Economic projections for Belgium – Autumn 2020

- As elsewhere, the COVID-19 pandemic and the various containment measures have caused a drop in Belgian GDP that is unprecedented in the post-war period, even though current statistics suggest that the decline was somewhat less steep than initially feared
- Despite the strong rebound after the spring, the economy is currently still way below its pre-crisis level and the recovery lost traction over the summer, but the second lockdown appears to have a more limited impact on economic activity
- The decline of 6.7 % in annual terms in 2020 should be followed by a gradual recovery with above-potential growth in the 2021-2023 period
- The pre-crisis level will only be reached again by the fall of 2022
- Private consumption picks up quite quickly (due to the normalisation of the saving ratio and rising income growth), while business investment takes longer to recover
- The COVID-19 impact on the labour market remains more limited than that on activity but the unemployment rate rises to some 7 %
- Core inflation is not affected much and continues to trend slightly upwards
- Wage costs are projected to rise quite rapidly in the coming years, fuelled by the indexation mechanisms
- The budget deficit widens to more than 10 % of GDP this year but, more importantly, stays at around 6 % of GDP by the end of the projection horizon
- The risks surrounding the outlook remain elevated and largely depend on the health situation and the timeline for the implementation of an effective medical solution
- As usual, the projections only take into account government measures that have been decided and are likely to pass the legislative process and were announced in sufficient detail at the cut-off date (25 November 2020). Additional government measures could affect the growth outlook but also the public finance projections.

Introduction

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 cut-off date for the Belgian projections was 25 November 2020. The baseline projections for Belgium are discussed in detail. While the Eurosystem has also developed two risk scenarios (one better and one worse than the baseline), no such scenarios for Belgium are presented here as they may not give a fully accurate picture of the true uncertainty around the baseline projections. Instead, individual risks are discussed in the final section of this article.

1. The COVID-19 containment measures caused a massive drop of global GDP and trade

The COVID-19 pandemic and especially the exceptional containment measures taken by many countries to limit the spread of the virus profoundly affected the global economy in the first half of the year. As restrictions were gradually eased, economic activity rebounded quite swiftly from late spring onwards. While, all in all, global output in the third quarter reached a level that was somewhat higher than expected, *inter alia* due to positive data surprises in the United States and China, the recovery was in most cases still far from complete. In addition, as COVID-19 infections flared up again after the summer, in Europe in particular, containment measures have been re-introduced in several countries and are likely to weigh on the recovery or reduce activity in certain countries again.

According to the current Eurosystem assumptions, global activity (excluding the euro area) should contract by 3 % in 2020. This is somewhat less than what was foreseen in the June 2020 Eurosystem projections but still dwarfs the 2008-2009 Global Financial Crisis in terms of impact on world growth. Global activity is then projected to increase by 5.8 % in 2021 and 3.7 % on average in 2022 and 2023. However, the strength of the recovery remains very uncertain and obviously crucially depends on the further COVID-19 developments. Moreover, the confinement measures are likely to have inflicted some persistent damage on the global economy. Viable businesses have collapsed during the lockdown or are at risk of doing so in the near future, unemployment is likely to be structurally higher than before the crisis, while consumer behaviour and preferences may have changed and international trade may not fully recover anytime soon.

On the trade side, global real imports (excluding the euro area) are projected to contract by more than 9 % this year, before increasing by 7.1 % in 2021 and by 3.9 and 3.4 % in 2022 and 2023, respectively. This scenario implies that the COVID-19 crisis does have a lasting impact on trade, which will only regain its pre-crisis level in the course of 2022. In addition, the assumed trade rebound is subject to downside risks, as the COVID-19 crisis may prove to be a game-changer for globalisation, possibly leading firms to rethink their production networks in favour of reshoring part of their operations in order to limit supply risks.

As regards the future EU-UK relationship, no substantial progress had been made in the negotiations before the cut-off date of the current projections. Hence, it was decided to switch to a no-deal scenario and the trade assumptions no longer incorporate a CETA-like free trade agreement by the end of the transition period on 31 December 2020, as was the case in the previous Eurosystem projections. Instead, it is assumed that EU-UK trade relations will simply be based on the WTO Most Favoured Nation principle. This is in line with the assumption in the EC's Autumn 2020 macroeconomic projections, for example, but the impact on UK growth in 2021 is estimated to remain generally limited (at less than 2 percentage points).

Table 1

The international environment

(annual percentage changes)

	2018	2019	2020 e	2021 e	2022 e	2023 e
World (excluding euro area) real GDP	3.8	2.9	–3.0	5.8	3.9	3.6
World (excluding euro area) trade	4.7	–0.4	–9.2	7.1	3.9	3.4
Euro area foreign demand [1]	4.0	0.6	–10.7	6.6	4.1	3.2
Belgium's relevant export markets [1]	3.9	1.8	–10.7	6.8	5.3	3.5

Source: Eurosystem.
1 Calculated as a weighted average of imports of trading partners.

As usual, the profile of world trade determines the growth path of euro area foreign demand and Belgian export markets, with the latter being an important element for the macroeconomic projections for Belgium in the medium term. Compared to the NBB's June 2020 projections, Belgian export markets should drop somewhat less in 2020 due to some positive data surprises in the first half of the year. However, trade growth has been revised down significantly for 2021 – partly as a result of the aforementioned change in the Brexit assumption – and, to a lesser extent, for 2022.

2. The euro area economy should recover further in the coming years

The euro area economy registered a strong, yet incomplete rebound after the record decline in the first half of the year. The recovery lost traction towards the end of the third quarter and the resurgence of the pandemic and the new containment measures, as well as the assumed no-deal Brexit continue to cloud the short-term outlook. At the same time, the recent news regarding the development of COVID-19 vaccines lends some support to the Eurosystem baseline assumption that an effective medical solution will be available in the first half of next year and will be fully implemented by mid-2022. Under this key assumption, the euro area economy should continue its gradual recovery in the following years on the back of strong monetary and fiscal policy support, the latter partly coming from the Next Generation EU funds.

Real GDP should post strong growth in 2021 and 2022 before decelerating somewhat in the final year of the projection period. While the pandemic will result in some persistent scarring compared to a no-COVID scenario, the recovery will bring euro area GDP back to its pre-crisis level by mid-2022. It will be mostly drive by domestic demand, as private consumption will be fueled by the dissipation of uncertainty and, hence, the return of the household saving ratio from the record highs in 2020 to more normal levels.

Table 2

Eurosystem projections for the euro area

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

	2018	2019	2020 e	2021 e	2022 e	2023 e
Real GDP (contributions in percentage points)	1.9	1.3	–7.3	3.9	4.2	2.1
of which:						
Domestic demand (exclude changes in inventories)	1.7	2.3	–6.3	3.9	4.5	2.0
Net exports	0.2	–0.5	–0.6	0.3	–0.4	0.0
Inflation (HICP)	1.8	1.2	0.2	1.0	1.1	1.4
Core inflation [1]	1.0	1.0	0.7	0.8	1.0	1.2
Domestic employment	1.6	1.2	–1.8	–0.9	1.8	1.0
Unemployment rate [2]	8.2	7.5	8.0	9.3	8.2	7.5
General government financing requirement (–) or capacity [3]	–0.5	–0.6	–8.0	–6.1	–3.9	–3.0

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

Inflation has dropped below zero in recent months but should bounce back relatively quickly as base effects from the past strong decline in energy prices unwind and indirect tax cuts are reversed in certain countries. Towards the end of the projection period, accelerating food prices should also push up euro area inflation. More fundamentally, core inflation is set to recover slowly from the current trough as the recovery gains traction. However, at 1.2 % in 2023 it is projected to stay well below 2 %.

