Economic projections for Belgium – Autumn 2019

Introduction

It has now become clear that the world economy has decelerated sharply this year. Recent estimates suggest that global growth (excluding the euro area) has dropped below 3 %, which is close to 1 percentage point lower than in 2018. In addition, the slowdown in world trade was even worse and trade volumes have actually declined in certain quarters and, at best, seem to have been growing only marginally in annual terms in 2019. The weakness in trade partly reflects changes in the composition of global output and, in particular, the widespread decline in manufacturing production, that is typically traded more than services. However, it also happened against the background of increasing trade restrictions and a broader trend towards less globalisation. The former also adversely affect trade growth through the uncertainty that they create. The latter is witnessed, inter alia, by the tentative evidence that global value chains are at the very least expanding at a slower pace, which also weighs on trade growth. All in all, the international environment is clearly worse than had been assumed in the previous Eurosystem and ECB projection exercises and, hence, the growth outlook for the euro area has been consistently revised downwards throughout the year.

However, in the euro area domestic demand and the services industries have so far generally been more resilient than trade and manufacturing. Growth in economic activity has declined markedly but has not turned negative. This is largely due to the ongoing labour market expansion and rising incomes. At the same time, financial market conditions have been broadly favourable throughout the year. Stock markets have posted strong gains and sovereign yields have fallen further, on the back of strong monetary accommodation in several parts of the world, including the euro area. Partly as a result of the slowdown in world demand, oil prices have come down from the high levels observed in mid-2018 and have not shown any sustained recovery despite several major supply disruptions.

At the time of writing, the signals coming from the short-term indicators for the global and euro area economy remain mixed. Some indicators suggest that the manufacturing recession has reached its trough. In addition, early statistics on economic activity in the third quarter have surprised on the upside for certain countries. In the euro area, this was the case for Germany where output remains almost flat but a second consecutive quarter of negative growth has been avoided and growth in the euro area as a whole stayed constant at a moderate 0.2 %. On the other hand, short-term indicators also indicate that the weakness in manufacturing is now at least partly spilling over to services. Confidence in the latter industry has clearly deteriorated after the summer. More importantly, employment growth has now fallen to the slowest pace since the start of the upturn of the euro area economy in 2013. This could further weaken the resilience of domestic demand.

Against that background, the December 2019 Eurosystem projections – of which the Bank's projections for Belgium presented in this article are part – point to continued low but positive growth in the euro area into the first quarter of 2020. Still, the common assumptions for these Eurosystem projections see a gradual and slow rebound in world trade, so that growth in euro area foreign demand will recover somewhat in the second half of the projection period. In addition, market interest rates should rise only gradually, while oil prices slowly

decline throughout the projection period. According to the new Eurosystem projections and on the basis of these assumptions, euro area growth is projected to fall to just above 1 % this year and in 2020. However, the assumed recovery in world trade would fuel euro area exports and annual activity growth would shoot up to 1.4 %, a level that is closer to the potential growth rate, in the two following years. Inflation has declined sharply this year due to the deceleration in energy prices. However, underlying domestic cost pressures, related to relatively high wage growth in particular, will gradually push up inflation in the projection period, although it will still fall clearly short of 2 % at the end of 2022.

These projections for the euro area – but also for Belgium – are largely conditioned by the aforementioned common assumptions. In this connection, it should be noted that the recent projections by both the EC and the OECD are clearly more pessimistic for the medium term and do not see a strong pick-up in euro area growth in 2021. The balance of risks for the Eurosystem projections seems clearly tilted to the downside. Renewed disruptions of international trade, increasing geopolitical tensions or a no-deal Brexit could lead to lower growth than foreseen in the projections.

Turning to Belgium, growth has been remarkably robust of late. Looking through the volatility in the revised national accounts and taking into account the first estimates for the third quarter of this year, the Belgian economy expanded by about 0.4 % in the last four quarters. Despite the weakening in business confidence since early 2018 and in sharp contrast to the euro area and the recent estimates of all relevant institutions, the Belgian economy has in fact not decelerated at all according to the current statistics. While growth is estimated to edge down somewhat in the fourth quarter to a level that is more in line with our assessment of the short-term indicators, annual growth for 2019 has been revised marginally upwards compared to our June 2019 projections to 1.3 %. Activity growth will then edge down gradually to 1 % by 2022. The further slowdown in business investment, in line with the weaker fundamentals, is only partially offset by two other elements. Private consumption growth rises temporarily due to the current boost in real incomes but loses traction in the outer years of the projection period, while rising foreign demand pushes up exports but the impact is mitigated due to growing losses in export market shares by the end of the projection period.

Employment growth has already decelerated slightly compared to the peak in job creation in 2017 even if the employment intensity of activity growth still edges up this year. 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 is lowered this year by the strong deceleration in energy prices. However, core inflation has edged up in 2019 and is projected to rise gradually until 2022, even though, just as in the past, the sharp rise in labour costs will not be fully reflected in inflation as this will be partly offset by a moderation in profit margins. However, the latter should still be above their long-term average at the end of the projection period.

Finally, turning to public finances, the budget deficit has fallen 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 widens again as of 2019. The trend increase in pensions and other social transfers, as well as the structural revenue decline due to the reduction of the corporate tax rates, more than offsets the continuing fall in interest charges on the outstanding debt. By the end of the projection period, the deficit is expected to increase to 2.8 % of GDP, which is a long way off the target of a structurally balanced budget. In addition, taking the most recent EC projections for the other countries up to 2021 as a benchmark, only Italy will have a marginally higher budget deficit

than Belgium by that year. The fiscal worsening also means that the government debt ratio does not decline and debt becomes larger than GDP again by 2022. 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.

1. The 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 as at 20 November 2019.

1.1 World economy and trade

After decelerating sharply in the second half of last year, global economic growth has remained subdued in 2019, on the back of trade policy uncertainty and heightened geopolitical tensions. While mainly affecting manufacturing, the sluggishness of economic activity has been broad-based across countries despite policy stimulus adopted in a number of major economies. Growth outside the euro area seems to have dipped below 3 % this year, almost 1 percentage point lower than in 2018 and the lowest rate since the recession.

In the advanced economies, economic activity has lost momentum in the second half of last year and continued to expand only moderately in the course of this year. In the US, growth has moderated, on average, as the boost from the 2017-2018 fiscal stimulus is fading. Economic activity remained sluggish in the euro area, dragged down by a slump in the German economy, and in the UK, where Brexit-related uncertainties have continuously weighed on investment. By contrast, the Japanese economy accelerated somewhat in the first two quarters, driven by solid domestic demand. In emerging market economies, economic growth has gradually decelerated. Battling with weakened domestic spending and prolonged trade tensions with the US, China's economic expansion officially fell to 6 % in the third quarter, its weakest rate in almost three decades. In the same vein, India's growth dropped to a seven-year low, dragged down by stagnating investment and a big fall in consumption. Following a major contraction in the second half of 2018, the Turkish economy recovered, on the back of improved financial conditions and fiscal and credit support. At the same time, the Argentinian economy continued to contract, as it suffered from a sharp deterioration of financial conditions and high inflation.

However, most international organisations see global growth picking up very gradually over the medium term, even though it should remain below its historical average. According to the Eurosystem assumptions, global activity would expand by 3.4 % annually in the outer years of the projection period. In advanced economies, activity is projected to continue to slow down gradually, mostly as a result of the fading cyclical momentum, as well as diminishing policy support. 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 rebound in several other emerging market economies that are recovering from past recessions. While the overall outlook for growth is relatively benign, it comes with great uncertainty and, in particular, significant downside risks.

