

Economic projections for Belgium – June 2021

- The swift roll-out of the vaccination campaigns implies that an effective medical solution for COVID-19 is now within reach, i.e. much earlier than what had to be assumed in the previous projections.
- Against this backdrop the remaining containment measures are gradually being loosened and further steps towards a full reopening of the economy have been announced.
- Belgian GDP growth surprised on the upside and outpaced that in the euro area in the last two quarters. It should gain further traction and shift to a higher gear in the summer. The pre-crisis level will already be reached again by the end of this year.
- Business investment has already made up for a large part of its loss in 2020, but will continue to support growth as its underlying fundamentals remain favourable.
- As more activities become possible again, private consumption will be the main growth engine, even without using the accumulated savings from 2020 for “revenge spending”.
- The impact of the pandemic on the labour market remains limited, but some further labour-shedding is expected when income support systems disappear.
- Headline inflation shoots up this year, mainly due to higher energy prices. Core inflation is drifting upwards as well due to price pressures as economies reopen, supply constraints and businesses looking to restore profit margins but it should peak by mid-2022.
- Wage costs are projected to rise quite rapidly in the coming years, mostly fuelled by the indexation mechanisms.
- The budget deficit is expected to come down only gradually in the next few years and, with normal economic growth, government debt remains on an upward path, also after the end of the projection period.
- The risks surrounding the outlook remain high and dependent on the health situation and the timeline and effectiveness of implementation of the vaccination campaigns.
- As usual, the projections only take into account government measures that have been decided and are likely to pass the legislative process and had been announced in sufficient detail by the cut-off date (26 May 2021). Additional government measures could affect the growth outlook as well as 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 26 May 2021. The baseline projections for Belgium are discussed in detail. While the Eurosystem has also developed two risk scenarios for the euro area (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 remaining uncertainty around the baseline projections. Instead, individual risks are discussed in the final section of this article.

1. The world economy is bouncing back strongly from the COVID-19 crisis

The COVID-19 pandemic and especially the exceptional containment measures taken by many countries to limit the spread of the virus have profoundly affected the world economy in the first half of last year. On average, global activity (excluding the euro area) shrank by 2.4% in 2020. At the same time, the second half of the year saw a strong rebound and, by the end of 2020, the global economy was already back to its pre-pandemic level, even though this can mostly be traced back to the exceptionally strong recovery in China. Elsewhere, and in the advanced countries in particular, the economy needs more time to fully get back on its feet. However, the economic damage of the second and third COVID waves since the autumn of last year has generally been much more limited than in the spring. The recovery was delayed, but not derailed. This is partly due to learning effects: while the first COVID wave took the world by surprise and full lockdowns were the initial policy answers, economic agents have gradually learned to live with the disease in the later stages of the pandemic. In that connection, the restrictions have often led to a more rapid development of digitalisation.

This spring, the number of infections and hospitalisations flared up again and the pandemic is still wreaking havoc in certain emerging market economies, such as India. At the same time, vaccination campaigns have progressed well in the advanced countries and most containment measures are gradually lifted, even before vaccination numbers reach the estimated level of herd immunity. This implies that an effective medical solution to the pandemic is now within reach, faster than anybody imagined and faster than what had to be assumed in the previous Eurosystem projections. This is the main reason, in addition to the aforementioned learning effects in the later stages of the pandemic, why the economic outlook has been revised upwards significantly. According to the current Eurosystem assumptions, global activity is projected to rebound sharply by 6.2% in 2021 and to increase by 4% on average in 2022 and 2023.

Global trade remained relatively resilient last year. Global real imports (excluding the euro area) dropped by 8.5% in 2020, i.e. by less than in 2009, even though overall economic activity declined more strongly last year than during the financial crisis. This may be due to the fact that containment measures were especially oriented towards the less trade-intensive services industry. According to the Eurosystem assumptions, global trade (excluding the euro area) is projected to increase by nearly 11% in 2021 and trade will regain its pre-crisis level by mid-2021 already. However, new risks come to the fore. As demand is recovering faster than supply, the global trade and output outlook could be temporarily threatened by supply-side constraints and shortages of intermediate inputs, as illustrated by the lengthening delivery times and upward pressure on commodity prices.

Table 1

The international environment

(annual percentage changes)

	2019	2020	2021 e	2022 e	2023 e
World (excluding euro area) real GDP	2.9	-2.4	6.2	4.2	3.7
World (excluding euro area) trade	-0.1	-8.5	10.8	4.9	3.7
Euro area foreign demand ¹	0.8	-10.0	8.6	5.2	3.4
Belgium's relevant export markets ¹	2.1	-9.8	8.5	6.4	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 December 2020 projections, Belgian export market figures have been revised upwards, reflecting an improved outlook in some of our trading partners.

Turning to the technical and financial assumptions underlying these new Eurosystem projections, the exchange rate is considered to remain constant throughout the projection period. In the case of the US dollar, this implies an exchange rate of \$ 1.21 to the euro, i.e. a clear appreciation of the euro compared to the average level in 2019 and 2020.

As usual, oil price and interest rate assumptions are based on market expectations of mid-May 2021. The price per barrel of Brent crude oil had reached \$ 68 in the second quarter of 2021 and is expected to remain at that level until the end of the year, before dropping gradually as of next year, reaching just over \$ 60 by the end of the projection period. The three-month interbank deposit rate is expected to rise only very mildly, from an average of -0.5 % in 2021 to -0.3 % in 2023. The Belgian sovereign long-term interest rate has recently turned slightly positive again and is expected to continue to rise gradually to 0.6 % in 2023. This should lead to an increase in the average mortgage interest rate over the projection horizon, although it should remain favourable and should not exceed 2 %. The average interest rate on business loans should also edge up only a little in the next few years.

