Economic projections for Belgium – spring 2005

Introduction

Having been decidedly dynamic for a little over a year – bolstered by the vigour of foreign demand and buoyant consumption – activity in Belgium slowed noticeably in late 2004 and early 2005. According to the latest data published by the NAI, GDP was static in the first quarter of 2005. The continuing rise in oil prices and the decline in exports, particularly to trading partners in the euro area, ultimately had a greater impact on the economy than had been predicted six months earlier in the autumn 2004 projections (1), while investments were slow to pick up. The high level of oil prices on the international markets also caused inflation to accelerate in the first few months of 2005. The initial situation of the spring 2005 economic projections, which relate to the years 2005 and 2006, therefore deteriorated in comparison with that prevailing a few months earlier, and the general economic context is uncertain for Belgium and, more broadly, for the euro area.

These projections which the Bank produces for the Belgian economy as part of a biannual exercise carried out by the Eurosystem central banks, in which the results for the euro area are obtained by aggregating the results for the various national economies (2), are based on a set of common assumptions regarding the international environment and the movement in interest rates, exchange rates and commodity prices. The projections also depend on assumptions specific to the Belgian economy in the case of variables whose movement is determined largely on a discretionary basis by the economic agents. That applies, for example to wage agreements resulting from negotiations between the social partners, and government decisions relating to the budget.

In the absence of full information on the negotiations in the various sectoral joint committees, the projections for labour costs in the private sector are based on the indicative norm adopted in the draft central agreement and endorsed by the government at the beginning of the year. The norm provides for a rise of 4.5 p.c. for the years 2005 and 2006 taken together.

The figures for public finances are deduced automatically, taking account of the endogenous effect of the macroeconomic environment, an expenditure pattern based on historical movements, and measures which have already been introduced. New government measures relating to revenue or expenditure, to be adopted during the next few months, e.g. to meet the budget targets for 2005 or for the purposes of the 2006 budget to be drawn up in the autumn, were not anticipated in this forecasting exercise. Such measures could in turn affect the projections for the economy as a whole.

The first chapter is devoted to the international environment. It summarises the Eurosystem projections for the euro area and sets out the main common assumptions. The next three chapters give a detailed presentation of the recent situation and the projections for the national economy.

They deal respectively with activity, employment and the main components of expenditure (chapter 2), movements in prices and labour costs (chapter 3) and the results for public finances (chapter 4). Finally, the main risks relating to the projections are discussed in the last chapter, which also contains a summary of the results obtained by other institutions.

(1) NBB (2004), "Economic projections for Belgium – autumn 2004", Economic Review 4-2004.
(2) The projections for the euro area are published in the June issue of the ECB's monthly bulletin.

In line with Eurosystem practice, the predicted movements in the variables relating to activity, employment and demand are presented without taking account of the specific effects due to the seasons and to calendar irregularities, in order to reflect the fundamental economic trends. Conversely, the sector accounts, notably those of general government, are drawn up and presented with allowance for calendar effects, in order to approximate to the accounting figures which will actually be recorded in 2005 and 2006. Thus, the real GDP growth rate in 2005 would be around 0.2 percentage point lower owing to the repercussions of the temporary effect due to the leap year in 2004, and because there are 53 Saturdays in 2005.

Following the restructuring of the BNRC implemented at the beginning of 2005, the new entities responsible for the rail infrastructure are now part of the general government sector, according to the conventions of the ESA95. As explained in the fourth section, the most visible effect of this sectoral reallocation is to increase the level of public debt by 2.5 percentage points of GDP. Other effects, of a purely accounting nature, could also influence other components of the national accounts. They were not included in these projections because the NAI has yet to examine them in detail.

The projections for Belgium were drawn up on the basis of the information available on 20 May 2005.

1. International environment

In 2004, global economic activity grew by around 5 p.c., the highest growth rate in decades. Although growth did slow down in the second half of the year, mainly under the impact of the rise in oil prices, it still remained robust, including at the start of 2005. This slowdown represented merely a return to a more sustainable pace for the expansion of the global economy. The forecasts produced by the major international organisations for the global environment in 2005 and 2006 remained largely unchanged compared to those of the autumn 2004, and are therefore still favourable. Thus, economic activity is expected to grow by around 4.3 p.c. on average during the year 2005 as a whole, and in 2006. The expansion of world trade, which was also very dynamic in 2004, with volume growth totalling 9.5 p.c., looks set to moderate slightly to 7.5 p.c. in 2005, slackening a little more in 2006.

1.1 Main developments in 2004 and the initial months of 2005

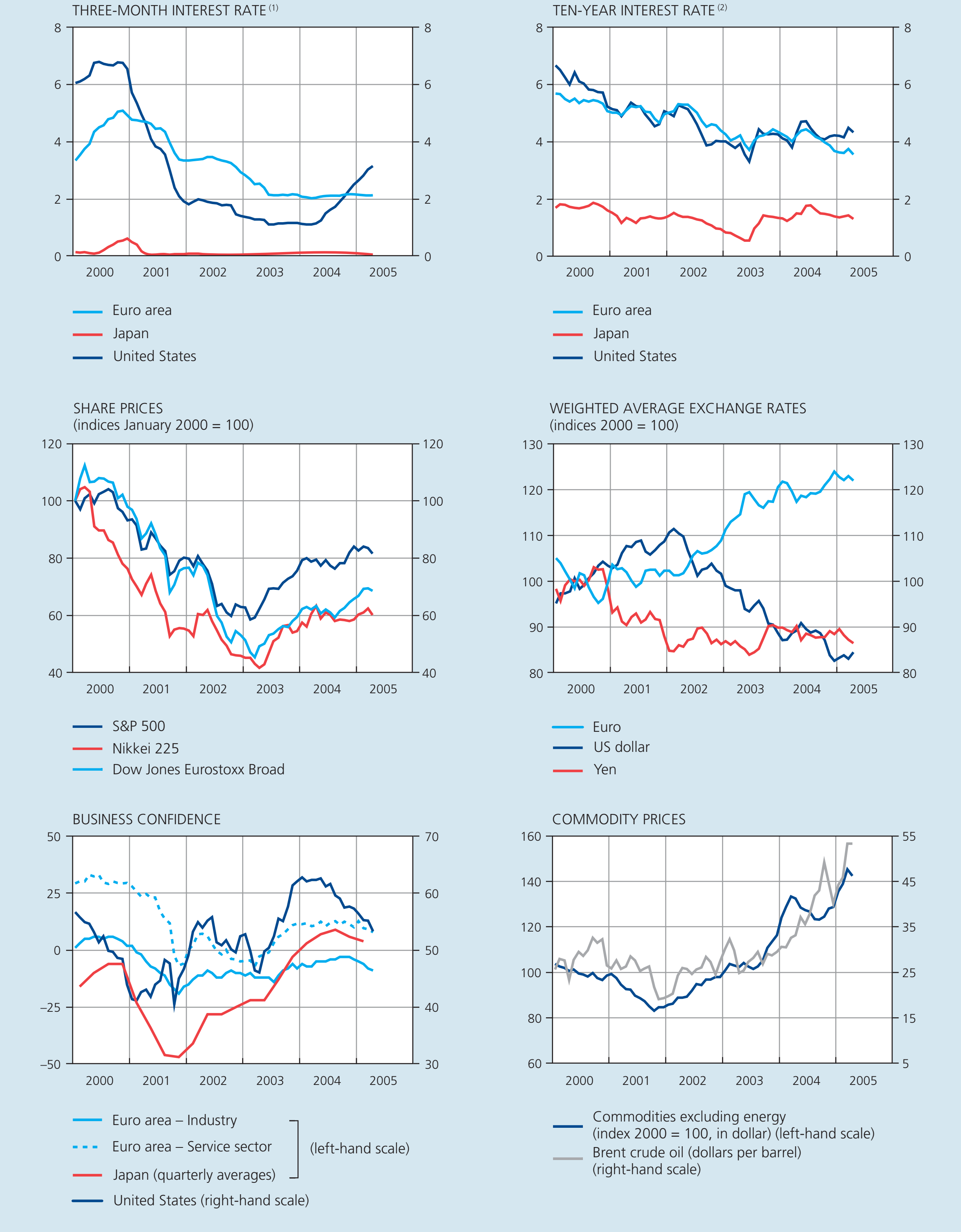
The world economy's strong performance in 2004 was underpinned mainly by highly advantageous financing conditions, the improvement in corporate balance sheets and the more favourable outlook for the labour market. Geographically, the growth was driven mainly by the United States and the emerging Asian countries, especially China. Economic activity was also dynamic in the new EU Member States and, partly as a result of the rise in oil prices, in the OPEC member countries and the Community of Independent States. Provisional figures for the first few months of the year present a mixed picture, but overall it seems that growth has remained robust.

The principal change in the international environment compared to the end of 2004 concerns commodity prices. Thus, the price of crude oil, which – after peaking at the end of October 2004 – had fallen steeply during the closing months of last year, resumed its strong upward trend in the first quarter of 2005. At the beginning of April, a record high of 57 US dollars per barrel of Brent crude was recorded, which was about 40 p.c. higher than at the end of 2004. This rise in crude oil prices was due partly to the dynamism of the world economy. Also, the particularly severe weather in the northern hemisphere in February and March generated extra demand for oil. In response to the vigour of global demand, the exporting countries further stepped up their production, leaving them with relatively little spare capacity. Thus, any small additional increases in demand or growing uncertainty over the adequacy of future supplies will intensify the pressure on prices. During April and May, oil prices eased slightly, but according to the prices quoted on the futures market in mid May, they are likely to remain high at around 50 dollars per barrel throughout the projection period. Prices of other commodities also produced a marked rise in 2004 and during the first few months of 2005. Although they subsided in April and May, they remained well above their end-2004 level.

The slackening pace of economic activity in the second half of 2004 was reflected in the development of the confidence indicators in the main economies. At that point, the indicators began to fall and continued to do so at the beginning of 2005. However, the timing and scale of the fall varied. As regards price movements, the inflationary pressures remained low overall, but in some countries there were growing fears over future inflation, fuelled partly by the rise in oil prices.

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).

Overall, monetary policy was tightened during 2004 and the initial months of 2005, although it remained accommodating. Thus, on 3 May 2005 the United States Federal Reserve raised the Federal Funds rate by 25 basis points to 3 p.c., the eighth consecutive increase since June 2004. In Australia and New Zealand too, the monetary policy target rate has been increased again in recent months. However, in the euro area the ECB Governing Council has kept the minimum bid rate for the Eurosystem's main refinancing operations unchanged at 2 p.c. since June 2003, reflecting the Governing Council's view that the current monetary policy was still appropriate for preserving medium-term price stability. Given the persistent deflationary pressures, the Bank of Japan also held its course and therefore maintained its policy of granting abundant liquidity at zero interest.

Following a brief interruption in February and March 2005, ten-year interest rates on benchmark loans in the main economies resumed their downward trend which had begun in the second half of 2004, especially in the euro area. Lower growth and inflation forecasts in the euro area were among the factors which caused a considerable widening of the interest rate differential between the United States and the euro area, bringing it to around 80 basis points in April. Historically speaking, both nominal and real interest rates remain at very low levels in both regions.

