Economic projections for Belgium – Autumn 2008

Introduction

Since the end of the summer of 2008, the economic outlook for the next 18 to 24 months has deteriorated very rapidly, both worldwide and for the euro area and Belgium. The financial tensions which emerged in mid 2007 developed into a financial crisis which was exceptionally serious in its scale, duration and geographical spread, and in the diversity and size of the financial players involved. The effects of contagion on the real economy multiplied and became significantly more severe, halting the growth of activity in most of the advanced economies and causing commodity prices to plummet. As the financial shocks are having an impact via various channels – tighter credit conditions, falling stock markets and capital losses, slackening global demand and deteriorating confidence – on households, non-financial corporations and credit institutions alike, and the absorption of these shocks generally has a prolonged effect on activity and demand, the weakness of economic activity is likely to persist for several quarters.

The Eurosystem therefore updated its biannual projections in a context in which the most negative risks identified six months earlier at the time of the previous exercise had largely materialised. According to the results for the euro area published in the ECB's December 2008 Monthly Bulletin, there will be negative activity growth in 2009 while inflation is projected to decline as a result of both the fall in oil prices and the sharp slowdown in activity. Although the uncertainty inherent in any forecasting exercise is particularly great in the present situation, the risks are still tending towards a sharper downturn in activity.

In the first three quarters of 2008, the deceleration in GDP growth in Belgium was not as marked as in the major European countries. However, towards the end of the year and in 2009, activity is likely to be affected by the deteriorating conditions. This context makes it probable that the decline in inflation which began in August 2008 will continue. Coinciding with the publication of new projections for the euro area, this article offers a brief update of the results for the Belgian economy [1]. Compiled as part of the joint Eurosystem exercise, these results incorporate the information available on 20 November 2008. As is usual in the case of public finances, these projections take account only of measures formally approved by the authorities, particularly for the 2009 federal budget, on which sufficient detail is available.

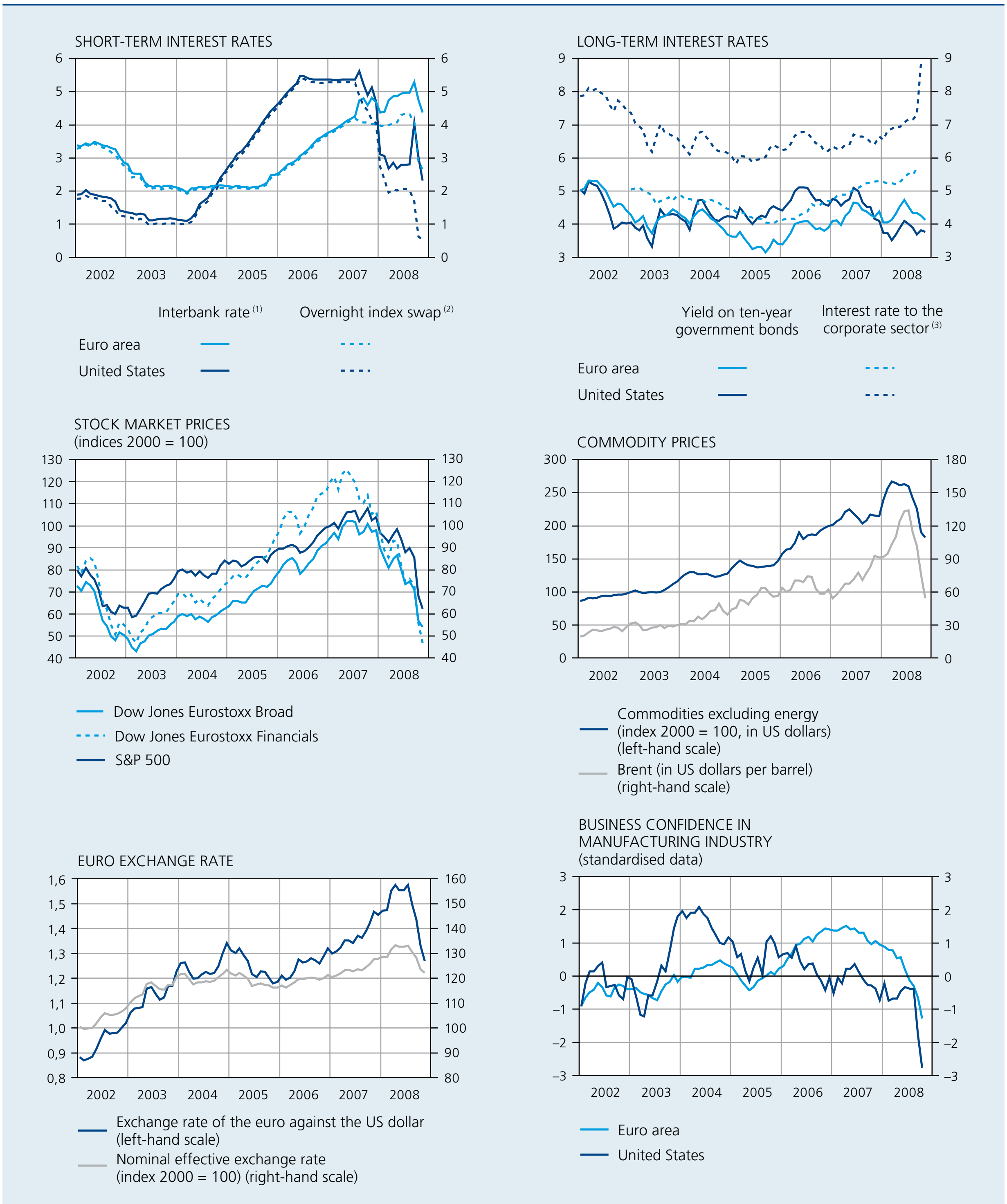
1. International environment and assumptions