While the massive government support measures and the short-term working schemes in particular have limited the damage on the labour market for now, unemployment is set to rise more strongly in 2021. However, the negative impact on the labour market remains more muted than that on euro area GDP and net job growth should turn positive again as of 2022 already.

The average budget deficit in the euro area worsens dramatically this year, to 8 % of GDP in 2020. Even though this mostly reflects the temporary support measures, as well as the dramatic fall in GDP, the pandemic also has a lasting negative impact on public finances. The projected improvement in the coming years should still leave the deficit at 3 % of GDP in 2023, which is five times larger than the pre-crisis level.

3. In Belgium, the recovery lost traction in the summer but the second lockdown has a more limited direct economic impact

As was the case in the whole euro area, the initial COVID-19 wave and the strong lockdown measures crippled the Belgian economy in the first half of the year. By mid-2020, economic activity had dropped by nearly 15 % compared to the last quarter of 2019. As for other countries, the negative impact was somewhat smaller than in the initial projections of the Bank and other institutions. In addition, according to the latest statistics, the rebound after this first lockdown was quite strong: the National Accounts Institute has recently revised its flash estimate for quarterly growth in the third quarter up from 10.7 % to 11.4 %.

All in all, this left Belgian GDP at a level that was still about 6 % lower than its normal path[1]. In other words, the rebound was only partial. Certain industries had not fully recovered from the COVID-19 downturn, partly due to the need to comply with social distancing measures, and because a number of restrictions (e.g. for large events) remained in place. Moreover, high-frequency indicators such as the NBB's business and consumer confidence indicators, as well as the information gathered from firms by the surveys conducted by the Economic Risk Management Group (ERMG)[2], suggest that the recovery lost steam over the summer, well before the second COVID-19 wave started to materialise.

By mid-October, the number of infections and hospitalisations had again increased strongly and new nationwide containment measures were introduced: bars and restaurants were closed and non-essential shops had to follow suit in early November.

The most recent ERMG survey, conducted from 2 November onwards, shows that sales by Belgian companies worsened again during the second lockdown, although the direct impact appears to be more limited than that reported in spring. This is due to a number of reasons. First, the economy had not yet fully recovered and, hence, the lockdown losses from a forced closure are smaller. Second, apart from the closure of certain businesses, there were fewer constraints for the economy as a whole than in the spring: more shops have remained open and, especially, despite the fact that sick leave rose somewhat (mostly due to the quarantines), the construction and

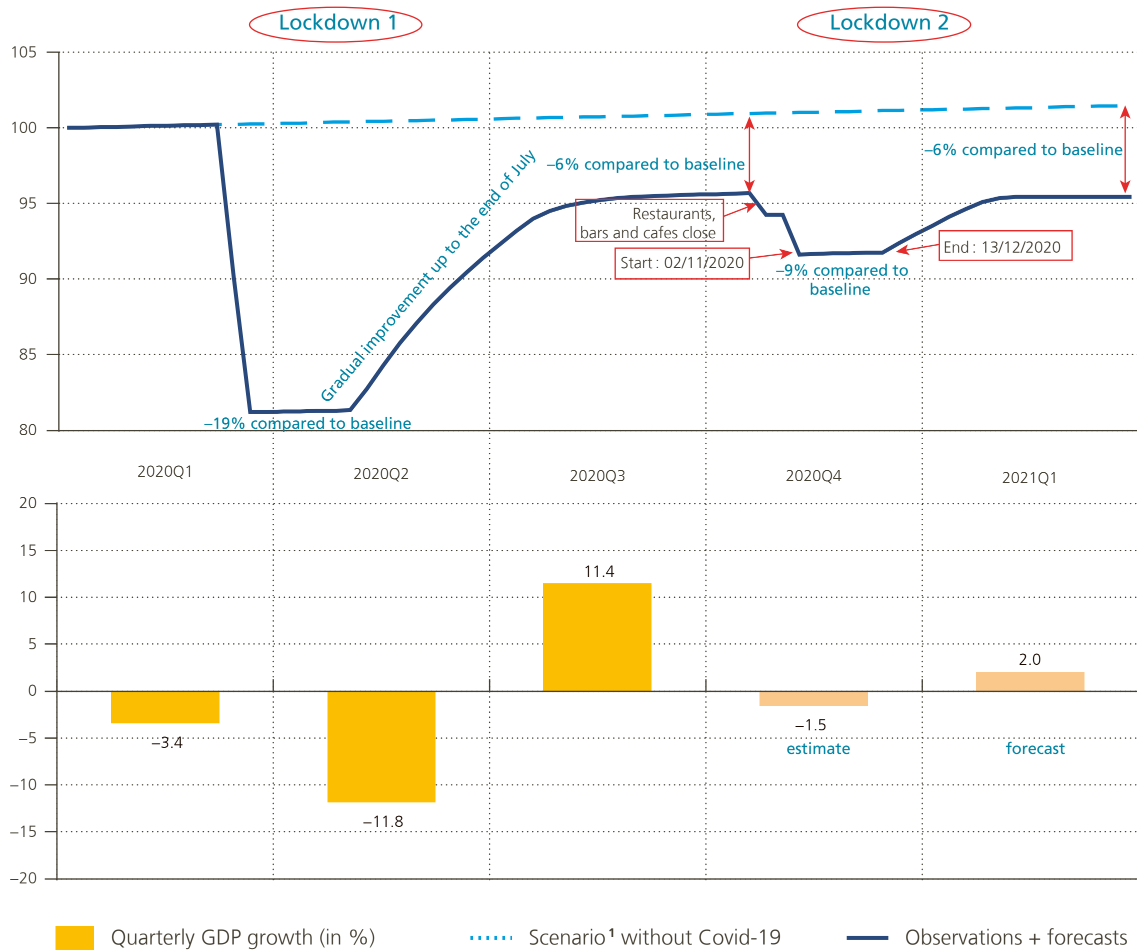
1 When comparing with the end-2019 level, the gap amounts to 5 %. However, when comparing with a no-COVID scenario, largely corresponding to the NBB's Autumn 2019 projections, the gap amounts to 6 %.

2 For more details on the results of the ERMG survey, please refer to the various press releases issued via a dedicated page on the website of the National Bank of Belgium as of 3 April.

Chart 1

The second lockdown pushes down economic output again, but the direct impact is more limited this time

(index, end of 2019 = 100, unless otherwise mentioned)



Sources: NAI, NBB.

1 This corresponds to the growth profile projected in the NBB's Autumn 2019 projections, but the figures have been updated with statistics until end-2019.

manufacturing industry have mostly remained fully operational this time, which was not the case in the spring. Finally, businesses seem to have been somewhat better prepared than in the spring to offset some of the losses of the closure of brick-and-mortar shops via e-commerce, take-away concepts and distance sales. All in all, it is estimated that the economy fell back to a level that is close to 10% below the no-COVID-19 baseline during the second lockdown. This compares with a loss of close to 20% in certain weeks in the spring.[1]

At the cut-off date for these projections, it was not clear how long this second lockdown would last. The measures were in principle valid until 13 December and in the NBB projections it was assumed that they would be discontinued then. This means that the economy would gradually recover from mid-December onwards as bars, restaurants and all shops open up again (albeit with social distancing measures and, hence, capacity

1 This estimate is calibrated on the basis of the ERMG surveys from that time but taking into account the quarterly statistics published by the NAI since then.

restrictions still firmly in place). In reality, shops reopened sooner, while bars and restaurants, but also various other businesses such as cinemas, as well as non-medical contact professions, will remain closed for longer. This element and the other risks to the projections are discussed in section 8.

