NBB Economic Review

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Economic projections for Belgium – December 2023

NationalBank
OF BELGIUM
Eurosystem

Economic projections for Belgium – December 2023

Introduction

The macroeconomic projections for Belgium set out in this article form part of the Eurosystem projections for the euro area. They are based on a set of technical assumptions and forecasts for the international environment drawn up jointly by participating institutions, namely the ECB and the national central banks of the euro area. The cut-off date for the Belgian projections was 30 November 2023. This article discusses the baseline projections for Belgium in detail, with a risk assessment for the baseline provided in the last section. As usual, the projections take into account only government measures that have been decided and are likely to pass the legislative process and that had been announced in sufficient detail by the cut-off date.

1. The global economy remains resilient

While the global economy started 2023 on solid footing, it is expected to decelerate in the second half of the year. So far, growth in advanced economies has proven to be more resilient than anticipated, notably in the United States, whereas the Chinese post-COVID-19 economic recovery lost pace more quickly than expected. Looking ahead, lagged effects of tighter monetary policy are expected to temporarily weigh on growth somewhat.

Global trade has continued to be much more sluggish than global GDP, which is considered mostly to reflect a demand composition effect. Post-pandemic consumption patterns, in particular, are still somewhat skewed towards less trade-intensive services, while higher interest rates and less dynamic lending could slightly dent more trade-intensive investment goods. In 2023, global trade (excluding the euro area) is expected to expand by only 1 %, a clearly weaker pace than global activity. Going forward, global trade should return to more normal levels and is, as of 2024, projected to increase by around 3 %, in line with the growth rates for global activity.

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 factor for the medium-term macroeconomic projections for Belgium. Based on the prevailing assumptions, Belgian export markets are expected to expand steadily as from early 2024, by 0.7 % on average per quarter, following weak growth throughout 2023.

Table 1

The international environment

(annual percentage changes)

	2022	2023 e	2024 e	2025 e	2026 e
World real GDP (excluding euro area)	3.3	3.3	3.1	3.2	3.2
World trade (excluding euro area)	5.5	1.1	3.0	3.0	3.2
Euro area foreign demand [1]	6.6	0.8	2.6	2.9	3.1
Relevant Belgian export markets [1]	7.6	–0.1	2.1	3.1	3.0

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

Turning to the technical and financial assumptions underlying the current Eurosystem projections, the exchange rate is assumed to remain constant throughout the projection period. The euro has become stronger since last autumn and was trading at around $ 1.08 at the cut-off date.

As usual, assumptions concerning oil prices and interest rates are based on market expectations. At the cut-off date for the common Eurosystem assumptions (24 November), a barrel of Brent crude oil was priced near € 80, with this price expected to trend gradually downwards to just below € 70 by the end of 2026. Gas prices have remained at rather low levels, at around € 45 per MWh (and even somewhat lower early December). As usual, the expected prices going forward are based on information from futures. At the cut-off date, gas prices were expected to trend slightly downwards over the projection horizon, towards € 35 per MWh by the end of 2026.

As regards financial conditions, the markets currently expect the three-month interbank deposit rate to peak at 4 % by the end of 2023, before moderating to 2.7 % on average in 2026. Likewise, the average interest rate on business loans is also expected to peak at year's end, at just over 5 %. It should then come down slightly to 4 % by 2026. The average mortgage rate has clearly moved up over the past year, from 2 % in 2022 to 3.6 % in 2023. It is expected to edge up slightly more, to reach 4.2 % on average in 2026.

Table 2

Eurosystem technical assumptions

(annual averages; in %, unless otherwise stated)

	2022	2023 e	2024 e	2025 e	2026 e
EUR/USD exchange rate	1.05	1.08	1.08	1.08	1.08
Oil price (US dollars per barrel)	103.7	84.0	80.1	76.5	73.6
Interest rate on three-month interbank deposits in euro	0.3	3.4	3.6	2.8	2.7
Yield on ten-year Belgian government bonds	1.7	3.2	3.3	3.4	3.5
Business loan interest rate	2.0	4.7	4.8	4.1	4.0
Household mortgage interest rate	2.1	3.6	4.0	4.1	4.2

Source: Eurosystem.

2. The euro area economy should recover gradually

The euro area economy has barely grown since the end of 2022 and annual growth for 2023 is set to come in at just 0.6 %. Growth is expected to strengthen gradually from early 2024 onwards, as consumer demand firms due to the increase in purchasing power. At the same time, foreign demand is expected to rebound as well, in line with the aforementioned assumptions for world trade. Euro area exports should pick up some pace and export market share losses should become smaller. Euro area business investment and housing investment are expected to start their recovery respectively at the start or the end of 2024. In annual terms, euro area GDP growth is expected to edge up to 0.8 % in 2024 and it should stabilise at 1.5 % in 2025 and 2026, in line with the pre-pandemic average cruising speed.

Headline inflation has continued to decline, even somewhat more rapidly than envisaged in the ECB's September projections, reaching 2.4 % in November. Energy inflation is expected to temporarily rebound as the impact of the rapid price declines gradually disappears from the annual inflation numbers. However, food and core inflation should continue to drop. Core inflation is expected to gradually fall to just above 2 % by the end of the projection horizon. Relatively strong wage growth that results from a tight labour market remains an important driver of higher-than-average core inflation, even if firms are expected to partially absorb higher wage costs through profit margins.

Even if employment growth is moderating, it should still outpace the expansion of the labour force, resulting in a further slight decrease of the unemployment rate, to 6.4 % in 2026.

The euro area budget deficit budget should continue to decline, particularly in 2023 and 2024, and to reach 2.6 % of GDP at the end of the projection period. The government debt ratio is more or less stable as of 2024, at around 88 % of GDP.

All in all, Eurosystem staff assesses risks to growth as being slightly tilted to the downside for the coming years, inter alia due to uncertainty about the recovery in foreign demand and about the further impact of the tightened euro area monetary policy. Risks to the inflation projections are assessed to be broadly balanced.