On the leading stock markets, prices remained relatively stable in the first three quarters of 2004, and subsequently began rising again until February 2005. During March and April, prices were steady at first, and later declined – mainly as a result of oil prices which were rising and volatile. In the initial months of 2005, stock markets in the United States produced a weaker performance than those in the euro area and Japan, as market operators increasingly feared that the Federal Reserve would tighten monetary policy sooner than expected.

The weighted average exchange rate of the euro, which had continued to rise during 2004, weakened by around 3 p.c. between the end of the year and mid May 2005, mainly on account of the euro's depreciation against the US dollar and the Asian currencies pegged to it, and against sterling. The weakening of the euro during the first few months of 2005 is mainly due to the relative deterioration in growth prospects for the euro area and the widening of the interest rate differential between the two economies in both the short and the long term.

1.2 Outlook for 2005 and 2006

According to the leading international bodies, economic activity is expected to grow by an average of 4.3 p.c. at global level in 2005. Nonetheless, growth will be held down by the spill-over effect of the weaker activity in the second half of 2004. In 2006, the growth rate is expected to be comparable to the 2005 figure. During the period covered by the projections, global economic activity is therefore predicted to slow down in comparison with 2004 while remaining robust. It will be supported mainly by the same factors as in 2004, in a context of continuing moderate inflation. Financing conditions are expected to become less favourable, however, as a result of a less accommodating monetary policy.

The slowdown in world growth in 2005 and 2006 is likely to be accompanied by a deceleration in the growth of world trade, which had already begun to run out of steam in the third quarter of 2004. The volume of world trade is predicted to grow by around 7.5 p.c. in 2005 and a little less in 2006, following a strong expansion of 9.5 p.c. in 2004.

Large discrepancies are expected to persist between the growth rates of the main regions of the world in 2005 and 2006. Global growth is likely to continue to be heavily dependent on activity in the United States and in the emerging economies, principally in Asia. In the United States, growth is forecast to dip to around 3.6 p.c. in 2005 and a little less in 2006, following the vigorous expansion in 2004. This is attributable largely to the weakening of the monetary and fiscal incentive effects. As a result, private consumption and investment should produce slightly weaker growth. Ultimately, net exports are expected to make a positive contribution to economic activity. In Japan, growth is projected to be weaker in 2005 and 2006 than in 2004, and will be sustained by both foreign and domestic demand, particularly investments. In the other Asian countries, the strong expansion looks set to continue, albeit at a slightly more modest pace of around 7 p.c., owing to the reduced buoyancy of foreign demand and the efforts made by the authorities of certain countries, particularly China, to restrain somewhat the rapid development of their production facilities. In the new EU Member States and in the United Kingdom, growth is expected to be substantial, though less than in 2004. In other parts of the world, such as Latin America, growth is also forecast to be less vigorous than in 2004, but still robust during the period covered by the projections.

TABLE 1 SPRING FORECASTS BY INTERNATIONAL INSTITUTIONS FOR 2005 AND 2006

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

	2004	2005			2006		
	Actual figures (1)	EC	IMF	OECD (1)	EC	IMF	OECD (1)
GDP at constant prices							
United States	4.4	3.6	3.6	3.6	3.0	3.6	3.3
Japan	2.6	1.1	0.8	1.5	1.7	1.9	1.7
Euro area	1.8 (2)	1.6	1.6	1.2	2.1	2.3	2.0
Inflation (3)							
United States	2.7	2.6	2.7	2.8	2.3	2.4	2.6
Japan	0.0	–0.1	–0.2	–0.2	0.2	0.0	0.1
Euro area	2.1	1.9	1.9	1.8	1.5	1.7	1.3
Unemployment rate (4)							
United States	5.5	5.2	5.3	5.1	5.0	5.2	4.8
Japan	4.7	4.4	4.5	4.4	4.1	4.4	4.1
Euro area	8.9	8.8	8.7	9.0	8.5	8.4	8.7

Sources : EC, IMF, OECD.
(1) Data adjusted for seasonal and calendar effects, except in the case of inflation.
(2) The percentage change calculated on the basis of gross data comes to 2.1 p.c. in 2004. The growth differential is due to a substantial positive calendar effect.
(3) Consumer price index.
(4) Percentages of the labour force.

In the euro area, economic activity slowed down in the second half of 2004. According to the EC's flash estimate, it strengthened slightly in the first quarter of 2005, but that was probably due to incidental factors. Quarter-on-quarter GDP in fact grew by 0.5 p.c. Economic activity in the euro area should gradually gather momentum in 2005 and 2006.

1.3 Eurosystem projections for the euro area

Assuming that the world global economic context remains dynamic in 2005 and 2006, while the shocks resulting from the euro's appreciation and the higher prices for petroleum products should ebb away, the Eurosystem projections indicate that GDP growth will strengthen gradually in the euro area, so that the slowdown observed in the second part of 2004 will have been temporary. However, it will probably be 2006 before real growth picks up to a quarterly rate in the region of 0.5 p.c. In all, GDP growth which had reached 1.8 p.c. in 2004 is not expected to exceed the range of 1.1 to 1.7 p.c. in 2005, owing to an unfavourable starting situation caused by the stagnation of GDP at the end of last year. It is predicted to reach between 1.5 and 2.5 p.c. in 2006.

Driven by world demand, exports are projected to continue making a substantial contribution to growth in the euro area, while the loss of competitiveness due to the euro's appreciation should be attenuated, as exchange rates are assumed to remain constant over the projection horizon. Domestic demand in the euro area, still relatively weak in 2004 and at the beginning of 2005, should gradually gain momentum, bolstered by investment. The investment revival is expected to stem from accelerating economic activity and corporate profits growth, while financing conditions are likely to remain favourable.

Inflation measured on the basis of the HICP is forecast at between 1.8 and 2.2 p.c. in 2005, a level comparable to the 2.1 p.c. recorded in 2004. Although higher oil prices will push up inflation, that should be offset by the weakness of internal inflationary pressure, particularly in view of the projected moderate wage increases. Wage moderation is likely to be maintained in 2006 while the rise in oil prices should slow down. Moreover, the reform of the health care system in the Netherlands is also predicted to have the statistical effect of cutting 0.2 percentage point off the inflation rate, contributing to reducing it to an annual average of between 0.9 and 2.1 p.c.

TABLE 2 EUROSYSTEM PROJECTIONS

(Percentage changes compared to the previous year)

	Euro area			*p.m. : Belgium*		
	2004	2005	2006	*2004*	*2005*	*2006*
Inflation (HICP)	2.1	1.8 – 2.2	0.9 – 2.1	*1.9*	*2.2*	*1.9*
GDP in volume	1.8	1.1 – 1.7	1.5 – 2.5	*2.7*	*1.4*	*2.4*
of which :						
Private consumption	1.1	1.2 – 1.6	1.0 – 2.2	*2.1*	*1.0*	*1.9*
Public consumption	1.3	0.4 – 1.4	1.1 – 2.1	*2.6*	*1.2*	*2.1*
Investment	1.7	0.5 – 2.7	1.9 – 5.1	*1.0*	*4.8*	*3.4*
Exports	6.1	3.1 – 5.9	4.5 – 7.7	*5.4*	*3.6*	*5.6*
Imports	6.1	2.6 – 6.0	4.4 – 7.8	*5.9*	*4.6*	*4.9*

Sources : ECB, NBB.

Box 1 – Eurosystem assumptions

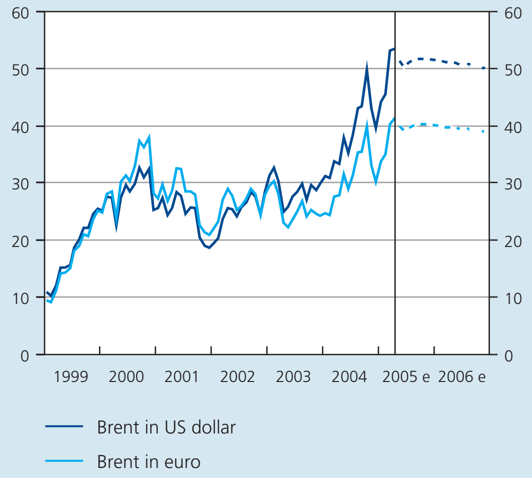
The Eurosystem economic projections for the euro area and the corresponding projections for Belgium are based on the following technical assumptions :

- short-term interest rates are fixed over the projection horizon at the level prevailing when the projections are produced, so as to reveal what would happen if the monetary policy intervention rates were kept unchanged. As a result, these projections are not necessarily the best unconditional forecasts, particularly for the long term, as monetary policy will always be geared to the maintenance of price stability. In the projections under review, the three-month interbank rate is fixed at 2.1 p.c. ;
- the long-term euro interest rates used are based on market expectations ; they stood at 3.5 p.c. when the projections were produced, and should gradually rise to 3.9 p.c. by the end of 2006 ;
- bilateral euro exchange rates are kept constant at their mid-May value, namely 1.29 dollar to the euro in the case of the US currency ;
- while earlier oil price predictions mostly fell within the 25 dollar range announced by OPEC, prices on forward contracts now indicate that the market expects oil prices to remain high for several months. Thus, in line with the implicit price movements reflected by these contracts during the first half of May, it is estimated that world oil prices should remain more or less steady during the projection period, at around the 50.5 dollars per barrel reached in the first half of May 2005. Taking an average over the year, a barrel of Brent is expected to cost 50.6 dollars in 2005 and 50.7 dollars in 2006, against 38.3 dollars in 2004.

The expected developments in world trade and the projection results for the euro area partners as regards the prices and volume of trade in goods and services can be used to deduce the external environment for the Belgian economy. The expansion of the export markets, calculated as the weighted sum of imports from third countries, is expected to drop to 5.6 p.c. in 2005, then to pick up again to 6.5 p.c. in 2006. While the euro appreciation was still depressing competitors' prices in 2004, that effect should cease during the projection period. As an annual average, competitors' prices are assumed to rise by 1.2 p.c. in 2005 and 2 p.c. in 2006.

CHART CRUDE OIL PRICE (1)

(Monthly averages)



Source : ECB.

(1) Actual movement up to April 2005, assumptions from May 2005 (monthly until June 2006 and quarterly thereafter).

ASSUMPTIONS ADOPTED FOR THE EUROSYSTEM PROJECTIONS

	2004	2005	2006
		(Annual averages)	
Three-month interbank rates in euro	2.1	2.1	2.1
Ten-year bond yields	4.2	3.6	3.8
Euro exchange rate against the US dollar	1.24	1.29	1.29
Oil price (US dollars per barrel)	38.3	50.6	50.7
		(Percentage changes)	
Export markets relevant to Belgium	7.3	5.6	6.5
Competitors' export prices	–0.9	1.2	2.0
of which :			
Competitors in the euro area	0.4	0.7	0.5

Source : ECB.