Against this background, real GDP is currently estimated to drop again by 1.5 % on a quarterly basis in the last three months of the year. In annual terms, GDP posts a 6.7 % drop in 2020. This is clearly lower than the initial estimates, including the Bank's, as the impact of the better-than-expected outcome for the first half of the year is more important for the annual growth rate than the impact of the second lockdown in the final quarter. The latter will mostly weigh on the annual growth for 2021 as the starting point at the end of 2020 is lower.

In the first quarter of 2021, economic output should rebound by 2 % on a quarterly basis, thereby returning rapidly to the level reached just before the second lockdown. At this point, the remaining restrictions, such as those for arts, recreation and events or, more generally, the required social distancing, will continue to weigh on activity.

The economy should recover further once the availability of an effective medical solution leads to the gradual relaxation of these remaining restrictions. Therefore, in the current baseline scenario, the economy should decelerate in the second quarter of next year, but growth rates should pick up again from mid-2021 onwards before normalising in the outer quarters of the projection period. In annual terms, real GDP is projected to grow by 3.5 % and 3.1 % respectively in 2021 and 2022. By the end of 2022, economic output should have caught up with its pre-crisis level, after which growth rates are expected to moderate and return to their pre-crisis average as well, which leads to an annual growth of 2.3 % in 2023. The latter is still above potential, but this is due to the carry-over effect from the still higher quarterly growth rates in the course of 2022.

It is important to note that, even if output has reached its pre-crisis level again by 2022, a gap of about 3 % remains when compared with the output level that could have been reached without the COVID-19 crisis. This reflects the persistent scarring due to the historically deep crisis, which has damaged the Belgian production

Table 3

GDP and main expenditure categories

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

	2018	2019	2020 e	2021 e	2022 e	2023 e
Household and NPI final consumption expenditure	1.9	1.5	−8.6	6.6	4.1	2.2
General government final consumption expenditure	1.2	1.7	0.0	4.3	0.4	1.3
Gross fixed capital formation	3.4	3.4	−12.1	2.1	5.8	5.1
General government	11.1	1.2	−2.6	13.2	1.1	8.7
Housing	1.5	5.2	−9.9	5.2	2.6	1.5
Businesses	2.8	3.2	−14.4	−1.0	7.9	5.6
p.m. Domestic expenditure excluding the change in inventories [1]	*2.0*	*2.0*	*−7.4*	*4.9*	*3.5*	*2.6*
Change in inventories [1]	0.3	−0.4	0.2	−0.4	0.0	0.0
Net exports of goods and services [1]	−0.5	0.2	0.5	−1.0	−0.4	−0.4
Exports of goods and services	0.6	1.0	−5.3	6.3	3.8	2.8
Imports of goods and services	1.3	0.8	−5.9	7.6	4.3	3.2
Gross domestic product	1.8	1.7	−6.7	3.5	3.1	2.3

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

capacity via increased bankruptcies and a rise in (structural) unemployment. The estimate of persistent scarring (measured at end-2022) has been revised down somewhat compared to the June 2020 projections, which is mostly due to the smaller initial impact, but should also be seen against the background of massive additional policy measures.

4. Belgian private consumption picks up quite quickly, while business investment takes longer to recover

During the first lockdown phase, which was spread (unevenly) over the first and second quarters of the year, all domestic demand components were negatively affected, with business investment posting the strongest percentage decline. According to the current statistics from the NAI, the rebound in the third quarter was largely driven by household spending, both on the consumption and the investment side.

The swift recovery in household consumption, as witnessed in the third quarter, did not come as a surprise and had been largely anticipated in the NBB's June 2020 projections. During the first lockdown, consumption possibilities had been strongly curtailed and household saving spiked accordingly as, on average, the impact on household disposable income remained limited thanks to the automatic stabilisers and the massive government support measures. The savings ratio shot up to 26.6 % of disposable income, according to the quarterly sectoral accounts for the second quarter of 2020. When the economy was gradually reopened, pent-up demand fuelled private consumption. This pattern should essentially be repeated in the context of the second lockdown, with household consumption taking another hit in the final quarter of 2020 but strongly recovering afterwards.

In annual terms, purchasing power per person declines only slightly in 2020. As market incomes recover, it should grow by close to 4 % in cumulative terms over the 2021-2023 period with income growth initially held back by the unwinding of the crisis support measures. In addition, the household saving ratio is projected to normalise and fall back to somewhat more than 14 % by 2023. This is still slightly higher than the pre-crisis level as the importance of the COVID-19 recession is likely to have a small persistent impact on precautionary saving.

All in all, private consumption should grow strongly throughout 2021, in addition to the post-lockdown recovery at the start of the year, before gradually returning to more normal growth levels towards the end of the projection period. In this connection, the findings of a June 2020 survey by the Bank suggest that, even when physical shopping outlets are open, consumption is mostly held back by the fear of being infected or by the imposition caused by the health and safety requirements when shopping. Hence, the implementation of an effective medical solution should further boost private consumption next year. By early-2022 household spending should have already reached its pre-crisis level again, despite the new setback in the context of the second COVID-19 wave.

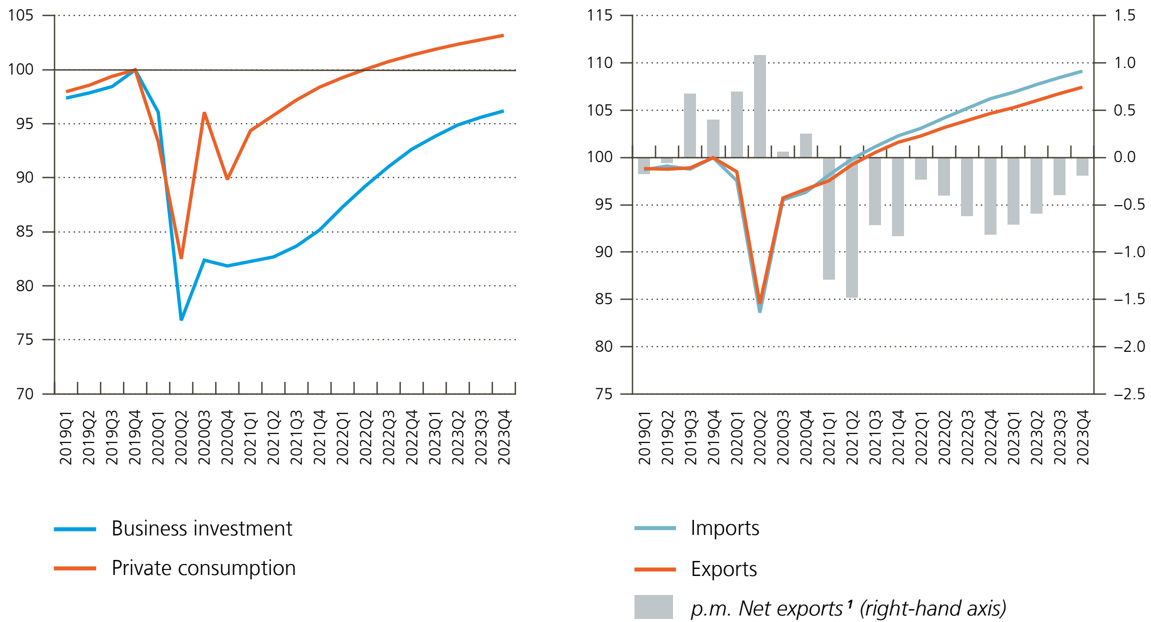
Business investment was cut by nearly a quarter in the first half of the year and only a small part of that loss was offset in the third quarter. Companies have to deal with a sudden and, in modern times, unprecedented shock that affects both the supply and the demand side. In addition, the COVID-19 shock erodes their operating surpluses and profit margins and the uncertainty about the recovery of demand remains very high (with a possible no-deal Brexit adding to that uncertainty). Hence, firms are massively pushing back or even cancelling their investment plans. As shown by the latest ERMG surveys, the downward impact on investment should last well into 2021. Accordingly, the current projections see business investment recovering only quite gradually and remaining below the pre-crisis level even at the end of the projection horizon.