Table 3

Eurosystem projections for the euro area

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

	2022	2023 e	2024 e	2025 e	2026 e
Real GDP (contributions in percentage points)	3.4	0.6	0.8	1.5	1.5
of which:					
Domestic demand (excluding changes in inventories)	3.1	0.6	1.1	1.5	1.4
Net exports	0.0	0.2	−0.2	0.0	0.1
Inflation (HICP)	8.4	5.4	2.7	2.1	1.9
Core inflation [1]	3.9	5.0	2.7	2.3	2.1
Domestic employment	2.5	1.4	0.4	0.4	0.4
Unemployment rate [2]	6.7	6.5	6.6	6.5	6.4
General government financing requirement (–) or capacity [3]	−3.6	−3.1	−2.8	−2.7	−2.6
Public debt [3]	90.9	88.7	88.3	88.1	88.1

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

3. Belgian growth should moderate somewhat in the near term and then remain constant

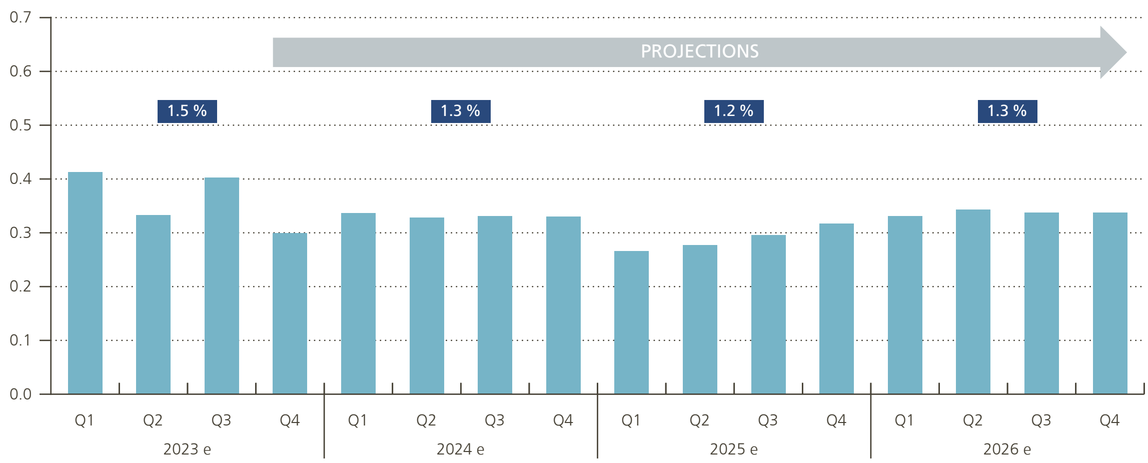
In the first three quarters of 2023, the Belgian economy was quite robust, growing at 0.4 % on average per quarter. It was therefore clearly stronger than that of the euro area, which has barely grown over the past four quarters. Growth has been very much in line with the NBB's June projections but outpaced the more recent forecast in the September Business Cycle Monitor in the third quarter.

Turning to the near-term outlook, sentiment indicators have given off mixed signals recently. Business sentiment slid throughout the year but appears to have bottomed out based on the latest observation from November, thanks to a spectacular recovery of confidence in the services industry. Consumer confidence has hovered near its long-term average for several months now but the decomposition reveals that households have become more wary about the economic outlook and are intent on increasing their savings. A broad assessment based on information from the NBB's business intelligence network, as summarised in the Business Echo published on 4 December, suggests that a (mild) slowdown in growth is most plausible. The current nowcast points to 0.3 % growth in the last quarter of 2023.

Figure 1

Belgian economic growth remains robust

(quarter-on-quarter growth of real GDP, in %, seasonally and calendar adjusted ; the numbers in the boxes indicate the annual growth rate)



Sources : NAI and NBB.

More generally, activity should continue to be supported by household consumption growth in 2023 as disposable income has benefited from a delayed indexation effect. While rising interest rates and a decline in mortgage lending have impacted residential investment, business investment has continued to expand quite fiercely. However, with growth slackening in the euro area and in some of Belgium's most important trading partners, exports are likely to be weak and net exports are expected to contribute negatively to growth. In annual terms, growth is estimated to come in at 1.5 % for 2023. This upward revision compared to the NBB's June projections can largely be traced back to statistical revisions for 2022 which implied a better starting point for the current year.

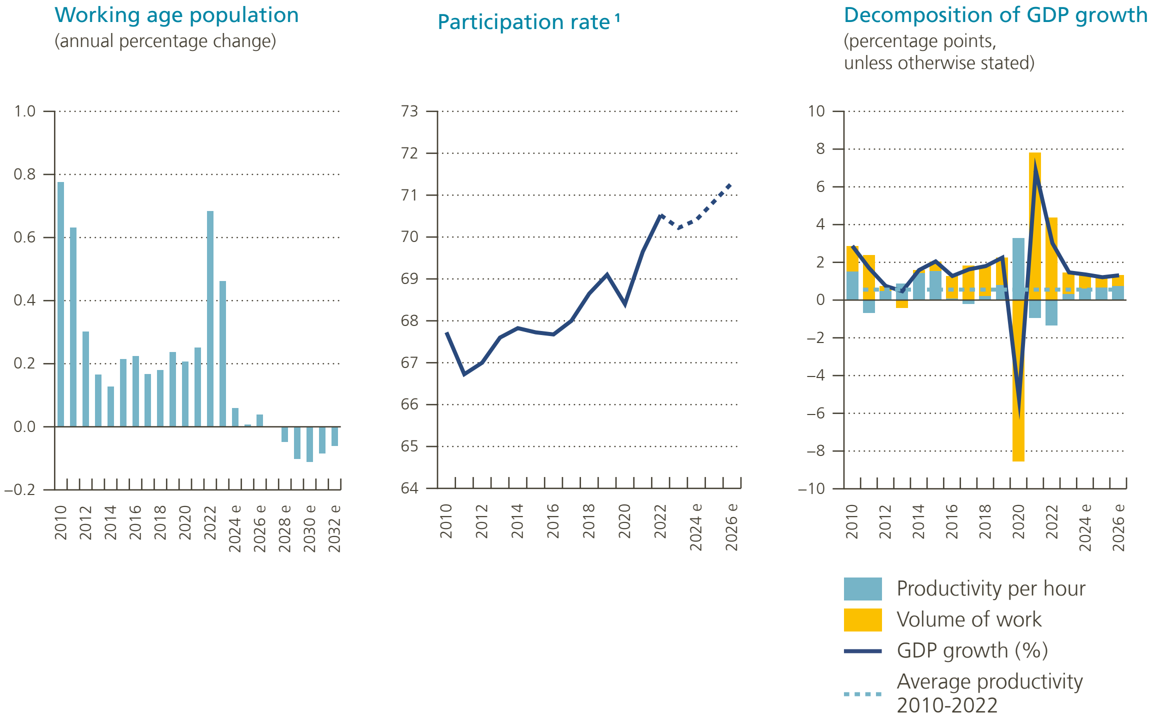
Beyond the near term, activity is expected to continue to grow at a quarterly rate of around 0.3 %. Both household consumption and business investment growth are expected to moderate somewhat in the near term. Net trade is expected to continue to drag down growth throughout the projection period, due to the diminished cost competitiveness of Belgian firms, but its contribution should turn somewhat less negative towards the end of the projection horizon.

