Economic projections for Belgium – December 2021

- Global growth is easing as supply struggles to keep up with demand, which results in delivery and production delays, shortages of (input) materials and rising prices. At the same time energy prices have skyrocketed.
- The current NBB projections are based on a set of common Eurosystem assumptions. The latter include significant declines in energy price as of the spring of next year (in line with the prices on futures markets), as well as the dissipation of the supply bottlenecks by late-2022.
- The recent resurgence of the COVID-19 pandemic (despite successful vaccination campaigns), that has led to the reintroduction of certain containment measures in many euro area countries, is another element that weighs on the near-term outlook.
- The Belgian economy has recovered much faster than expected from the initial COVID-19 shock and has already reached its pre-pandemic level. However, the aforementioned headwinds (supply bottlenecks, high energy prices, resurgence of the pandemic) should lead to a clear slowdown: the economy will barely grow until the spring of 2022.
- However, the outlook for the medium term is brighter and growth should pick up after the first quarter of 2022. It will be mainly driven by private consumption owing to solid income growth and a normalisation of the savings ratio.
- The labour market continued to surprise on the upside in recent quarters; job creation should decelerate but stay positive also thanks to an increase in the participation rate.
- Surging prices lead to unprecedented labour cost growth as of 2022 via the indexation mechanisms, which worsens cost competitiveness in the short term.
- In turn, higher wage costs are passed on to core inflation, although no longer-lasting wage-price spiral is included in the projections. Declining firm profit margins should partially absorb labour cost increases, while external price pressures should ease in the course of 2022.
- Against this backdrop, headline inflation peaks in the first months of 2022 (at close to 8 %) and core inflation peaks by mid-2022 but both fall back to levels that are clearly below 2 % by the end of the projection period.
- The budget deficit is expected to stay above 4 % of GDP by the end of the projection horizon and government debt remains on an upward path, also after the end of the projection period.
- The risks surrounding the outlook remain high and pertain to the expected price developments on international markets, as well as the health situation.
- 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 (1 December 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 1 December 2021. The baseline projections for Belgium are discussed in detail and individual risks are discussed in the final section of this article.

1. Global growth is easing while price pressures are mounting

The global economy had already reached its pre-crisis level again by the end of 2020, mainly thanks to the exceptionally strong recovery in China. Elsewhere, and for the advanced countries in particular, the recovery phase took a bit longer and the pre-crisis level was only reached in the course of 2021. Meanwhile, survey data suggest that the momentum for growth in the second half of the year is already easing again, as several headwinds (re-)emerged or intensified.

Supply continues to struggle to keep up with the surge in demand, not least in the euro area, which results in shortages of specific materials, lengthening delivery (and production) times and upward pressure on prices. Based on current survey indications these supply issues are assumed to dissipate only by the end of 2022. In addition, the spectacular surge in energy prices substantially raises production costs for energy-intensive manufacturing industries and pushes up headline inflation numbers. Finally, the recent resurgence of COVID-cases has already triggered the reintroduction of restrictive measures in many countries. All in all, the short-term economic outlook has been slightly revised down compared to the spring, but the balance of risks continues to be tilted to the downside. According to the current Eurosystem assumptions, global activity (excluding the euro area) growth is projected to reach 6 % in 2021 but would gradually decline over the projection horizon, to 3.7 % in 2024.

The supply shortages and rising input prices are mainly hampering production in the manufacturing industry and therefore also international goods trade. According to the Eurosystem assumptions, global trade (excluding the euro area) growth is still estimated to increase by 11 % in 2021 but the growth rate would fall to an annual average of just over 4 % over the remainder of the projection horizon.

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

Table 1

The international environment

(annual percentage changes)

	2020	2021 e	2022 e	2023 e	2024 e
World (excluding euro area) real GDP	–2.3	6.0	4.5	3.9	3.7
World (excluding euro area) trade	–8.0	11.1	3.9	4.4	4.0
Euro area foreign demand [1]	–9.3	8.9	4.0	4.3	3.9
Belgium’s relevant export markets [1]	–9.7	7.9	5.5	5.8	3.4

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

in the medium term. Compared to the NBB's June 2021 projections, Belgian export market figures have been revised slightly down in 2021 and 2022, reflecting the headwinds in the near term. Belgian export market growth in 2023, on the other hand, has been revised up and is expected to amount to 5.8 %, before dropping to 3.4 % in 2024.

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 $ 1.13 to the euro, i.e. a mild depreciation of the euro compared to the average level in the first half of 2021.

As usual, oil price and interest rate assumptions are based on market expectations. At the cut-off date (25 November), a barrel of Brent crude oil was priced at just over €70 and the price was expected to gradually trend down to close to €60 by the end of 2024. However, the resurgence of COVID-19 fears and the threat of a new virus variant in particular wreaked havoc on the financial markets and the oil price suddenly plummeted by close to 10 USD on Friday 26 November, just after the cut-off date of the assumptions. At the time of writing, it was still clearly below the assumptions used for the near term. At the same time, gas prices have risen significantly and are now clearly higher than the assumptions used for this exercise.

The three-month interbank deposit rate is expected to rise somewhat, from an average of –0.5 % in 2021 to 0 in 2024. The Belgian sovereign long-term interest rate is currently close to zero, but should rise to 0.5 % on average in 2024. This should lead to an increase in the average mortgage interest rate by about 70 basis points over the projection horizon. The average interest rate on business loans should rise to a similar degree. Even so, financing conditions remain very favourable compared to long-run averages.

The mechanical impact of the revised assumptions on economic activity compared to the June forecasting exercise is negative in 2021 and 2022, but positive in 2023.

Table 2

The Eurosystem technical assumptions

(annual averages; in %, unless otherwise stated)

	2020	2021 e	2022 e	2023 e	2024 e
EUR/USD exchange rate	1.14	1.18	1.13	1.13	1.13
Oil price (US dollars per barrel)	41.5	71.8	77.5	72.3	69.4
Interest rate on three-month interbank deposits in euro	–0.4	–0.5	–0.5	–0.2	0.0
Yield on ten-year Belgian government bonds	–0.1	0.0	0.2	0.4	0.5
Business loan interest rate	1.6	1.6	1.7	2.0	2.2
Household mortgage interest rate	1.6	1.5	1.8	2.0	2.2

Source: Eurosystem.

2. The euro area growth outlook remains solid while inflation should come down soon

The euro area economy has posted strong growth in the previous two quarters, at over 2 % in quarterly terms, mainly supported by a strong performance from the services industry and dynamic consumer spending in response to the gradual reopening of the economy. This reopening effect on growth is now fading and the euro area economy is assessed to be slowing down in the final quarter of this year in particular, due to the aforementioned headwinds. While supply bottlenecks are mainly weighing on industrial production, a worsening of the health situation is likely to dampen private consumption growth (in particular for the services industry).

