

Economic projections for Belgium – Spring 2006

Introduction

Despite the persistence of high oil prices and a general upward trend in interest rates, albeit starting from unusually low levels, the world economy remained vigorous in 2005 and early 2006, while inflation was relatively moderate. In the euro area, where growth still lags behind that of the other main economic regions, a cyclical upturn occurred in the second half of 2005. It proved to be stronger in Belgium, as is evident from the significant improvement in the indicators obtained from the business survey up to April 2006, and from real quarterly GDP growth estimated at 0.8 p.c. for the first three months of the year. The starting situation for the spring 2006 economic projections, which relate to the years 2006 and 2007, therefore seems slightly more favourable than had been predicted six months ago, in the autumn 2005 projections.⁽¹⁾ However, the euro's recent appreciation combined with the additional increase in commodity prices and higher interest rates, could affect the outlook for growth and inflation in Belgium, and more generally in the euro area.

Produced as part of a biannual exercise by the Eurosystem central banks – the results for the euro area being obtained by aggregating the results for the various national economies⁽²⁾ – these projections for Belgium are prepared by the Bank on the basis of a set of common assumptions concerning the international environment and movements in interest rates, exchange rates and commodity prices. They also depend on assumptions specific to the Belgian economy as regards variables which are to a large extent influenced by the discretionary action of the economic agents. That applies, for example, to the wage agreements resulting from negotiations between the social partners, and to government decisions on the budget.

As regards labour costs in the private sector, the yet fragmentary and uncertain indications currently available for the expected developments in Germany, France and the Netherlands point to relatively moderate growth in 2007. According to the technical assumption made for this exercise, the increase in hourly labour costs will be in line with the effect of indexation.

The figures for public finances take account of the recent data on tax revenues, the endogenous effect of the macroeconomic environment, and an expenditure pattern based on past developments and measures already introduced. New government measures concerning revenue or expenditure, to be adopted in the months ahead at the time of the supplementary budget review announced by the federal government for 2006, or in connection with the 2007 budget, were not taken into account in the projection exercise. In some circumstances, they could in turn affect the projections for the economy as a whole.

The first section deals with the international environment. It summarises the Eurosystem projections for the euro area and presents the principal common assumptions. The next three sections go into more detail on the recent situation and the projections for the national economy, dealing respectively with activity, employment and the main expenditure components (section 2) – which, in accordance with Eurosystem practice, are presented without taking account of specific seasonal effects and the impact of irregularities in the calendar – prices and labour costs (section 3) and the public finance figures (section 4). Finally, the main risks relating to the projections are

(1) NBB (2005), "Economic projections for Belgium – Autumn 2005", Economic Review 4-2005.

(2) The projections for the euro area were published in the ECB's June monthly report.

discussed in the last section, which also contains a summary of the results obtained by other institutions.

The projections for Belgium were drawn up on the basis of information available as at 19 May 2006.

1. International environment

1.1 World economy

In 2005 the world economy continued to grow strongly, despite the sharp rise in oil prices and less accommodating monetary policies. Inflationary pressure also remained moderate worldwide. Global GDP grew by 4.6 p.c., slightly below the very strong growth recorded in 2004. After slowing down at the start of the year, industrial activity took off again, while the service sector maintained its momentum. World trade also picked up again in the second half of the year, expanding by an average of around 7 p.c. in 2005. The cyclical indicators and the statistics available point to sustained robust economic activity in the initial months of 2006. In the United States, according to the provisional estimates, GDP surged again in the first quarter. In Japan, the economic recovery continued. In the euro area, there was a further significant strengthening of business confidence in industry and services at the beginning of 2006, and – according to a first estimate – GDP growth was fairly sustained in the first quarter.

However, owing to the very strong global demand and the narrow margins of unused capacity, in both production and refining, oil prices increased sharply and were highly volatile. The price per barrel of Brent increased from around 40 dollars in December 2004 to 63 dollars in March 2006. Geopolitical factors and the persistence of sustained demand pushed the price still higher, to an average of just over 70 dollars in May. These factors are expected to continue operating throughout the projection period and, taking account of the inertia in bringing new capacity into service, the oil price is likely to maintain this high level for the coming two years.

Furthermore, the stimulus provided by monetary policy has diminished. In the United States, the progressive tightening of monetary policy has continued. Since June 2004, the Federal Reserve has raised the Fed funds rate by 25 basis points in sixteen successive steps. On 10 May 2006, the date of the latest increase when this article went to press, the interest rate thus stood at 5 p.c. In the context of ebbing deflation in Japan, the Bank of Japan adjusted its monetary policy operating target on 9 March 2006, thus ending the policy of quantitative easing which

it had applied since March 2001, and opening the way to a less expansionary monetary policy in the future, while retaining its zero interest rate policy. In the euro area, the ECB Governing Council raised the Eurosystem key rate by 25 basis points on 6 December 2005 and on 8 March 2006, bringing it to 2.50 p.c.⁽¹⁾

Nonetheless, financing conditions remained favourable, and this combined with strong corporate profits underpinned economic activity. Despite the higher interest rates on the benchmark 10-year bonds in the leading economies at the end of 2005 and in the first few months of 2006, rates remained fairly low, partly because of the increased credibility of monetary policy in the industrialised countries, the formation of foreign exchange reserves by Asian central banks, and the investment on the financial markets of the windfall profits made by the oil-exporting countries. In addition, there was a further decline in the interest spread on emerging market and corporate bonds.