In the outer years of the projection period, growth will be increasingly held back by labour shortages in particular. According to the current demographic outlook, the working age population will barely increase after 2024. Even though the participation rate should continue to edge up and productivity growth is expected to recover, the economy is projected to grow more moderately in the coming years.

Small variations in quarterly growth rates, as well as differences in the carry-over effect, are set to cause annual GDP growth to fluctuate from 1.3 % in 2024 to 1.2 % in 2025 and back to 1.3 % in 2026.

Figure 2

Belgian economy to hit (labour supply) limits



Sources: NAI and NBB.

1 Labour force divided by the working age population (15-64 years). Note that the retirement age will increase from 65 to 66 in 2025 and to 67 in 2030. However, for comparison purposes, we show the working age population as those between 15 and 64 years for the entire period.

4. Domestic demand continues to drive growth

In the most recent quarters, Belgian activity growth has been shored up by domestic demand, notably business investment, which has expanded buoyantly since 2022, despite rising interest rates. Based on interviews with business leaders conducted for the Business Echo, it appears that firms are already heavily investing in digitalisation and automation in response to higher wage costs and labour shortages, in particular. Investments in the greening of production processes have also become more substantial, in order to reduce exposure to energy price volatility and comply with environmental regulations. It seems that higher interest rates have not in fact constrained business investment so far, as firms have been able to obtain intragroup funding or draw on their cash reserves. This is in line with the findings of Piette and Tielens (2023) who found that, over the past few decades, low financing costs have enabled firms to increase their profit margins and reinforce their balance sheets, as well as their liquidity position.

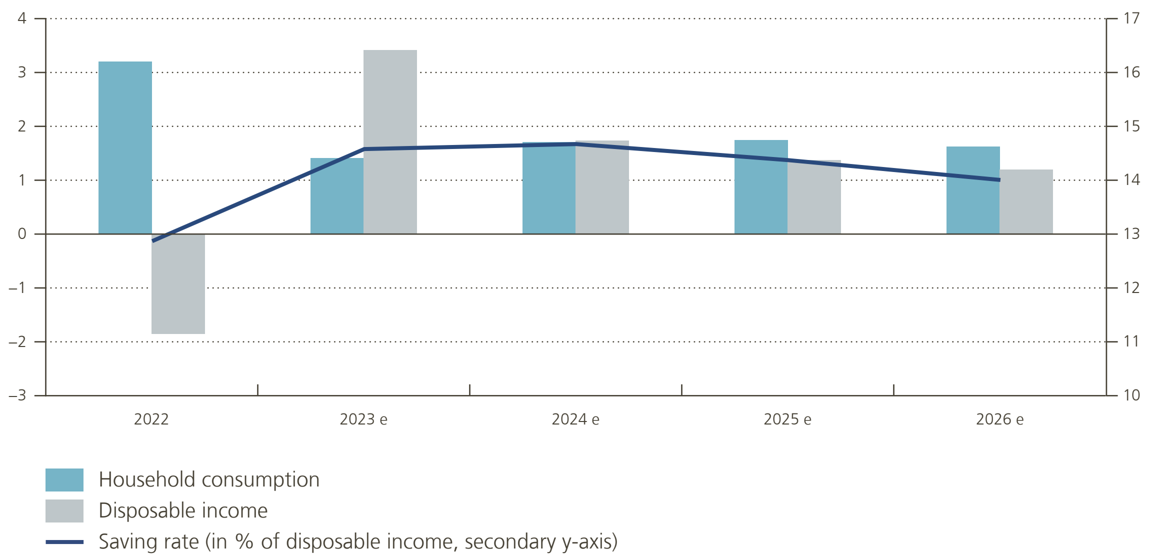
Household consumption has had its ups and downs in recent quarters, according to the latest statistics. Consumer confidence has held quite steady, near its long-term average, for a number of months, but more detailed sub-indicators reveal that households are intent on ramping up their savings. Indeed, the saving rate is expected to reach 15 % in 2023, up from 12 % in 2022. This is the result of consumption smoothing over these years. In 2022, real household income was affected by the cost-of-living crisis, but consumption remained strong as Belgian households were probably anticipating upcoming automatic indexation. Indeed, in 2023, household purchasing power has been temporarily boosted by the delayed impact of automatic indexation which strongly pushed up wage growth that year, at a time when actual inflation was already coming down rapidly. Moreover, purchasing power has been supported this year by tax reductions which undo some of the bracket creep due to high inflation: the personal income brackets were indexed on 1 January 2023 based on 2022 inflation figures, while household tax settlements will be more favourable as taxes withheld on income in 2022 did not yet reflect this indexation.

Following exceptionally strong disposable income growth in 2023 (nearly 3.5 % in real terms), household income will continue to expand more slowly as from next year, by 1.4 % on average per year. Consumption is expected to remain an important driver of activity, growing at a pace close to its long-term average. The saving rate is set to decline somewhat, to 14 %, but to remain above pre-pandemic levels. With interest rates on the rise, incentives to save have become stronger and the share of capital income – more of which is typically saved – in total household income has increased.