However, energy price pressures are expected to weaken further as of the spring of 2022 and supply chain disruptions should dissipate in the course of next year. In addition, the Eurosystem projections are anchored to the assumption that the health situation should improve again in the spring. Hence, beyond the near term, the euro area growth outlook remains solid. The expansion of private consumption and total investment should continue to be the main growth engines. Government investment in particular is boosted by the NGEU funds. Despite the short-lived deceleration at the end of this year, euro area growth should still come in at above 4 % in 2022. It is then projected to gradually decline to a level that is close to the trend growth rate.

Headline inflation has surged in recent months to a peak of close to 5 % in November, mostly reflecting the strong increases in energy prices. However, it should gradually fall and already be back below 2 % by the end of next year. Second-round effects via higher wage claims remain quite limited and core inflation stays below 2 % throughout the projection period, even though it comes close to that level at the end of 2024.

Eurosystem staff assesses risks to growth as being tilted to the downside, for the near-term in particular. It is currently still unclear how the pandemic will evolve over the coming weeks. Beyond the near-term, the pick-up of activity is conditional, for instance, on the dissipation of supply disruptions. At the same time, Eurosystem staff mostly sees upside risks to inflation. The latter include the possibility of a stronger wage-price spiral, as well as an upward shift in inflation expectations.

The labour market has been resilient so far, inter alia thanks to government support measures such as the short-term working schemes. Employment growth should remain very strong until the spring and only gradually lose traction in the projection period. The unemployment rate continues to decline and should be 1 percentage point below the pre-crisis level in 2024.

The euro area budget deficit still remains high in 2021 but declines throughout the projection period as the government support measures are gradually phased out. It reaches a level that is comfortably below 2 % of GDP in 2024 and also below the pre-crisis deficit. This does not only reflect the more favourable cyclical conditions but also a strong improvement in the structural budget balance. The government debt is on a declining path, also when economic growth normalises. It falls to below 90 % of GDP in 2024.

Table 3

Eurosystem projections for the euro area

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

	2020	2021 e	2022 e	2023 e	2024 e
Real GDP (contributions in percentage points)	−6.5	5.1	4.2	2.9	1.6
of which:					
Domestic demand (exclude changes in inventories)	−5.7	3.4	3.9	2.5	1.3
Net exports	−0.4	1.3	0.4	0.2	0.2
Inflation (HICP)	0.3	2.6	3.2	1.8	1.8
Core inflation [1]	0.7	1.4	1.9	1.7	1.8
Domestic employment	−1.5	1.1	1.3	1.0	0.6
Unemployment rate [2]	7.9	7.7	7.3	6.9	6.6
General government financing requirement (–) or capacity [3]	−7.2	−5.9	−3.2	−2.1	−1.8
Public debt [3]	97.3	96.6	93.2	90.7	89.7

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

3. The Belgian economy decelerates sharply in the near term but growth should pick up again in the spring of next year

The recovery of the Belgian economy has accelerated in the course of 2021. Third-quarter growth came in at 2.0 % in quarter-on-quarter terms, 0.2 pp higher than was expected in both our June 2021 projection exercise and in the September 2021 Business Cycle Monitor, as well as the NAI's flash estimate. However, this growth rate was mechanically boosted by a level effect related to the gradual normalisation of health-related measures in the course of the second quarter: the restrictions on activities and associated spending opportunities that negatively affected (part of) the second quarter, did not affect the third to the same degree. GDP growth in the fourth quarter will not benefit from a similar boost. As indicated in the Business Cycle Monitor published on 9 December 2021, activity should decelerate sharply to a quarterly growth of just 0.2 % in the fourth quarter due to increasing headwinds.

First, pervasive supply bottlenecks are negatively affecting growth by limiting the production capacity of firms. The manufacturing and logistical industries were unprepared for the much faster than expected recovery in the second half of 2020. The demand glut caused freight tariffs to skyrocket. Major ports became jammed with ships and containers and delivery times increased across the board and are hampering production. The difficulties to anticipate volatile demand caused bullwhip effects exacerbating the supply-chain problems. A recent NBB ad-hoc business survey (published on 8 November) found that firms in (retail) trade, manufacturing and construction in particular have been hit. Moreover, an increasingly tight labour market presents a significant hurdle for firms seeking to maintain or even expand their production.

Second, the strong hike in energy prices, which was particularly marked in Europe, is weighing on economic growth. On the one hand, energy-intensive manufacturing industries are faced with higher costs and sometimes reduce output levels, in particular when they can not fully pass on these cost increases to output prices. On the other hand, higher energy bills negatively affect demand through their impact on purchasing power (as it takes time for the indexation mechanisms to kick in and the indexation does not fully offset the price hikes, for the low-income households in particular) or consumer confidence and, hence, precautionary saving.

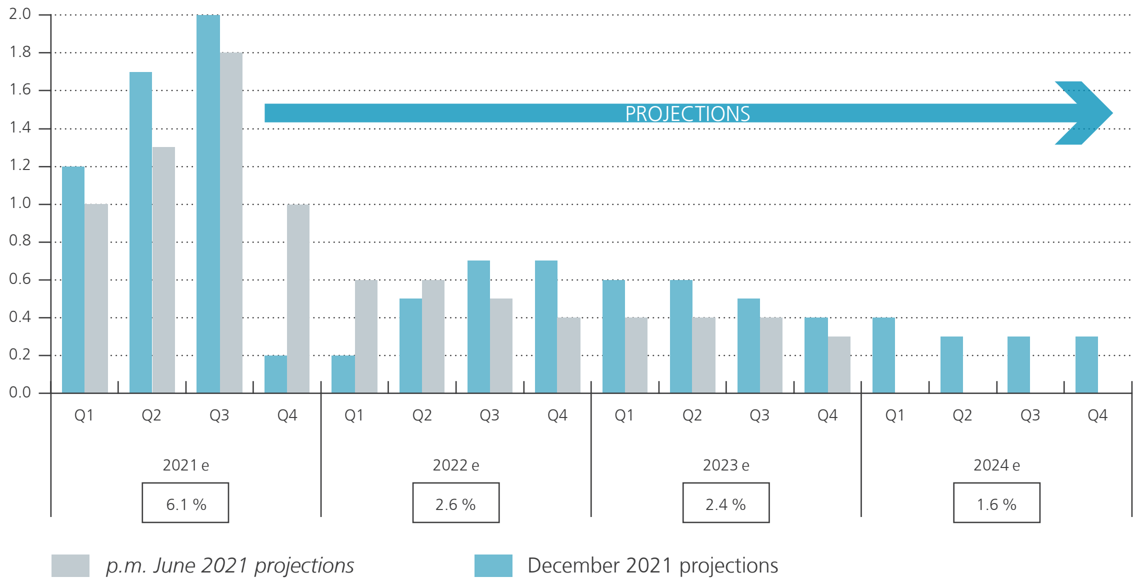
Finally, the resurgence of the ongoing pandemic has put further strains on the economy. In the end, it turned out that even a very high vaccination rate could not prevent the spread of the virus. Infection and hospitalisation numbers started to rise again and important containment measures were reintroduced in several euro area countries, including full lockdowns in a number of cases. In Belgium, working-from-home policies and face mask mandates have been tightened again, while consumption in restaurants and bars is regulated through the COVID Safe Ticket (CST), which effectively bans the unvaccinated. In addition, nightlife venues were closed again and large-scale indoor and certain outdoor events were cancelled. The increasing infection rate also leads to a higher number of workers on sick leave or in quarantine, which puts strains on production in many firms. Even though hospitalisation numbers started dropping at the time of writing, it was assumed, also given the uncertainty surrounding the emergence of the new omicron variant, that the current restrictive measures will remain in place to some degree in a large part of the following quarter as well.