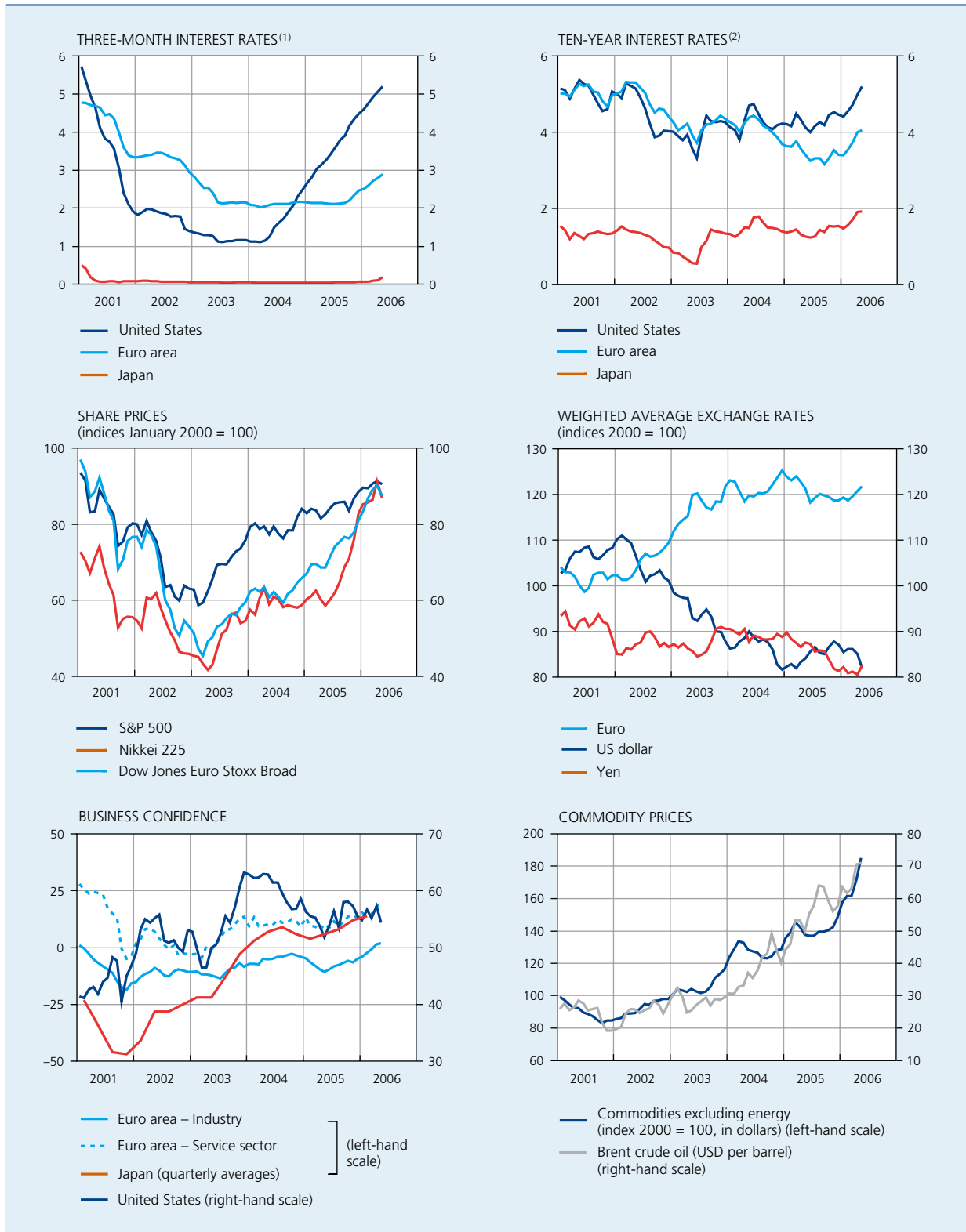
The strong growth and substantial corporate profits, together with the low level of long-term interest rates, also supported the rise in share prices. The Japanese Nikkei and the Dow Jones Euro Stoxx recorded particularly strong increases, but share prices subsided in mid-May 2006. House prices produced a more varied picture. They continued to soar in certain industrialised countries, while moderating in others such as the United Kingdom, where the market cooled off. As a result of the widening interest rate spread between the United States and the euro area, the dollar appreciated during 2005, despite the large US current account deficit. However, during the initial months of 2006, the dollar lost ground, particularly against the euro. Overall, the fluctuations in the weighted average exchange rates of the main industrialised countries have remained relatively limited since the beginning of 2005.

In this context, and despite the persistently high oil price, the international institutions have issued favourable forecasts for 2006 and 2007. According to the European Commission, global GDP will maintain its vigorous growth, at 4.6 p.c. in 2006 and 4.3 p.c. in 2007, permitting consolidation of the labour market. World trade is projected to continue expanding rapidly. Inflation should be contained as a result of growing international competition in a context of globalisation, wage moderation and increased credibility of monetary policy. Financing conditions look set to remain favourable and should thus continue to underpin growth.

(1) On 8 June 2006, the Governing Council raised the key rate to 2.75 p.c.

CHART 1 FINANCIAL AND COMMODITY MARKET DEVELOPMENTS AND CONFIDENCE LEVELS IN THE MAIN ECONOMIES

(Monthly averages, unless otherwise stated)



Sources: BIS, EC, ECB, HWWA, ISM, OECD, NBB.

(1) Interest on three-month interbank deposits.

(2) Yield on ten-year government bonds (benchmark loans).

TABLE 1 PROJECTIONS FOR THE MAIN ECONOMIC REGIONS EXCLUDING THE EURO AREA

(Percentage changes against the previous year, unless otherwise stated)

	2005	2006	2007
	Actual	Projections	
GDP at constant prices			
United States	3.5	3.2	2.7
Japan	2.7	2.8	2.4
China	9.9	9.5	9.0
India	8.0	7.3	7.3
Middle East and North Africa ..	5.4	5.2	5.0
Commonwealth of Independent States	6.7	6.5	6.3
United Kingdom	1.8	2.4	2.8
World	4.6	4.6	4.3
<i>p.m. World trade</i>	7.1	8.5	7.1
Inflation⁽¹⁾			
United States	3.4	2.9	1.6
Japan	-0.3	0.7	1.0
Unemployment rate⁽²⁾			
United States	5.1	4.8	5.1
Japan	4.4	4.3	4.3

Source: EC, spring forecasts, May 2006.

(1) Consumer price index.

(2) Percentages of the labour force.

World growth is also expected to be more evenly spread among the various economic regions. In the United States, the economy should continue growing at a sustained rate, albeit slightly more slowly than in 2005. The prediction is that, after a vigorous first six months, activity will slacken pace following a short-term interest rate hike and cooling of the housing market. The contribution of the United States to the development of global economic activity is thus expected to decline somewhat over the next two years.