The very high level of uncertainty but also certain physical constraints during the first lockdown phase (that affected the construction industry) pushed residential investment down by 20 % in the first half of the year but the summer months saw a firm rebound of nearly 16 % on a quarterly basis. As the construction industry

Chart 2

Private consumption recovers more easily than business investment and net exports weigh on growth

(index, 2019Q4 = 100, unless otherwise mentioned)



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

remains operational during the second lockdown, residential investment is expected to take only a minor hit in the last quarter of the year. Since the fundamentals remain healthy, with historically low mortgage rates in particular, housing investment should rebound strongly in 2021 and post relatively solid growth afterwards.

Export growth is projected to largely mirror the trend in export market growth, dropping markedly in the second quarter of this year, but gradually picking up thereafter. Belgian exporters are set to see some decline in their market shares throughout the entire projection period, reflecting longer-term competitiveness trends. Imports show a pattern that is similar to that of exports, although they recover somewhat more strongly. This can be traced back to the swift recovery of household consumption, which is partly imported and possibly even to a higher degree than in the past, given the growing popularity of e-commerce (from foreign firms in particular). In addition, the expected recovery of global tourism should be a drag on net exports as Belgians typically spend substantially more on tourism abroad than foreign tourists spend in Belgium. As a result, net exports reduce GDP growth slightly over the following years, by an annual average of close to 0.6 pp.

Turning to public expenditure, public consumption posts zero growth in 2020. This reflects, on the one hand, the decline in spending caused by the postponement of many regular (non-COVID-19 related) medical procedures in order to free up capacity for COVID-19-patients in the hospitals, and, on the other hand, higher government support for coronavirus-related spending in the healthcare system. The healthcare budget for 2021 has been increased, boosting public consumption growth, before rates revert to normal as of 2022. As the interruptions in the construction industry have also affected public works, government investment also shrinks in 2020, but it is projected to rebound sharply next year as a reflection of government recovery plans. Public investment growth in 2022 should remain fairly limited in the run up to 2023, the year in which the usual local election cycle boosts investment.

5. The COVID-19 impact on the labour market remains all in all quite "limited"

The Belgian labour market has expanded continuously since mid-2013 and the unemployment rate reached a historical low in 2019 at 5.4 %. While the labour market was already expected to lose some traction, the COVID-19 containment measures put a sudden stop to this favourable trend and, in the first half of the year, employment fell by close to 1 % compared to the end of 2019.

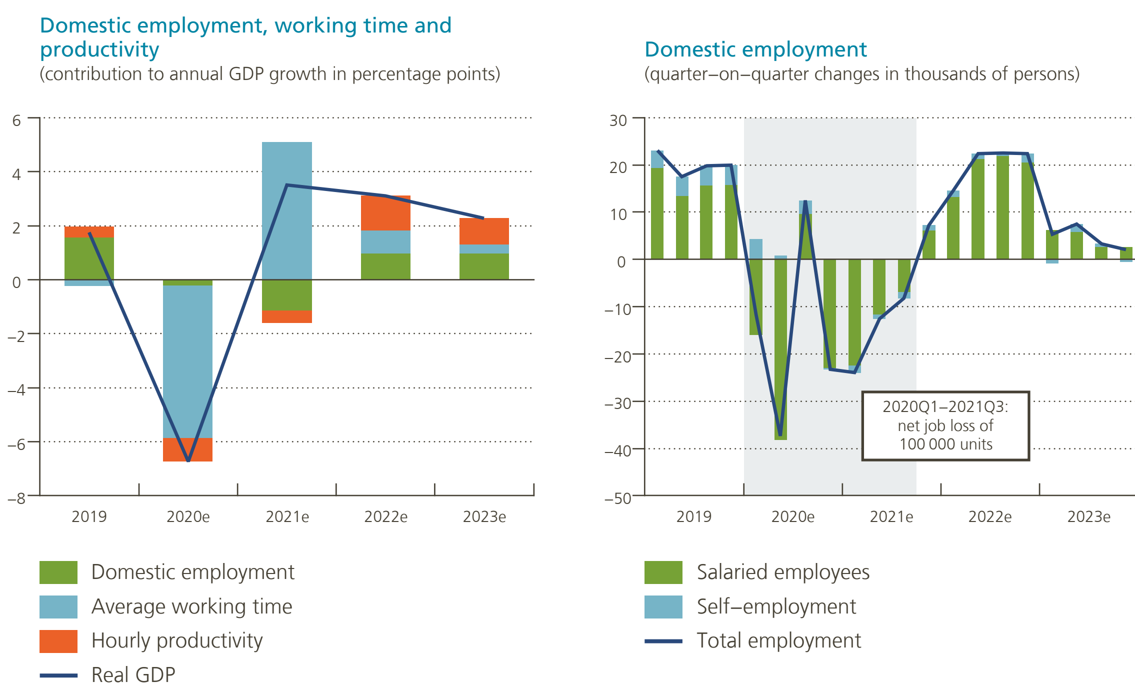
However, in response to the crisis, the government has put in place measures to limit permanent job losses in the short term so that workers can be reintegrated once activity picks up again. In this connection, the temporary unemployment scheme for employees and the bridging rights system for the self-employed were broadened and reinforced. These systems have cushioned the initial shock on employment.

At the peak of the first COVID-19 wave, in April, over 1 million employees benefited from temporary unemployment benefits, albeit on a part-time basis for most; while about half of the self-employed (about 400 000 people) applied for a bridging right. During the summer, the requests for this financial support declined, although about 10 % of private salaried employment remained affected by temporary unemployment. The second lockdown should again have led, albeit to a lesser extent than in the spring, to a more intensive use of such financial support schemes.

The drop in activity in the first half of the year was mainly reflected by a strong fall in average hours worked and, due to labour-hoarding, a decline in labour productivity. In fact, the first statistics suggest that employment

Chart 3

From the first quarter of 2020 until the third quarter of 2021, about 100 000 jobs should be lost



Sources: NAI, NBB.

was already on the rise again in the third quarter of 2020. Remarkably, the number of self‑employed has even continued to grow throughout the first three quarters of 2020. However, employment should decline again in the final quarter of 2020 and job losses are likely to continue well into next year as the temporary support systems come to an end. Only by the final quarter of 2021 will jobs start to be created in net terms again.

