

# Economic projections for Belgium, 2004-2005

## Introduction

There has been a marked improvement in the economic situation in Belgium since mid 2003, driven mainly by foreign demand. This improvement followed a long period of weak growth extending over almost three years and harming employment and investment, while this weakness of economic activity curbed inflation, which was also tempered by the appreciation of the euro. That is the context surrounding the Bank's economic projections for 2004 and 2005, presented in this article.

The projections were produced as part of twice-yearly exercises carried out jointly by experts from the ECB and from the national central banks within the Eurosystem. Using a procedure which is intended to ensure a common basis of assessment for the various countries while taking account of their specific characteristics, the national central banks are responsible, in particular, for producing projections for their own economy: following aggregation, these give the projections for the euro area<sup>(1)</sup>. The latter are published in June and December by the ECB. Up to now, the results for Belgium have only been published in June, and have been confined to the estimates for the current year. In a desire for transparency, the Bank has decided to publish in the Economic Review the projections for the current year and the subsequent year twice yearly, on the same date as the ECB.

The Bank's economic projections provide a framework for a coherent summary of the available information on recent developments and the outlook, and the appraisal of that information. They combine the results of econometric models<sup>(2)</sup> and experts' judgements. They are based on the assumptions adopted within the Eurosystem concerning the international environment and on the movement in

interest rates, exchange rates and commodity prices, and on the results for the euro area. In this case, the projections for the euro area assume that the gradual recovery which began in mid 2003 will continue in 2004 and 2005, and that inflation will remain relatively moderate.

Furthermore, assumptions specific to the Belgian economy also need to be drawn up for the variables whose movement is largely determined on a discretionary basis by the economic agents. That applies, for example, to the wage agreements arrived at by collective bargaining, and government decisions concerning the budget.

As regards labour costs in the private sector, the movements assumed for 2005 are based on application of the current system of wage-fixing, in which the norm is based on the movement expected in Germany, France and the Netherlands. The as yet fragmentary and indefinite indications available for these three countries suggest a relatively modest rise in labour costs, which would aid the recovery of employment and help to contain the pressure on costs and prices.

The figures for public finances are derived automatically, taking account of the endogenous effect of the macroeconomic environment, of a movement in expenditure based on historical patterns and of measures which have already been decided on. New government measures relating to revenue or expenditure would modify these

(1) For more information on Eurosystem procedures, see ECB (2001) "A Guide to Eurosystem Macroeconomic Projection Exercises", *ECB Occasional Paper*, June 2001

(2) The Bank's quarterly model is central to this framework. A description of it may be found in Ph. Jeanfils (2000), "A Model with Explicit Expectations for Belgium", *NBB Working Paper*, No. 4, National Bank of Belgium, March 2000. Since that paper was published, the model has been re-estimated and some of the behaviour equations have been reformulated.

figures. In particular, the 2005 budget to be drawn up in the autumn is not included in this exercise. The measures that could be taken could in turn affect the projections for the economy as a whole.

Like any forecast, the projections presented here must be viewed as the most likely outcome, given the assumptions made. However, they are surrounded by uncertainty. For instance, the current recovery in Belgium and the euro area could be slightly stronger than predicted in the immediate future. At the same time, the main risks concern the future movement in exchange rates and long-term interest rates, in a context of persistent deficits on the balance of payments and public finances in the United States. Furthermore, if the recent price rises on the oil markets were to persist or even accelerate, that could curb growth and fuel inflation.

The first chapter of the article focuses on the international environment. It contains a description of recent developments and of the spring forecasts issued by the leading international institutions for the main economic areas, including the Eurosystem projections for the euro area. The assumptions made within the Eurosystem are discussed in a box; they apply to both the euro area and Belgium. The next three chapters give a detailed account of the recent situation and the projections for the national economy. They deal with activity, employment and the main components of expenditure (chapter 2), movements in prices and costs (chapter 3) and the figures for public finances (chapter 4). Finally, the last chapter presents a summary of the results of other institutions.

The projections for Belgium were drawn up on the basis of the information available on 25 May 2004.

### Box 1 – Seasonal variations and calendar effects in the projections

Besides the influence of the seasons, economic observations may be affected by the variation in the numbers of the different days of the week in successive periods under consideration – months, quarters or even years – since the level of output or consumption is not the same on Sundays as on Mondays or Tuesdays, etc. To prevent the analysis from being distorted by this bias, statistical institutions use methods which enable them to filter out these effects. Thus, the NAI has for some years been publishing quarterly accounts adjusted for seasonal variations and calendar effects.

In accordance with Eurosystem practice, the projections for activity, employment and the volume of labour and for demand are produced on a quarterly basis without taking account of the specific effects connected with the seasons and calendar irregularities. Thus, the series presented in chapter 2, including the annual data obtained by aggregating the quarterly results, are of the same type as the NAI's statistics adjusted for seasonal variations and calendar effects. In principle, the movement in these series reflects only fundamental economic developments, due in particular to cyclical movements or trends.

On the other hand, the sectoral accounts, and particularly the general government accounts presented in chapter 4, are compiled and presented taking account of calendar effects, in accordance with the practice prevailing in the compilation of the government account in the set of national accounts.

The calendar effects cause only temporary deviations in the level of the economic variables and are soon eliminated over time. Nonetheless, they may have a perceptible effect on the variations between two successive periods. Thus, the actual GDP growth rate would be increased by around 0.1 percentage point in 2004 owing to the leap year, and would be decreased by around 0.25 percentage point in 2005, which is one day shorter than the previous year, as well as containing 53 Saturdays.

## 1. International environment

The outlook for the international environment in 2004 and 2005 has become more favourable in recent months, as there have been increasingly clear signs of a global revival, accompanied by robust expansion of international trade, since mid 2003.

### 1.1 Revival in world economic growth in 2003

In the United States, growth strengthened further in 2003. Private consumption continued to underpin activity throughout the year, and there was a surge in both investment and exports in the second half of the year. However, there was also a sharp rise in imports in the fourth quarter. In Japan, growth exceeded expectations in 2003, particularly in the final quarter, driven by a steep rise in exports and the recovery of investment. In the other Asian countries, economic growth was in the region of 7 p.c. in 2003; for China the figure was actually around 9 p.c., while India recorded over 7 p.c. growth. In the countries of the Commonwealth of Independent States, and especially in Russia, economic growth also exceeded 7 p.c. GDP continued its strong expansion in central and eastern Europe, and in the Middle East. Furthermore, an acceleration was also recorded in other parts of the world, such as Latin America and Africa.

Economic activity also improved in the euro area, which a certain delay. Having stagnated in the first half year, activity picked up in the second half of 2003. Exports rose sharply in the third quarter, as export markets strengthened. Investments revived in the fourth quarter. On the other hand, private consumption remained subdued. The recovery in the euro area lagged well behind that in the United States in terms of both timing and scale: GDP grew by only 0.4 p.c. over the year as a whole.

Apart from the fiscal measures stimulating the economy in the United States, the acceleration in world growth in 2003 drew substantial support from low financing costs, attributable in particular to the low level of interest rates in the main industrialised countries, in a context of moderate inflation. Moreover, the spread between corporate and government bond yields narrowed considerably.

Interest rates remained low during the first four months of 2004. Thus, in the United States the target for the federal funds rate was held at 1 p.c. In the euro area, the Governing Council of the ECB kept the minimum bid rate on the main refinancing operations of the Eurosystem unchanged at 2 p.c., that decision reflecting its assessment that the monetary policy stance was

appropriate for maintaining price stability in the euro area in the medium term.

In the main economies, ten-year benchmark bond yields were at a low level, on average, in 2003 compared to the preceding years. After halting their decline in the second half of 2003, they fell further in the United States and in the euro area during the first three months of 2004. However, signs of raising yield expectations emerged recently. In a context of strengthening activity, the ten-year bond yield in the United States increased by around 50 basis points, on average, in April compared to the previous month, and that movement continued in the first half of May. Rates also recovered in the euro area and in Japan, although to a lesser extent. Moreover, the US monetary authorities announced on 4 May 2004 that policy accommodation could be removed at a pace that is likely to be measured.

For 2004 and 2005, international institutions consider that the recovery will continue to be bolstered in the world in general, and in the euro area in particular, by the low level of financing costs in a context of moderate inflation. In the United States, the past depreciation of the dollar and the expected improvement on the labour market should have a relatively limited impact on prices, thanks to such factors as the sustained growth of productivity and the scope still available in the utilisation of production capacity. In Japan, the easing of deflationary pressure is expected to be only gradual; according to some international institutions, it is not until 2005 that the rate of increase in consumer prices will become slightly positive. As regards the euro area, the negative output gap, the low pressure of wages and the past appreciation of the euro look set to exert a moderating effect on prices.

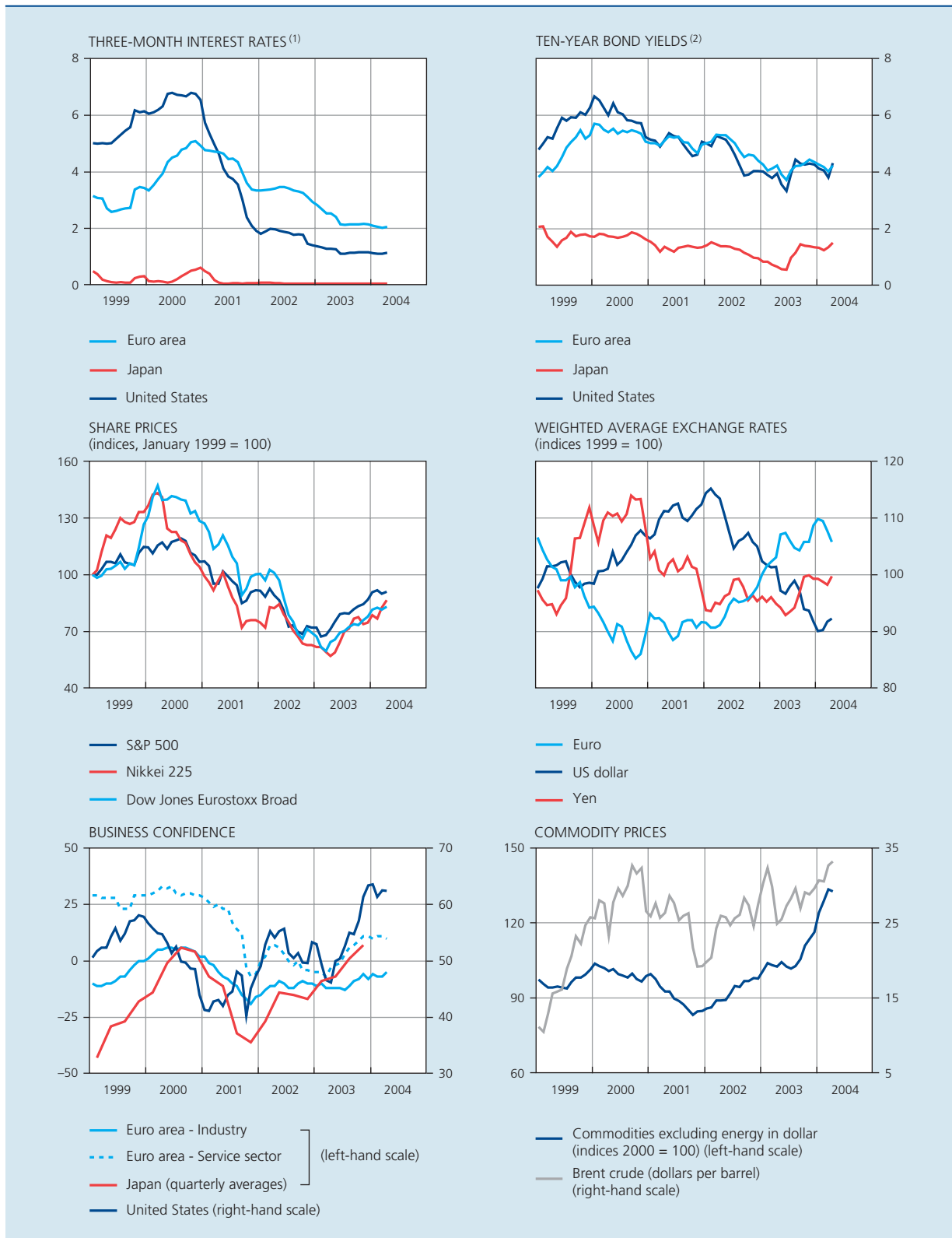
From the second quarter of 2003 to February 2004, prices picked up again on the main stock markets. In March 2004, however, substantial downward pressure on prices was observed on some markets and, following a recovery in April, prices dropped again in the first half of May.

The weighted average exchange rate of the euro, which had continued to make strong gains in 2003, strengthened further at the beginning of 2004 before dipping in March and April. The nominal effective exchange rate of the US dollar moved in the opposite direction. From March, the dollar was clearly bolstered by the more positive assessment of market operators regarding the economic outlook in the United States. The yen appreciated in the second half of 2003, in view of the signs of a sustained recovery by the Japanese economy. In April 2004 the weighted average exchange rate of the yen was still roughly at its December 2003 level.

**CHART 1**

**DEVELOPMENTS ON THE FINANCIAL AND COMMODITY MARKETS AND DEVELOPMENT OF CONFIDENCE IN THE MAIN ECONOMIES**

(Monthly averages, unless otherwise stated)



Sources: BIS, EC, ECB, HWWA, ISM, OECD, NBB.

(1) Interest rate on three-month interbank deposits.

(2) Yield on ten-year government bonds (benchmark loans).