For more than a year, the advanced economies of Europe and North America had already been in a cyclical slowdown phase when in mid September 2008 the financial crisis suddenly worsened. Despite action by governments and monetary authorities seeking to restore confidence in the financial institutions, risk aversion on the financial and capital markets became much more acute. In consequence, the fall in stock market prices – down by 25 p.c. in Europe between July 2007 and August 2008 – accelerated strongly, reaching a total of 45 p.c. in mid November. The widening of interest rate margins which had begun a year earlier also intensified significantly. This loss of confidence spread very rapidly, affecting not only the money market but also government bonds – particularly those of emerging countries – and corporate bonds.

(1) The previous version of the economic projections for 2008 and 2009 was presented in more detail in the spring, in the June 2008 issue of the Bank's Economic Review.

CHART 1 DEVELOPMENTS ON THE FINANCIAL, PROPERTY AND COMMODITY MARKETS

(monthly averages)



Sources : Bloomberg, EC, ECB, Federal Reserve, ISM, Standard & Poor’s.

(1) Interest rate on non-collateralised three-month interbank deposits (Euribor for the euro area, Libor for the United States).

(2) Fixed rate paid to the party receiving the variable rate (Eonia for the euro area, actual federal funds rate for the US), in a three-month interest rate swap.

(3) For the euro area, rates on bank loans to non-financial corporations (MIR survey); for the United States, yield on corporate bonds with a BAA rating (Moody’s).

The financial market developments seriously depressed the economic outlook, while they in turn were fuelled by the deterioration in the economic environment. Thus, business and consumer confidence indicators, which had been falling since 2007, virtually collapsed from September 2008, in both the United States and the euro area. Foreign trade has also lost much of its dynamism in recent months. In this context, the stagnation or decline in activity seen in the advanced economies during 2008 is set to continue for several more quarters. Mainly owing to the effect of international trade, the economic slowdown is also spreading to the emerging economies, whereas they had acted as an engine of growth since the beginning of the millennium. Some of those countries are also seriously affected by the drying up of capital inflows in the form of direct investment or loans, while commodity producers are being hit by the slump in prices on the international markets.

The deteriorating global demand outlook has reversed the trend in commodity prices. Thus, having doubled between the end of 2003 and the end of 2006, and risen further by 2.5 times in 2007 and early 2008 to peak at 145 dollars per barrel of Brent in mid July, oil prices plummeted to well below 60 dollars in mid November, thus wiping out the increase recorded since the beginning of 2007. The pattern was similar for other commodities. The euro's depreciation against the dollar by almost 20 p.c. between April and mid November 2008, following an almost constant appreciation since 2002, mitigated the fall in commodity prices to some extent.

Taking account of the easing of the inflationary pressure resulting from commodity price movements and the sharp deceleration in activity, the central banks of the leading economies have considerably relaxed their monetary policy stance since the summer of 2008, including via a coordinated reduction in the key interest rates. In the United States, the Federal Reserve continued the process of reducing the target federal funds rate which it had initiated in September 2007, cutting it to 1 p.c. The Bank of England slashed its key rate by 200 basis points to 3 p.c., while the ECB Governing Council reduced the rate of the main refinancing operations in two stages by a total of 100 basis points. When the forecasts were concluded, that rate stood at 3.25 p.c. [1].

The recent movement in commodity prices and exchange rates and the easing of monetary policy should be viewed in the context of the sharp deterioration in the economic climate, and will only have a gradual effect in bolstering activity and demand. In the current circumstances, the restructuring of the financial sector – via a reduction in debt levels and recapitalisation of banking institutions – and the evaporation of business and consumer confidence are likely to depress the economic outlook for quite some time.

Thus, the IMF now expects the leading advanced economies to see a contraction in GDP around the end of 2008 and in early 2009, and a very modest growth revival in the second half of 2009; this is a scenario on which most forecasters agree. For countries outside the euro area, the volume change in GDP is projected to be negative in 2009 in the United States and the United Kingdom, with falls of 0.7 and 1.3 p.c. respectively. Those economies are particularly hard hit by the property market correction and the credit squeeze. The growth prospects were also downgraded for the emerging economies. They are still robust in China and India, but the adjustment was sharper for Brazil and Russia, owing to the slump in income from commodities and the drying-up of the capital markets. The financial crisis is also spreading its contagion to some exposed European economies outside the euro area.

Overall, the volume growth of global GDP is set to slow from 5 p.c. in 2007 to 3.7 p.c. in 2008 and 2.2 p.c. in 2009, the weakest growth since 1993. A corresponding slowdown in world trade is also forecast, with expansion of only 2.1 p.c. in 2009.

In view of the sluggishness of the global economy and the tighter financing conditions, the euro area is also expected to experience a period of generally feeble growth up to the end of 2009. The decline in GDP seen in the second and third quarters of 2008 is likely to persist until the beginning of next year, giving way to a fragile recovery.

All components of demand are likely to contribute to the weakening of activity. Externally, export growth will suffer as a result of the lack of dynamism in world trade. In the euro area, corporate investment is set to fall in 2009 owing to the weakness of demand, the erosion of profit margins and the rising financing cost. Investment in housing is projected to maintain the decline which began in 2008, owing to the downturn in the property market in a number of countries. Finally, having been curbed by the recent surge in inflation, private consumption is expected to feel the effect on household disposable income of the deterioration in the labour market, which will be reflected, in particular, in higher unemployment in 2008 and 2009. Moreover, the decline in the value of financial assets and – in certain countries – property, plus the general climate of uncertainty will also depress household spending in 2009.