The annual averages of employment growth are also determined by carry‑over effects (in particular from the strong employment growth in the course of 2019), but from the first quarter of 2020 until the third quarter of 2021, about 100 000 jobs should be lost. This is somewhat lower than firms' estimates in the most recent ERMG survey (November 2020) that point to some 140 000 job losses in the private sector by end‑2021 but those responses may be slightly too pessimistic (given the recent boost to confidence from the announced availability of a vaccine in early‑2021) and may not yet reflect the surprising uptick in employment in the third quarter of 2020. Given the size of the shock on GDP, a decline of 100 000 jobs should be considered as quite moderate and points to the resilience of the Belgian labour market in bad times.

The increase of the number of unemployed job‑seekers will also be slower and more limited than initially expected. However, in 2020 in particular, this also reflects a rising number of discouraged workers (mostly without unemployment benefits) dropping out of or not entering the labour force during the first lockdown as a result of few job opportunities, restrictions on physical movements and associated health risks. In 2021, the increase in the number of job‑seekers should better reflect the expected job destructions and the harmonised unemployment rate should rise to 7 %. While employment will outpace the labour force as of 2022, the minor decline in the number of unemployed job‑seekers should still leave the unemployment rate close to 7 % up to the end of the projection period. Despite the much larger shock on GDP, the projected increase in the unemployment rate is comparable to that seen in the 2008‑2010 period, due to the Global Financial Crisis.

Table 4

Labour supply and demand

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

	2018	2019	2020 e	2021 e	2022 e	2023 e
Total population	55	58	56	49	47	45
Working age population [1]	13	17	14	8	6	4
Labour force	40	58	19	30	20	27
Domestic employment	70	76	–10	–56	46	47
Employees	56	61	–23	–55	44	44
Self‑employed	13	14	13	–1	3	2
Unemployed job‑seekers	–30	–19	29	86	–26	–20
p.m. Harmonised unemployment rate [2, 3]	*6.0*	*5.4*	*5.6*	*7.4*	*7.1*	*6.7*
Harmonised employment rate [2, 4]	*69.7*	*70.5*	*69.8*	*68.9*	*69.5*	*70.1*

Sources : FPB, NAI, NEO, Statbel, NBB.
1 Population aged 15‑64 years.
2 On the basis of data from the labour force survey.
3 Job‑seekers in % of the labour force aged 15‑64 years.
4 Persons in work in % of the total population of working age (20‑64 years).

6. Relatively strong labour cost growth is mainly due to price indexation

Labour cost developments in both 2020 and 2021 are strongly affected by specific temporary factors related to the COVID-19 crisis. Unit labour cost growth is particularly high in 2020. This reflects the normal decline in labour productivity in crisis periods due to labour hoarding but also the specific impact of the temporary unemployment scheme. While the latter is financed through government transfers and, hence, does not directly affect labour costs, there are important composition effects due to the over-representation of low-wage earners in this scheme. Low-wage earners tend to be affected more by temporary unemployment (as shown in the monitoring reports of the working group on the social impact of COVID-19[1]), mostly because they work relatively more often in the most heavily affected industries such as accommodation, events and non-food retail. This implies that the average wage of those workers that are not on temporary unemployment and are paid by the firms increases. This pushes up average wage costs in 2020 (technically via higher wage drift) but partly unwinds in 2021, as low-wage earners switch from temporary unemployment to regular employment. In addition, the crisis-related job losses lead to larger severance payments that also represent costs for firms and are recorded as social contributions. The same applies when employers top up temporary unemployment benefits in line with industry- or company-specific agreements. Finally, in certain industries (including federal health care) employees have received compensation or bonuses during the crisis.

The crisis-related increase in labour costs is, however, partially offset by the impact of several temporary government measures which take the form of wage subsidies. These include the partial exemption of the transfer of withholding tax on earned income for employers in severely hit sectors to stimulate the return of the workforce from temporary unemployment, various government subsidies (related to the payment of end-of-year bonuses in the hospitality sector and the specific bonuses for health care workers or targeted to service voucher companies), as well as the compensation of social contributions paid for employers forced to close during the second lockdown.

Turning to the underlying trends, hourly wage costs should post solid growth throughout the projection period. Yearly increases will exceed 2 % in the three following years. About 70 % of that increase can be traced back to the indexation mechanisms. As Belgian inflation rates are set to remain higher than in the euro area, this will also lead to relatively buoyant nominal wage developments.

Conventional wage growth should rise more moderately. As there is currently no information on the nationwide private-sector wage norms for the projection period, the technical assumption was made that the increase in negotiated wages, excluding the salary increases for health care workers, should be limited in 2021. The increase is expected to moderately accelerate over the remainder of the projection period. This should be broadly in line with the developments observed in the most recent period, despite the strong pick-up in employment, economic activity and productivity. On average, negotiated wages are projected to rise by 0.6 % per annum. The latter growth rate includes the significant pay rise for health care workers in federal and Walloon care facilities (that pushes up nationwide wage growth by a cumulative 0.5 % in the 2021-2022 period). However, this does not affect total wage costs, as it is fully offset by wage subsidies. It should also be stressed that a similar measure to increase wages in the Flemish care facilities could not be incorporated into these projections, as it was announced just at the cut-off date and the details were not yet sufficiently known.

As hourly labour productivity will recover gradually and rebound strongly in the outer years of the projection period, unit labour costs should increase more moderately than hourly labour costs. They are set to increase by 1.6 % per year in the 2021-2023 period.

1 Please refer to https://socialsecurity.belgium.be/nl/sociaal-beleid-mee-vorm-geven/sociale-impact-covid-19, available in Dutch or French.

Table 5

Price and cost indicators

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

	2018	2019	2020 e	2021 e	2022 e	2023 e
Private sector labour costs[1]:						
Labour costs per hour worked	1.5	2.3	3.3	2.2	1.9	2.3
of which:						
Conventional wages	0.4	0.7	0.5	0.5	0.8	0.6
Wage drift and other factors	0.2	−0.1	2.4	−0.4	0.1	0.1
Indexation	1.7	1.8	1.0	1.2	1.7	1.7
Social contributions	−0.8	0.0	0.3	0.5	−0.6	0.0
Wage subsidies	0.0	−0.1	−1.0	0.5	0.0	0.0
p.m. Labour costs per hour worked according to the national accounts[2]	*1.5*	*2.3*	*4.3*	*1.8*	*1.9*	*2.4*
Labour productivity[3]	0.3	0.6	−1.2	−0.5	1.4	0.9
Unit labour costs[1]	1.2	1.7	4.5	2.8	0.5	1.4
Total inflation (HICP)	2.3	1.2	0.4	1.7	1.9	1.9
Core inflation[4]	1.3	1.5	1.3	1.4	1.6	1.7
of which:						
Services	1.6	1.8	1.7	1.7	1.9	2.1
Non-energy industrial goods	0.8	1.0	0.7	0.9	1.1	1.1
Energy	8.9	−0.8	−11.2	0.9	1.6	1.1
Food	2.7	1.3	2.8	3.2	3.0	2.9
p.m. Inflation according to the national index (NCPI)	*2.1*	*1.4*	*0.8*	*1.4*	*1.7*	*1.8*
Health index[5]	1.8	1.5	1.0	1.4	1.7	1.7

Sources: Eurostat, 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.

