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Economic projections for Belgium – June 2022

NationalBank OF BELGIUM
Eurosystem

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- The war in Ukraine dramatically affects the economic outlook: it led to new disruptions in supply chains (that also suffered from the lockdowns in China) and pushed up energy and commodity prices. At the same time, high-frequency indicators continue to point to moderating growth, not to a deep recession.
- The current NBB projections are based on a set of common Eurosystem assumptions. The latter include a gradual relaxation of external price pressures (declining energy price futures and gradual normalisation of supply chains).
- In the baseline scenario it is also assumed that there is no further escalation in the war or the sanctions affecting the relations with and, in particular, the energy imports from Russia.
- After a solid increase in activity in the first quarter, the Belgian economy is expected to barely grow in the near term, mostly due to the impact of high inflation on private consumption. However, growth should pick up again by the end of the year.
- In the two following years, activity growth remains above potential and is mostly driven by a recovery in private consumption (as income prospects remain solid) and slower but continued growth in investment.
- Job creation should decelerate somewhat, but the unemployment rate remains historically low.
- Surging prices lead to unprecedented labour cost growth as of 2022 through the indexation mechanisms, which weighs on cost competitiveness.
- Higher wage costs are partly passed on to services and goods inflation, but the current projections do not point to a longer-lasting wage-price spiral. Declining firm profit margins should partly absorb rising costs.
- As external price pressures should ease in the line with the aforementioned common assumptions, headline inflation declines gradually (to below 2 % before the end of next year).
- The budget deficit is projected to rise again to 5 % of GDP at the end of the projection horizon despite the disappearance of temporary measures to support purchasing power. Government debt remains on an upward sloping path in 2024.
- The risks surrounding these projections remain high and pertain to the expected price developments on international markets, but also to domestic factors such as the degree to which firms will be able to pass through their higher costs.
- 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 (24 May 2022). Additional government measures could affect the macroeconomic 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 24 May 2022. The baseline projections for Belgium are discussed in detail and individual risks are discussed in the final section of this article.

1. New headwinds for the international economy have emerged

After the faster than expected post-pandemic recovery, the global and, in particular, European economy had to face new headwinds. Partly due to the strong rebound in demand, supply chains of consumer and investment goods became clogged. This weakened the further economic expansion, even though the latter remained firmly supported by the recovery in the services industry. On international energy markets, the tensions between demand and supply have led to huge price increases, in particular for natural gas. The latter negatively affect the growth outlook, not just through rising costs of firms, but also via their impact on household purchasing power.

While uncertainty remained high, there were tentative signs at the start of 2022 that global supply chain problems were easing and trade flows were picking up again. However, new exogenous shocks have tested the resilience of the international economy since then. Apart from the human tragedy, the Russian invasion of Ukraine in February also brought about a re-intensification of supply chain issues for certain industries and, more generally, increased pressure on energy and other commodity prices. Meanwhile, the severe lockdowns imposed in certain industrial and logistical hubs in China in an attempt to bring down rising numbers of COVID-19 infections have dealt yet another blow to global supply chains.

The new worsening of the supply chain problems weighs to some extent on activity growth but also fuels upward price pressures in an already high-inflation environment. Several countries, such as the United States, the United Kingdom but also those in the euro area, are currently posting multi-decade high inflation rates. While this can still mainly be traced back to the spike in energy prices, core inflation has increased as well as higher energy or input prices are partly being passed on to final prices for goods and services.

The geopolitical situation remained very fragile at the time of writing. The further developments in the war in Ukraine are highly uncertain and can have a substantial impact on the outlook for the euro area in particular. At the same time, the very stringent COVID-19 containment measures have recently been relaxed in China and there are some tentative indications that supply chain problems were no longer worsening. Recent monthly data also seem to point to a deceleration of inflationary pressures. In line with the common external assumptions for this joint Eurosystem forecasting exercise, the projections are anchored to a gradual normalisation of the global supply chains in the coming quarters. In addition, it is assumed that there will be no further escalation in the war in Ukraine (with the most intensive phase of the conflict lasting until the end of this year) or in the economic sanctions against Russia. This also implies that there will be no sudden stop of energy imports from Russia, that could lead to energy rationing in certain euro area countries. Further measures have already been announced after the cut-off date of the projections but those should in principle not lead to energy shortages that can affect the economic outlook substantially.

Against this general backdrop, the world economy is expected to stall briefly in the second quarter of 2022 with quarter-on-quarter growth close to zero but should gain traction again in the second half of 2022. In annual terms, global activity (excluding the euro area) growth is projected to still reach 3 % in 2022 (also taking into

account the strong carry-over effect from 2021) and to strengthen gradually afterwards. Trade growth should remain weak in the near term but will pick up again as the supply disruptions gradually recede.

As usual, the profile of world trade determines the outlook for 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 December 2021 projections, Belgian export market figures have been revised clearly down for the entire projection period. According to the assumptions, Belgian export market growth is expected to amount to 4.1 % on average in 2022 and 3.3 % in 2023. By 2024, Belgian export market growth should stabilize around 3.5 % by 2024, in line with the euro area average. This is relatively close to the international environment taken into account for the intermediate update of the NBB macroeconomic projections of 28 March 2022.

Table 1

The international environment

(annual percentage changes)

	2020	2021	2022 e	2023 e	2024 e
World (excluding euro area) real GDP	−2.3	6.4	3.0	3.4	3.6
World (excluding euro area) trade	−7.8	12.3	4.3	3.1	3.7
Euro area foreign demand [1]	−8.9	10.4	3.4	2.2	3.5
Belgium's relevant export markets [1]	−9.5	9.4	4.1	3.3	3.5

Source: Eurosystem.
1 Calculated as a weighted average of imports of 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 $ 1.05 to the euro, i.e. a depreciation of the euro compared to the average level in 2021.

As usual, oil price and interest rate assumptions are based on market expectations. At the cut-off date for the common Eurosystem assumptions (20 May 2022), a barrel of Brent crude oil was priced just over €100 and the price was expected to gradually trend down to close to just under €80 by the end of 2024. The path for natural gas and electricity prices, that are currently higher than usual, is based on information from futures. Gas prices are expected to come down in different steps, after each winter. Meanwhile, oil prices have continued to increase and were above the level assumed for the second quarter at the time of writing. Prices for natural gas on the other hand had declined further to levels that are below the assumptions for these projections.

The three-month interbank deposit rate is expected to turn positive in the course of 2022, for the first time since 2015, and rise further to 1.6 % on average in 2024, in line with market expectations on ECB monetary policy. The average mortgage interest rate is also clearly edging up. It is expected to rise from about 2 % in 2022 to nearly 3 % in 2024. The average interest rate on business loans rises even more to just above 3 % in 2024. Even so, financing conditions still remain favourable compared to long-run averages.

Compared to the December 2021 projections the mechanical impact of the revised assumptions on economic activity is clearly negative and lowers activity growth for 2022 and 2023 in particular.

