline in those prices will weigh on inflation over the entire 2019-2021 period. This is broadly offset by rising core inflation during the projection period, even though, just as in the past, the sharp rise in labour costs will not be fully reflected in prices, but will lead to a contraction in profit margins. The latter should continue to drop to a level that corresponds to their long-term average by 2021.

Finally, turning to public finances, the budget deficit has declined to just 0.7 % of GDP but this largely reflects the strong rise in advance payments by businesses in the context of the increased surcharge on any shortfall in those advance payments. As this temporary factor unwinds and higher prepayments are offset by lower tax settlements, the budget deficit will widen 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 more than 2 % of GDP, which is a long way from the target of a structurally balanced budget. The government debt ratio edges down, but debt still remains larger than GDP by 2021. 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 technical assumptions

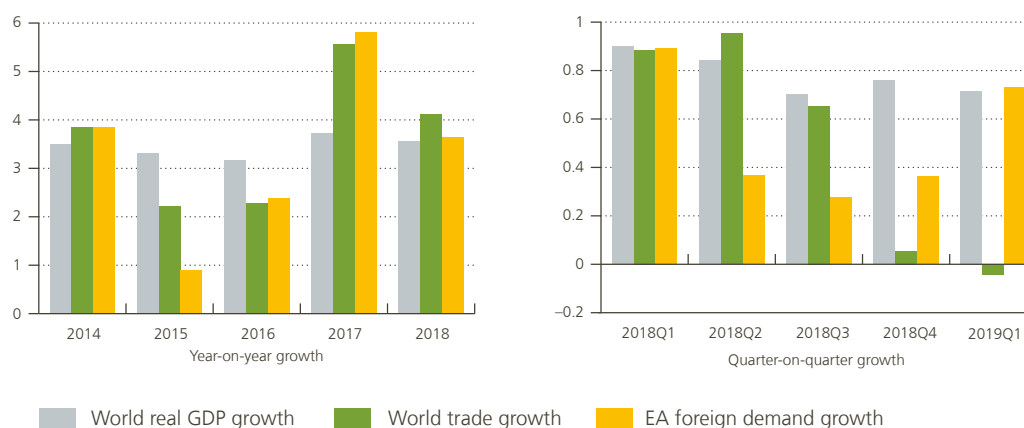
The macroeconomic projections for Belgium described in this article are part of the joint Eurosystem projections for the euro area. That projection exercise is based on a set of technical assumptions and forecasts for the international environment drawn up jointly by the participating institutions, namely the ECB and the national central banks of the euro area. The assumptions are based on information available by 21 May 2019.

1.1 World economy and trade

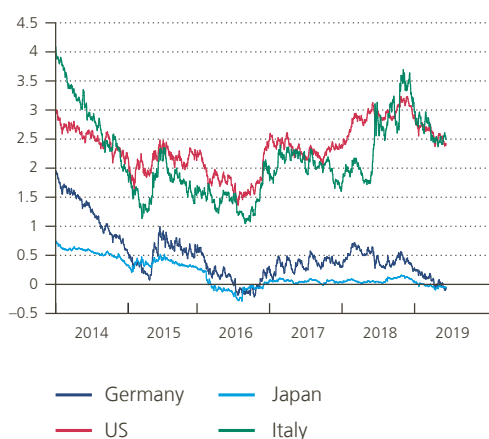
Chart 1

The global economy, trade and developments on the financial markets

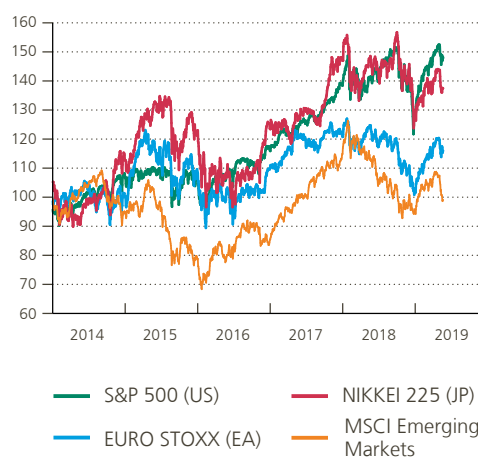
World/euro area real GDP and trade growth
(percentage changes compared to the previous period)



Ten-year government bond yields
(daily data, in %)



Stock market prices
(daily data, indices 2014 = 100)



Sources: ECB, Thomson Reuters.

Following solid growth in 2017 and at the beginning of 2018, the world economy lost some momentum in the second half of last year and growth continued to moderate into 2019. Overall year-on-year growth in advanced economies edged down in the third quarter of 2018, and more so in the fourth quarter, driven by a greater than expected weakening in euro area growth, due in part to disruptions to the German car industry, and natural disasters causing output to collapse in Japan. In contrast, US growth benefited from an expansionary fiscal policy throughout 2018 and into 2019. Mired in uncertainty by the Brexit negotiations, the UK economy continued to grow at a relatively stable but slower pace than in 2017. Emerging market economies saw, on average, slightly weaker but still firm growth over 2018 and early 2019. However, this again masks great heterogeneity. China's growth gradually declined over the year to the first quarter of 2019, as Chinese authorities engaged in regulatory tightening to dampen credit growth, and trade tensions with the US eventually began to weigh on exports. Vulnerable emerging market economies with substantial domestic and external imbalances, most notably Turkey and Argentina, were hit hard by investor concerns about the balance sheet effects of a strengthening US dollar. The restrictive policy measures that were put in place to stem further currency depreciation and accelerating inflation drove both countries into sharp recessions by the second half of 2018. Conversely, in other large EMEs, particularly in India, growth remained on a much stronger footing.

Most international organisations predict a modest pickup of global growth from its current weakness in the second half of 2019. Medium-term growth is expected to remain relatively steady, close to 3.6% annually in the outer years of the projection period. In advanced economies, activity is projected to continue to slow down gradually, predicated on the waning impact of US fiscal stimulus. In addition, China – the largest emerging market economy – is estimated to continue its transition towards a lower but more sustainable growth path, notwithstanding increasing policy stimulus. However, these downward forces should be broadly offset by a gradual recovery in several other emerging market economies that are currently, or were until recently, in recession. While the overall outlook for growth remains relatively benign, it is marked by great uncertainty and significant downside risks.

World trade growth took a severe hit and even turned negative in the closing months of 2018 and early 2019, driven by a sharp decline in the volumes of goods exported by emerging Asia. China's exports have been particularly volatile over this period and its imports have been trending down in line with domestic demand. This has happened against the background of increasing trade restrictions, but the sharp deceleration in trade is broad-based and goes beyond the products and countries directly targeted by tariff increases. The indirect impact of trade restrictions spreading through existing global value chains or generated by increased uncertainty is likely to have played a major role.

The fall in world trade has also depressed euro area foreign demand, even though the latter was boosted, in the first quarter of 2019, by a massive surge in import demand from UK companies. This seems to be related to very strong precautionary increases in those companies' inventories in the run-up to the initial 29 March Brexit deadline. A no-deal Brexit on that date was averted in the end, but could have severely disrupted trade relations.

