Economic projections for Belgium – autumn 2004

1. Introduction

In the spring of 2004 the macro-economic projections for the euro area, produced as part of the Eurosystem's twice yearly exercise, expected that the recovery in activity which had begun in mid 2003 would gather strength. That recovery would initially be export-driven, supported by the momentum of the global economy and international trade in a favourable context on the financial and commodity markets. In particular, in line with the trend in prices implied in forward contracts, the price of a barrel of Brent crude oil was expected to fall by the second half of 2004, from an average of 37 dollars in the first half year.

In that context, the Bank had predicted that the renewed vigour of activity in Belgium, apparent since the third quarter of 2003, would be sustained in 2004 and 2005 after more than two years in the doldrums. The initial impetus provided by exports was expected to be gradually reinforced by an endogenous strengthening of the economy, via investment and employment. However, the accelerating growth was not expected to fuel inflation in view of the moderating effects exerted by the euro's recent appreciation, the expected decline in oil prices and the relatively weak pressure on production capacity, leading to a restrained rise in labour costs.

Coinciding with the publication of the new euro area projections in the ECB Bulletin dated December 2004, 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.

(1) NBB (2004), " Economic projections for Belgium, 2004-2005 ", Economic Review 2-2004.

For instance, the rise in the oil price persisted after the spring, and the euro appreciated once again at the end of the year. In Belgium, GDP growth was also more robust than expected up to the third quarter of 2004. The new projections also take account of the government budgets available for 2005.

The cut-off date for the projections for Belgium was 19 November 2004.

2. International environment and assumptions

In 2004 the global economy reached the peak of the current business cycle, with real growth attaining almost 5 p.c. The expansion should remain strong in 2005, bordering on the potential growth rate, though it is likely to be lower than in 2004, particularly because of the progressive return towards a neutral economic policy stance. World trade should continue to grow strongly, in line with activity in general.

The high oil prices are also expected to inhibit growth. Owing to buoyant demand, particularly from the United States and China, the low level of stocks, limited production and transport capacities, and uncertainty regarding the continuity of supplies from certain major producers, prices on the international markets continued to rise through the year, reaching a maximum averaging over 49 dollars per barrel of Brent in October 2004. The forward markets now predict that the price will drop back towards a level of around 40 dollars per barrel in two years' time, which is 10 dollars higher than previously forecast, reflecting a gradual return towards an equilibrium price which has itself been revised upwards.

Box 1 – Eurosystem assumptions

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

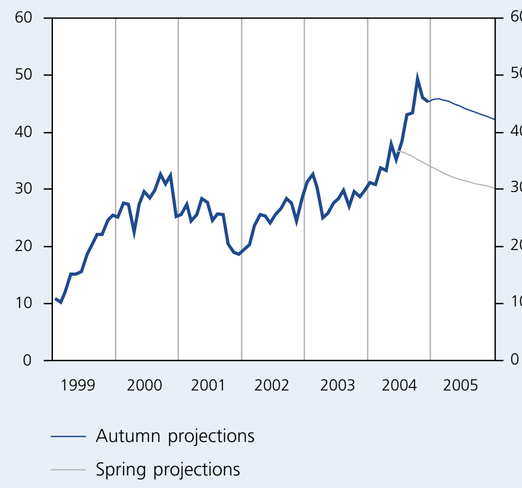
- **short-term interest rates** are set at 2.2 p.c. for the period of the projections;
- **long-term interest rates** in euro are based on market expectations; when the projections were produced, they stood at 4 p.c. and are expected to rise slowly, reaching 4.3 p.c. by the end of 2005;
- **bilateral euro exchange rates** are kept constant at their mid-November value, namely 1.29 dollars to the euro in the case of the US currency;
- in line with the trend in prices implied in forward contracts, **world oil prices** are expected to fall slowly during the period covered by the projections, from the level of over 49 dollars per barrel reached in October 2004. On average over the year, the price per barrel of Brent is likely to come to 39 dollars in 2004 and 44.4 dollars in 2005, against 28.9 dollars in 2003;
- **Belgium's export markets**, measured as the weighted sum of imports from third countries, including the euro area partners, are predicted to expand by around 7 p.c. in 2004 and 2005;
- while the euro's appreciation had a major impact on **competitors' prices** in 2003, that effect should moderate during the period under consideration. In annual average terms, competitors' prices are assumed to continue falling by 1.7 p.c. in 2004, becoming steady in 2005;
- the results for **public finances** take account of the macroeconomic environment and of the budget measures already announced and sufficiently outlined.