2. Activity, employment and demand in Belgium

2.1 Activity

In Belgium, the growth of economic activity slowed down at the end of 2004 and the beginning of 2005. While the economy had expanded continuously at a quarterly rate of 0.7 to 0.9 p.c. from the third quarter of 2003, GDP grew by just 0.3 p.c. in the fourth quarter of 2004. According to an initial NAI estimate, growth halted in the first three months of 2005.

Although the previous projections, which had been published in December 2004, predicted that growth would slacken, the cyclical downturn was sharper than forecast. Since then, oil prices and – for a time – the exchange rate have risen faster than expected, and business confidence has continued to decline. Moreover, the expansion of foreign demand has been somewhat disappointing, mainly because of sluggish trade within the euro area.

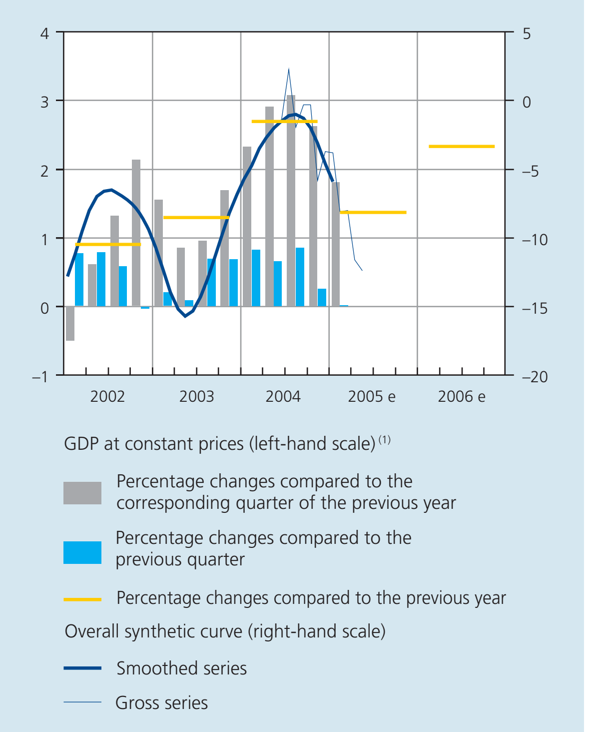
As a result of the slowdown recorded, average growth for 2005 was cut from 2.5 to 1.4 p.c., which is only half the 2004 growth rate of 2.7 p.c. Apart from the adverse carry-over effect on the 2005 figure caused by the slowdown at the end of 2004, the growth rate for the beginning of 2005 was also revised downwards. However, economic activity is expected to pick up during the year. Given more dynamic foreign demand and internal growth bolstered by both consumption and investment, GDP should increase by 2.4 p.c. in 2006.

Slower growth was also recorded in the euro area. GDP was up by no more than 0.3 p.c. per quarter in the second half of 2004, whereas activity had grown by a quarter-on-quarter average of 0.6 p.c. during the first half year. The Belgian economy therefore avoided a downturn a little longer, although recently the decline has become more marked. Belgium's export markets were less buoyant than in mid 2004, and domestic demand was weaker. The substantial rise in oil prices seems to have had a particularly negative effect on household purchasing power, so that private consumption did little to boost economic growth.

The weakening of economic activity is also confirmed by the Bank's business survey. The overall synthetic indicator has been declining since September 2004. During the initial months of 2005, the gross results deteriorated more sharply, indicating that growth slowed further at the beginning of 2005. The rather abrupt fall in the overall indicator since September 2004 is largely attributable to the fact that, in manufacturing industry, confidence has fallen sharply, dropping to a level below its long-term average. In trade and services, the decline in confidence set in later and was less severe, whereas in the building industry confidence actually strengthened slightly. The main reason for the gloomier outlook seems to be the sensitivity of manufacturing industry to higher energy prices, which have evidently had a serious impact on industrial activity since the end of last year. Moreover, owing to the less buoyant international environment, export growth also fell short of expectations. This weakness of activity in manufacturing industry is fairly widespread, and is also reflected in the relatively sharp reduction in the capacity utilisation rate in April; mirroring the decline in confidence, this rate has been falling since the third quarter of 2004. However, demand expectations have stabilised, and that may presage a restoration of confidence if the external environment does not deteriorate any further.

Apart from manufacturing industry, the building sector also held growth down in the first quarter. However, that seems to be due mainly to temporary factors, especially the adverse weather conditions in March; the rapid revival of confidence in this sector in April and May confirms that hypothesis.

CHART 2 GDP AND BUSINESS SURVEY INDICATOR
(Seasonally adjusted data)

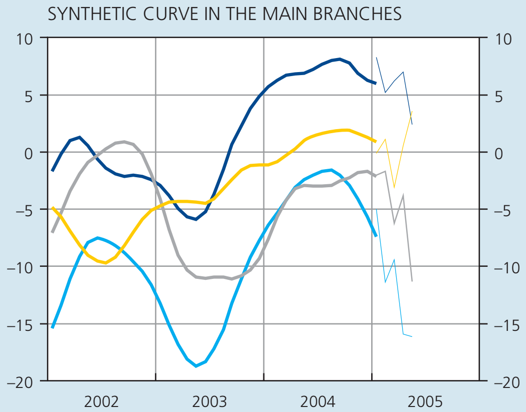


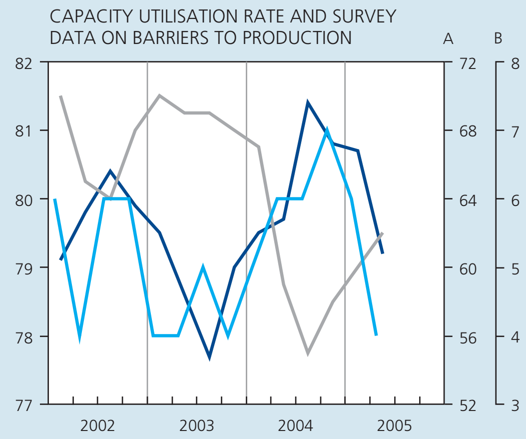
Sources: NAI, NBB.
(1) Calendar adjusted data.

In the short term, the building sector should recover following the temporary weakness recorded in the first quarter. Since confidence in the service sector has been more or less maintained at the high level of 2004, despite the recent fall, activity should also continue to expand. Conversely, in manufacturing industry it is likely to remain sluggish at first, before resuming an upward trend, as – according to the projection assumptions – the factors which depressed activity at the beginning of 2005 should cease to have a negative impact: the export markets are expected to gather momentum somewhat, exchange rates should remain steady and oil prices should not rise further.

CHART 3 BUSINESS SURVEY INDICATORS IN THE MAIN BRANCHES 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.

2.2 Employment

Driven partly by the strong activity growth in the second half of 2003 and the first three quarters of 2004, job creations averaged around 28,000 in 2004, expanding domestic employment by some 0.7 p.c. in comparison with the previous year's level. At the beginning of the year, the pace of job creation was still sustained, but is likely to slow down temporarily during 2005, especially in the branches of activity most sensitive to the economic cycle. For those branches, which had made a significant contribution to the improvement in the labour market in 2004, the slackening pace of activity was reflected in a decline in the leading indicators of the trend in employment, such as the synthetic business curve, the outlook for employment and the shortages of skilled labour in manufacturing industry, the use of agency workers, temporary lay-offs or the trend in the number of persons wholly unemployed and receiving benefits for less than one year.

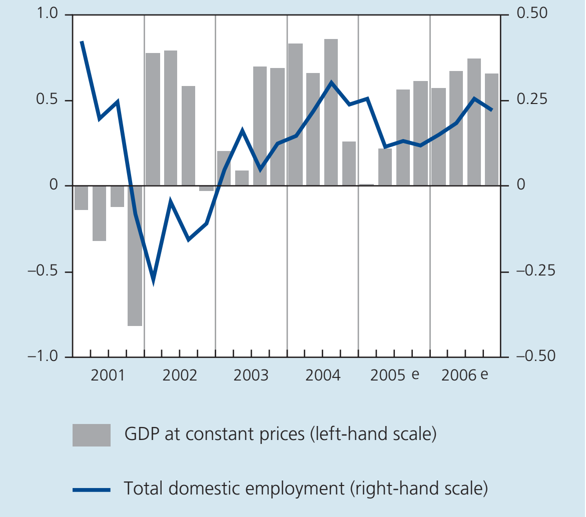
As the expansion of employment remained strong at the beginning of the year, it is expected that 34,000 new jobs will be created in 2005 – 28,000 of them in the private sector. Despite a gradual improvement during 2006 in the wake of the revival in activity, the increase in overall domestic employment is expected to fall to an average of 28,000 units in 2006. The employment rate is thus likely to increase from 60.4 p.c. of the population of working age in 2004 to 60.6 p.c. in 2005 and 60.7 p.c. in 2006.

The fluctuations in overall employment will probably depend mainly on the employment picture in the private sector. As for the other categories, the expansion in public sector jobs is expected to slow down in 2005, when the recruitment freeze introduced by the Flemish government will begin to have an effect. This limited expansion should be maintained in 2006.

In 2004, the number of self-employed persons increased for the first time since 1997, though admittedly the rise was due partly to better recording of spouses working as assistants. A new change in the employment rules applicable to them from 1 July 2005, entailing compulsory extension of their social insurance – making it more

CHART 4 EMPLOYMENT AND ACTIVITY

(Data adjusted for seasonal and calendar effects, quarterly averages, percentage changes compared to the previous quarter)



Sources: NAI, NBB.

comprehensive but also more expensive – could discourage some people who work, or wish to work, under these arrangements. That would curb the expansion of self-employed activity in 2005, and give rise to a further decline in the self-employed workforce from 2006.

The labour force – which, apart from persons in work, also includes unemployed job seekers – is projected to increase sharply in 2005 and 2006 to reach almost 4.9 million persons. This growth is due both to the increase in the population of working age, which is expected to grow by around 60,000 persons over the two years, and the rise in the activity rate.

Population ageing is expected to have little impact on the labour force in 2005 and 2006. The generation born during World War II, currently retiring from the labour market, is relatively small whereas the cohorts of women entering the 55-64 age group are, on average, better qualified and more active than their predecessors. Moreover, owing to the fact that they are obliged to remain available for the labour market, newly unemployed persons aged from 50 to 58 years are still included in the labour force, i.e. as unemployed job seekers, whereas they used to be disregarded. In total, the activity rate is expected to come to 66.5 p.c. in 2005 and 66.6 p.c. in 2006.

TABLE 3 LABOUR SUPPLY AND DEMAND

(Annual averages; year-on-year change in thousands of persons, unless otherwise stated)

	2001	2002	2003	2004 e	2005 e	2006 e
Population of working age	19	31	30	23	24	36
Labour force	56	9	49	67	51	33
p.m. Harmonised activity rate (1)	*64.2*	*64.8*	*64.9*	*66.1*	*66.5*	*66.6*
National employment	60	–13	3	29	34	28
p.m. Harmonised employment rate (1)	*59.9*	*59.8*	*59.6*	*60.4*	*60.6*	*60.7*
Frontier workers	0	0	1	1	0	0
Domestic employment	60	–12	2	28	34	28
Self-employed persons	–5	–3	–3	2	1	–1
Employees	66	–9	5	26	33	29
Public sector	4	16	10	9	5	6
Private sector	62	–25	–5	17	28	24
Unemployed job seekers	–5	22	46	38	17	5
p.m. Harmonised unemployment rate (2)	*6.7*	*7.4*	*7.9*	*7.8*	*7.9*	*8.0*

Sources: EC, NAI, NEMO, NBB.