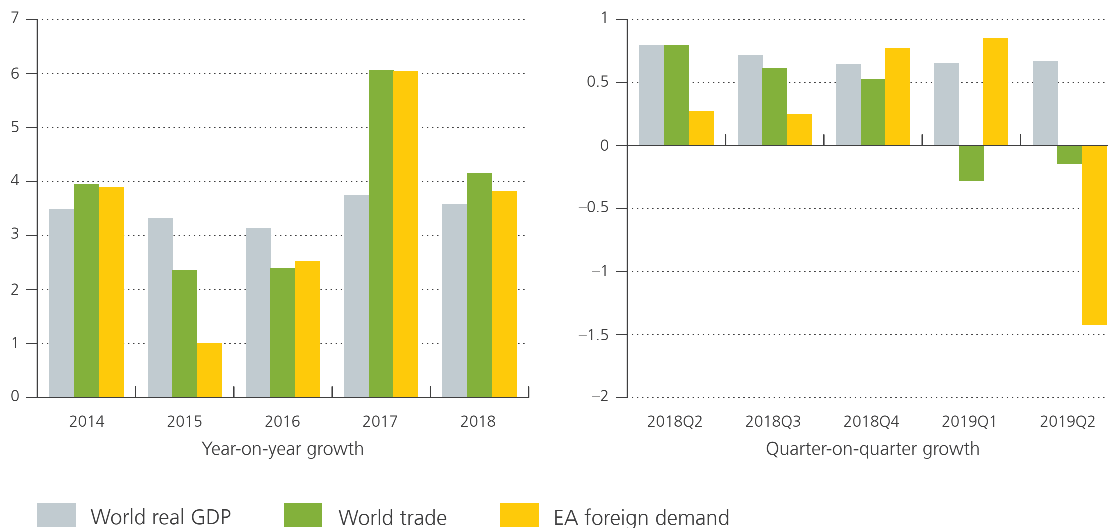
Escalating trade tensions and the global slowdown in industrial production have weighed heavily on international trade growth, which turned negative in the middle of 2019. The decline in the volumes of goods imported was broad-based but emerging Asia, including China, has been particularly affected. The slowdown in global trade is also partly due to composition effects in world output, with reduced investment spending, as well as a downturn in car production and sales. A slowdown in the development of global value chains also weighs on trade growth.

Chart 1

The global economy, trade and developments on the financial markets

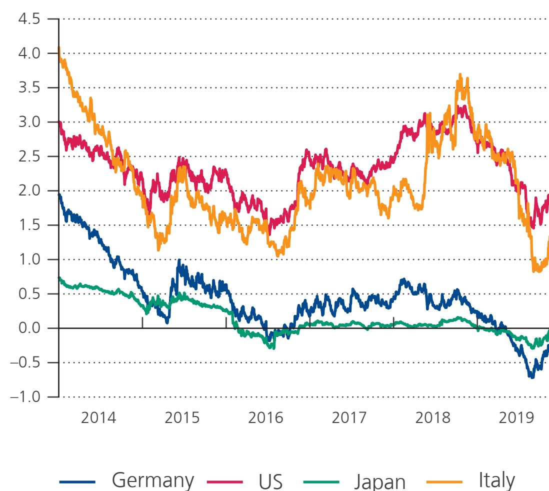
World / euro area real GDP and trade growth

(percentage changes compared to the previous period)



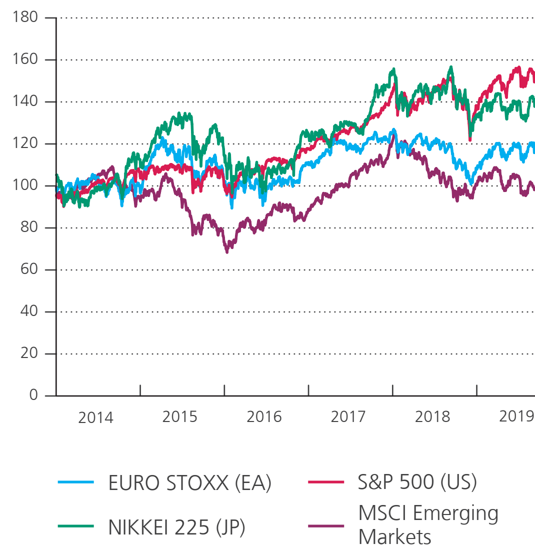
Ten-year government bond yields

(daily data, in %)



Stock market prices

(daily data, indices 2014 = 100)



Sources: Eurosystem, Refinitiv.

Considering the weakness in forward-looking indicators for trade, such as export orders in manufacturing, global trade growth is expected to remain subdued throughout the rest of the year. However, over the medium term, global imports are projected to gradually pick up, although they would expand at a slower pace than global activity until the end of the projection period. 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 has slowed down (or even turned negative) in recent quarters, but, in accordance with the Eurosystem common assumptions, it is set to bottom out and rebound slightly going forward.

Table 1

The international environment

(annual percentage changes)

	2018	2019 e	2020 e	2021 e	2022 e
World (excluding euro area) real GDP	3.8	2.9	3.1	3.3	3.4
World (excluding euro area) trade	4.6	0.0	0.8	2.4	2.7
Euro area foreign demand [1]	3.8	0.7	1.0	2.3	2.6
Belgium's relevant export markets [1]	3.4	1.8	1.7	2.5	2.7

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

Global equity markets have rebounded sharply after the decline in 2018, even though there has been some volatility in 2019 as well with markets mostly reacting to developments in the US-China trade talks. On the back of broad-based monetary easing and dovish communication by several central banks, financial conditions have improved, overall, especially in advanced economies. Government bond yields have further declined across the board – moving clearly into negative territory in some cases –, leading to a further flattening of the yield curve. In the euro area, financial asset prices have been supported by the announcement of a new policy package by the Eurosystem, at its September 2019 meeting. Meanwhile, the Italian spread has eased significantly since a new government was formed.

The euro has been rather volatile over the last few months, with no clear trend in nominal effective terms. It showed higher volatility relative to Sterling, against persistent uncertainty regarding the Brexit outcome. Owing to higher risk aversion over the summer, it has depreciated slightly against safe-haven currencies, namely the Japanese yen and the US dollar. After a significant rebound at the beginning of 2019, oil prices slipped again during the summer, falling below $ 60 per barrel on the back of the deteriorating outlook and persistent trade tensions between the US and China and despite various supply disruptions that only caused temporary price hikes.

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 $ 1.10 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 prices per barrel of Brent crude oil to come down slightly from their current level, to around $ 56 by 2022.

The interest rate assumptions are also based on market expectations. The three-month interbank deposit rate has been in negative territory since end-2015. Markets currently expect the interbank deposit rate to stay negative, around the current level, until the end of the projection horizon. Long-term yields on Belgian government bonds have reached an all-time low recently and are expected to rise only slightly in the coming years. Similarly, bank interest rates on business investment loans and household mortgage loans should remain favourable and increase only marginally during the projection period.

On balance, the current Eurosystem assumptions are clearly less favourable than those used in the Bank's spring 2019 macroeconomic projections, mainly on account of the worsened outlook for external demand.

Table 2

Technical assumptions

(annual averages ; in %, unless otherwise stated)

	2018	2019 e	2020 e	2021 e	2022 e
EUR/USD exchange rate	1.18	1.12	1.10	1.10	1.10
Oil price (US dollars per barrel)	71.1	63.8	59.6	57.4	56.8
Interest rate on three-month interbank deposits in euro	–0.3	–0.4	–0.4	–0.4	–0.3
Yield on ten-year Belgian government bonds	0.8	0.2	0.1	0.3	0.4
Business loan interest rate	1.6	1.5	1.6	1.6	1.7
Household mortgage interest rate	1.9	1.8	1.7	1.8	1.9

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 will remain subdued in the final quarter of 2019 and only pick up mildly afterwards. This projected recovery as of next year will be supported by the assumed rebound in world trade, favourable financing conditions in the context of the very accommodative monetary policy stance, as well as fiscal stimulus measures in various countries. In annual terms, real GDP growth should bottom out at just above 1 % in 2020 but jump to 1.4 % in the outer years of the projection period. As domestic demand is projected to grow at a broadly steady pace, the acceleration is due to the disappearance of the negative growth contribution of net exports as euro area exports will benefit from the recovery in world trade.

Inflation has fallen sharply this year, on the back of the strong deceleration in energy prices. Core inflation is again virtually unchanged at 1 % on average. In the following years, robust wage growth and recovering profit margins should lead to a gradual increase in core inflation. Total inflation will be held back in 2020 by a further deceleration of energy prices but should rise in the 2021-2022 period, while remaining clearly below the 2 % level at the end of the projection horizon.