Moreover, the global recovery in 2003 was in line with the strengthening confidence apparent in the main economies. In the United States, the business confidence indicator showed a marked rise from May 2003, reaching a high level by the end of the year. Since the beginning of 2004 it has fluctuated around that high level, indicating a continuing economic expansion. In Japan, business confidence has been improving almost continuously since the beginning of 2002. In the euro area, it has strengthened from the spring of 2003. This improvement came to a halt in November 2003, in both industry and the service sector; however, business confidence did improve in industry in April 2004.

Prices of crude oil and other commodities rose by an average of around 14 p.c. in 2003, compared to the previous year. Nonetheless, this increase occurred mainly in the second half of the year; it also encouraged expansion in certain countries, such as Russia and the OPEC members. Oil prices continued to rise during the first four months of 2004, so that the price of Brent crude peaked at 38.7 dollars per barrel on 14 May. The reason for this increase is the buoyancy of demand in the United States and Asia, the low level of commercial inventories in the United States, the OPEC announcement of cuts in production in anticipation of the expected seasonal downturn in demand and – in May – the growing concern about the continuity of oil supplies. At the same time, the surge in

prices of other commodities expressed in US dollars continued, driven mainly by increasing world demand.

## 1.2 Outlook for 2004 and 2005

The figures for the initial months of the year suggest that the world recovery will broaden and gain momentum in 2004. The main international institutions expect global economic activity to expand by an average of around 4.5 p.c. The average growth achieved during the year will anyhow be boosted by the carry-over effect due to the strengthening of activity in the second half of 2003. In 2005, growth is expected to moderate slightly, reverting to a more sustainable rate.

Stimulated by investment and the persistent strong growth of productivity, expansion in the United States looks set to continue in 2004. The gradual improvement on the labour market should provide support for private consumption. However, growth is expected to weaken in 2005. In Japan, growth will also strengthen in 2004 before faltering slightly in 2005. The recovery will likely be sustained by the expansion of exports to an important extent, while domestic demand will be underpinned by the maintenance of short-term interest rates at zero. According to the projections, the expansion will continue in the other Asian countries in 2004 and 2005 at a rate

**TABLE 1** SPRING FORECASTS BY INTERNATIONAL INSTITUTIONS FOR 2004 AND 2005

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

	2003	2004			2005		
	Actual figures	EC	IMF	OECD	EC	IMF	OECD
<b>GDP at constant prices</b>							
United States . . . . .	3.1	4.2	4.6	4.7	3.2	3.9	3.7
Japan . . . . .	2.7	3.4	3.4	3.0	2.3	1.9	2.8
Euro area . . . . .	0.4	1.7	1.7	1.6	2.3	2.3	2.4
<b>Inflation<sup>(1)</sup></b>							
United States . . . . .	2.3	1.4	2.3	2.3	1.2	2.2	2.0
Japan . . . . .	-0.3	0.0	-0.4	-0.2	0.2	-0.1	0.1
Euro area . . . . .	2.1	1.8	1.7	1.7	1.6	1.6	1.4
<b>Unemployment rate<sup>(2)</sup></b>							
United States . . . . .	6.0	5.6	5.5	5.5	5.6	5.4	5.2
Japan . . . . .	5.3	4.8	4.9	5.0	4.7	4.9	4.6
Euro area . . . . .	8.8	8.8	9.1	8.8	8.6	8.9	8.5

Sources: EC, IMF, OECD.

(1) Consumer price index.

(2) Percentages of the labour force.

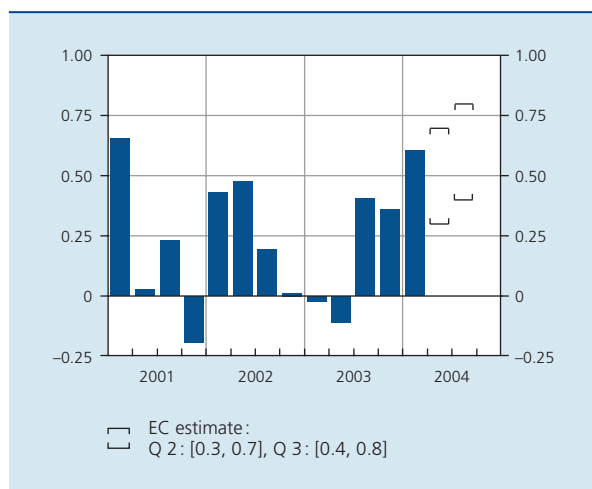
of at least 7 p.c., fuelled by exports – particularly to the United States – and the robustness of domestic demand. In Russia and in other members of the Commonwealth of Independent States, economic growth is expected to reach around 6 p.c. in 2004 and 5 p.c. in 2005. The United Kingdom and the countries which joined the EU on 1 May are likely to record strong growth in 2004 and 2005, driven by domestic demand and on-going structural changes in the case of the new EU members. Activity growth is expected to improve markedly in other parts of the world, such as Latin America and Africa.

The acceleration in world growth in 2004 and 2005 should be accompanied by vigorous expansion of world trade, which was already in evidence in the second half of 2003. All in all, the international institutions expect volume growth in world trade in goods and services to reach around 7 to 8.5 p.c. in 2004 and approximately 7 to 10 p.c. in 2005, driven in particular by the dynamism of growth in Asia and the expansion of intra-regional trade relations in that area, which will also encourage trade with the rest of the world. This strong expansion of world trade will generate substantial growth in the euro area's export markets.

The low growth recorded on average in the euro area in 2003 masks a recovery during the year. According to an initial provisional estimate, the recovery continued in early 2004, with GDP growing by 0.6 p.c. in the first quarter. The expansion of activity in the euro area is expected

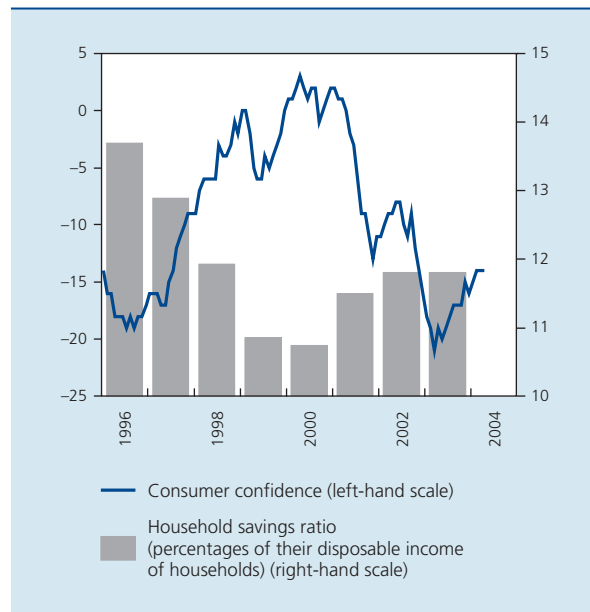
**CHART 2** CYCLICAL PROFILE OF GDP IN THE EURO AREA

(Seasonally adjusted data; percentage changes at constant prices compared to the preceding quarter)



Source : EC.

**CHART 3** HOUSEHOLD SAVINGS RATIO AND CONSUMER CONFIDENCE IN THE EURO AREA



Sources : EC, OECD.

to accelerate gradually in 2004 and 2005, with growth rising from 0.4 p.c. in 2003 to around 1.7 p.c. in 2004 and 2.3 p.c. in 2005.

The rapid growth of the export markets should stimulate the euro area's exports substantially in 2004 and 2005, as the positive impact of the expansion in world trade is expected to outweigh the negative effects of the past appreciation of the euro. The EC is therefore expecting the volume of exports of goods and services to grow by 4.9 and 5.9 p.c. respectively in 2004 and 2005. However, this expansion is likely to be accompanied by a comparable increase in imports of goods and services, so that net exports would not contribute to GDP growth during those two years.

Encouraged in particular by the recovery of foreign demand, investments are forecast to give a substantial boost to growth in the euro area in 2004 and 2005. In line with the growth of this expenditure component in the fourth quarter of 2003, the EC estimates that investment will expand by 2.4 and 3.6 p.c. respectively in those two years. In addition, the increase in gross fixed capital formation is likely to be supported by the low level of financing costs. If such an investment revival is to materialise, the financial position of non-financial corporations will have to have improved sufficiently to cease acting as a brake.

Private consumption increased only modestly in the past three years, partly because of a rise in the household savings ratio. Having exhibited a downward trend in the 1990s, the savings ratio has in fact been climbing again since 2001. This rise was accompanied by a decline in consumer confidence in 2001 and 2002, followed by an only very gradual improvement in 2003. This higher propensity to save could be due to increased precautionary savings, particularly on account of the growing concern over the fiscal consequences of population ageing and the sustainability of the existing pension systems.

Private consumption is expected to increase only gradually in 2004 and 2005: according to the EC forecast, it will expand by just 1.6 p.c. in 2004, but this growth should accelerate in 2005 to reach 2.3 p.c. In 2004, private consumption will probably still be curbed by the absence of any marked improvement on the labour market. Normally, favourable trends on the share and property markets in 2003 would trigger positive wealth effects, but in view of the relatively low propensity to consume out of wealth in the euro area, in comparison with the United States and the United Kingdom, for example, the effects on private consumption are likely to be modest in 2004. Employment is expected to expand more rapidly in 2005. Combined with a further fall in inflation, this should generate stronger growth in the real disposable income of households, which should stimulate private consumption.

## EUROSYSTEM PROJECTIONS FOR THE EURO AREA

The assessment of the growth of the main economies and world trade according to the Eurosystem projections is much the same as that made by the other international institutions. Thus, foreign demand has been the main engine of the recent revival of activity in the euro area.

The economy is expected to strengthen gradually during 2004, in a context of sustained world growth and relatively accommodating macroeconomic policies. The internal dynamism of the economy should be progressively augmented, initially through business investment. With a certain delay, employment should also pick up, contributing to the growth of household disposable income and bolstering consumer confidence. In all, although GDP growth was only 0.5 p.c. in 2003, it is expected to range between 1.4 and 2.0 p.c. in 2004 and between 1.7 and 2.7 p.c. in 2005.

Having reached 2.1 p.c. in 2003, inflation measured by the harmonised index of consumer prices (HICP) should be between 1.9 and 2.3 p.c. in 2004, dropping to between 1.1 and 2.3 p.c. in 2005. Domestically generated inflationary pressure should in fact remain weak in view of the gradual progress of the economic recovery, and as the restrained rise in labour costs associated with the cyclical expansion in productivity leads to a slower rise in unit labour costs. Despite the rising price of petroleum products and non-energy goods, import prices should continue to feel the effects of the earlier appreciation of the euro.

**TABLE 2** EUROSYSTEM PROJECTIONS  
(Percentage changes compared to the previous year)

	Euro area			p.m.: Belgium		
	2003	2004	2005	2003	2004	2005
Inflation (HICP) . . . . .	2.1	1.9 – 2.3	1.1 – 2.3	1.5	1.8	1.7
GDP volume . . . . .	0.5	1.4 – 2.0	1.7 – 2.7	1.1	2.3	2.6
of which :						
Private consumption . . . . .	1.0	1.0 – 1.4	1.4 – 2.6	1.7	1.8	2.3
Public consumption . . . . .	2.0	0.9 – 1.9	0.4 – 1.4	2.8	2.3	2.2
Investment . . . . .	-0.8	0.7 – 2.9	1.9 – 5.1	1.1	1.3	4.5
Exports . . . . .	-0.2	3.2 – 6.0	5.0 – 8.2	2.1	4.9	5.4
Imports . . . . .	1.7	2.8 – 6.2	5.0 – 8.4	3.8	4.4	5.0

Sources: ECB, NBB.

## Box 2 – The Eurosystem assumptions

The Eurosystem's economic projections for the euro area and the corresponding projections for Belgium are based on the following technical assumptions:

- **short-term interest rates** are set for the projection period at the level prevailing when the projections are produced, so as to indicate the potential consequences of maintaining the intervention rates of monetary policy. As a result, these projections are not necessarily the best unconditional forecasts, particularly for the long term, in that monetary policy will always respond in order to maintain price stability. In the projections under review, the three-month interbank rates are set at 2.1 p.c.;
- the assumed **long-term interest rates** in euro are based on market expectations; when the projections were produced, they stood at 4.3 p.c. and are expected to edge upwards to 4.5 p.c. by the end of 2005;
- the **bilateral euro exchange rates** are kept constant at the value recorded at the beginning of May, namely 1.19 dollars to the euro in the case of the US currency;
- in accordance with the implicit price movements reflected in forward contracts, **world oil prices** should fall slightly during the projection period, from the level of almost 37 dollars per barrel reached in the first half of May 2004. Taking the average for the year, a barrel of Brent is likely to cost 34.6 dollars in 2004 and 31.8 dollars in 2005, against 28.9 dollars in 2003.

The external conditions for the Belgian economy can be deduced from the expected developments in world trade and from the results of the projections produced by partners in the euro area as regards prices and the volume of trade in goods and services. The export markets, calculated via the weighted sum of imports from third countries, are expected to expand by more than 5 p.c. in 2004 and almost 7 p.c. in 2005. While the appreciation of the euro had weighed heavily on competitors' prices in 2003, that effect should moderate during the projection period. Taking an annual average, competitors' prices are expected to fall by a further 1.5 p.c. in 2004 and to rise by 1.5 p.c. in 2005.