As regards the mechanical impact on economic activity, the stronger outlook for export markets is likely to more than offset the higher oil price and interest rates. Hence, the new set of Eurosystem assumptions in principle accounts for an upward revision of the projections.

Table 2

The Eurosystem technical assumptions

(annual averages; in %, unless otherwise stated)

	2019	2020	2021 e	2022 e	2023 e
EUR/USD exchange rate	1.12	1.14	1.21	1.21	1.21
Oil price (US dollars per barrel)	64	42	66	65	62
Interest rate on three-month interbank deposits in euro	-0.4	-0.4	-0.5	-0.5	-0.3
Yield on ten-year Belgian government bonds	0.2	-0.1	0.1	0.4	0.6
Business loan interest rate	1.5	1.6	1.6	1.6	1.7
Household mortgage interest rate	1.8	1.6	1.5	1.7	1.8

Source: Eurosystem.

2. Activity in the euro area should rebound strongly

The euro area economy has posted a strong recovery in the summer of 2020 but the resurgence of the pandemic and the various containment measures since the fall have led to minor contractions in the last two quarters. However, the strong improvement in the short-term indicators point to a rebound in the second quarter of 2021. More generally, the successful roll-out of the vaccination campaigns allows for a gradual loosening of the containment measures. Based on the current information and policy announcements, the full reopening of the economy should come much faster than assumed in the previous Eurosystem projections. The baseline scenario now assumes a full phasing-out of containment measures by early-2022. At the same time, the current supply bottlenecks should not be a persistent impediment to growth. Against that background and in line with

the ongoing recovery in foreign demand, the economic outlook for the euro area has been revised upwards significantly in the current projections.

In the baseline scenario euro area activity should accelerate strongly as of the second half of the year, driven by a sharp rebound in private consumption. This allows real GDP to exceed its pre-crisis level from the first quarter of 2022, one quarter earlier than previously projected. This does not only reflect a smaller economic impact of the pandemic given the progress in the vaccination campaign, but also substantial additional fiscal policy measures – including, in part, Next Generation EU funds – and an upgrade to the outlook for foreign demand, in part due to the inclusion of recently approved and announced fiscal policy packages in the US into the baseline. All in all, the euro area economy should expand strongly by about 11.5 % in the 2021-2023 period and stand 4.7 % above its pre-crisis level with a positive output gap. Domestic demand, and in particular private consumption, is expected to drive most of the rebound.

Inflation was very low in 2020 but has edged upwards in recent months, with the upswing mostly driven by energy prices. It is expected to peak at 1.9 % in 2021, close to target. However, this inflation spike is largely driven by strong base effects as well as specific factors, such as the reversal of the German VAT rate and rising input prices and transportation costs due to supply bottlenecks, which are considered temporary. The uptick in inflation should not be persistent: as these temporary factors will gradually fade, headline inflation is expected to drop back to about 1.5 %, in the latter two years of the projection horizon. Core inflation edges up gradually to 1.4 % in 2023.

Risks to growth are seen as balanced over the projection horizon. Less favourable medical developments (e.g. related to virus mutations or vaccine acceptance), as well as disruptions from a wave of bankruptcies could further delay a full recovery. At the same time, a stronger surge in private consumption following a steeper decline in the saving ratio due to more important revenge consumption effects may boost domestic demand more. Risks to inflation, for the current year in particular seem to be tilted to the upside and mostly pertain to the surge in input costs and its impact on consumer prices.

Table 3

Eurosysteem projections for the euro area

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

	2019	2020	2021 e	2022 e	2023 e
Real GDP	1.3	-6.8	4.6	4.7	2.1
of which (contributions in percentage points):					
Domestic demand (excluding changes in inventories)	2.3	-5.8	3.8	4.6	1.9
Net exports	-0.5	-0.6	0.7	0.0	0.2
Inflation (HICP)	1.2	0.3	1.9	1.5	1.4
Core inflation ¹	1.0	0.7	1.1	1.3	1.4
Domestic employment	1.2	-1.6	0.3	1.2	1.0
Unemployment rate ²	7.5	7.8	8.2	7.9	7.4
General government financing requirement (-) or capacity ³	-0.6	-7.3	-7.1	-3.4	-2.6
Public debt ³	83.9	98.0	99.4	96.3	95.2

Source: ECB.

1 Measured by the HICP excluding food and energy.

2 In % of the labour force.

3 In % of GDP.

Massive government support measures and the short-time working schemes in particular have cushioned the blow of the crisis on the labour market. Employment is projected to recover gradually over the projection horizon and reach its pre-crisis level around the beginning of 2023, lagging about one year with respect to real GDP. The projected increase in the unemployment rate remains limited as the withdrawal of job retention schemes is expected to be compensated by the post-pandemic recovery. In annual terms, unemployment should be below its pre-crisis level by 2023.

The euro area budget deficit still remains high in 2021 but drops in the outer years of the projection period, as the government support measures are gradually phased out. The government debt ratio peaks at just below 100 % this year but the decline in the deficit puts it back on a declining path thereafter, also when economic growth normalises.

3. The Belgian economy continues to gain traction and should shift to a higher gear in the summer

Since the number of COVID-19 infections and hospitalisations flared up again in the autumn of last year, nationwide containment measures were reintroduced that affected, at least temporarily, bars and restaurants, non-essential shops, non-medical contact professions, schools and many leisure activities. It had already been anticipated in the NBB December projections that these new restrictions would have a more limited direct impact on economic activity. First, the construction and manufacturing industries have mostly remained fully operational. Second, businesses in the trade and services industry seem to have been somewhat better prepared than in the spring to offset some of the restrictions on brick-and-mortar shops via e-commerce, take-away concepts and sales by appointment. In the end, growth has exceeded our short-term projections according to the current quarterly statistics: economic activity remained roughly flat in the last quarter of 2020 and it was up by 1 % in the first quarter of this year (this figure having been revised upwards significantly from the first NAI flash estimate). According to these quarterly statistics, economic activity was clearly more resilient in Belgium than elsewhere in the euro area after the summer of 2020. All in all, this has left Belgian GDP at a level that is only some 4 % below the pre-pandemic level by the beginning of spring 2021.