Table 2

The Eurosystem technical assumptions

(annual averages ; in %, unless otherwise stated)

	2020	2021	2022 e	2023 e	2024 e
EUR/USD exchange rate	1.14	1.18	1.07	1.05	1.05
Oil price (US dollars per barrel)	41.5	71.1	105.8	93.4	84.3
Interest rate on three-month interbank deposits in euro	–0.4	–0.5	0.0	1.3	1.6
Yield on ten-year Belgian government bonds	–0.1	0.0	1.4	1.9	2.1
Business loan interest rate	1.6	1.6	1.9	2.9	3.1
Household mortgage interest rate	1.6	1.5	2.0	2.6	2.9

Source : Eurosystem.

2. According to the baseline scenario, the euro area economy expands at a relatively solid pace over the projection horizon

The euro area economy expanded only moderately in the previous two quarters, at just 0.4 % on average in quarterly terms. Re-intensifying supply chain pressures, high (energy) prices and uncertainty are likely to dampen growth in the near term.

However, according to the futures prices on international markets, energy price pressures are still expected to gradually weaken over the projection horizon and supply chain disruptions should dissipate in the course of next year. Hence, beyond the near term, the euro area growth outlook remains solid, with private consumption serving as the main engine of growth. In annual terms, euro area GDP grows by 2.8 % in 2022 and is set to slow down somewhat to just above 2 % in 2023-24.

Headline inflation has skyrocketed in recent months and has even exceeded 8 % in May, mostly reflecting another strong increase in energy prices, even if core inflation has also been on the rise. With energy prices assumed to come down, headline inflation should gradually fall to just above 2 % in 2024. Second-round effects via higher wage claims remain quite limited and core inflation moderates over the projection period, while remaining a bit higher than total inflation.

The labour market has been resilient so far and job creation is expected to continue despite the economic impact of the war. Employment growth is expected to moderate but remains in positive territory. The unemployment rate stabilises at a level slightly below 7 %.

The euro area budget deficit improves throughout the projection period, as the COVID stimulus and energy compensatory measures gradually disappear. However, even in 2024, the deficit remains higher than before the pandemic. The government debt ratio is on a declining path, also when economic growth normalises. It falls to below 90 % of GDP in 2024.

Eurosystem staff assesses risks to growth as being tilted to the downside, for 2022 and 2023 in particular. At the same time, risks to inflation are assessed to be mainly on the upside. The possibility of a stronger wage-price spiral, as well as an upward shift in inflation expectations, represent domestic upside risks to inflation, while energy price developments and the geopolitical situation remain very uncertain. In this connection, the baseline projections assume that there is no further escalation of the war or the sanctions on Russia and, in particular, that there is no sudden stop in energy imports from Russia to the euro area that could lead to

rationing and production cuts. A downward scenario was also prepared, that incorporates an escalation of the war and a strengthening of the sanctions imposed against Russia, leading to strong upward pressure on commodity prices and global value chains. Such a scenario is projected to trigger a severe recession in the euro area at the turn of 2022-23.

Table 3

Eurosystem projections for the euro area

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

	2020	2021	2022 e	2023 e	2024 e
Real GDP (contributions in percentage points)	−6.5	5.4	2.8	2.1	2.1
of which:					
Domestic demand (exclude changes in inventories)	−5.6	3.6	2.3	1.6	1.8
Net exports	−0.4	1.4	0.1	0.4	0.2
Inflation (HICP)	0.3	2.6	6.8	3.5	2.1
Core inflation [1]	0.7	1.5	3.3	2.8	2.3
Domestic employment	−1.5	1.1	1.9	0.5	0.4
Unemployment rate [2]	8.0	7.7	6.8	6.8	6.7
General government financing requirement (–) or capacity [3]	−7.1	−5.1	−3.8	−2.6	−2.4
Public debt [3]	97.2	95.6	93.0	90.6	89.6

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 flatlines in the near term but growth picks up at the end of the year again

In view of the substantial changes in the international environment, the Bank has published an intermediate update of the macroeconomic projections on 28 March 2022. While the growth outlook was revised significantly down due to a temporary deceleration in the course of 2022, these updated projections did not point to a deep recession or a stagflationary scenario. In annual terms, the growth rate for 2023 was affected the most but remained slightly above potential and the growth rate picks up again in 2024. The current projections, that were produced following the regular Eurosytem procedures, by and large confirm the March 2022 outlook.

The Belgian economy proved to be quite resilient in the first months of the year. First-quarter growth came in at 0.5 % in quarter-on-quarter terms; clearly up from the NAI flash-estimate and nearly in line with our nowcast in the March 2022 Business Cycle Monitor (BCM). As expected, the tailwinds from the improvements in the health situation and the supply chains outweighed any impact of the war, the very high inflation and the huge drop in consumer confidence towards the end of the quarter.

Moreover, the most recent survey data and other high-frequency indicators do not seem to point to a sharp recession in the near term but are rather consistent with weaker growth. However, growth in the first quarter was still partly supported by reopening effects from the gradual removal of the sanitary restrictions and the

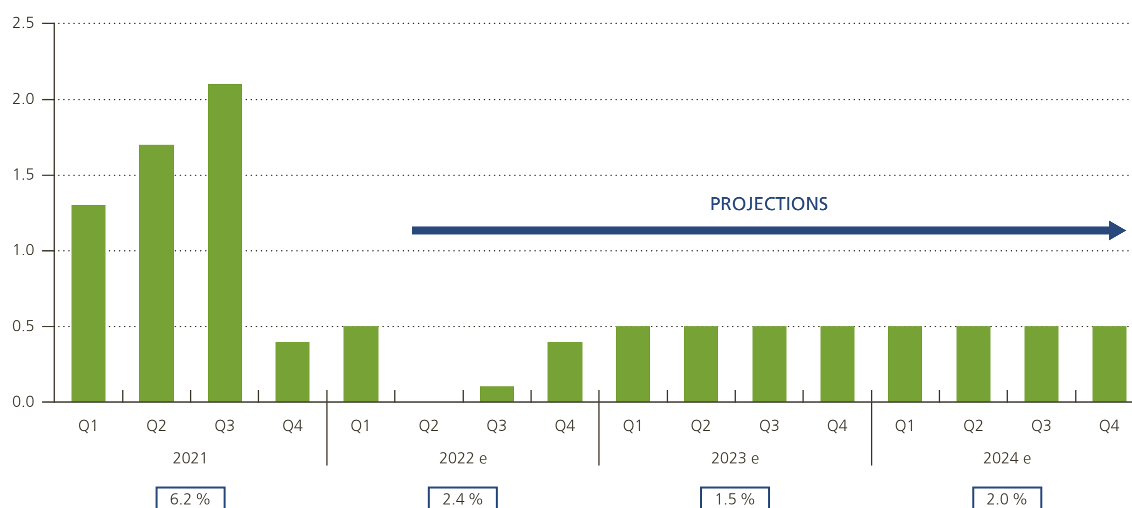
general improvement of the health situation. That should have a much smaller impact on activity growth in the next quarters of the year, while, if anything, the headwinds coming from the geopolitical uncertainty, renewed supply chain problems and very high energy prices will gain strength. Hence, as indicated in the most recent BCM published on 9 June 2022, we currently expect the Belgian economy to flatline in the second quarter due to a strong deceleration in domestic demand. Contrary to the March 2022 update, we no longer think that a minor contraction is the most plausible scenario, as certain high-frequency indicators came in above expectations.