(1) Percentages of the population of working age (15-64 years).

(2) Percentages of the labour force. This series corresponds to the results of the second quarter labour force survey, adjusted by using administrative data in accordance with the Eurostat methodology.

Since only part of the expansion of the labour force, and hence of the labour supply, is absorbed by the demand for labour, the number of unemployed job seekers is projected to increase by around 22,000 units over the whole of the period covered by the forecasts. This rise partly reflects the inclusion of older unemployed persons, as already mentioned. Expressed as a percentage of the labour force, the harmonised unemployment rate is expected to rise by 0.1 percentage point in 2005 and 2006, to reach 7.9 p.c. in 2005 and 8 p.c. in 2006.

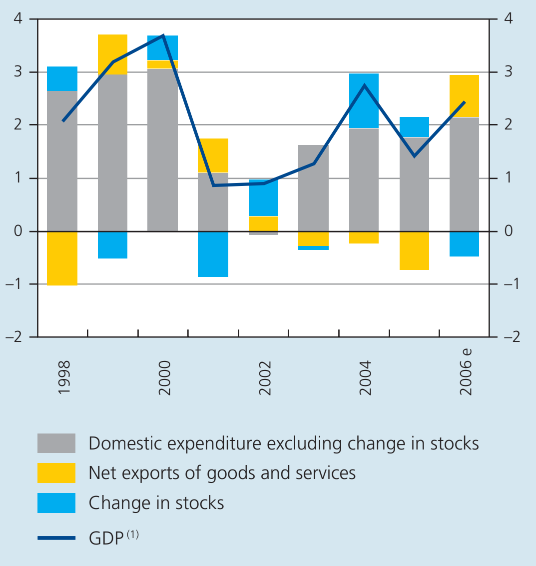
2.3 Expected developments in the main categories of expenditure

Despite the marked slackening of economic growth predicted for 2005, domestic demand excluding change in stocks should continue to demonstrate some resilience, contributing to economic growth at a rate of 1.8 percentage points against 1.9 percentage points in 2004. In 2006 it should regain momentum and sustain activity at a rate of 2.1 percentage points.

Substantial stock building took place in 2004. This probably continued at the beginning of 2005, as a result of weakening demand, so that stocks should now be more in line with demand.

CHART 5 MAIN CATEGORIES OF EXPENDITURE AT CONSTANT PRICES

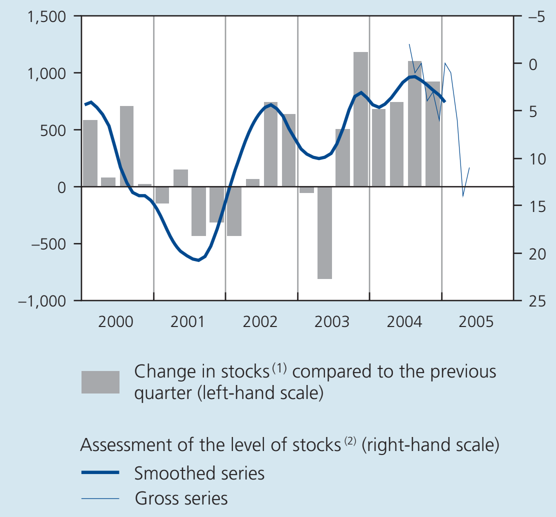
(Calendar adjusted data ; contribution to the change in GDP, percentage points, unless otherwise stated)



Sources : NAI, NBB.
(1) Annual rate of change.

CHART 6 DEVELOPMENTS IN STOCKS AND ASSESSMENT OF THEIR LEVEL

(Seasonally adjusted data)



Sources : NAI, NBB.
(1) Millions of euro, at 2000 prices, calendar adjusted data.
(2) Question of the monthly business survey in manufacturing industry : a low value indicates that a large part of the interviewed enterprises judges the level of stocks as "too low".

The business survey in manufacturing industry indicates that, in the second quarter of 2005, firms revised their opinion of stock levels from "low" to "normal". That opinion implies that the increase in stocks should gradually diminish and will no longer make such a large contribution to economic growth as in 2004, when this factor boosted growth by 1 percentage point. Stocks should continue to make a 0.4 percentage point contribution to economic growth in 2005, before having a negative impact of 0.5 percentage point in 2006.

Apart from the less positive contribution made by domestic demand, net exports are also expected to have a significant negative effect on growth in 2005. However, after three successive years of negative contributions, net exports should again stimulate activity in 2006.

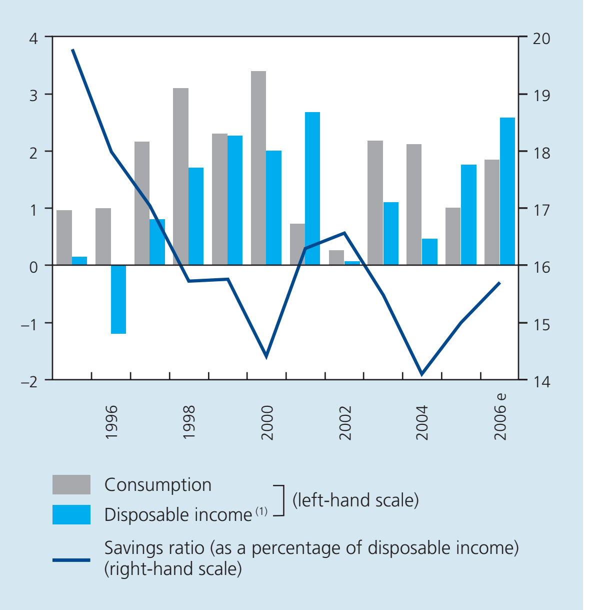
Among the components of domestic demand, household consumption – which had been relatively robust in the two preceding years, growing at rates of over 2 p.c. – is projected to grow by just 1 p.c. in 2005 before recovering to a rate of 1.9 p.c. in 2006. In contrast to previous years, private consumption is also expected to lag behind the growth of real disposable income. In 2005, the household savings ratio should thus increase from 14.1 to 15 p.c. of disposable income, the rise being due mainly to consumers' greater uncertainty regarding the assessment of the general economic situation and the negative effect on their purchasing power exerted by the rise in oil prices. Thus, private consumption hardly expanded at all in the fourth quarter of 2004, and – according to the projections – it is likely to have remained weak in early 2005. In 2006, the savings ratio is predicted to rise further to 15.7 p.c. of disposable income, as households will not immediately spend the whole of the increased resources generated in that year by the implementation of the tax reform, or they may already have spent part of it in anticipation.

Even though the rise in wages over the projection period is likely to be similar to that recorded in 2004, the nominal rate of increase in disposable income is expected to rise sharply in 2005 from 2.6 to 4.1 p.c. This acceleration will probably be stimulated by an increase in corporate dividend payments, but also by a faster rise in incomes indexed directly or indirectly to the movement in prices.

In 2006, disposable income is projected to increase by slightly more again, namely 4.6 p.c., following the implementation of the tax reform which will mean a substantial cut in taxes on incomes. In real terms, following a modest 0.5 p.c. rise in 2004, household purchasing power is expected to grow steadily, by 1.8 and 2.6 p.c. respectively in 2005 and 2006.

CHART 7 CONSUMPTION, DISPOSABLE INCOME AND SAVINGS RATIO OF INDIVIDUALS

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



Sources: NAI, NBB.
(1) Data deflated by the deflator of final private consumption expenditure.

TABLE 4 GDP AND MAIN CATEGORIES OF EXPENDITURE, AT 2000 PRICES

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

	2002 (2)	2003	2004	2005 e	2006 e
Consumption expenditure of individuals	0.3	2.2	2.1	1.0	1.9
Consumption expenditure of general government	2.3	2.7	2.6	1.2	2.1
Gross fixed capital formation	–3.4	–0.6	1.0	4.8	3.4
Housing	–3.3	2.6	1.5	1.9	3.2
General government	–0.6	1.0	–1.0	10.3	14.6
p.m. Excluding sales of public buildings	*–3.3*	*1.0*	*5.9*	*8.3*	*4.3*
Enterprises	–3.8	–1.9	1.1	5.2	2.1
p.m. Excluding purchases of public buildings	*–3.5*	*–1.9*	*0.2*	*5.4*	*3.4*
Change in stocks (1)	0.7	–0.1	1.0	0.4	–0.5
p.m. Total domestic expenditure	*0.6*	*1.6*	*3.1*	*2.2*	*1.7*
Net exports of goods and services (1)	0.3	–0.3	–0.2	–0.7	0.8
Exports of goods and services	1.3	1.7	5.4	3.6	5.6
Imports of goods and services	1.0	2.1	5.9	4.6	4.9
GDP	0.9	1.3	2.7	1.4	2.4

Sources: NAI, NBB.
(1) Contribution to the change in GDP.
(2) These figures are influenced by the reclassification of the public radio and television companies from the non-financial corporations sector to the general government sector. Without that operation, consumption expenditure of individuals was up by 0.8 p.c. in 2002, that of general government was up by 1.7 p.c., gross fixed capital formation by enterprises and by general government fell by 3.7 p.c. and 1.5 p.c. respectively, final domestic expenditure grew by 0.1 p.c. and GDP by 1 p.c.

TABLE 5 GROSS DISPOSABLE INCOME OF INDIVIDUALS, AT CURRENT PRICES

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

	2002	2003	2004 e	2005 e	2006 e
Gross primary income	2.3	1.7	2.3	3.6	3.2
of which :					
Wages and salaries	3.4	2.7	3.2	3.4	3.3
Compensation per person	3.7	2.5	2.4	2.4	2.4
Employment	–0.3	0.1	0.7	1.0	0.8
Gross operating surplus and gross mixed income	0.3	2.8	3.1	3.7	3.8
Income from movable property (1)	–0.6	–5.3	–4.5	4.7	1.9
Current transfers (1)	4.5	–3.2	1.1	1.3	–3.1
of which :					
Current taxes on income and assets	2.7	0.1	3.0	2.8	–0.7
Gross disposable income	1.8	2.9	2.6	4.1	4.6
p.m. At constant prices (2)	*0.1*	*1.1*	*0.5*	*1.8*	*2.6*
Consumption expenditure	2.0	4.0	4.4	3.2	3.9
Savings ratio (3)	16.6	15.5	14.1	15.0	15.7

Sources : NAI, NBB.
(1) These are net amounts, i.e. the difference between income or transfers received from other sectors and those paid to other sectors, excluding transfers in kind.
(2) Figures deflated by the deflator of final consumption expenditure of individuals.
(3) Gross savings, including the change in the net claims of households to pension funds, as a percentage of gross disposable income, including the change in these net claims.