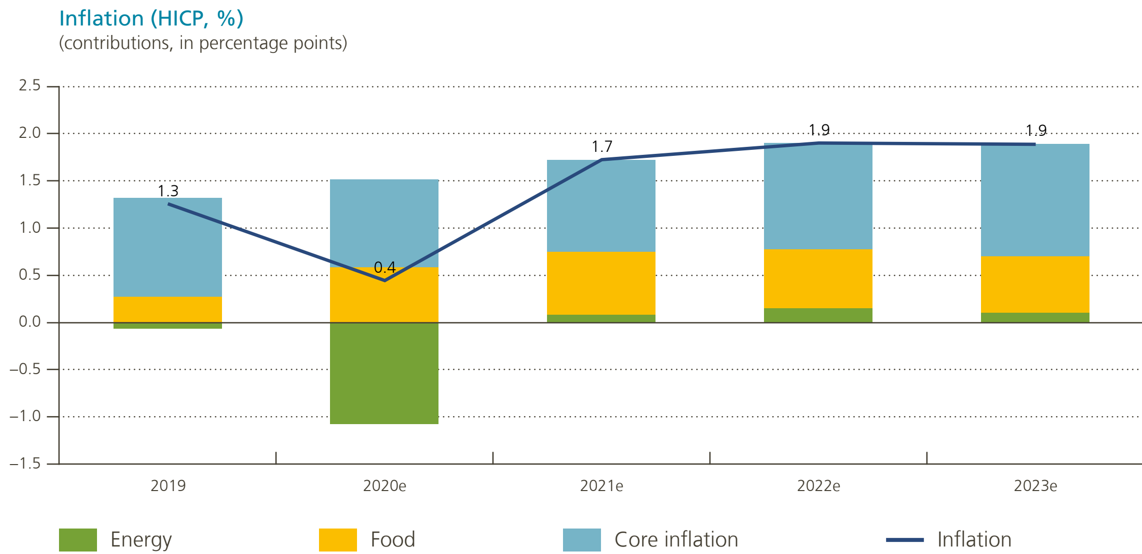
5 Measured by the national consumer price index excluding tobacco, alcoholic beverages and motor fuel.

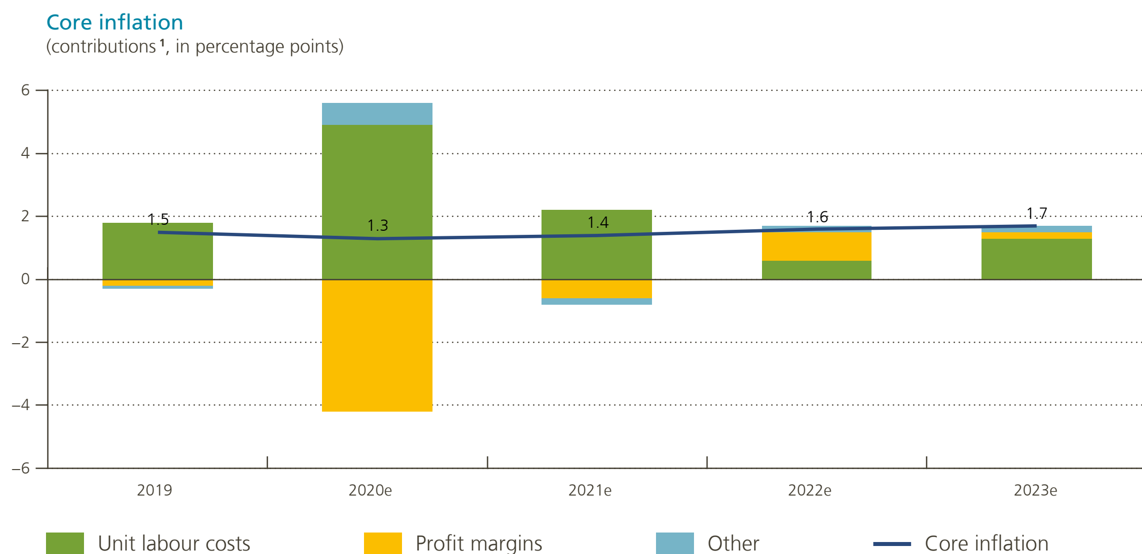
The strong crisis-related increase in wage costs is partly offset by a decline in corporate margins. As wage costs moderate somewhat, profit margins will recover only partially. By 2023, they should be close to the long-run average which is below the pre-crisis level.

All in all, core inflation is projected to edge up gradually from 1.3 % to 1.7 % over the projection horizon. Services inflation should initially stabilise at 1.7 % and rise only slowly to just above 2 % by 2023. The pass-through of rising labour costs is moderated by the weak profit margin growth, as the COVID-19 crisis continues to depress demand in the first part of the projection period and certain services prices are assumed to remain

Chart 4

Lower energy prices bring down inflation in 2020 but core inflation rises gradually



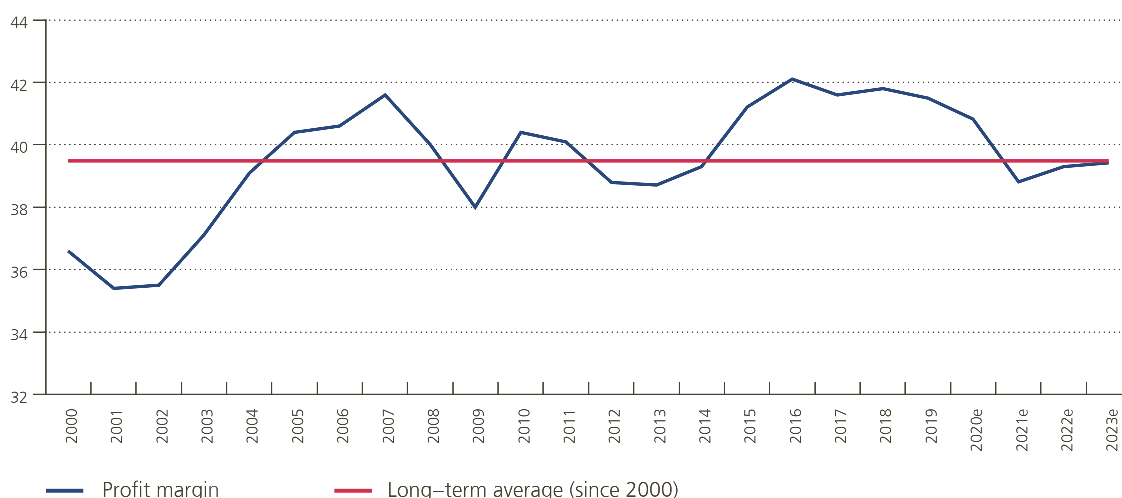


Sources: Eurostat, NAI, NBB.

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. This term also comprises a statistical adjustment due to differences between the consumption deflator and the HICP inflation.

Chart 4 (next)

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



Sources: Eurostat, NAI, NBB.

constant when facilities are closed during a lockdown (in line with Eurostat recommendations). Inflation is somewhat more volatile for non-energy industrial goods: it drops to 0.7 % in 2020 but should then pick up gradually as the domestic and international economy, as well as international trade recover. Core inflation is clearly more resilient in Belgium than in the euro area as a whole, where it was close to zero in the final quarter of 2020. Through the indexation systems, this also pushes up wage growth in Belgium.

