Economic projections for Belgium - Autumn 2005

Introduction

Since the spring of 2005, the economic environment has been dominated by the continuing steep rise in oil prices on the international markets and the appreciation of the US dollar against the euro. Meanwhile, activity continued to expand strongly in most economic regions.

These factors could possibly increase the inflationary pressure in the euro area, while the predicted gradual strengthening of activity still holds true. Indeed, the macro-economic projections for the euro area drawn up by the Eurosystem experts and published in the December 2005 ECB Bulletin present an inflation figure which has been revised upwards, whereas the GDP growth prospects have hardly been revised at all compared to the spring.

Coinciding with the publication of the new projections for the euro area, this article gives a brief presentation of the results for the Belgian economy. Those results, obtained using the same methods and procedures as in the spring (1), take account of developments which have occurred since then. In particular, they were compiled on the basis of the new national accounts data, published by the NAI this autumn. In that connection, the revisions were larger than usual, owing not only to the incorporation of more complete data, but also because of substantial changes to the methodology, most of them requested by Eurostat (2). Those revisions cause significant changes in the movement in certain components of demand in 2004 and early 2005. The new projections also take account of the government budgets available for 2006. The projections for Belgium were produced on the basis of the information available as at 21 November 2005.

1. International environment and assumptions

Fuelled by the sustained, vigorous expansion of activity in most of the economic regions, demand for petroleum products has remained high in the past few months, whereas pressure on extraction and refining capacity persisted. International prices therefore maintained a resolute upward trend during 2005, with the price per barrel of Brent reaching around 68 dollars for a time at the end of the summer, owing to the damage caused by the hurricanes in the Gulf of Mexico, compared to an average of 38.3 dollars in 2004. Prices later subsided, but are still highly volatile. According to market expectations, the level of around 60 dollars per barrel reached in mid November is likely to persist until the end of 2006; that is about 10 dollars higher than the figure taken as an assumption in the spring.

However, the relentless rise in oil prices has only slightly depressed world growth. Although there was a deceleration after the 2004 peak, growth should remain high in 2005 and 2006, underpinned mainly by the United States, Asia and the oil-exporting economies. International trade was sluggish in late 2004 and early 2005, following a temporary slowdown in industrial output. However, trade should remain robust in the months ahead.

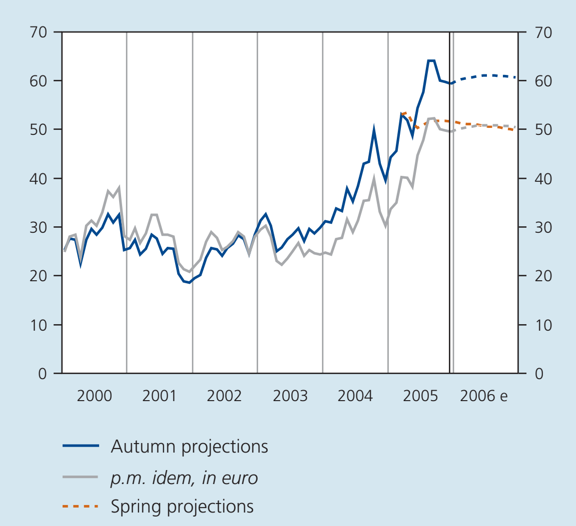
In the euro area, after four quarters of weak economic activity, a revival took place in the second half of 2005, despite the high oil prices. However, the growth rate continues to trail behind that of other economies. According

(1) NBB (2005), "Economic projections for Belgium – spring 2005", Economic Review 2-2005.

(2) The NAI published a short comment on the 2005 revisions in the national accounts for Belgium at http:\\www.nbb.be\DOC\DQ\F\METHOD\detrekF. pdf.