All in all and based on the current information set, these headwinds are likely to still depress growth at the start of 2022. However, they should gradually dissipate in the course of next year. The futures on the energy markets, on which the assumptions for these projections are based, point to declining prices, in particular for gas from the spring onwards. The health situation is assumed to improve again after the winter months and should allow for a relaxation of the containment measures, once the booster vaccination campaign picks up speed. Finally, the aforementioned NBB survey shows that firms on average expect that supply bottlenecks will last well into 2022 but improve thereafter and certain indicators suggest that some supply chain problems may even ease in the near term.

Chart 1

Quarterly growth is depressed in the near term but should pick up again in the course of 2022

(quarter-on-quarter growth in real GDP, percentages, seasonally and working-day adjusted; the numbers in the boxes show the annual growth in percentages)



Sources: NAI, NBB.

Against this backdrop, growth should remain flat in the first quarter of 2022 but then gradually pick up again to above-potential levels, partly reflecting a normalisation after the headwinds dissipate. In the longer term, growth is projected to gradually decline to its potential level.

In annual terms, growth is now estimated to come in at just above 6 % in 2021. This is even higher than the estimate of 5.5 % in the NBB's June 2021 projections despite the slower growth at the end of the year but also reflects upward revisions of the NAI statistics for the first three quarters of the year. Yearly growth then declines to around 2.5 % in the two following years and is projected to drop to just above potential in 2024. Beyond the near term, the slowdown in annual growth is also due to the decline in public consumption as the boost from COVID19-related health care spending disappears.

All in all, the post-crisis recovery of the Belgian economy has been remarkably strong. The return to quarterly growth numbers that are lower on average than in 2021 should also be seen as a normalisation after turbulent times. While the economy has already returned to its pre-pandemic level, there is still some damage compared to a hypothetical 'no-COVID-19'-scenario in which the December 2019 projections are taken as a benchmark. However, this damage is much smaller than feared initially (which is in line, for instance, with the limited increase seen for the unemployment rate).

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

Private consumption had lagged the recovery seen in the other demand components and was still about 10 % below pre-crisis levels in the first quarter of 2021 whereas other demand components had already regained their losses. However, consumption growth accelerated significantly in the course of 2021. Although a peak over the summer was expected, the November NAI data release indicated that the expansion in the third quarter (+6.3 %) was even more spectacular than projected, pushing household consumption above pre-crisis levels several quarters sooner than expected in the June exercise.

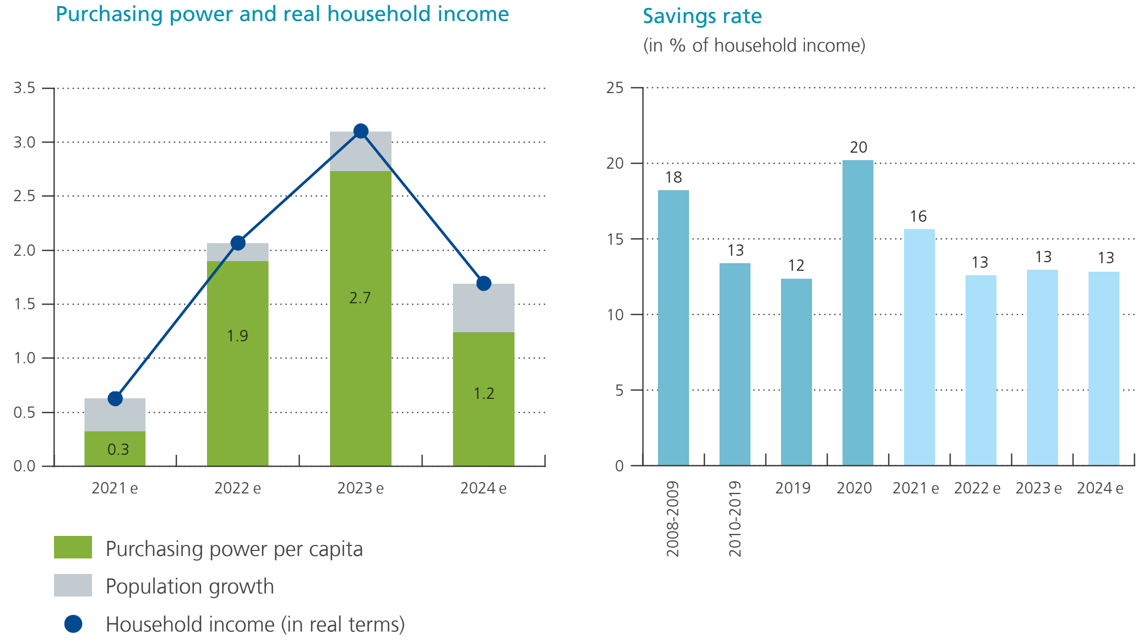
Going forward, we project a strong deceleration in quarter-on-quarter growth from the fourth quarter of 2021 onwards. This will be caused in large part by the disappearance of the base effect from the easing of restrictions in the second quarter. In addition, the aforementioned headwinds should in particular weigh on private consumption. Supply bottlenecks imply longer waiting times for durable consumption goods, while higher energy prices erode consumers' purchasing power and confidence. In addition, the resurgence of the pandemic should dampen household consumption, mostly for leisure and certain services industries. Households have already adapted their behaviour in response to the news about rising infection rates : even prior to the official restrictive measures, mobility indicators regarding retail and recreation clearly fell back below their pre-pandemic levels.

In the longer term fundamentals for household consumption remain sound. All in all, growth rates for private consumption remain above-average until the end of 2023, before normalising in 2024. Private consumption is supported by the continued net job creation and robust real disposable income growth. Even though certain groups in the population have certainly recorded big income losses in 2020, average household income was shielded by the automatic stabilisers and massive government support measures. The latter have been gradually wound down in 2021, but disposable incomes have been boosted by strong employment growth. However, part of the gains has been eroded by higher inflation. Purchasing power is projected to only increase by 0.6 % in 2021 or 0.3 % per capita. This will be (partially) compensated in 2022 and beyond as the wage indexation mechanisms kick in with the usual lag and drive up nominal wages, while inflationary pressures are expected to come down. Overall, real disposable income should grow by around 7 % in the 2022-2024 period, which amounts to a total gain in purchasing power of nearly 6 % per capita.

Chart 2

Household purchasing power and savings ratio

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



Sources: NAI, NBB.