EUROSYSTEM PROJECTIONS: RESULTS AND ASSUMPTIONS

	2003	2004	2005
Projections for the euro area		*(Annual averages)*	
GDP in volume	0.5	1.6 – 2.0	1.4 – 2.4
Inflation (HICP)	2.1	2.1 – 2.3	1.5 – 2.5
Eurosystem assumptions			
Three-month interbank rates in euro	2.3	2.1	2.2
Ten-year bond yields	4.2	4.2	4.2
Euro exchange rate against the US dollar	1.13	1.24	1.29
Oil price (US dollars per barrel)	28.9	39.0	44.4
		(Percentage changes)	
Export markets relevant to Belgium	2.9	7.1	7.1
Competitors' export prices	–6.1	–1.7	0.2
of which: Competitors in the euro area	–0.1	0.4	0.5

Source: ECB.

CHART 1 PRICE OF CRUDE OIL
(Monthly averages – barrel of Brent in dollar)



Source : ECB.

The impact of the higher oil prices on economic activity in the euro area appears to have been less significant than the effects of the dynamism of external demand in the first half of the year. According to the new Eurosystem projections, GDP growth in 2004 would be slightly higher than predicted in June, at between 1.6 and 2 p.c., following a rise of just 0.5 p.c. in 2003. Growth is expected to accelerate only slightly in 2005, reaching between 1.4 and 2.4 p.c., but will be more strongly supported by domestic demand. Inflation in terms of the overall HICP is likely to range between 2.1 and 2.3 p.c. in 2004 and between 1.5 and 2.5 p.c. in 2005. The energy component is expected to account for much of the rise in the HICP in 2004 and early 2005. After that, inflation should subside.

3. Activity, employment and demand

In Belgium, too, the marked revival in business activity which began in 2003 continued unabated for much of 2004. According to the NAI estimates, which go up to the third quarter, real GDP grew at a rate of 0.75 p.c. per quarter from mid 2003. Year-on-year growth came to 3 p.c. in the third quarter of 2004, the largest annual increase in four years. This acceleration was also more sustained than expected, as GDP growth was slightly but systematically higher than predicted in successive quarters, owing to upward adjustments to the national accounts data and new observations which were better than forecast.

GDP growth should continue durably at a robust rate, though below that of the past few quarters. In the short term, the recent results of the business surveys – the main source of information for assessing developments in activity in real time – indicate a dip in the upward trend which had been sustained until the summer. In more fundamental terms, the composition of economic growth should become more balanced in 2004 and 2005, particularly in view of the increase in employment and investment, whereas at the end of 2003 the marked revival in economic activity had been driven by accelerating exports and substantial stock building.

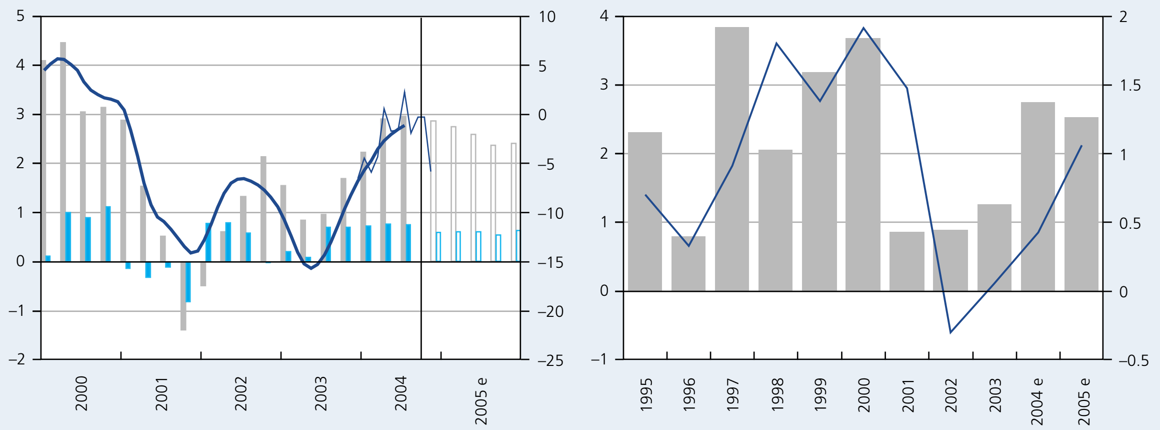
Overall, economic growth looks set to rise from 1.3 p.c. in 2003 to 2.7 p.c. in 2004, representing a 0.4 percentage point revision for this year compared to the spring projections. Growth is expected to reach 2.5 p.c. in 2005, once again outpacing that in the euro area.