Economic growth should then remain weak in the summer as well as very high inflation levels continue to depress private consumption and rising costs for firms slow down hiring and investment. At the same time, the fundamentals remain sound, as witnessed by the resilience in business confidence and the economy should rebound gradually once the headwinds start to fade. In line with the common narrative for these Eurosystem projections, external inflationary pressures should gradually decline as headwinds fade, which paves the way for a pick-up in growth as of the closing months of 2022. In the final years of the projection horizon, the economy should continue to expand at a quarterly rate that is slightly higher than potential, as the delayed indexation of incomes fuels consumer spending and firm investment rebounds after the temporary deceleration.

Chart 1

Quarterly growth flatlines in the near term but should pick up again by the end 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, figures have been rounded to 1 decimal)



Sources: NAI, NBB.

All in all, the Belgian economy remains robust. Some deceleration is normal, given the inflationary environment, supply chain bottlenecks and high vacancy rates on the labour market. In annual terms, growth is estimated to come in at 2.4 % in 2022; a large part of which is determined by the carry-over effect from the strong recovery throughout 2021. Annual growth then temporarily declines to 1.5 % in 2023 and bounces back to 2 % in 2024.

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

Private consumption had rebounded sharply throughout the first three quarters of 2021, mostly due to reopening effects. However, it contracted in the last quarter of 2021. While the health situation worsened in that period as well and certain containment measures were taken, this was by no means comparable to the previous COVID-19 waves. Hence, it seems likely that the decline in consumer spending can at least partly be traced back to the strong uptick in energy prices in the fall of that year.

In the first quarter of this year, private consumption returned to positive, albeit moderate growth, as the health situation improved again and energy prices declined in the first half of the quarter. However, energy prices went up again after the Russian invasion of Ukraine and the various sanctions, while consumer confidence nosedived in March. Increasing inflation erodes consumers' purchasing power in the short run, as the indexation mechanisms only work with a certain lag and offer no complete protection against rising energy prices (e.g. petrol and diesel prices are not included in the health index to which the indexation of incomes is anchored). Anecdotal information suggests that households significantly cut back their energy consumption[1] but the raging inflation is likely to depress consumption more broadly, in particular that of households for which energy constitutes a higher-than-average share of their expenditure. All in all, private consumption should hardly expand in the second and third quarter of the year and only start to recover towards the end of 2022 and in 2023.

It should be stressed that even though households' purchasing power is currently under pressure from rising prices, income growth prospects over the projection period remain solid. In real terms, average wages have declined in 2021 and will do so again this year but they rebound sharply as of 2023 as the indexation mechanisms kick in. Moreover, household incomes are supported by robust employment growth. All in all, real total disposable income for households in 2022 is estimated to still expand slightly in real terms, even if it would remain more or less flat in per capita terms. Over the whole 2022-2024 period real incomes are projected to grow by more than 4.5 % (or close to 3.5 % per capita). This contrasts sharply with the situation in the euro area: household incomes decline significantly this year and the recovery in the 2023-2024 period is much more muted than in Belgium (with a growth rate that is less than half of the one for Belgian households). This illustrates that the Belgian automatic indexation mechanisms, that do not exist in most other euro area countries (apart from Luxembourg and Malta), protect household purchasing power relatively well compared to other countries. In the latter, real wages and replacement incomes decline more than in Belgium and a larger part of the burden of the external energy shock falls upon households.

As in previous projections, private consumption growth is also supported by a normalisation of the savings ratio. The latter gradually comes down further from the pandemic-related peak of 20 % in 2020. As there is no more forced saving due to containment measures the savings ratio should come back to levels that are more in line with those reached prior to the pandemic. In the 2022-2024 period Belgian households should save on average about 13.5 % of their disposable income.

This is still slightly higher than in the pre-pandemic years for two reasons. First, increased uncertainty as well as the awareness of the greater need for fiscal consolidation may warrant some additional precautionary saving. Second, as interest rates are expected to rise, incentives to save become stronger. The current projection of the savings ratio also still implies that the 'savings buffer' accumulated during the pandemic is not used to finance additional consumption. Among other reasons, those savings were mostly accumulated by high-income households[2] that currently suffer relatively less from the high energy prices[3] and, hence, are not likely to have to dip into these savings to keep consumption up.

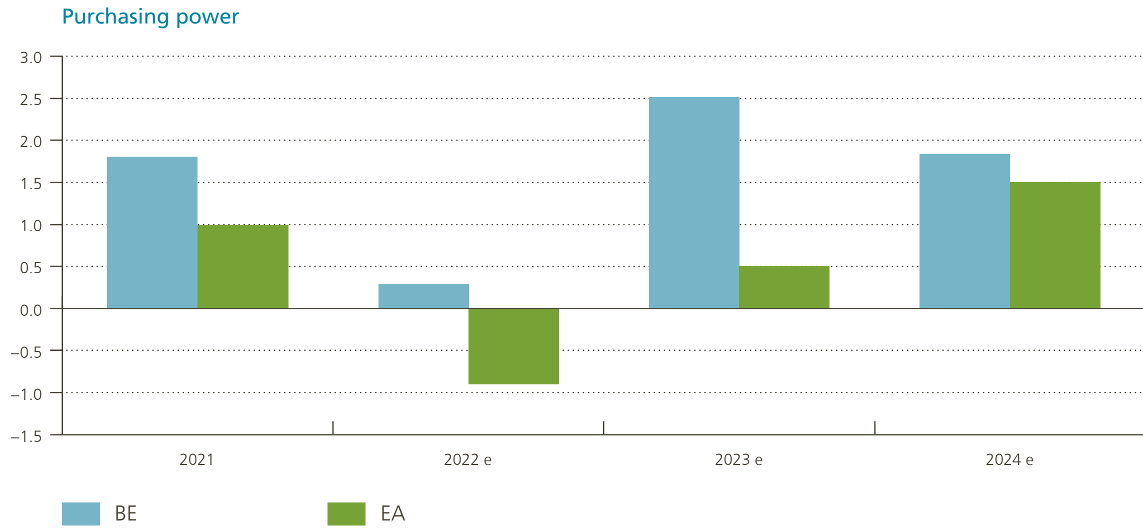
1 Fluvius noted that households in Flanders used 16 % less gas in February 2022 compared to the corresponding month of the previous year.
2 This is confirmed in a recent analysis by Basselier and Minne (2021), Household savings during and after the COVID-19 crisis: Lessons from surveys | nbb.be, November 2021.
3 Please refer to the ECARES working paper by Capeau, Decoster, Güner, Hassan, Van Houtven, Vanderkelen and Vanheukelom on the purchasing power effects of the recent energy price shock, March 2022.