CHART 1 CRUDE OIL PRICE

(Monthly averages – barrel of Brent in dollar)



Source : ECB.

to the new Eurosystem projections, GDP growth is expected to reach between 1.2 and 1.6 p.c. in 2005, following growth of 1.8 p.c. in 2004. Growth is forecast to accelerate slightly in 2006 to reach between 1.4 and 2.4 p.c., borne along by exports and investments. Inflation, which stood at 2.1 p.c. in 2004 on the basis of the HICP, is predicted to remain between 2.1 and 2.3 p.c. in 2005 and between 1.6 and 2.6 p.c. in 2006, whereas in the spring it had been expected to slow down. The energy component should largely contribute to this revision.

Box – 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 set at 2.3 p.c. over the projection horizon ;
– long-term interest rates in euro are based on market expectations ; when the projections were produced, they stood at 3.5 p.c. and are expected to rise slowly, reaching 3.7 p.c. by the end of 2006 ;
– bilateral euro exchange rates are kept constant at their mid-November 2005 level, namely 1.19 dollar to the euro in the case of the US currency ;
– in line with the implicit price movements reflected by forward contracts, world oil prices are expected to remain at a level close to 60 dollars per barrel. On average over the year, the price per barrel of Brent is likely to come to 55 dollars in 2005 and 60 dollars in 2006, against 38.3 dollars in 2004 ;
– Belgium's export markets, measured as the weighted sum of imports by third countries, including the euro area partners, are predicted to expand by just over 5 and 6 p.c. respectively in 2005 and 2006 ;
– while competitors' export prices had fallen by 0.7 p.c. in 2004, they are assumed to increase by over 3 p.c. in 2005 and 2006, partly because of the euro's depreciation during the current year ;
– the results for public finances take account of the macroeconomic environment and the budget measures already announced and specified in sufficient detail.

EUROSYSTEM PROJECTIONS: RESULTS AND ASSUMPTIONS

	2004	2005	2006
Projections for the euro area		*(Annual averages)*	
GDP in volume	1.8	1.2 – 1.6	1.4 – 2.4
Inflation (HICP)	2.1	2.1 – 2.3	1.6 – 2.6
Eurosystem assumptions			
Three-month interbank rates in euro	2.1	2.2	2.3
Ten-year bond yields	4.2	3.4	3.6
Euro exchange rate against the US dollar	1.24	1.25	1.19
Oil price (US dollar per barrel)	38.3	55.0	60.0
		(Percentage changes)	
Export markets relevant to Belgium	7.3	5.4	6.1
Competitors' export prices	–0.7	3.2	3.7
of which: competitors from the euro area	1.1	2.1	1.9

Source: ECB.

2. Activity, employment and demand

In the context of a temporary weakness in the industrial activity and foreign trade of the euro area, GDP growth in Belgium dipped sharply at the end of 2004 and in the first quarter of 2005. As predicted in the spring projections, a modest recovery followed. According to the NAI estimates, which go up to the third quarter of 2005, GDP grew by just 0.1 p.c. in real terms in the first quarter, then by 0.2 p.c. and 0.4 p.c. respectively in the ensuing two quarters. Year-on-year growth, which had reached 2.8 p.c. in the third quarter of 2004, the fastest annual growth for four years, dropped back to 1.1 p.c. twelve months later.