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### ASSUMPTIONS ADOPTED FOR THE EUROSISTEM PROJECTIONS

	2003	2004	2005
	<i>(Annual averages)</i>		
Three-month interbank rates in euro . . . . .	2.3	2.1	2.1
Ten-year bond yields . . . . .	4.2	4.3	4.4
Euro exchange rate against the US dollar . . . . .	1.13	1.20	1.19
Oil price (US dollars per barrel) . . . . .	28.9	34.6	31.8
	<i>(Percentage changes)</i>		
Export markets relevant to Belgium . . . . .	2.5	5.3	6.9
Competitors' export prices . . . . .	-7.1	-1.5	1.5
of which:			
Competitors in the euro area . . . . .	-0.3	0.3	0.8

Source: ECB.

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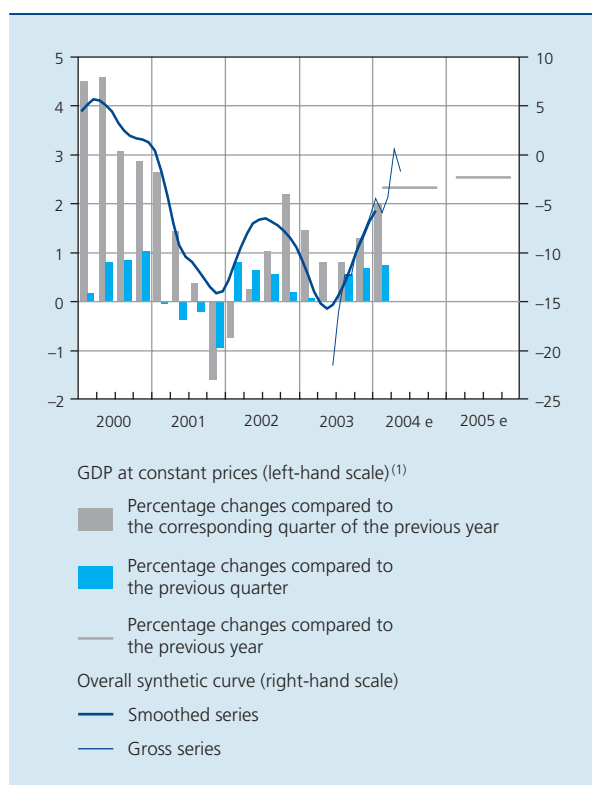


## 2. Activity, employment and demand in Belgium

### 2.1 Development of activity

The strengthening of activity seen in the euro area since the second half of 2003 also occurred in Belgium. From the third quarter of 2003 to the first quarter of 2004, the latest figure available when these projections were produced, GDP grew by an average of 0.6 to 0.7 p.c. per quarter, or around 2.5 p.c. on an annual basis. The recent movements in the economic indicators and the forecasts for the European economy suggest that this trend should be maintained over the projection period, putting an end to three years of growth hovering around 1 p.c. or less, well below the economy's potential. The real GDP growth rate is thus expected to rise from 1.1 p.c. in 2003 to 2.3 p.c. in 2004 and 2.6 p.c. in 2005.

**CHART 4** GDP AND ECONOMIC INDICATORS  
(Seasonally adjusted data)



Sources: NAI, NBB.

(1) Calendar adjusted data.

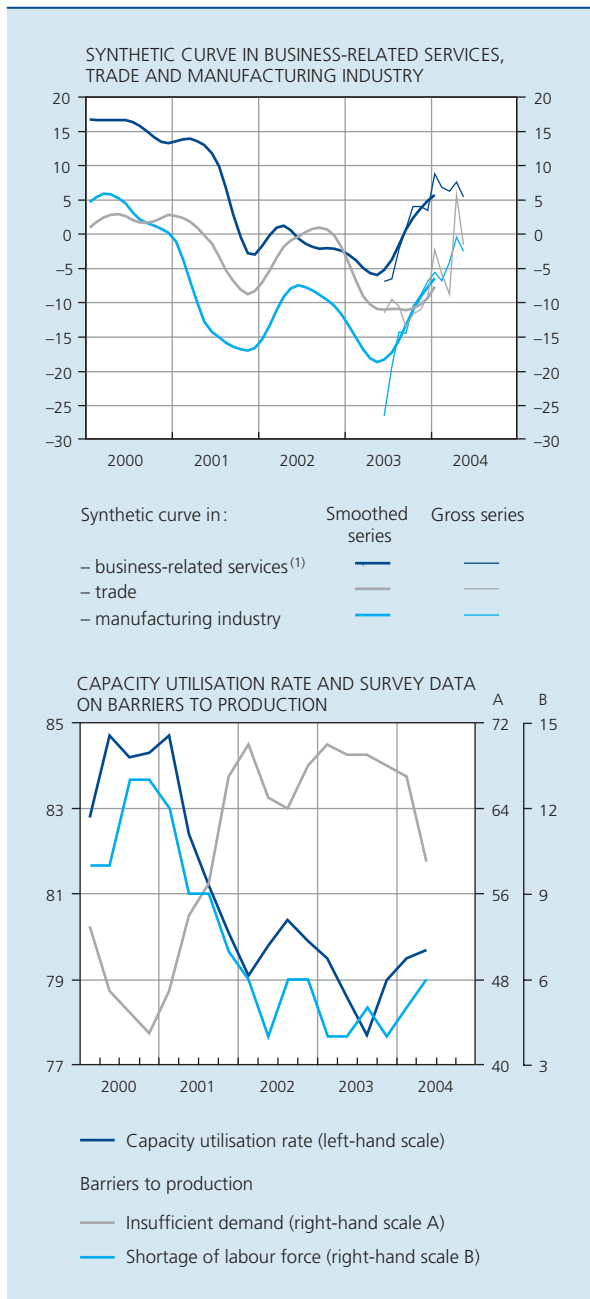
Although broadly affected by the same circumstances as neighbouring countries, particularly the appreciation of the single currency and the contrasting movements in external demand, the Belgian economy demonstrated greater dynamism than that of the euro area in 2003. The slackening of activity had been less marked in the first part of the year, and the recovery recorded since then has also been stronger. Consequently, the annual average rate of GDP growth was well ahead of the figure for the euro area as a whole, and that should be the case again in 2004. In particular, it seems that the state of public finances and the fears concerning the reforms in the area of social protection and pensions have depressed domestic demand to a greater extent in certain euro area countries. However, a sustained and substantial divergence between Belgium's growth and that of the euro area is not very likely in the medium term, owing to the high degree of integration of the various economies and relatively comparable situations in terms of trends in labour force and productivity.

The dynamism of the export markets clearly started to outweigh the effects of the euro appreciation from mid 2003. Accordingly, exports mainly triggered the revival in activity. That revival was principally apparent in manufacturing industry, the branch which had been hardest hit by the tensions and uncertainty associated with the launch of the military operations in Iraq. In the market services sector, activity expanded steadily after the trough of 2001.

The pattern indicated by the results of the Bank's business surveys reflects these developments. After pursuing a downward trend in the first part of the year, which also featured large monthly fluctuations in the gross series caused by geopolitical events in particular, the synthetic indicator for manufacturing industry rose steeply from July 2003. That rise was maintained in the initial months of 2004, and was further supported by a fall of the euro, which was down by around 6 p.c. in relation to its peak against the dollar, reached in mid February 2004. Business confidence aside, the improvement in the economic climate is also apparent in the increasing rate of capacity utilisation during the last nine months. Although, in contrast to the cyclical indicators, this rate of capacity stayed until April 2004 below the average of recent years, there has been a marked fall in the proportion of firms citing insufficient demand as the reason for under-utilisation of their factors of production. Apart from manufacturing industry, it is the business-related services sector that has seen the biggest improvement in business confidence. Having remained subdued in 2003, it also recovered in the trade sector at the beginning of 2004.

**CHART 5 BUSINESS SURVEY INDICATORS AND CAPACITY UTILISATION IN MANUFACTURING INDUSTRY**

(Seasonally adjusted data)



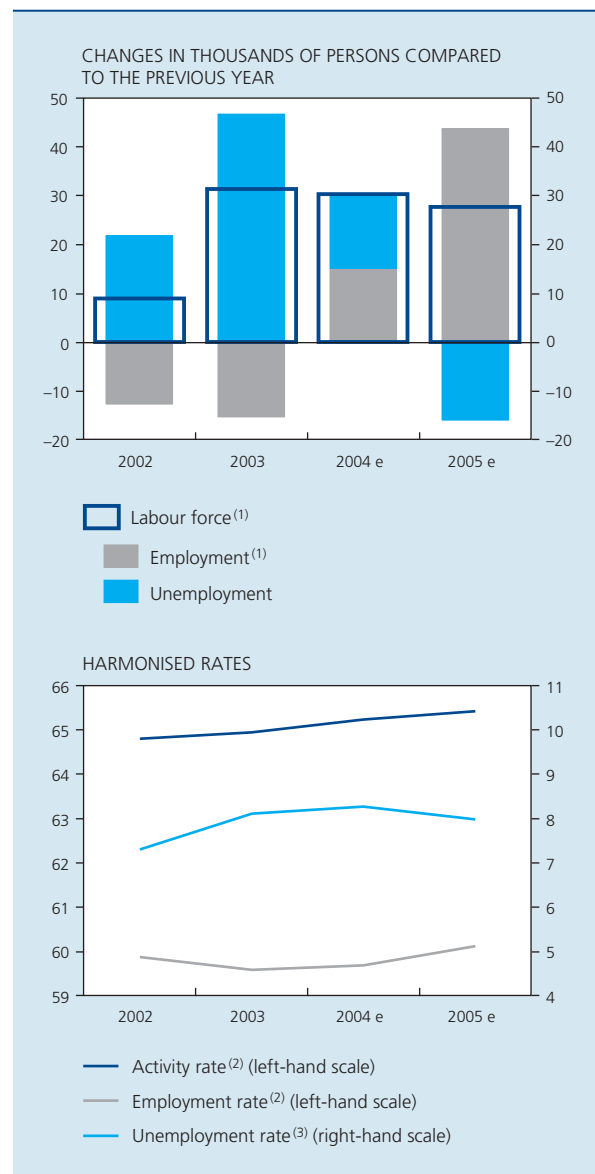
Source: NBB.  
 (1) The business-related services curve is not included in the overall synthetic curve.

According to the current projections, GDP growth should continue in 2004 and 2005 at a rate comparable to that of recent quarters. The sustained impetus provided by foreign demand should gradually be joined by an endogenous strengthening of the economy, via investment and employment.

## 2.2 Employment

The recovery in economic activity recorded during 2003 seems to have had a favourable impact on the recent employment movement. Various short-term labour market related indicators also appear to signal an end to the downward phase, in which the number of persons in work has fallen quarter on quarter for more than two years. For instance, the business surveys report an improvement in employment prospects since the third quarter of 2003, and the number of hours worked by

**CHART 6 LABOUR SUPPLY**



Sources: EC, NAI, NSI, NEMO, NBB.  
 (1) Estimates for 2003.  
 (2) Percentages of the population of working age.  
 (3) Percentages of the labour force.

**TABLE 3** DOMESTIC EMPLOYMENT  
(Percentage changes compared to the previous year)

	2000	2001	2002	2003	2004	2005
Domestic employment (persons) . . . . .	1.9	1.5	-0.3	-0.4	0.4	1.1
of which :						
Number of employees . . . . .	2.5	1.9	-0.3	-0.4	0.5	1.4
Volume of labour by employees <sup>(1) (2)</sup> . . . . .	3.0	1.5	-0.6	-0.7	0.7	1.5
Average hours worked per employee <sup>(2)</sup> . . . . .	0.5	-0.4	-0.3	-0.3	0.1	0.1

Sources: NAI, NBB.

(1) These figures take no account of overtime work by full-time employees, nor are the data adjusted for temporary lay-offs.

(2) Calendar adjusted data.

temporary agency staff has increased considerably since the last quarter of that year. In the first quarter of 2004, the number of totally unemployed drawing benefits still exceeded the figure of one year before by around 7 p.c. but the rate of increase has slowed since the third quarter of 2003.

The volume of labour, i.e. the total number of hours worked, generally adapts quickly to movements in activity, so that – following a marked fall – it should have risen again by the end of 2003. On the other hand, employment expressed in terms of numbers of persons usually takes time to react, not expanding until employers are convinced that the recovery is genuine and sustained, and start taking on staff. The number of persons in work should therefore rise again only in 2004.

In 2004 and 2005 employment should further be supported by the expected continuing growth of GDP. In the wake of the accelerating activity, the total number of hours worked by employees is expected to increase by 0.7 and 1.5 p.c. respectively. In contrast to the three preceding years, when activity was sluggish, the estimated expansion in paid employment, reaching 0.5 and 1.4 p.c. respectively in 2004 and 2005, is likely to be slightly lower than the rise in the volume of labour, as the average number of hours worked per employee is increasing slightly, as is usual in the ascending phase of the cycle. Overall, the productivity gains – which link the movement in activity to that in employment – is expected to revert to 1.5 p.c. on an annual basis, after increasing sharply at the start of the recovery.

National employment, i.e. all persons in work including the self-employed and the balance of frontier workers, is forecast to grow by around 15,000 units in 2004

and 44,000 units in 2005. The growth of employment over these two years should thus more than offset the net job losses recorded in the two preceding years. However, since the expected expansion in employment in 2004 more or less matches the expansion in the population of working age, the harmonised employment rate will probably increase by only 0.1 percentage point to 59.7 p.c.; in 2005 it should continue rising to reach 60.1 p.c.