Chart 2

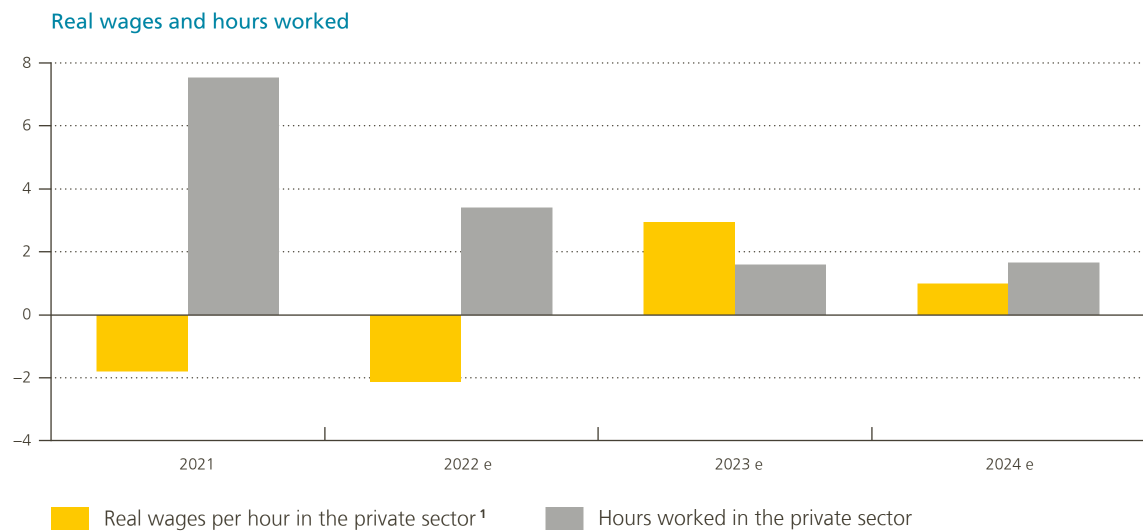
Household purchasing power and savings ratio

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

Purchasing power

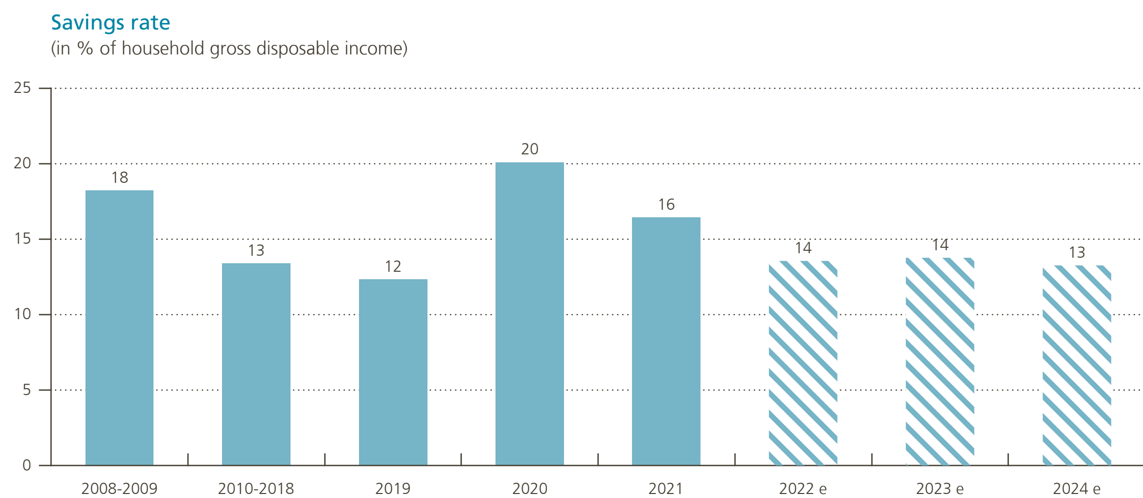


Real wages and hours worked



Savings rate

(in % of household gross disposable income)



Sources: Eurosystem, NAI, NBB.

1 Real wages include the sum of conventional wages and the indexation effect in the private sector, deflated by HICP.

Increased uncertainty among households, combined with the downward impact on their purchasing power from high energy prices and upward sloping mortgage rates, is expected to lower the appetite for residential investment as well. Housing investment has posted very strong growth since the second half of 2020 and expanded strongly again in the first quarter of 2022. However, the projections point to more subdued but still positive growth in the coming years, at an average of about 0.3 % per quarter.

Business investment had recovered quickly from the initial impact of the COVID-lockdowns but fell back in the second half of 2021 and stood 4 % below its pre-pandemic level by the end of 2021. Rising input costs and supply chain difficulties are likely to have been the main reasons for this contraction. While first-quarter growth was buoyant again, possibly as a result of the temporary improvement in the supply chains, the current conditions are likely to continue to weigh on businesses' investment plans, leading to only moderate growth in the short run. Business investment is set to expand by about 0.8 % on average per quarter in 2022. The fundamentals for business investment growth beyond the short run remain supportive, however: demand is expected to rebound as the aforementioned headwinds fade and financing conditions remain favourable despite rising interest rates. Moreover, recent survey information shows a high degree of capacity utilisation in manufacturing, which could trigger some expansion investment. All in all, business investment should accelerate again in the two following years.

Table 4

GDP and main expenditure categories

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

	2020	2021	2022 e	2023 e	2024 e
Household and NPI final consumption expenditure	–8.2	6.4	3.7	2.2	2.4
General government final consumption expenditure	–0.4	4.4	2.1	–1.6	1.3
Gross fixed capital formation	–6.1	7.8	1.5	3.8	3.3
General government	1.5	2.6	3.1	7.4	4.4
Housing	–6.8	10.1	3.6	1.2	1.4
Businesses	–7.0	8.0	0.5	4.1	3.7
p.m. Domestic expenditure excluding the change in inventories [1]	*–5.8*	*6.1*	*2.7*	*1.6*	*2.4*
Change in inventories [1]	–0.3	–0.5	0.0	0.0	0.0
Net exports of goods and services [1]	0.4	0.6	–0.2	–0.1	–0.3
Exports of goods and services	–5.5	9.6	1.0	1.7	2.5
Imports of goods and services	–5.9	9.1	1.3	1.8	2.8
Gross domestic product	–5.7	6.2	2.4	1.5	2.0

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

Turning to public expenditure, public consumption growth in 2022 is still somewhat affected by the booster vaccination drive, as well as by the additional expenditure related to the inflow of Ukrainian refugees. In addition, the social tariff for natural gas and electricity was temporarily extended to protect a larger group of lower-income households from the surge in energy prices. The unwinding of these factors will cause public consumption to decline in real terms in 2023. Public investment growth remains robust throughout the projection period, in line with the announced government plans to increase the government investment ratio. In 2023, public investment growth is expected to be particularly high, boosted by the usual local election cycle.