(1) On 4 December 2008, at its meeting in Brussels, the Governing Council reduced the key rate to 2.5 p.c.

TABLE 1 GDP GROWTH FORECASTS FOR THE MAIN ECONOMIC AREAS

(percentage changes compared to the previous year, in volume)

	2007	2008	2009	*p.m. 2009 Projections April 2008*
	Actual	Projections		
World	5.0	3.7	2.2	*3.8*
of which:				
United States	2.0	1.4	–0.7	*0.6*
Japan	2.1	0.5	–0.2	*1.5*
United Kingdom	3.0	0.8	–1.3	*1.6*
China	11.9	9.7	8.5	*9.5*
India	9.3	7.8	6.3	*8.0*
Russia	8.1	6.8	3.5	*6.3*
Brazil	5.4	5.2	3.0	*3.7*
p.m. World trade	*7.2*	*4.6*	*2.1*	5.8

Source: IMF (World Economic Outlook – Update, 6 November 2008).

While the vigour of demand and activity had caused inflation to accelerate sharply in 2007 and early 2008, the rapid deterioration in the economic environment is likely to bring an appreciable easing of inflationary pressures. It is primarily fostering a decline in prices of commodities, particularly oil. According to the assumptions used in the Eurosystem projections, in 2009 those prices are expected to rise slightly above the level to which they had dropped by mid November 2008, but – at an average of 67 dollars per barrel – they will still be well below the figures recorded in 2007 and during much of 2008. On the domestic front, the continuing sustained rise in labour costs, caused in particular by the cyclical weakness of productivity gains, will be more than offset by the erosion of corporate profit margins.

All in all, according to the Eurosystem projections, having reached 2.6 p.c. in 2007, GDP growth in the euro area is forecast at between 0.8 and 1.2 p.c. in 2008 and between –1 and 0 p.c. in 2009. Inflation is projected to rise from 2.1 p.c. in 2007 to between 3.2 and 3.4 p.c. in 2008, before subsiding to between 1.1 and 1.7 p.c. in 2009.

TABLE 2 EUROSYSTEM PROJECTIONS

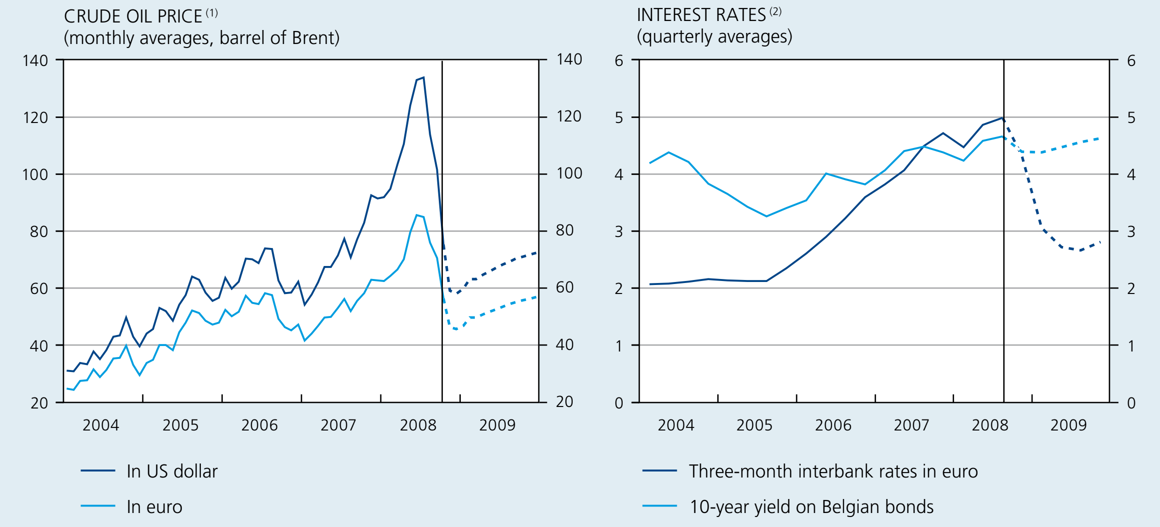
(percentage changes compared to the previous year)

	Euro area			*p.m. Belgium*		
	2007	2008	2009	*2007*	*2008*	*2009*
Inflation (HICP)	2.1	3.2 / 3.4	1.1 / 1.7	*1.8*	*4.6*	*1.9*
GDP in volume	2.6	0.8 / 1.2	–1.0 / 0.0	*2.6*	*1.4*	*–0.2*
of which:						
Private consumption	1.6	0.1 / 0.5	–0.3 / 0.7	*2.0*	*0.8*	*0.0*
Public consumption	2.3	1.9 / 2.3	1.3 / 1.9	*2.3*	*1.8*	*1.8*
Investment	4.2	0.2 / 1.2	–6.0 / –3.0	*6.1*	*4.8*	*–0.9*
Exports	5.9	2.4 / 3.4	–1.4 / 1.0	*3.9*	*2.4*	*–0.1*
Imports	5.4	2.0 / 3.0	–1.9 / 1.1	*4.4*	*4.0*	*0.3*

Sources: ECB, NBB.