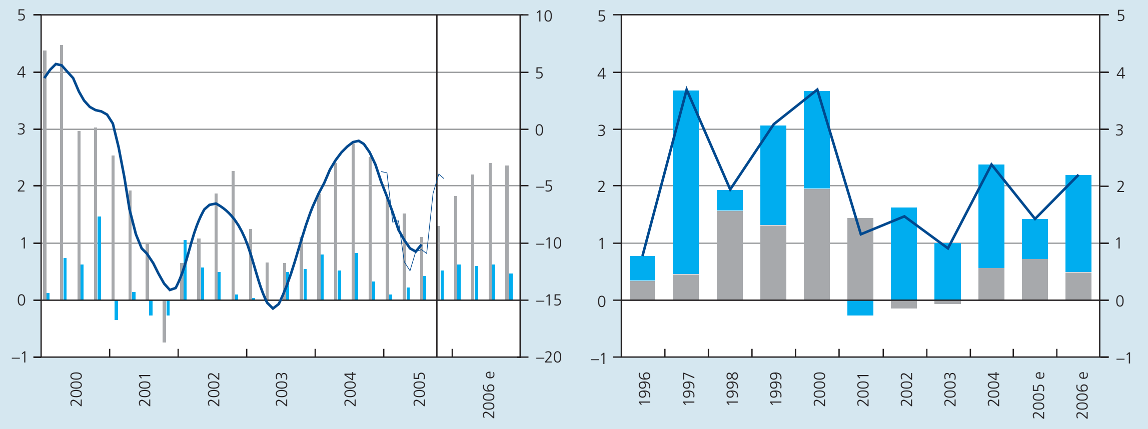
The gradual strengthening of activity should maintain. In the short term, the recent results of the business surveys, the primary source of information for assessing the trend in activity in real time, point to an upturn since the summer. More fundamentally, the sturdier growth appears to originate from the external sector, after the recent strength of demand from the business sector, both having so far stood up relatively well in the face of the oil shock. Conversely, the contribution of private consumption demand is likely to be curbed at first by the movement in consumer purchasing power. In all, growth looks set to fall from 2.4 p.c. in 2004 to 1.4 p.c. in 2005. In 2006, it is predicted to reach 2.2 p.c., once again a slightly higher figure than that forecast for the euro area.

Being largely cushioned by the movements in productivity, the activity's saw tooth profile takes some time to be reflected, in a damped way, in the movement in employment. The number of persons in work in Belgium is estimated to increase by 0.7 p.c. in 2005, then by 0.5 p.c. in 2006, following a rise of 0.6 p.c. in 2004. In all, net job creation is expected to total around 75,000 for the period 2004–2006 as a whole, following a cumulative decline of 10,000 jobs in 2002 and 2003. However, in view of the expansion of the labour force, the number of job seekers is likely to continue to rise; the unemployment rate is forecast at 8.4 p.c. in 2005 and expected to remain at that level in 2006.

The forecast employment growth is slightly below the figure predicted in the spring forecasts. However, the main factor that is expected to depress the growth of individual purchasing power in 2005 and 2006 is the quickening pace of overall inflation, outstripping the rise in the health index, the reference for the indexation of a large part of incomes. However, this factor will be partly offset in the second year by the substantial effects of the implementation of the tax reform. Overall, disposable income is likely to increase in real terms by 0.6 p.c. in 2005 and 1.8 p.c. in 2006. Owing to a further expected

CHART 2 GDP, BUSINESS SURVEY INDICATOR AND EMPLOYMENT

(seasonally adjusted data)



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

fall in the savings ratio in the first year, the volume growth of private consumption should remain stable at 1.3 p.c. in 2005 – the same rate as in 2004 – and 1.6 p.c. in 2006. Public consumption is expected to expand at roughly the same rate.

The business investment recovery which had begun in 2004 was very rapidly consolidated in the first half of 2005, partly as a result of major projects in the marine transport sector. The investment is picking up, following two years of unusually steep decline in the context of a steady improvement in corporate profitability, a recovery in stock market prices and low interest rates. According to the revised national accounts data, it now appears that investment in housing also surged in 2004. Following this rapid expansion in private investment, a return to a more balanced picture in line with that of activity and income is expected in the period covered by the forecasts. However, these movements are more dynamic than would appear from the decline in the rate of expansion of business investment, down from 9.9 p.c. in 2005 to 0.8 p.c. in 2006, mainly reflecting the absence of new ship purchases in the forecasts. Public investment, particularly that of the local authorities, should also be buoyant in 2005 and 2006, driven by the traditional electoral cycle. The major deals concerning the sale of buildings, which were scheduled in particular as part of the 2006 budgets, conceal this trend to some extent.