While recent employment growth has been very vigorous, it has lost some momentum since the spring of 2019 due to the slowdown in activity, robust growth in labour costs and increasing labour supply constraints. Job creation will remain rather subdued over the projection horizon. However, activity growth will be supported by the gradual recovery in labour productivity. Labour force growth is projected to moderate. While it is boosted by net migration and the expected integration of refugees, as well as the increasing labour market participation, the impact of population ageing will gradually weigh more heavily on the labour force. The unemployment rate will continue to decline steadily to just above 7 % by 2022, which is lower than the pre-crisis level.

The average budget deficit in the euro area had declined to 0.5 % of GDP in 2018 but will more than double in the projection period, despite the further decline in interest charges. The worsening of the deficit is mostly due to cuts in direct taxes and increases in transfers. The fall in the government debt ratio is expected to continue, supported by the low level of interest rates: in 2022, 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)

	2018	2019 e	2020 e	2021 e	2022 e
Real GDP	1.9	1.2	1.1	1.4	1.4
Household and NPI final consumption expenditure	1.4	1.3	1.4	1.3	1.2
General government final consumption expenditure	1.1	1.5	1.6	1.5	1.5
Gross fixed capital formation	2.4	4.5	1.7	1.9	2.1
Exports of goods and services	3.3	2.3	1.9	2.5	2.6
Imports of goods and services	2.7	3.1	2.5	2.8	2.8
Inflation (HICP)	1.8	1.2	1.1	1.4	1.6
Core inflation [1]	1.0	1.0	1.3	1.4	1.6
Domestic employment	1.5	1.1	0.6	0.5	0.4
Unemployment rate [2]	8.2	7.6	7.4	7.2	7.1
General government financing requirement (–) or capacity [3]	–0.5	–0.7	–0.9	–1.1	–1.1

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

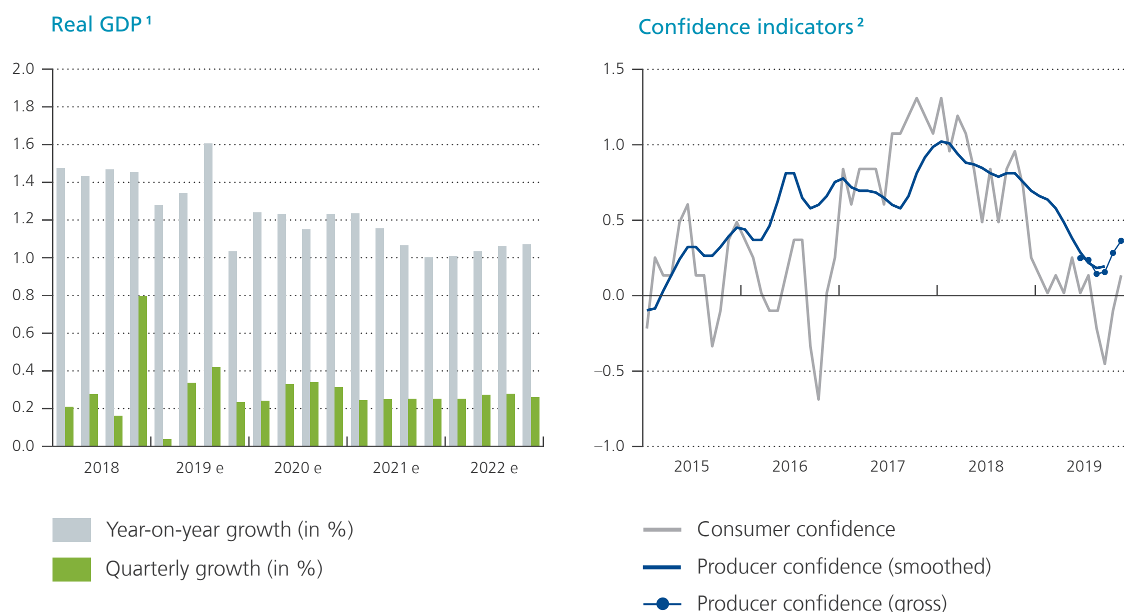
2. Activity and demand

While the euro area economy slowed down again from the second quarter of the year, Belgian activity growth remained more robust: the Belgian economy expanded at an average quarterly rate of 0.4 % in the last four quarters and, in fact, did not decelerate compared to the previous one-year period. The first statistics on the growth rate of activity in the third quarter (0.4 %) constitute an upward surprise with respect to the Spring 2019 projections (that were also anchored to trade assumptions that turned out to be too optimistic) and, more importantly, to the more recent short-term estimate in the September 2019 NBB Business Cycle Monitor that saw growth edging down to 0.2 %.

Compared to the euro area as a whole and the main neighbouring countries, but also in view of the significant softening of the confidence indicators since early 2018, the recent Belgian growth performance is quite remarkable. However, our current short-term assessment sees Belgian growth moderating somewhat in the final quarter of 2019 to 0.2 %, a rate that seems more in line with the current levels of the high-frequency indicators, despite the uptick in recent months. This would still imply an annual growth rate of 1.3 % for 2019, i.e. marginally higher than the estimate in the Bank’s spring projections, notwithstanding the less favourable external environment.

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.

Similar to the euro area, growth is projected to remain sluggish until the first quarter of 2020. The current projections then point to the growth rate edging up somewhat to 0.3 %, fuelled by higher private consumption and foreign demand. Activity will then gradually slow down again in the outer years of the projection period. In annual terms, growth will gradually fall to 1 % by 2022. The annual growth rates for the 2019-2021 period are almost unchanged compared to the Bank's spring projections. The negative impact of the less favourable external assumptions is broadly offset by the higher growth in the third quarter and somewhat stronger government expenditure growth.

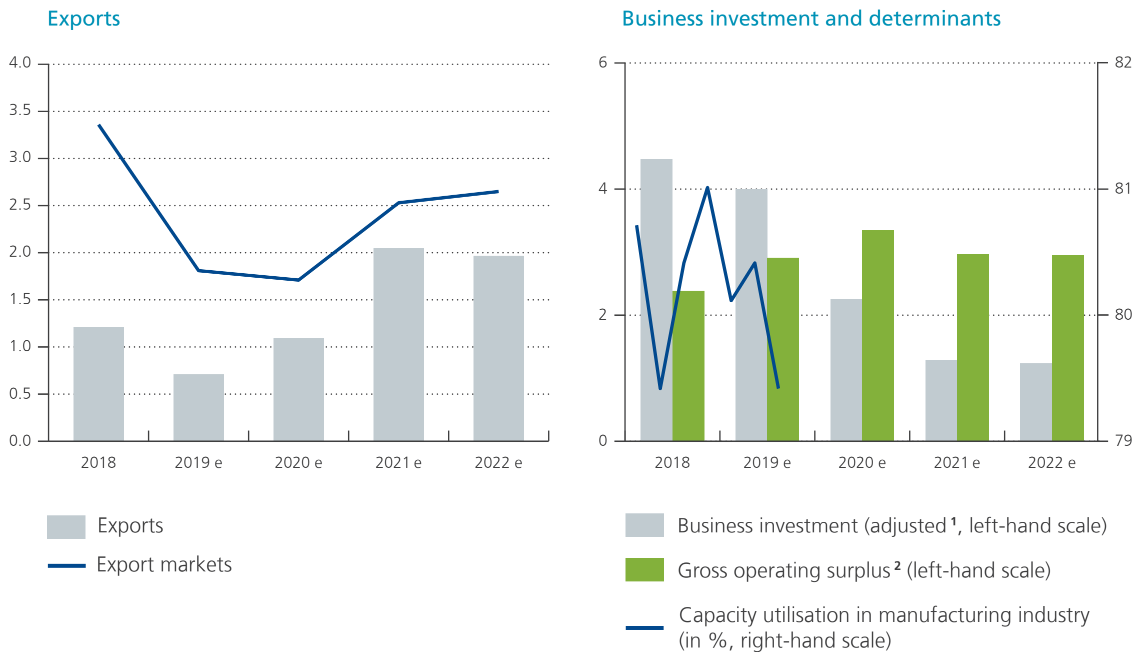
Turning to demand components, growth in the years ahead will continue to be driven mainly by domestic demand, although this component's contribution to growth will gradually weaken. Net exports continue to weigh on growth during the entire projection horizon. As described in chapter 1, Belgium's export market growth will increase going forward, which spurs export growth. However, the latter is held back as export market shares are projected to decline. Labour costs will increase at a sustained rate and export firms' cost competitiveness will evolve less favourably than in recent years. Import growth continues to outpace export growth, but to a somewhat lesser extent towards the end of the projection horizon, considering that domestic demand is expected to soften.