Following slower growth in 2004, private investment in housing probably remained subdued at the beginning of 2005. However, it is expected to gather momentum during the year, bolstered by the growth of disposable income and – according to the assumption adopted – the low level of long-term interest rates. This improvement is also shown by the indicator of the volume of definite projects placed with architects, where the latest figures show an increase. The growth of private investment in housing is projected to rise from 1.5 p.c. in 2004 to 1.9 p.c. in 2005, climbing to 3.2 p.c. in 2006.

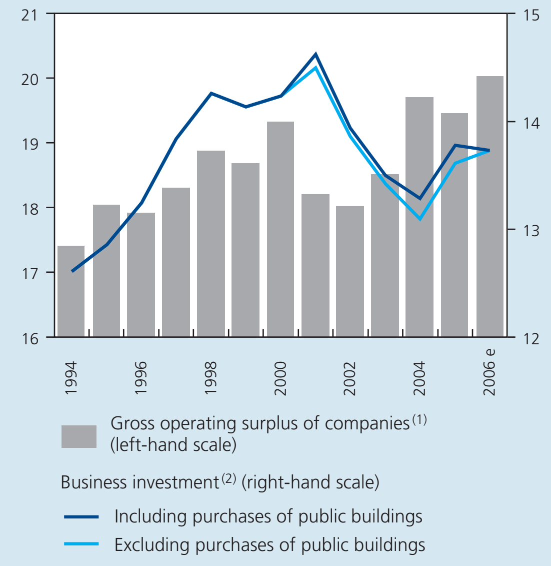
Like private consumption, public consumption will also provide only limited support for domestic demand in 2005. The growth of public consumption is expected to fall to 1.2 p.c. in 2005, as expenditure on health care expands more slowly. It should then speed up in 2006 to reach 2.1 p.c. Conversely, public investment expenditure is projected to expand strongly by 10.3 and 14.6 p.c. respectively in 2005 and 2006, having remained practically stable in the preceding years. The strong recovery in public investment expenditure is linked to the cycle of local elections, scheduled for 2006. A substantial rise in local investment is traditionally recorded in the election year and the preceding year. Apart from this electoral cycle, sales of buildings also have a considerable influence on the movement recorded in public investment. These sales, regarded as disinvestment by general government, are expected to total around 500 million euro in 2005, which is comparable to the 2004 figure, whereas no sales are currently planned for 2006. Leaving aside these amounts, public investment is expected to grow by 8.3 and 4.3 p.c. respectively in 2005 and 2006.

After a period of weakness which has persisted since 2001, in which the growth of corporate investment has lagged behind the expansion in economic activity, the “accelerator” effect is likely to operate to the full again, in contrast to previous years. Leaving aside purchases of public buildings, forming the counterpart to the operations mentioned above, firms are projected to increase their gross fixed capital formation by 5.4 p.c. in 2005 and 3.4 p.c. in 2006, following a rise of just 0.2 p.c. in 2004. Taking account of these purchases, the growth rates should come to 5.2 and 2.1 p.c. respectively in 2005 and 2006. Thus, following a sharp fall between 2001 and 2004, the investment ratio should pick up in 2005, rising from 13.3 to 13.8 p.c. of GDP, before dipping slightly in 2006.

The contraction of the investment ratio between 2001 and 2004 was initially accompanied by a decline in the available resources of firms, measured by means of their gross operating surplus as a percentage of GDP.

CHART 8 BUSINESS INVESTMENT AND GROSS OPERATING SURPLUS

(Percentages of GDP)



Sources: NAI, NBB.
(1) Gross data, at current prices.
(2) Calendar adjusted data, at constant prices.

Corporate profitability recovered from 2003 onwards, but without prompting any rise in the investment ratio, as the resources becoming available internally were partly allocated to other purposes. Thus, firms continued to reduce their debt ratio and maintained a steady increase in dividends.

These inhibiting factors should weaken over the projection period: the gross operating surplus, expressed as a percentage of GDP, is expected to remain at a high level, while the corporate balance sheet position has improved and financing conditions should remain favourable. The interest rate on investment loans is in fact likely to remain at a low level, whereas the cost of equity should be held down by the relative firmness of share prices.

However, the expansion of investment is dependent on a strengthening of economic activity. Thus, the slackening pace of growth of economic activity since September 2004 has led to a fall in the capacity utilisation rate in manufacturing industry, indicating that firms will not proceed with investments unless the economic climate is buoyant.

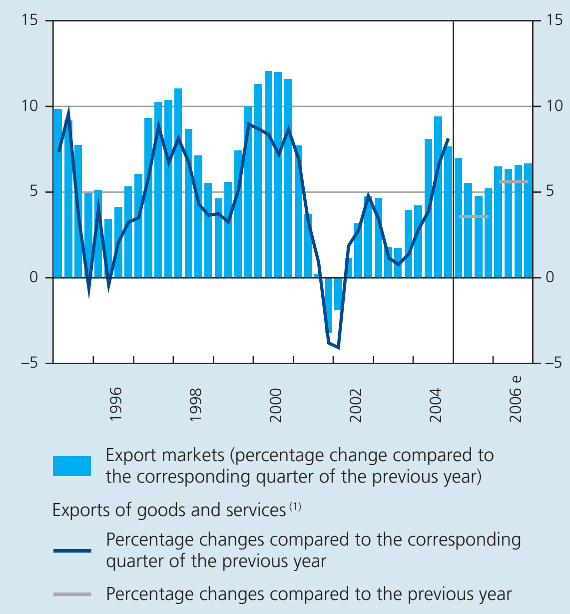
Economic activity in Belgium received a substantial boost from the expansion of foreign demand in 2004, which peaked in the middle of the year. Although the export markets maintained robust growth, a weakening subsequently set in, especially on the markets within the euro area. The indicator relating to foreign orders in manufacturing industry also showed a downward trend in the final months of 2004 which persisted in the first few months of 2005.

However, the volume growth of Belgian exports of goods and services speeded up in 2004, to give annual average expansion of 5.4 p.c. It is likely to drop back to 3.6 p.c. in 2005, in parallel with the weakening of demand on foreign markets. According to the assumptions adopted, the contraction of the export markets should be only temporary, and they are forecast to accelerate again by the end of the projection horizon. Exports should therefore gain momentum, to achieve growth of 5.6 p.c. in 2006.

The volume of imports also grew strongly in 2004 by 5.9 p.c. Owing to the temporary weakness of both domestic expenditure and exports, growth is expected to fall to 4.6 p.c. in 2005, before rising to 4.9 p.c. in 2006. Following these movements, net exports are projected to curb economic activity by 0.7 percentage point in 2005, whereas they should boost GDP growth by 0.8 percentage point in 2006.

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

(Seasonally adjusted data)



Sources: ECB, NAI, NBB.
(1) Calendar adjusted data.

3. Prices and costs

3.1 Prices

During the first quarter of 2005, inflation measured by the HICP showed a marked acceleration, reaching 2.8 p.c. in March, the highest inflation rate recorded since the spring of 2001. However, in April inflation eased to 2.4 p.c., and – apart from a temporary halt during the last quarter of 2005 – the deceleration is expected to continue until the end of 2006. In all, inflation should average 2.2 and 1.9 p.c. respectively in 2005 and 2006, against 1.9 p.c. in 2004 and 1.5 p.c. in 2003.

The accelerating inflation in 2004 and 2005 can be mainly attributed to a set of factors, discussed below, whose influence on consumption prices is rapid and substantial, but whose impact on inflation is generally short-lived. The strong rises in petroleum product prices are the main factor here, but not the only one. It is the very disappearance of these factors regarded as temporary that accounts for the forecast fall in inflation in 2006, but this will only become reality if these factors do not generate second-round effects – in other words, if they do not trigger any wage and price spiral. For the purposes of the present projections, it was assumed that these second-round effects would be limited and, in particular, that the rise in labour costs for the period 2005-2006 would

TABLE 6 HARMONISED INDEX OF CONSUMER PRICES IN BELGIUM
(Percentage changes compared to the previous year)

	Total	Energy	Unprocessed food (1)	Underlying trend in inflation (2)	Processed food	Non-energy industrial goods	Services	*p.m. Health index (3)*
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	1.9	6.6	0.9	1.4	2.2	0.3	2.1	*1.6*
2005 e	2.2	9.8	2.4	1.3	n.	n.	n.	*2.1*
2006 e	1.9	4.2	2.3	1.6	n.	n.	n.	*1.8*
	Excluding primarily administrative price changes (4)							
1999	1.2	1.7	0.0	1.3	0.6	0.8	2.2	
2000 (5)	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	1.8	5.2	0.9	1.5	2.2	0.3	2.3	
2005 e	2.1	9.1	2.4	1.3	n.	n.	n.	
2006 e	1.8	3.0	2.3	1.6	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, in January and July 2000, of the fact that prices discounted in sales have been taken into account in the HICP since 2000.

be moderate, in accordance with the indicative wage norm of 4.5 p.c. which has been put forward. Of course, the inflation projection is heavily dependent on that assumption of continuing wage moderation, and on the other technical assumptions described earlier, mainly those relating to the movement in short-term interest rates, exchange rates and crude oil prices.

IMPACT OF FACTORS PRESUMED TO BE TEMPORARY

The high inflation recorded in the first quarter of 2005 was due primarily to energy products, whose prices rose by around 12 p.c. during this period, mainly as a result of the steep increases in crude oil prices. While the dollar-denominated oil price was still averaging 32 dollars per barrel in the first quarter of last year, it rose to 48 dollars in the first quarter of 2005, and then to 54 dollars in April. The assumption underlying this projection is that the oil price will decline very gradually to 50 dollars by the end of 2006.

As the euro exchange rate has been hovering around 1.3 dollars for some time – the technical assumption adopted for this projection is also that the euro exchange rate will remain close to that level until the end of 2006 – the moderating effect exerted by the euro appreciation is gradually waning. Thus, the euro-denominated price rose by 44 p.c. between the first four months of 2004 and the corresponding period of 2005, which is only slightly less than the rise in dollar-denominated oil prices recorded over the same period, namely 52 p.c.