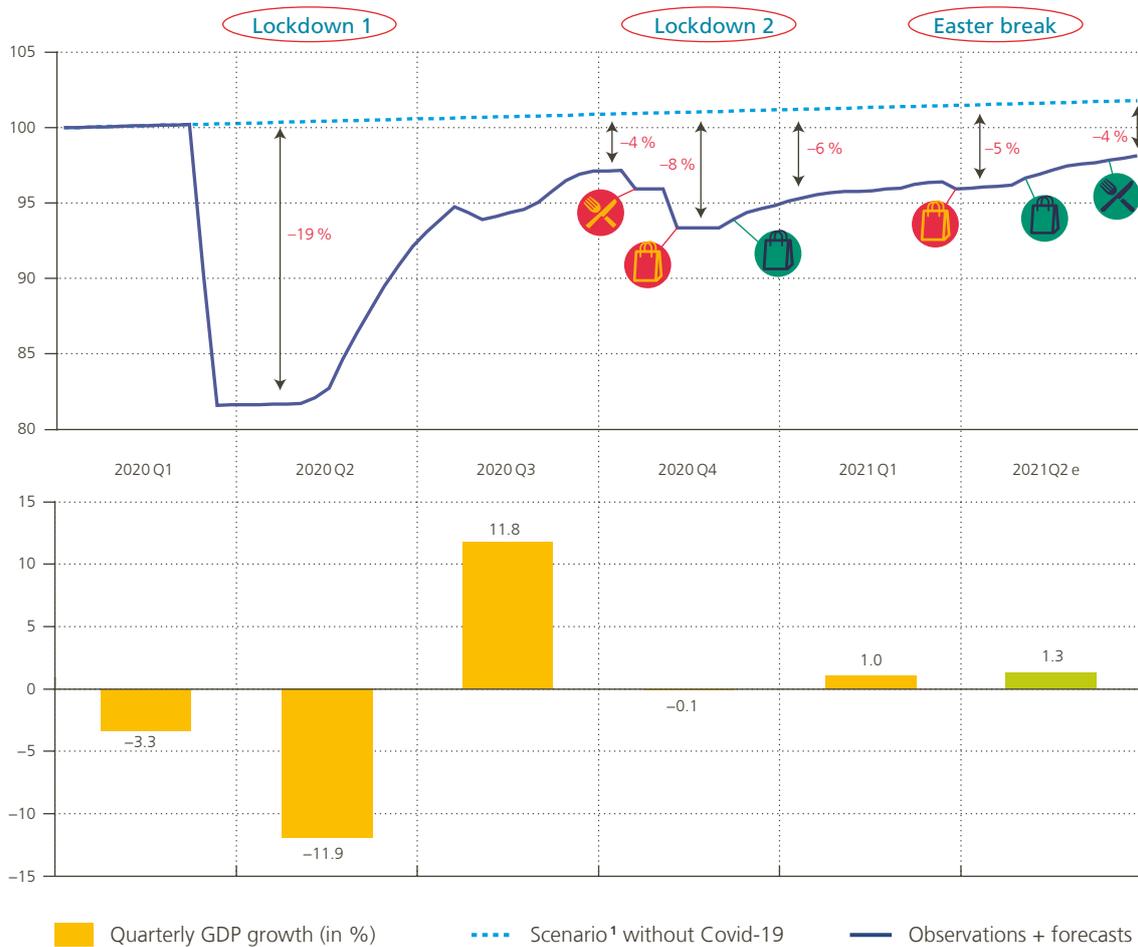
At the start of the second quarter of 2021, certain measures were tightened up again for schools, non-medical contact professions and retail. While this undoubtedly weighed on the affected businesses, the macroeconomic impact of this new containment episode should again be negligible, as shown in the surveys conducted by the Economic Risk Management Group (ERMG).¹ After the Easter holiday, further steps were taken and announced with a view to fully reopening the economy. As of May 8, bars and restaurants were allowed to open their outdoor facilities, for instance, for the first time since their mandatory closure in October last year, and they have been allowed to reopen completely in early June. While bars and restaurants only make up a rather small share in total Belgian value added, we expect their full reopening to act as a catalyst for the retail sector as well, as shoppers may now be more eager to return to the city centres. This may be amplified as the measures regarding telework are gradually lifted as well. Against this backdrop, we currently expect activity growth to edge up further, to 1.3 %, in the second quarter of 2021.

In addition, as in other euro area countries, the vaccination campaign is now in full swing. With nearly 40 % of the total Belgian population having received at least one dose of the COVID-19 vaccine (and 15 % being fully vaccinated) at the cut-off date for these projections, it seems more likely that an effective medical solution to the pandemic can be found as early as this summer. This is sooner than what had to be assumed in the baseline scenarios of the previous Eurosystem and NBB macroeconomic projections. The latter were still anchored to the

¹ For more details on the results of the ERMG surveys, please refer to the various press releases issued via the [dedicated page on the NBB website](#) as of 3 April 2020.

Chart 1

The recent containment measures have had a limited impact on macroeconomic activity



Sources: NAI, NBB.

1 This corresponds to the growth profile projected in the NBB's Autumn 2019 projections.

technical hypothesis that such a medical solution would be gradually implemented by mid-2022. The earlier vaccination is clearly a game-changer. The experience of countries that are further ahead in the vaccination schedule (Israel, UK) shows that containment measures can be lifted before the estimated level of herd immunity is reached. Hence, it currently seems plausible that the most important remaining restrictions in the Belgian economy may already be lifted by the end of the summer holiday period, as the government envisages. One possible exception could pertain to social distancing measures and other safety measures that may remain in place for somewhat longer and could restrict the capacity of certain services industries.