In addition, the savings ratio should decline from the exceptional peak in the crisis year 2020 to around the pre-pandemic level. Compared to pre-crisis levels, 2020 saw Belgian households accumulate an additional €23 billion in 'surplus savings'. The various containment measures disrupted spending patterns, 'forcing' households to save and the savings ratio reached an annual average of 20.2 %. Savings should fall to 15.6 % of gross disposable income in 2021, following the rebound in household consumption as restrictions were scaled back. This is still higher than usual as containment measures (e.g. the closure of bars and restaurants, as well as contact professions) were still in place for several months in 2021. The savings ratio will then fall back further as of 2022, to levels that are close to the pre-crisis ones. The minor uptick of the savings ratio in the outer years is due to some consumption smoothing in the presence of volatile income developments brought about by the indexation mechanisms. In 2023, wages and social transfers are indexed on the basis of past high inflation, while actual inflation is already declining rapidly (see below); this leads to a spike in real income growth in that year, a larger part of which is saved. The 2024 level is slightly higher than the pre-crisis level, which should be seen against the backdrop of the structural worsening in public finances and the greater need for fiscal consolidation. The latter may have an upward impact on precautionary saving.

Table 4

GDP and main expenditure categories

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

	2020	2021 e	2022 e	2023 e	2024 e
Household and NPI final consumption expenditure	–8.2	6.4	5.7	2.6	1.8
General government final consumption expenditure	0.2	4.5	–0.7	0.9	1.4
Gross fixed capital formation	–6.2	9.4	1.8	4.4	2.3
General government	0.6	8.7	3.6	9.3	3.6
Housing	–6.8	10.4	2.4	1.6	1.2
Businesses	–7.0	9.2	1.3	4.5	2.4
p.m. Domestic expenditure excluding the change in inventories[1]	*–5.7*	*6.5*	*3.1*	*2.6*	*1.8*
Change in inventories[1]	–0.3	–0.9	–0.5	0.1	0.0
Net exports of goods and services[1]	0.4	0.4	0.1	–0.2	–0.2
Exports of goods and services	–5.5	9.0	4.2	4.1	2.4
Imports of goods and services	–5.9	8.7	4.1	4.4	2.6
Gross domestic product	–5.7	6.1	2.6	2.4	1.6

Sources: NAI, NBB.

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

The savings ratio does not dip below the pre-crisis level: our baseline assumption remains that the additional savings that households have accumulated last year will not be tapped into much for pent-up demand or 'revenge spending'. This is confirmed in a recent analysis by Basselier and Minne (2021)[1]. Savings were mostly accumulated by relatively well-off households with a lower marginal propensity to consume. In addition, they may have been already used partially for renovation works and are invested predominantly in less liquid assets, as suggested by the financial statistics.

The rebound of business investment after the immediate crisis impact has been remarkable. Firms kept investing, in line with the solid recovery in business confidence. In volume terms, by the second quarter of 2021 business investment already exceeded pre-crisis levels by 1.5 %. However, contrary to expectations, third-quarter growth came in negative at –2.4 % according to the current statistics. The extent and speed of the recovery of this demand component may imply that much of the 'recovery dynamics' is already behind us. Furthermore, rising input costs are weighing on margins, supply chain difficulties and labour market tightness are hampering production and flare-ups of the COVID-19 virus indicate that the health crisis is not over yet. These conditions will weigh on business investment growth in the short run, bringing annual growth to 9.2 % in 2021, slightly below what we expected in the June exercise. However, continued strong demand should, in principle, encourage firms to invest in capacity expansion. Other fundamentals for business investment growth such as financing conditions and confidence levels in general also remain sound. Business investment should pick up from the first quarter of next year on, although the decline in the second half of 2021 will also affect annual growth in 2022, which should remain limited to 1.3 %.

Public consumption growth in 2020 was revised down by 0.4 pp since the June exercise, in large part due to healthcare spending that was (partially) shifted to 2021 as hospital capacity had to be reserved for COVID-19-patients. Partly because of this shift, our projection for 2021 has been revised up by 0.8 pp to 4.5 %.

1 Household savings during and after the COVID-19 crisis: Lessons from surveys | nbb.be, November 2021

A further boost to public consumption in 2021 comes from the costs related to the 2021 vaccination drive, that came in higher than previously expected. In addition, public employment in the first half of 2021 was up due to the replacement of a much larger than usual cohort of teachers on sick leave. Although the booster vaccination drive will affect 2022, we expect a gradual return to normal for health care spending from 2022 onwards. The disappearance of most COVID-spending will temporarily push public consumption growth into negative territory and will weigh somewhat on activity growth in 2022.

Public investment growth is expected to come in at 8.7 % this year. It is boosted by the investment projects included in the recovery plans, even if account is taken of the existing capacity constraints in the construction sector. The latter are likely to cause a postponement of some of these projects to 2022 or later. Nevertheless, government investment for 2021 is substantial, also in part because of the delivery of several military transportation aircraft in the course of 2021. The disappearance of this one-off element reduces investment growth somewhat next year but it remains robust throughout the projection period, in line with the announced government plans to increase the government investment ratio.

Housing investment posted very strong growth since the second half of 2020. The pre-crisis level has now been exceeded by about 3.5 % in real terms, more or less in line with our earlier expectations. Anecdotal evidence suggests that part of the accumulated savings 'surplus' was routed to investment in housing, which is one of the main savings motives among households. Even though the underlying fundamentals for housing investment remain healthy, growth is projected to moderate in the projection period, also in view of the limited increase in mortgage interest rates that is expected on the basis of the common Eurosystem assumptions.

Driven by buoyant world demand, Belgian export growth was strong in the first half of 2021, but came in negative in the third quarter, as export market growth slowed and supply chain problems escalated, weighing on world trade. After having recovered somewhat more slowly from the COVID-shock and suffering a potentially Brexit-related dip at the beginning of the year, imports held up slightly better than exports in the third quarter, also on account of the delivery of the aforementioned military transportation aircraft. Leaving aside the short-run volatility, as in previous exercises onwards, net exports are expected to contribute negatively to GDP throughout the projection period : continued strong domestic demand will drive up imports and losses in export market shares are projected to continue, in line with longer-term competitiveness trends. These losses are slightly exacerbated by the relatively strong increase in wage costs discussed in section 6.