Private consumption, which is the most important component of final demand, has been subdued until the first quarter of 2019 but accelerated thereafter. It is still projected to grow strongly in the near term but lose some traction in the coming years in line with income developments. From 2019 to 2022, real household disposable income grows by a cumulative 7 %, with a peak in 2019. While real incomes are fuelled by continued employment growth and rising wages, the peak in disposable income in 2019 is partly due to the built-in lags in the indexation mechanisms in combination with declining inflation: as wages and replacement incomes are typically indexed on the basis of past higher inflation rates, real incomes are temporarily boosted. In addition, the third phase of the tax shift has come into force in January 2019 and has further increased take-home pay. While real wages are set to continue rising, the expansion of employment will ultimately moderate and lead to

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 Adjusted to take account of major transactions in specific investment goods with other countries.
2 In nominal terms.

lower growth of labour income. Property incomes, that are usually saved to a larger extent, will also contribute positively to the growth of household incomes, albeit to a limited extent, as interest rates are expected to edge up only marginally.

Households tend to only gradually adjust their spending to rising incomes and typically aim to smooth out volatility in income growth. In this connection, private consumption is rising more slowly than households' purchasing power in 2019. This generates a strong upswing in the savings ratio this year, to over 13 %. In the following years, the savings ratio edges down again slightly as consumption grows somewhat stronger than real disposable income.

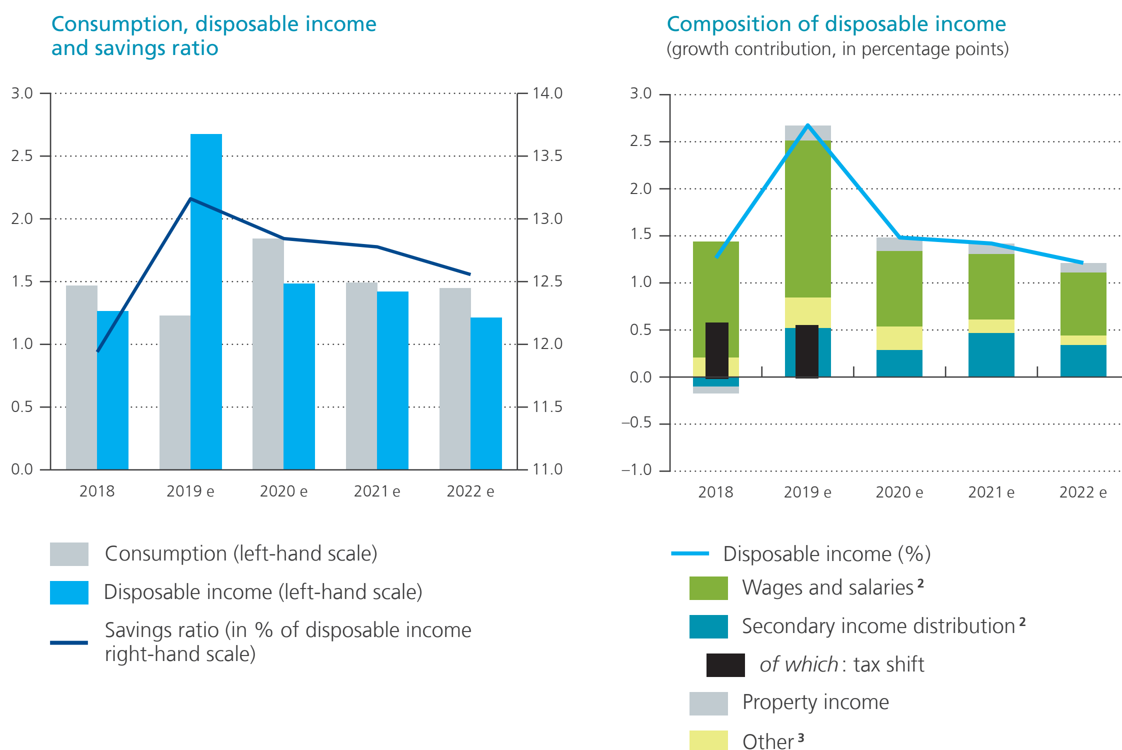
Business investment growth has been very buoyant in recent years, which seems unsustainable in the long-run, especially considering the relatively weaker demand prospects. Moreover, costs are on the rise and, as usual in Belgium, are expected to be only partially passed on in (selling) prices, which implies a slowdown in margin growth. Also, the capacity utilisation indicator in manufacturing seems to have passed its peak, which indicates that investment in additional production capacity is becoming less urgent.

Turning to another domestic demand component, household investment in new dwellings or renovation projects posted exceptionally strong growth this year, which may be related to search-for yield effects in the low interest rate environment. Although mortgage rates would remain favourable, moderating purchasing power should weigh on household investment as well.

Chart 4

Household consumption and disposable income [1]

(volume data adjusted for seasonal and calendar effects, 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 the self-employed).

Finally, as regards public expenditure, public consumption is growing more strongly this year, partly as a result of an acceleration of health care spending that had been curbed in recent years due to various government measures. In the following years, public consumption should moderate somewhat again. Public investment growth is, as usual, affected by the local electoral cycle: following the sharp acceleration in 2018, in the run-up to the local elections, investment growth is considerably lower in 2019. For 2020, and especially for 2021, account is being taken of more substantial spending on a number of major public investment projects, e.g. in connection with the Oosterweel link infrastructure project around Antwerp.

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.

Table 4

GDP and main expenditure categories

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

	2018	2019 e	2020 e	2021 e	2022 e
Household and NPI final consumption expenditure	1.5	1.2	1.8	1.5	1.5
General government final consumption expenditure	0.9	1.9	1.3	1.2	1.3
Gross fixed capital formation	4.0	3.8	1.8	1.8	1.1
General government	10.6	−2.5	0.8	5.9	−0.5
Housing	1.0	5.9	0.8	1.6	1.5
Businesses	3.9	4.2	2.3	1.3	1.2
p.m. Domestic expenditure excluding the change in inventories [1]	*1.9*	*2.0*	*1.7*	*1.5*	*1.3*
Change in inventories [1]	0.3	−0.5	0.0	0.0	0.0
Net exports of goods and services [1]	−0.7	−0.2	−0.4	−0.4	−0.3
Exports of goods and services	1.2	0.7	1.1	2.0	2.0
Imports of goods and services	2.1	0.9	1.6	2.5	2.3
Gross domestic product	1.5	1.3	1.2	1.1	1.0

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

3. Labour market

After five years of uninterrupted strong job creation, domestic employment will expand by a further 67 000 units in 2019. Already high in previous years, the employment intensity of activity growth is estimated to have risen even more, to above 1, in 2019. However, employment growth itself is projected to moderate gradually and economic growth will be supported more and more by increasing labour productivity.