Figure 3

Household consumption, purchasing power and saving rate

(volume data,[1] percentage change compared to the previous year, unless stated otherwise)



Sources: NAI and NBB.

1 Data are deflated by the household consumption expenditure indicator.

Rising mortgage rates and high building costs have been dragging down residential investment since 2022. We expect residential investment to continue to contract until mid‑2024. Even then, however, growth is expected to edge up only slowly, to 0.3 % on average per quarter in 2025 and 2026, which is clearly more subdued than what was observed during the post‑pandemic rebound or the decade before the pandemic, characterised by lower interest rates.

In this context, it should also be noted that the European Green Deal defines the transition to energy‑efficient building stock as an objective for EU Member States. In Belgium, all three Regions have committed to the aim of achieving an energy‑efficient housing stock with an average EPC rating of A by 2050. This will require a huge renovation wave in the coming decades, which should benefit residential investment. However, we expect this mainly to affect the years beyond the projection horizon. To this end, numerous hurdles will need to be overcome, such as capacity constraints, including a lack of workers in the construction industry and a lack of financial means for households to renovate.

Turning to public expenditure, public consumption is projected to grow rather moderately over the projection horizon, at approximately 1 % on average per year. Public investment growth is more volatile throughout the projection period as it follows the regular local election cycle with a particularly strong boost in 2023 and 2024 (due as well to specific investment programmes) and a decline thereafter.

As discussed in Section 1, Belgian export growth is largely determined by foreign demand, which is expected to recover in early 2024. However, due to diminished cost competitiveness (owing to relatively high wage cost growth in 2022‑23, as discussed in Section 6), Belgian firms are expected to lose more export market share than usual. With wage cost growth moderating as from next year, however, the loss of market share is expected to become less substantial over the projection horizon, and export growth should pick up somewhat. Import growth is expected to continue to slightly outpace export growth as a result of strong domestic demand. All in all, the contribution of net exports to GDP growth is set to be negative in all years of the projection period, but less so in the outer years.

Table 4

GDP and main expenditure categories

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

	2022	2023 e	2024 e	2025 e	2026 e
Household and NPI final consumption expenditure	3.2	1.4	1.7	1.7	1.6
General government final consumption expenditure	4.2	0.1	0.7	1.0	1.1
Gross fixed capital formation	−0.2	5.4	3.7	1.5	1.9
General government	−1.6	5.1	10.6	−3.8	−0.8
Housing	−3.2	−4.7	−2.6	0.4	1.4
Businesses	1.1	8.6	4.3	2.7	2.5
p.m. Domestic expenditure, excluding the change in inventories [1]	*2.5*	*2.0*	*2.0*	*1.5*	*1.6*
Change in inventories [1]	0.4	0.2	−0.1	0.0	0.0
Net exports of goods and services [1]	0.1	−0.8	−0.6	−0.3	−0.3
Exports of goods and services	4.9	−1.1	0.1	2.2	2.3
Imports of goods and services	4.9	−0.3	0.7	2.6	2.6
Gross domestic product	3.0	1.5	1.3	1.2	1.3

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

5. Job creation remains resilient, but more in line with its historical average

In the third quarter, employment growth was close to its historical average, much lower than during the post-COVID-19 recovery when job creation was extraordinarily fierce. Since the end of 2022, net quarterly job growth has moderated, ranging from 0.1 % to 0.2 %. While the employment rate fell only marginally in the first two quarters of 2023, the unemployment rate remained stable and average working hours have continued to recover, reaching pre-crisis levels.

Leading indicators, such as the employment prospects according to business surveys, suggest moderate employment growth ahead, more in line with historical averages. To date, there has been no indication of a severe deterioration in the labour market, and resilient activity growth is expected to continue to shore up demand for labour. Moreover, business intelligence suggests that some labour hoarding, in particular for specific (technical) profiles, should by and large continue in the slackening manufacturing industry as well, as the labour market is still very tight and skill shortages for a significant number of jobs persist. The vacancy rate remains close to its historical peak reached in 2022, which illustrates the structural nature of most shortages.

The Belgian economy is currently expected to add 45 000 jobs in 2023 and 35 000 jobs on average in the following years. As the working age population will barely increase as from 2024, net job creation will be accompanied by an increase in the employment rate. The unemployment rate levels off to around 5.5 % over the projection horizon due to the continuing rise in the participation rate. The latter is mainly attributable to increasing levels of education and higher participation by women, older workers and immigrants in the labour force. By 2026, the employment rate will have increased by slightly more than 1 percentage point, reaching 73 %. This is insufficient to meet the 80 % target by 2030.

Compared to its main neighbours, Belgium has room for improvement with respect to its employment rate. It is necessary to focus not only on reducing unemployment but also on addressing inactivity. Recent reforms to public employment services at the regional level target the inactive population and should enlarge the pool of registered job seekers in order to tackle labour shortages for some – not necessarily highly skilled – jobs.

Table 5

Labour supply and demand

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

	2022	2023 e	2024 e	2025 e	2026 e
Total population	97	73	39	35	40
Working age population[1]	51	34	4	0	3
Labour force	93	71	41	36	38
Domestic employment	104	45	37	34	33
Employees	86	36	31	26	24
Branches sensitive to the business cycle[2]	62	15	17	14	13
Administration and education	12	8	5	1	2
Other services[3]	12	13	9	9	9
Self-employed	18	9	6	8	9
Unemployed job-seekers	–11	26	3	2	6
p.m. Harmonised unemployment rate[4, 5]	*5.6*	*5.6*	*5.5*	*5.5*	*5.6*
Harmonised employment rate[4, 6]	*71.9*	*71.8*	*72.1*	*72.6*	*73.0*

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

1 Population aged 15-64 years. Note that the retirement age will increase from 65 to 66 in 2025. However, for comparison purposes, we show the population aged 15-64 years for the entire period.

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 services, public social services, personal services and domestic services.

4 Based on 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. Core inflation and wage cost growth are both coming down

6.1 Growth in wage costs has reached record levels but is expected to moderate

Wage costs reached record levels in 2023: hourly wage costs in the private sector are expected to grow by 7.5 % this year, after an already very high increase of 4.6 % in 2022. These exceptional growth rates can essentially be traced back to automatic indexation following the inflationary surge recorded in 2022. Growth in nominal wage costs is expected to slow to 3.3 % in 2024, to 2.8 % in 2025 and to 1.5 % in 2026. The main driver of wage cost growth remains automatic wage indexation.