Growth in Belgian exports will be quite subdued throughout the projection period: exports should expand by just 1 % in real terms this year and only accelerate to a growth rate of 2.5 % in 2024. This is not only due to the deceleration in foreign demand discussed in section 1, but also reflects the fact that worsening cost competitiveness of Belgian exporters is likely to lead to a decline in market shares that exceeds the trend level. Very strong wage cost pressures (as discussed in section 6) will partly spill over to export prices or decrease exporting firms' profitability. The current projections point to a significant decline in export market shares for Belgian firms by about 5.5 % in the projection period, which is more than twice as much than the trend decline. This automatically reduces growth in imports as well (as exports have a large import content) but import growth is fueled by the projected increase in domestic demand (and household consumption in particular). Hence, it slightly outpaces export growth over the projection period causing net exports to reduce GDP growth in all years of the projection period, by about 0.7 percentage points in total.

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

The labour market has been particularly resilient during the pandemic and employment expanded already very strongly in 2021. In parallel, the decline in the use of temporary unemployment and bridging rights, combined with greater recruitment difficulties in some sectors that could imply overtime or adjustment in working time for current workers, has led to a rapid rebound in the average working time. However, in contrast to employment in persons, the average working time has not yet returned to its pre-crisis level. The recovery in average hours worked should continue throughout the projection period and the number of temporary unemployed is projected to normalise.

Also in view of the important carry-over effect related to last year's increase, job creation will remain buoyant in 2022 as well. However, net hiring is projected to slow down over the projection period. Labour demand, in the branches that are sensitive to the business cycle in particular, will gradually be weighed down by the rising wage costs, as well as the projected deceleration in activity growth. As the latter factor is temporary, employment will gain some traction again in the second half of the projection period. While employment in other services should post a relatively constant increase, net hiring in administration and education will slow down somewhat, also because of the exceptionally large inflows in education in 2021.

In addition, job creation will continue to be supported by a trend increase in the number of self-employed. Growth in the number of self-employed actually increased somewhat during and in the aftermath of the pandemic period. This is partly related to the various protective measures (such as the bankruptcy moratorium) and subsidies that were in place and that may have delayed exits from self-employment. In the projection period, the increase in the number of self-employed is projected to return to its pre-pandemic trend.

All in all, employment should continue to expand, albeit at a more moderate rate compared to the most recent period before the pandemic and in the recovery phase. The harmonized employment rate (20 to 64 years old) is projected to increase gradually but in 2024 it still remains far below the 80 % target.

While the working age population slows down and peaks in 2023, the labour force continues to increase due to the projected further increase in the participation rate. The latter is boosted to some extent by a number of reforms (including some increases in take-home pay) that are likely to increase the effective labour supply. The inflow of refugees, notably in the context of the war in Ukraine, should only have a temporary impact on the population of working age and, to a lesser extent, the labour force, as it is assumed that those refugees will gradually return home in the latter years of the projection period.

Unemployment declines substantially this year. Job creation loses steam as of 2023 but is still sufficient to keep the unemployment rate broadly constant at historically low levels.

Table 5

Labour supply and demand

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

	2020	2021	2022 e	2023 e	2024 e
Working age population [1]	15	15	39	4	–3
Labour force	16	56	59	37	32
Domestic employment	–1	86	85	29	37
Employees	–15	66	68	15	23
Branches sensitive to the business cycle [2]	–29	43	51	3	11
Administration and education	6	13	7	3	3
Other services [3]	8	10	10	9	9
Self-employed	14	20	17	14	14
Unemployed job-seekers	17	–30	–26	8	–5
p.m. Harmonised unemployment rate [4, 5]	*5.6*	*6.3*	*5.7*	*5.8*	*5.7*
Harmonised employment rate [4, 6]	*70.0*	*70.6*	*71.8*	*72.1*	*72.7*

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).

6. Inflation pushes up labour cost growth to unprecedented levels but is projected to moderate

Inflation has surged since the summer of last year and has now reached a multi-decade high of close to 10 % for the HICP indicator in May 2022 [1]. This is primarily due to the stratospheric increase in energy prices with energy inflation even exceeding 60 % since the start of 2022. In the more recent months, core inflation has been rising as well. It has more than doubled over the past 8 months, from 1.6 % in September 2021 to 3.4 % in May. While prices of certain services are also rising more quickly than usual, this reflects a spike in the prices of non-energy industrial goods, that are fueled by supply bottlenecks.

As wages are automatically linked to the health index, the unusually high inflation rates strongly increase labour cost growth. Taking into account the recent and projected inflation developments, hourly wage costs should increase by an unprecedented 12 % in the 2022-2023 period. This increase is almost exclusively driven by the indexation effect. On the basis of the nationwide wage norm for 2021 and 2022, there should still be an increase

1 The May figure is the flash estimate, that was not yet available at the time of the forecast.

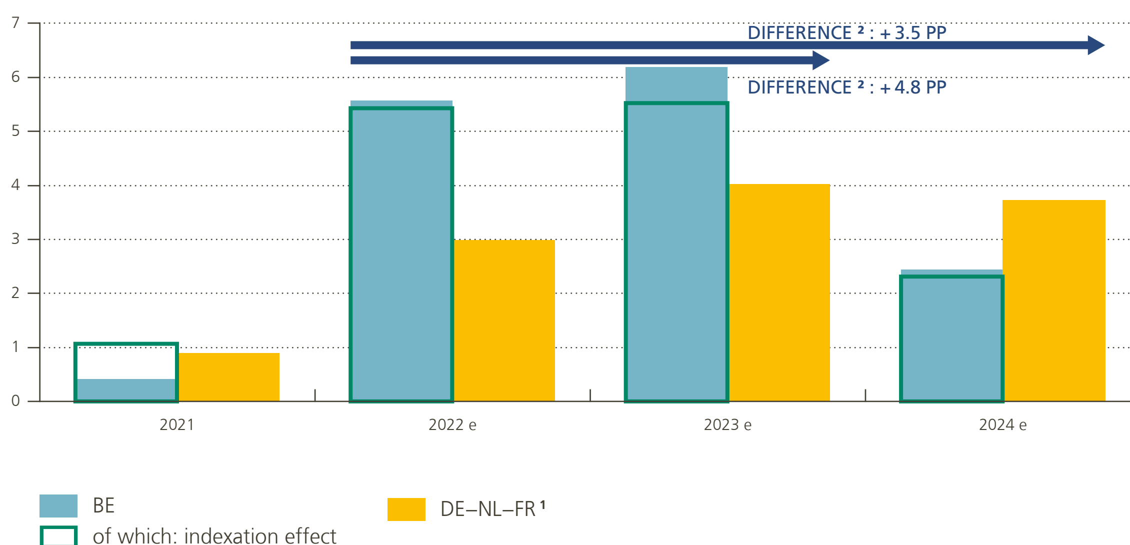
of conventional wages of some 0.6 %. This increase also incorporates the pay increases in care institutions (amounting to some 0.2 % of the total private‑sector wage bill) that are financed by the federal and regional governments and offset by wage subsidies.