The strengthening of activity should generate an expansion in private sector employment, running at only 0.4 p.c. in 2004 but rising to 1.2 p.c. in 2005. The rate of increase in productivity per person should therefore come to 1.1 p.c. in 2005, after substantial gains in 2004 reflecting the absorption of the labour reserves which accumulated in firms at the time of the cyclical downturn, despite a decline in employment of around 1 p.c. over the preceding two years as a whole. If a small increase in the public sector workforce is also taken into account, net job creation comes to around 62,000 jobs for the period 2004-2005 as a whole. In view of the increase in the labour force, due to the rise in the population of working age and in the activity rate, job creation should cause the unemployment rate to stabilise at an average of 7.8 p.c. in 2004 and 2005, against 8 p.c. in 2003.

The rise in employment will be the main factor contributing to the increase in household disposable incomes in 2005. The favourable movement in non-labour incomes – connected with the rise in business operating surpluses – will also contribute to the increase, either directly in the case of self-employed persons or indirectly via profit distributions in the case of companies. Thus, private consumption should rise at a steady 2.2 p.c. in 2004 and 2005, comparable to the 2003 figure, but this growth would be due mainly to the acceleration in purchasing power, as the savings ratio will be stable at 14.2 p.c. of disposable income in 2005, after a cumulative decline of more than 2 points in the preceding two years. The contribution made to growth by private consumption will probably remain substantial, partly explaining why the Belgian economy has outperformed the euro area average of late. This performance is largely

CHART 2 GDP, BUSINESS SURVEY INDICATOR AND EMPLOYMENT

(Seasonally adjusted data)



GDP at constant prices (left-hand scale) (1)

Percentage changes compared to the corresponding quarter of the previous year

Percentage changes compared to the previous quarter

Overall synthetic curve (right-hand scale)

Smoothed series

Gross series

Percentage changes compared to the previous year

GDP at constant prices (left-hand scale) (1)

Total domestic employment in persons (right-hand scale)

Sources : NAI, NBB.

(1) Calendar adjusted data.

based on stable, balanced fundamentals which provide support for household expectations. Public consumption is also likely to be more dynamic in Belgium : real growth of 3.5 p.c. is expected in 2004, due mainly to the rise in expenditure on health; an increase of 1.6 p.c. is predicted for 2005.

Following a substantial fall in 2002 and 2003, the signs of a fragile recovery in business investment appeared at the beginning of 2004. In parallel with the improvement in employment, this should accelerate during the period covered by the projections, bolstered mainly by the steady growth of both demand and profitability. In all, business investment is forecast to increase by 3.5 p.c. in 2004 and 4.9 p.c. in 2005, or 2.9 and 4.7 p.c. respectively if the purchase of public buildings is excluded. Despite the latter transactions, public investment is likely to remain strong in the run-up to the local elections. Investments by individuals in housing are expected to accelerate in 2005 in parallel with the rise in household disposable incomes.

According to the Eurosystem assumptions, Belgium should see external demand increase at a sustained rate in 2004 and 2005. Real export growth is therefore expected to speed up, rising from 1.7 p.c. in 2003 to 3.8 p.c. in 2004 and 5.4 p.c. in 2005, as the negative effects on competitiveness of the euro's past appreciation ebb away. Imports are expected to rise at much the same rate as exports in 2005, whereas they had outstripped export growth in 2003 and early 2004. This means that net exports should make a small positive contribution to growth once again in 2005, in contrast to the change in stocks, following the substantial stock building recorded at the beginning of the economic upswing. Changes in stocks were also among the reasons why growth in Belgium outpaced that for the euro area as a whole.