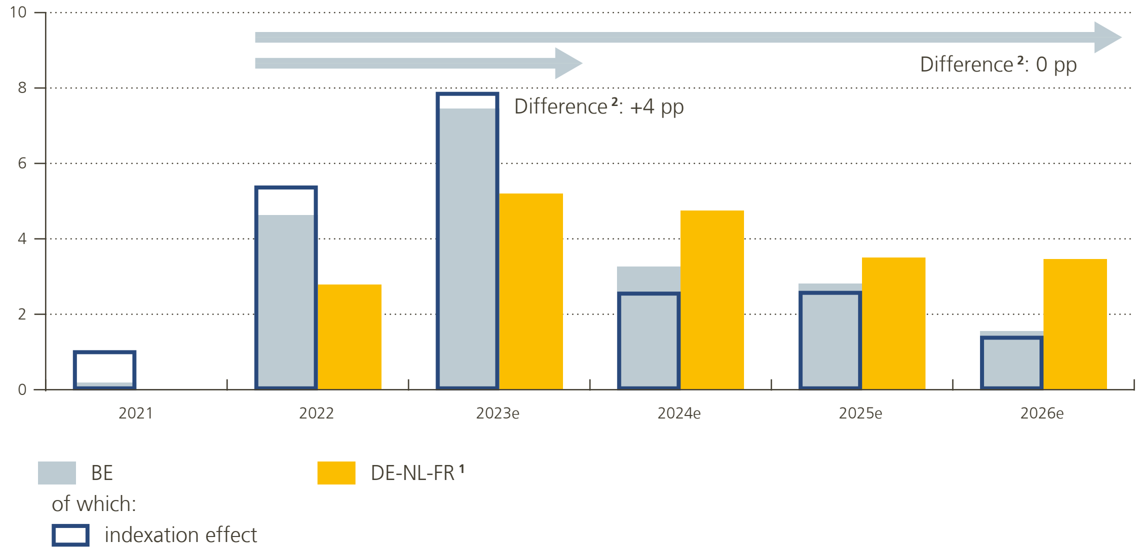
Due to this institutional feature, wages in Belgium increased at a much faster pace than in neighbouring countries in 2022 and 2023. As a result, the cumulative wage gap between Belgium and its main trading partners (Germany, France and the Netherlands), which had closed in 2019, has widened again. In this context, according to the Competitiveness Act, there is no room for real wage growth in 2023-2024. Due to the size of the gap, current projections assume there will be no margin to negotiate real wage increases for 2025 and 2026 either. This has been confirmed by the Central Economic Council, according to whose October 2023 report the official wage gap will still be 1.7 % in 2024. In other words, collectively negotiated real wage growth is expected to be zero throughout the projection period.

This is also confirmed (ex post) by the December Eurosystem projections. Over 2022 and 2023, the wage gap[1] between Belgium and its main trading partners is expected to widen by around 4 percentage points. Despite very moderate growth in Belgian real wages over the next years, the gap is expected to close only gradually towards the end of the projection horizon, as nominal wage claims in neighbouring countries catch up.

Figure 4

Hourly wage growth in the private sector: Belgium versus main trading partners

(percentage change compared to the previous year, cumulative wage gap since 2019)



Sources: Eurosystem, NAI and NBB.

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

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

Wage drift represents developments in bonuses and other pay components not included in collectively negotiated wage increases, as well as the impact on payroll of changes in the composition of the workforce. After two years of negative contribution, it is expected to return to positive territory in 2023. This partly reflects employers' more frequent use of alternative forms of remuneration to compensate for zero real wage growth. In 2023, the positive drift notably includes the possibility given to employers to grant a "purchasing power bonus" – which is subject to advantageous tax treatment – of € 500 per worker for companies with high profits and of up to € 750 per worker for firms with very high profits. Structural trends in the composition of the workforce, such as increasing education levels and age, are also likely to fuel wage drift in the near term. The deceleration of employment, which will probably affect mostly low-paid workers such as the young or low skilled, should also exert some upward pressure on wage drift. Belgian wage drift should return to its historical average in 2025 and 2026.

Rising wage costs weigh on the competitiveness of Belgian firms. To offset in part the increase in input and wage costs, the government decided on a temporary reduction in social security contributions for the first two

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

quarters of 2023. This resulted in a decrease in employer social security contributions in 2023 but, due to carry-over effects, will lead to an increase in 2024.

Hourly labour productivity has declined significantly over the last two years. This development should be viewed in the context of very dynamic job creation after the pandemic, which brought back a relatively large number of low-productivity jobs. According to current projections, productivity will recover and rise progressively over the projection horizon toward its historical average.

The sharp rise in hourly wage costs this year has not been accompanied by an increase in labour productivity, putting pressure on firms and weighing on core inflation. The very large increase in unit labour costs amounts

Table 6

Price and cost indicators

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

	2022	2023 e	2024 e	2025 e	2026 e
Private sector labour costs [1]:					
Labour costs per hour worked	5.0	7.6	3.3	2.9	1.6
of which:					
Real conventional wages	0.4	0.0	0.0	0.0	0.0
Wage drift and other factors	–0.9	0.2	0.2	0.2	0.2
Indexation	5.4	7.9	2.6	2.6	1.4
Social contributions	–0.2	–0.7	0.5	0.0	–0.1
Wage subsidies	0.4	0.1	0.1	0.1	0.0
p.m. Labour costs per hour worked according to the national accounts [2]	*4.6*	*7.5*	*3.3*	*2.8*	*1.5*
Labour productivity [3]	–1.8	0.4	0.7	0.7	0.8
Unit labour costs [3]	7.0	7.1	2.7	2.2	0.8
Total inflation (HICP)	10.3	2.3	4.0	1.8	1.4
Core inflation [4]	4.0	6.0	2.7	1.8	1.7
Services	3.8	6.2	3.5	2.3	2.1
Non-energy industrial goods (NEIG)	4.2	5.4	1.4	1.0	1.1
Energy	57.9	–28.4	10.0	–0.8	–2.4
Food	8.3	12.7	5.0	2.9	2.4
p.m. Inflation according to the national index	*9.6*	*4.1*	*3.2*	*1.6*	*1.4*
Health index [5]	9.3	4.3	3.5	1.7	1.4

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

1 Labour cost is defined here not according to the national accounts concept but rather according to a broader concept which includes reductions in social security contributions for target groups and wage subsidies. This concept provides a better picture of the true labour cost for firms.