Supported by structural intervention, economic activity in Japan is also expected to remain on course, gradually conquering deflation. Domestic demand is forecast to remain robust, while the expansion in the Asian emerging countries is expected to stimulate Japanese exports. In China, growth is again projected at a minimum of 9 p.c. in 2006 and 2007, although that rate is slightly below the 2005 figure. The slowdown is attributed primarily to the dip in net exports, due partly to the more moderate expansion of activity in the United States.

In India, too, growth is expected to slacken its pace somewhat, though nevertheless remaining robust. On the basis of expanding domestic demand and strong intra-regional trade, the emerging Asian countries are likely to remain a key growth area for global economic activity.

In the context of persistently high oil prices, the growth prospects also look good for the oil-exporting countries, particularly Russia and the countries of the Middle East and North Africa. After the emerging Asian countries, the CIS countries have become the fastest growing region of the world. The Latin American economies should maintain sustained growth over the next two years at a rate close to 4 p.c., while annual growth of over 5 p.c. is expected for the countries of sub-Saharan Africa.

For the new Member States of the European Union, activity is expected to expand by an average of 4.5 to 5 p.c. Foreign direct investment there is promoting fixed capital formation and making it possible to finance the current account deficits on the balance of payments. In the United Kingdom, growth is expected to pick up in 2006 and 2007, after subsiding from 3.1 p.c. in 2004 to 1.8 p.c. in 2005. This was due mainly to a slowdown in domestic demand against the background of a cooling housing market and high energy prices.

1.2 Eurosystem projections for the euro area

Despite the forecast slight slackening of global growth, which nonetheless remains relatively robust, the high level of commodity prices and the recent appreciation of the euro, the external environment should generally remain conducive to growth in the euro area. Recent information points to the temporary nature of the deceleration recorded at the end of 2005. In the first quarter of 2006, real growth totalled 0.6 p.c. Initially underpinned by the dynamism of external demand, growth is projected to continue at a quarterly rate in the region of 0.5 p.c. The average annual GDP growth in terms of volume, which came to just 1.4 p.c. in 2005, should reach between 1.8 and 2.4 p.c. in 2006 and 1.3 to 2.3 p.c. in 2007.

Export demand should also help to strengthen investment, in a context of a revival in business confidence, good profitability and continuing favourable financing conditions. Private consumption should be boosted by the gradual improvement in the labour market situation, and hence in household disposable income. However, the increases in indirect taxes in 2007, primarily in Germany, could exert a temporary moderating effect.

TABLE 2 EUROSYSTEM PROJECTIONS
(Percentage changes against the previous year)

	Euro area			<i>p.m. Belgium</i>		
	2005	2006	2007	2005	2006	2007
Inflation (HICP)	2.2	2.1 – 2.5	1.6 – 2.8	2.5	2.4	1.9
GDP by volume	1.4	1.8 – 2.4	1.3 – 2.3	1.5	2.5	2.0
of which:						
Private consumption	1.4	1.4 – 1.8	0.5 – 1.7	1.3	2.1	1.8
Public consumption	1.4	1.3 – 2.3	0.7 – 1.7	1.9	1.9	2.4
Investment	2.5	2.3 – 4.5	1.6 – 4.8	8.4	0.9	2.0
Exports	4.1	5.2 – 8.0	3.3 – 6.5	2.6	5.2	4.3
Imports	5.0	5.3 – 8.7	2.8 – 6.2	3.8	4.9	4.2

Sources: ECB, NBB.

Inflation measured by the HICP averaged 2.2 p.c. in 2005, the main factor being the increase in oil prices. It is forecast to range between 2.1 and 2.5 p.c. in 2006, and between 1.6 and 2.8 p.c. in 2007, under the impact of a further substantial contribution from the energy

component in the first year and adjustments to indirect taxes in the second year. Apart from these factors, inflationary pressure should be contained during the projection period, owing to the continuing wage moderation and the influence of international competition.

Box – Eurosystem assumptions

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

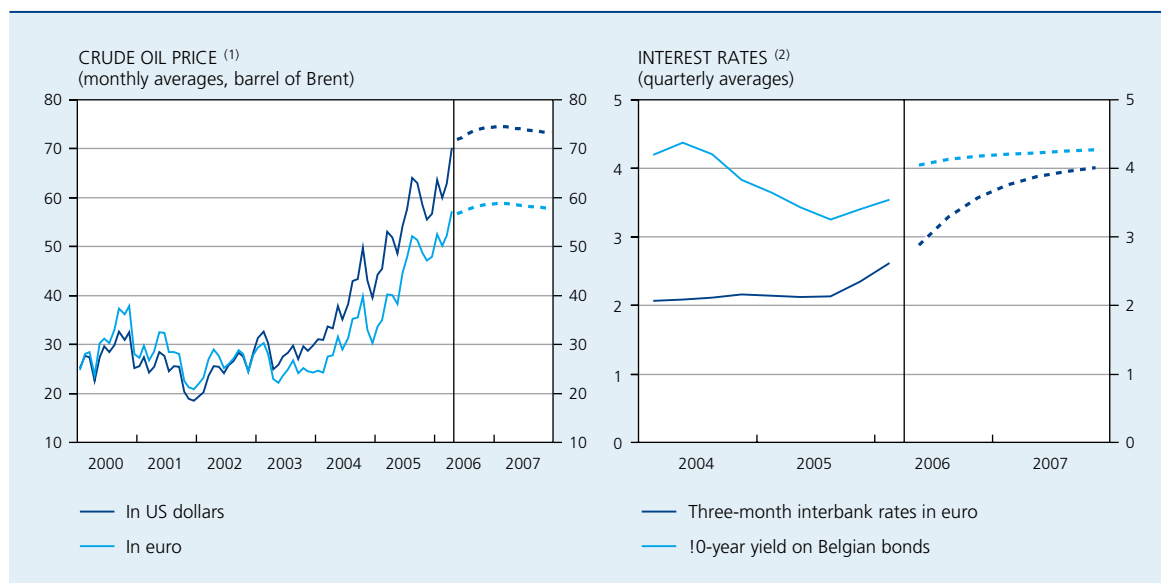
- The interest rates are based on market expectations. In previous projection exercises, the Eurosystem assumed that short-term interest rates would remain constant over the projection horizon. In order to further improve the quality and the internal consistency of the macroeconomic projections, it was decided to base the assumption on market expectations in accordance with the same approach as that already adopted for long-term rates. This is a purely technical adjustment, and does not imply any change in the ECB's monetary policy strategy or in the role of the projections within that strategy.