Despite the recent weakness and the current low levels of forward-looking indicators for trade, such as export orders in manufacturing, most international organisations expect the global trade momentum to turn positive again and gain traction as of the second quarter of this year, and to gradually return to a pace that is more in line with that of global activity. The expected recovery of world trade is mirrored by the growth path of euro area foreign demand and Belgian export markets, with the latter being an important determinant of the macroeconomic projections for Belgium in the medium-term. Belgian export market growth declined throughout 2018 but, in accordance with the Eurosystem common assumptions, it is set to pick up slightly in the coming quarters, to an annual growth rate of at least 3% in the outer years of the projection period.

Table 1**The international environment**

(annual percentage changes)

	2018	2019 e	2020 e	2021 e
World (excluding euro area) real GDP	3.8	3.3	3.6	3.6
World (excluding euro area) trade	4.6	0.7	2.8	3.4
Euro area foreign demand ¹	3.6	1.7	2.6	3.1
Belgium's relevant export markets ¹	3.3	2.4	3.0	3.3

Source: Eurosystem.

¹ Calculated as a weighted average of imports of trading partners.**1.2 Technical assumptions about exchange rates, interest rates and commodity prices**

After great volatility and sharp corrections in financial markets in late 2018, the first months of 2019 saw a strong rebound in global equity markets and an easing of financial conditions, especially in advanced economies. New concerns about global trade and additional tariff hikes have, however, increased financial volatility again since May. The overall decline in longer-term interest rates that started in the final months of 2018 continued into 2019, supported by recent monetary policy decisions and forward guidance by the major advanced economy central banks. Euro area specific risks have remained contained. Italian bond yields, which jumped higher in the autumn of last year in the context of budget discussions between the Italian government and the European Commission, have softened since and stayed on a downward path since December 2018. Meanwhile, from the last quarter of 2018 onwards, the euro has depreciated slightly and very gradually, both bilaterally against the other main advanced economy currencies and in nominal effective terms.

Oil prices fell sharply between October and December 2018, from a high of around \$ 85 to just above \$ 50 per barrel, because of record US oil production, as well as weakening global growth prospects. Since the start of the year, prices have rapidly rebounded to about \$ 73 in May, mostly due to supply-side factors, such as production cuts by OPEC, interruptions of production in Venezuela and Lybia, and the end to certain waivers of US sanctions on Iran.

In the Eurosystem projections, bilateral exchange rates are assumed to remain unchanged over the projection horizon at the average levels prevailing in the last ten working days before the cut-off date. In the case of the US dollar, this implies an exchange rate of \$ 1.12 to the euro.

As usual, the assumptions concerning commodity prices take account of market expectations as reflected in forward contracts on the international markets. At the cut-off date, markets expected the price per barrel of Brent crude oil to edge down again as of the second half of the year.

The interest rate assumptions are also based on market expectations. The three-month interbank deposit rate has been stable for about three years, at around –30 basis points. Markets currently expect the interbank deposit rate to edge up very slowly and stay below zero even at the end of the projection horizon. Long-term yields on Belgian government bonds are currently low as well, and are set to average 0.5 % in 2019. They are expected to rise only gradually to just 0.9 % on average in 2021. Similarly, bank interest rates on business investment loans and household mortgage loans will also record only a moderate rise during the projection period.

All in all, the current Eurosystem assumptions are clearly less favourable than those used in the Bank's autumn 2018 macroeconomic projections. The favourable impact of the lower interest rates is more than offset by the strong downward revision in Belgian export markets, by more than 2 pp over the 2019-2021 period.

Table 2

Technical assumptions

(annual averages; in %, unless otherwise stated)

	2018	2019 e	2020 e	2021 e
EUR/USD exchange rate	1.18	1.12	1.12	1.12
Oil price (US dollars per barrel)	71.1	68.1	65.8	62.7
Interest rate on three-month interbank deposits in euro	-0.3	-0.3	-0.3	-0.2
Yield on ten-year Belgian government bonds	0.8	0.5	0.7	0.9
Business loan interest rate	1.6	1.6	1.7	1.8
Household mortgage interest rate	1.9	1.8	1.9	2.0

Source: Eurosystem.

1.3 Estimates for the euro area

According to the Eurosystem's current estimates and in line with the recent high-frequency indicators, euro area growth would moderate again after the rebound in the first quarter. The latter was indeed in part related to specific factors, including the spike in UK import demand, in anticipation of the initially planned Brexit deadline, as well as the mild winter weather that boosted construction activity in a number of countries. As of the second quarter, growth will benefit less from such temporary factors and weaken again. However, the aforementioned assumed gradual recovery of foreign demand will provide a stronger impetus in the outer years of the projection period. In addition, the euro area expansion will be supported by the still very accommodative stance of monetary policy and some fiscal easing. In annual terms, real GDP growth would decline significantly in 2019 but recover somewhat to a rate that is more in line with potential growth in 2020 and 2021. Even though consumption growth would remain moderate, growth in the euro area will be driven exclusively by domestic demand, as imports will outpace exports.

Inflation would moderate this year, on the back of the strong deceleration in energy prices. Thereafter the further slowdown in energy prices would however be more than offset by the gradual increase in core inflation over the projection period. This reflects rising domestic cost pressures, as past increases in wage costs will feed into prices, allowing profit margins to recover. All in all, inflation will edge up in the 2020-2021 period but stay clearly below the 2 % level at the end of the projection horizon.

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. Growth will be supported by the gradual recovery in labour productivity. The labour force will continue to expand, albeit more slowly. In that context, the impact of population ageing will be offset by increased labour market participation, notably among older workers, but also by the continuing net immigration and the increasing integration of migrants into the labour market. However, the unemployment rate will maintain its downward trend, dropping to 7.3 % in 2021. That corresponds to slightly less than 13 million unemployed, which is still somewhat above the figure recorded before the great recession.

The average budget deficit in the euro area has declined to 0.5% of GDP in 2018 but will edge up again in the projection period, despite the further decline in interest charges. The widening of the deficit is mostly due to cuts in direct taxes and planned expenditure increases in countries that have already reached budget surpluses, such as Germany and the Netherlands, but also in Italy and France, which both still have government deficits. 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 more than 11 percentage points compared to its 2014 peak.

Table 3

Eurosystem projections for the euro area

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

	2017	2018	2019 e	2020 e	2021 e
Real GDP	2.5	1.8	1.2	1.4	1.4
Household and NPI final consumption expenditure	1.8	1.3	1.4	1.4	1.3
General government final consumption expenditure	1.2	1.1	1.4	1.4	1.4
Gross fixed capital formation	2.9	3.3	2.7	2.0	2.0
Exports of goods and services	5.5	3.2	2.2	2.9	3.2
Imports of goods and services	4.1	3.2	2.7	3.2	3.4
Inflation (HICP)	1.5	1.8	1.3	1.4	1.6
Core inflation¹	1.0	1.0	1.1	1.4	1.6
Domestic employment	1.6	1.5	1.0	0.6	0.6
Unemployment rate²	9.1	8.2	7.7	7.5	7.3
General government financing requirement (–) or capacity³	–1.0	–0.5	–0.9	–0.9	–0.9

Source: Eurosystem.