The bulk of the expected additional jobs will probably be the result of the acceleration of activity. This endogenous job creation should be underpinned by the cuts made in employers' social security contributions, especially for certain risk groups such as the low skilled and older workers, in order to reduce labour costs. In the conclusions of the September 2003 Employment Conference, the government also announced the creation of a number of subsidised jobs. For instance, it is committed to creating 12,000 additional jobs in the social economy between now and 2007. Furthermore, there should be 25,000 new jobs created in the home assistance sector by 2005, following modifications to the service voucher system. However, this last measure's net effect on employment will fall short of the number of jobs recorded, as it partly concerns existing informal activity for which an estimate is incorporated in the national accounts figures for employment. Such shifts from undeclared to official employment have no impact on the estimate of the total number of persons in work. The projections include only the additional jobs created as the attractiveness of the system stimulates demand for this type of services.

The activity rate, which reflects the extent to which the population of working age is in work or seeking employment, is influenced not only by a large upward trend

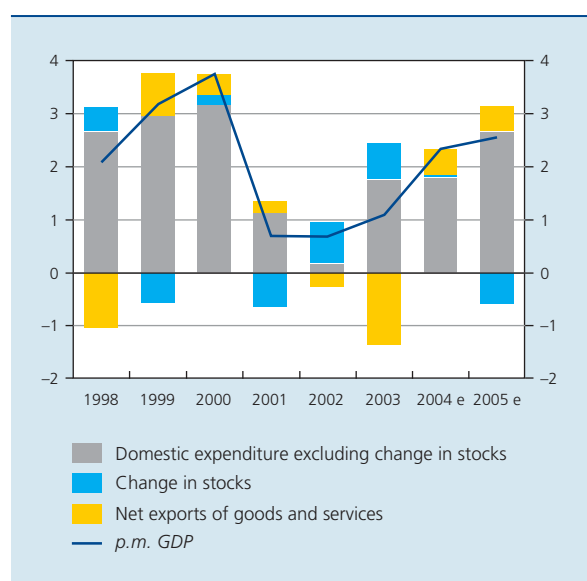
but is also affected by cyclical movements. Favourable economic conditions in fact encourage more people to entertain hopes of a job and present themselves on the labour market. In all, the expansion of the labour force in 2004 should still outstrip the growth of employment, causing unemployment to rise further. According to the forecasts, the year-on-year change in the numbers of unemployed will not become negative until the end of 2004; the numbers of unemployed will therefore increase by a further 15,000 units, on average, in 2004. In contrast, in 2005 a net decline of about the same scale is expected. Consequently, the harmonised unemployment rate is likely to increase by 0.2 percentage point to 8.3 p.c. in 2004 before subsiding to 8 p.c. of the labour force in 2005.

### 2.3 Expected movements in the main categories of expenditure

In 2003, the 1.1 p.c. GDP growth had been supported mainly by the strong revival in domestic demand – leaving aside changes in stocks – since that had contributed 1.8 percentage points. The contribution which domestic demand makes to growth should be on a comparable scale in 2004 before increasing in 2005.

Stocks also made a contribution to growth in 2003, namely 0.7 percentage point. Stock formation was substantial for the second consecutive year, much of it taking place in the second half of 2003. This may have meant

**CHART 7** MAIN CATEGORIES OF EXPENDITURE  
(Contribution to the change in GDP, percentage points, calendar adjusted data)



Sources: NAI, NBB.

that businesses anticipated some strengthening of final demand. The increase in stocks is expected to be more limited over the projection period. It should continue to have a small, positive impact on GDP growth in 2004,

**TABLE 4** GROSS DISPOSABLE INCOME OF INDIVIDUALS, AT CURRENT PRICES  
(Percentage changes compared to the previous year, unless otherwise stated)

	2000	2001	2002	2003 e	2004 e	2005 e
Gross primary income	5.1	4.6	2.8	1.5	2.8	3.6
of which:						
Wages and salaries	4.5	5.7	4.0	1.7	3.4	3.9
Wages per person	2.0	3.7	4.3	2.1	2.8	2.5
Employment	2.5	1.9	-0.3	-0.4	0.5	1.4
Current transfers <sup>(1)</sup>	7.0	6.4	1.7	-3.2	1.4	2.5
of which:						
Current taxes on income and assets	6.9	5.3	2.8	0.2	3.6	3.1
Gross disposable income	4.7	4.2	3.0	2.5	3.1	3.8
p.m. At constant prices <sup>(2)</sup>	2.3	1.7	1.3	0.7	1.2	2.0
Savings ratio <sup>(3)</sup>	14.5	15.4	16.2	15.4	14.9	14.8

Sources: NAI, NBB.

(1) These are net amounts, i.e. the difference between transfers received from other sectors and those paid to other sectors, excluding transfers in kind.

(2) Data deflated by the deflator of final consumption expenditure of individuals.

(3) Gross savings, including changes in the net equity of households in pension fund reserves, as a percentage of gross disposable income, including those changes.

before weakening and therefore exerting a negative influence on GDP growth in 2005.

Despite the strong support provided by total domestic demand, GDP growth was modest in 2003 owing to the highly negative contribution of net exports. In contrast to the two preceding years, net exports are forecast to have a positive effect on economic growth in 2004 and 2005, therefore participating in its acceleration.

Private consumption should make a substantial contribution to growth in 2004 and 2005, just as it did last year. In 2003 it expanded by 1.7 p.c., outstripping the rise in real disposable income of individuals. The rise in the savings ratio observed in 2001 at the height of the geopolitical uncertainty and the stock market corrections therefore did not persist after 2002. According to the projections, the savings ratio should drop back again, mainly in 2004. However, it is thought that the acceleration in consumption, where the growth rate will rise to 1.8 and 2.3 p.c. over the projection period, will also be due to the rise in disposable income.

The expected improvement in employment plays a dominant role in that respect. The faster rise in the wage bill is also due in part to the increase in compensation per person, although the rate of increase is likely to remain relatively modest for the reasons set out in section 3.2. The implementation of the tax reform, which will still be having a major impact in 2006, will also help to bolster the disposable income of individuals, which is expected to rise in real terms by 1.2 p.c. in 2004 and by 2 p.c. in 2005, after an estimated increase of 0.7 p.c. in 2003.

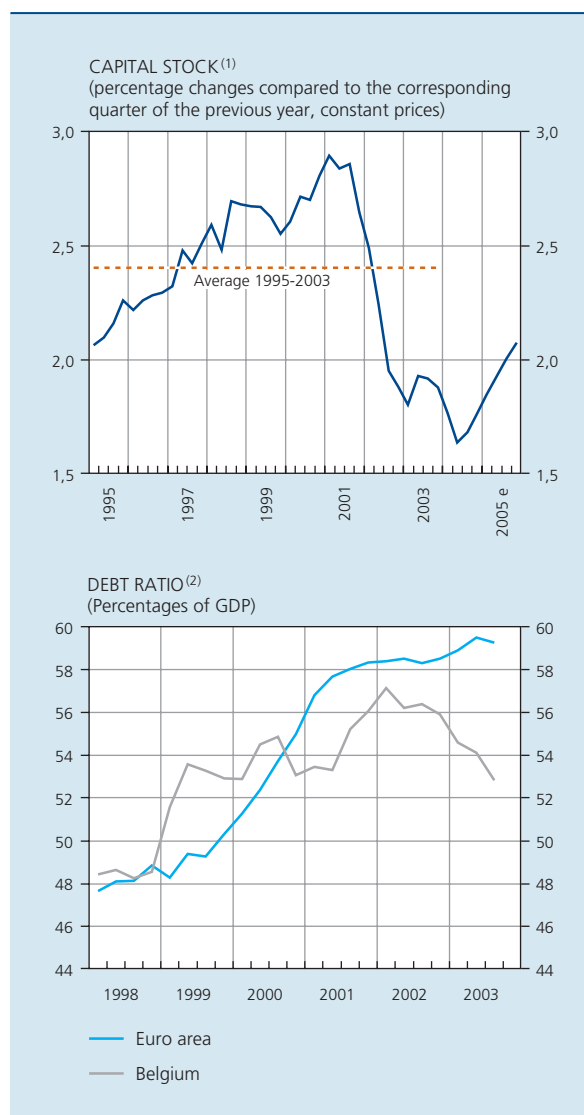
Investments by individuals in housing are likely to remain modest in 2004, growing by 1.1 p.c., as shown by the current flattening of the indicator of the volume of definite projects placed with architects. In 2005, growth should accelerate to 2.4 p.c. on account of the low level of investment spending in preceding years and relatively favourable financing conditions, due to the presumed low level of long-term interest rates over the projection period.

Public consumption expenditure, which was boosted by 2.8 p.c. in 2003 by a temporary increase in health care expenditure, is expected to return to a growth rate of around 2¼ p.c. in 2004 and 2005, barely higher than the average for the past ten years. In contrast, public investment expenditure looks set to expand significantly, especially during the final year of the projection. That acceleration is due mainly to the local election cycle, the next elections being scheduled for 2006. The reason is that local expenditure represents, on average, 45 p.c. of public investment, and most of that money is spent in the run-up to the elections. Furthermore, in contrast to previous years,

no decision has been taken at this stage on the sale of public buildings in 2005; in 2004, the sales will probably cut the level of public investment by around 4.5 p.c., an amount comparable to the figure for previous years.

The emergence of favourable demand prospects should encourage enterprises to step up their investments in 2004 and 2005. An acceleration in gross fixed capital formation is expected by the beginning of 2004, after a decline in the second half of the previous year. Owing to the negative growth overhang effect caused by that decline, investment is likely to expand by only 0.7 p.c.

**CHART 8** CAPITAL STOCK AND DEBT RATIO OF FIRMS  
(Seasonally adjusted data)



Sources: ECB, NAI, NBB.

(1) After deduction of depreciation.

(2) Total lending by financial institutions in the euro area and fixed-income securities issued, excluding loans between associate companies, probably greater in Belgium than in the euro area.

**TABLE 5** GDP AND MAIN CATEGORIES OF EXPENDITURE, AT 2000 PRICES

(Percentage changes compared to the previous year, calendar adjusted data)

	2000	2001	2002 <sup>(2)</sup>	2003	2004 e	2005 e
Final consumption expenditure of individuals .....	3.4	0.9	0.4	1.7	1.8	2.3
Final consumption expenditure of general government .....	2.7	2.5	1.9	2.8	2.3	2.2
Gross fixed capital formation .....	3.5	0.5	-2.1	1.1	1.3	4.5
Housing .....	0.9	-0.6	-1.6	1.3	1.1	2.4
General government .....	2.0	-12.4	1.6	-6.2	7.4	13.0
Enterprises .....	4.6	2.5	-2.7	1.8	0.7	4.2
Change in stocks <sup>(1)</sup> .....	0.2	-0.7	0.8	0.7	0.1	-0.6
Total domestic expenditure .....	3.5	0.5	1.0	2.5	1.9	2.1
Net exports of goods and services <sup>(1)</sup> .....	0.4	0.2	-0.3	-1.4	0.5	0.5
Exports of goods and services .....	8.6	1.3	0.8	2.1	4.9	5.4
Imports of goods and services .....	8.4	1.1	1.1	3.8	4.4	5.0
GDP .....	3.7	0.7	0.7	1.1	2.3	2.6

Sources: NAI, NBB.

(1) Contribution to the change in GDP.

(2) These data are influenced by the reclassification of the public broadcasting corporations, transferred from the non-financial corporations sector to the general government sector. Excluding this operation, the change in final consumption expenditure of individuals was 0.9 p.c. in 2002, and that of general government 1.3 p.c.; for gross fixed capital formation of firms and general government the respective figures were -2.6 p.c. and 0.6 p.c.; for final domestic expenditure the change was 0.3 p.c. and for GDP 0.8 p.c.

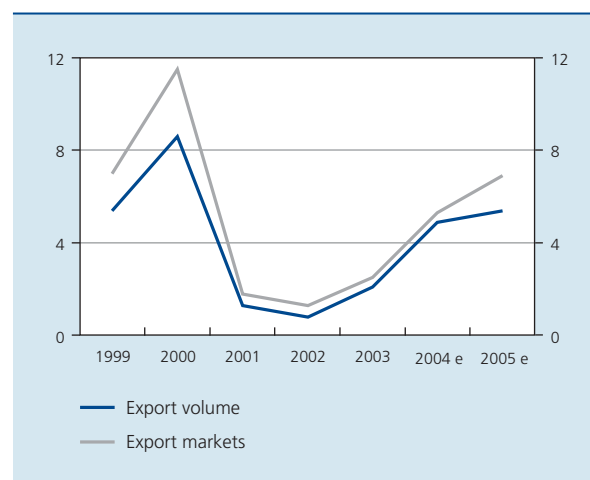
on average in 2004, against 4.2 p.c. in 2005, while the pattern will be similar over the two years. This recovery should stimulate the expansion of the capital stock of enterprises, expected to reach 2 p.c. at the end of 2005, though this is still well below the trend increase observed since 1995 and the growth rates close to 3 p.c. recorded in early 2001, before the start of a major process of adaptation of the means of production in line with the weakness of demand.

Although the capacity utilisation rate in manufacturing industry was still low at the beginning of 2004, the prerequisites for a recovery in business investment appear to be present. Financial conditions are favourable and, according to the Bank Lending Survey, banks are also expecting credit to continue to ease, especially for large firms. At the same time, the strengthening of economic activity will continue to exert a beneficial influence on the scope for self-financing. In addition, the level of borrowings of Belgian firms has declined over the past two years. Consequently, the current debt ratios are healthy and new investment can proceed without causing any significant imbalances. The decline in the prices of capital goods, already apparent for two years now, may also promote the propensity to invest.