5. Job creation should decelerate but continue throughout the projection period

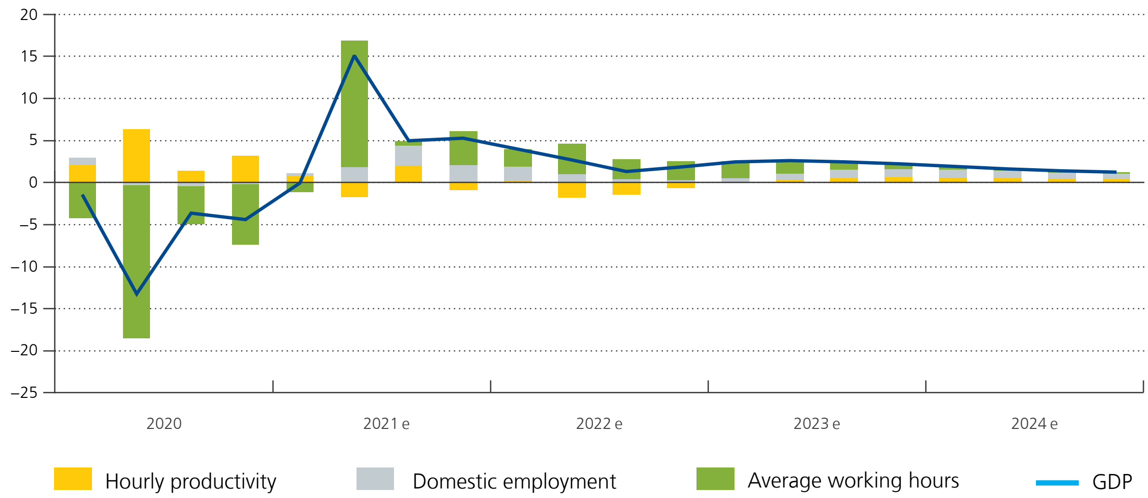
On the labour market the post-crisis recovery is mostly seen in the gradual decline in the use of temporary employment, as well as the bridging rights for the self-employed. At the height of the crisis in 2020, a substantial part of the working population made use of those systems, which minimised job losses. The gradual normalisation from the summer of 2020 onwards has not led to an increase in the number of unemployed, which suggests that most of these workers have returned to regular employment, either in their old job or in a new job. This is due to very high labour demand, as also witnessed by historically high vacancy rates.

Technically, movements in and out of the system of temporary unemployment and bridging rights are seen as changes in average working time (as the workers concerned are still considered to be employed). Hence, the return to normal increases average working time, that took a big hit at the height of the crisis, also beyond the effect caused by the increased use of temporary unemployment and bridging rights. Average working time is still below its pre-crisis level and should continue to recover gradually throughout the projection period.

Chart 3

Domestic employment, working time and productivity

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



Sources: NAI, NBB.

At the same time, the recovery has fueled job creation. Employment growth has continued to surprise on the upside, with an average net increase of 25 000 in the last five quarters; thereby amply making up for the losses incurred in the first half of 2020. Job creation should slow down in the projection period and in the near term in particular. In addition to the labour market impact of the estimated slowdown in activity, this reflects two elements. First, according to survey data, hiring difficulties have become pervasive in the economy: they affect most industries and do not only concern high-skilled workers. Hence, the creation of new jobs is likely to decelerate. Second, the flexible use of the temporary unemployment system was scheduled to come to an end on 31 December 2021[1]. Among the workers that are still in the system some may not succeed in returning to regular employment. Hence, employment growth should fall in the course of 2022. It will pick up again at the end of next year, albeit at a lower rate than the one observed in 2021. In annual terms, some 40 000 extra jobs should be created every year in the 2022-2024 period (with 2022 benefiting from a significant carry-over effect from the strong employment growth in the course of 2021). All in all, the harmonized employment rate of the 20 to 64 years old is expected to reach 72 % in 2024.

Turning to the different sub-segments of employment, the branches sensitive to the business cycle show a decreasing job creation in the projection period, that is roughly in line with GDP dynamics, while employment growth in education and administration falls back strongly in 2022 after the aforementioned significant increase in 2021. Remarkably and unlike what has been observed in other euro area countries, the number of self-employed continued to grow in 2020 and 2021. 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) may partially account for that. However, outflows out of self-employment have been unusually low during the crisis, also due to the protective measures. Against this backdrop, we expect a slowdown in the number of self-employed in the first half of the projection period before growth picks up again in the second half.

1 On December 10 (i.e. beyond the cut-off date for these projections), the government decided to prolong the support measures until the end of the first quarter of 2022.

Table 5

Labour supply and demand

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

	2019	2020	2021 e	2022 e	2023 e	2024 e
Working age population [1]	17	15	7	10	15	11
Labour force	59	16	52	29	30	31
Domestic employment	77	–1	81	44	41	39
Employees	63	–15	62	36	31	26
Branches sensitive to the business cycle [2]	37	–29	39	22	19	13
Administration and education	11	6	11	3	3	2
Other services [3]	14	8	12	11	9	11
Self-employed	14	14	19	8	10	13
Unemployed job-seekers	–19	17	–29	–15	–10	–8
p.m. Harmonised unemployment rate [4, 5]	*5.4*	*5.6*	*6.3*	*6.1*	*5.9*	*5.7*
Harmonised employment rate [4, 6]	*70.5*	*70.0*	*70.4*	*71.2*	*71.6*	*72.0*

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

1 Population aged 15-64 years.

2 Agriculture, industry, energy and water, construction, trade, hotels and restaurants, transport and communication, financial activities, property services and business services.

3 Health, welfare, community, public social services, personal services and domestic services.

4 On the basis of data from the labour force survey.

5 Job-seekers in % of the labour force aged 15-64 years.

6 Persons in work in % of the total population of working age (20-64 years).

Job creation is supported by a continued increase in labour market participation. The latter fell in the crisis year 2020 and the return to the job market of discouraged workers may partly explain the strong hike in 2021. Participation is projected to continue to increase in the projection period. This does not only reflect the slow upward trend related to cohort effects but also results from a number of measures that make work more attractive (including the increase in the minimum wage and the gradual abolition of the special social security contribution, that is only paid on income from work). All in all, the labour force should increase by around 90 000 persons in the 2022-2024 period.

As employment growth exceeds the increase in the labour force, unemployment will fall. The harmonised unemployment rate should come down to about 5.7 % at the end of the projection period, which is still somewhat higher than before the crisis.

6. Core inflation and labour cost growth reach a peak in 2022

Inflation has been rising substantially in recent months with the HICP indicator even peaking at above 7 % in November. This is primarily due to the stratospheric increase in energy prices. Taking into account the benchmark

Eurosystem assumptions on price developments on the international energy markets, inflation should remain very high over the course of winter and even peak at close to 8 %. However, the current projections point to a gradual decline as of March 2022.

The high energy inflation in 2021 comes from two factors. First, there is a base effect. Mostly due to the COVID‑19 crisis, oil prices dropped significantly in the first half of 2020, which resulted in negative energy inflation rates and weighed on total inflation. The subsequent recovery brought back oil prices to the pre-crisis level in the spring of 2021, which already boosted energy inflation in the first half of this year. Second, after the spring, oil prices increased further and electricity and gas prices started to skyrocket. The most spectacular increase was in gas prices and resulted from the interplay of several factors: booming demand from Asia and an inelastic energy supply, the heating season in the previous winter that lasted longer than usual in Europe,