The short-term rate in euro stood at 2.9 p.c. when the projections were prepared. According to market expectations, it is set to increase to an annual average of 3.1 p.c. in 2006 and 3.9 p.c. in 2007. The representative long-term interest rate for Belgium is projected at 4 p.c. in 2006 and 4.2 p.c. in 2007.

- The bilateral euro exchange rates are kept constant at their value as at the beginning of May 2006, namely 1.27 US dollar to the euro.



ASSUMPTIONS CONCERNING THE MOVEMENT IN OIL PRICES AND INTEREST RATES



Source: ECB.

(1) Actual figures up to April 2006, assumption from May 2006.

(2) Actual figures up to the first quarter of 2006, assumption from the second quarter of 2006.

– In accordance with the movement in implicit prices reflected in forward contracts, global oil prices are expected to continue edging upwards during 2006, from around 72 dollars per barrel, the level reached in the first half of May 2006. Taking an average over the year, Brent is forecast to cost 70.3 dollars per barrel in 2006 and 73.9 dollars in 2007, compared to 54.4 dollars in 2005.

ASSUMPTIONS UNDERLYING THE EUROSISTEM PROJECTIONS

	2005	2006	2007
	(Annual averages)		
Three-month interbank rates in euro	2.2	3.1	3.9
Ten-year bond yields in Belgium	3.4	4.0	4.2
Euro exchange rate against the US dollar	1.24	1.25	1.27
Oil price (US dollars per barrel)	54.4	70.3	73.9
	(Percentage changes)		
Export markets relevant to Belgium	5.9	7.2	5.3
Export competitors' prices	3.1	2.2	1.2
of which: competitors from the euro area	2.2	2.5	1.4

Source: ECB.

The expected developments in world trade and the results of the projections for the euro area's partners concerning trade in goods and services can be used to assess the external conditions for the Belgian economy. Boosted by an acceleration at the beginning of the year, the volume growth of the export markets, calculated as the weighted sum of imports from third countries, should average over 7 p.c. in 2006, before dropping to 5.3 p.c. in 2007. The competitors' export prices should remain moderate, rising by 2.2 p.c. in 2006 and 1.2 p.c. in 2007.

2. Activity, employment and demand in Belgium

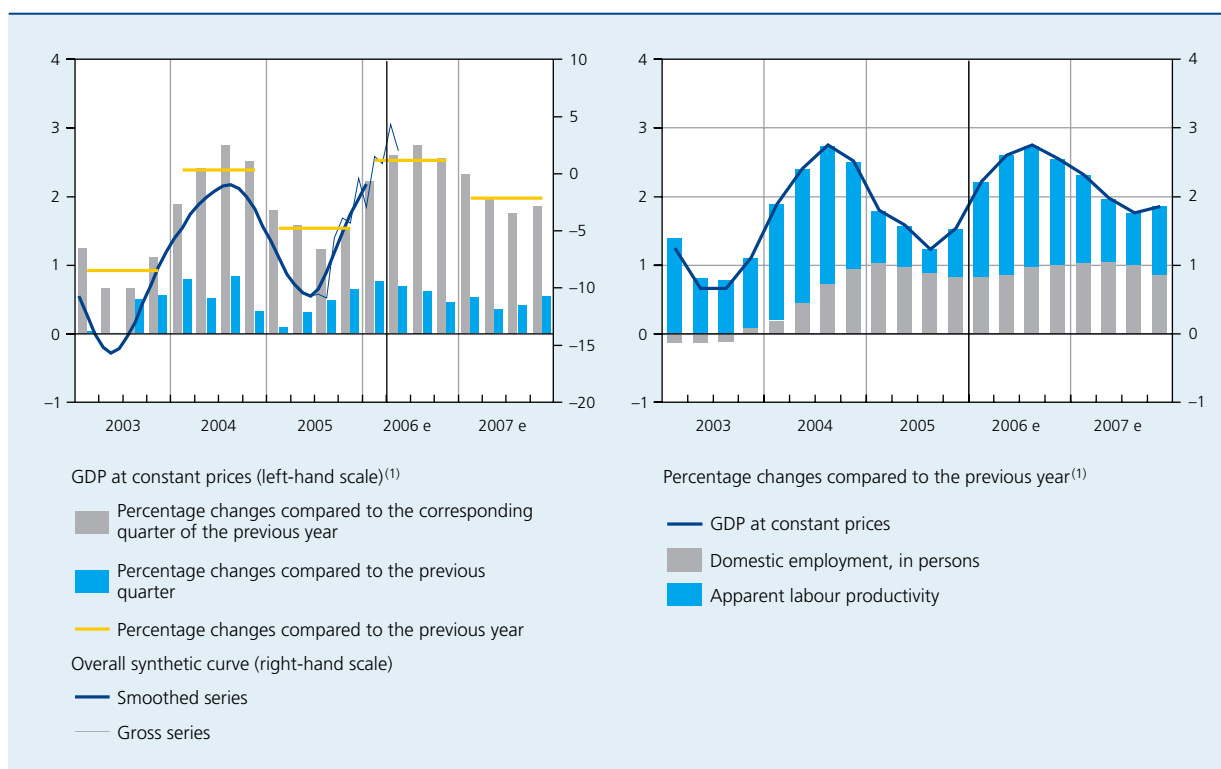
2.1 Activity and employment

In Belgium, economic activity strengthened considerably at the end of 2005 and in the initial months of 2006. At the beginning of 2005, GDP growth had dipped sharply following the temporary weakening of foreign trade, which had a marked effect on industrial activity. It gradually speeded up again, rising from 0.1 p.c. in the first quarter of 2005 to 0.6 p.c. in the final quarter. According

to an initial NAI estimate, it reached 0.8 p.c. in the first quarter of 2006, outpacing the potential growth rate, owing to a cyclical upturn in industry and consolidation of the sustained rate of growth in business services.