As already stated, the marked strengthening of exports during 2003 started the cyclical upswing. In Belgium, in line with the expansion of world trade described above, the growth of the export markets picked up from the third

**CHART 9** EXPORT MARKETS AND EXPORTS OF GOODS AND SERVICES AT CONSTANT PRICES

(Percentage changes compared to the corresponding quarter of the previous year, data adjusted for seasonal and calendar effects)



Sources: ECB, NAI, NBB.

quarter of 2003, the main impetus coming from markets outside the euro area. In 2003, the latter expanded by 5 p.c. while markets within the euro area produced only 1.3 p.c. growth.

Driven by this stronger growth, exports of goods and services also posted a recovery in the third quarter of 2003. The expansion came to 2.1 p.c. for the year 2003 as a whole. This recovery is reflected in the marked rise since May 2003 in the business survey indicator relating to foreign orders in the manufacturing industry. During the initial months of 2004, in parallel with the expansion of the export markets, the rise in this indicator was also supported by the euro's depreciation.

During the period covered by the projections, the rise in exports is expected to accelerate to 4.9 and 5.4 p.c. respectively in 2004 and 2005, driven by expanding foreign demand. In particular, the growth rate of markets in the euro area, which had lagged behind the growth of markets elsewhere in 2002 and 2003, should gradually come closer to matching the expansion of these markets.

Supported by domestic spending, the volume of imports of goods and services grew by 3.8 p.c. in 2003, well outpacing the expansion of exports. The acceleration in the volume growth of imports should continue during the period of the projections, sustained by the rising exports and the strengthening of the domestic demand components. However, the rise in imports is expected to fall short of the increase in exports, so that net exports should make a positive contribution to GDP growth in 2004 and 2005, at a rate of around 0.5 percentage point in each year.

These volume movements should be reflected in a growing balance of payments surplus in goods and services, as a percentage of GDP, in 2004 and 2005, as the expected price movements will have a neutral impact over the two years as a whole. As regards the other current account items, the income surplus is predicted to remain steady and the deficit on current transfers should fall slightly. The current account surplus should therefore increase, rising from 3.1 p.c. of GDP in 2003 to 3.9 p.c. of GDP in 2005.

### 3. Prices and costs

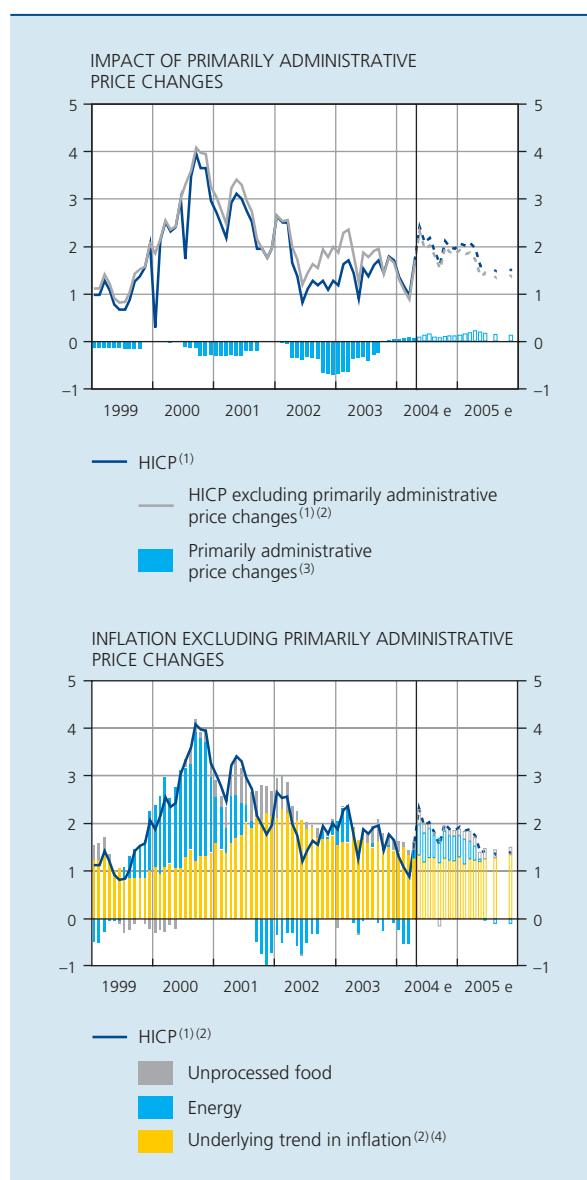
#### 3.1 Prices

Inflation measured by the HICP had fallen to 1 p.c. in March 2004. Following the crude oil price rises commented on below, it accelerated fairly sharply to reach 1.7 p.c. in April, and is expected to exceed 2 p.c.

temporarily after that. Subsequently, leaving aside short-term volatility, inflation should slacken, falling to around 1.6 p.c. by mid 2005, before gathering pace slightly as a result of the economic recovery. In all, inflation is expected to average 1.8 p.c. in 2004 and 1.7 p.c. in 2005, against 1.5 p.c. in 2003. Of course, these projections depend very much on the technical assumptions described earlier,

**CHART 10** INFLATION: ANALYTICAL BREAKDOWN

(Contributions of the various components in percentage points, unless otherwise stated)



Sources: EC, NBB.

(1) Percentage changes compared to the corresponding month of the previous year.

(2) Excluding the estimated effect, in January and July 2000, of the fact that prices discounted in sales have been taken into account in the HICP since 2000.

(3) That is measures relating to the radio and television licence fee, tariff changes in the network industries in which liberalisation is farthest advanced, namely telecommunications, electricity and gas, and changes to indirect taxes.

(4) Measured by the HICP excluding unprocessed food and energy.



**TABLE 6** HARMONISED INDEX OF CONSUMER PRICES FOR BELGIUM

(Percentage changes compared to the previous year)

	Total							p.m. Health index <sup>(3)</sup>
	Energy	Unprocessed food <sup>(1)</sup>	Underlying trend in inflation <sup>(2)</sup>					
				Processed food	Non-energy industrial goods	Services		
1999 .....	1.1	2.0	0.0	1.1	0.6	0.8	1.8	0.9
2000 .....	2.7	16.3	0.2	1.1	1.3	0.0	2.3	1.9
2001 .....	2.4	1.4	6.9	2.1	2.2	2.0	2.1	2.7
2002 .....	1.6	-3.6	3.2	2.1	1.5	1.7	2.6	1.8
2003 .....	1.5	0.2	1.7	1.7	2.8	1.0	1.9	1.5
2004 e .....	1.8	4.5	1.4	1.5	n.	n.	n.	1.6
2005 e .....	1.7	2.3	2.1	1.6	n.	n.	n.	1.6
Excluding primarily administrative price changes <sup>(4)</sup>								
1999 .....	1.2	1.7	0.0	1.3	0.6	0.8	2.2	
2000 <sup>(5)</sup> .....	3.0	16.8	0.2	1.5	1.2	0.7	2.4	
2001 .....	2.6	1.9	6.9	2.2	2.1	1.9	2.5	
2002 .....	1.9	-2.7	3.2	2.4	1.5	1.6	3.4	
2003 .....	1.8	1.0	1.7	2.0	2.1	1.0	2.7	
2004 e .....	1.7	3.0	1.4	1.6	n.	n.	n.	
2005 e .....	1.5	0.8	2.1	1.5	n.	n.	n.	

Sources: EC; FPS for Economy, SMEs, Self-employed and Energy; NBB.

(1) Fruit, vegetables, meat and fish.

(2) Measured by the HICP excluding unprocessed food and energy.

(3) National consumer price index, excluding products considered harmful to health, namely tobacco, alcoholic beverages, petrol and diesel.

(4) That is measures relating to the radio and television licence fee, tariff changes in the network industries in which liberalisation is farthest advanced, namely telecommunications, electricity and gas, and changes to indirect taxes.

(5) Excluding the estimated effect of the fact that prices discounted in sales have been taken into account in the HICP since 2000.

especially those relating to the movement in short-term interest rates, exchange rates, and crude oil prices, and on continuing wage moderation.

The slight acceleration in inflation, projected between 2003 and 2004, is due to a series of mainly administrative price changes. As may be seen from box 3, price changes of this type acted as a considerable brake on inflation in 2002 and 2003; in contrast, in 2004 and 2005 they will presumably boost inflation by 0.1 and 0.2 percentage point respectively. Furthermore, the inflation profile observed recently was largely determined by the movement in the prices of generally highly volatile components, namely energy and unprocessed food. In the future too, these components are expected to trigger substantial short-term fluctuations in inflation.

The movement in energy prices was the main factor contributing to a temporary slackening of inflation in February and March 2004. In April, on the other hand, this component was the source of a sharp acceleration which – in all likelihood – will continue in May. These see-saw movements are attributable primarily to base effects following substantial fluctuations in the crude oil price a year previously. Oil prices in fact surged at the beginning of 2003 owing to the strike in Venezuela and the Iraq war, but then fell steeply as soon as it was clear that the war in Iraq would soon be over. Since then, however, the dollar price of crude has been pushed up again by the vigour of world demand, OPEC production restrictions, the low level of commercial stocks in the United States and fears that political agitation and terrorist attacks in various oil-producing countries may jeopardise supplies. In April 2004, the price of a barrel of Brent crude increased to almost 35 dollars, roughly as high as during the run-up



### Box 3 – The reversed effect of primarily administrative price changes

In 2002 and 2003, inflation was kept down to a considerable extent by the abolition of the radio and television licence fee in Flanders and Brussels, the reduction in that fee in Wallonia and the changes made by the Electricity and Gas Regulation Committee in calculating the regulated prices of gas and electricity. As regards this last factor, the system of regulated prices still applies in Wallonia and Brussels, and there was no knowledge of any further cuts at the time drawing up the projections. On the other hand, for Flanders, where the gas and electricity market has been fully liberalised since July 2003, the standard supplier has announced tariff cuts. However, in that region a tax (called the Elia contribution) has been introduced to compensate for the loss of revenue incurred by the municipalities following liberalisation. In April 2004, the law on environmental levies and eco-bonuses was implemented. This can be expected to lead to small net reductions in prices.

#### PRIMARILY ADMINISTRATIVE PRICE CHANGES

(Estimated contribution to inflation in percentage points)

	2002	2003	2004	2005
Abolition of the radio and television licence fee in Flanders and Brussels . . . . .	-0.27	-0.27	-	-
Reduction in the radio and television licence fee in Wallonia . .	-	-0.05	-0.05	-
Impact of changes in electricity and gas tariffs . . . . .	-0.09	-0.13	-0.01	-0.04
Indirect taxes on electricity and gas . . . . .	-	-	0.02	0.04
Environmental levies and eco-bonuses . . . . .	-	-	-0.05	-0.02
Indirect taxes on tobacco and petroleum products . . . . .	-	0.12	0.19	0.17
<b>Total . . . . .</b>	<b>-0.36</b>	<b>-0.33</b>	<b>0.10</b>	<b>0.15</b>

The rather small downward effect of these factors in 2004 and 2005 does not outweigh the increase in indirect taxes on tobacco and petroleum products. For the latter, a ratchet system was in fact introduced to increase the excise duty. According to this system, half of each price reduction resulting from application of the programme contract is offset by an increase in excise duty which applies permanently thereafter. During 2004-2008, this system is to be applied each year until a maximum increase in duty of 0.028 euro per litre is reached. In 2003, this system was already applied to petrol, raising the excise duty by 0.014 euro per litre.

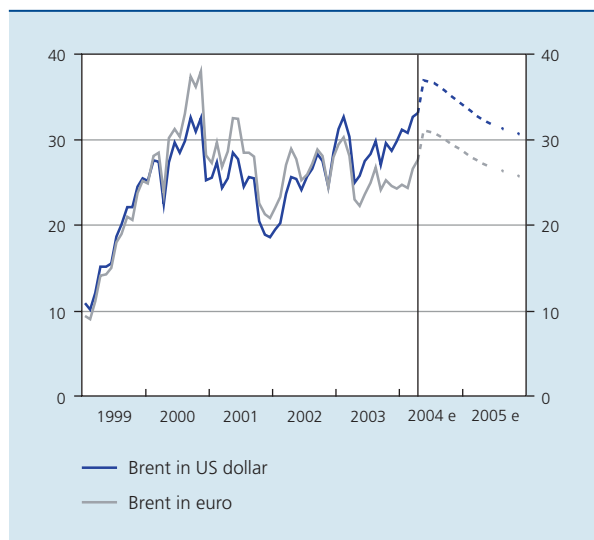
Naturally, there is still a possibility that the eventual inflation figure may be influenced by government measures which were not known when these projections were drawn up.

to the Iraq war or during the autumn of 2000. The price continued to rise in May.

However, the impact of these movements on inflation was largely attenuated by the appreciation of the euro. In consequence, the price of crude oil denominated in euro remained relatively stable until March 2004, and in April it was still almost 10 euro below the peak recorded in November 2000. Crude oil price changes have an almost immediate impact on consumer prices of motor vehicle fuel and heating oil, so that oil prices are the most direct

transmission channel whereby movements in the euro exchange rate influence consumer prices. Another point worth mentioning is that the upward pressure exerted on oil prices meant that, during the first four months of 2004, the ratchet system described in box 3 had not yet given rise to any increases in excise duty on petrol, while the increases in the duty on diesel had not yet reached their maximum amounts.

**CHART 11** CRUDE OIL PRICES<sup>(1)</sup>  
(Monthly averages)



Source: ECB.

(1) Prices recorded up to April 2004, assumptions from May 2004 (monthly until June 2005 and quarterly thereafter).