TABLE 1 **GDP, EMPLOYMENT AND MAIN CATEGORIES OF EXPENDITURE**

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

	2002 [3]	2003	2004 e	2005 e
GDP [1]	0.9	1.3	2.7	2.5
Total domestic employment in persons	–0.3	0.1	0.4	1.1
Categories of expenditure [1]				
Final consumption expenditure of individuals	0.3	2.2	2.2	2.2
Final consumption expenditure of general government	2.3	2.7	3.5	1.6
Gross fixed capital formation	–3.4	–0.6	3.2	4.7
Housing	–3.3	2.6	1.0	2.6
General government	–0.6	1.0	6.6	8.9
Enterprises	–3.8	–1.9	3.5	4.9
Change in stocks [2]	0.7	–0.1	0.5	–0.1
Total domestic expenditure	0.6	1.6	3.2	2.5
Net exports of goods and services [2]	0.3	–0.3	–0.4	0.1
Exports of goods and services	1.3	1.7	3.8	5.4
Imports of goods and services	1.0	2.1	4.4	5.5

Sources : NAI, NBB.
(1) At 2000 prices.
(2) Contribution to the change in GDP.
(3) These figures are influenced by the reclassification of the public broadcasting companies from the non-financial corporations sector to the general government sector. Without that operation, final consumption expenditure of individuals increased by 0.8 p.c. in 2002, that of general government increased by 1.7 p.c., gross fixed capital formation of enterprises and general government were down by –3.7 p.c. and –1.5 p.c. respectively, and domestic expenditure and GDP were up by 0.8 p.c. and 1.0 p.c. respectively.

4. Prices and costs

The pattern of inflation in 2004 and 2005 mainly reflects the recent rises in crude oil prices and the modest fall expected in 2005. Measured by the HICP, inflation gathered speed, rising from 1 p.c. in March 2004 to 2.7 p.c. in October. After a temporary dip, it should return to that level in the initial months of 2005 before subsiding to around 2 p.c. towards the end of the year. Overall, inflation is expected to average 1.9 p.c. in 2004 and 2.2 p.c. in 2005, figures which are respectively 0.1 and 0.5 point higher than in the spring projections. This revision is due mainly to the higher level of oil prices.

Primarily administrative price changes are also expected to add to the accelerating inflation, their contribution rising from 0.1 point in 2004 to 0.2 point in 2005. This effect is slightly greater than was predicted in the spring, owing to increases in indirect taxes introduced in the 2005 budget.

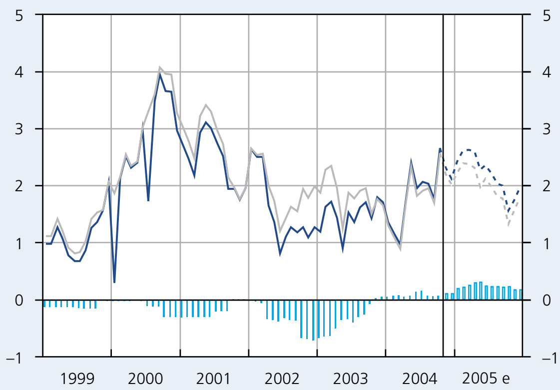
Leaving aside primarily administrative price changes, and changes in the prices of energy and unprocessed food, for which the favourable effect of the mild weather in 2004 is expected to fade away, the underlying inflation rate should average 1.5 p.c. in 2004 and 1.4 p.c. in 2005, against 2 p.c. in 2003. Apart from the indirect effects which more expensive commodities are likely to exert on the selling prices of processed products or certain services, inflationary pressure should remain moderate as far as both imports and domestic costs are concerned, at least in the absence of any second round effects via wages in Belgium and in the euro area.