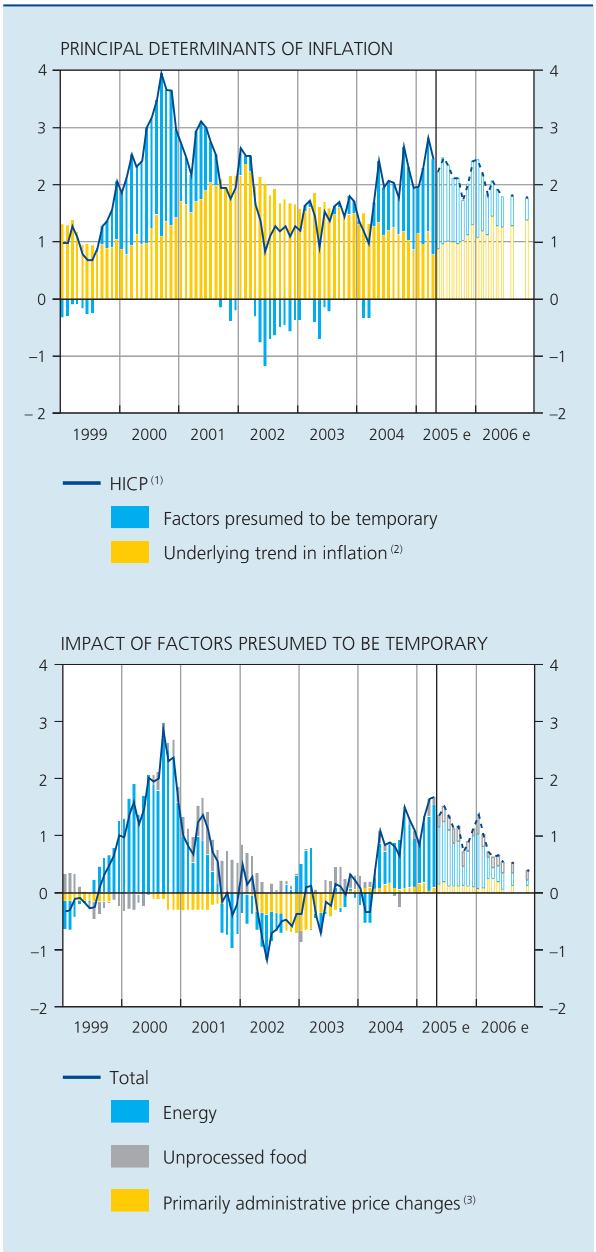
Movements in the crude oil price have a virtually immediate impact on consumer prices of motor fuel and heating oil, where price rises of 14 and 37 p.c. respectively were recorded in the first four months of 2005. Gas and electricity prices are also greatly influenced by these movements, but the effect occurs after a certain time lag.

In recent years, consumer prices of gas and electricity have also been influenced mainly by administrative tariff adjustments aimed at preparing the market for liberalisation, and more recently by the price reductions resulting from the actual liberalisation of the market in Flanders. The cumulative impact of this last factor since July 2003 was not included in the HICP until March 2005, so that the average price of electricity fell sharply in that month. However, this fall is likely to be largely offset, from mid 2005 onwards, by the introduction of the Elia levy in Flanders, which is intended to compensate the local authorities for the loss of income which they suffered following the liberalisation of the market.

Furthermore, the movement in energy prices is greatly influenced by the excise duties charged on motor fuel, under the ratchet system in force since August 2003. According to this system, half of each price reduction resulting from the application of the programme

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, 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.

(2) HICP excluding primarily administrative price changes, unprocessed food and energy.

(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.

contract is offset by an increase in excise duty which then remains in force permanently until the annual maximum is reached: that limit is 28 euro per 1,000 litres for petrol and 35 euro per 1,000 litres for diesel. Despite the upward pressure on crude oil prices, temporary reductions had already led to increases in the excise duty on petrol and diesel totalling 28 and 25.7 euro per 1,000 litres respectively during the first four months of 2005, via the ratchet system. It is assumed that the rest of the increases in excise duty planned for 2005 will take effect in the forthcoming months, and that the excise duty on motor fuel will continue to edge upwards in 2006, since the ratchet system will remain in force until the end of 2007.

In all probability, the rate of energy price rises will subside gradually from May 2005, as a result of the factors mentioned above, and should then slow down sharply during 2006. For the year 2005 as a whole, energy prices are projected to increase by an average of 9.8 p.c., against 6.6 p.c. in 2004. In 2006, the rate of increase is forecast to slow to around 4 p.c.

Indirect taxes on a number of non-energy products have also been raised recently, and further increases are planned. The excise duty on drinks in non-reusable containers was increased in January 2005 (but will be cut again in July 2005). In addition, the excise duty on tobacco was raised in January 2005 and an additional increase in January 2006 will push up inflation until the end of the projection horizon.

Overall, the inflationary impact of all the primarily administrative price changes will probably come to 0.1 percentage point during 2005 and 2006, as in 2004. In 2002 and 2003, this type of price change was still exerting downward pressure on inflation, at a rate of 0.3 percentage point, mainly as a result of the measures concerning the radio and television licence fee.

The acceleration of inflation in March 2005 was primarily caused by the fairly steep increases in the prices of vegetables – owing to the bad weather – and meat. Although the impact of the first of these factors was short-lived, the rate of increase in the prices of unprocessed food will continue to be influenced by base effects which overall will have an upward impact for the rest of 2005. The rate of increase in the prices of unprocessed food had in fact been very low in 2004, owing to particularly favourable supply conditions. After accelerating from 0.9 p.c. in 2004 to 2.4 p.c. in 2005, it should amount to 2.3 p.c. in 2006, assuming neutral supply conditions.

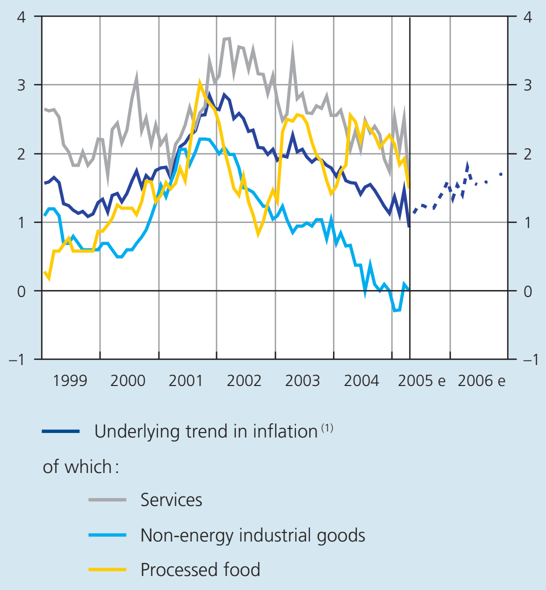
UNDERLYING TREND IN INFLATION

A good indicator of the underlying trend in inflation is obtained by disregarding the factors mentioned above, namely the primarily administrative price changes and the movement in the prices of unprocessed food and energy, which are volatile components. While the average rate of price increase measured in this way had already fallen from 2 p.c. in 2003 to 1.5 p.c. in 2004, it will probably continue to slow down to reach 1.3 p.c. in 2005. The relatively modest price rises in the first half of 2005 are still due to the euro appreciation, which contributed to weak pressure from foreign prices. While exchange rate changes have a more or less immediate impact on energy prices, there is generally some time lag before they are passed on in full to other consumer prices. Their effect was felt mainly in the case of non-energy goods with a relatively greater import component. The low level of the underlying trend in inflation is also due to the marked deceleration in labour costs during the 2003-2004 period, which essentially accounts for the moderation of price increases in the most labour-intensive services during the recent period [1].

(1) For a detailed analysis of the cost structure – particularly the respective shares of imports and labour costs – of the various components of the HICP, cf. Cornille D. and B. Robert, 2005, *Sectoral interdependences and cost structure in the Belgian economy: an application for input-output tables*, in the present issue of the Economic Review.

CHART 11 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.

However, the slackening of the underlying trend in inflation probably ended at the beginning of this year. The expectation is that the cessation of the downward effect of the euro appreciation, coupled with the rise in both energy and non-energy commodity prices, will contribute towards a gradual, moderate increase in the underlying trend in inflation during 2005, pushing the rate to 1.6 p.c. in 2006. On the other hand, the indicative nominal wage norm of 4.5 p.c. for 2005-2006 in principle implies a modest increase in labour costs, which should help to keep down internal pressure on prices. The relatively muted increase in demand during the period covered by the projections is also unlikely to exert any substantial upward pressure on prices.

In view of the developments described above, the health index – which is the benchmark for the indexation of wages and other incomes – is expected to rise by 2.1 p.c. and 1.8 p.c. respectively in 2005 and 2006. Naturally, that outcome is also heavily dependent on the initial assumptions adopted for the projection.

In both years, the rise in the health index exceeds the rise in the underlying trend in inflation, mainly because this index is not entirely protected from the impact of oil price fluctuations. Indeed, heating oil, gas and electricity are included in the basket of products making up the health index, whereas petrol and diesel are omitted. In addition, the health index is derived from the national consumer price index, and in recent years that index has been rising increasingly faster than the HICP. This disparity is due to the fact that a number of products whose prices are falling fairly rapidly, such as personal computers, are not yet included in the national consumer price index, despite their relatively substantial share of household consumption expenditure.

3.2 Labour costs

The wage negotiations conducted by the many sectoral joint committees in the course of 2005 are taking place within the framework of the draft central agreement of January 2005, which was endorsed by the government and in which the social partners agreed to an indicative wage norm of 4.5 p.c. at the national level for the increase in hourly labour costs in the private sector during the period 2005-2006. Since little information is available as yet on those negotiations, the estimates of the progress in labour costs described below are based on the assumption that, although this norm is only indicative, it will not be exceeded at the macroeconomic level.

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

	2001	2002	2003	2004 e	2005 e	2006 e
Gross wages per hour worked	3.7	3.5	3.1	3.2	2.5	2.4
Collectively agreed wages (1)	3.3	3.8	1.8	2.4	2.1	2.1
Collectively agreed real increases	0.8	1.5	0.4	1.0	0.1	0.2
Indexation	2.5	2.3	1.5	1.4	2.0	1.9
Wage drift (2)	0.3	–0.2	1.2	0.7	0.4	0.4
Employers' social security contributions (3)	0.5	0.7	–0.4	–0.7	–0.3	–0.1
of which:						
Contributions paid to government	0.0	0.3	–0.5	–0.7	–0.3	–0.1
Labour costs per hour worked	4.1	4.2	2.7	2.5	2.2	2.3
Change in working time per employee (3)	–0.5	–0.5	–0.2	0.1	0.0	0.1
Labour costs per employee	3.6	3.6	2.5	2.5	2.2	2.4
Labour productivity (4)	–0.9	1.7	1.7	2.4	0.5	1.9
Unit labour costs	4.6	1.9	0.8	0.1	1.7	0.5

Sources: FPS Employment, Labour and Social Dialogue; NAI; NBB.
(1) Wage increases fixed by joint committees.
(2) Increases and bonuses granted by enterprises on top of central and sectoral collectively agreed wage increases, wage drift resulting from changes in the structure of employment (e.g. as a result of scale increases and 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 workers.

The context of wage moderation prevailing in neighbouring countries, notably in Germany and the Netherlands, is in fact encouraging cautious pay agreements. Moreover, there is currently every indication that, during 2005-2006, indexation will have a greater impact on the increase in labour costs than assumed by the national negotiators when setting the indicative wage norm. Higher inflation, due mainly to the rise in energy prices, is in fact affecting indexation with a certain time lag, because indexation is dependent on the movement in the health index which takes no account of motor fuel prices but does include the prices of other energy products (electricity, heating oil, natural gas, etc.). According to the current forecasts, indexation will push up wages by around 4 p.c. during 2005-2006, namely by 2 p.c. in 2005 and by 1.9 p.c. in 2006.