1 Measured by the HICP excluding food and energy.

2 In % of the labour force.

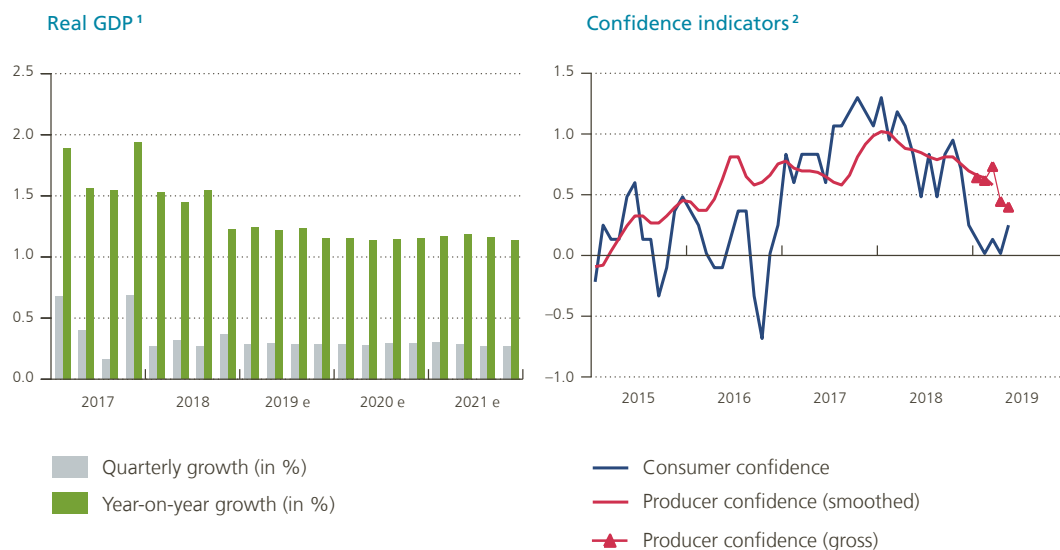
3 In % of GDP.

2. Activity and demand

The Belgian economy grew by 1.4% in 2018, clearly below the pace recorded in 2017. While the euro area economy slowed down further in the second half of last year, Belgian quarterly growth remained quite stable and in line with the short-term estimate of our autumn 2018 projections. Growth edged down marginally at the start of 2019 to 0.3% on a quarterly basis, according to the revised NAI statistics. This is at odds with what was observed in the euro area, where GDP growth rebounded in the first quarter of this year, but is in line with confidence indicators for Belgium. The latter had initially remained relatively resilient but have recently worsened. Consumer confidence, for example, took a clear dive as of December and is currently close to its long-term average. Producer confidence, on the other hand, though gradually deteriorating, still remains above average. At the cut-off date of the projections, there were no clear indications of a strong pickup of activity in the near term, which is consistent with the nowcasting models used by the Bank that show stable growth of 0.3% in the second quarter.

Chart 2

GDP and confidence indicators



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.

The current projections point to a broadly constant growth rate of about 0.3 % until the end of the projection horizon. In annual terms, activity is set to expand by 1.2 % in 2019. Growth edges down marginally in 2020 but rises to 1.2 % again in 2021. The broadly constant growth rate can be traced back to an acceleration in private consumption that is, however, largely offset by lower investment growth and a more negative growth contribution from net exports. Compared to the Bank's autumn projections, the current growth outlook implies a limited downward revision of 0.4 pp in cumulative terms over the 2019-2021 period, which is largely concentrated in 2019 and which can be traced back to the sharp downward adjustment of export market growth.

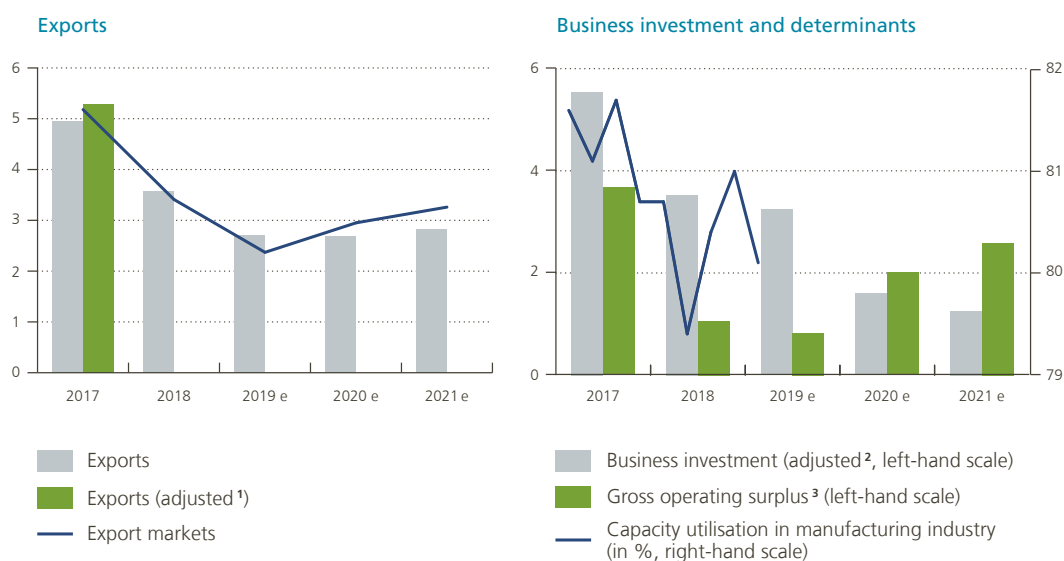
Turning to demand components, growth in the years ahead will continue to be driven mainly by domestic demand. Net exports supported growth in 2018 and continued to do so at the start of 2019 due to a marked decline in imports, but their growth contribution will gradually turn negative. While the expansion of Belgium's export markets gains traction as of the second half of this year, export growth remains broadly constant in annual terms over the projection period, as market share losses reappear. Against the backdrop of strong gains in cost competitiveness, Belgian exports had grown more or less in line with the expansion in export markets over the past couple of years, while export market shares had previously displayed a downward trend. As labour costs have accelerated and will continue to increase at a more sustained rate, export firms' cost competitiveness will evolve less favourably than in recent years and their market shares are projected to decline gradually over the projection period. As import growth is expected to edge up, in line with accelerating domestic demand, net exports would reduce growth again in the outer years of the projection period.

As usual, according to the technical assumption adopted for all the quarters covered by the projection period, the growth contribution of changes in inventories is set at zero, particularly in view of the great statistical uncertainty surrounding this concept.

Chart 3

Exports and business investment

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



Sources: NAI, NBB.

1 Export growth adjusted for 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. 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.

The declining support from net exports is offset by a rising contribution from domestic demand and, in particular, private consumption. The latter is the most important component of final demand and has been relatively lacklustre for several years already.¹ In the last quarter of 2018, private consumption growth again came in significantly below what was expected in the Bank's autumn projections, partly as a result of a severe drop in household spending on durables. The latter is likely to have been of a mostly temporary nature, as a consequence of anticipation effects in car registrations following the stricter emission testing procedures (WLTP) introduced in September. Private consumption did in fact recover somewhat in the first quarter of this year due to a rebound in purchases of durables.