As in the preceding two years, the rise in unit labour costs in the private sector should remain modest during the period covered by the forecasts, averaging around 0.5 p.c. Apart from the steep rise in productivity in 2004, a movement which is generally observed at the beginning of phases of accelerating activity and which is likely to diminish during 2005, this development is expected to come from relatively low increases in hourly labour costs, in the order of 2.5 p.c. per annum from 2003 to 2005. The 2.3 p.c. rise in hourly costs assumed for 2005 corresponds

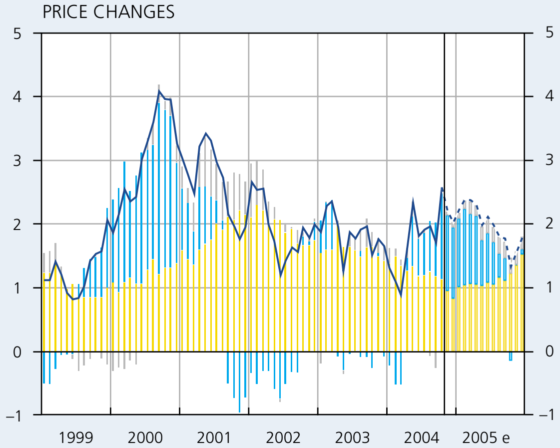
CHART 3 INFLATION: ANALYTICAL BREAKDOWN

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

IMPACT OF PRIMARILY ADMINISTRATIVE PRICE CHANGES



INFLATION EXCLUDING PRIMARILY ADMINISTRATIVE PRICE CHANGES



Sources: EC, NBB.

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

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

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

to a technical assumption based – as specified by the law of 1996 on employment promotion and the preventive safeguarding of competitiveness – on the average movement in labour costs expected in the three neighbouring countries, and therefore does not in any way anticipate the outcome of the current round of pay talks.

5. Public finances

The autumn projections, like those of the spring, indicate a budget deficit of 0.3 p.c. of GDP for general government in 2004, at least if no further measures are taken at the end of the year. The upward and downward revisions to public revenues and expenditure in relation to the spring forecasts almost entirely cancel one another out. On the revenue side, it looks as if tax receipts will significantly exceed expectations. This mainly concerns corporation tax revenues and to a lesser extent VAT and other indirect taxes which have grown relatively strongly in the first three quarters of 2004. Besides, the government has downgraded the amount which it expects to receive from the one-off declaration of financial assets, so that the original estimate of 850 million euro taken as a technical assumption in the spring forecasts has been reduced to a range of 200 to 300 million euro. This adjustment is only partly offset by the non-recurring capital transfer totalling 175 million euro made by Belgocontrol in exchange for the government's assumption of the company's pension liabilities. On the expenditure side, the cost of health care was considerably higher than expected during the first half year, and an over-run of slightly more than 625 million euro is predicted for the 2004 health budget. On the other hand, the economy measures introduced by certain communities and regions in the autumn are having a favourable impact: in addition to one-off sales of property, these measures concern structural reductions in expenditure.

The projection for the budget balance in 2005 has been upgraded sharply in comparison with the spring estimate, which was still predicting a deficit of 1 p.c. of GDP. One of the main reasons is the allowance made for the 2005 budgets drawn up in the autumn. Thus, the federal government has implemented various consolidation measures. As regards structural measures, this mainly concerns the introduction of a general tax on company cars, an increase in the tax on drinks in non-returnable packaging and in some other minor taxes, and finally, tougher measures to combat the evasion of taxes and social security contributions. The government's estimate of the proceeds from this last measure was taken as a technical assumption in the autumn forecasts. In addition, there will be new non-recurring measures such as sales of additional buildings which should bring in 485 million euro for the government, and the securitisation and sale of certain tax arrears, which should raise 300 million euro. Account was also taken of a one-off capital transfer totalling 150 million euro made by BIAC in exchange for the government's assumption of the company's pension liabilities. Overall, the projections currently point to a government deficit of 0.4 p.c. of

TABLE 2 PRICE AND COST INDICATORS

(Percentage changes compared to the previous year)

	2002	2003	2004 e	2005 e
Total HICP	1.6	1.5	1.9	2.2
of which : Energy products	–3.6	0.2	6.9	7.5
GDP deflator	1.8	2.0	2.0	2.2
Labour costs in the private sector				
Unit labour costs	1.7	1.0	–0.1	1.1
Hourly labour costs	4.2	2.7	2.6	2.3 (1)

Sources : NAI, NBB.
(1) Technical assumption based on the average movement in labour costs expected in the three neighbouring countries.