In addition, the reductions in employers' social security contributions, agreed at the 2003 Employment Conference, will become fully operational, and additional reductions in charges were agreed upon during the central negotiations at the end of 2004. These are structural cuts aimed mainly at certain target groups, namely older workers, high wage earners and the low paid. The various cuts should slow the growth of labour costs by 0.3 and 0.1 percentage point respectively in 2005 and 2006.

Taking into account the estimated indexations and the impact of the reductions in charges, and assuming a wage drift of 0.4 p.c. per annum for the increases granted at the firm level or determined by changes in the structure of employment – i.e. the average wage drift recorded after 1996 – and modest collectively agreed real increases at the sectoral level, the growth of hourly labour costs in the private sector is projected to total 2.2 p.c. in 2005 and 2.3 p.c. in 2006. In that case, the rise in labour costs in 2005-2006 will be 0.7 percentage point lower than in the 2003-2004 period.

Among other factors, the revival of economic growth in 2004 may have put an end to the downward trend in average working time per employee, recorded in preceding years. In 2005 and 2006, no significant change in working time is expected. Consequently, labour costs per employee should rise at the same rate as those per hour worked during both years. However, the growth rates of 2.2 and 2.4 p.c. respectively represent a deceleration in comparison with the 2.5 p.c. increases recorded in 2003 and 2004.

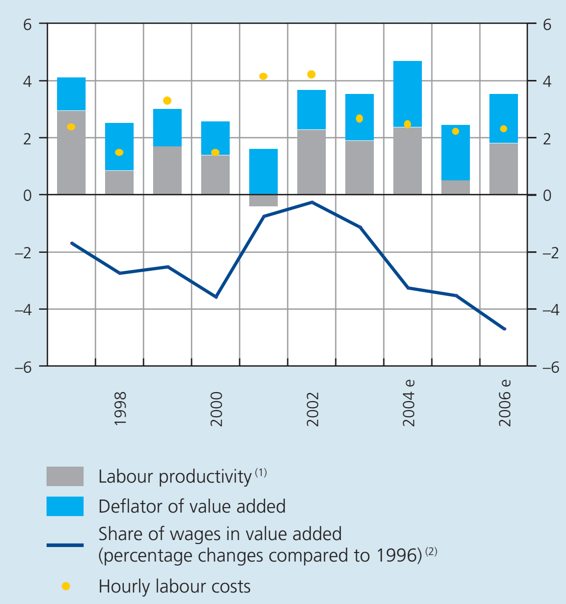
Partly because economic activity is expanding more slowly this year than last, labour productivity – value added in volume per person in work – is expected to increase by just 0.5 p.c., following a 2.4 p.c. rise in 2004. This means that the growth of unit labour costs, which remained fairly stable in 2004, should accelerate to 1.7 p.c. in 2005. The strengthening economic growth forecast for 2006 should be accompanied by an acceleration in productivity gains, reaching 1.9 p.c., so that unit labour costs are predicted to rise by only 0.5 p.c.

Since the rise in unit labour costs in 2005 and 2006 will probably fall short of the growth of the deflator of value added – i.e. the value of a unit of output – estimated at 1.9 and 1.7 p.c. respectively, the share of labour incomes in value added is expected to fall by 0.3 p.c. in 2005 and 1.2 p.c. in 2006.

On the basis of the developments described above, the share of wages, which had increased in 2001 and 2002 but declined in 2003 and 2004, is likely to continue its downward trend in the years ahead. By 2006, the share of labour income in the value added of the private sector in Belgium is expected to be 4.7 p.c. lower than in 1996. This means that the increase in labour costs has been helpful in slowing the substitution of capital for labour, which is conducive to employment.

CHART 12 LABOUR COSTS, DEFLATOR AND LABOUR PRODUCTIVITY IN THE PRIVATE SECTOR

(Percentage changes compared to the previous year)



Sources: NAI, NBB.

(1) Ratio between value added at constant prices and the volume of labour expressed in hours worked by employees and self-employed persons.

(2) Ratio between labour costs and the labour incomes imputed to self-employed persons, on the one hand, and value added at market prices on the other.

4. Public finances[1]

4.1 Overview

According to provisional figures published by the NAI in April 2005, the general government accounts ended the year 2004 more or less in balance. Under the macro-economic conditions described above, the government accounts would record a deficit again from 2005. The deficit would be limited to 0.5 p.c. of GDP this year, but would increase to 1.4 p.c. of GDP in 2006. These projections only take account of fiscal measures which have already been announced and are specified in sufficient detail; they obviously do not take into account the effect of decisions which are still to be taken, particularly at the time when the 2006 budget will be drawn up. In line with the ESCB methodology, no account is taken of the actual budget targets – e.g., the budget balance fixed for this year and the next year under the December 2004 stability programme – nor of measures which are yet to be passed in order to meet those targets. The projections therefore indicate what would happen if no new fiscal measures were taken.

The deterioration in the budget balance would result from the opposing effect of four different factors.

First, general government interest charges would continue to decline in 2005 and 2006. The projections are based on the technical assumption that the short-term market rate remains unchanged while the long-term market rate merely edges upwards from an average of 3.6 p.c. in 2005 to 3.8 p.c. in 2006. In this context, the implicit rate on the public debt would continue to fall, dropping from 5 p.c. in 2004 to 4.6 p.c. in 2006, mainly as a result of long-term debts being refinanced at lower rates. Combined with the slightly slower fall in the debt level, the reduction in interest charges would continue at a rate of 0.6 p.c. of GDP between 2004 and 2006.

On the other hand, the economic situation would impose stress on the budget balances. Thus, as indicated above, the projections are based on a sharp deceleration in growth in 2005. Slightly more robust growth is predicted for 2006.

In addition, the gradual disappearance of non-recurring factors causes the general government accounts to deteriorate. In 2004, those factors exerted a positive influence on the budget balances equal to 0.8 p.c. of GDP. Thus, the fact that part of the BNRC's operating subsidies and the whole of the investment grants scheduled for 2004 were paid in advance in 2003 cut the level of expenditure by around 0.4 p.c. of GDP last year. Moreover, the proceeds from new sales of real estate by the federal government and certain federated entities, and those from the one-off declaration of financial assets, each totalled 0.2 p.c. of GDP. Furthermore, various shifts between the withholding tax on earned incomes and the tax assessments caused a temporary increase in tax revenues totalling 0.1 p.c. of GDP. These factors were only offset to a very small extent by the fact that the Flemish government postponed until 2004 part of the subsidies intended for De Lijn in 2003[2].

In 2005, they would bring a further improvement in the budget balances equal to 0.4 p.c. of GDP. On the one hand, the new property sales planned by both the federal government and certain federated entities, plus the securitisation and sale of tax arrears, should raise around 0.3 p.c. of GDP. Also, the above-mentioned shifts between the withholding tax on earned incomes and the assessments will boost taxes by a further 0.1 p.c. of GDP this year. For 2006, account was taken of a small negative effect on tax revenues caused by the said securitisation and sale of tax arrears; there are no plans as yet for any significant new non-recurring measures.

TABLE 8 BELGIAN GOVERNMENT BUDGET BALANCES
(Percentages of GDP)

	2004	2005 e	2006 e
Primary balance (a)	4.9	4.1	2.9
p.m. Revenue	*49.3*	*49.5*	*48.4*
Primary expenditure	*44.5*	*45.4*	*45.5*
Interest charges (b)	4.9	4.6	4.3
Financing requirement (–) or capacity (c = a – b)	0.0	–0.5	–1.4
p.m. Financing requirement (–) or capacity according to the EDP(1)	*0.1*	*–0.4*	*–1.3*

Sources: NAI, NBB.
(1) The ESA 95 methodology was adapted in 2001 to exclude from the calculation of the overall balance the net interest gains on certain financial transactions, such as swaps. However, in the framework of the excessive deficit procedure (EDP) no account is taken of this adjustment, which is also disregarded in the EC's assessment of the stability programmes.

(1) The projections relating to public finances allow for the calendar effects on the macroeconomic variables. According to these calculations, real GDP growth figures are 2.9 p.c. in 2004, 1.3 p.c. in 2005 and 2.4 p.c. in 2006, against 2.7, 1.4 and 2.4 p.c. respectively for calendar-adjusted GDP.
(2) The repayment of stock market taxes unlawfully collected was another non-recurring factor in 2004. On 15 July 2004, the Court of Justice of the European Communities ruled that the levying of the tax on stock market transactions and that on the delivery of bearer securities at the time of new issues was contrary to the European directive concerning indirect taxes on the raising of capital. The repayments were accounted for in full in 2004, in accordance with the ESA 95 methodology.

TABLE 9 IMPACT OF NON-RECURRING FACTORS [1] ON THE BUDGET BALANCES

(Percentages of GDP)

	2004	2005 e	2006 e
Total non-recurring factors	0.8	0.4	0.0
of which :			
One-off declaration of financial assets	0.2	0.0	0.0
Shifts between the withholding tax on earned incomes and assessments	0.1	0.1	0.0
Securitisation and sale of tax arrears	0.0	0.1	0.0
Shift in the funding of the BNRC	0.4	0.0	0.0
Sales of real estate	0.2	0.2	0.0
Shift in the funding of De Lijn	–0.1	0.0	0.0

Sources : NAI, NBB.
(1) A positive (negative) figure indicates an improvement (deterioration) in the budget balances.

Finally, the projections point to a further easing of fiscal policy in 2006, due essentially to the measures intended to reduce the burden of taxes and parafiscal levies on labour. Unlike in 2005, these measures will be offset to only a limited extent by increases in various taxes on goods and services.

4.2 Revenue

The on-going implementation of the personal income tax reform will continue to reduce the burden on taxpayers in 2005 and 2006. Although no new measures are to take effect as yet under this reform, a number of measures which came into force in previous years will have an effect on the tax assessments only. In 2005, that effect – which will mainly influence federal government revenues and, via the additional percentages, those of the local authorities – comes to 0.2 p.c. of GDP. A supplementary effect equivalent to 0.5 p.c. of GDP is expected in 2006.

Apart from the personal income tax reform, the planned reductions in social security contributions will also depress fiscal and parafiscal revenues. This primarily concerns the continuing implementation of the cuts in employers' contributions planned at the 2003 Employment Conference, intended to augment the structural reductions and reduce the burdens on specific target groups. Also, the personal contributions paid on the lowest wages are being cut by the introduction, in 2005, of the "work bonus", the scope of which is to be extended in 2006. Among other things, this work bonus replaces the tax credit introduced at the time of the personal income tax reform for taxpayers on low earned incomes.

These reductions in fiscal and parafiscal pressure on labour will be partly offset by increases in the taxes on goods and services. Thus, the rates of excise duty on tobacco and mineral oils are going up in 2005 and 2006. In addition, the levy on vehicles for business use and the levy on drinks in throwaway packaging were increased in 2005 ; however this latter increase was cancelled at the time of the April 2005 federal budget inspection.