In accordance with the implicit prices reflected in forward contracts, crude oil prices quoted on the world market should drop from June onwards, falling to 34 dollars a barrel at the end of 2004 and 30 dollars a barrel by the end of 2005, while the exchange rate between the euro and the US dollar is expected to remain unchanged at 1.19 dollar to the euro. In consequence, the rate of increase in energy prices should rise to around 9 p.c. during May, June and July. After that, however, a slight slackening is predicted, intensifying from the first quarter of 2005, although in that regard it should be noted that the uncertainty surrounding that assumed pattern seems greater than usual.

The uncertainty over the future movement in unprocessed food prices is also considerable, since prices depend very much on supply conditions which are sometimes highly unstable. In recent months, those conditions have tended to be favourable. Assuming that they will evolve in a more neutral way in the future, the rate of increase in the prices of unprocessed foods should be about 1.4 p.c. in 2004 and 2 p.c. in 2005, i.e. roughly the same as in 2003.

Leaving aside the primarily administrative price changes and the volatile movements in the prices of unprocessed food and energy, one obtains a good indicator of the underlying trend in inflation. While the average pace of price rises measured in this way had already dropped

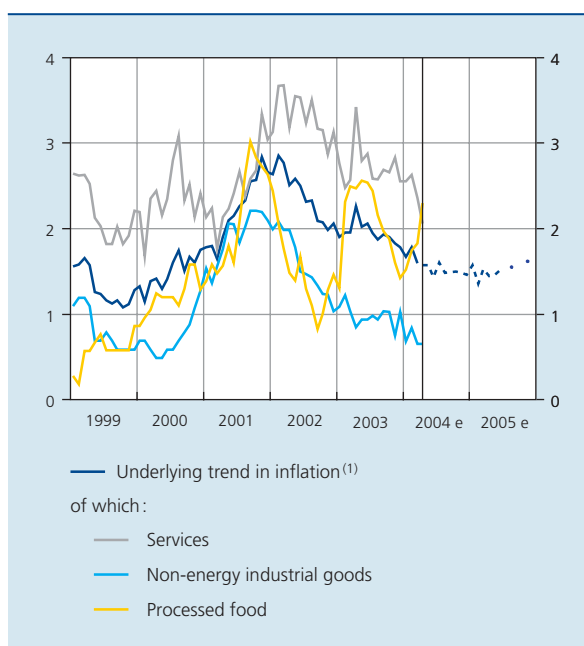
from 2.4 p.c. in 2002 to 2 p.c. in 2003, the pace is expected to decelerate further, to 1.6 p.c. in 2004 and 1.5 p.c. in 2005. This slowing is due to the appreciation of the euro, which has reduced external pressure on prices, despite the increase in prices of energy and non-energy commodities. While changes in exchange rates are reflected almost immediately in consumer prices of energy, it takes longer for them to be transmitted to most other products. Moreover, as may be seen from box 4, the scale of that transmission and its timing may vary from one period of sharp exchange rate fluctuations to another.

The slowing pace of the underlying trend in inflation is also due to the fact that the rise in labour costs, as explained below, moderated considerably in 2003 and should remain muted, and to the generally modest rate of increase in domestic demand. The pattern of the underlying trend in inflation observed over the first four months of 2004 is in line with that prediction.

Despite high volatility, attributable mainly to the movement in package travel prices, the underlying trend for services continued to fall during the first four months of 2004. The principal contributory factor was the small rise in labour costs, which play a more significant role

**CHART 12** UNDERLYING TREND IN INFLATION

(Percentage changes compared to the corresponding month of the previous year)



Sources: EC, NBB.

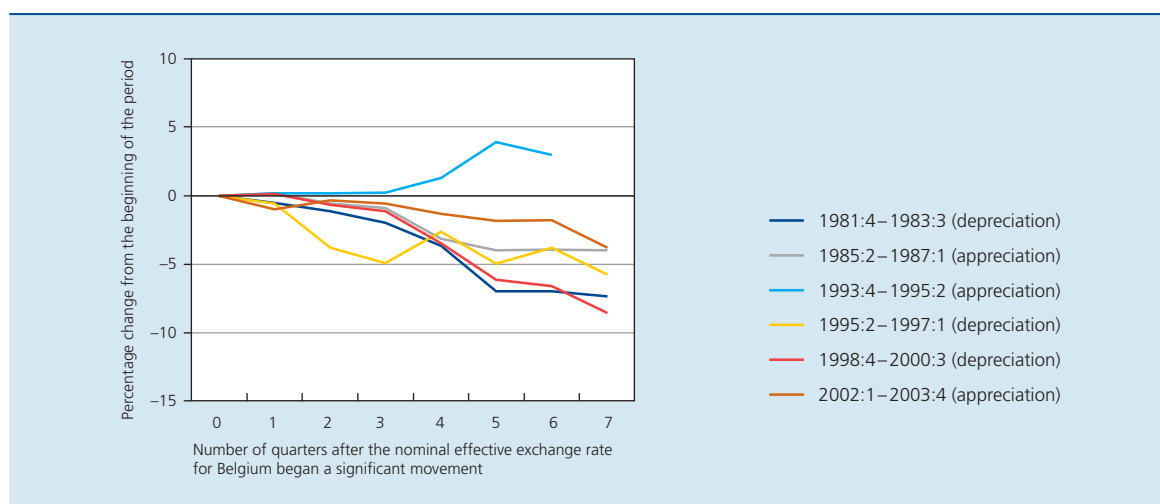
(1) Measured by the HICP excluding unprocessed food and energy, and primarily administrative price changes.

## Box 4 – Transmission of exchange rate changes

The strong appreciation of the nominal effective exchange rate for Belgium, since the first quarter of 2002, has undeniably played a role in the easing of the underlying inflation rate in the past two years. That is mainly apparent in the non-energy industrial goods component which - apart from a substantial proportion of directly imported consumer goods – also includes goods which are produced in Belgium by means of imported manufactured products. Consequently, the movement in the prices of imported manufactured goods during the period from the first quarter of 2002 to the fourth quarter of 2003 can provide an indication of the extent to which the euro's recent appreciation has exerted downward pressure on consumer prices. That movement is relatively modest if one compares it to the changes in import prices during other periods of substantial variations in exchange rates.

### PRICES OF IMPORTED MANUFACTURED PRODUCTS<sup>(1)</sup>

(Percentage change from the beginning of the period)<sup>(2)</sup>



Sources: NAI, NSI, NBB.

(1) Unit values for manufacturing industry products, excluding diamonds. They concern the Belgium-Luxembourg Economic Union up to 1992, Belgium only thereafter.

(2) The various import price movements have been reassessed according to the scale and direction – in the case of a depreciation – of the change in the nominal effective exchange rate during the latest appreciation period, in order to permit mutual comparison between import price movements.

It is commonly acknowledged that, in the long term, exchange rate changes are entirely reflected in import prices. In the shorter term, however, there is no obvious straight link between the exchange rate fluctuations and the movement in import prices, since foreign exporters can set their prices by taking account, to varying degrees, of the specific conditions in the country of destination ("pricing-to-market").

In so far as such a "pricing-to-market" strategy is applied, exchange rate variations lead to fluctuations in foreign exporters' margins, but not in import prices. It is generally accepted that the degree to which that strategy is applied depends on the nature of the exchange rate changes. If the observed change in the exchange rate is regarded as temporary, the price adjustment will be less pronounced, as a rule, than if the change is considered to be permanent. In the former case, there is in fact a danger that the economic agents may have to adjust their prices again in the opposite direction at a later date. The direction of the exchange rate movement may also play a role, since the extent to which foreign exporters can allow their margin to fluctuate may not be symmetrical. For instance, if the euro depreciates, the "pricing-to-market" strategy causes foreign exporters' margins to shrink, which is perhaps less tenable than widening of their margins if the euro appreciates.



Moreover, it must be pointed out that other factors may also play a role. For example, the appreciation period which began in the first quarter of 2002 was accompanied by constant upward pressure on prices of energy and non-energy commodities, caused among other things by strong world demand.

in services than in other components. In the case of non-energy industrial goods, where the impact of the euro's appreciation is greater, the rate of increase in prices also continued to slow down during the first four months of 2004. However, these movements were partly offset by the acceleration in the pace of price increases for processed food, due to the February 2004 increase in the maximum price for bread subject to regulation. However, this form of price regulation will be abolished in July 2004. The fall in the underlying inflation trend is expected to come to a halt in the second half of 2004, giving way to a slight rise from mid 2005. The transmission to consumer prices of the appreciation of the exchange rate and of the slackening pace of increases in labour costs should gradually come to an end, and the economic upturn should subsequently lead to a slight acceleration in inflation.

Taking account of the developments described above, the health index – which is the benchmark for the indexation of wages and other incomes – looks set to rise by 1.6 p.c. in both 2004 and 2005. Of course, this figure is heavily dependent on the initial assumptions adopted for the projection.

### 3.2 Labour costs

In 2004, as in the previous year, the movement in private sector wages is largely determined by the pay agreements concluded in the first half of 2003 and by the automatic linking of wages to the health index, which together constitute the collectively agreed increases. These pay negotiations were conducted within the framework of the December 2002 central agreement, whereby the social partners had agreed an indicative norm of 5.4 p.c. for the increase in hourly labour costs in the private sector during the 2003-2004 period.

In view of the sluggishness of the economy at the time of the negotiations and the uncertainty hanging over the economic recovery, the social partners had called on the joint committees to make a special effort as regards wage moderation in 2003, and to postpone the major part of the real collectively agreed wage increases until 2004. Although these increases are ordinarily relatively smaller in the first year covered by a biennial central agreement,

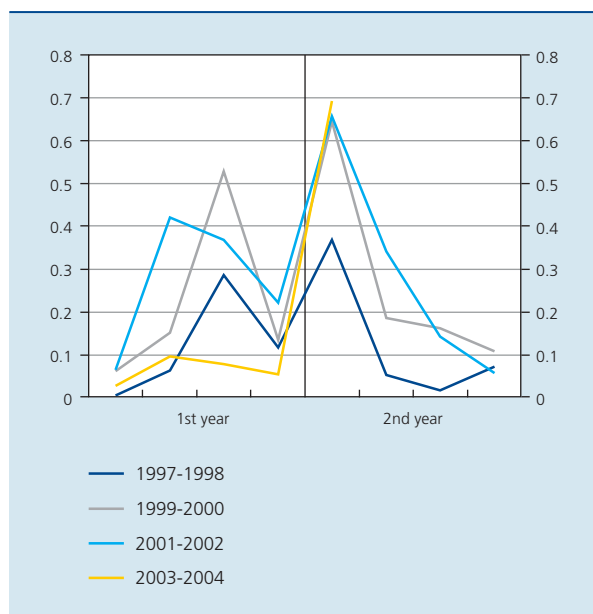
they remained in 2003 – quarter on quarter – below the levels observed under the three preceding central agreements. As expected, real collectively agreed wages rose faster in the first quarter of 2004. The increase is expected to average 0.8 p.c. over the year as a whole, after a rise of just 0.4 p.c. in 2003.

Inflation which, despite a slight acceleration, is still relatively subdued, should lead to wage indexation averaging 1.6 p.c. in 2004, against 1.5 p.c. in 2003. The overall increase in collectively agreed wages is therefore expected to represent 2.4 p.c. in 2004, i.e. a cumulative increase of 4.2 p.c. over the 2003-2004 period, against 7.2 p.c. in 2001-2002.

A number of agreements explicitly allowed some scope for decisions on collectively agreed pay increases in individual firms. These increases are included in the wage drift together with premium pay and the impact of changes in the structure of employment which influence the average level of wages. This wage drift is estimated at 0.8 p.c. in 2004, representing a slight acceleration compared to 2003, when it came to 0.5 p.c.

A series of reductions in employers' social security contributions, agreed at the September 2003 Employment Conference, take effect during this year. In 2004, 400 million euro will be set aside for this. Once the cuts are fully operational, the budget earmarked for these measures will come to 840 million euro. The measures relate in part to generalised reductions in the form of an extension of the structural cuts in contributions, but the major part of the budget is devoted to reducing the labour costs relating to specific groups of workers. Thus, some of the measures target workers on low wages and staff in the non-market sector. Taken together, these provisions will probably yield a 0.5 percentage point reduction in the rise in hourly labour costs in the private sector in 2004, which is therefore estimated at 2.6 p.c. Altogether, the cumulative rise in labour costs per hour worked is expected to come to 4.8 p.c. in 2003-2004, which is below the indicative wage norm for that period, and well below the 2001-2002 figure, when the cumulative rise in labour costs had reached 9.2 p.c.

**CHART 13 REAL COLLECTIVELY AGREED WAGES<sup>(1)</sup>**  
(Percentage changes compared to the previous quarter)



Source : FPS Employment, Labour and Social Consultation.

(1) Pay increases for manual and non-manual workers, defined by joint committees, excluding increases granted by individual firms and indexation.

Owing partly to the strengthening economic growth, the fall in the average hours worked per employee, seen in previous years, is expected to end in 2004. As a result, labour costs per person employed will probably rise slightly faster this year than the costs per hour worked. However, the 2.8 p.c. growth represents an acceleration compared to the 1.8 p.c. rise recorded in 2003, a year in which the average number of hours worked per employee fell by 0.3 p.c.

Also owing to the increase in the number of hours worked by employees, but mainly because of the revival in economic activity, labour productivity – the volume of value added per person in work – should continue to rise by 2.3 p.c. in 2004, after a 1.6 p.c. increase in 2003. Unit labour costs should therefore show only a modest increase of 0.5 p.c., comparable to 2003 when the rise was just 0.2 p.c.