Table 6

Price and cost indicators

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

	2019	2020	2021 e	2022 e	2023 e	2024 e
Total inflation (HICP)	1.2	0.4	3.2	4.9	1.2	1.2
Core inflation [1]	1.5	1.4	1.2	2.4	1.9	1.5
of which:						
Services	1.8	1.8	1.6	2.5	2.4	2.0
Non-energy industrial goods (NEIG)	1.0	0.7	0.8	2.1	1.1	0.9
Energy	−0.8	−11.0	22.9	23.6	−7.0	−4.0
Food	1.3	2.6	1.0	2.7	2.6	2.4
p.m. Inflation according to the national index	*1.4*	*0.7*	*2.4*	*4.5*	*1.3*	*1.2*
Health index [2]	1.5	1.0	2.0	4.4	1.3	1.3
Private sector labour costs [3]:						
Labour costs per hour worked	2.1	4.3	−0.3	4.5	2.8	1.8
of which:						
Real conventional wages	0.7	0.6	0.4	0.6	0.2	0.6
Wage drift and other factors	−0.2	3.1	−1.5	−0.4	0.3	0.1
Indexation	1.8	1.0	1.1	4.2	2.3	1.3
Social contributions	−0.1	0.4	−0.3	−0.1	0.1	−0.1
Wage subsidies	−0.1	−1.0	0.0	0.3	0.0	−0.1
p.m. Labour costs per hour worked according to the national accounts [4]	*2.2*	*5.3*	*−0.3*	*4.2*	*2.9*	*1.9*
Labour productivity [5]	1.0	4.3	0.1	−0.9	0.2	0.4
Unit labour costs [3]	1.1	−0.1	−0.4	5.5	2.6	1.4

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

1 Measured by the HICP excluding food and energy.

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

3 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.

4 Excluding wage subsidies and reductions in contributions for target groups.

5 Value added in volume per hour worked by employees and the self-employed.

the resulting lower-than-usual stocks for gas and increasing European carbon prices (ETS – Emission Trading System) that pushed up the cost for producing electricity, etc. Based on the current futures, electricity and gas prices should drop as of April 2022. After that, prices should continue to decline gradually up to the end of the projection horizon. Along with the declining path of the Eurosystem assumption of the Brent oil price, energy inflation should fall into negative territory again in 2023 and 2024 and push down total inflation.

The sharp acceleration of inflation in recent months pushes up wage costs through the indexation mechanisms, as the rising energy costs mostly feed into the health index. In the private sector, nominal hourly labour costs should increase by 4.5 % in 2022. This is the highest increase since the start of this time series – so at least since 1996 – and primarily due to the indexation effect (4.2 %).

The labour cost projections also take into account the wage norm for the 2021-2022 period capping the nationwide increase in conventional wages at 0.4 % (most of which would be granted in 2022), as well as the structural wage increases for the care sector of 0.6 % in the 2021-2022 period. Given that the latter wage increases are financed by the governments through wage subsidies, they do not increase overall wage costs. As surveys indicate that hiring difficulties lead to stronger wage pressures (in Flanders in particular), the estimates for the final quarter of this year and 2022 include a slightly higher wage drift. Finally, wage costs are also affected by other factors, mostly related to more technical composition effects. The latter reflect the fact that, on average, mostly lower-income workers were affected by temporary unemployment. When they return to regular employment in 2021 and 2022 this mechanically reduces the average wage cost per hour.

As the negotiation of the wage norm for 2023-2024 will only take place at the end of 2022, the real conventional wage growth for those years had to be based as usual upon a technical assumption (0.8 %). Considering the time needed to reach agreements at the industry level, this increase should mostly affect 2024. Wage drift should decline but remain positive for those years. This mainly reflects durable changes in the structure of employment such as a larger share of employees that is higher educated and the fact that employees tend to retire later (which increases the share of older and higher-paid employees).

While the projected decline in energy inflation reduces the indexation effect in the last years of the projection period, hourly labour costs should still strongly expand by more than 9 % over three years. The nominal wage growth in the neighbouring countries will also reflect higher inflation to some extent, but the substantial increase in Belgian wage costs is likely to erode relative cost competitiveness, in particular in 2022.

As costs are at least partly passed on to final selling prices, the high energy inflation, the large increases in the prices of intermediate inputs and materials, and the increase in labour costs feed into core inflation. The latter has started to increase since the late spring. Services inflation, in particular, has been up due to "reopening effects", as many businesses increased prices when they were allowed to reopen, while goods inflation already reflected the rise in input costs. The second-round effects coming from the aforementioned strong increase in wage costs should keep core inflation on an upward path in the first half of next year as well. However, according to the current projections, underlying price pressures should gradually ease as of the second half of 2022. This is conditional on the expected decline in energy prices and the assumption that supply chain bottlenecks will have mostly dissipated by then, which would lower pipeline price pressures for input costs. More generally, the projection that the hike in underlying inflation is transitory reflects the fact that increased wage costs should be partly absorbed by firm profit margins, in line with historical regularities. Profit margins typically decelerate or decline when wage costs increase rapidly, as companies do or can not pass on the full extent of the cost increases to final selling prices. In this connection, the current projections point to declining profit margins throughout the 2022-2024 period (even if they would remain above a long-run average in level terms).

All in all, core inflation is projected to peak at 2.4 % in 2022, the highest level this century. In the absence of a genuine wage-price spiral and as the exogenous cost drivers are assumed to lose traction next year, core inflation would gradually fall back to its long-term average of around 1.5 % by 2024.

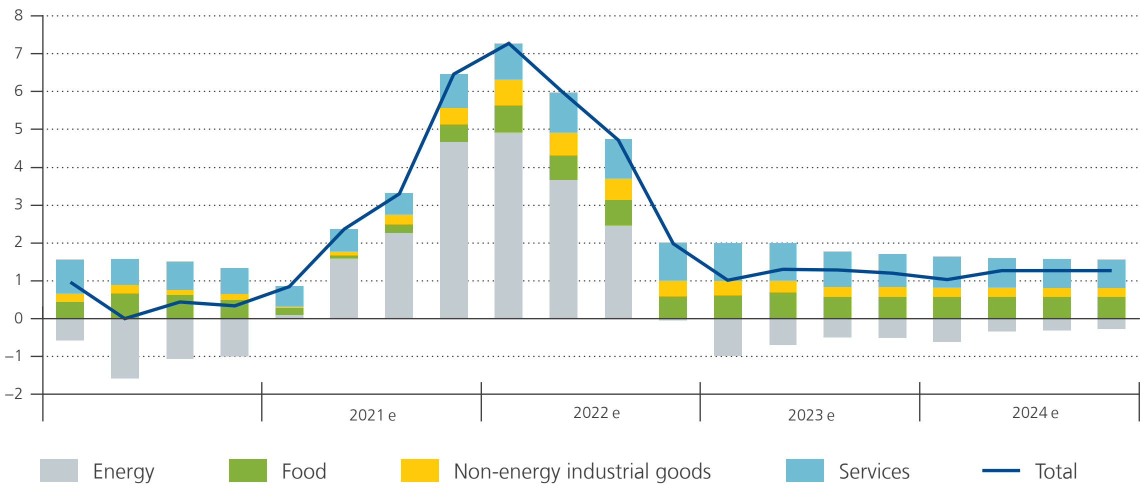
Food inflation, finally, should also go up, from 1.0 % in 2021 to 2.7 % in 2022 and fall back slightly to 2.4 % in 2024. These figures take into account the assumption that excise duties on tobacco products will increase each year for the rest of the projection horizon. All in all, in yearly averages total inflation comes in at just below 5 % next year but drops substantially in the final years of the projection period, mostly due to the decline in energy prices.