The prospect of a gradual return to normal, coupled with strong demand in both the manufacturing and construction industries has already pushed up consumer and producer confidence far above their pre-pandemic levels in May. In fact, many industries are faced with longer delivery times, as supply cannot keep up with rapidly rising demand. The impact of those supply bottlenecks on actual output should remain limited for now as most firms can dip into their inventories or find alternative supply routes, albeit at significantly higher costs.

Hence, the stage is set for the Belgian economy to gain further traction well into the summer: the third quarter should see quarterly growth peaking at just below 2% before it gradually normalises to a rhythm

that is more in line with potential growth by mid-2022. All in all, GDP is expected to grow by 5.5 % in annual terms this year, bringing output back to its pre-crisis level by the end of the year already. As growth moderates in the following years (in annual terms, 3.3 % in 2022 and 1.6 % in 2023), some persistent damage from the COVID-19 crisis will remain, albeit less than in our previous projections. By the end of next year, economic activity should still be 1.2 % below its pre-crisis path with no more catching-up in the following year.

4. Domestic demand and private consumption in particular will drive growth

All (non-public) demand components took a big hit during the spring lockdown in 2020. However, the paths of the various demand components diverged after that as they were affected differently by the subsequent containment measures.

In this respect, the resilience of business investment has been remarkable. While it fell by close to 25 % in the first half of 2020, it rebounded sharply, beyond the expectations of most observers, in the following three quarters. By the end of March 2021, business investment was already just 1 % below its pre-pandemic level, according to the current NAI statistics. This suggests that the sharp fall in the spring of 2020 was only due to the mechanical effects of the lockdown, which also weighed on the construction industry and deliveries, but that firms have generally kept investing throughout the crisis, despite the large uncertainty and notwithstanding earlier indications from surveys. While the latter pointed to a weaker and slower recovery of investment, the ERMG survey did suggest that large companies have shifted investment towards IT and digitalisation. The strong investment performance is consistent with the solid recovery in business confidence since the summer of 2020, to a ten-year high in April 2021.

Table 4

GDP and main expenditure categories

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

	2019	2020	2021 e	2022 e	2023 e
Household and NPI final consumption expenditure	1.5	-8.7	3.8	7.2	2.5
General government final consumption expenditure	1.6	0.6	3.7	-0.1	0.9
Gross fixed capital formation	3.5	-6.9	10.9	2.1	2.4
General government	2.4	-1.4	13.2	0.5	8.5
Housing	5.2	-6.9	10.5	2.1	1.4
Businesses	3.2	-7.8	10.6	2.4	1.7
<i>p.m. Domestic expenditure excluding the change in inventories¹</i>	1.9	-6.0	5.4	4.0	2.1
Change in inventories ¹	-0.4	0.0	-0.9	0.0	0.0
Net exports of goods and services ¹	0.2	-0.3	1.0	-0.7	-0.5
Exports of goods and services	1.0	-4.6	6.8	4.8	2.5
Imports of goods and services	0.8	-4.3	5.6	5.7	3.1
Gross domestic product	1.8	-6.3	5.5	3.3	1.6

Sources: NAI, NBB.

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

The current projections see a continued recovery in business investment with the pre-crisis level already being reached by mid-2021. Throughout the projection period, the underlying determinants for business investment remain quite favourable with profit margins expected to recover and interest rates for firms assumed to edge up only slightly in the next few years. Moreover, the production capacity utilisation indicator in manufacturing is on the rise again and could signal the upcoming need for investment in additional production capacity. Hence, business investment should continue to expand, albeit at more moderate rates.

However, the further recovery should now be primarily driven by private consumption. Recent growth in private consumption has been bumpier than that of business investment. This is because consumer spending has been more directly affected by the sequencing of the containment measures. As restrictive measures were reintroduced in the fall of 2020, private consumption plummeted again in the final quarter of last year (after an initial strong recovery). The gradual relaxation of those measures since December 2020 led to a new – more limited – uptick of consumption in the first quarter of 2021 and the rebound should now gain traction as the whole economy gradually reopens. Consumption growth is likely to peak in the summer months also due to pent-up demand for certain services, including travel, but it should remain buoyant until the end of next year. We do not expect the quarterly growth rates to normalise until the last year of the projection period.

Despite the major economic crisis, Belgian households still saw their disposable income expand by 1.4% on average in 2020 (or 1.3% per capita). This is due to the automatic stabilisers and the massive government support measures, even though certain groups in the population have recorded big income losses. Purchasing power will continue to expand in the projection period, as the economy recovers, albeit at a slower rate in 2021 and 2022 due to the gradual withdrawal of the government support measures. Overall, disposable income should grow by more than 4% in the 2021-2023 period, which amounts to a total gain in purchasing power of slightly more than 3% per capita.

In 2020, Belgian households accumulated some € 25 billion in additional savings compared to the year before as the various containment measures got in the way of their usual spending patterns. Consequently, the savings ratio reached an unprecedented annual average of 21.7%, mostly because of forced saving. The gradual normalisation of the savings ratio will fuel consumption growth as life returns to normal. By the end of the projection period, the savings ratio should have fallen to just above 14%. This is still somewhat higher than the pre-crisis level, as households may anticipate future tax hikes, given the need for fiscal consolidation after the deterioration of public finances. The projected profile for the savings ratio (remaining above the 2019 level) also implies that the extra wealth that households have accumulated last year will not be tapped into much for “revenge spending”. In this connection, we assume that higher-than-normal spending should remain limited to certain leisure categories (bars, restaurants, travel) and will, all in all, not take the form of a generalised spending spree that would temporarily push the savings ratio below the pre-crisis level. It should be kept in mind that the additional savings in 2020 were mostly accumulated by relatively well-off households with a lower marginal propensity to consume. In addition, financial statistics suggest that these excess savings have been invested more than usual in less liquid assets.