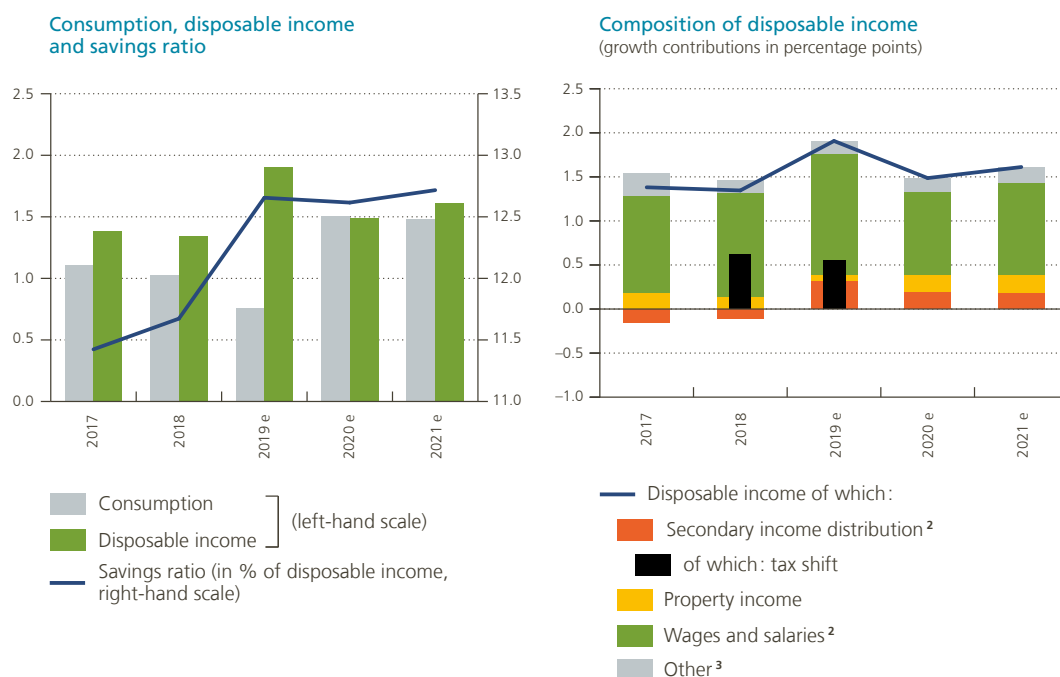
While consumer confidence has weakened to around its long-term average, the fundamentals remain relatively strong and point to a further pick-up in private consumption growth. Over the next three years, the cumulative increase in real household disposable income will amount to slightly more than 5%. Taking the expected population growth into account, this corresponds to an increase in purchasing power of 3.5% per person by 2021. A large part of this real income growth can be traced back to labour income. On the one hand, job creation will remain robust in the years ahead, although the expansion of employment will ultimately moderate. On the other hand, and more importantly, real wages are set to rise more strongly in the coming years. In addition, the third phase of the tax shift that came into force in January 2019 has further increased take-home pay. Finally, property incomes, that are however saved to a larger extent, will also continue to contribute positively to the growth of household incomes, mainly as a result of rising interest rates.

¹ Please refer to the article on "Why has Belgian private consumption growth been so moderate in recent years?" in this Economic Review for a more detailed discussion on this topic.

Chart 4

Household consumption and disposable income¹

(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).

As usual, households only gradually adjust their spending to rising incomes and typically aim to smooth out volatility in income growth. In this connection, real household incomes will receive a strong boost, particularly in 2019, not only from the aforementioned cut in personal income taxes but also from a marked indexation effect, as wages and replacement incomes are increased on the basis of the past hike in inflation, while current inflation is already declining. As of 2020, disposable income growth edges down to about 1.5% per year.

Against this backdrop the current projections point to a slight further increase in consumption growth in the first half of the projection period, after which growth moderates marginally in the final year. In annual terms, private consumption outpaces GDP in both 2020 and 2021. While the savings ratio shoots up to 12.7% this year, partly due to the carry-over of weak consumption growth at the end of 2018, it remains broadly constant thereafter.

Business investment has decelerated somewhat in 2018 following an exceptionally strong performance in the two previous years and is expected to gradually continue losing momentum. This further moderation of the business investment cycle is consistent with the underlying fundamentals: costs are on the rise and, as usual in Belgium, are expected to be only partially passed on in (selling) prices, causing firms' profit margins to shrink, as explained in chapter 4. Additionally, interest rates are gradually picking up and final demand is no longer accelerating. Moreover, the capacity utilisation indicator in manufacturing seems to have passed its peak, which indicates that investment in additional production capacity is becoming less urgent.

In contrast, household investment in new dwellings or renovation projects has recorded only meagre growth in recent years. The current projections point to a further expansion of that investment averaging about 0.3 % per quarter, driven by an increase in household income that could offset the dampening effect of the expected rise in mortgage interest rates.

Finally, as regards public expenditure, the growth of public consumption will remain relatively moderate throughout the projection period, on the basis of the current medium-term outlook for the budget. Public investment on the other hand will, as usual, be determined by 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 4

GDP and main expenditure categories

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

	2018	2019 e	2020 e	2021 e
Household and NPI final consumption expenditure	1.0	0.8	1.5	1.5
General government final consumption expenditure	0.9	1.1	1.0	1.0
Gross fixed capital formation	2.9	3.4	1.4	1.7
General government	6.8	-2.7	-0.2	6.8
Housing	1.8	4.3	1.5	1.0
Businesses	2.7	4.1	1.6	1.3
<i>p.m. Domestic expenditure excluding the change in inventories¹</i>	<i>1.4</i>	<i>1.5</i>	<i>1.4</i>	<i>1.4</i>
Change in inventories ¹	-0.3	-0.3	0.0	0.0
Net exports of goods and services ¹	0.3	0.1	-0.2	-0.3
Exports of goods and services	3.6	2.7	2.7	2.8
Imports of goods and services	3.3	2.6	2.9	3.1
Gross domestic product	1.4	1.2	1.1	1.2

Sources: NAI, NBB.

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

3. Labour market

After five consecutive years of strong job creation, the employment intensity of growth would increase even further this year, to just above 1, and the number of persons in work is expected to rise further by about 60 000. Employment growth is then predicted to moderate in the next two years as activity growth will gradually be supported more by increases in hourly labour productivity. The latter has been particularly weak recently and even negative in 2018 but is projected to recover, also in view of the recent strong investment growth.

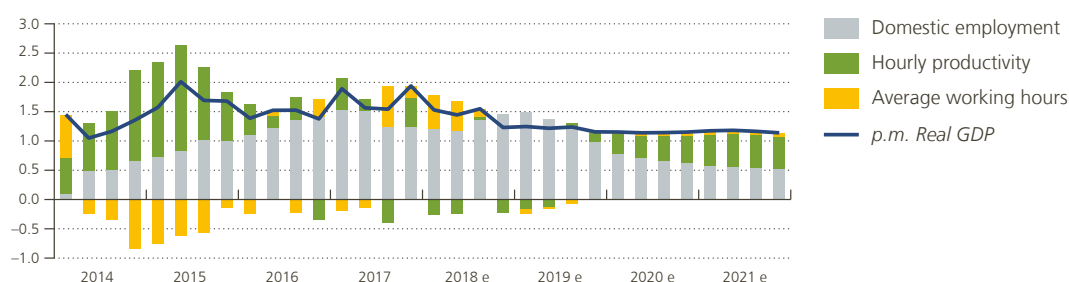
The deceleration of employment during the projection period reflects both the slower pace of activity growth and the fact that the job intensity of growth gradually returns to normal as a result of accelerating wage costs and the declining impact of policies implemented to shore up the effective labour supply, e.g. by curbing early retirement schemes. 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 increasingly holding back the further expansion of employment. Labour market tensions are also expected to affect the average working time: the long-term trend of a decline in working hours has been interrupted recently due to greater pressure to work overtime or to curb part-time working arrangements. Similarly, supply-side pressures lead to a slight increase in average hours worked over the projection period, albeit to a lesser extent than in 2018.