The national consumer price index is used to calculate the health index, 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 also strongly increases to 4.4 % in 2022, before dropping back in 2023 and 2024. The pivotal index for public wages and social benefits has been passed in August 2021. It is set to be exceeded again in December 2021, February 2022, and April 2023.

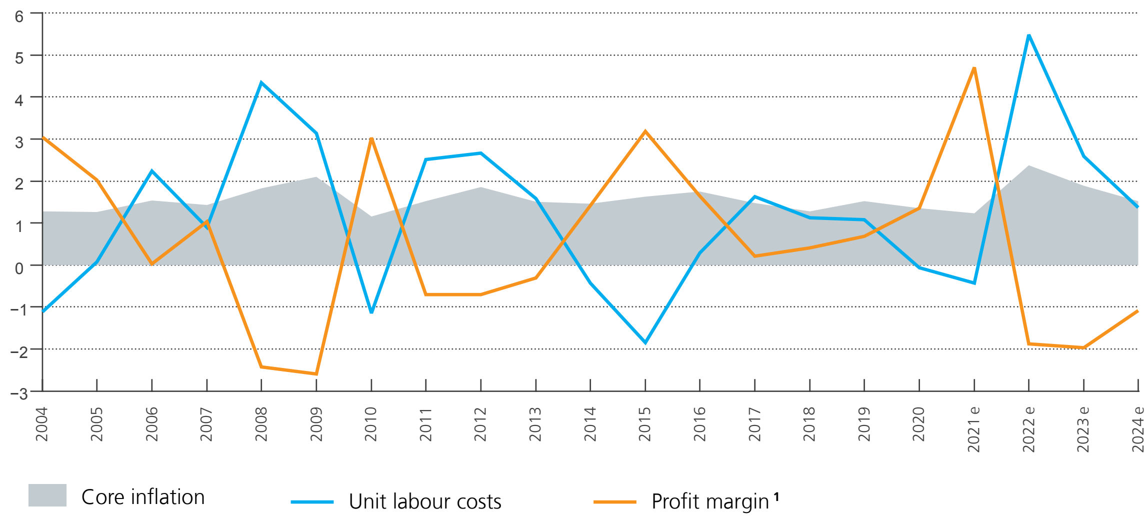
Chart 4

Inflationary pressures peak in 2022

Total HICP inflation (in %) and contribution of the different components (in p.p.)



Core inflation (in %) : unit labour costs versus profit margins



Sources: ECB, Eurostat, NAI and NBB calculations.
1 The profit margin is proxied here as the difference between the GDP deflator growth and unit labour cost growth in the private sector.

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

Following a deficit of 9.1 % of GDP in 2020, the 2021 deficit is expected to shrink to 6.3 % of GDP due to the strong economic recovery and the partial unwinding of temporary COVID-19 related support measures. The recovery pushed up fiscal and parafiscal revenues while temporary discretionary measures that provided additional support to households and enterprises fell from some 4.2 % of GDP to 2.5 % of GDP. Particularly in the first half of the year, temporary unemployment benefits and replacement income for self-employed, in addition to regional transfers to enterprises remained important. While temporary COVID-19 measures have declined further throughout the year, it was decided to still prolong certain measures, including the flexible use of the temporary unemployment system, on 10 December, i.e. after the cut-off date of these projections.

The budgetary improvement in 2021 was to some extent offset by the implementation of recovery plans at various government levels, and particularly at the regional level. It should be noted here that only resilience measures outside Belgium's National Recovery and Resilience Plan, that was submitted in the context of the Next Generation EU programme, are weighing on the budget balance. Those within the Plan are financed by additional grants received from the EU. In addition, the summer floods, that caused severe damage, particularly in Wallonia, urged governments to provide support for more than € 1 bn. Finally, a series of structural spending measures that are steadily increasing current spending, kicked in. This mostly pertains to the federal and regional budget increases and wage subsidies in the health care and social sector, and the rise in minimum social benefits decided by the federal government.

In 2022, the general government budget balance is expected to further improve to a deficit of 4.2 % of GDP. At unchanged policy, and in line with the assumption that the health situation will improve again as of next spring, the temporary COVID-19 measures would almost disappear. At the same time, fiscal and parafiscal revenues would further normalize as the economic recovery continues. On the expenditure side, the increasing impact of the structural measures taken in 2021 reduces the drop in primary expenditure relative to GDP. All in all, no noticeable consolidation efforts were decided in the initial 2022 budgets. This should be seen against the background of the European Commission's decision to extend the general escape clause, that allows member states to temporarily deviate from their medium-term budgetary objectives, to 2022.

Table 7

General government accounts

(in % of GDP)

	2019	2020	2021 e	2022 e	2023 e	2024 e
General government						
Revenue	49.9	50.1	49.1	49.3	49.6	49.9
of which : fiscal and parafiscal revenue	42.9	43.1	42.3	42.3	42.6	43.0
Primary expenditure	49.9	57.2	53.8	52.1	52.2	52.9
Current expenditure	46.5	53.6	49.8	48.3	48.5	49.0
Capital expenditure	3.4	3.6	3.9	3.8	3.8	3.9
Primary balance	0.1	−7.1	−4.6	−2.8	−2.7	−3.0
Interest charges	2.0	1.9	1.6	1.4	1.3	1.3
Financing requirement (–) or capacity	−1.9	−9.1	−6.3	−4.2	−4.0	−4.2

Sources : NAI, NBB.

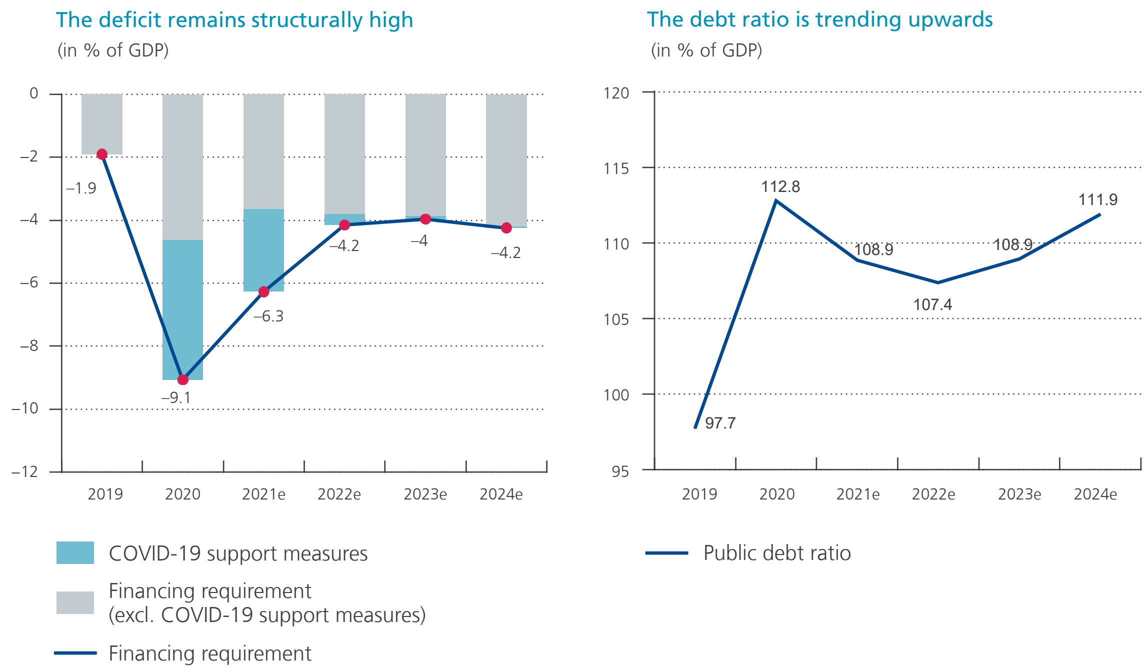
In 2023, the deficit is projected to slightly decrease, albeit to a still high level of 4.0 % of GDP. This is mainly due to the above-potential increase in activity and a favorable growth composition (as labour income outpaces GDP). However, despite the disappearance of the emergency support following the 2021 floods and of the temporary compensation for high energy prices decided in 2021, the primary expenditure to GDP ratio is rising marginally in 2023, mostly reflecting pension expenditures. In 2024 the budget balance widens again to 4.2 % of GDP. This worsening is entirely driven by the increase in primary expenditure, mostly attributable to a structural increase in social benefits.