After expanding by 5.6 p.c. in real terms in 2004, exports of goods and services slowed down in the first half of 2005, the main factors being the previous appreciation of the euro and the temporary weakening of external demand addressed to Belgium. The revival in demand, particularly that from European partners, and the euro's depreciation by around 12 p.c. against the dollar since the peak at the end of 2004 should boost the export growth rate from 2.3 p.c. in 2005 to around 5 p.c. in 2006. As last year, the growth of imports is likely to be much higher than of exports in 2005, at 3.5 p.c., this time because of the exceptionally strong business investment. As this effect subsides in 2005, the growth of imports is expected to fall back below that of exports in 2006, at 4.4 p.c. The contribution of net exports to GDP growth will thus be negative at 0.9 percentage point in 2005, before making a positive contribution of 0.7 percentage point in 2006.

TABLE 1 GDP, EMPLOYMENT AND MAIN CATEGORIES OF EXPENDITURE

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

	2003	2004	2005 e	2006 e
GDP [1]	0.9	2.4	1.4	2.2
Total domestic employment in persons	–0.1	0.6	0.7	0.5
Components of expenditure [1]				
Final consumption expenditure of households	1.0	1.3	1.3	1.6
Final consumption expenditure of general government	2.6	1.9	1.8	1.6
Gross fixed capital formation	–0.6	4.4	8.5	1.0
Housing	3.7	9.1	2.8	2.9
General government investment	1.0	1.1	12.1	–2.4
Business investment	–2.0	3.3	9.9	0.8
Change in stocks [2]	–0.1	0.7	–0.4	0.1
Total domestic expenditure	0.9	2.8	2.5	1.5
Net exports of goods and services [2]	0.0	–0.3	–0.9	0.7
Exports of goods and services	2.8	5.6	2.3	5.1
Imports of goods and services	2.9	6.3	3.5	4.4

Sources: NAI, NBB.
(1) At 2000 prices.
(2) Contribution to the change in GDP.

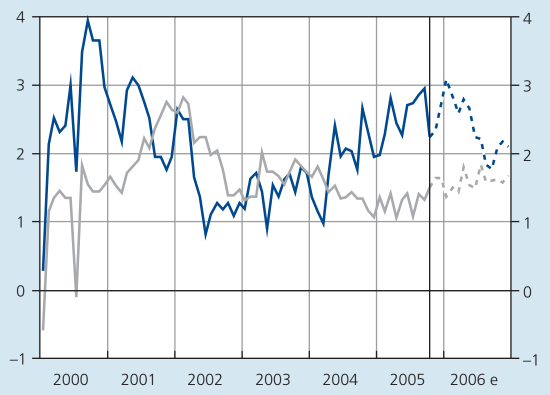
3. Prices and costs

The high level of oil prices contributed directly towards the acceleration in overall inflation during 2004 and 2005. Measured in terms of the HICP, inflation increased from 1 p.c. in March 2004 to 2 p.c. in January 2005, then 3 p.c. in September. The temporary measures to reduce the cost of heating oil for households will reduce the inflation rate by around 0.3 percentage point in the final three months of the year, and will increase it by a similar amount a year later, but leaving aside these movements it is only during 2006 that overall inflation is expected to actually drop back towards 2 p.c. Overall, it is estimated to average 2.5 p.c. in 2005 and 2.3 p.c. in 2006, exceeding the spring projections by 0.3 and 0.4 percentage point respectively.

This revision is due almost exclusively to the revision of the energy component of the price index. In Belgium, inflation is actually more sensitive to oil price movements than in the euro area, owing to the higher weight of petroleum products in the index and a lower average level of excise duty on those products.

CHART 3 INFLATION

(HICP – percentage changes compared to the corresponding period of the previous year)



Sources: EC, NBB.
(1) Measured by the HICP excluding unprocessed food and energy.