Moreover, as in 2004 the federal government included in the 2005 budget a detailed programme for controlling tax evasion and improving the collection of taxes. Some of these measures had already been planned in 2004 but not yet implemented. According to the government, this initiative should achieve a structural increase in tax revenues of around 0.1 p.c. of GDP. This technical assumption was included in the projections.

In 2005, leaving aside the effect of the one-off declaration of financial assets, the securitisation and sale of tax arrears, and the shifts between the withholding tax on earned incomes and assessments, the structural measures will result in a small rise in fiscal and parafiscal revenues. The measures aimed at easing the burden of taxes and parafiscal levies on labour are more than offset by the increases in various other taxes, mainly on goods and services. Conversely, in 2006 the impact of the measures already planned will reduce the burden of taxes and parafiscal levies by 0.6 p.c. of GDP.

TABLE 10 STRUCTURAL MEASURES CONCERNING PUBLIC REVENUE

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

	2005 e	2006 e
Taxes	629	–1,210
Personal income tax reform [1]	–542	–1,397
Increase in taxes on goods and services	765	167
Control of tax evasion and improved tax collection	325	0
Others	81	21
Social security contributions	–273	–493
Employers' contributions	–321	–140
Employees' contributions	47	–353
Total	356	–1,703
p.m. Percentages of GDP	*0.1*	*–0.6*

Sources : FPS Finance, NSSO, NBB.
(1) Including the secondary effects of the additional percentages for local authorities.

4.3 Primary expenditure

Primary expenditure, which had totalled 45.6 and 44.5 p.c. of GDP respectively in 2003 and 2004, is projected to come to 45.4 p.c. of GDP in 2005. Actual expenditure, which includes the non-recurring factors, is expected to increase by 2.8 p.c. in real terms. This large rise is due in particular to the advances paid in 2003 on the subsidies for the BNRC – payable, in principle, in 2004, a year in which the subsidies were therefore particularly small. Adjusted to take account of non-recurring and cyclical factors, and of indexation effects [1], real primary expenditure should increase by 2.3 p.c. in 2005 and 2.4 p.c. in 2006.

The 2005 expenditure estimate takes account of the federal government budgets, including the social security budget, and those of the communities and regions. However, it is the local authorities that are expected to see the largest increase, due to a traditional surge in investments in the run-up to the local elections. In addition, the increase in the allocation for service vouchers and the measures in favour of shift work and entities employing researchers, recorded as subsidies in accordance with the ESA 95, are expected to swell expenditure in 2005.

(1) Effect due to the difference between the actual indexation of the salaries of public sector employees and social security benefits, on the one hand, and the rise in the national consumer price index on the other.

It is of course very difficult to estimate the rate of increase in primary expenditure in 2006, since no budget is available as yet. However, local authority spending should again increase at an above-average rate, still being influenced by investments. Social security spending should also rise rapidly, boosted by expenditure on health care and an increase in social benefits for the self-employed. As regards federal government expenditure and that of the communities and regions, the growth figures in these projections are based on the average recorded in the past.

4.4 Debt

Since 1993, when the public debt peaked at almost 137 p.c. of GDP, the debt level has been declining steadily by an average of 4 percentage points per annum. At the end of 2004, the general government debt level totalled 95.5 p.c. of GDP.

TABLE 11 CONSOLIDATED GROSS DEBT OF GENERAL GOVERNMENT

(Percentages of GDP, unless otherwise stated)

	1993	1999	2000	2001	2002	2003	2004	2005 e	2006 e
Level of the debt	136.7	114.5	109.0	108.0	105.4	100.0	95.5	95.9	93.8
Change in the debt			–5.5	–1.1	–2.6	–5.4	–4.5	0.4	–2.1
Endogenous change (1)			–5.8	–3.3	–3.0	–3.6	–5.1	–2.6	–2.6
Primary balance required to stabilise the debt (1)			1.1	3.9	3.1	2.1	–0.2	1.4	0.4
Implicit interest rate on the debt (2)			6.2	6.1	5.7	5.3	5.0	4.8	4.6
Growth of nominal GDP (2)			5.2	2.5	2.7	3.2	5.3	3.2	4.2
Actual primary balance			6.9	7.2	6.1	5.7	4.9	4.1	2.9
Change resulting from other factors			0.4	2.2	0.4	–1.8	0.6	3.1	0.5
Transactions with the NBB (including capital gains on gold)			0.0	0.0	–0.1	–0.1	0.0	0.0	0.0
Privatisation operations and other financial transactions			–0.1	0.0	0.0	–2.3	–0.4	0.0	0.0
Net formation of financial assets outside the public sector			0.3	–0.3	–0.3	0.3	0.1	0.0	0.0
Other (3)			0.3	2.6	0.8	0.4	0.9	3.1	0.5

Sources: NAI, NBB.

(1) The endogenous change in the public debt is determined by the difference between the primary balance required to stabilise the debt – i.e. the balance 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 – and the actual primary balance.

(2) Percentages.

(3) Mainly lending, equity investment, the impact of exchange differences and of issue and repurchase premiums, statistical discrepancies and the incorporation of CREDIBE and the Railway Infrastructure Fund in the general government sector, in 2001 and 2005 respectively.

This year, however, the public debt is expected to rise by 0.4 p.c. of GDP, since exogenous factors are exerting upward pressure equal to 3.1 p.c. of GDP. This is due mainly to the restructuring of the BNRC which, on 1 January 2005, was converted to a holding company with two subsidiaries, namely the BNRC railway company – concentrating on the carriage of passengers and goods by rail – and the infrastructure manager, Infrabel, which will also be responsible for the construction and funding of any new rail infrastructure. In addition, a fund – the Railway Infrastructure Fund – was set up as the owner of the rail infrastructure in place on 31 December 2004, and it took over the corresponding debt. According to the ESA 95 methodology, this fund comes under the general government sector; in 2005, this restructuring therefore adds 7.4 billion euro – corresponding to 2.5 p.c. of GDP – to the debt as defined by the Maastricht criteria.

In 2006, the debt ratio should resume its downward trend, dropping to 93.8 p.c. of GDP by the end of the year.

5. Assessment of the uncertainty surrounding the projections

The marked deceleration in activity seen in late 2004 and in early 2005 in Belgium is a key factor in the new macroeconomic projections. The scale of the slowdown was greater than foreseen in the previous projection of autumn 2004. According to the information available when this exercise was concluded, it also appears to have been more severe than in the euro area in general. This movement is due partly to isolated factors, but also to weaker activity in industry, where only a gradual recovery is expected during 2005. In all, the slowdown at the beginning of the year and the muted dynamism projected thereafter make it necessary to revise GDP growth by more than one percentage point for the year as a whole. In this connection, a check should be done to verify whether industrial activity in the euro area does not also weaken more severely in the coming months, which would depress Belgium's exports and delay the growth recovery. Conversely, however, the possibility of a speedier rebound cannot be ruled out either.

The increase in oil prices on the international markets up to April 2005 contributed to the slowing of activity. It was also a major factor in the recent quickening of inflation. The oil markets remain highly volatile, making the outlook for prices particularly uncertain. According to the assumption adopted, oil prices will remain close to 50 dollars per barrel. That is around 10 dollars higher than the level assumed in previous exercises. However, it is uncertain whether that already reflects a new equilibrium value for supply and demand on the world oil market.

Internal inflationary pressures should remain weak in 2005 and 2006, taking account of a nominal rise of 4.5 p.c. in hourly labour costs in the private sector over the two years together. In the projections, this technical assumption leads to modest real increases, in view of the expected effect of the indexations. Steeper wage increases, e.g. following agreements in particular sectors or firms, would generate higher inflation and hamper job creation.

TABLE 12 COMPARISON OF THE FORECASTS FOR BELGIUM

(Percentage changes compared to the previous year)

	Real GDP		Inflation		Publication date
	2005	2006	2005	2006	
NBB – Spring 2005	1.4	2.4	2.2	1.9	June 2005
p.m. Autumn 2004	*2.5*	–	*2.2*	–	*December 2004*
Federal Planning Bureau	1.7	2.6	2.1	1.8	May 2005
EC	2.2	2.3	2.0	1.8	April 2005
IMF	2.1	2.3	2.1	2.0	April 2005
OECD	1.3	2.4	2.2	1.6	May 2005
Belgian Prime News	2.2	2.4	1.9	1.7	March 2005
Consensus Economics	2.1	2.4	2.0	1.8	May 2005
Economist's Poll	2.0	2.2	1.9	1.7	May 2005
p.m. Actual figures 2004	*2.7*		*1.9*		

Moreover, the results presented here are also dependent on other assumptions adopted by the Eurosystem. The large current account imbalances, which have persisted for several years and will only be rectified to a very small extent in 2005 and 2006, are a threat to world growth. They could give rise to substantial adjustments to exchange rates or long-term interest rates. Moreover, the low level of the latter in itself entails a risk of an upward correction.

The main differences between the Bank's projections for 2005 and the forecasts published previously by the Federal Planning Bureau and international institutions, except for the OECD forecasts, are a lower GDP growth rate and slightly higher inflation.

Annex

PROJECTIONS FOR THE BELGIAN ECONOMY : MAIN RESULTS

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

	2002	2003	2004	2005 e	2006 e
Growth (calendar adjusted data)					
GDP at 2000 prices	0.9	1.3	2.7	1.4	2.4
Contributions to growth :					
Domestic expenditure, excluding change in stocks	–0.1	1.6	1.9	1.8	2.1
Net exports of goods and services	0.3	–0.3	–0.2	–0.7	0.8
Change in stocks	0.7	–0.1	1.0	0.4	–0.5
Prices and costs					
Harmonised index of consumer prices	1.6	1.5	1.9	2.2	1.9
Health index	1.8	1.5	1.6	2.1	1.8
GDP deflator	1.8	2.0	2.3	2.0	1.7
Terms of trade	1.0	–0.1	–0.9	–0.5	–0.1
Unit labour costs in the private sector	1.9	0.8	0.1	1.7	0.5
Hourly labour costs in the private sector	4.2	2.7	2.5	2.2	2.3
Hourly productivity in the private sector	2.3	1.9	2.4	0.5	1.8
Labour market (calendar adjusted data)					
Domestic employment (average annual change, thousands of units)	–12.4	2.3	28.2	34.3	27.6
Harmonised unemployment rate (p.c. of labour force)	7.4	7.9	7.8	7.9	8.0
Harmonised unemployment rate 15-64 years (p.c. of labour force)	7.6	8.2	8.6	8.7	8.7
Incomes					
Real disposable income of individuals	0.1	1.1	0.5	1.8	2.6
Savings ratio of individuals (p.c. of disposable income)	16.6	15.5	14.1	15.0	15.7
Public finances					
Primary balance (p.c. of GDP)	6.1	5.7	4.9	4.1	2.9
General government financing requirement (–) or capacity (p.c. of GDP)	0.1	0.3	0.0	–0.5	–1.4
Public debt (p.c. of GDP)	105.4	100.0	95.5	95.9	93.8
Current account (p.c. of GDP according to balance of payments)	**5.7**	**4.5**	**3.4**	**2.0**	**2.8**

Sources : EC, NAI, NSI, NBB.