The recovery was accompanied by a steep rise in business confidence, and to a lesser extent, by stronger consumer confidence. The climate improved especially in manufacturing industry, thanks to the marked rise in export orders. Although confidence recently appears to have moved ahead somewhat of the revival in real activity, there is still a strong correlation between the two. The restoration of confidence was also confirmed by the strong increase in

CHART 2 ACTIVITY AND EMPLOYMENT
(Seasonally adjusted data)



Sources: NAI, NBB.

(1) Calendar adjusted data.

the capacity utilisation rate, principally in the case of semi-finished products, bringing it to its highest level since the beginning of 2001. During the initial months of 2006, industrial production and export volumes were also well above the levels of the final quarter of 2005. According to the indicators already available, this dynamism should be maintained in the second quarter.

The stronger than expected improvement in economic activity observed in the first half year accounts for the upgrading of the GDP growth forecast for 2006, from 2.2 to 2.5 p.c., against 1.5 p.c. growth in 2005. However, economic growth is projected to slow down gradually during the year, moving closer to its potential rate, owing to the persistently high oil prices and the euro's recent appreciation against the dollar. Furthermore, external demand is expected to slacken while short-term interest rates and, to a lesser extent, long-term rates should continue to rise. Thus, Belgium's GDP growth is expected to drop to 2 p.c. in 2007. It would then be close to the growth rate forecast for the euro area as a whole, having significantly outpaced it in 2006.

Employment normally mirrors movements in activity, albeit after a certain time-lag and with some attenuation. However, the weakening of economic activity seen at the beginning of 2005 had little impact, since a total of 39,000 extra jobs

were created on average over the year, corresponding to an increase of 0.9 p.c. against 2004. This apparent breaking of the link between cyclical variations in activity and employment is due to the labour hoarding effect. Faced with a downturn which they consider temporary, employers prefer to retain their staff rather than incur the successive costs of redundancies followed by recruitment of staff whom they may need to train to meet their requirements once business picks up. Flexibility mechanisms in the organisation of labour, such as variable working hours and temporary unemployment in fact enable firms to adjust the volume of labour in line with output. When business activity accelerates, it first triggers an increase in the actual hours worked, without directly leading to any increase in the rate of job creation.

The rate of labour utilisation is reflected in the growth of productivity per worker, which slowed to 0.6 p.c. in 2005. Owing to the impact of labour hoarding, it should pick up during 2006-2007 to an average of 1.3 p.c., which is closer to its long-term growth rate. Employment should thus continue growing steadily at 0.9 to 1 p.c. per annum, corresponding to the creation of 80,000 new jobs over the period 2006-2007 as a whole.

The creation of new jobs is likely to relate primarily to employees in the private sector. In the public sector, employment is forecast to rise by a total of 8,000 persons

TABLE 3 LABOUR SUPPLY AND DEMAND

(Calendar adjusted data, annual averages, year-on-year changes in thousands of persons, unless otherwise stated)

	2002	2003	2004	2005	2006 e	2007 e
Working-age population	31	30	30	31	36	37
Labour force	15	44	63	58	37	48
<i>p.m. Harmonised activity rate⁽¹⁾</i>	64.8	64.9	65.9	66.7	66.9	67.2
National employment	-7	-3	24	39	38	42
<i>p.m. Harmonised employment rate⁽¹⁾</i>	59.9	59.6	60.4	61.1	61.3	61.6
Frontier workers	0	1	1	0	0	0
Domestic employment	-6	-3	24	39	38	42
Self-employed persons	-7	-6	-2	5	6	4
Employees	1	2	26	34	32	38
Public sector	17	10	7	-1	4	3
Private sector	-16	-7	19	34	28	34
Unemployed job-seekers	22	47	38	20	-1	6
<i>p.m. Harmonised unemployment rate⁽²⁾</i>	7.5	8.2	8.4	8.4	8.2	8.2

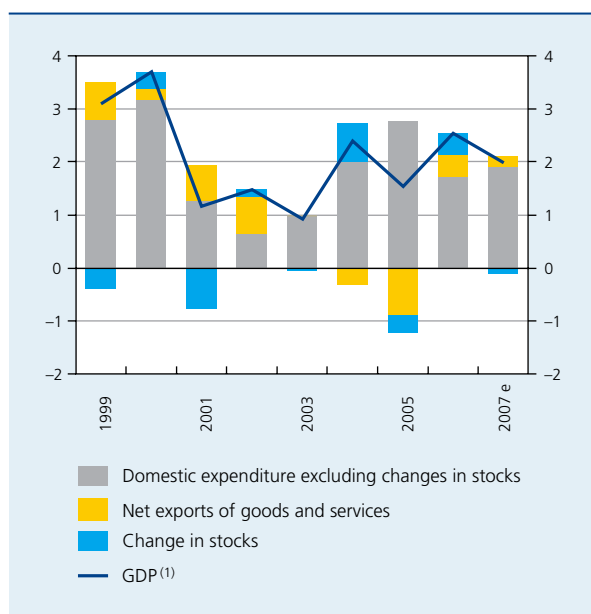
Sources: EC, NAI, NEMO, NBB.

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

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

CHART 3 MAIN EXPENDITURE CATEGORIES AT 2000 PRICES

(Calendar adjusted data, contribution to GDP growth in percentage points, unless otherwise stated)



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

by 2007, following a slight decline in 2005, due mainly to a recruitment freeze on the part of the Flemish Region. Having already increased last year for the first time since 1997, the number of self-employed persons is likely to continue rising by a further 10,000 units over the projection period, one reason being the opportunities which the self-employed status offers for the population of the new EU Member States, in terms of access to the Belgian labour market.

The number of additional jobs during the period 2006-2007 more or less corresponds to the predicted increase in the supply of workers on the labour market, resulting partly from the expansion of the working-age population and partly from the increase in the activity rate, from 66.7 p.c. in 2005 to 67.2 p.c. in 2007. The number of unemployed job-seekers is expected to remain more or less steady in 2006 and 2007, despite the inclusion of unemployed job-seekers aged between 50 and 58 years, who are now required to remain available for the labour market. They are therefore counted as unemployed and are included in the labour force. The harmonised unemployment rate, expressed as a percentage of the labour force, is forecast to remain steady at 8.2 p.c.