2 Excluding wage subsidies and reductions in social security contributions for target groups.

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

4 As measured by the HICP, excluding food and energy.

5 As measured by the national consumer price index, excluding tobacco, alcoholic beverages and motor fuels.

to 7.0 % for 2023 and will moderate gradually in line with hourly labour costs, but also thanks to the recovery of labour productivity.

6.2 Headline inflation continues to fall while core inflation is subsiding more slowly

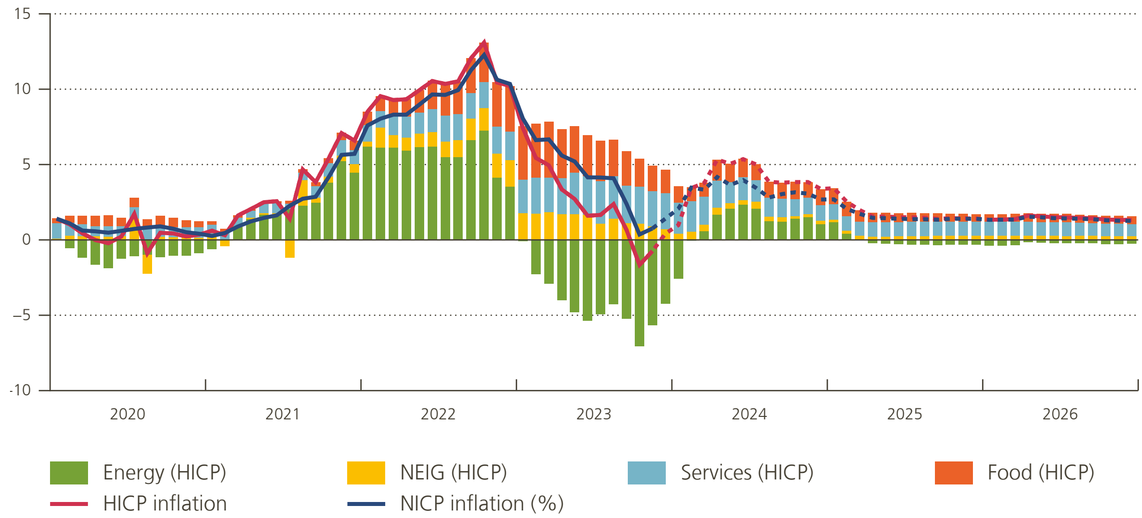
After an extremely high inflation rate in 2022, inflation declined sharply, even dipping into negative territory at the end of 2023. This sharp fall in headline inflation in 2023 can largely be explained by the drop in energy prices, while core inflation remains high.

Overall, energy prices fell sharply from mid‑2022 onwards, with the exception of prices for Brent crude oil, which temporarily rose again between July and September 2023. This increase in the price of Brent was due to reduced production by oil-producing countries such as Russia and Saudi Arabia, as well as concerns arising from the conflict in the Middle East. Government measures to curb energy bills also exerted downward pressure on energy inflation. In contrast, the ending of these measures will have a temporary upward impact. The "basic package" for electricity and gas implied a reduction in households' energy bills of € 61/month for electricity and € 135/month for gas from November 2022 to March 2023. Each monthly transfer was spread out over 12 months in the inflation index. The (last) transfer from March 2023, for example, is included in the index from March 2023 to February 2024. In other words, as from December 2023, the disappearance of the basic package from the index will cause the energy index to progressively rise until February 2024. All in all, energy inflation is expected to peak temporarily in 2024 before returning to more normal levels.

Figure 5

Inflation and contributions

(contributions to HICP inflation in percentage points, unless stated otherwise)



Sources: Eurostat and NBB calculations.
Note: Dotted lines correspond to HICP (in red) and NICP (in blue) inflation over the projection period.

Core inflation has been more persistent and has outpaced headline inflation since February 2023, peaking in May 2023. It is expected to come down gradually, while remaining above its long-term average[2] of 1.5 % over the projection horizon.

2 The long-term averages mentioned in this section refer to those over the period 1997-2019.

For non-energy industrial goods (NEIG), external factors such as the rise in import and commodity prices, as well as supply chain problems, contributed to the initial hike in prices. These external factors have now subsided and allowed NEIG inflation to come down. However, it is expected to remain above its long-term average of 0.9 %, as domestic factors such as the acceleration of wage costs due to indexation and the pass-through of high energy prices to production costs (especially for energy-intensive products) continue to have an impact. Services inflation has decreased since September 2023, but the decline is expected to be more moderate than that of NEIG inflation. Wage pressures are still gradually feeding through. In addition, the prices of many services are directly linked to past inflation (railway and bus tickets, some insurance policies, nursery fees, telecommunication services, etc). Furthermore, landlords have once again been allowed to index rents – which were frozen at the end of 2022 – since October 2023 in Flanders and Brussels and since November 2023 in Wallonia. The rent indexation freeze concerned properties with a low energy performance score (EPC) at the height of the energy crisis, so as not to penalise the tenants of these dwellings. Services inflation is expected to follow a downward trend, but is set to remain higher than its long-term average of 2.0 % over the projection horizon.

Lastly, food inflation is also on a downward trajectory, for both processed and unprocessed foods, and most likely peaked in the first quarter of 2023. Indeed, international food commodity prices have started to decline and input price pressures have also eased. However, we expect food inflation to remain historically high over the projection horizon. Firstly, the federal government launched a new anti-tobacco plan at the end of October to achieve a “smoke-free” generation by 2040. The plan includes a high excise duty on tobacco. In addition, climate change means the frequency and scale of extreme weather events (such as droughts, floods and storms) are likely to increase further, with negative consequences for crops, thereby exerting upward pressure on prices.