Chart 5

Domestic employment, working time and productivity

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



Sources: NAI, NBB.

All in all, an additional 121 000 jobs are projected to be created over the 2019-2021 period. This amounts to an upward revision compared to the Bank's autumn 2018 projections, despite somewhat lower GDP growth. This is due to the incorporation of the most recent statistics which suggest that employment remained surprisingly buoyant and grew at a relatively constant quarterly rate of 0.4% over the last two quarters. Most jobs were created in the branches sensitive to the business cycle. Naturally, employment growth in those industries will also slow down the most, while job creation in other services will hold up better and employment in administration and education will continue to grow at a broadly constant pace. The number of self-employed is also projected to decelerate, although to a lesser extent than the number of employees. Rising wage growth does not depress the increase in the number of self-employed; also, self-employed status has become somewhat more attractive by the improvements made to the social security scheme for self-employed persons and by the opportunities for retired persons to combine their pension with a self-employed occupation.

Strong job creation coupled with a limited increase in the working age population, mainly due to ageing, increased the harmonised employment rate to just under 70% in 2018, up from 67.2% in 2015. The employment rate is expected to continue rising to more than 71% in 2021. This still falls short of the Belgian EU2020-objective of a 73.2% employment rate by next year.

The number of unemployed job-seekers is expected to decline by a further 42 000 persons over the projection period, driven mainly by the gradual departure from the labour force of a large cohort of unemployed persons aged 63 and over, entering retirement. While the ongoing decline in unemployed job seekers causes the registered unemployment rate to drop further over the projection horizon, the harmonised unemployment rate – which measures the number of people actually seeking work on the basis of a survey – is assumed to be much less affected as a large part of those older people currently disappearing from the unemployment figures were not actively looking for a job in the past either. The harmonised unemployment rate, which reached a historically low level of 6% last year, is therefore expected to decline only slightly and bottom out at 5.7% during the projection period.

Table 5

Labour supply and demand

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

	2014	2015	2016	2017	2018	2019 e	2020 e	2021 e
Total population	55	59	57	54	53	52	53	51
Working age population ¹	9	16	16	12	11	10	11	9
Labour force	33	21	33	37	31	41	21	17
Domestic employment	20	41	59	65	62	61	34	27
Employees	14	30	46	52	51	49	25	19
Branches sensitive to the business cycle ²	0	18	29	38	37	34	13	7
Administration and education	7	3	3	2	2	1	2	2
Other services ³	7	9	14	13	12	13	10	10
Self-employed	6	10	13	12	11	12	9	8
Unemployed job-seekers	14	-19	-26	-28	-30	-19	-13	-10
<i>p.m. Harmonised unemployment rate ^{4,5}</i>	8.6	8.6	7.9	7.1	6.0	5.7	5.7	5.7
<i>Harmonised employment rate ^{4,6}</i>	67.3	67.2	67.7	68.5	69.7	70.5	70.9	71.2

Sources: FPB, NAI, NEO, StatBel, 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).

4. Costs and prices

4.1 Labour costs

Hourly labour costs are expected to accelerate significantly over the projection horizon and increase by some 2.3 % on average every year. The projections take into account the maximum margin of 1.1 % for negotiated wage increases in the 2019-2020 period. While not all social partners agreed to sign the interprofessional agreement, this wage norm was translated into law via a Royal Decree of 19 April 2019. We assume that the full extent of the margin will be used. In line with the stylised facts concerning the time needed to implement the wage norm at industry and company level, a somewhat bigger rise in negotiated wages is expected in the second year. This is slightly lower than the technical assumption included in the Bank's autumn 2018 projections, when the wage norm for the 2019-2020 period was not yet known. The current projections assume constant growth in negotiated wages in 2021.

Annual wage growth is also affected by changes in indexation. As indicated, wage indexation is quite large in 2019 in particular, as the spike in the health index towards the end of 2018 is passed on to wages via the existing indexation mechanisms with the usual delay. The indexation effect is somewhat lower in the outer years of the projection horizon.

Table 6

Price and cost indicators

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

	2017	2018	2019 e	2020 e	2021 e
Private sector labour costs¹:					
Labour costs per hour worked	1.5	1.2	2.5	2.0	2.4
of which:					
Negotiated wages	0.2	0.4	0.4	0.7	0.7
Indexation	1.6	1.7	2.0	1.4	1.7
Social contributions ¹	-0.3	-0.7	0.0	-0.2	0.0
Wage drift and other factors	-0.1	-0.2	0.1	0.1	0.1
<i>p.m. Labour costs per hour worked according to the national accounts²</i>	1.4	1.2	2.4	1.9	2.4
Labour productivity³	0.0	-0.3	-0.1	0.4	0.6
Unit labour costs¹	1.5	1.5	2.6	1.6	1.8
Total inflation (HICP)	2.2	2.3	1.5	1.6	1.5
Core inflation⁴	1.5	1.3	1.6	1.8	1.9
of which:					
Services	1.9	1.6	1.9	2.2	2.4
Non-energy industrial goods	0.8	0.8	1.0	1.1	1.2
Energy	9.9	8.9	1.1	-0.2	-2.1
Food	1.4	2.7	1.2	1.8	1.9
<i>p.m. Inflation according to the national index (NCPI)</i>	2.1	2.1	1.7	1.6	1.5
Health index⁵	1.8	1.8	1.6	1.6	1.6

Sources: EC, FPS Employment, Labour and Social Dialogue, NAI, Statbel, NBB.

1 Not shown according to the national accounts concept but according to a broader, macroeconomically more relevant concept that includes reductions in contributions for target groups and wage subsidies.

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 fuel.

Wage drift and other factors reduced the growth in wage costs quite significantly in 2018, possibly because new jobs were mostly created for workers with lower productivity and, hence, lower wages. Against this backdrop, the projections for wage drift were revised down, also because the decelerating labour demand could reduce wage pressures. Overall, wage drift is still expected to have a slight upward effect on wage costs, as the share of older workers is increasing and because of the trend towards a more educated workforce.

Finally, the increase in labour costs is moderated somewhat by the additional cuts in social security contributions implemented in 2019 and 2020, in order to gradually bring down the base rate in employers' social contributions to 25 %, as decided under the tax shift programme. However, the impact of these reductions is much smaller than in 2018.

All in all, unit labour costs rise sharply this year but decelerate somewhat thereafter. This is due to the projected recovery in productivity as of 2020, implying that growth in unit labour costs is somewhat more moderate than the rise in hourly wage costs in the outer years of the projection period. However, even in the 2020-2021 period, unit labour costs still increase more rapidly than in the recent past.