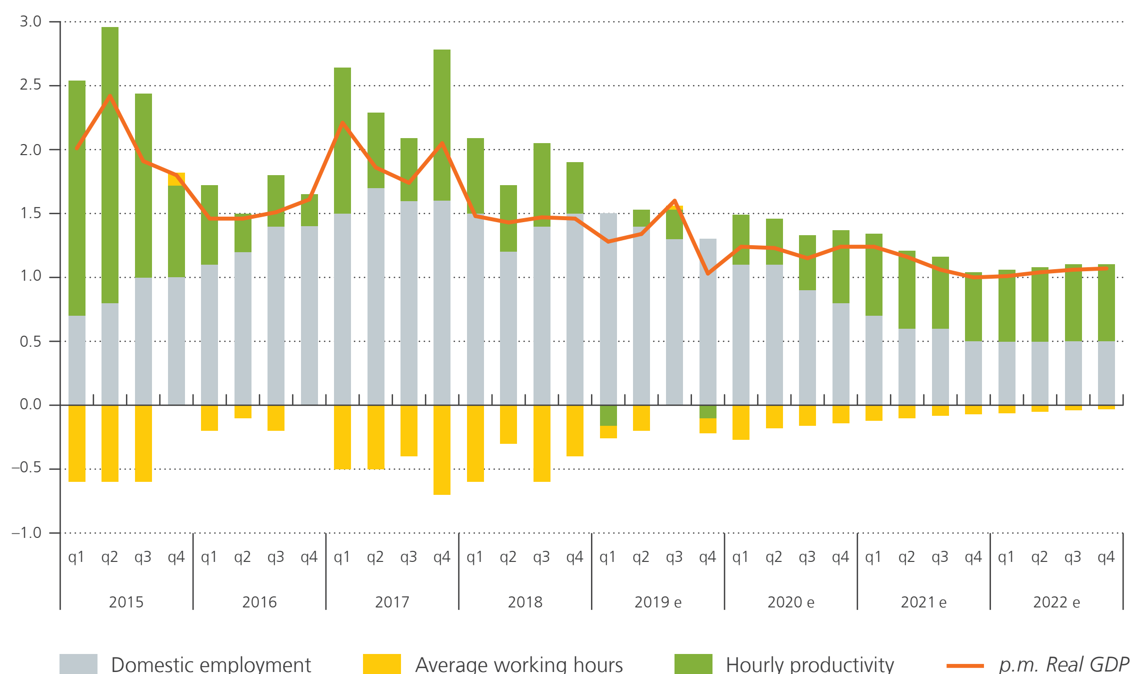
The slowdown of employment growth in the projection period not only reflects the slowing pace of activity growth, but also a return to a more standard level of employment intensity of growth against the backdrop of the recent acceleration in wage costs and the fading impact of reforms to boost the effective labour supply. In addition, after years of strong job creation combined with a steep fall in unemployment, labour shortages affecting certain occupations and particular segments of the labour market are still holding back the expansion of employment, even though labour demand pressure should decline over the projection horizon, as economic growth slows down.

In this context, average working time will decline slowly over the projection period. This is mainly related to a trend for self-employed workers. While the latter work more hours than employees, on average, there has been a sharp drop in the average working time of the self-employed since 2012. This can be largely traced back to changes in the composition of the self-employed workforce and, in particular, the fast-growing number of retired people that combine their pension with a professional activity under the status of self-employment, as well as the growing number of second jobs as self-employed for salaried workers: in both cases, this typically takes the form of a part-time arrangement. The average working time of employees is also expected to decrease, but to a lesser extent than that of self-employed workers.

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, 169 000 jobs will be created over the 2019-2022 period, almost a third less than in the previous four years. The branches sensitive to the business cycle are contributing the most to job creation, but this increase is projected to decline over the projection horizon. The number of self-employed is also projected to decelerate, although to a lesser extent than the number of employees, thanks to the success of liberal professions and more generally the development of new forms of self-employment. In addition, the acceleration in wage costs obviously only weighs on the growth of salaried workers.

The strong job creation, coupled with a slower growth of the working age population, pushed up the harmonised employment rate from 67.2 % in 2015 to 69.7 % % in 2018. This upward trend is expected to continue to more than 72 % in 2022. The Belgian EU2020 objective of 73.2 % will not be reached, however.

The number of unemployed job-seekers is expected to decline by a further 63 000 over the projection period, but this is mainly driven by the gradual departure from the active population of a large cohort of unemployed persons aged 63 and over entering retirement. The harmonised unemployment rate – which measures the number of people actually seeking work on the basis of a survey – should be much less affected by this phenomenon 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. This rate is projected to further decline this year to a historically low level of 5.5 %. Even though employment growth loses traction it should remain broadly constant thereafter and reach 5.4 % at the end of the projection period.

Table 5

Labour supply and demand

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

	2015	2016	2017	2018	2019 e	2020 e	2021 e	2022 e
Total population	59	57	54	55	54	53	51	47
Working age population [1]	16	16	12	13	13	11	9	6
Labour force	21	33	49	36	48	23	22	14
Domestic employment	40	58	76	66	67	47	30	25
Employees	30	46	64	53	51	32	18	13
Branches sensitive to the business cycle [2]	19	28	38	37	32	18	6	1
Administration and education	0	2	9	4	3	3	2	2
Other services [3]	12	16	17	11	15	11	10	10
Self-employed	10	12	12	13	17	15	13	11
Unemployed job-seekers	–19	–26	–28	–30	–20	–24	–8	–11
p.m. Harmonised unemployment rate [4, 5]	*8.6*	*7.9*	*7.1*	*6.0*	*5.5*	*5.4*	*5.4*	*5.4*
Harmonised employment rate [4, 6]	*67.2*	*67.7*	*68.5*	*69.7*	*70.8*	*71.6*	*71.9*	*72.2*

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

Labour costs started to rebound as of 2017, after years of strong moderation via various government measures. In the 2017-2018 period, the increase in negotiated wages was still quite limited and clearly below the ceiling imposed by the nationwide wage norm. For 2019, however, negotiated wage growth seems to be somewhat higher than projected in the Bank's projection exercise last June. Information published by the Federal Public Service Employment, Labour and Social Dialogue points to a rapid translation of the 2019-2020 nationwide wage norm into industry agreements. Based on this, negotiated wages are expected to increase by 0.7 % in 2019. As it is still assumed that the maximum wage margin of 1.1 % for the period 2019-2020 will be fully used, the distribution of the wage increases over those years has therefore been adjusted, with slower wage growth of just 0.4 % in 2020. As regards negotiated wages in the 2021-2022 period, a technical assumption of a minor acceleration to 1.2 % in this two-year period was used, taking into account the macroeconomic situation, developments on the labour market with continued low unemployment and the expected productivity growth. In line with the more usual distribution over the two-year period covered by a wage norm, a somewhat stronger increase is projected for 2022 than in 2021.

Nominal wages are pushed up by indexation in 2019 in particular. This reflects the spike in the health index in the second half of 2018 and at the beginning of 2019, which is passed on only later to wages due to the usual time lags in indexation mechanisms. As indicated earlier, this has boosted real incomes in 2019. Given the expected

moderate growth of the health index near the end of 2019 and in 2020, the impact of indexation is projected to be significantly lower in 2020 but should pick up again in 2021 and 2022. Wage drift should also have a positive, albeit small, impact on hourly labour costs. This reflects, amongst other elements, the fact that the workforce is getting older, which leads to higher wages, as the latter are typically linked to seniority and/or age.

Finally, further steps in the tax shift still reduce employer-paid payroll contributions in 2019 and 2020, albeit to a more limited extent than in 2018. In 2020, this is due to an increase in a specific wage subsidy in the construction sector.

All in all, hourly labour costs increase quite significantly this year, by just under 2.5 %, due to the aforementioned strong indexation effect. They are expected to decelerate next year but gain traction again in the last two years of the projection period. Productivity is flat in 2019 but then increases at a broadly constant rate until 2022.

Table 6

Price and cost indicators

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

	2018	2019 e	2020 e	2021 e	2022 e
Private sector labour costs[1]:					
Labour costs per hour worked	1.5	2.4	1.2	2.1	2.5
of which:					
Negotiated wages	0.4	0.7	0.4	0.5	0.7
Indexation	1.7	1.8	1.0	1.5	1.6
Social contributions[1]	−0.8	−0.2	−0.3	0.0	0.0
Wage drift and other factors	0.2	0.1	0.1	0.1	0.1
p.m. Labour costs per hour worked according to the national accounts[2]	*1.5*	*2.5*	*1.6*	*2.1*	*2.5*
Labour productivity[3]	0.6	0.0	0.5	0.6	0.6
Unit labour costs[1]	0.8	2.4	0.8	1.5	1.9
Total inflation (HICP)	2.3	1.3	1.3	1.5	1.7
Core inflation[4]	1.3	1.5	1.5	1.7	1.8
of which:					
Services	1.6	1.8	1.8	2.2	2.3
Non-energy industrial goods	0.8	1.0	1.0	1.1	1.2
Energy	8.9	−0.8	−0.3	−0.7	−0.2
Food	2.7	1.3	1.6	1.9	2.0
p.m. Inflation according to the national index (NCPI)	*2.1*	*1.4*	*1.3*	*1.5*	*1.6*
Health index[5]	1.8	1.5	1.3	1.6	1.7

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

1 Labour costs 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 the self-employed.

4 Measured by the HICP excluding food and energy.

5 Measured by the national consumer price index excluding tobacco, alcoholic beverages and motor fuel.

All in all, growth in unit labour cost peaks in 2019. Given the projections for hourly labour costs and productivity, it moderates as of next year but unit labour cost growth remains clearly more buoyant than the increases seen in the years preceding the projection period.