Box – Eurosystem assumptions

ASSUMPTIONS CONCERNING THE MOVEMENT IN OIL PRICES AND INTEREST RATES



Source : ECB.
(1) Actual figures up to October 2008, assumption from November 2008.
(2) Actual figures up to the third quarter of 2008, assumption from the fourth quarter of 2008.

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

- The interest rates are based on market expectations. As an annual average, three-month interbank deposit rates in euro are forecast to fall from 4.7 p.c. in 2008 to 2.8 p.c. in 2009. That presupposes some normalisation of the spreads which have developed in relation to the ECB key rate since August 2007. Yields on ten-year Belgian government bonds are projected at 4.5 p.c. in 2008 and 2009. In relation to these benchmark yields, it is also assumed that the cost of financing corporate and household investment will be raised by an additional 75 and 106 basis points respectively.
- Bilateral euro exchange rates are kept constant at their mid November 2008 level, namely 1.27 US dollar to the euro.
- In accordance with the movement in implicit prices reflected in forward contracts, international market prices for a barrel of Brent are expected to average 67.3 dollars in 2009, against 99.9 dollars in 2008.
- The growth of Belgium's export markets in real terms, measured as the weighted total of the volume of imports of the trading partners, including those in the euro area, is likely to decline from 5.4 p.c. in 2007 to 3.2 p.c. in 2008 and 0.8 p.c. in 2009.
- The export prices of euro area competitors are forecast to increase by 2.3 p.c. in 2008 and 1.7 p.c. in 2009.
- As is usual according to the Eurosystem conventions, the figures for public finances take account of the macroeconomic environment and budget measures which have already been announced and have been specified in sufficient detail.

ASSUMPTIONS UNDERLYING THE EUROSYSTEM PROJECTIONS

	2007	2008	2009
		(annual averages)	
Three-month interbank rates in euro	4.3	4.7	2.8
Ten-year bond yields in Belgium	4.3	4.5	4.5
Euro exchange rate against the US dollar	1.37	1.46	1.27
Oil price (US dollar per barrel)	72.7	99.9	67.3
		(percentage changes)	
Export markets relevant to Belgium	5.4	3.2	0.8
Competitors' export prices	0.2	2.4	3.8
of which: competitors on the euro area markets	1.1	2.3	1.7

Source: ECB.

2. Activity, employment and demand

In Belgium, the slowdown in activity which had begun in mid 2007 owing to the weakening of foreign demand was less pronounced than in the euro area. According to the NAI's official estimates, though real quarterly GDP growth was weak, at 0.3 and 0.1 p.c. respectively in the second and third quarters of 2008, it still remained positive, in contrast to what happened in the euro area. In particular, domestic demand remained relatively buoyant at the beginning of the year, the main impetus coming from business investment.

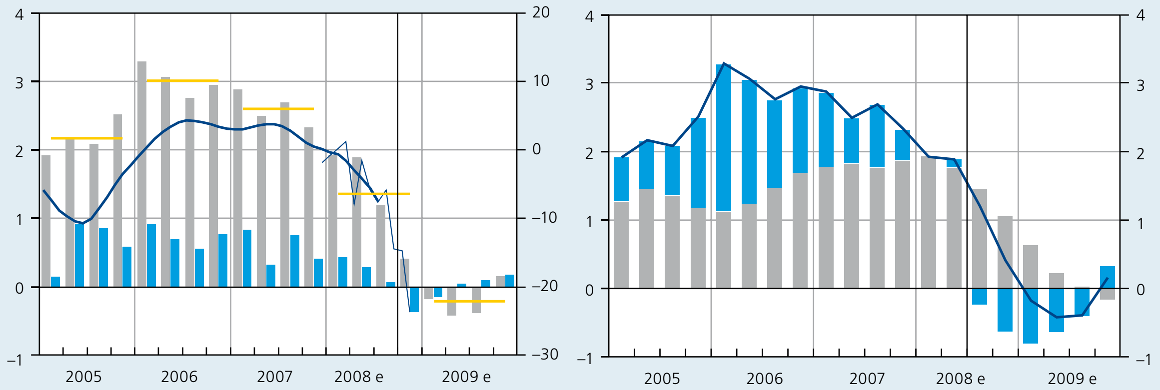
However, the very rapid fall in the business survey indicator and the consumer confidence indicator in recent months has shown that the deterioration in the international economic situation and the worsening financial crisis will have a more widespread impact on the economy. In Belgium as in the euro area, activity is expected to contract towards the end of 2008 and in early 2009, giving way to a very weak recovery in the ensuing quarters. Thus, the annual average rate of volume GDP growth is expected to drop from 2.6 p.c. in 2007 to 1.4 p.c. in 2008 and -0.2 p.c. in 2009.

In this context, net job creation which had been a significant factor supporting the Belgian economy in the last three years is expected to decelerate in 2009, declining from an annual average of over 65,000 between 2005 and 2008 to less than 8,000 in 2009. This figure actually reflects the expansion achieved during 2008 since, according to the projections, the number of persons in work is likely to fall by almost 8,000 units between the fourth quarter of this year and the end of 2009.