The projected increase in wage costs in 2022 and 2023 is likely to strongly outpace that in the three main neighbouring countries that are considered in the legal framework guiding wage negotiations in Belgium. Hence, the projections for 2023 and 2024 were based on the technical assumption that there would be no room for any conventional pay rises in the new wage norm covering the 2023‑2024 period. As the high level of vacancy rates suggest that the labour market is very tight, in particular in certain regions and industries, the projections do take into account a limited positive wage drift in 2022 and 2023. In addition, the unwinding of several pandemic‑related government measures that are recorded as wage subsidies come to an end and increase wage costs somewhat in 2022 in particular.

Chart 3

Hourly wage cost growth in the private sector

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



Sources: Eurosystem, NAI, NBB.

1 Weighted average of wage cost growth in the neighbouring countries, based on the current Eurosystem projections.

2 The cumulative difference in wage cost growth between Belgium and the neighbouring countries that is shown here is not necessarily identical to the official assessment by the Central Economic Council.

Despite the very moderate growth in conventional wages, the Eurosystem projections currently point to the wage cost gap[1] between Belgium and the three reference countries worsening substantially in 2022 and 2023, by close to 5 %. This is only partially offset in 2024, when the indexation effect moderates in Belgium and nominal wage claims rise more strongly in the neighbouring countries. The strong increase in hourly wage costs also translates into a very large increase in unit labour costs, despite a mild recovery of labour productivity at the end of the projection period.

1 This is an estimation based on the current Eurosystem projections and is not necessarily identical to the official assessment by the Central Economic Council.

Inflation rates have recently clearly exceeded expectations and Belgian inflation again came in well above our December 2021 projections. This is primarily due to the continued volatility on energy markets that has pushed up international energy prices above the futures prices to which the Eurosystem projections are anchored, although core inflation surprised on the upside as well. The war in Ukraine and the ensuing sanctions against Russia have exacerbated the energy price pressures. In addition, supply chains that had started normalising since the start of the year, became more disrupted again, also due to the severe lockdowns in certain industrial hubs in China in an attempt to fight the new COVID-19 wave. This has pushed up prices for non-energy commodities, intermediate input materials and food products. As indicated above, these underlying price pressures have now started to affect core inflation as well, in particular via price increases of non-energy industrial goods.

The current inflation projections are based on the assumption that those external price pressures will wane in the projection period. First, as discussed in section 1, the futures for energy products that are part of the Eurosystem common assumptions again point to declining price levels in the 2022-2024 period. This market outlook may be affected by exogenous geopolitical events and, hence, can be wrong, as was the case in the previous projections. In that connection, the further developments in the Ukraine war seem key and in the baseline scenario of the Eurosystem projections it is assumed that there will be no sudden stop in the euro area energy imports from Russia that could lead to energy rationing. While uncertainty around these energy assumptions remains very high, it currently seems unlikely that petrol and natural gas prices would continue to increase at the same rhythm. This implies that energy inflation should come down once the strong increases since the fall of 2021 no longer affect yearly inflation rates, even if price levels remain high. Second, the common assumption that supply chains will gradually normalise should in principle lower the inflation of imported other commodities and intermediate inputs as well.

Turning to the individual inflation components, energy inflation is projected to rise to close to 50 % on average this year. This estimate takes into account the different temporary government measures to curb the increase in household energy bills. The latter include the temporary reduction of the VAT rate on electricity and gas to 6 %, the lowering of the excise duties on motor fuels, the extension of the social tariff on natural gas and electricity, as well as various one-off subsidies. Without these measures, inflation would have even been higher in 2022 (but lower in 2023[1]). Based on the current futures, electricity and gas prices should decline gradually, with significant drops in April 2023 and April 2024. In Belgium, these price movements on international markets are passed on relatively quickly to retail energy prices. Hence, taking into account the declining path of the Brent oil futures as well, energy inflation should fall into negative territory in 2023 and even more strongly in 2024, pushing down total inflation.

Food inflation also rises this year, to more than 5 %. As rising food prices are partly caused by higher energy costs and disrupted supply chains (pushing up prices for fertilizer and packaging for instance), food inflation should also gradually moderate in the projection period as these external pressures unwind. According to the current projections, that also take into account yearly increases in excise duties on tobacco products, it should fall back to some 2.5 % by 2024.

The projected decline in food and, especially, energy inflation implies that total inflation should be close to a peak now and fall steadily from the start of the summer onwards. However, the large increases in energy costs, input materials and wage costs feed into core inflation. While total inflation should drop relatively soon, core inflation is projected to increase further until the late summer and ease much more gradually.

Inflation in non-energy industrial goods has been mostly pushed up by rising energy and other input costs. It is projected to come down once these cost pressures start to recede and should fall back below 2 % as of next year already. Services inflation has increased as well and is likely to be somewhat more persistent as the

1 As the measures come to an end on the 1st of October 2022, the index is pushed up again, with an upwards impact on the year-on-year inflation rates up to September 2023.

Table 6

Price and cost indicators

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

	2020	2021	2022 e	2023 e	2024 e
Private sector labour costs[1]:					
Labour costs per hour worked	4.3	0.3	5.8	6.3	2.4
of which:					
Real conventional wages	0.6	0.4	0.6	0.0	0.0
Wage drift and other factors	3.1	−0.6	−0.4	0.4	0.2
Indexation	1.0	1.1	5.4	5.5	2.3
Social contributions	0.4	−0.4	−0.1	0.2	0.0
Wage subsidies	−0.9	−0.1	0.3	0.1	0.0
p.m. Labour costs per hour worked according to the national accounts[2]	*5.3*	*0.4*	*5.6*	*6.2*	*2.4*
Labour productivity[3]	4.3	−0.3	−0.6	0.1	0.5
Unit labour costs[3]	0.0	0.6	6.5	6.1	1.9
Total inflation (HICP)	0.4	3.2	8.2	2.6	1.3
Core inflation[4]	1.4	1.3	3.3	2.7	2.2
of which:					
Services	1.8	1.6	3.4	3.2	2.8
Non-energy industrial goods (NEIG)	0.7	0.8	3.1	1.9	1.3
Energy	−11.0	22.4	47	0.2	−6.4
Food	2.6	0.9	5.4	3.3	2.5
p.m. Inflation according to the national index	*0.7*	*2.4*	*7.8*	*3.4*	*1.7*
Health index[5]	1.0	2.0	7.3	3.5	1.8

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.

significant hike in wage costs should be partly passed on to final prices in the more labour-intensive services sector in particular.