4.2 Prices

Accelerating unit labour costs exert upward pressures on prices but stylised facts suggest that, in the past, movements in unit labour costs were partly offset by changes in profit margins. The latter had expanded strongly up to 2016, as the reduction in unit labour costs was not entirely passed on to consumer prices. The current projections suggest that profit margins will not grow anymore but remain broadly constant up to 2022 at a level that exceeds the historical average. This reduces domestic inflationary pressures.

Nevertheless, the decline in core inflation observed in the final months of the summer, should be only temporary. Core inflation should be fuelled by the recent and future increases in wage costs and rise gradually throughout the projection period to just below 2 % by end-2022.

This can be mainly traced back to services inflation, which is more sensitive to domestic cost pressures. At the start of 2019, it accelerated strongly, notably due to a base effect: as of January 2018, the radio and television licence fee was abolished in the Walloon Region, which moderated the inflation rate for that year as a whole. Since the second half of 2019, services inflation has moderated somewhat, owing notably to lower price increases for restaurants, bars and hotels, package holidays and transport services. However, it picked up again in October and while it should still stay somewhat subdued until well into 2020, it should rise gradually throughout the projection period. Prices of non-energy industrial goods typically react less to domestic cost pressures than those of services and, hence, they should increase significantly less.

While the pick-up in core inflation should be reflected in total inflation, the latter is also affected by price developments of the more volatile components. This is the case in 2019 in particular, as total inflation drops significantly despite the uptick in core inflation. The reason is a big slowdown in energy inflation, that turned out negative in the second half of the year. Oil prices are on average lower than in 2018 while gas prices have also fallen, mostly due to increased supplies of (shale) gas. In addition, reduced distribution fees have curbed electricity prices. Energy inflation should not change much over the projection horizon. Due to the aforementioned assumption for Brent prices based on oil futures, in particular, oil prices should continue to fall very gradually up to 2022.

Food inflation also contributed, albeit to a lesser extent, to the divergence between core and total inflation in 2019. At the start of the year, average food inflation has declined due to a base effect: in January 2018, food inflation was boosted by an increase in the so-called sugar tax on soft drinks introduced in 2016. Moreover, excise duties on tobacco have been raised more moderately in 2019 than the year before. Food inflation should pick up a little to about 2 % by 2022.

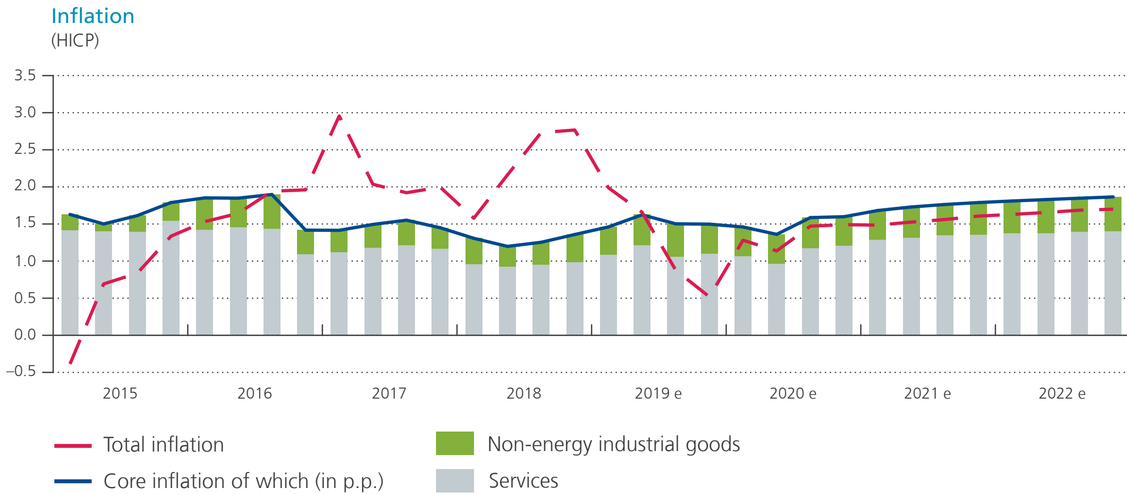
All in all, total inflation should rebound over the projection horizon, in line with the developments for core inflation. The above analysis pertains to the HICP, which permits comparison of inflation rates across the EU member countries. Inflation measured according to the Belgian national consumer 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. The growth rate of the health index should continue to moderate in 2020, after which it will pick up again. The different evolution of the HICP and the national indices is notably due to a different treatment of heating oil in the calculation of the index: the NCPI (and hence the health index) applies the so-called "payment approach", that uses the average price over the past 12 months as reflected in the annual invoices actually paid by consumers. In the HICP, heating oil is calculated using the "acquisition approach", which means taking into account the prices at the time inflation is calculated.

Chart 6

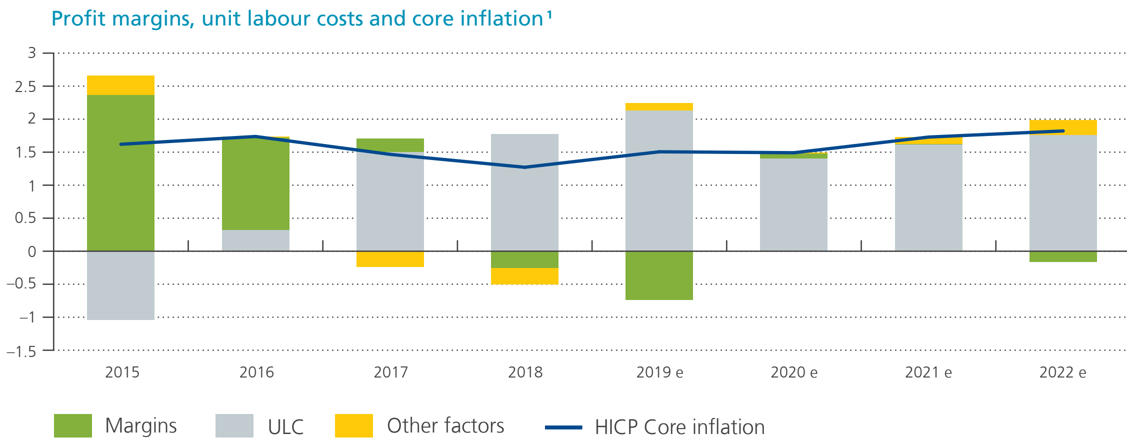
Inflation and determinants

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

Inflation
(HICP)



Profit margins, unit labour costs and core inflation[1]



Profit rate of non-financial corporations
(in %, gross operating surplus divided by gross value added)

Sources: EC, NAI, NBB.

1 The chart is inspired by an article in the Bulletin of the Banque de France no. 225 (September/October 2019) by Diev, Kalantzis and Lalliard: "Why have strong wage dynamics not pushed up inflation in the euro area?". Margins are defined as GDP deflator growth minus unit labour cost growth. "Other factors" are mainly determined by changes in the terms of trade excluding energy and food, and by price differences between private consumption and other domestic demand components such as government consumption and investment. The term "other factors" also comprises a statistical adjustment due to differences between the consumption deflator and the HICP inflation.

5. Public finances

5.1 Budget balance

According to the latest estimates, the public finances will end the year 2019 with a deficit of 1.6 % of GDP, more than doubling the previous year's deficit. In the macroeconomic context described above, the general government budget deficit is expected to increase in the coming years.