TABLE 2 PRICE AND COST INDICATORS

(Percentage changes compared to the previous year)

	2003	2004	2005 e	2006 e
Total HICP	1.5	1.9	2.5	2.3
of which: energy products	0.2	6.6	12.9	8.0
Health index	1.5	1.6	2.1	2.1
GDP deflator	1.7	2.3	2.3	2.4
Labour costs in the private sector				
Hourly costs	1.6	2.1	2.3	2.8
Unit costs	0.2	0.0	1.7	0.9

Sources: NAI, NBB.

Leaving aside the changes in the price of energy and unprocessed food, the underlying trend in inflation is expected to remain at 1.4 p.c. in 2005, a figure comparable to that for the euro area. Beyond the indirect effects of higher commodity costs on the selling prices of processed products or certain services, inflationary pressure looks set to remain moderate at first, in regard to both imports and domestic costs. It is expected to increase gradually during the period covered by the projections for two reasons, namely an increase in import prices expressed in euro and a faster rise in unit labour costs.

Having remained more or less steady in the preceding two years, unit labour costs in the private sector are expected to increase by 1.7 p.c. in 2005 and 0.9 p.c. in 2006. The reason for this acceleration lies in the slower growth of productivity, especially in 2005. It is also due to the faster rise in the health index, which is used as the reference for wage indexation. Although the effect of the higher prices of petroleum products on this index is only about half its impact on the overall consumer price index, the current forecast implies a faster rise than was taken into account in the sectoral wage negotiations. Overall, taking also account of the information available from the FPS Employment, Labour and Social Dialogue on the real increases granted at the level of the sectoral joint committees and the reductions in contributions decided on by the government, hourly labour costs in the private sector are expected to rise by an annual average of around 2.6 p.c. in 2005 and 2006, against an average increase of 1.9 p.c. in 2003 and 2004. This forecast is similar to the one presented in November 2005 by the Secretariat of the Central Economic Council in the technical report on the maximum margins available for the movement in labour costs. In that report, the Secretariat notes that the cumulative increase planned for 2005 and 2006 exceeds the indicative norm of 4.5 p.c. adopted in the draft central agreement. Overall, the relative position of Belgian firms is likely to deteriorate during those two years by around 2 p.c. against the three neighbouring countries, also because the expected rise in hourly labour costs in those countries is considerably lower than the figure adopted at the time of the negotiation of the central agreement at the end of 2004.

4. Public finances

Taking account of the latest information, it seems that public finances should be in balance once again at the end of 2005. Compared to the spring estimate, the current forecasts show an improvement in the balance of 0.4 p.c. of GDP. As regards revenue, advance payments by companies, registration fees and tax assessments present a very favourable picture. The revenue expected from the securitisation of tax arrears has also been upgraded to 600 million euro, and Aquafin will make an exceptional VAT payment. Conversely, account must also be taken of the cost of the temporary 17.35 p.c. cut which the government has granted on the cost of heating oil and natural gas supplied to households. On the expenditure side, health care costs proved lower than expected in the first half year. Similarly, an operating leasing will be taken on the new Antwerp law courts, avoiding the need to record an item of non-recurring investment expenditure.

The projection concerning the 2006 budget balance has improved significantly in comparison with the spring estimate, which was still predicting a deficit of 1.3 p.c. of GDP. That improvement is due to the base effect of better tax revenues than initially forecast for 2005, and the fact that the budgets drawn up in the autumn were also taken

TABLE 3 GENERAL GOVERNMENT ACCOUNT [1]

(Percentages of GDP)

	2003	2004	2005 e	2006 e
Revenue	51.2	49.4	49.9	49.2
of which: fiscal and parafiscal revenue	44.3	44.6	44.9	44.4
Primary expenditure	45.8	44.6	45.5	45.5
Primary balance	5.4	4.8	4.4	3.7
Interest charges [2]	5.3	4.8	4.4	4.1
Financing requirement (–) or capacity [2]	0.1	0.0	0.0	–0.4
p.m. Effect of temporary measures	*1.2*	*0.8*	*0.4*	*0.5*
Consolidated gross debt	98.5	94.7	94.2	90.9

Sources: NAI, NBB.