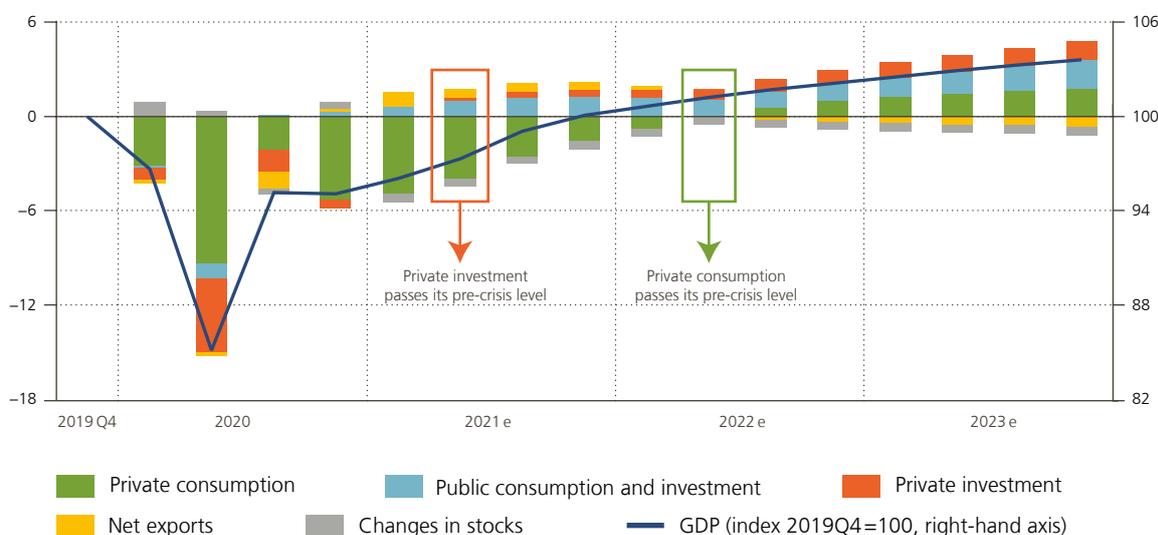
Finally, housing remains the key motive to save. In this connection, the very strong recovery in housing investment is quite remarkable. The decline in the spring of last year was most likely only due to work interruptions in the construction industry. From the second half of 2020 onwards, residential investment has rebounded spectacularly: according to the current quarterly statistics, housing investment had already significantly exceeded its pre-crisis level by the end of the first quarter of 2021. Full details behind those quarterly statistics are not yet known but anecdotal evidence suggests that the savings surplus was partly used by households to renovate their homes (which is recorded as investment spending rather than as consumption). Considering that the underlying fundamentals remain healthy, with historically low mortgage rates in particular, housing investment should continue to post solid growth throughout the projection period.

Export growth has come in strongly recently, reflecting favourable external demand, and it is projected to be largely driven by the assumptions on export market growth, even though Belgian exporters should face some

Chart 2

Net exports reduce GDP growth in the second part of the projection period

(contributions to GDP growth compared to 2019Q4; in percentage points, unless otherwise mentioned)



Sources: NAI, NBB.

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

market share loss throughout the entire projection period, in line with longer-term competitiveness trends. Imports typically exhibit a pattern that is roughly similar to that of exports, although they have recovered somewhat more slowly over the last few quarters and current statistics show a fall at the beginning of the year that may be related to Brexit. As domestic demand rebounds strongly over the projection horizon, so will import growth. In addition, the expected recovery of global tourism should be a drag on net exports as Belgians typically spend a lot more on tourism abroad than foreign tourists spend in Belgium. As a result, net exports will dampen GDP growth over the coming years.

Turning to public expenditure, public consumption is projected to grow strongly this year, due to increased outlays for healthcare in particular. It will shrink in 2022 as coronavirus-related temporary spending disappears. Government investment is set to rebound sharply in 2021. This takes into account government recovery plans but growth will remain fairly limited next year in the run-up to 2023, the year in which the usual local election cycle boosts investment.

5. The labour market remains remarkably resilient

The total volume of hours worked decreased by 6% in annual terms 2020 due to the sharp drop in the spring. This is just a bit less than the fall in real GDP. However, all in all, there was virtually no decline in employment, as job shedding in the first half of the year was offset by net hiring in the second. This is due to some labour hoarding at the level of the firm but primarily stems from the massive use of the temporary unemployment scheme for salaried workers and bridging rights for self-employed. The latter element explains the sharp fall in average hours worked. The recovery will technically be first supported by a rebound in the average working time. Productivity will also recover as rising demand will put more pressure on firms to use their available resources efficiently.

Chart 3

Domestic employment, working time and productivity

(contribution to GDP growth, percentage points, seasonally and calendar adjusted data)



Sources: NAI, NBB.

In the first quarter of 2021, some 470 000 people, accounting for over 12 % of salaried workers, were still affected by the temporary unemployment scheme (against a whopping 31 % in April 2020). As the economy rebounds strongly and the COVID-19 restrictions are lifted, the number of temporarily unemployed should gradually decline. In addition, the general application of the more flexible COVID-19 temporary unemployment scheme is currently scheduled to end on 30 September 2021.

The share of temporarily unemployed workers ultimately losing their job, while quite substantial in specific hard-hit industries, is now expected to be rather limited for the economy as a whole. Most of the workers affected by temporary unemployment will relatively easily return to regular employment, either in their existing jobs or in new jobs. Indeed, the number of vacancies has remained high and many industries already face increasing problems to hire new staff, given the strong recovery in demand. While a rising number of bankruptcies could lead to more job losses, this is likely to be offset by hiring by new firms or in other industries.