GDP in 2005, corresponding to a structural deficit of 0.5 p.c. of GDP.

The deviation from the balanced budget announced by the government for 2005 is due to various factors. Thus, unlike the budget, the Eurosystem projections cannot yet take account of any proceeds from the harmonisation of taxation on savings in the EU, as there is still uncertainty over the entry into force of the framework legislation and its immediate effect on tax revenues. It is also assumed that the overspending of the 2004 health budget will not be entirely offset next year, so that the projection for that expenditure is higher than in the budget for 2005. Finally, the budget is based on a slightly more favourable estimate of the macroeconomic environment. The growth of activity is a little stronger than the figure in the Bank's projections (2.5 p.c. against 2.3 p.c. (1)) and the latter are based on a slower rise in the wage bill, which has an adverse effect on public revenues.

The debt ratio, which had already fallen just below the 100 p.c. level at the end of 2003, is likely to continue contracting to around 95.3 p.c. in 2005. However, the reduction in the debt will slow down to some extent when the current BNRC is broken up on 1 January 2005.

(1) The GDP growth rate of 2.3 p.c. taken into account in producing the forecasts for public finances for 2005 was obtained by allowing for a calendar effect of –0.25 percentage point in the growth of 2.5 p.c. explained elsewhere in the article. This last growth figure is the outcome of changes predicted solely on the basis of economic developments, connected in particular with cyclical or trend movements. The calendar effect is negative in 2005 because the year is one day shorter than 2004 and comprises 53 Saturdays. Allowance for this effect is made in order to conform to the method of compiling the government accounts used in the national accounts, and therefore to anticipate their results as accurately as possible.

TABLE 3 GENERAL GOVERNMENT ACCOUNT

(Percentages of GDP)

	2002	2003	2004 e	2005 e
Revenue	50.3	51.3	49.4	49.2
Primary expenditure	44.2	45.6	44.8	45.0
Primary balance	6.1	5.7	4.6	4.2
p.m. Structural primary balance	*6.0*	*4.5*	*4.2*	*4.0*
Interest charges	6.0	5.4	4.8	4.5
Financing requirement (–) or capacity	0.1	0.3	–0.3	–0.4
p.m. Structural balance	*–0.1*	*–1.0*	*–0.7*	*–0.5*
Debt	105.4	100.0	96.1	95.3

Sources : NAI, NBB.

The entity which will manage the company's infrastructure and the majority of its debts is most likely to come under the statistical definition of the general government sector, and this will inflate the consolidated gross debt by around 2.5 p.c. of GDP.

6. Assessment of factors creating uncertainty

The Belgian projections for 2004-2005 are dominated by the same determinants as in the spring, namely the consolidation of growth via employment and investment in a context of relatively favourable external demand, with inflationary pressures under control, apart from the rise in energy prices. The possibility of a stronger than expected recovery, which had been mentioned in the spring projections, has materialised in Belgium, and to a lesser extent in the euro area. The further oil price rises since the spring, also mentioned as a factor of uncertainty, were mainly confined to the energy component of inflation and appear to have had little effect on activity and consumer demand in the short term. These factors explain why growth in 2004 has been upgraded from 2.3 to 2.7 p.c. and why inflation has been revised upwards from 1.7 to 2.2 p.c. in 2005.

However, it must be remembered that the results presented here are based on the information available when the projections were produced, and on the assumptions adopted. Experience has shown that rapid and substantial changes to the general context can sometimes occur, and that could yet give rise to significant revisions for 2004, and especially for 2005.

Developments on the international oil markets are still a major source of uncertainty. If prices are maintained at high levels, that could threaten the vigour of the global economy and international trade. The high oil price could also fuel inflation, particularly if it were to trigger wage increases. However, there is still a possibility that prices could fall sooner than predicted.