All in all, the persistent deterioration of the budget balance since 2019, can be traced back to an increase in the primary expenditure to GDP ratio. Within primary expenditures, the rise is primarily attributable to current spending. Capital spending only contributes to a minor extent.

Interest payments are expected to steadily decline over the projection horizon, from 1.9 % of GDP in 2020 to 1.3 % in 2024, as newly issued and refinanced debt are financed at much lower rates than in the past. Indeed, 10-year bond yields are expected to remain close to zero in 2021 and 2022, and only slightly increase the years after. While the debt to GDP ratio is declining in 2021 and 2022, taking advantage of buoyant nominal GDP growth, there is an underlying upward trend that becomes visible from 2023 onwards. This should induce federal and regional governments to start planning measures to curb this trend without delay.

Chart 5

The deficit shrinks, but remains structurally high after the pandemic



Sources: NAI, NBB.

8. The baseline projections are still surrounded by considerable (downside and upside) risks

The uncertainty surrounding the baseline economic projections that are described in this article is still much larger than usual. One important source of this uncertainty is the developments regarding the pandemic. While the concerns about the COVID-health situation had initially declined over the summer, the recent uptick in the number of infections and hospitalisations has showed that the initial vaccination campaign was not sufficient to put an end to the pandemic and, hence, that health developments can continue to affect economic outcomes. These projections take into account the health situation and the containment measures as they were or could reasonably be anticipated at the cut-off date (1 December 2021). In line with the common Eurosystem approach we have also assumed that the current restrictive measures should be maintained well into the first quarter of 2022. Thereafter, an improvement in the health situation should allow for a relaxation of the current measures. Obviously, a different development of the pandemic will in principle change the macroeconomic outlook. Clearly, a stronger and more protracted deterioration of the health situation constitutes an important negative risk for the current GDP projections, in particular if it comes with more stringent containment measures. On the other hand, if it is confirmed that the infection and hospitalisation numbers seem to have reached a peak and people's mobility increases again, the economic impact could be more short-lived and the outlook for the first quarter of 2022 in these projections might be too pessimistic.

At the same time, no account could be taken of any government support measures that are announced after the cut-off date. This was the case, for instance, for the extension, to the first quarter of 2022, of the crisis-related easier access to temporary unemployment and bridging rights that was announced on 10 December. A preliminary assessment suggests that the macroeconomic and budgetary impact of this measure should be relatively limited.

The second main source of uncertainty pertains to the international markets for energy, as well as intermediate goods and raw materials. As regards energy prices the projections are – in line with the usual Eurosystem practices – anchored to the futures prices. The latter currently indicate declining prices in the course of next year, with strong decreases in the case of gas. It should be noted that the price expectations derived from these futures are not always accurate (as was illustrated in the Spring projections, when futures prices did not anticipate the spectacular increase witnessed in reality since the summer). After the cut-off date for these projections, oil prices have declined while gas prices have increased significantly. The current supply bottlenecks are assumed to dissipate as of late 2022. This is fully in line with the average expectations of Belgian firms, as suggested by the ad-hoc NBB firm survey carried out at the end of October. The assumptions regarding international energy prices and supply bottlenecks strongly determine the inflation outlook in these projections. It is an important element in the assessment that there will be no longer-lasting wage-price spiral. The latter assessment is also based upon the feature that large wage cost increases are typically partly absorbed by firm profit margins and the fact that the current legal framework will not allow very high increases in conventional wages. Inflation may be higher for longer if the external price pressures remain higher than currently assumed or if profit margins do not decline.

Finally, 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 for those years.

Annex

Projections for the Belgian economy: summary of the main results

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

	2020	2021 e	2022 e	2023 e	2024 e
Growth (calendar adjusted data)	−5.7	6.1	2.6	2.4	1.6
Real GDP					
Contributions to growth:					
Domestic expenditure, excluding change in inventories	−5.7	6.5	3.1	2.6	1.8
Net exports of goods and services	0.4	0.4	0.1	−0.2	−0.2
Change in inventories	−0.3	−0.9	−0.5	0.1	0.0
Prices and costs					
Harmonised index of consumer prices	0.4	3.2	4.9	1.2	1.2
Health index	1.0	2.0	4.4	1.3	1.3
GDP deflator	1.3	4.3	3.6	0.6	0.3
Terms of trade	0.5	−0.8	−0.5	0.3	0.2
Unit labour costs in the private sector [1]	−0.1	−0.4	5.5	2.6	1.4
Hourly labour costs in the private sector [1]	4.3	−0.3	4.5	2.8	1.8
Hourly productivity in the private sector	4.3	0.1	−0.9	0.2	0.4
Labour market					
Domestic employment (annual average change in thousands of persons)	−0.8	81.0	44.0	40.7	38.7
Total volume of labour [2]	−8.5	5.9	3.4	2.1	1.0
Harmonised unemployment rate (in % of the labour force aged 15 years and over)	5.6	6.3	6.1	5.9	5.7
Incomes					
Real disposable income of individuals	0.9	0.6	2.1	3.1	1.7
Savings ratio of individuals (in % of disposable income)	20.2	15.6	12.6	13.0	12.9
Public finances (in % of GDP)					
Primary balance	−7.1	−4.6	−2.8	−2.7	−3.0
Budget balance	−9.1	−6.3	−4.2	−4.0	−4.2
Public debt	112.8	108.9	107.4	108.9	111.9
Current account (according to the balance of payments, in % of GDP)	0.8	1.0	1.0	1.2	1.3

Sources: EC, NAI, Statbel, NBB.
1 Including wage subsidies (mainly reductions in payroll tax) and targeted reductions in social contributions.
2 Total number of hours worked in the economy.