2.2 Expected developments in the main expenditure categories

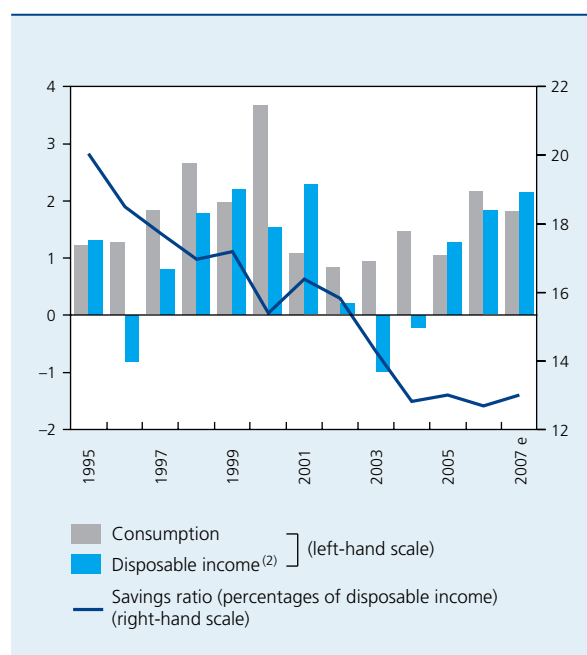
Most of the expenditure categories should contribute to GDP growth in 2006 and 2007, the latter thus presenting a more balanced structure than in 2004 and 2005. Having dampened economic activity for two years, net exports should once again stimulate growth, particularly in 2006. Domestic demand is projected to remain robust during the period in question. Nonetheless, in relation to 2005, it will be based more on consumption expenditure, while the growth rate of investment is expected to slacken, following the exceptional dynamism recorded last year. The contribution of stocks to GDP growth is estimated at 0.4 point in 2006, becoming negligible in 2007.

In 2006, half of the contribution of domestic demand to GDP growth is likely to come from private consumption, which looks set to expand by 2.1 and 1.8 p.c. respectively in 2006 and 2007, against 1.3 p.c. in the two preceding years.

Private consumption should thus record its highest growth rate since 2000, buttressed by an accelerating increase in purchasing power. Following the fall in

CHART 4 CONSUMPTION, DISPOSABLE INCOME AND SAVINGS RATIO OF INDIVIDUALS

(Percentage changes at constant prices compared to the previous year⁽¹⁾, unless otherwise stated)



Sources: NAI, NBB.
(1) Non calendar adjusted data.
(2) Data deflated by the deflator of private final consumption expenditure.

TABLE 4 GROSS DISPOSABLE INCOME OF INDIVIDUALS, AT CURRENT PRICES

(Percentage changes against the previous year, unless otherwise stated)

	2003	2004	2005 e	2006 e	2007 e
Gross primary income	0.3	2.3	3.5	3.4	3.5
of which:					
Wages and salaries	1.8	2.9	3.5	3.5	3.2
Compensation per person	1.7	2.1	2.4	2.5	2.1
Employment	0.1	0.7	1.0	0.9	1.1
Gross operating surplus and gross mixed income	1.1	0.2	4.3	3.7	3.0
Property income ⁽¹⁾	-8.8	1.9	2.7	2.6	5.9
Current transfers ⁽¹⁾	-1.1	2.3	1.1	-0.3	0.9
of which:					
Current taxes on income and assets	0.3	3.3	3.6	0.6	2.7
Gross disposable income	0.6	2.3	4.1	4.2	4.0
<i>p.m. At constant prices</i> ⁽²⁾	-1.0	-0.2	1.3	1.8	2.2
Consumption expenditure of individuals	2.6	4.0	3.8	4.6	3.7
Savings ratio ⁽³⁾	14.3	12.8	13.0	12.7	13.0

Sources: NAI, NBB.

(1) These are net amounts, i.e. the difference between incomes or transfers received from other sectors and those paid to other sectors, excluding transfers in kind.

(2) Figures deflated by the deflator of private final consumption expenditure.

(3) Gross savings as a percentage of gross disposable income, these two aggregates including the net claims of households on pension funds.

inflation, the real increase in private disposable income should strengthen from 1.3 p.c. in 2005 to 1.8 and 2.2 p.c. in 2006 and 2007. In nominal terms, both the primary income earned by individuals and their disposable income, after allowing for net transfers paid to other sectors – which mainly cover taxes and contributions paid to the government, and social benefits received – should increase at a more or less constant rate in 2005 and during the projection period, by around 3.5 p.c. for primary income and 4 p.c. for disposable income. The main reason for the faster growth of disposable income lies in the effects of the implementation of the tax reform initiated in 2001 and reductions in social contributions planned, in particular, for 2007. In that year, the rise in the average level of interest rates taken into account in the assumptions should boost the net capital income of individuals. Within the primary income, that contribution should offset the slight deceleration in wages and the income of self-employed.

According to the projections, the private savings ratio will show little change, hovering around 13 p.c. of disposable income. The consolidation of job creation and the more modest increases in energy prices should cause households to cut back their precautionary savings somewhat in

2006, following a temporary increase in 2005. Conversely, that rate is forecast to increase slightly again in 2007, with individuals making relatively little use of their capital incomes for consumption purposes.

Following an acceleration at the end of 2005, residential investment should remain relatively dynamic in 2006. In the construction sector, confidence stabilised at a high level and the increase in the number of building permits granted, which had already surged by 11 p.c. in 2006, accelerated further at the beginning of 2006. Investment is projected to rise by 3.6 p.c. in 2006, against 3.2 p.c. in 2005, thus exceeding the growth of real disposable income for the fourth year in a row. This growth is underpinned by the continuing low level of long-term interest rates and price rises on the secondary market. According to expectations, the influence of these factors will diminish over the period considered, and that should curb the rate of growth of residential investment, bringing it down to 1.7 p.c. in 2007, comparable to the rise in disposable income.

In 2006 public consumption is expected to maintain the growth rate seen in preceding years. However, there should be a slight acceleration in 2007 on account of health care spending.