Expressed as the percentage change, the annual average growth of domestic employment in persons is forecast to fall from 1.8 p.c. in 2007 to 1.5 p.c. in 2008 and 0.2 p.c. in 2009. In the latter year, employment growth will therefore outpace GDP growth. There are various reasons why employment is less responsive to cyclical fluctuations. First, in some branches of activity, employment is not very sensitive to cyclical movements. That applies, for example, to the health sector and personal services. The service voucher system is also expected to continue expanding in 2009, though at a more modest pace than in previous years. Next, even in sectors which are sensitive to the business cycle, employment exhibits a degree of inertia. The main factor here is the time and cost entailed in making staff redundant, or in recruiting staff during a recovery period. Also, firms begin by adjusting the number of hours worked, especially by cutting overtime or resorting to temporary lay-offs, while maintaining their workforce if possible. Thus, the expected increase in the number of persons in work corresponds to a 0.3 p.c. reduction in the volume of labour in 2009. Apparent productivity per hour worked is set to stagnate in 2008 and in 2009; expressed per worker, it is actually likely to show a slight fall, following an average rise of 1.1 p.c. during the period 2000-2007.

CHART 2 GDP, BUSINESS SURVEY INDICATOR AND EMPLOYMENT

(seasonally adjusted data)



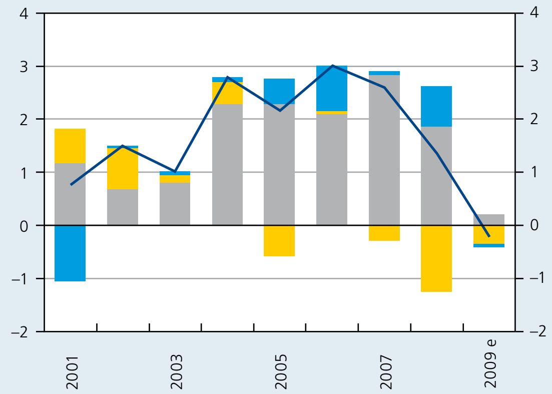
Sources : NAI, NBB.
(1) Calendar adjusted data.

Although the labour force is expected to grow more slowly in 2009 than during the period of sustained activity expansion between 2005 and 2008, that growth will still outstrip the rise in the number of persons in work. Thus, the unemployment rate is forecast to rise from 6.6 p.c. in the fourth quarter of 2008 to 7.1 p.c. in the fourth quarter of 2009, after having recorded a fall of 2.1 percentage points over the four preceding years. As an annual average, the unemployment rate will increase from 6.7 p.c. in 2008 to 6.9 p.c. in 2009.

The repercussions of the global financial crisis are felt via various channels, and ultimately affect all the main expenditure categories. In this way, having been the main engine of GDP growth between 2004 and the first half of 2008, domestic demand will virtually stagnate in 2009. That is likely to reduce demand for imports so that the contribution of net exports to GDP growth should be only slightly negative, in contrast to 2008, though that improvement will not be due to any expansion of exports.

CHART 3 MAIN EXPENDITURE CATEGORIES

(calendar adjusted volume data, contribution to the change in GDP, unless otherwise stated)



Sources : NAI, NBB.
(1) Annual percentage changes.

TABLE 3 GDP, EMPLOYMENT AND MAIN CATEGORIES OF EXPENDITURE

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

	2006	2007	2008 e	2009 e
GDP (1)	3.0	2.6	1.4	–0.2
Total domestic employment in persons	1.4	1.8	1.5	0.2
Total volume of labour (2)	1.5	2.0	1.4	–0.3
Real disposable income	2.5	2.8	–0.3	1.5
Components of expenditure (1)				
Final consumption expenditure of individuals	2.1	2.0	0.8	0.0
Final consumption expenditure of general government	0.1	2.3	1.8	1.8
Gross fixed capital formation	4.8	6.1	4.8	–0.9
Housing	7.9	1.3	0.8	–0.5
Government	–10.6	3.4	–4.4	7.5
Business	5.6	8.5	7.4	–1.9
p.m. Domestic expenditure excluding change in stocks (3)	*2.1*	*2.8*	*1.9*	*0.2*
Change in stocks (3)	0.9	0.1	0.8	–0.1
Net exports of goods and services (3)	0.1	–0.3	–1.3	–0.3
Exports of goods and services	2.7	3.9	2.4	–0.1
Imports of goods and services	2.7	4.4	4.0	0.3

Sources: NAI, NBB.
(1) In volume.
(2) Total number of hours worked in the economy.
(3) Contribution to the change in GDP.

In fact, the volume of exports is set to fall by 0.1 p.c. in 2009, compared to an increase of 2.4 p.c. in 2008. The deterioration in the global economic climate is therefore probably the first channel through which the financial crisis will affect the Belgian economy, via the marked slowdown in foreign demand, taking account of Belgium's very open economy. According to the assumptions used in this exercise, the decelerating expansion of export markets which began in 2008 will become still more marked, since growth will total only 3.2 p.c. this year and 0.8 p.c. in 2009. That is the weakest annual expansion since 1993, well below the average growth of 7.5 p.c. recorded between 2004 and 2007.

Having been curbed in 2008 by the slight fall in real disposable income due mainly to higher inflation, private consumption is not forecast to rise in 2009, mainly owing to the stock market slide and the ensuing rise in the savings ratio. The fall in share prices since the beginning of 2008, amounting to around 45 p.c. in Belgium as in most other European financial centres, has in fact led to a 15 p.c. reduction in the net financial assets of households. Even though the wealth effects have so far been relatively moderate in Belgium, a drop on that scale would depress private consumption for the next two to three years by 1.5 percentage point, as there is no likelihood of any immediate upturn. That effect will largely materialise in 2009, so that, in parallel with stagnating consumption, the savings ratio will rise from 12.7 p.c. in 2008 to 14.3 p.c. in 2009, as households set aside a larger part of their income for the rebuilding of their assets. The sharp deterioration in consumer confidence since September 2008 should be viewed in this context, although it is also a more general reflection of the fear of worsening economic conditions and labour market prospects.