4.2 Prices

Accelerating unit labour costs exert upward pressure on inflation. However, as can be observed from past correlations, changes in the rate of increase in unit labour costs tend to be partially absorbed by firms' profit margins in Belgium. Profit margins had expanded markedly up to early 2017, notably because the deceleration in unit labour costs was only partially passed on to prices. Likewise, over the projection period, rising unit labour costs will not entirely translate into higher prices, as profit margins will continue to decline towards their long-run average in 2021 according to macroeconomic indicators.

Hence, core inflation would rise clearly less than the growth rate of unit labour costs but still edges up to almost 2% by the end of 2021. In absolute terms, services inflation – which is more sensitive to domestic wage cost pressures – increases more than inflation for non-energy industrial goods. There has already been a clear rise in services inflation since the start of 2019, although that is partly due to specific factors, including the disappearance from the inflation data of the abolition, as of January 2018, of the radio and television licence fee in the Walloon Region and the bigger than usual holiday-related price increases in April. The strong growth in unit labour costs, particularly in 2019, is projected to gradually push up services inflation further, to 2.4% at the end of the projection horizon. The pick-up in core inflation is not apparent in the figures for total inflation due to the slowdown of energy prices, in particular.

In 2019, energy price increases are dropping sharply due to a significant fall in gas prices, as well as a slowdown in the increase in prices of petroleum products and – to a lesser extent – electricity prices. The fall in gas prices seems to be mostly related to increased supplies of (shale) gas. Oil prices have recently recovered, but this follows a significant decline since the fourth quarter of last year and, overall, the rate of increase is clearly below the average pace observed in 2018. Moreover, since July 2018, excise duties on motor fuels have remained stable, whereas in past years they had increased, on average, owing to the ratchet system and the periodic indexations. No additional increases in excise duties were taken into account in the projection period and, in line with the oil price assumptions, energy inflation should become negative as of 2020.

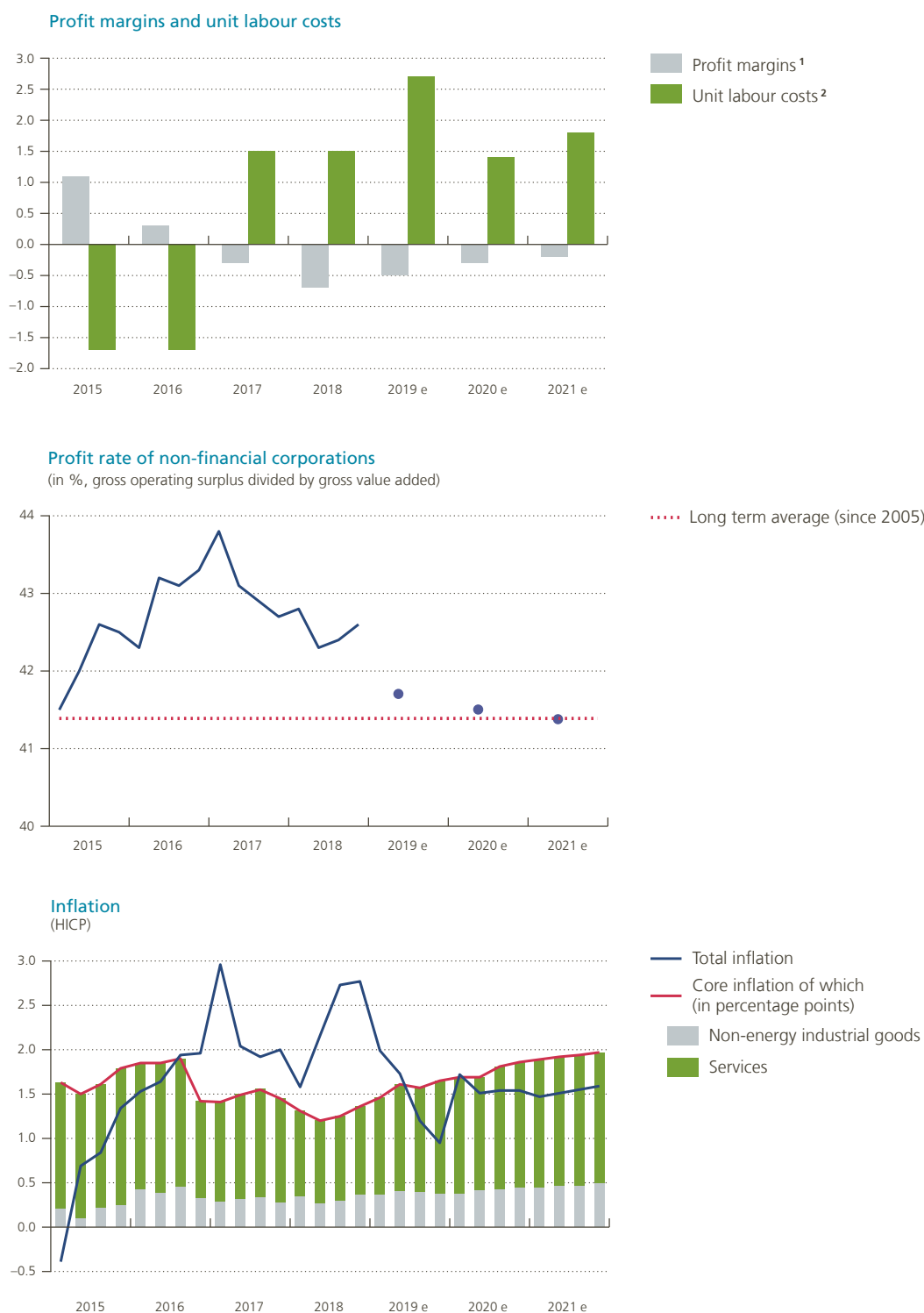
Food inflation is also expected to drop in 2019, after which it would edge up slowly. This drop is partly related to government measures. In January 2018, food inflation was boosted by an increase in the so-called sugar tax on soft drinks introduced in 2016. This impact disappears in the 2019 inflation figures, while excise duties on tobacco have also been increased less strongly in 2019 than last year.

All in all, total inflation will slow down to 1.5% on average in 2019, and will only rise marginally thereafter. The above analysis pertains to 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 fuels, and serves as a reference for price indexation of wages and replacement incomes. Notwithstanding some volatility in the monthly data, the health index is set to grow at a relatively constant rate in annual terms throughout the projection period. It is expected that the threshold index for certain indexation mechanisms, including those for government wages and replacement incomes, will next be exceeded in January 2020.

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.

5. Public finances

5.1 Budget balance

According to the data published by the NAI in April 2019, the Belgian government recorded a budget deficit of 0.7 % of GDP in 2018, representing a small improvement over 2017. Against the macroeconomic background described above, the general government budget deficit is expected to increase substantially in 2019 and the following years.