Due to the expected rise in excise duties on tobacco from January 2021, food inflation is expected to accelerate following an already strong hike in 2020, when both COVID-19 factors – temporary promotion ban in supermarkets and supply difficulties – as well as other factors – such as weather conditions and African swine fever – temporarily pushed it up. The strong hike in food prices and the bigger share of food in spending during the spring lockdown implies that total inflation would have been around 0.4 percentage point higher than the official measure in April and May if one adjusts consumption basket weights to better reflect actual spending patterns.[1]

Despite the resilience of core inflation and the uptick in food inflation, total inflation becomes very low in 2020, mainly as a result of the past decline in energy prices (primarily oil-derived products, but gas and electricity also contributed negatively). Total inflation is expected to shoot up again in 2021 and developments in headline inflation will be more in line with those in core inflation, as energy price growth should return to positive territory. In this respect, while the price of a barrel of Brent crude oil should be as low as $ 42 on average in 2020, it should slightly rise over the projection horizon (by around 4 % on average per year), according to the Eurosystem assumptions.

1 For a further analysis, see Jonckheere, J. and H. Zimmer (2020), "Consumer prices in light of the COVID-19 crisis", NBB, *Economic Review*, December.

The national consumer price index (NCPI) is used to calculate the health index (see above), which excludes tobacco, alcoholic beverages and motor fuels, and serves as a reference for price indexation of wages and replacement incomes. As electricity, heating oil and gas are taken into account in the health index, its growth rate only comes down to 1 % in 2020 and picks up to 1.7 % in 2022 and 2023. The threshold index for public wages and social benefits is next set to be exceeded in July 2021.

7. The general government deficit shoots up and is expected to come down only gradually in the next few years

In 2020, the general government deficit is estimated to shoot up, reaching 10.6 % of GDP, the highest deficit recorded since the mid-1980s. On the revenue side, fiscal and parafiscal revenues decline in line with economic activity. Primary expenditure is rising relative to GDP, and is boosted by automatic and discretionary government support measures that help absorb the COVID-19 economic shock.

While market incomes of both companies and households are very seriously affected by the economic crisis, the government sector partly offsets those losses. This cushions the blow for households and companies that see their after-tax disposable income decline to a lesser extent than their market incomes. In addition, indirect taxes such as VAT and excise duties also shrink due to the declining tax bases such as private consumption. Income losses by households are further offset by temporary replacement incomes that help preserve employment and keep the self-employed afloat. So, the government budget has clearly absorbed most of the income losses generated by the coronavirus crisis. Furthermore, the government has taken discretionary measures to shore up businesses, support the most vulnerable, and manage the health crisis. These stimulus measures and temporary replacement incomes weigh on the budget balance to the tune of roughly € 22 billion.

Since the health crisis is expected to persist for at least part of next year, and economic recovery will only be gradual, most stimulus measures will continue to burden public finances in 2021, albeit at a lower cost, and the negative impact via automatic stabilisers will only gradually unwind. At the same time, regional and federal governments are planning recovery and resilience measures to boost the economy and its potential, primarily through government investment and transfers to firms. The projections are based on the assumption that parts of these plans will be financed via grants from the Resilience and Recovery Facility, an EU instrument that should

Table 6

General government accounts

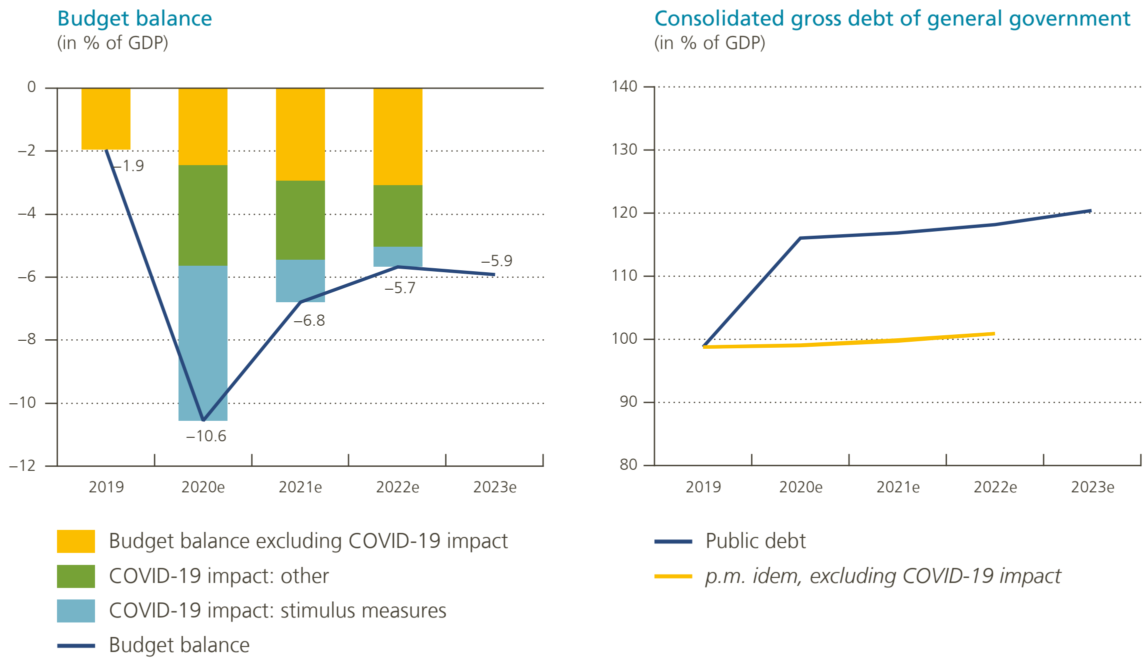
(in % of GDP)

	2019	2020 e	2021 e	2022 e	2023 e
General government					
Revenue	50.1	50.5	51.4	50.9	50.7
of which : fiscal and parafiscal revenue	43.0	43.1	43.8	43.3	43.2
Primary expenditure	50.1	59.1	56.4	55.0	55.1
Primary balance	0.0	−8.6	−5.0	−4.1	−4.4
Interest charges	2.0	2.0	1.8	1.6	1.5
Financing requirement (–) or capacity	−1.9	−10.6	−6.8	−5.7	−5.9

Sources : NAI, NBB.

Chart 5

Public finances are seriously hit by the COVID-19 pandemic



Sources: NAI, NBB.

help Member States as they emerge from the crisis. As a result of the persistence of the health crisis and its impact on economic activity, the 2021 deficit forecast remains high, at 6.8 % of GDP.

In 2022 and 2023, the budgetary situation is expected to improve, as the economy slowly recovers and temporary support measures unwind. The budget deficit is expected to persist at just below 6 % of GDP, though. This mostly reflects the fact that the coronavirus crisis has a lasting impact on GDP within the projection period. Structural increases in pensions and health-care-related expenditure further impede budgetary consolidation. Interest payments, for their part, contribute to the improvement of public finances over the projection horizon on the back of expected interest rates close to zero, despite higher borrowing requirements.