At the same time, rising cost pressures are also partly absorbed in corporate profit margins in line with historical regularities. Profit margins typically decelerate or decline when wage costs increase rapidly, as companies do not or cannot pass on the full extent of the cost increases to final selling prices.[1] In this connection, the current

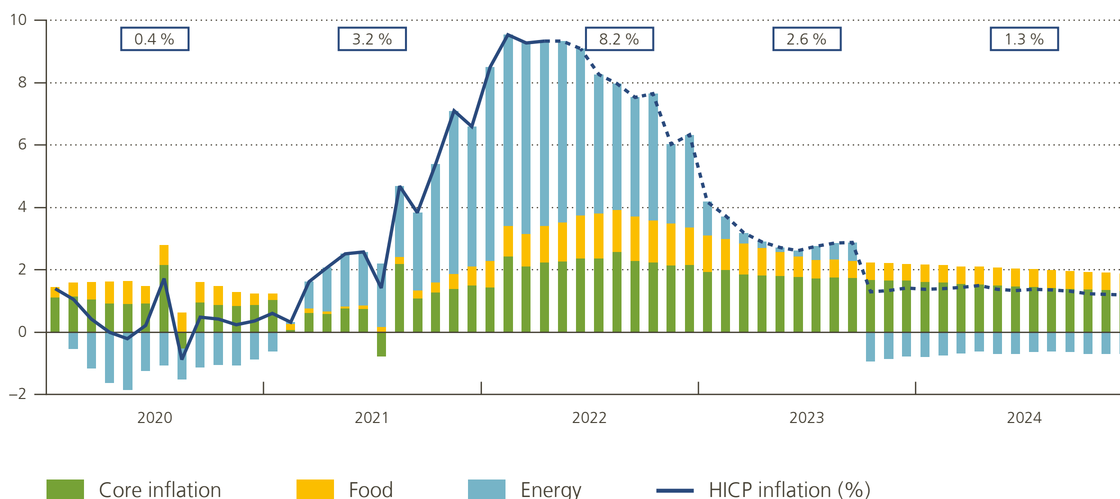
1 A similar result was found in a recent study by the Bank based on micro data (Bijnens, Gert and Cédric Duprez, 2022). On average, the pass-through of costs to prices was found to be 60%, which is broadly comparable to the pass-through in the models and approaches used for the macroeconomic projection exercises.

projections point to declining profit margins throughout the 2022-2024 period (even if they would remain above a long-run average in level terms). This implies that there should not be a persistent wage-price spiral and that domestic wage cost pressures will also recede gradually. Clearly, this is conditional on the absence of non-linear reactions in price-setting, not assumed by our projection models, and the compliance with the Law on Competitiveness and Employment that caps conventional wage increases. Under those conditions, also services inflation will gradually ease, albeit more slowly: it will still be close to 3 % in 2024.

All in all, core inflation is projected to peak at 3.8 % in 2022, which is by far the highest annual figure observed since the start of the HICP measure (1996). For comparison: the previous highest annual core inflation rate observed was 2.2 % in 2002. It is projected to decline gradually but, due to the more persistent services inflation, remains above 2 % in 2024 and well above its long-term average of 1.5 % (recorded in the 1997-2019 period). Because of the projected rapid decline in energy prices, the annual average of total inflation should decline more steeply from a staggering 8.2 % in 2022 to below 1.5 % in 2024.

Chart 4

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



Sources: Eurostat and NBB calculations.

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 natural gas are taken into account in the health index, its growth rate also strongly increases to 7.3 % in 2022, before dropping back in 2023 and 2024. The pivotal index for public wages and social benefits has been passed 4 times in less than 1 year, in August 2021, December 2021, February 2022 and April 2022. It is set to be exceeded again in October 2022, February 2023 and February 2024.

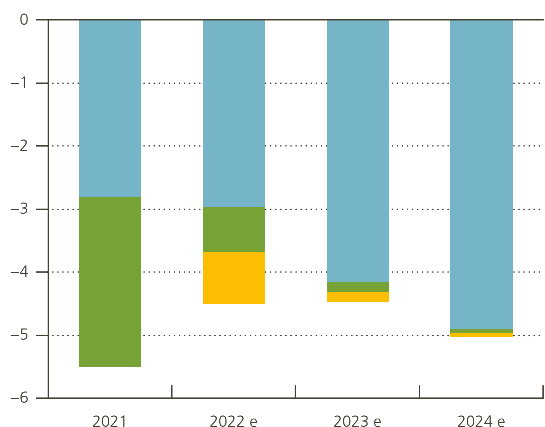
7. The general government deficit does not improve and the debt ratio is on the rise

The general government deficit has come down substantially in 2021 and should narrow further to 4.5 % of GDP this year. This mostly reflects the further cyclical recovery after the pandemic with above-potential growth and the gradual unwinding of the temporary support measures (including those related to the floods in the summer of 2021). However, temporary measures of some 1.5 % of GDP negatively affect the government deficit in 2022. On the one hand, certain measures taken in the context of the pandemic (such as additional social security expenditure related to COVID-19 testing and vaccination) continue to weigh on spending. On the other hand, the war in Ukraine and the spike in energy prices have pushed the government to take various new measures that worsen the deficit. First, several measures aim at lowering the cost of energy and electricity for households. They include the temporary reduction in VAT on electricity and gas, reduced excise duties on petrol and gasoil, lump-sum transfers for electricity and heating and the extended use of the social tariff for electricity. Second, the war leads to an increase in humanitarian aid in Ukraine and for refugees coming to Belgium, while defence spending is increased in the longer run.

Chart 5

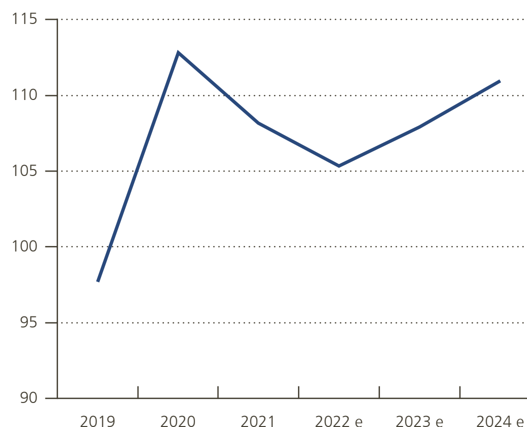
The deficit remains structurally high and the public debt ratio is on an upward trajectory

The budget deficit remains high
(in % of GDP)



Financing requirement (excl. temporary COVID-19 and UA and energy related support measures)
Temporary COVID-19 support measures
Temporary UA and energy related measures

The government debt ratio is on a rising path at the end of the projection horizon
(in % of GDP)



Sources: NAI, NBB.
The above depicted figures on the Belgian budget balance only consider Belgian revenues and expenditures. They disregard the deficit at the EU level that originates from the grants from the EU to its member states in the context of the Next Generation EU programme between 2021 and 2026, which are financed with European debt. This EU deficit, which amounts to 0.4 % of GDP annually during these 6 years, represents an additional implicit deficit for the Belgian government, that will have to be paid back in the coming decades.

While these temporary measures should unwind in the projection period, the government deficit does not decline and actually increases to about 5 % of GDP in 2024, despite continued above-potential GDP growth. This is primarily due to the stepwise increase in current primary spending: the latter is projected to be close to

half of GDP by 2024. Beyond the short-term volatility due to the timing of indexations and the different evolution of the health index and the GDP deflator, population ageing accounts for part of the increase as pensions, as well as expenditure on health and elderly care continue to expand. Other drivers are the rising government sector employment, as well as the gradual increase in certain minimum allowances. Capital spending rises more slowly in the projection period and mostly reflects the announced government plans to beef up investment.