As stated in the technical report by the Central Council for the Economy, the movement in hourly labour costs in Belgian firms has, on average, kept in phase with that seen in the three main neighbouring countries (Germany, France and the Netherlands) since 1996, the year in which the law on competitiveness came into force. If, as

**TABLE 7 LABOUR COSTS IN THE PRIVATE SECTOR**  
(Percentage changes compared to the previous year)

	2001	2002	2003 e	2004 e	2005 e
Gross wages per hour worked	3.7	4.8	2.3	3.2	2.5
Collectively agreed wages <sup>(1)</sup>	3.3	3.8	1.8	2.4	2.0
Real agreed adjustments	0.8	1.5	0.4	0.8	0.4
Indexations	2.5	2.3	1.5	1.6	1.6
Wage drift <sup>(2)</sup>	0.3	1.0	0.5	0.8	0.5
Employers' social security contributions <sup>(3)</sup>	0.2	0.2	-0.3	-0.5	-0.3
of which :					
Paid to public authorities	-0.2	0.1	-0.3	-0.5	-0.3
Labour costs per hour	3.9	5.0	2.1	2.6	2.2
Change in hours worked per employee <sup>(3)</sup>	-0.3	-0.6	-0.3	0.2	0.1
Labour costs per employee	3.6	4.4	1.8	2.8	2.4
Labour productivity <sup>(4)</sup>	-1.2	1.4	1.6	2.3	1.2
Unit labour costs	4.8	2.9	0.2	0.5	1.1

Sources : FPS Employment, Labour and Social Consultation; NAI; NBB.

(1) Wage increases fixed by joint committees.

(2) Increases granted by enterprises over and above those under central and sectoral collective agreements, wage drift resulting from changes in the structure of employment (e.g. as a result of job creation programmes) and errors and omissions.

(3) Contribution to the rise in labour costs.

(4) Ratio between value added at constant prices and the number of persons in work (employees and self-employed).

stipulated by the law, costs in Belgium continue to keep in line with the pace of change in neighbouring countries, the trend which began in 2003 should continue in 2005: wage moderation has in fact been announced in the Netherlands, and the increases expected in France, and especially Germany, are small, On the basis of the outlook for labour costs and hours worked per person in work in the neighbouring countries, the rise in labour costs per hour worked in the private sector could there average 2 to 2.5 p.c.

Taking account, in particular, of the impact in 2005 of the fiscal and parafiscal measures which will reduce the tax wedge between labour costs and net remuneration, the increase in labour costs per hour worked could therefore come to 2.2 p.c. in Belgium next year. The said reductions in employers' contributions will probably exert a moderating influence of 0.3 p.c., so that the rise in gross wages per hour worked will come to 2.5 p.c. The indexations should be around 1.6 p.c. Assuming a wage drift of 0.5 p.c., these estimates therefore imply an adjustment to real collectively agreed wages of 0.4 p.c. in 2005, making the situation comparable to that seen in 2003, the first year of the current central agreement.

Assuming that the average hours worked per employee continue to increase during the upward phase in economic activity, remuneration per employee should rise slightly faster than wages per hour worked, and labour productivity could increase by 1.2 p.c., bringing the increase in unit labour costs to 1.1 p.c.

### 3.3 Costs and deflators

Since the environment in which firms operate is very open to competition, be it on the export markets or on their own domestic market, selling prices cannot be adjusted at will, according to the movement in production costs among others. Firms are thus obliged to set their prices within limits determined by market conditions and demand. In view of the rise in their production costs, mainly labour costs and import prices, companies will therefore be forced to adjust their operating margins, in part at the very least.

The deflator of domestic demand, which reflects the movement in selling prices on the domestic market, increased by an average of 1.5 p.c. per annum in the 2001-2003 period, and that rise is expected to continue at more or

**TABLE 8** DEFLATORS  
(Percentage changes compared to the previous year)

	2001	2002	2003 e	2004 e	2005 e
<i>Deflators of components of demand and of GDP</i>					
Final demand <sup>(1)</sup> . . . . .	1.6	0.2	0.1	1.1	1.5
Domestic demand <sup>(1)</sup> . . . . .	1.8	1.2	1.5	1.7	1.7
Exports . . . . .	1.5	-0.9	-1.4	0.7	1.3
Imports . . . . .	1.5	-1.7	-1.8	1.0	0.9
<i>p.m. Terms of trade</i> . . . . .	0.0	0.8	0.3	-0.3	0.4
<b>GDP</b> . . . . .	<b>1.8</b>	<b>1.7</b>	<b>1.7</b>	<b>1.3</b>	<b>2.0</b>
<i>Costs of domestic origin per unit of value added</i>					
Labour costs <sup>(2)</sup> . . . . .	5.0	3.2	0.7	0.9	1.6
Gross operating surplus <sup>(3)</sup> . . . . .	-1.4	-1.1	3.9	0.5	2.8
of which:					
Operating margin of firms <sup>(4)</sup> . . . . .	-4.0	-2.7	5.8	0.0	4.0
Indirect taxes net of subsidies . . . . .	-2.2	3.6	0.5	5.4	1.7

Sources: NAI, NBB.

(1) Including changes in stocks.

(2) Per unit of GDP at constant prices, excluding mixed income of self-employed persons.

(3) Per unit of GDP at constant prices, including mixed income of self-employed persons.

(4) Per unit of value added of firms.

less the same rate in 2004 and 2005. Export price movements are more erratic, and – in view of the high import content of exports, and competition conditions dictated by prices prevailing on external markets – they are greatly influenced by the movements in prices of imported goods and services. Export prices are expected to rise by 0.7 p.c. in 2004 and 1.3 p.c. in 2005, the terms of trade being overall neutral over the two years.

The movement in internal costs included in all goods and services produced is reflected in the GDP deflator. Those costs consist of wages, operating margins and indirect taxes net of subsidies. Labour costs expressed per unit of value added increased substantially in 2001 and 2002, by an average of more than 4 p.c. per annum. In the face of the difficulties encountered in making proportionate adjustments to their selling prices, firms were forced to cut their operating margins, which contracted by an annual average of more than 3 p.c. during that period. In contrast, the wage moderation of 2003 and 2004 and the relatively modest increase expected in 2005 are contributing to the limited rise in domestic costs over these three years, and should make it possible to restore unit operating margins, which are expected to increase by an annual average of almost 3 p.c. over the 2003-2005 period. Apart from the margin, the amount of the operating surplus of firms could also benefit, particularly from 2004 onwards, from the revival in final demand. However, the improvement is expected to be tempered in the current year by the slightly adverse movement in the terms of trade, following the rise in import prices caused, in particular, by higher oil prices. Furthermore, some increases in indirect taxes, particularly on tobacco and petroleum products, and the bringing forward to 2003 of part of the subsidy intended for the BNRC should also depress the operating surplus in 2004.

## 4. Public finances<sup>(1)</sup>

### 4.1 General

Despite a persistent cyclical downturn, the Belgian government succeeded in avoiding a budget deficit in 2003, for the fourth consecutive year. According to provisional data published by the NAI in March 2004, the general government account showed a surplus of around 0.2 p.c. of GDP.

This result compares favourably with the situation of public finances in other EU Member States. Only Spain and the Scandinavian countries recorded a higher surplus. In contrast, the accounts of the United Kingdom, the

Netherlands and Greece ended the year in deficit, by a figure equalling or slightly exceeding the reference value of 3 p.c. of GDP set by the Treaty on European Union. Finally, in France and Germany, where the 3 p.c. of GDP ceiling had already been exceeded in 2002, the budget deficit continued to grow, reaching around 4 p.c. of GDP. Overall, the then fifteen Member States would have recorded a deficit averaging 2.6 p.c. of GDP in 2003.

The fact that Belgium achieved a small budget surplus in 2003, despite the difficult cyclical environment, was due to the influence of non-recurring factors.

For the third consecutive year already the expansion of activity has fallen well short of the trend growth rate. Thus, the favourable impact on public finances of the economic boom of 1999 and 2000 has evaporated steadily and, according to the harmonised ESCB cyclical adjustment method, the macroeconomic environment probably would have worsened the budget balance all in all by around 0.4 p.c. of GDP in 2003. The fact that the actual level of GDP was more than 1 p.c. below the trend figure was only partly offset by the composition of GDP, which was slightly more favourable to public finances than it is on average.

On the other hand, non-recurring factors had a substantial favourable effect on public finances in 2003. This concerns mainly the Belgacom capital transfer, totalling 5 billion euro, in connection with the assumption by the federal government of that company's pension liabilities, and the proceeds from further real estate sales by the federal government. The effect of these factors was only partly offset by such items as the bringing forward, to 2003, of part of the operating subsidies and the whole of the investment grant to the BNRC, planned for 2004. Altogether, the non-recurring factors would have improved the budget balances by around 1.5 p.c. of GDP in 2003. Adjusted to take account of these factors and of the influence of the economic cycle, the deficit came to around 0.9 p.c. of GDP.

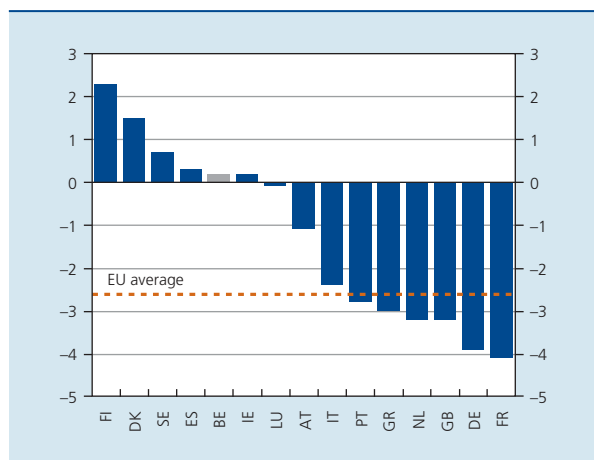
In the macroeconomic context described above, the small surplus in 2003 would become a deficit from this year onwards. It should be limited to 0.3 p.c. of GDP in 2004, but would reach 1 p.c. of GDP in 2005. These projections take account only of budget measures which have already been announced and are sufficiently detailed; they obviously disregard the effect of any decisions that will

(1) As indicated in box 1, the projections for public finances are drawn up and presented taking account of calendar effects on the macroeconomic variables, in accordance with the practice prevailing in the compilation of the government account in the set of national accounts. Calculated in this way, the real growth of GDP comes to 2.4 p.c. in 2004 and 2.3 p.c. in 2005, against 2.3 and 2.6 p.c. respectively for calendar adjusted GDP.



**CHART 14 BUDGET BALANCES IN THE EU**

(2003, percentages of GDP)



Sources: EC, NAI.

be taken in drawing up the budget for 2005. No account is taken of the budget targets as such (e.g. the budget balance targeted for both years in the latest stability programme dated November 2003), nor of measures which have yet to be taken in order to meet these targets. The projections therefore indicate what would happen in the absence of any additional budget measures.

The deterioration in the budget balance would be the outcome of opposing effects produced by four different factors.

First, general government's interest charges are expected to continue falling in 2004 and 2005. The projections are based on the technical assumption that short-term market interest rates will remain unchanged, while long-term market rates will only increase from an average of some 4.3 p.c. in 2004 to around 4.4 p.c. in 2005. Against that background, the implicit interest rate on public debt would fall from around 5.4 p.c. in 2003 to approximately 5 p.c. in 2005, mainly as a result of the refinancing of long-term debts at lower rates. Together with the fall in the debt ratio, that would cut interest charges by around 0.8 p.c. of GDP between 2003 and 2005.

Next, the projections are based on a progressive cyclical recovery. The expansion in activity should increase over the period in question, slightly outstripping the trend growth rate in both 2004 and 2005 and, hence, mitigating the negative effect of the weak business cycle of recent years. However, the composition of GDP will become less advantageous for public finances as, in

accordance with the projections, labour incomes on the one hand, and private consumption and investment in housing on the other, lag behind the expansion in activity in 2004. Overall, the adverse influence of the macroeconomic environment described above is therefore expected to moderate by only around 0.2 p.c. of GDP, to 0.2 p.c. of GDP in 2005.

However, the effect of the small improvement in the cyclical component of the budget balance and the sharp fall in interest charges is far outweighed by the progressive disappearance of the favourable impact of non-recurring factors and, to a lesser extent, by a further loosening of structural budgetary policy.

**TABLE 9 CYCLICALLY ADJUSTED AND STRUCTURAL BUDGET BALANCES**  
(Percentages of GDP)

	2003	2004 e	2005 e
Overall balance (a) . . . . .	0.2	-0.3	-1.0
Interest charges (b) . . . . .	5.6	5.1	4.8
Primary balance (c = a + b) . . . . .	5.8	4.8	3.8
<i>p.m. Revenue</i> . . . . .	51.6	50.0	49.2
<i>Primary expenditure</i> . . . . .	45.8	45.2	45.4
Cyclical component (d) . . . . .	-0.4	-0.5	-0.2
Level of GDP . . . . .	-0.7	-0.4	-0.3
Composition effects . . . . .	0.3	-0.1	0.1
Cyclically adjusted primary balance (e = c - d) . . . . .	6.2	5.3	4.1
Influence of non-recurring factors <sup>(1)</sup> (f) . . . . .	1.5	0.8	0.1
of which:			
Belgacom capital transfer . . . . .	1.9	0.0	0.0
Shift in BNRC financing . . . . .	-0.4	0.4	0.0
Sale of real estate . . . . .	0.1	0.1	0.0
Shifts between withholding tax on earned income and tax assessments . . . . .	0.0	0.1	0.1
One-off declaration of financial assets . . . . .	0.0	0.3	0.0
Structural primary balance (g = e - f) . . . . .	4.7	4.5	4.0
<i>(p.m. Change in the structural primary     balance)</i> . . . . .		(-0.2)	(-0.5)
<i>p.m. Change in the structural financing balance (h = a - d - f)</i> . . . . .	-0.9	-0.6	-0.8

Sources: NAI, NBB.