The national consumer price index (NICP) shows more moderate movement than the HICP (4.1 % versus 2.3 %, respectively, in 2023), which can mainly be explained by differences in methodology[3] and the relative weight of energy prices, in particular.

The NICP is used to calculate the health index, which excludes tobacco, alcoholic beverages and motor fuels and serves as a reference for the indexation of wages and various forms of replacement income. The pivot index for public sector wages and social benefits has been exceeded eight times since August 2021, most recently in October 2023. Over the projection horizon, it is expected to be passed again in March 2024, January 2025 and April 2026.

7. The general government deficit is expected to worsen substantially and the debt ratio to rise

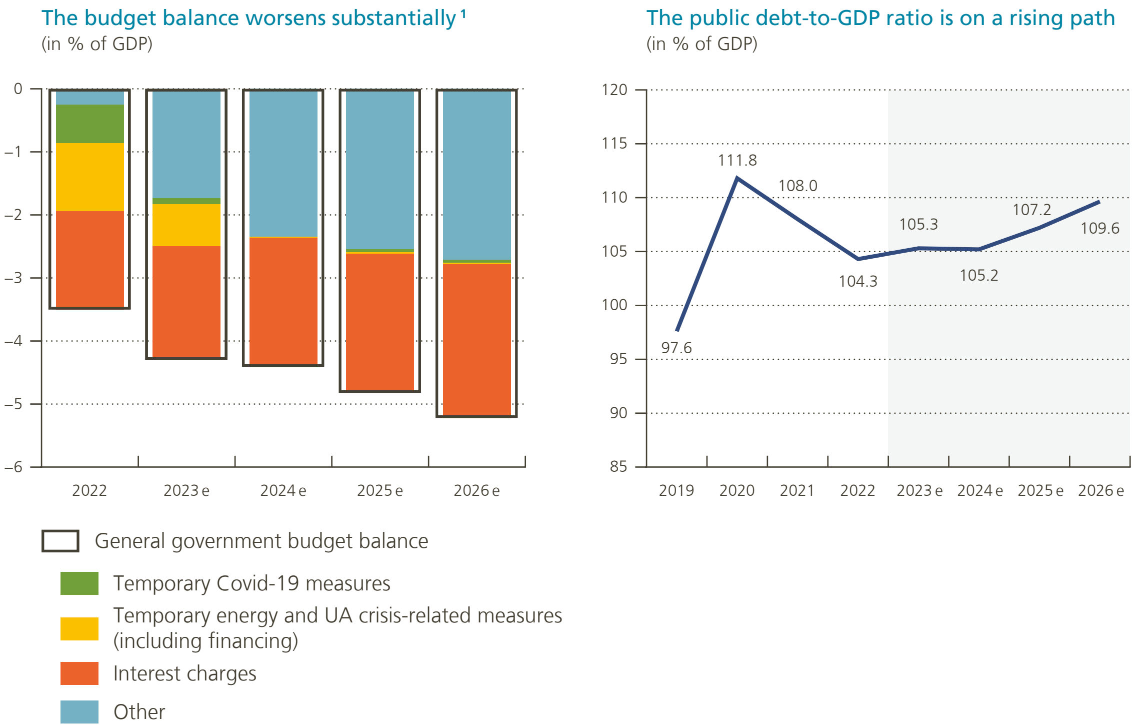
After narrowing to 3.5 % of GDP in 2022, the general government deficit is expected to widen to 4.3 % of GDP in 2023 and to 4.4 % of GDP in 2024. In 2025 and 2026, the budget balance is projected to worsen further, by 0.4 % of GDP per year, with the deficit reaching 5.2 % of GDP in 2026.

The budget balance in 2023 will nonetheless benefit from the unwinding of temporary pandemic-related measures, amounting to 0.5 % of GDP. In addition, the net cost of temporary measures related to the energy crisis and the war in Ukraine will also be about 0.4 % of GDP lower than in 2022. While the total volume of measures to support household purchasing power (such as the basic energy package), business profitability (for example the temporary exemption from social security contributions) and Ukraine (including support for refugees) remains close to the level seen in 2022, the yield from the sources used to finance these measures has increased sharply. The latter consist mainly of a tax on the excess profits of electricity producers, an increase

3 For more detailed information, please see “Economic projections for Belgium – June 2023” published in NBB Economic Review 2023 No 3.

Figure 6

Budget deficit and public debt-to-GDP ratio



Sources: NAI and NBB.

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

in the contribution of the nuclear sector, and additional corporate tax revenue from returns on frozen Russian assets held in Belgium.

The deterioration of the budget balance is nevertheless due to several factors. Firstly, the decrease in temporary costs has been partially offset by measures that increase current primary expenditure, such as a further increase in minimum social benefits at the federal level, additional resources for social policies in Flanders, and additional subsidies and transfers in the context of resilience plans by the Communities and Regions. In addition, current expenditure is rising steadily as a result of population ageing. Secondly, public investment is rising, driven by federal investment in defence, regional infrastructure projects, and local government investment, which is expected to increase in the run-up to the local elections in 2024. Thirdly, on the revenue side, personal income tax revenue is experiencing the downside of a number of factors which temporarily boosted it in 2022. More precisely, the substantial indexation of tax brackets in 2023, based on 2022 inflation, will depress personal income tax revenue. Last year, the low indexation of tax brackets, compared to that of wages, temporarily provided the government with additional revenue. Moreover, personal income tax receipts were temporarily higher in 2022 due to an administrative deferral of 2021 positive tax assessments. Lastly, receipts from property registration fees have suffered due to the declining number of real estate transactions in 2023. A final important factor is the increase in interest expenses on public debt, by over 0.2 % of GDP.