(1) Eurostat is currently examining the statistical treatment of the reorganisation of the BNRC in 2005, which is considered to have the sole effect of increasing the general government debt without affecting the overall financing balance. Eurostat is also working on the clarification of the rules on operations concerning the securitisation of tax arrears. Finally, Eurostat will need to confirm that the innovative financial partnership with the private sector, intended to optimise the management of the State's real estate, which is planned for 2006, will have a positive influence on the overall financing balance; that could depend on the actual way in which this operation is implemented.

(2) In accordance with the methodology used in the framework of the excessive deficit procedure (EDP), which includes net interest gains from certain financial transactions such as swaps and FRAs.

into account. The federal government thus introduced various consolidation measures. The structural measures, estimated at 0.2 p.c. of GDP, include the introduction of new taxes on some types of financial investments. An advance levy will thus be introduced on the yield generated by investment funds which invest over 40 p.c. in bonds, and a 1.1 p.c. levy will apply to the premiums on certain life insurance contracts. In the 2006 budget, it was also decided to introduce supplementary reductions in charges that will gradually be phased in. For 2006, extensive use will again be made of temporary measures – in line with the practice adopted in the past few years. These measures are expected to improve the general government balance by 0.5 p.c. of GDP, about half of that effect coming from scheduled real estate transactions. Among other things, the government is expecting to raise 565 million euro via an innovative financial partnership with the private sector, intended to optimise the management of the State's real estate. It was also decided to sell tax arrears, as in 2005, which should bring in 600 million euro. However, the future loss of tax revenues following these securitisation operations needs to be taken into account. Moreover, another tax regularisation operation will take place in 2006, which is expected to generate 400 million euro. In view of the uncertainty surrounding the actual proceeds of some of these measures, the figures presented by the government have been taken as working assumptions. Overall, the projections currently point to a deficit of 0.4 p.c. of GDP for general government in 2006.

Having achieved a balanced budget in 2000, the government has since succeeded in maintaining that performance. However, the primary balance has declined during that period, in the context of a downturn in economic activity, whereas the weight of interest charges has also fallen steeply. In 2006, the decline in the primary balance is nevertheless expected to outstrip the fall in interest charges, causing the overall balance to deteriorate. This projected reduction in the primary balance should be due to the steep fall in revenue, attributable mainly to the cuts in levies on labour, associated with the effects of the personal income tax reform on the tax assessments, and the reduction in social security contributions.

In 2005, the debt ratio is expected to fall by only 0.6 p.c. of GDP. The slower pace of debt reduction is due mainly to the break-up of the BNRC on 1 January 2005. In so far as the Railway Infrastructure Fund – which retains the infrastructure as it stood on 31 December 2004 plus the associated debt – comes under general government in the statistical definition, that reorganisation will increase the consolidated gross debt by 7.4 billion euro, or 2.5 p.c. of GDP. In 2006, the pace of debt ratio reduction is likely to quicken again, bringing the debt to 90.9 p.c. of GDP by the end of the year.

5. Assessment of the uncertainty surrounding the projections

In Belgium, as throughout the euro area, the main effect of the additional increase in oil prices during the summer, reinforcing the upward trend of the past two years, was to give a direct boost to the inflation rate, but so far without curbing overall activity too severely. It accounts for the upward revision in the inflation forecast for 2005 and 2006 by 0.3 and 0.4 point respectively compared to the spring projections, and the smaller adjustment to the GDP growth prediction, down by 0.2 point in 2006. Since then, oil prices have dropped in October and November 2005, but the developments on the international oil markets still represent a major source of uncertainty for both prices and growth.