TABLE 5 GDP AND MAIN CATEGORIES OF EXPENDITURE AT 2000 PRICES

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

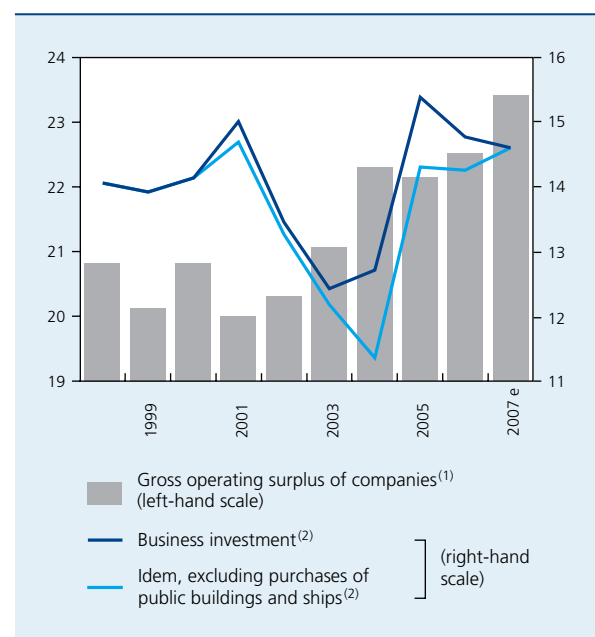
	2003	2004	2005	2006 e	2007 e
Consumption expenditure of individuals	1.0	1.3	1.3	2.1	1.8
Consumption expenditure of general government	2.6	1.9	1.9	1.9	2.4
Gross fixed capital formation	-0.6	4.4	8.4	0.9	2.0
Housing	3.7	9.1	3.2	3.6	1.7
General government	1.0	1.1	14.1	-5.6	6.3
<i>p.m. Excluding sales of public buildings</i>	1.0	6.9	5.2	5.8	-6.7
Enterprises	-2.0	3.3	9.4	0.8	1.5
<i>p.m. Excluding purchases of government buildings and ships</i> ..	-2.2	-0.1	10.6	2.4	3.0
Change in stocks ⁽¹⁾	-0.1	0.7	-0.3	0.4	-0.1
<i>p.m. Total domestic expenditure</i>	0.9	2.8	2.5	2.2	1.8
Net exports of goods and services ⁽¹⁾	0.0	-0.3	-0.9	0.4	0.2
Exports of goods and services	2.8	5.6	2.6	5.2	4.3
Imports of goods and services	2.9	6.3	3.8	4.9	4.2
GDP	0.9	2.4	1.5	2.5	2.0

Sources: NAI, NBB.

(1) Contribution to the change in GDP.

The increase in public investment in 2006, excluding sales of public buildings, should also be in line with the trend in previous years. Local authority investment is expected to remain substantial at first, as a result of the run-up to the municipal and provincial elections in October. In 2007 investment is forecast to decline by 6.7 p.c. However, the expected pattern of public investment is greatly distorted by significant sales of public buildings, classed as government disinvestment in the national accounts. In all, these sales are estimated at 0.7 billion euro in 2006, with enterprises and foreign countries appearing as the counterparties for 0.6 and 0.1 billion euro respectively. Taking account of these sales, public investment is expected to fall by 5.6 p.c. in 2006 before rising by 6.3 p.c. in 2007.

Having been decidedly reticent in the preceding years, enterprises substantially stepped up their investment in 2005 by around 10 p.c. According to the projections, investment growth should drop to 0.8 p.c. in 2006 and 1.5 p.c. in 2007. However, abnormal factors, particularly the absence of major additional investment in maritime transport after the first half of 2005, and the real estate transactions relating to the sales of buildings by public authorities, representing large amounts in 2006, depress the growth rates recorded. Leaving aside all exceptional transactions, enterprises are projected to increase their gross fixed capital formation by 2.4 and 3 p.c. in 2006 and 2007 respectively.

CHART 5 BUSINESS INVESTMENT AND GROSS OPERATING SURPLUS
(Percentages of GDP)

Sources: NAI, NBB.

(1) Gross data at current prices.

(2) Calendar adjusted data, at constant prices.

The caution displayed by enterprises during 2002-2004 caused the investment ratio to decline by 1.3 percentage points of GDP, despite the relatively favourable situation in terms of demand and financing conditions. After the catching up which ensued in 2005, this rate – expressed exclusive of exceptional transactions – is expected to remain steady at 14.3 p.c. of GDP in 2006 and 14.4 p.c. in 2007.

Demand and financing conditions look set to remain favourable during the projection period, and investment should therefore continue to bolster GDP growth. First, in manufacturing industry the rate of capacity utilisation has increased considerably in the recent period, owing to the revival in output. Next, enterprises have substantial own resources, measured on the basis of the gross operating surplus, at 22.1 p.c. of GDP in 2005. These resources should increase further during the period in question, to reach 23.4 p.c. of GDP in 2007, owing to the wider margins due to the slower pace of input price increases and the moderate rise in labour costs, combined with the increase in the volume of sales.

Finally, the conditions for raising external finance via borrowing or share issues also remain favourable, even if the long-term interest rate is likely to increase slightly to 4.3 p.c. by the end of the projection period. At the end of 2005, for the first time since the second quarter of 2002, the prospect of stronger demand and the favourable credit conditions brought a year-on-year increase in the volume of lending to non-financial corporations.

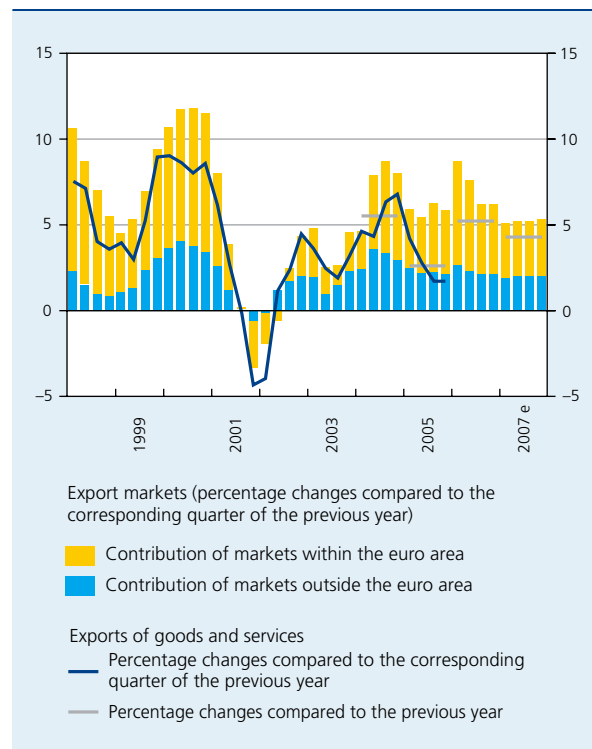
The volume of exports of goods and services had contracted sharply in the first quarter of 2005, following the weakening of external demand addressed to Belgium. Although the export markets then rapidly resumed their sustained growth, exports took a little longer to recover, picking up from the end of the year. Overall, exports of goods and services grew by 2.6 p.c. in 2005, which was well below the expansion of the export markets.