In these bleak circumstances, business investment is forecast to fall by 1.9 p.c. in 2009, following more than four years of vigorous expansion right up to 2008, a year in which investment grew by an estimated 7.4 p.c. In addition to the weakening of demand for exports and consumption, there are similarly cyclical pressures depressing operating margins and hence the internal financing capacity of companies. Furthermore, external finance has also become more expensive owing to both the increase in the rates charged on loans and the higher cost of raising finance by issuing shares or bonds. These developments are also due to the stronger risk aversion caused by the financial crisis.

The widening of interest margins on mortgage loans is contributing to the expected 0.5 p.c. decline in investment in housing in 2009. However, this deceleration was already apparent in 2007, coinciding with a steady easing of price rises on the secondary property market.

3. Prices and costs

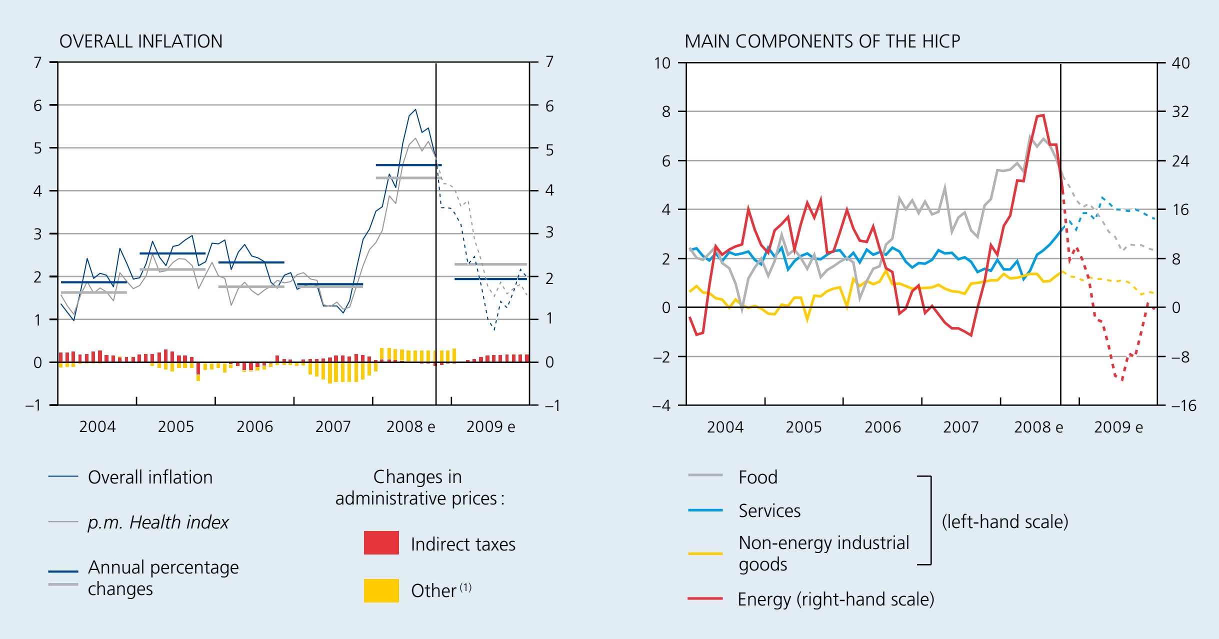
Inflation has eased in Belgium, having risen rapidly from October 2007 and peaked at 5.9 p.c. in July 2008, when it was 1.9 points above the level for the euro area. This fall should continue during the closing months of the year and for much of 2009. Measured by the HICP, overall inflation is thus estimated at an average of 1.9 p.c. in 2009, compared to 4.6 p.c. in 2008. The health index, which is used as the reference for the indexation of wages and social benefits, is expected to increase by 4.3 p.c. in 2008 and 2.3 p.c. in 2009.

Just as the energy and food components of the consumer price index were the source of rising inflation in recent months, they are also the reason for its decline. On the one hand, the basis effects caused by increases in food prices will gradually fade away as commodities are not expected to increase further in price, in contrast to 2007. Also, according to the assumptions used in this exercise, oil prices should remain steady in 2009 at around 67 dollars per barrel, well below the price prevailing for much of 2008. Consumer prices of energy are therefore projected to fall by 3.6 p.c. in 2009, in contrast to the rise of over 20 p.c. recorded in 2008. The rise in electricity and gas distribution and transport charges has also contributed significantly to this increase, whereas the government's decision to raise excise duty by reactivating the ratchet system is expected to have only a limited impact in 2009.

However, the decline in overall inflation is partly offset by the faster increases in service prices. For this component, which represents around 37 p.c. of the consumer price index, inflation went up from 1.5 p.c. in the first five months of 2008 to 3.2 p.c. in October. According to the projections, it is set to average 3.9 p.c. in 2009. A more detailed breakdown shows that various factors are contributing to this rise. First, indirect effects due to energy and food price increases are gradually working their way through in transport, tourism and catering services, for which these products are major inputs. Next, the movement in the prices of certain services such as rents and

CHART 4 INFLATION

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



Sources : EC, NBB.

1 Impact on overall inflation, in percentage points, of price changes connected with measures concerning the radio & television licence fee and changes to network industry tariffs.