Government revenue as a share of GDP has been on a slowly declining trend since 2013 and should reach a trough this year. However, it is projected to increase again as of next year. While this mostly reflects the increase in the more heavily taxed labour share in GDP, the government revenue ratio is also pushed up by certain tax increases, such as the higher proceeds from certain environmental taxes (related to the ETS scheme) and nuclear energy production, as well as some hikes in indirect taxes.

Finally, interest payments are also expected to increase as of 2023, for the first time since the 1990s. Higher sovereign yields are gradually passed on to the implicit interest rate on government debt. If the current market rates remain constant, the latter will further increase beyond the projection horizon and, together with the rising debt ratio, continue to push up interest charges.

The government debt ratio declines to about 105 % this year but debt dynamics become unfavourable in the outer years of the projection period. This obviously primarily reflects the significant deficits. Even though the interest rate growth differential remains beneficial – with nominal GDP growth still exceeding the implicit interest rate on public debt –, its favorable impact is slowly fading as market interest rates are rising.

Table 7

General government accounts

(in % of GDP)

	2019	2020	2021	2022 e	2023 e	2024 e
General government						
Revenue	**49.9**	**50.2**	**49.3**	**49.0**	**50.1**	**50.4**
of which: taxes and social contributions	42.9	43.1	42.6	42.1	43.1	43.3
Primary expenditure	**49.9**	**57.3**	**53.1**	**52.0**	**53.0**	**53.7**
Current expenditure	46.6	53.6	49.4	48.4	49.3	49.9
Capital expenditure	3.4	3.6	3.8	3.6	3.7	3.8
Primary balance	**0.0**	**−7.1**	**−3.9**	**−3.0**	**−2.9**	**−3.3**
Interest charges	**2.0**	**1.9**	**1.7**	**1.5**	**1.6**	**1.7**
Financing requirement (–) or capacity [1]	**−2.0**	**−9.0**	**−5.5**	**−4.5**	**−4.5**	**−5.0**

Sources: NAI, NBB.

1 These figures do not take account of the implicit deficit of on average 0.4 % of GDP annually over the period 2021-2026, due to the debt financed grants to EU member states from the NGEU-programme.

8. The baseline projections are still surrounded by considerable uncertainty

The uncertainty surrounding the baseline economic projections that are described in this article is still much larger than usual. While the risks related to the pandemic seem to have subsided, the ongoing war in Ukraine have brought the geopolitical risks to the fore. The latter may affect the outlook for the Belgian economy, in particular

via the energy price channel and its impact on household purchasing power and company costs. This uncertainty pertains to both the real (growth) and the nominal (costs, inflation) side of the current projections.

As regards the nominal side, it should be reiterated that the anticipated decline of inflation in the current projections is predicated upon a series of assumptions. First, energy prices are expected to come down, according to the futures prices on international markets. It should be noted that the price expectations derived from these futures are not always accurate (as was the case in the two previous editions of projections, when the downward path anticipated at the cut-off date, did not materialise in reality). At the same time, the current supply bottlenecks are assumed to dissipate gradually by the end of 2023, but an intensification of geopolitical tensions could obviously throw a spanner in the works. Third, the assessment that there will not be a longer-lasting wage-price spiral also depends on the feature that firms' profit margins will partially absorb part of the price shock, as has been observed in past episodes of high wage costs, and that the 1996 Law on Competitiveness and Employment will be complied with as regards the limitations on conventional wage increases. Inflation may be higher or more persistent if the external price pressures remain higher than currently assumed, if profit margins do not decline or if conventional wages rise faster. Keeping inflation in check will also require an adequate monetary policy response and well-anchored inflation expectations.

Turning to the real side, the most recent high-frequency indicators suggest that the near-term outlook may be somewhat more benign than in the current projections. Business confidence indicators, for instance, are holding up relatively well, while other recent data, such as on payment transactions, also seem to point to a mild slowdown rather than a deeper crisis. The estimate for growth in the second quarter is also towards the lower end of the range provided by the Bank's nowcasting applications. This could point to some upside risks in the near term. However, in the longer term, the uncertainty is clearly much larger and risks are assessed to be broadly balanced.

Finally, rising interest rates have reminded us of the cost of high (public) debt. 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	2022 e	2023 e	2024 e
Growth (calendar adjusted data)	−5.7	6.2	2.4	1.5	2.0
Real GDP					
Contributions to growth:					
Domestic expenditure, excluding change in inventories	−5.8	6.1	2.7	1.6	2.4
Net exports of goods and services	0.4	0.6	−0.2	−0.1	−0.3
Change in inventories	−0.3	−0.5	0.0	0.0	0.0
Prices and costs					
Harmonised index of consumer prices	0.4	3.2	8.2	2.6	1.3
Health index	1.0	2.0	7.3	3.5	1.8
GDP deflator	1.3	4.5	6.1	1.0	0.5
Terms of trade	0.5	−0.7	−2.6	−0.2	0.4
Unit labour costs in the private sector [1]	0.0	0.6	6.5	6.1	1.9
Hourly labour costs in the private sector [1]	4.3	0.3	5.8	6.3	2.4
Hourly productivity in the private sector	4.3	−0.3	−0.6	0.1	0.5
Labour market					
Domestic employment (annual average change in thousands of persons)	−0.8	86.0	84.7	28.9	36.7
Total volume of labour [2]	−8.5	6.3	3.1	1.4	1.4
Harmonised unemployment rate (in % of the labour force aged 15 years and over)	5.6	6.3	5.7	5.8	5.7
Incomes					
Real disposable income of individuals	0.9	1.8	0.3	2.5	1.8
Savings ratio of individuals (in % of disposable income)	20.1	16.4	13.5	13.8	13.3
Public finances (in % of GDP)					
Primary balance	−7.1	−3.9	−3.0	−2.9	−3.3
Budget balance	−9.0	−5.5	−4.5	−4.5	−5.0
Public debt	112.8	108.2	105.3	107.9	110.9
Current account (according to the balance of payments, in % of GDP)	0.8	−0.4	−2.2	−2.2	−2.0

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.

Conventional signs

%	per cent
e	estimate
p.m.	*pro memoria*
p.p.	percentage point

List of abbreviations

Countries or regions

BE	Belgium
DE	Germany
FR	France
NL	Netherlands
EA	Euro area

Abbreviations

BCM	Business Cycle Monitor
COVID-19	Coronavirus disease-19
EC	European Commission
ECB	European Central Bank
EU	European Union
FPB	Federal Planning Bureau
FPS	Federal Public Service
GDP	Gross domestic product
HICP	Harmonised index of consumer prices
NAI	National Accounts Institute
NBB	National Bank of Belgium
NEIG	Non-energy industrial goods
NEO	National Employment Office
NPI	Non-profit institutions serving households
Statbel	Belgian Statistical Office
VAT	Value added tax

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