Table 7

General government accounts

(in % of GDP)

	2018	2019 e	2020 e	2021 e
General government				
Revenue	51.7	50.8	50.6	50.6
Primary expenditure	50.1	50.1	50.4	50.8
Primary balance	1.6	0.7	0.2	-0.2
Interest charges	2.3	2.1	2.0	1.9
Financing requirement (-) or capacity	-0.7	-1.3	-1.7	-2.1
Overall balance per subsector				
Federal government ¹	-0.1	-1.2	-1.6	-1.7
Social security	0.0	0.0	0.0	0.0
Communities and Regions ¹	-0.5	-0.2	-0.3	-0.4
Local authorities	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.

The expected deterioration of the budget balance in 2019 is due to the decline in revenue. The main reason for this is the reduction in corporate income tax receipts resulting from lower assessments, which are the corollary to the shift in favour of advance payments in preceding years. The tax burden on labour is further reduced via the so-called tax shift, the final phase of which is scheduled for 2020. Primary expenditure is projected to edge upwards over the projection horizon and interest charges will continue to decline, although at a slower pace than in recent years.

The deficits are expected to occur mainly at the level of the federal government, although the Communities and Regions sub-sector will also continue to record a small deficit during the projection period. In contrast, the local government and social security accounts should remain broadly in balance.

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

5.2 Revenues

Table 8

Public revenues

(in % of GDP)

	2018	2019 e	2020 e	2021 e
Fiscal and parafiscal revenues	44.6	43.8	43.5	43.6
Levies applicable mainly to labour incomes	24.9	24.9	24.9	25.0
Personal income tax	11.1	11.0	11.0	11.1
Social contributions	13.8	13.9	13.9	13.9
Taxes on corporate profits	4.4	3.6	3.4	3.4
Levies on other incomes and on assets	4.0	4.0	4.0	4.0
Taxes on goods and services	11.3	11.3	11.2	11.2
of which:				
VAT	6.9	6.9	6.9	6.9
Excise duty	2.2	2.2	2.2	2.1
Non-fiscal and non-parafiscal revenues	7.1	7.0	7.0	7.0
Total revenues	51.7	50.8	50.6	50.6

Sources: NAI, NBB.

In 2019, government revenue is expected to decrease by 0.9 percentage point of GDP. In 2020, a further decline of 0.2 percentage point of GDP is projected and in 2021 the revenue ratio will remain stable.

The decline in government revenue in 2019 and 2020 is mainly due to the decrease in corporate income tax receipts, resulting from the offsetting impact of the temporary rise in 2017 and 2018. The increase in the basic rate of tax surcharge applied to inadequate advance corporate income tax payments induced firms to step up their advance payments, generating a temporary revenue boost in 2017 and 2018. This is expected to lead to a drop in revenue collected via the assessments in 2019 and 2020. In 2020, corporate income tax receipts should return to their structural level, which is almost the same in relation to GDP as that prevailing before the increase in the tax surcharge rate.

In addition, measures relating to the tax shift result in a further reduction in the tax burden on labour incomes. In 2019, the main cuts concern personal income tax, with revenue expected to decrease by 0.2 percentage point of GDP. Moreover, measures intended to activate savings by granting tax exemption for a first tranche of income from dividends will reduce personal tax assessments in 2019. In 2020, there is a further cut in employer's social contributions, but its effect on revenue will be broadly compensated by favourable private sector employment growth.

5.3 Primary expenditure

The primary expenditure ratio is expected to stabilise at 50.1 % of GDP in 2019. In nominal terms, spending would therefore expand at much the same rate as economic activity. The increase in expenditure will be tempered by a decline in public investment, which had been boosted in the run-up to the municipal and provincial elections

in October 2018. In addition, no indexation of social benefits and public sector wages is planned until next year, and that will have a moderating effect on the expected expenditure trend in 2019.

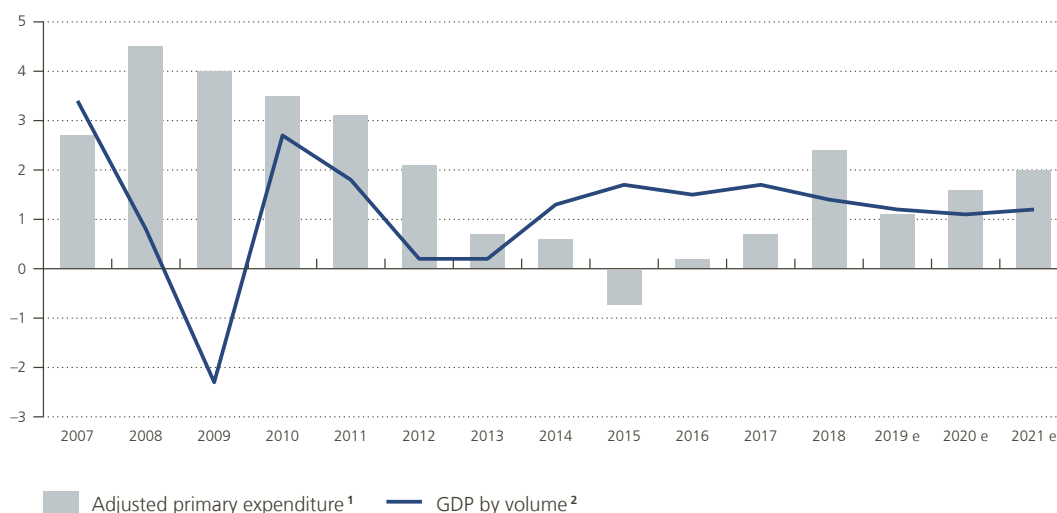
Adjusted for the impact of temporary factors, the economic cycle and the gap between inflation and actual indexation, real primary expenditure is forecast to increase by 1 % in 2019.

Under unchanged policy conditions, the spontaneous expansion of primary expenditure is expected to exceed the GDP growth rate in 2020 and 2021, leading to an increase in the expenditure ratio. This situation is due mainly to the drift in social benefits resulting from population ageing. The natural increase in pensions and health care expenditure, combined with the welfare adjustments, will place a heavy burden on public finances. In recent years, it has been possible to neutralise the demographic pressure on social security expenditure by strict control of spending on health care, the 2015 index jump and the fall in unemployment.

Chart 7

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 2018, the public debt ratio declined to 102 % of GDP. The debt ratio is expected to decline further during the projection period, but the reduction will be modest.

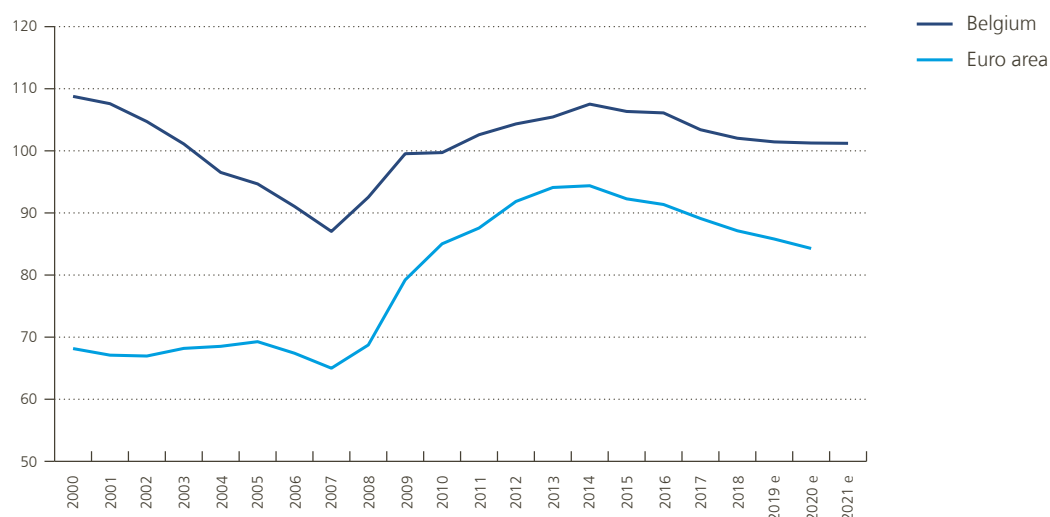
In 2019, debt expressed as percentage of GDP will fall to 101.4%. After that the debt ratio should continue falling but very slowly, to 101.2% in 2021. The favourable impact of the primary balance will gradually fade over the projection period, as the surplus will become much smaller and revert to a deficit in 2021.