The current account imbalances recorded for a number of years now deteriorated recently, heightening the risk of erratic or sudden movements in exchange rates and long-term interest rates, which could cause severe disruption to the international environment, the main source of growth for the euro area. Moreover, the strengthening of exports and investment in the euro area as a whole from the second half of 2005, and the subsequent growth of consumption and employment, have yet to be confirmed. The marked slowdown in exports and GDP growth in Belgium at the beginning of 2005 showed that the country's economy is still heavily dependent on the European economic situation. Under some circumstances, Belgium could see a more robust recovery, but only if it maintains a satisfactory competitive position in relation to its partners.

The forecasts published recently by the NAI and the international institutions indicate GDP growth comparable to the Bank's figures. The inflation figures are more divergent, reflecting both differences in the concepts used – the national consumer price index, presented in the NAI's economic budget, being more sensitive to the effects of energy price rises than the harmonised index – and the volatility of the assumptions relating to oil prices, depending on the date on which they are adopted.

TABLE 4 COMPARISON OF THE FORECASTS FOR BELGIUM

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

	Real GDP (1)		Inflation (2)		Budget balance (3)		Date of publication
	2005	2006	2005	2006	2005	2006	
NBB – Autumn 2005	1.4	2.2	2.5	2.3	0.0	–0.4	December 2005
p.m. Spring 2005	*1.4*	*2.4*	*2.2*	*1.9*	*–0.4*	*–1.3*	*June 2005*
NAI	1.4	2.2	3.0	2.9	–	–	October 2005
EC	1.4	2.1	2.7	2.6	0.0	–0.3	November 2005
OECD	1.4	2.0	2.6	2.4	0.0	–0.4	November 2005

(1) The Bank's forecasts, and in principle those of the NAI and the OECD, are produced without adjustment for calendar effects. As a rule, the EC forecasts do allow for those effects.
(2) HICP, except for NAI: national consumer price index.
(3) Percentages of GDP.

Annex

PROJECTIONS FOR THE BELGIAN ECONOMY: SUMMARY OF THE 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	1.5	0.9	2.4	1.4	2.2
Contributions to growth:					
Domestic expenditures, excluding change in stocks	0.6	1.0	2.0	2.8	1.4
Net exports of goods and services	0.7	0.0	–0.3	–0.9	0.7
Change in stocks	0.1	–0.1	0.7	–0.4	0.1
Prices and costs					
Harmonised index of consumer prices	1.6	1.5	1.9	2.5	2.3
Health index	1.8	1.5	1.6	2.1	2.1
GDP deflator	1.8	1.7	2.3	2.3	2.4
Terms of trade	0.7	–0.1	–0.5	–0.2	0.2
Unit labour costs in the private sector	1.4	0.2	0.0	1.7	0.9
Hourly labour costs in the private sector	4.4	1.6	2.1	2.3	2.8
Hourly productivity in the private sector	3.0	1.4	2.1	0.6	1.9
Labour market					
Domestic employment (annual average change, in thousands of units)	–6.3	–3.3	23.5	30.4	20.5
Harmonised unemployment rate (1) (p.c. of the labour force)	7.3	8.0	7.9	8.4	8.4
Incomes					
Real disposable income of individuals	0.2	–1.0	–0.2	0.6	1.8
Savings ratio of individuals (p.c. of disposable income)	15.8	14.3	12.8	12.3	12.5
Public finances					
Primary balance (p.c. of GDP)	5.7	5.4	4.8	4.4	3.7
General government financing requirement (–) or capacity (p.c. of GDP) (2)	0.0	0.1	0.0	0.0	–0.4
Public debt (p.c. of GDP)	103.2	98.5	94.7	94.2	90.9
Current account (p.c. of GDP according to the balance of payments)	**4.6**	**4.1**	**3.3**	**1.8**	**3.2**

Sources: EC, NAI, NSI, NBB.
(1) Adjusted series (Eurostat).
(2) According to the methodology used in the framework of the excessive deficit procedure (EDP).