Table 7

General government accounts

(in % of GDP)

	2018	2019 e	2020 e	2021 e	2022 e
General government					
Revenue	51.4	50.4	50.1	49.9	49.9
Primary expenditure	50.0	50.1	50.5	50.8	51.1
Primary balance	1.4	0.3	−0.4	−0.9	−1.2
Interest charges	2.1	1.9	1.8	1.6	1.5
Financing requirement (–) or capacity	−0.7	−1.6	−2.1	−2.6	−2.8
Overall balance per sub-sector					
Federal government [1]	−0.2	−1.3	−1.8	−2.1	−2.3
Social security	0.0	−0.1	0.0	0.0	0.0
Communities and Regions [1]	−0.4	−0.2	−0.4	−0.5	−0.5
Local authorities	−0.1	0.0	0.1	0.0	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 tax settlement.

Revenue is estimated to have dropped sharply in 2019, and should then further decline until 2021 and remain stable thereafter. Corporation tax revenue is set to normalise after the temporary hike in 2017 and 2018. The tax burden on labour is being further reduced via the tax shift aiming to improve firms' competitiveness and to promote employment, the final phase of which is scheduled for 2020. Primary expenditure is expected to gradually rise over the projection horizon, while interest charges will continue to decline.

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 deficits 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. Consequently, they only take account of budget measures which have already been announced and specified in sufficient detail. Hence, the measures decided by the Communities' and Regions' governments are integrated, while there are no new measures for the federal government and social security as a federal government agreement had still not been reached at the cut-off date for these projections.

5.2 Revenue

Government revenue is expected to decline by 0.9 percentage point of GDP in 2019 and by an additional 0.3 and 0.2 of a percentage point in respectively 2020 and 2021. In 2022, the revenue ratio should broadly remain stable and hover around half of GDP.

Table 8

Public revenues

(in % of GDP)

	2018	2019 e	2020 e	2021 e	2022 e
Fiscal and parafiscal revenues	44.2	43.2	42.9	42.8	42.8
Levies applicable mainly to labour incomes	24.4	24.2	24.3	24.3	24.3
Personal income tax	10.9	10.6	10.8	10.7	10.8
Social contributions	13.5	13.6	13.6	13.5	13.5
Taxes on corporate profits	4.3	3.7	3.5	3.4	3.4
Levies on other incomes and on assets	4.0	3.8	3.7	3.7	3.7
Taxes on goods and services	11.5	11.4	11.4	11.4	11.4
of which:					
VAT	6.8	6.7	6.7	6.8	6.9
Excise duty	2.7	2.6	2.6	2.5	2.5
Non-fiscal and non-parafiscal revenues	7.2	7.2	7.2	7.1	7.1
Total revenues	51.4	50.4	50.1	49.9	49.9

Sources: NAI, NBB.

The drop in government revenue in 2019 is mainly due to the decline in corporation tax receipts. Indeed, revenue collected from the corporation tax settlements is set to decline, that being the corollary of the higher advance payments in 2017 and 2018 – resulting in a temporary rise in corporation tax revenues in both years – due to the increase in the basic tax surcharge rate applied to inadequate advance payments. Additionally, measures relating to the tax shift have resulted in a 0.3 percentage point of GDP reduction in revenue from personal income tax. Moreover, revenue from VAT and excise duties are both down by 0.1 percentage point of GDP, while the low interest rate environment has had a negative impact on withholding tax receipts.

The fall in the revenue ratio in 2020 is caused by an additional decline in corporation tax receipts due to the offsetting impact of the rise in advance payments in 2018, and the impact of the December 2017 reform, lowering the standard Belgian corporate tax rate to 25 % in 2020 (2021 tax year). Additionally, the levies on other income and on assets will decrease as a result of the Constitutional Court's ruling to abolish the tax on securities accounts.

In 2021, the introduction of the Flemish "job bonus" – a tax break for taxpayers on low incomes – will reduce personal income tax revenue.

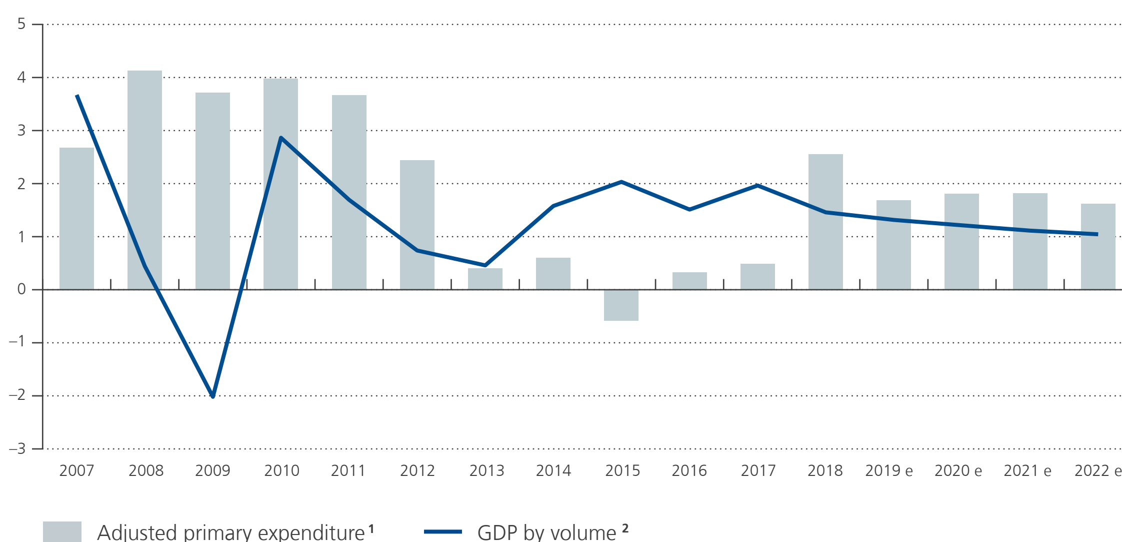
5.3 Primary expenditure

The primary expenditure ratio is expected to go up slightly to 50.1 % of GDP in 2019. Spending growth should just exceed growth of economic activity. The rapid growth of spending on pensions and health care is the main driver behind the increase in expenditure, but its impact is 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 envisaged until 2020, and that will have a moderating effect on the expected expenditure trend for 2019.

Chart 7

Primary expenditure of general government and GDP

(percentage changes compared to the previous year)



Adjusted primary expenditure [1] GDP by volume [2]

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.

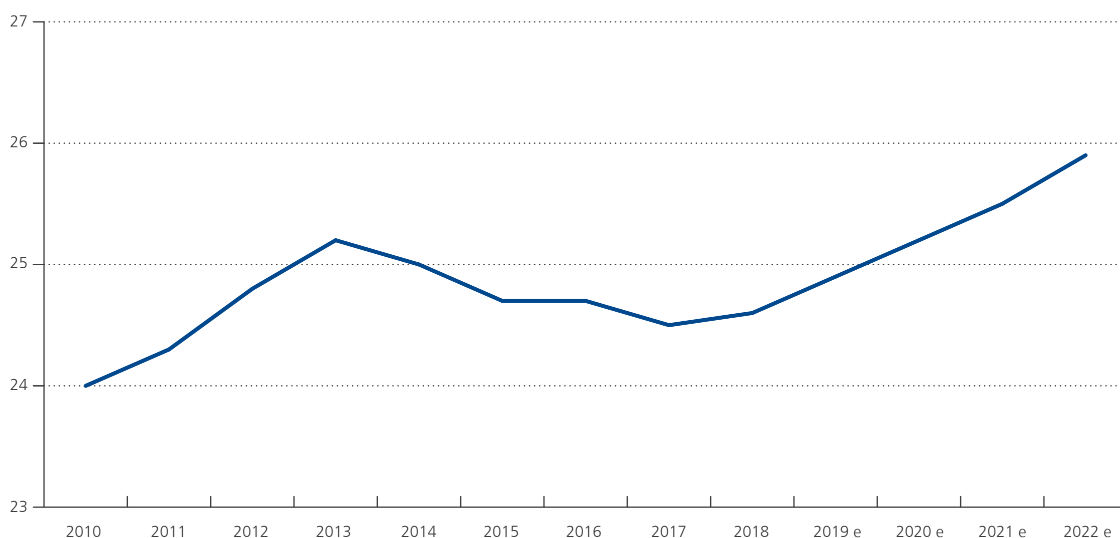
2 Calendar adjusted data.