TABLE 4 PRICE AND COST INDICATORS
(percentage changes compared to the previous year)

	2006	2007	2008 e	2009 e
Total HICP	2.3	1.8	4.6	1.9
of which: energy products	7.3	0.2	20.6	–3.6
GDP deflator	2.3	2.4	2.2	3.0
Labour costs in the private sector:				
Unit labour costs	1.5	3.1	3.8	3.2
Hourly labour costs	3.1	3.7	3.5	3.3

Sources: EC, NAI, NBB.

some government-regulated charges generally mirror inflation. Finally, and more generally, a fairly widespread acceleration in inflation has been evident since September 2008 for the other service components, possibly on account of the increase in labour costs.

The change in unit labour costs in the private sector is estimated respectively at 3.1 p.c. in 2007, 3.8 p.c. in 2008 and 3.2 p.c. in 2009, compared to an annual average rise of 0.7 p.c. during the period 2002-2006. This steep increase is due both to the fall in labour productivity – already appreciable in 2007, owing to the marked expansion of employment in the private sector, and further reinforced in 2008 and in 2009, as a result of the prolonged weakness of economic activity – and to the continuing sustained rise in hourly labour costs.

The accelerating pace of the increase in hourly labour costs in 2007 and in 2008 occurred in the context of the persistent pressure on certain labour market segments, in the wake of the economic boom. In addition, two temporary factors – namely the earlier payment of the holiday allowance on termination of a contract of employment, and the payment of redundancy allowances in connection with the restructuring of large companies – accentuated the rise in hourly labour costs in 2007, by a total of around 0.6 percentage point. Although these factors have the opposite effect on the movement in labour costs in 2008, that is not enough to offset the greater impact of indexation.

For 2009, the 3.3 p.c. increase in hourly labour costs assumed for the purpose of this exercise essentially corresponds to the expected effect of indexation, which takes some time to react to the 2008 acceleration in inflation measured by the health index. This assumption is in line with that made by the Secretariat of the Central Economic Council, taking account of the adjustment to the outlook for growth and inflation in recent months. It does not in any way anticipate the outcome of the current negotiations between the social partners.

4. Public finances

According to the latest information, public finances are expected to end the year 2008 with a deficit of 0.9 p.c. of GDP. In the macroeconomic context described above, that deficit would reach 1.7 p.c. of GDP in 2009.

These projections take account of the impact of the various measures taken by the government in response to the financial crisis, such as the provision of funds for financial institutions in the form of capital injections or loans, and the provision of guarantees. The funding of these measures by the Belgian government increased the consolidated gross public debt by 6.1 p.c. of GDP. The slightly negative impact of these measures on the overall balance in 2008 is expected to disappear in 2009 since, according to the estimates, revenue from interest, dividends and fees paid for the provision of guarantees will then slightly exceed the additional interest charges payable by the government. However, these numbers disregard the indirect effects of the financial crisis, such as the repercussions on economic activity and the level of interest rates, and it is assumed that no guarantees will be invoked.

Expressed as a percentage of GDP, public revenues are projected to rise from 48.1 p.c. in 2007 to 48.5 in 2008, dropping to 48.3 p.c. in 2009. Nevertheless, in 2008 they will reflect the downward influence of various structural measures, as well as the disappearance of a range of non-recurring measures which had increased revenues in 2007. However, this impact is more than offset by the fact that earned incomes, which are taxed at a relatively higher

TABLE 5 GENERAL GOVERNMENT ACCOUNTS [1]
(percentages of GDP)

	2006	2007	2008 e	2009 e
Revenues	48.7	48.1	48.5	48.3
of which: fiscal and parafiscal revenues	43.8	43.3	43.6	43.1
Primary expenditure	44.4	44.5	45.7	46.3
Primary balance	4.3	3.5	2.8	2.1
Interest charges	3.9	3.8	3.7	3.8
Financing requirement (–) or capacity	0.3	–0.3	–0.9	–1.7
p.m. Effect of non-recurring measures	*0.8*	*–0.2*	*–0.4*	*0.1*
Consolidated gross debt	87.8	83.9	87.8	87.6

Sources: NAI, NBB.
(1) According to the methodology used in the excessive deficit procedure (EDP).

rate, are projected to grow significantly faster than GDP in nominal terms. What is more, owing to the rising inflation, payroll tax will increase faster than earned incomes. In 2009, fiscal and parafiscal revenues are projected to contract significantly in relation to GDP. That is due mainly to various structural measures passed by the federal government and affecting personal income tax, and to the increase in the tax reduction granted by the Flemish Region. However, this fall will be partly offset by the proceeds generated by measures which the government has taken on account of the financial crisis.

Primary expenditure, which came to 44.5 p.c. of GDP in 2007, should increase to 45.7 and 46.3 p.c. of GDP respectively in 2008 and in 2009. The real trend growth of primary expenditure will be slightly higher than the trend growth of GDP in those two years. Expenditure on health care and pensions, in particular, is projected to rise substantially.

The borrowing requirement estimated at 1.7 p.c. of GDP for 2009 is a particularly marked deviation from the balanced budget targeted by the government for this year. There are various reasons for this divergence. First, the general government budget assumes economic growth of 1.2 p.c. in 2009, i.e. a far more optimistic scenario than the macroeconomic outlook described above. Consequently, the projected revenues fall well short of the figure anticipated in the general government budget, especially as tax revenues are estimated taking into account a less favourable basis for 2008. Furthermore, according to the ESCB methodology, the projections disregard budget measures for which details are not yet available. That applies, for instance, to the possible levies on electricity producers and to much of the revenue to be generated by the measures designed to combat tax evasion and social security fraud. Finally, the government assumes that the communities and regions and the local authorities will together record a surplus of 0.4 p.c. of GDP in 2009, whereas the estimates suggest that they will show a deficit of 0.1 p.c. of GDP.

