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PRESS RELEASE

The potential growth of the Belgian economy
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Potential output is the output that could be produced through normal use of the available production factors labour and capital, i.e. without causing inflationary pressures. In addition to fertile research ground for academics, the concept is also of great importance to various policymakers. In particular, calculations of the structural budget balance – a key concept in the European budgetary framework – take into account the output gap, which is the extent to which the actual GDP differs from the potential output. In addition, a persistently positive output gap may indicate that the economy is overheating, possibly increasing inflationary pressures and necessitating action by the monetary authorities. Lastly, potential output reflects how much an economy in equilibrium can grow and a persistently low potential growth can point to the need for structural reforms.

Unlike actual GDP, potential output cannot be measured directly but has to be estimated. For this end, several methods exist, the results of which may differ somewhat. This article focuses predominantly on the production function approach, which enables to estimate the growth contributions of the different production factors.

Like several other advanced economies, the potential growth in Belgium fell sharply during the crisis period. Despite the economy's recent modest recovery, there is so far no return to the cruising speed of about 2% of the period before the Great Recession. The contribution of total factor productivity to the growth has declined the most, but in addition to the impact of the financial crisis, global developments have been reducing productivity growth in advanced economies already since a longer time. Moreover, also factors specific to Belgium are weighing on the recovery of the productivity growth. Both the labour and the capital components of potential growth also reduced during the crisis period, but these decreases were fairly limited compared with those in other euro area countries. This was mainly thanks to the high level of protection in the labour market and the fact that investment growth was reduced only to a lesser extent compared to these other countries.

In the near future, population ageing is expected to have a further negative impact on (potential) growth. To offset this negative effect of an ageing population and to safeguard future prosperity, a joint improvement of the potential growth determinants should be pursued. First of all, there is still a lot of room to further increase the employment rate, especially for targeted groups (at risk) such as older workers, women, young workers, the low-skilled and non-EU citizens. In addition, attracting, training and efficiently employing additional foreign employees could reduce the population ageing problem. Another very important agenda item is to boost productivity growth and investment through structural reforms. In order to create an environment in which investment and innovation can thrive, it is crucial to encourage the entrepreneurship culture in Belgium and to simplify the administrative burdens for businesses, the excessive regulation and the complex tax system. In addition, the mobility problem should be addressed through targeted investments in infrastructure, more attractive public transport and the deployment of new technologies.

Since the recent financial crisis, the traditional output gap methods have been criticized because of their difficulty of correctly assessing the business cycle and, thus, the output gap in real time. This was evident from the fact that the initial estimates of the output gap in the crisis years had to be revised strongly afterwards, which made the concept then of little use to policy makers. The literature tends to ascribe this phenomenon to the fact that traditional measures pay little attention to financial cycles. The alternative concept of 'sustainable' output therefore seeks to take these cycles in financial variables explicitly into account. The estimate based on such an alternative method for Belgium indeed points at different values for the output gap - higher before and during the Great Recession and lower now - but this cannot immediately be attributed to substantial imbalances in the Belgian lending and house prices in the period prior to the crisis. Thus, it seems this different estimate is the result of the general model uncertainty. Moreover, for Belgium, the method for sustainable output does not solve the problem of major ex post revisions.

More generally, estimates of potential output and potential growth remain uncertain to some degree and they should therefore be interpreted with caution.

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