The international environment could also be affected by turbulence or sudden changes affecting exchange rates and long-term interest rates in a context of large current account imbalances, or by an abrupt slowdown in the economies where growth has been particularly dynamic in recent years, especially China. Moreover, the expected expansion in employment, consumption and investment throughout the euro area has yet to be confirmed.

Underpinned by consumption, the Belgian economy has demonstrated greater resilience than the euro area since the beginning of 2002, and the growth predicted for 2004 and 2005 is also higher. However, it is not likely that any significant differential will be maintained in the medium term, as Belgium is still subject to the vagaries of international business activity and faces a situation which is comparable overall to that of the neighbouring countries in terms of potential growth.

TABLE 4 COMPARISON OF THE FORECASTS FOR BELGIUM
(Percentage changes compared to the previous year)

	Real GDP (1)		Inflation (2)		Publication date
	2004	2005	2004	2005	
NBB – Autumn 2004	2.7	2.5	1.9	2.2	December 2004
p.m. Spring 2004	*2.3*	*2.6*	*1.8*	*1.7*	*June 2004*
NAI	2.4	2.5	1.6	2.1	October 2004
IMF	2.5	2.3	1.8	1.6	September 2004
EC	2.5	2.5	2.0	1.9	October 2004
OECD	2.7	2.4	1.8	2.0	November 2004
Belgian Prime News (3)	2.5	2.5	1.9	1.8	September 2004

(1) The Bank's forecasts, and in principle those of the NAI and the OECD, are produced with adjustment for calendar effects. As a rule, the IMF and EC forecasts do allow for those effects. For Belgian Prime News, the treatment varies according to the institutions taking part.
(2) HICP, except for NAI : national consumer price index.
(3) Average of the forecasts of institutions taking part.

Compared to the forecasts published recently by the NAI and the international institutions, the Bank's projections differ by indicating slightly more sustained GDP growth, principally in 2004, and stronger inflation in 2005. These differences are due chiefly to the available information on Belgium's national accounts and the oil price assumptions made when the various forecasts were produced.

Annex 1

PROJECTIONS FOR THE BELGIAN ECONOMY : SUMMARY OF THE MAIN RESULTS

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

	2001	2002	2003	2004 e	2005 e
Growth (calendar adjusted data)					
GDP at 2000 prices	0.9	0.9	1.3	2.7	2.5
Contributions to growth :					
Domestic expenditure, excluding change in stocks	1.1	–0.1	1.6	2.6	2.5
Net exports of goods and services	0.6	0.3	–0.3	–0.4	0.1
Change in stocks	–0.9	0.7	–0.1	0.5	–0.1
Prices and costs					
Harmonised index of consumer prices	2.4	1.6	1.5	1.9	2.2
Health index	2.7	1.8	1.5	1.6	2.0
GDP deflator	1.8	1.8	2.0	2.0	2.2
Terms of trade	0.1	1.0	–0.1	–0.5	0.1
Unit labour costs in the private sector	4.8	1.7	1.0	–0.1	1.1
Hourly labour costs in the private sector	3.9	4.2	2.7	2.6	2.3 (1)
Hourly productivity in the private sector	–0.9	2.4	1.6	2.7	1.2
Labour market					
Domestic employment (annual average change, thousands of units)	60.5	–12.3	2.3	17.2	45.1
Harmonised unemployment rate (p.c. of labour force)	6.7	7.3	8.0	7.8	7.8
Incomes					
Real disposable income of individuals	2.7	0.1	1.1	0.9	1.8
Savings ratio of individuals (p.c. of disposable income)	16.3	16.6	15.5	14.3	14.2
Public finances					
Primary balance (p.c. of GDP)	7.2	6.1	5.7	4.6	4.2
General government financing requirement (–) or capacity (p.c. of GDP)	0.6	0.1	0.3	–0.3	–0.4
Public debt (p.c. of GDP)	108.0	105.4	100.0	96.1	95.3
Current account (p.c. of GDP according to balance of payments)	3.9	5.7	4.2	3.9	3.6

Sources : EC, NAI, NSI, NBB.

(1) Technical assumption based on the average movement in labour costs expected in the three neighbouring countries.