A break in the downward trend in the debt ratio is expected in 2008. At the end of this year, the government debt would total 87.8 p.c. of GDP, or around 4 percentage points above the level recorded at the end of 2007. This increase is due to loans taken out by the Belgian State to finance the injections of capital into financial institutions and the loans granted to them. In 2009, the public debt ratio would fall again, although much more slowly than in previous years owing to the relatively low nominal GDP growth and the expanding borrowing requirement.

5. Assessment of the risk factors

While the spring projections for Belgium estimated GDP growth at 1.5 p.c. in 2009, the Bank now expects activity to contract by 0.2 p.c. The exceptionally large scale of this adjustment is similar to the adjustment to the corresponding projections for the euro area. It reflects the general and very rapid deterioration in the economic outlook since the end of September 2008. The forecasts produced by various institutions at the end of the summer still expected GDP to grow by more than 1 p.c. in 2009. In view of the recent developments, all institutions are now expecting GDP to contract in late 2008 and early 2009, with a subsequent very weak recovery.

The scenarios for a marked worsening of the financial crisis and its spread to the real economy, mentioned among the potential risks when the previous exercises were published, have therefore largely materialised. Nevertheless, the uncertainty surrounding the current forecasts still seems to be very considerable, though the risk of a sharper downturn in activity is dominant. Indeed, past experience of banking and financial crises in various countries has shown that their effects may be substantial and long-lasting.

For the moment, it is uncertain whether the worst of the crisis is already – or almost – over, particularly as regards the increased cost of funding sources or the fall in stock market prices. Non-financial corporations and households could also face credit restrictions. The scale of the effects of the crisis on economic activity and world trade is another major factor of uncertainty. The slump in business and consumer confidence, but also the plummeting commodity prices on the international markets, indicate that there is now a widespread impact on the expectations of economic agents as regards activity, demand and incomes. The restoration of a degree of macroeconomic stability is therefore a primary requirement for a recovery in economic activity.

Variations between inflation forecasts are largely attributable to the assumptions made regarding oil prices. In view of the recent sharp fall in those prices, the latest inflation forecasts for 2009 are generally lower, down to around or below 2 p.c. In the short term, a more marked slowdown in activity would cause the inflationary pressures to ease further via an additional fall in commodity prices or a more marked erosion of corporate margins.

TABLE 6 COMPARISON OF THE FORECASTS FOR BELGIUM

(percentage changes compared to the previous year)

	GDP in volume		Inflation (1)		Budget balance (2)		Date of publication
	2008	2009	2008	2009	2008	2009	
NBB – Autumn 2008	1.4	–0.2	4.6	1.9	–0.9	–1.7	December 2008
p.m. Spring 2008	*1.6*	*1.5*	*4.1*	*2.3*	*–0.3*	*–0.8*	*June 2008*
NAI	1.6	1.2	4.7	2.7	n.	n.	September 2008
EC	1.4	0.1	4.7	2.5	–0.5	–1.4	3 November 2008
OECD	1.5	–0.1	4.6	1.9	–0.7	–1.3	25 November 2008
Belgian Prime News	1.6	1.3	4.5	2.4	–0.4	–0.7	September 2008

(1) HICP, except for NAI: national consumer price index.
(2) Percentages of GDP.

Annex

PROJECTIONS FOR THE BELGIAN ECONOMY: SUMMARY OF THE MAIN RESULTS

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

	2005	2006	2007	2008 e	2009 e
Growth (calendar adjusted data)					
GDP in volume	2.2	3.0	2.6	1.4	–0.2
Contributions to growth:					
Domestic expenditure, excluding change in stocks	2.3	2.1	2.8	1.9	0.2
Net exports of goods and services	–0.6	0.1	–0.3	–1.3	–0.3
Change in stocks	0.5	0.9	0.1	0.8	–0.1
Prices and costs					
Harmonised index of consumer prices	2.5	2.3	1.8	4.6	1.9
Health index	2.2	1.8	1.8	4.3	2.3
GDP deflator	2.4	2.3	2.4	2.2	3.0
Terms of trade	–0.3	–0.7	0.5	–3.0	1.1
Unit labour costs in the private sector	0.9	1.5	3.1	3.8	3.2
Hourly labour costs in the private sector	2.4	3.1	3.7	3.5	3.3
Hourly productivity in the private sector	1.5	1.6	0.6	–0.3	0.1
Labour market					
Domestic employment (annual average change in thousands of persons)	54.8	58.1	77.4	67.5	7.9
Total volume of labour (1)	0.9	1.5	2.0	1.4	–0.3
Harmonised unemployment rate (2) (p.c. of the labour force)	8.5	8.3	7.5	6.7	6.9
Incomes					
Real disposable income of individuals	0.4	2.5	2.8	–0.3	1.5
Savings ratio of individuals (p.c. of disposable income)	12.6	12.9	13.7	12.7	14.3
Public finances (3)					
Overall balance (p.c. of GDP)	–2.6	0.3	–0.3	–0.9	–1.7
Primary balance (p.c. of GDP)	1.6	4.3	3.5	2.8	2.1
Public debt (p.c. of GDP)	92.1	87.8	83.9	87.8	87.6
Current account (according to the balance of payments, p.c. of GDP)	**2.6**	**2.0**	**1.7**	**–2.0**	**–1.4**

Sources: EC, DGSEI, NAI, NBB.
(1) Total number of hours worked in the economy.
(2) Adjusted series (Eurostat).
(3) According to the methodology used in the excessive deficit procedure (EDP).