Variations in net job creations for salaried employment are mostly reflected in branches sensitive to the business cycle, even though employment in certain industries classified under other services has also been hit by the pandemic. Conversely, public administration and education have been more shielded during the crisis. Remarkably and unlike what has been observed in other euro area countries, the number of self-employed continued to grow in 2020. The structure of self-employment in Belgium, with a larger share of highly-educated people in professional and managerial occupations, and its long-term upward trend (against a declining trend in the euro area) can explain that positive outcome for 2020. The number of self-employed is expected to continue to rise over the projection period, albeit at a lower rate in 2022 and 2023, also taking into account the possible incidence of bankruptcies, in the hospitality and retail industries in particular.

All in all, the increase in unemployment should even be smaller than initially estimated. The harmonised unemployment rate is expected to peak at 6 % in 2022. This reflects the limited and gradual outflow to unemployment when the flexible temporary unemployment scheme comes to an end in September 2021. However, employment will accelerate again after that and the unemployment rate should already drop again in 2023. Hence, the labour market impact of the pandemic will remain quite limited, in comparison to the negative shock on economic activity.

Table 5

Labour supply and demand

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

	2019	2020	2021 e	2022 e	2023 e
Working age population ¹	17	6	-2	10	15
Labour force	58	17	26	11	27
Domestic employment	76	-1	32	8	32
Employees	61	-15	16	3	25
Branches sensitive to the business cycle ²	39	-28	6	-7	14
Administration and education	8	6	5	2	3
Other services ³	14	7	6	7	8
Self-employed	14	14	16	6	7
Unemployed job-seekers	-19	18	-6	3	-5
<i>p.m. Harmonised unemployment rate^{4,5}</i>	5.4	5.6	5.8	6.0	5.9
<i>Harmonised employment rate^{4,6}</i>	70.5	70.0	70.0	70.0	70.3

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

- 1 Population aged 15-64 years. Working-age population estimations have been revised down by the Federal Planning Bureau, reflecting the impact of the pandemic with a higher mortality rate and lower net migration inflow.
- 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).

6. The upcoming surge in inflation will remain temporary and limited

Labour costs have peaked in 2020. In addition to the negative impact of the aforementioned labour hoarding on productivity growth, this is primarily due to a technical element that can be traced back to the massive use of temporary unemployment. The latter has affected relatively more workers in lower-paid jobs, which means that the average wage per hour has temporarily increased significantly. This temporary composition effect should unwind in 2021 and 2022, which automatically reduces growth in average hourly wages in those years.

Turning to the more structural drivers of wage cost growth, the projections take into account a conventional wage increase of about 0.5% per annum. For the 2021-2022 period, this reflects the maximum available wage margin of 0.4% calculated by the Central Economic Council in addition to the agreed specific wage adjustments for the health and elderly care sector. These adjustments are financed via wage subsidies from the federal and regional governments, but the institutions concerned are mostly classified within the private sector. The associated wage increases amount to an additional 0.6% (on top of the aforementioned 0.4%) in the 2021-2022 period. For 2023, the projections are anchored to the technical assumption of a conventional wage increase of 0.4%.

Apart from the unwinding of the aforementioned composition effect, the wage drift is generally positive. This reflects alternative ways of rewarding employees (e.g. one-off telework compensation) and specific

bonus schemes. In this connection and in accordance with a conciliation proposal of the federal government, considering that some industries have not suffered from the crisis as much as others, a one-shot premium could be negotiated in firms that did well during the crisis, as a top-up on the nation-wide 0.4% margin. Finally, the wage drift projections also reflect the more structural trends affecting the employed population (older and better educated).

However, nominal hourly wage costs are primarily pushed up by price index-linking. The indexation is relatively low in 2021 but reaches an annual average of 1.8% in the following years. All in all, hourly wage costs should increase by 2% per year in the 2022-2023 period.

Table 6

Price and cost indicators

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

	2019	2020	2021 e	2022 e	2023 e
Private sector labour costs¹:					
Labour costs per hour worked	2.2	3.5	0.3	1.9	2.0
of which:					
Conventional wages	0.7	0.6	0.5	0.5	0.4
Wage drift and other factors	-0.2	2.2	-1.1	-0.5	0.2
Indexation	1.8	1.0	1.0	1.9	1.7
Social contributions	0.0	0.3	0.1	-0.1	-0.1
Wage subsidies (-)	-0.1	-0.7	-0.1	0.1	-0.1
<i>p.m. Labour costs per hour worked according to the national accounts²</i>	2.3	4.2	0.4	1.8	2.1
Labour productivity³	0.6	0.4	1.4	0.9	0.8
Unit labour costs¹	1.6	3.1	-1.1	0.9	1.2
Total inflation (HICP)	1.2	0.4	2.2	2.1	1.8
Core inflation⁴	1.5	1.4	1.2	1.8	1.6
of which:					
Services	1.8	1.8	1.6	2.1	2.0
Non-energy industrial goods	1.0	0.7	0.7	1.3	1.1
Energy	-0.8	-11.0	12.3	2.6	-1.0
Food	1.3	2.6	0.6	2.7	3.2
<i>p.m. Inflation according to the national index (NCPI)</i>	1.4	0.7	1.5	2.0	1.6
Health index⁵	1.5	1.0	1.2	2.0	1.6

Sources: EC, FPS Employment, Labour and Social Dialogue, Statbel, NAI, 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 projected normalisation of productivity should reduce unit labour costs growth in the recovery phase. Overall, they will increase by just over 1 % on average in the two outer years of the projection period.