The government debt ratio is estimated to shoot up dramatically this year, by almost one-fifth. This reflects not only the large government deficit but also the deep recession, as the debt ratio is expressed as a share of GDP. In the remaining years of the projection period, the debt ratio is expected to remain on an upward path. High primary deficits, of more than 4 % even by the end of the projection horizon, more than offset the favourable impact from growth and historically low interest rates. Therefore, bringing public finances back onto a sustainable path in the medium term requires structural measures to push up economic growth and consolidate public finances.

8. The baseline projections come with important downside and upside risks

Clearly, the uncertainty surrounding the baseline economic projections that are described in this article is still much larger than usual. As suggested by the Economic Policy Uncertainty indicator, the uncertainty level has declined somewhat compared to the peak observed in the spring, but it is still comparable to the level that prevailed at the height of the Global Financial Crisis in 2008-2009. In addition, the balance of risks is difficult to assess, as it is intricately linked to the further development of the pandemic.

First, there is uncertainty regarding the short term. On the basis of the information available at the cut-off date of the projections, it was assumed that the current lockdown measures would have ended on 13 December. In reality, non-essential shops were allowed to open on 2 December already (albeit under certain restrictions), while bars and restaurants will remain closed for longer. On balance, this may lead to upward risks for private consumption in December. By consequence, the NBB's Business Cycle Monitor for 2020Q4, which has a later cut-off date and was already able to incorporate the new information, shows a slightly less severe fall in GDP. At the same time, a new flare-up of COVID-19 infections early next year could lead to a much longer closure of bars and restaurant or, especially, additional containment measures, that would depress growth in 2021.

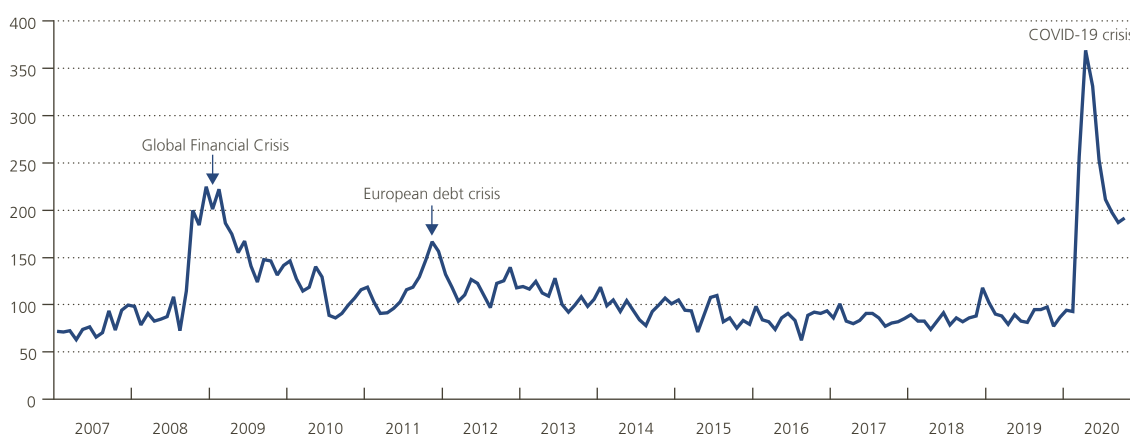
In the medium term, a quicker availability and implementation of an effective medical solution than what is assumed in these projections could lead to a faster dissipation of the remaining uncertainty and boost both private consumption and investment. This could be the case if the current optimism regarding the start of the vaccination campaigns is confirmed. Alternatively, unexpected setbacks in the implementation of such a medical solution are likely to increase uncertainty again and the negative impact on the real economy could then also be amplified by adverse financial developments.

The behaviour of economic agents in the current conditions constitutes a second vector of uncertainty. In this connection, the projected evolution of the household saving ratio would appear to be key and comes with

Chart 6

Economic Policy Uncertainty in Belgium

(newspaper-based uncertainty indicator; higher values represent greater economic policy uncertainty)



Source: Algaba, A., Borms, S., Boudt, K. & Van Pelt, J. (2020). The Economic Policy Uncertainty index for Flanders, Wallonia and Belgium. Research note. doi: 10.2139/ssrn.3580000.

downside and upside risks. Given the unprecedented nature of the economic shock, precautionary saving could remain higher for longer. At the same time, a reassuring medical scenario such as in the baseline projections could also push households to spend (part of) the accumulated wealth due to extra saving in 2020. This would imply that the saving ratio could temporarily drop below its pre-crisis level in the projection period, which in turn would boost private consumption and growth. Similarly, the recovery of corporate investment depends on the development of business confidence, which is very difficult to predict.

Finally, the baseline projections take account of the policy environment that was known at the cut-off date. Measures that were or will be announced after that date are not incorporated. The package that was announced in late November by the Flemish government to increase salaries and improve working conditions in Flemish care facilities could not be included in the projections, for example. A specific element of uncertainty pertains to the Brexit scenario : if a trade deal is still agreed on in December, exports in 2021 are likely to be somewhat higher than in the current baseline scenario. More generally, in the near term, both fiscal and monetary support could be more accommodative if the current COVID-19 wave dents the growth outlook. In the longer term, the unsustainable budget position will have to be addressed, which may require consolidation measures in the second part of the projection period. Depending on the specific measures that will be taken, the growth and budget outlook may be quite different.

Annex

Projections for the Belgian economy: summary of the main results

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

	2018	2019	2020 e	2021 e	2022 e	2023 e
Growth (calendar adjusted data)						
Real GDP	1.8	1.7	−6.7	3.5	3.1	2.3
Contributions to growth:						
Domestic expenditure, excluding change in inventories	2.0	2.0	−7.4	4.9	3.5	2.6
Net exports of goods and services	−0.5	0.2	0.5	−1.0	−0.4	−0.4
Change in inventories	0.3	−0.4	0.2	−0.4	0.0	0.0
Prices and costs						
Harmonised index of consumer prices	2.3	1.2	0.4	1.7	1.9	1.9
Health index	1.8	1.5	1.0	1.4	1.7	1.7
GDP deflator	1.6	1.7	0.6	1.6	1.5	1.5
Terms of trade	−0.9	0.8	0.4	0.1	−0.1	−0.1
Unit labour costs in the private sector [1]	1.2	1.7	4.5	2.8	0.5	1.4
Hourly labour costs in the private sector [1]	1.5	2.3	3.3	2.2	1.9	2.3
Hourly productivity in the private sector	0.3	0.6	−1.2	−0.5	1.4	0.9
Labour market						
Domestic employment (annual average change in thousands of persons)	69.7	75.6	−10.0	−56.2	46.4	46.7
Total volume of labour [2]	1.6	1.3	−5.8	3.9	1.8	1.3
Harmonised unemployment rate (in % of the labour force aged 15 years and over)	6.0	5.4	5.6	7.4	7.1	6.7
Incomes						
Real disposable income of individuals	1.1	3.1	0.1	1.4	1.4	2.2
Savings ratio of individuals (in % of disposable income)	11.6	13.0	20.7	16.6	14.4	14.4
Public finances						
Primary balance (in % of GDP)	1.3	0.0	−8.6	−5.0	−4.1	−4.4
Budget balance (in % of GDP)	−0.8	−1.9	−10.6	−6.8	−5.7	−5.9
Public debt (in % of GDP)	99.8	98.1	116.1	116.9	118.2	120.4
Current account (according to the balance of payments, in % of GDP)	−0.8	0.3	0.5	−0.4	−0.8	−1.2

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.