In 2024, the budget deficit should increase slightly, to 4.4 % of GDP. The temporary energy and Ukraine-related measures, which continued to push up the deficit by 0.7 % of GDP in 2023, will be eliminated. The balance is nevertheless expected to deteriorate slightly for several reasons. Firstly, costs linked to population ageing will continue to rise steadily and local government investment is expected to peak in an election year. Interest costs will also continue to rise slightly, by 0.3 % of GDP. Lastly, a timing mismatch between the indexation of private sector wages and government spending is a key explanatory factor for the change in the balance between 2023 and 2024. While private sector indexation will outpace automatically indexed government spending in 2023, the reverse is expected in 2024. As a result, automatic indexation will have a relatively more favourable effect on revenue than on expenditure in 2023, while the reverse will be true in 2024. It should be noted that in 2024, corporate tax revenue is set to increase as a result of returns related to Russian assets held at Euroclear further to the imposition of international sanctions. These receipts should be transmitted in full by the Belgian government to Ukraine as capital transfers, meaning they will not have a positive effect on the balance. This should also be the case in 2025 and 2026.

In 2025, the deficit is expected to increase to 4.8 % of GDP. Indeed, interest expenses are projected to continue to increase, by 0.2 % of GDP. On the revenue side, a decrease in dividends is expected, after an interim dividend from Belfius bank brought forward receipts in 2024. The increase in aging costs will be tempered in 2025 by the raising of the statutory retirement age from 65 to 66, while investment is expected to fall somewhat after the elections.

In 2026, the deficit should deteriorate further, to 5.2 % of GDP, under the impetus of two factors, which are also expected to structurally deteriorate the balance in the following years: rising interest charges and aging costs. The 2026 deficit could be considered structural given the absence of temporary measures and economic activity close to potential level.

The public debt ratio is expected to increase to 105.3 % of GDP in 2023, despite a favourable denominator effect, with nominal GDP growth at 5.5 %. Indeed, the gross debt ratio has been temporarily inflated by the excess cash available to the federal government following the successful issuance of a short-term State Note in September 2023. In subsequent years, high budget deficits will put public debt on a structural upward trajectory, to just below 110 % of GDP in 2026. The normalisation of nominal growth and the steady increase in the implicit interest rate on outstanding public debt should make interest rate growth dynamics (or the snowball effect) less favourable and insufficient to offset the debt-increasing dynamics of primary budget deficits.

Table 7

General government accounts

(in % of GDP)

	2022	2023 e	2024 e	2025 e	2026 e
General government					
Revenue	**49.6**	**50.0**	**50.4**	**50.3**	**50.2**
of which: taxes and social contributions	42.6	43.0	43.3	43.4	43.4
Primary expenditure	**51.6**	**52.5**	**52.8**	**52.8**	**52.9**
Current expenditure	48.0	48.8	48.6	48.8	49.1
Capital expenditure	3.6	3.7	4.2	4.0	3.8
Primary balance	**−2.0**	**−2.5**	**−2.4**	**−2.6**	**−2.7**
Interest charges	**1.5**	**1.8**	**2.1**	**2.2**	**2.4**
Financing requirement (–) or capacity [1]	**−3.5**	**−4.3**	**−4.4**	**−4.8**	**−5.2**

Sources: NAI and NBB.

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

8. The baseline projections are still subject to considerable uncertainty

Headline inflation has come down significantly from its peak in October of last year and even hit negative territory in the autumn of 2023. This indicates, once again, how volatile components such as energy prices can quickly change the headline numbers. Core inflation, too, has reached its peak but remains quite elevated. In order for it to moderate further, firms will have to (partly) absorb the cost shock into their profit margins, as has been observed in past episodes of increasing wage costs. Compliance with the provisions of the 1996 Competitiveness and Employment Act as regards restrictions on collectively negotiated wage increases in the future will also be required. Inflation may turn out to be higher or more persistent if external price pressures shoot up again, profit margins do not decline further as currently anticipated, or collectively negotiated wages rise faster.

As for the real economy, the outturn for the third quarter surprised on the upside and was somewhat at odds with slackening (business) confidence indicators and (negative) activity growth in the euro area. At a quarterly rate of 0.3 %, growth remains robust over the entire projection horizon, which hinges *inter alia* on assumptions about the international environment, with both world trade growth and euro area activity growth assumed to recover as from the spring of next year.

Finally, rising interest rates have highlighted the cost of high (public) debt. In the longer term, the unsustainable fiscal position and spending trends will have to be addressed, which may require consolidation measures in the outer year(s) of the projection period. Depending on the specific measures taken, growth and the budget outlook could be quite different for those years.

Annex

Projections for the Belgian economy: summary of the main results

Projections for the Belgian economy: summary of the main results

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

	2022	2023 e	2024 e	2025 e	2026 e
Growth (calendar adjusted data)	3.0	1.5	1.3	1.2	1.3
Real GDP					
Contributions to growth:					
Domestic expenditure, excluding change in inventories	2.5	2.0	2.0	1.5	1.6
Net exports of goods and services	0.1	−0.8	−0.6	−0.3	−0.3
Change in inventories	0.4	0.2	−0.1	0.0	0.0
Prices and costs					
Harmonised index of consumer prices	10.3	2.3	4.0	1.8	1.4
Health index	9.3	4.3	3.5	1.7	1.4
GDP deflator	5.9	4.0	2.4	1.9	1.6
Terms of trade	−3.7	3.3	0.2	0.1	0.0
Unit labour costs in the private sector [1]	7.0	7.1	2.7	2.2	0.8
Hourly labour costs in the private sector [1]	5.0	7.6	3.3	2.9	1.6
Hourly productivity in the private sector	−1.8	0.4	0.7	0.7	0.8
Labour market					
Domestic employment (annual average change in thousands of persons)	103.7	44.7	37.4	34.0	32.7
Total volume of labour [2]	4.4	1.1	0.7	0.5	0.6
Harmonised unemployment rate (in % of the labour force aged 15 years and over)	5.6	5.6	5.5	5.5	5.6
Household incomes					
Real disposable household income	−1.9	3.4	1.7	1.4	1.2
Saving rate (in % of disposable income)	12.9	14.6	14.7	14.4	14.0
Public finances (in % of GDP)					
Primary balance	−2.0	−2.5	−2.4	−2.6	−2.7
Budget balance	−3.5	−4.3	−4.4	−4.8	−5.2
Public debt	104.3	105.3	105.2	107.2	109.6
Current account (according to the balance of payments, in % of GDP)	−1.0	0.1	−0.1	−0.5	−0.9

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

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