Core inflation is expected to reach 1.2 % on average in 2021, down from 1.4 % in 2020. This decline is mainly determined by the low inflation rates observed over the first five months of the year, of 0.9 % on average. However, core inflation should rise significantly in the coming months. With economies reopening and supply constraints putting (temporary) pressure on input prices, transport costs and commodities, inflation for non-energy industrial goods is expected to rise. A similar upward trend is expected for services inflation in the form of “reopening inflation” : businesses will be looking to offset some of the losses incurred during the COVID-19 lockdown, as well as the additional costs made for operating under COVID-19 rules, by charging higher prices to consumers, especially as the latter are willing to pay them, given long closures and significant additional personal savings. All in all, core inflation should rise quickly to about 1.6 % by the end of the year. At the same time, the price hikes should not fundamentally alter inflation expectations or start a wage-price spiral as price pressures (for both goods and services) should moderate somewhat beyond the near term. Core inflation is expected to weaken again around mid-2022. In annual averages, 2022 will see an increase to 1.8 % but core inflation will be slightly lower in 2023.

Total HICP inflation, which also includes the more volatile energy and food prices, is projected to pick up from 0.4 % in 2020 to nearly 2.2 % in 2021 and slow down slightly after that. Turning to the underlying components, the spike in 2021 is entirely due to energy prices that are expected to post double-digit growth in 2021 (after a decline in 2020), mostly reflecting higher Brent oil prices at the start of the year. Declining core and food inflation, on the other hand, are bringing down headline inflation. Energy inflation should moderate in 2022 and even turn negative in 2023, on the basis of the assumptions discussed in section 1, while, at the same time, core and food inflation are expected to pick up. The latter is partly explained by an expected further increase in excise duties on tobacco.

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 indexation of wages and replacement incomes. As electricity, heating oil and gas are taken into account in the health index, its growth rate picks up to 1.2 % in 2021 and even to 2 % in 2022. The threshold index for public wages and social benefits is next set to be exceeded in October 2021.

Chart 4

Services prices will accelerate in the short term due to “reopening inflation”

(year-on-year percentage change)



Sources: Statbel, NBB.

7. The general government deficit is expected to remain high after the pandemic

In 2020, the general government deficit ended up at 9.4 % of GDP, its highest level since the mid-1980s, though lower than expected at the end of last year, because fiscal stimulus turned out to be a bit less costly while the containment measures had also put the brakes on certain government expenditure.

In 2021, the deficit is shrinking somewhat, thanks to the strong economic rebound. However, it is expected to remain high, at 6.8 % of GDP. As the health crisis persists at least through the first half of the year, the government budget continues to support the economy. Tax revenues remain subdued, shoring up households' and companies' after-tax disposable income. The lengthening and extension of the temporary lay-off schemes for employees and bridging rights for self-employed workers further cushions income losses. Other discretionary measures, such as current transfers to companies forced to close or with substantially reduced turnover, solvency-boosting tax measures, and specific support measures to certain sectors (e.g. catering and events) continue to weigh on the budget. On top of this, health care expenditure is significantly higher due to the vaccination campaign and the normalisation in non-COVID-related medical treatments, that had been postponed in 2020. The stimulus measures and temporary replacement incomes weigh on the budget balance to the tune of roughly € 13 billion.

In the meantime, regional and federal governments are starting to roll out recovery initiatives centered around the Recovery and Resilience Plan, that was submitted in the context of the Next Generation EU recovery instrument. The plan kicks in in 2021 and is assumed to be ex-ante budget-neutral up to 2026. The expenditure, the bulk of which consists of public investment and capital transfers, is balanced by grants from the Recovery and Resilience Fund. In addition, regional authorities are unfolding supplementary recovery initiatives, that weigh on their budget balances. The projections assume a slightly more gradual increase for public investment than put forward in the governments' plans, as supply and administrative constraints might delay their implementation.

In 2022, the budgetary situation is expected to further improve, as the economy fully recovers from the COVID shock, leading to an unwinding of the temporary support measures. Yet, at a level of 4 % of GDP, the deficit remains above what was expected without the coronavirus crisis. In 2023, the budget deficit is expected to deteriorate again to 4.5 % of GDP, primarily on account of structurally increasing pension payments.

Table 7

General government accounts

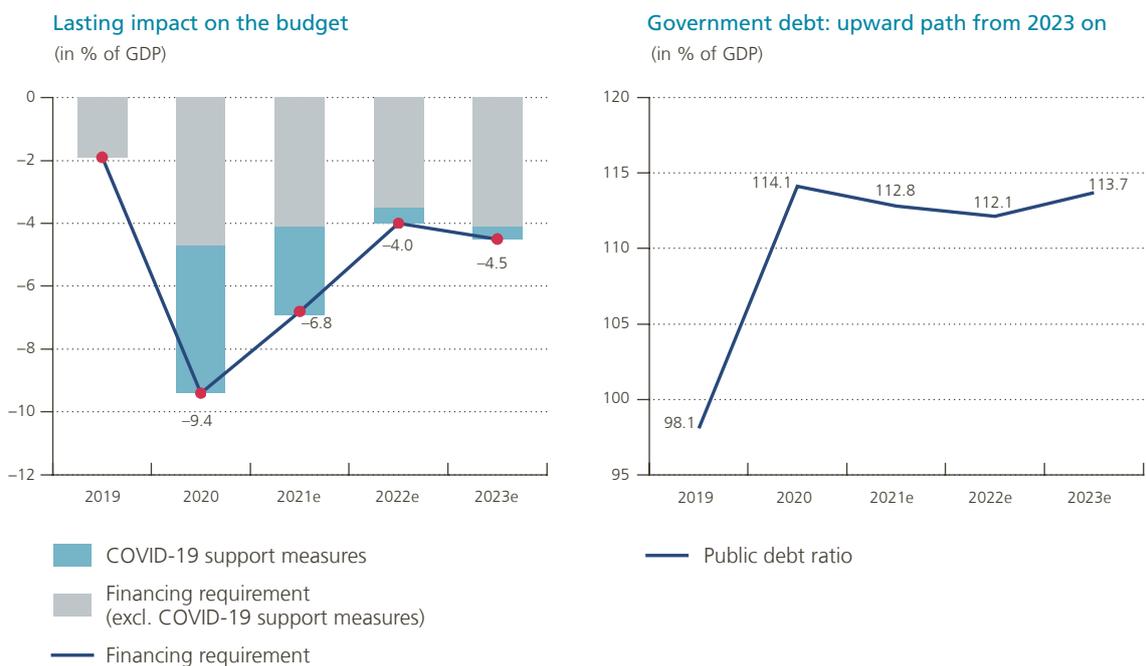
(in % of GDP)