This picture contrasts with the latest EC forecasts for the euro area, whose debt ratio is expected to decline faster. Hence, the gap with Belgium will widen.

Chart 8

Consolidated gross debt of general government

(in % of GDP)



Sources: EC, NBB.

6. Conclusion and risk assessment

The Eurosystem’s spring 2019 projections generally point to a less upbeat growth outlook. The Bank’s projections for Belgian growth have been revised down as well, albeit to a clearly lesser extent than those for other euro area countries. Recent statistics and our short-term estimate for the second quarter of 2019 are still in line with the previous projections, but the strong downward revision in trade and export markets translates into slightly lower annual growth for both 2019 and 2020. The Belgian economy is now expected to grow at a rate comparable to that in the euro area this year but, contrary to Belgian growth, the latter would edge up in the outer years of the projection horizon.

In the coming years, Belgian growth will be supported by domestic demand. Household consumption will pick up due to increases in purchasing power, which should compensate for the gradual normalisation of the corporate investment cycle and the more negative growth contribution of net exports. In the euro area, domestic demand is similarly driving economic activity. The growth rate of business investment declines further from 2020 onwards, but household consumption growth remains stable over the projection period. Net exports weigh most heavily on growth in 2019 but improve thereafter.

The Bank’s growth estimates are towards the lower end of the range of the most recent forecasts of the other institutions, especially for 2020. They already incorporate the first vintage of statistics (GDP, labour market) pertaining to the first quarter of 2019 and, compared to the projections by the other institutions, were also informed by more recent high-frequency indicators (partly up to May) that continued to point to a broadly unchanged economic environment. The Bank’s projection for economic growth in 2020 is in particular more

Table 9

Comparison with the estimates of other institutions

(in %)

Institution	Publication date	GDP growth (in volume)			Inflation (HICP, unless otherwise mentioned)		
		2019	2020	2021	2019	2020	2021
Belgian Prime News	March 2019	1.3	1.2		1.8	1.6	
IMF	April 2019	1.3	1.4	1.5	1.9	1.6	1.9
OECD	May 2019	1.2	1.3		1.6	1.5	
EC	May 2019	1.2	1.2		1.8	1.6	
Consensus Economics	May 2019	1.2	1.3	1.2	1.7	1.6	1.6
Federal Planning Bureau ¹	June 2019	1.3	1.3	1.4	1.7	1.5	1.6
NBB	June 2019	1.2	1.1	1.2	1.5	1.6	1.5

¹ Economic budget (June 2019) for 2019-2020 and Economic Outlook (February 2019) for 2021. The inflation rates are the NCPI figures.

pessimistic than that by the Federal Planning Bureau. The difference can be largely traced back to a different assumption about government investment growth.

Once again, risks to the current projections pertain primarily to the international environment and are clearly tilted to the downside. The global trade momentum is one of the main uncertainties for this exercise, also given the fact that the assumed recovery in trade is not yet visible in forward-looking indicators, such as those concerning export orders in manufacturing. In this context, additional trade restrictions would intensify the headwinds for the recovery of euro area growth, in particular if they are directly connected to euro area exports. However, even if tariffs do not specifically target EU products, increasing trade tensions typically have a broader impact via indirect channels (including through uncertainty, global value chains and financial markets) that could weigh on the euro area and the Belgian growth outlook. Similarly, a supply-driven hike in oil prices would also lower growth projections.

At the domestic level, risks may be more balanced or slightly tilted to the downside. First, private consumption has come in lower than expected in recent quarters. While this was partly due to temporary factors and fundamentals, including the outlook for income growth, remain strong, household consumption may continue to be lower than expected. This is clearly connected to the outlook for wages: we assume, for instance, that wage negotiations at the industry and company level will lead to a full use of the available margin of 1.1 % for the 2019-2020 period, and that wage drift will turn slightly positive. Lower wage growth would curb consumption and, most likely, activity growth. Second, as employment growth loses steam, productivity should in fact pick up somewhat to keep activity growth broadly constant over the projection period. At the same time, business investment may slow down less than in the current projections. Finally, in view of the projected large structural deficit in 2021, it is clear that future governments will need to restore balance to public finances. The size and nature of those measures will determine to what extent the Belgian growth outlook will be affected.

Annex

Projections for the Belgian economy: summary of the main results

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

	2017	2018	2019 e	2020 e	2021 e
Growth (calendar adjusted data)					
Real GDP	1.7	1.4	1.2	1.1	1.2
Contributions to growth:					
Domestic expenditure, excluding change in inventories	1.1	1.4	1.5	1.4	1.4
Net exports of goods and services	0.6	0.3	0.1	-0.2	-0.3
Change in inventories	0.0	-0.3	-0.3	0.0	0.0
Prices and costs					
Harmonised index of consumer prices	2.2	2.3	1.5	1.6	1.5
Health index	1.8	1.8	1.6	1.6	1.6
GDP deflator	1.7	1.1	1.4	1.5	1.6
Terms of trade	-0.9	-1.4	-0.2	-0.3	0.0
Unit labour costs in the private sector ¹	1.5	1.5	2.6	1.6	1.8
Hourly labour costs in the private sector ¹	1.5	1.2	2.5	2.0	2.4
Hourly productivity in the private sector	0.0	-0.3	-0.1	0.4	0.6
Labour market					
Domestic employment (annual average change in thousands of persons)	64.5	61.7	60.8	33.7	26.9
Total volume of labour ²	1.5	1.6	1.2	0.7	0.6
Harmonised unemployment rate (in % of the labour force aged 15 years and over)	7.1	6.0	5.7	5.7	5.7
Incomes					
Real disposable income of individuals	1.4	1.3	1.9	1.5	1.6
Savings ratio of individuals (in % of disposable income)	11.4	11.7	12.7	12.6	12.7
Public finances					
Primary balance (in % of GDP)	1.6	1.6	0.7	0.2	-0.2
Budget balance (in % of GDP)	-0.8	-0.7	-1.3	-1.7	-2.1
Public debt (in % of GDP)	103.4	102.0	101.4	101.3	101.2
Current account (according to the balance of payments, in % of GDP)	0.7	-1.3	-1.6	-2.0	-2.2

Sources: EC, NAI, Statbel, 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.