(1) A positive (negative) figure improves (deteriorates) the budget balance.



In 2004, non-recurring factors would still improve the budget balance by 0.8 p.c. of GDP. First, the budget resources transferred to the BNRC would fall short of the normal level by 0.4 p.c. of GDP, owing to the said shift to 2003. Moreover, the government is expecting substantial proceeds resulting from the one-off declaration of financial assets. In so far as these proceeds cannot be predicted with any accuracy, the government's estimate of around 0.3 p.c. of GDP was included in the projections as a technical assumption. In addition, the federal government is planning further sales of real estate which should reduce capital expenditure by almost 0.1 p.c. of GDP again. Finally, certain increases in the withholding tax on earned income (in particular the increase in the withholding rate for municipal taxes and the introduction of a withholding tax on certain replacement incomes) would temporarily increase the tax revenue. In 2005, only this last element will still exert some influence on the general government account, since the increase in the withholding tax on earned income would not be entirely offset by lower tax assessments until 2006. Overall, the virtual disappearance of the non-recurring factors would cause the budget balances to deteriorate by 1.4 p.c. of GDP between 2003 and 2005.

Furthermore, the projections indicate a continued loosening of structural budgetary policy, as the structural primary balance will decline by 0.7 p.c. of GDP between 2003 and 2005. That is due both to the planned continuation of the reductions in taxes and social security contributions, the cut in non-fiscal and non-parafiscal revenues and the mildly expansionary spending policy.

#### 4.2 Revenue

The continued implementation of the personal income tax reform will curtail tax revenues in the years under consideration. The final phase of the reform concerns incomes of 2004. Only the increase in the married person's tax allowance was partially included from the start in the withholding tax on earned incomes, although where self-employed persons are concerned the cost can be expected to be reflected immediately in the advance payments. Moreover, the tax assessments are likely to be reduced as certain measures applicable to incomes of 2002 – such as the introduction of a tax credit for taxpayers whose earned income is low, and the concession for dependent children – had not been incorporated in the withholding tax on earned incomes in that year. In principle, the reform should be fully implemented in 2004, but the costs will continue to rise in 2005 (and even more so in 2006), since not all the measures have been incorporated immediately in the withholding tax on earned

incomes. Overall, the additional cost to the budget totals around 0.4 p.c. of GDP from 2003 to 2005.

The planned cuts in social security contributions will also depress fiscal and parafiscal revenues. These cuts first concern the reductions in employers' contributions, agreed at the 2003 Employment Conference. These are intended to augment the structural reductions and reduce the charges in respect of specific target groups, essentially the lowest paid workers and knowledge-based occupations. In addition, the employees' contributions paid on the lowest wages would be further reduced from 2005; eventually, this measure is to replace the tax credit introduced a few years ago. The overall impact on the budget of these new reductions in contributions should be just over 0.3 p.c. of GDP in the years under consideration.

However, the above reduction in the tax burden, which mainly benefits labour, would be partly offset by the full-year effect of the August 2003 increase in the energy contribution levied on the majority of energy products, and by the further increases in certain consumption taxes in 2004 and 2005. Especially, the rate of excise duty on tobacco and mineral oils was increased in 2004 for instance, and further increases have been announced for 2005. These measures would boost the proceeds from these taxes by almost 0.3 p.c. of GDP between 2003 and 2005.

**TABLE 10** STRUCTURAL MEASURES CONCERNING PUBLIC REVENUE

(Millions of euro, unless otherwise stated; changes compared to the previous year)

	2004	2005
Taxes .....	321	-201
of which :		
Personal income tax reform <sup>(1)</sup> .....	-612	-494
Increase in the energy contribution ..	128	0
Increase in excise duty on tobacco ..	155	130
Increase in excise duty on mineral oils	177	215
Elia contribution .....	115	57
Control of tax evasion and more efficient collection .....	310	0
Social security contributions .....	-515	-475
Reduction in employers' contributions ..	-533	-272
Reduction in personal contributions ...	18	-203
<b>Total</b> .....	<b>-194</b>	<b>-676</b>
<b>p.m. Percentages of GDP</b> .....	<b>-0.1</b>	<b>-0.2</b>

Sources: FPS Finance, NSSO, NBB.

(1) Including indirect effects on municipal taxes.

The introduction of the Elia contribution on electricity distribution should bring in around 0.05 p.c. of GDP per annum, even if the yield in 2004 will probably be slightly lower as the levy is only being introduced during the year.

Finally, the federal government included in the 2004 budget a detailed programme aimed at controlling tax evasion and improving collection. According to the government, this initiative should lead to a structural increase in tax revenues of around 0.1 p.c. of GDP. This technical assumption was adopted in the projections.

The structural measures already known should therefore, on balance, reduce fiscal and parafiscal revenues by 0.3 p.c. of GDP between 2003 and 2005.

Leaving aside the non-recurring factors, there would be a modest fall in non-fiscal and non-parafiscal revenues of 0.2 p.c. of GDP over the period in question. The main reason for this drop is the contraction in property incomes, partly as a result of the full liberalisation of the electricity market in the Flemish Region.

#### 4.3 Primary expenditure

Adjusted for cyclical effects and non-recurring factors and deflated by the national consumer price index, primary expenditure would increase by an average of 2.3 p.c. in 2004 and 2005<sup>(1)</sup>. This rate of expansion is slightly higher than the trend growth of activity, and can therefore be regarded as mildly expansionary: just over 0.2 p.c. of GDP of the deterioration in the structural primary surplus between 2003 and 2005 is attributable to the spending policy.

The expenditure estimates for 2004 take account of the (revised) federal government budget, including social security, and those of the communities and regions. For general government, structural primary expenditure is expected to increase by around 2.2 p.c. at constant prices, a growth rate close to the average of 2.1 p.c. for the past ten years, but well below the figure of around 3 p.c. recorded on average in 2002 and 2003.

Primary expenditure is significantly increased by the strong growth of health care spending, in particular, which – as stipulated in the latest government agreement – is permitted to grow by 4.5 p.c. per annum in real terms until 2007. Investment would also expand very strongly.

It is naturally very difficult to project the growth rate of primary expenditure in 2005 since no budget is available as yet. The projections are based on the assumption of structural growth of around 2.3 p.c. at constant prices, or just above the average growth rate for the past decade. They take account of such factors as the targeted increase in health care spending and a further acceleration in investment spending, resulting from the sharp rise in gross fixed capital formation by local authorities, connected with the electoral cycle.

#### 4.4 Debt

Despite the downturn in GDP growth observed in recent years, the contraction of the public debt has continued unabated. By the end of 2003, the consolidated gross debt of general government was only slightly higher than GDP.

According to the projections, the debt reduction will slow down during the period in question, despite the gradual economic recovery. This is related to the deterioration in the budget balance, but also to some relatively substantial, unfavourable operations which have no impact on the balance. For instance, account was taken of the BNRC restructuring announced by the federal government and mentioned in the latest stability programme. This operation could have the effect of swelling the public debt by around 2.6 p.c. of GDP in 2005, since – according to the ESA 1995 methodology – the new entity which will manage the major part of the debts and hold the property rights relating to the railway company's infrastructure is more than likely to be incorporated in the general government sector. Overall, the public debt is projected to total 98 p.c. of GDP by the end of 2005.

(1) The growth rate mentioned is slightly biased by a new change to EU funding: the portion of VAT revenues transferred to the European institutions is to be reduced once again in 2004, while the fourth resource, recorded as expenditure for general government, is to be increased. This operation is neutral for the budget but increases revenue and expenditure.

**TABLE 11** CONSOLIDATED GROSS DEBT OF GENERAL GOVERNMENT

(Percentages of GDP, unless otherwise stated)

	1993	1999	2000	2001	2002	2003	2004 e	2005 e
Level of the debt . . . . .	136.7	114.5	109.1	108.1	105.8	100.7	98.2	98.0
Change in the debt . . . . .			-5.4	-1.0	-2.3	-5.1	-2.6	-0.1
Endogenous change . . . . .			-5.7	-3.1	-2.6	-3.2	-3.5	-3.2
Primary balance required to stabilise the debt <sup>(1)</sup> . . . . .			1.2	4.0	3.5	2.6	1.3	0.6
Implicit interest rate on the debt <sup>(2)</sup>			6.2	6.2	5.7	5.4	5.2	5.0
Growth of nominal GDP <sup>(2)</sup> . . . . .			5.1	2.4	2.4	2.9	3.8	4.3
Actual primary balance . . . . .			6.9	7.1	6.1	5.8	4.8	3.8
Change resulting from other factors . . . .			0.4	2.1	0.3	-1.8	0.9	3.0
Transactions with the NBB (including surplus gains on gold sales) . . . . .			0.0	0.0	-0.1	-0.1	0.0	0.0
Privatisation operations and other financial transactions <sup>(3)</sup> . . . . .			-0.1	0.0	0.0	-2.3	0.0	0.0
Net formation of financial assets outside the public sector . . . . .			0.3	-0.3	-0.2	0.2	0.0	0.0
Other <sup>(4)</sup> . . . . .			0.2	2.5	0.7	0.4	0.9	3.0

Sources: NAI, NBB.

(1) This balance is equal to the difference between the implicit interest rate on the debt and the rate of growth of nominal GDP, multiplied by the ratio between the debt at the end of the previous year and the GDP of the period in question.

(2) Percentages.

(3) Including the sale of the CREDIBE portfolio and the partial repayment of debts to the SHLAF by the regional social housing corporations in 2003.

(4) Mainly lending, equity investment, exchange differences, issue and repurchase premiums, statistical discrepancies and the incorporation in the general government sector of Credibe (2001) and of the institution which will manage part of the BNRC's debt (2005).

## 5. Summary of the results of other institutions

The main results of the Bank's projections deviate a little from the forecasts published recently by the Federal Planning Bureau and the international institutions, as they suggest slightly higher growth and inflation, mainly for 2004. These differences do not reflect any major divergences in the general assessment of the outlook for the Belgian economy, but are probably due to the statistical information available when each of the forecasts was produced and to the assumptions adopted.

For instance, while all the institutions assume a cyclical upturn from mid 2003, the GDP growth recorded in the quarterly national accounts published successively up to the first quarter of 2004 slightly exceeded general expectations. Similarly, the rise in oil prices on the international markets, in April and May 2004, and the slight fall in the euro could only gradually be incorporated in the assumptions, with an upward effect on the latest inflation forecasts.

**TABLE 12** COMPARISON OF THE FORECASTS FOR BELGIUM  
(Percentage changes compared to the previous year)

	Real GDP		Inflation		Date of publication
	2004	2005	2004	2005	
NBB .....	2.3	2.6	1.8	1.7	June 2004
Federal Planning Bureau .....	2.0	2.7	1.6	1.5	May 2004
IMF .....	1.8	2.4	1.4	1.4	April 2004
EC .....	2.0	2.5	1.5	1.6	April 2004
OECD .....	2.0	2.6	1.6	1.4	May 2004
Belgian Prime News .....	2.1	2.3	1.5	1.6	March 2004
Consensus Economics .....	1.8	2.1	1.7	1.7	May 2004
Economist's Poll .....	1.9	1.9	1.4	1.5	May 2004
<i>p.m. Actual figures 2003</i> .....		1.1		1.5	

## Annex

## PROJECTIONS FOR THE BELGIAN ECONOMY: MAIN RESULTS

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

	2001	2002	2003	2004 e	2005 e
<b>Growth (calendar adjusted data)</b>					
GDP at 2000 prices . . . . .	0.7	0.7	1.1	2.3	2.6
Contributions to growth:					
Domestic spending, excluding changes in stocks . . . . .	1.1	0.2	1.8	1.8	2.7
Net exports of goods and services . . . . .	0.2	-0.3	-1.4	0.5	0.5
Changes in stocks . . . . .	-0.7	0.8	0.7	0.1	-0.6
<b>Prices and costs</b>					
Harmonised index of consumer prices . . . . .	2.4	1.6	1.5	1.8	1.7
Health index . . . . .	2.7	1.8	1.5	1.6	1.6
Deflator of GDP . . . . .	1.8	1.7	1.7	1.3	2.0
Terms of trade . . . . .	0.0	0.8	0.3	-0.3	0.4
Unit labour costs in the private sector . . . . .	4.8	2.9	0.2 e	0.5	1.1
Labour costs per employee . . . . .	3.6	4.4	1.8 e	2.8	2.4
Productivity per employee . . . . .	-1.2	1.4	1.6 e	2.3	1.2
<b>Labour market</b>					
Domestic employment (average yearly change, thousands of units) . . . . .	60.4	-12.4	-15.2 e	15.0	43.7
Harmonised unemployment rate (p.c. of labour force) . . . . .	6.7	7.3	8.1	8.3	8.0
<b>Incomes</b>					
Real disposable income of individuals . . . . .	1.7	1.3	0.7 e	1.2	2.0
Savings ratio of individuals (p.c. of disposable income) . . . . .	15.4	16.2	15.4 e	14.9	14.8
<b>Public finances</b>					
Financing requirement (-) or capacity of general government (p.c. of GDP) . . . . .	0.5	0.0	0.2	-0.3	-1.0
Public debt (p.c. of GDP) . . . . .	108.1	105.8	100.7	98.2	98.0
<b>Current account (p.c. of GDP according to the balance of payments) . . . . .</b>					
	3.7	5.3	3.1	3.6	3.9

Sources: EC, NAI, NSI, NBB.