	2019	2020	2021 e	2022 e	2023 e
General government					
Revenue	50.2	50.6	50.2	50.2	50.1
of which: fiscal and parafiscal revenue	43.1	43.5	43.1	43.0	42.9
Primary expenditure	50.1	58.0	55.4	52.8	53.2
Primary balance	0.1	-7.4	-5.2	-2.6	-3.1
Interest charges	2.0	2.0	1.7	1.4	1.4
Financing requirement (-) or capacity	-1.9	-9.4	-6.8	-4.0	-4.5

Sources: NAI, NBB.

Chart 5

Public finances badly hit by the COVID-19 pandemic



Sources: NAI, NBB.

Interest payments are expected to continue to shrink throughout the projection horizon, as interest rates remain far below the implicit interest rate on current outstanding debt. The debt ratio, that jumped to 114 % of GDP in 2020, temporarily stabilises over the projection horizon thanks to buoyant GDP growth this and next year. By the end of the projection horizon, however, debt is expected to get back on an upward path, as high primary deficits more than offset the downward impact on the debt ratio from interest rates remaining below trend growth. 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 are still surrounded by (downside and upside) risks

Clearly, the uncertainty surrounding the baseline economic projections that are described in this article is still much larger than usual and intricately linked to the further development of the pandemic. The risks for the growth projections appear to be on the upside. Downside risks mainly relate to the medical situation: lower vaccine effectiveness (e.g. against new virus mutations) or acceptance could delay the lifting of the containment measures. This could depress growth longer.

In the short run, there is uncertainty regarding the length of the lockdown and income support measures. On the basis of the information available at the cut-off date for the projections, it is assumed that bars and restaurants will have been allowed to reopen completely as of June 9. Over the course of the summer, more relaxations are likely to follow, affecting larger events for example. However, the application of those relaxation measures still

appears to be conditional upon certain health criteria being met by that date. At the same time, the income support measures are expected to be phased out by the end of September. However, if the lifting of containment measures takes longer, it seems likely that income support would be further extended.

In addition to (the timing of) the policy decisions, the behaviour of economic agents in the current conditions constitutes an important source of uncertainty and may bring upward risks to the growth projections that outweigh the health-related risks. In this connection, the projected evolution of the household saving ratio is still key. With the economy gradually reopening and more activities becoming possible again, households may want to spend (part of) the wealth accumulated from 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 more strongly than currently envisaged. Similarly, if these excess savings are not spent on consumption, they could also be tapped into more strongly for the purpose of housing investment. Furthermore, business investment is currently assumed to decelerate but it has surprised on the upside in the recent past. Firms may continue to invest at a higher pace, which would push up the growth outlook.

In the longer term, the unsustainable budget position will have to be addressed, which may require consolidation measures in the outer year(s) of the projection period. Depending on the specific measures that will be taken, the growth and budget outlook may be quite different.

Turning to the inflation outlook, risks are tilted to the upside, in particular for the near term. The ongoing recovery could generate more inflationary pressures, especially if current supply constraints turn out to be more persistent than expected or if companies pass on higher costs to a larger extent to consumers.

Annex

Projections for the Belgian economy: summary of the main results

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

	2019	2020	2021 e	2022 e	2023 e
Growth (calendar adjusted data)					
Real GDP	1.8	-6.3	5.5	3.3	1.6
Contributions to growth:					
Domestic expenditure, excluding change in inventories	1.9	-6.0	5.4	4.0	2.1
Net exports of goods and services	0.2	-0.3	1.0	-0.7	-0.5
Change in inventories	-0.4	0.0	-0.9	0.0	0.0
Prices and costs					
Harmonised index of consumer prices	1.2	0.4	2.2	2.1	1.8
Health index	1.5	1.0	1.2	2.0	1.6
GDP deflator	1.7	1.1	2.2	1.9	1.7
Terms of trade	0.8	0.2	-1.2	0.0	0.1
Unit labour costs in the private sector ¹	1.6	3.1	-1.1	0.9	1.2
Hourly labour costs in the private sector ¹	2.2	3.5	0.3	1.9	2.0
Hourly productivity in the private sector	0.6	0.4	1.4	0.9	0.8
Labour market					
Domestic employment (annual average change in thousands of persons)	75.6	-0.8	31.6	8.4	32.1
Total volume of labour ²	1.3	-6.0	3.9	2.4	1.0
Harmonised unemployment rate (in % of the labour force aged 15 years and over)	5.4	5.6	5.8	6.0	5.9
Incomes					
Real disposable income of individuals	3.0	1.4	1.2	0.7	2.4
Savings ratio of individuals (in % of disposable income)	12.9	21.7	19.7	14.5	14.4
Public finances (in % of GDP)					
Primary balance	0.1	-7.4	-5.2	-2.6	-3.1
Budget balance	-1.9	-9.4	-6.8	-4.0	-4.5
Public debt	98.1	114.1	112.8	112.1	113.7
Current account (according to the balance of payments, in % of GDP)					
	0.3	-0.2	-0.3	-0.5	-0.6

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.