Under unchanged policy conditions, the spontaneous expansion of primary expenditure is expected to exceed the GDP growth rate in the period from 2020 to 2022, leading to an increase in the expenditure ratio. This situation is due mainly to the drift in social benefits resulting from population ageing. Demographic pressure on pensions, other social benefits and health care expenditure (itself also fuelled by the cost of new treatments) 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 benefits by strict control of spending on health care, the 2015 index jump and the fall in unemployment.

Chart 8

Social benefits

(in % of GDP)



Sources: NAI, NBB.

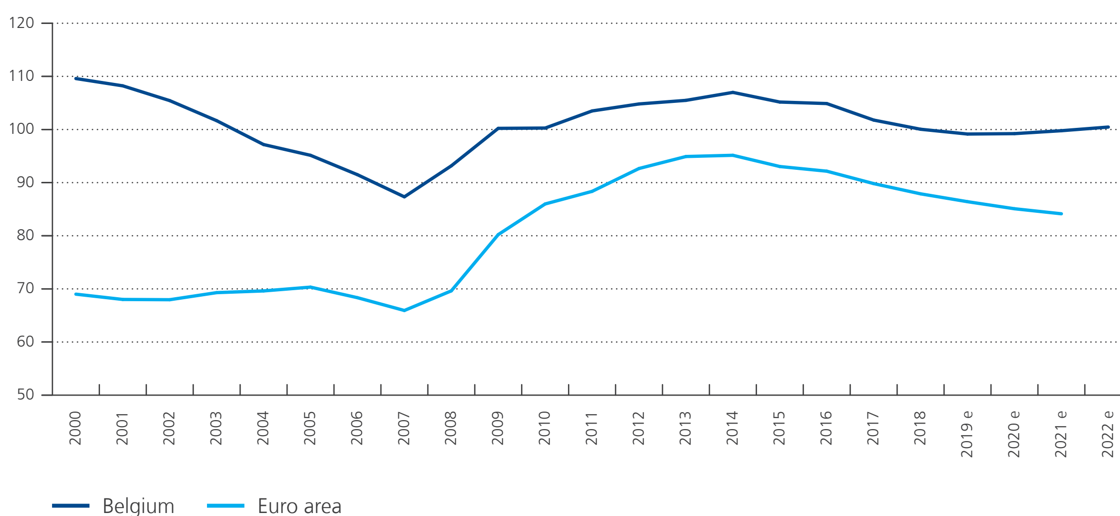
5.4 Debt

In 2018, the public debt ratio declined to 100 % of GDP. A modest reduction in the debt ratio is expected for 2019, but the trend will most likely reverse for the rest of the forecast horizon.

Chart 9

Consolidated gross debt of general government

(in % of GDP)



Sources: EC, NBB.

In 2019, debt expressed as percentage of GDP will fall to 99.1. After that, it will increase again, to 100.5 % in 2022. The initial favourable impact of the primary balance will quickly fade over the projection period, as the surplus is much smaller in 2019 and should turn into a deficit from 2020 onwards.

Based on the latest EC forecasts, the debt ratio is expected to decline in the euro area, resulting in a widening gap between Belgium and the euro area.

Conclusion and risk assessment

The Eurosystem's autumn 2019 projections point to very subdued growth in the euro area until well into 2020 and a rebound afterwards. Against this backdrop, a gradual deceleration of Belgian economic growth in the coming years, to just 1 % by 2022, is projected. Revisions with respect to the previous growth projections in June 2019 are, all in all, limited.

Domestic demand will still be the primary driver of Belgian GDP growth in the coming years. Household consumption picks up due to increases in purchasing power and accelerating healthcare costs are causing an expansion of government consumption. Nevertheless, consumption growth cannot fully compensate for the gradual normalisation of the corporate investment cycle and the continuously negative growth contribution of net exports.

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	2022	2019	2020	2021	2022
Federal Planning Bureau [1]	September 2019	1.1	1.1			1.5	1.4		
Belgian Prime News	September 2019	1.1	0.9			1.2	1.2		
IMF	October 2019	1.2	1.3	1.3		1.5	1.3	1.5	
EC	November 2019	1.1	1.0	1.0		1.3	1.4	1.4	
OECD	November 2019	1.3	1.1	1.1		1.3	1.1	1.5	
Consensus Economics	December 2019	1.2	1.0	1.2		1.4	1.3	1.6	
NBB	December 2019	1.3	1.2	1.1	1.0	1.3	1.3	1.5	1.7

1 Economic Budget (September 2019) for 2019-2020. The inflation rates are the NCPI figures.

The Bank's growth estimates are more or less in line with the most recent forecasts by the other institutions. The higher estimate of 2019 annual growth can be traced back to the positive surprise of third-quarter growth, which could not be reflected in the projections that were released in September or October. However, despite the convergence in views regarding the medium-term outlook, the uncertainty stays high.

As regards the international environment, risks continue to be tilted to the downside. At the current juncture, short-term indicators send out mixed messages. Certain confidence indicators seem to suggest that the recession in euro area manufacturing may be bottoming out. At the same time, there are tentative signs that the weakness in manufacturing is spilling over to other industries as confidence in the services

industry has softened after the summer. In addition, the slowdown in job growth may start to erode the resilience of domestic demand in the euro area. Finally, further trade restrictions would of course weigh on both the euro area and Belgian growth outlook.

At the domestic level, risks appear to be more balanced. First, in 2019, private consumption growth remains clearly lower than the increase in household disposable income (boosting the savings rate) and is projected to slightly outpace it thereafter. Given the recent strengthening of consumption growth, a risk on the upside could be that households, with their rising incomes (in 2019 in particular), consume more than currently expected for the coming years. Regarding investment, both residential and business investment may slow down less than foreseen in the current projections, given continued favourable financing conditions and taking into account past upward surprises. Finally, government expenditure growth is currently projected to contribute significantly to GDP growth over the coming years. However, given the projected large structural deficit throughout the projection period, it is clear that future governments will need to restore balance to public finances. The size and nature of those measures will determine how 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)

	2018	2019 e	2020 e	2021 e	2022 e
Growth (calendar adjusted data)					
Real GDP	1.5	1.3	1.2	1.1	1.0
Contributions to growth:					
Domestic expenditure, excluding change in inventories	1.9	2.0	1.7	1.5	1.3
Net exports of goods and services	−0.7	−0.2	−0.4	−0.4	−0.3
Change in inventories	0.3	−0.5	0.0	0.0	0.0
Prices and costs					
Harmonised index of consumer prices	2.3	1.3	1.3	1.5	1.7
Health index	1.8	1.5	1.3	1.6	1.7
GDP deflator	1.5	1.6	1.5	1.6	1.6
Terms of trade	−1.0	−0.2	0.2	0.2	0.1
Unit labour costs in the private sector [1]	0.8	2.4	0.8	1.5	1.9
Hourly labour costs in the private sector [1]	1.5	2.4	1.2	2.1	2.5
Hourly productivity in the private sector	0.6	0.0	0.5	0.6	0.6
Labour market					
Domestic employment (annual average change in thousands of persons)	65.7	67.2	47.0	30.4	24.8
Total volume of labour [2]	0.9	1.3	0.8	0.5	0.5
Harmonised unemployment rate (in % of the labour force aged 15 years and over)	6.0	5.5	5.4	5.4	5.4
Incomes					
Real disposable income of individuals	1.3	2.7	1.5	1.4	1.2
Savings ratio of individuals (in % of disposable income)	11.9	13.2	12.8	12.8	12.6
Public finances					
Primary balance (in % of GDP)	1.4	0.3	−0.4	−0.9	−1.2
Budget balance (in % of GDP)	−0.7	−1.6	−2.1	−2.6	−2.8
Public debt (in % of GDP)	100.0	99.1	99.2	99.8	100.5
Current account (according to the balance of payments, in % of GDP)	−1.0	−1.4	−2.0	−2.1	−2.3

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.