The recent figures point to a further acceleration of the export markets at the beginning of 2006, slightly surpassing expectations. This improvement which, according to the foreign trade statistics, also boosted the volume of exports, will have done much to support the consolidation of growth during the first half of 2006. The more vigorous foreign demand is based entirely on the demand from partners within the euro area, where the growth rate is expected to match that of markets outside the euro area. According to the assumptions adopted by the Eurosystem, the expansion of Belgium's export markets will accelerate in 2006 to reach 7.2 p.c., before dropping back to 5.3 p.c. in 2007.

These developments are projected to generate a recovery in the volume growth of exports, boosting it to 5.2 p.c. in 2006, before slowing down to 4.3 p.c. in 2007, owing to developments on the export markets and the delayed effects of the recent currency appreciation. Taking the projection period as a whole, however, the loss of market shares is expected to be less than in 2005, owing to the larger proportion represented by euro area partners in the expansion of the relevant export markets, and the improvement in price competitiveness resulting from the more moderate trend in Belgium's export prices, in line with the prices of competitors. As a result of less steep increases in the prices of energy and commodities, the pace of import price rises is also expected to slow down, although initially they may continue to outstrip export prices, causing a deterioration in the terms of trade in 2006 of 0.6 p.c., against 0.7 p.c. in 2005. Conversely, a small improvement is expected in 2007.

The growth rate of the import volume is estimated to increase from 3.8 p.c. in 2005 to 4.9 p.c. in 2006 and 4.2 p.c. in 2007, the acceleration being less than that of exports, as the unusually dynamic investments bolstered the volume of imports in 2005. Also, after dampening

CHART 6 EXPORT MARKETS AND EXPORTS OF GOODS AND SERVICES
(Data adjusted for seasonal and calendar effects)



Sources: ECB, NAI, NBB.

growth for two years, net exports should contribute to growth at a rate of 0.4 p.c. of GDP in 2006. However, that contribution is expected to fall slightly in 2007, to 0.2 p.c. of GDP.

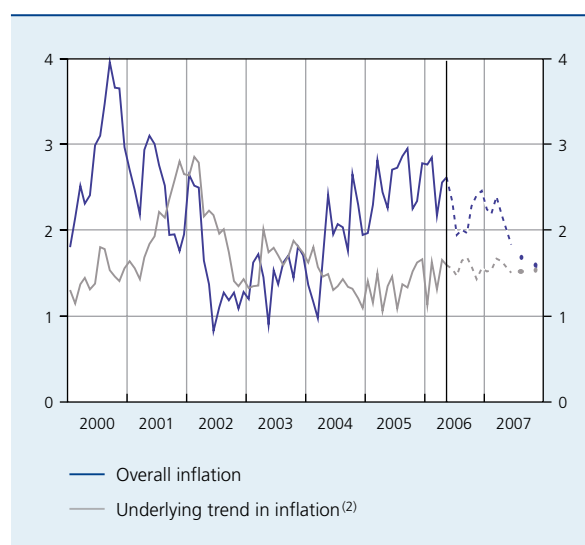
While the steep increases in import prices and the slackening growth of export volumes had considerably eroded the balance of current transactions in 2005, the movement in import and export volumes and prices should lead to a modest improvement in that balance during the projection period, boosting it to 2.1 p.c. of GDP in 2006 and 2.3 p.c. in 2007, against 1.7 p.c. in 2005.

3. Prices and costs

Since 2004, the movement in overall inflation in Belgium has been determined mainly by energy prices. The almost continuous rise in the past two years pushed inflation measured by the HICP to over 2 p.c. Energy prices also exert a dominant influence on the recent monthly fluctuations, and in the projections up to the end of 2007. Thus, temporary measures aimed at reducing the cost of heating oil for households had slowed inflation by around 0.2 point in the final quarter of 2005, but the new increase in the price of crude oil on the international markets brought inflation to 2.8 p.c. at the beginning of the current year. The profile of the projections is influenced by a sequence of effects, namely the downward

CHART 7 INFLATION

(HICP – percentage changes compared to the previous year, unless otherwise stated ⁽¹⁾)



Sources: EC, NBB.

(1) 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 from 2000 onwards.

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

basis effect in the summer of 2006, as the corollary to particularly high oil prices twelve months earlier, then the upward effect caused by the temporary measures

TABLE 6 PRICE AND COST INDICATORS

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

	2003	2004	2005	2006 e	2007 e
HICP	1.5	1.9	2.5	2.4	1.9
Health index	1.5	1.6	2.2	1.7	1.9
Deflators of the demand components and of GDP					
Imports	-2.1	2.8	6.4	3.8	1.3
Exports	-2.1	2.3	5.6	3.3	1.4
<i>p.m. Terms of trade</i>	-0.1	-0.5	-0.7	-0.6	0.1
Domestic demand	1.9	2.7	2.7	2.1	1.8
GDP	1.7	2.3	2.2	1.5	1.9
Costs of domestic origin per unit of value added (contributions to the change in the GDP deflator)					
Labour costs	0.4	0.1	1.1	0.4	0.6
Gross operating surplus	1.2	1.5	0.9	0.9	1.5
Indirect taxes net of subsidies	0.1	0.7	0.3	0.3	-0.2

Sources: EC, NAI, NBB.

mentioned. More fundamentally, the energy component is expected to continue making a major contribution to overall inflation until the initial months of 2007. That will then diminish rapidly, coinciding with the slight fall incorporated in the assumption adopted for oil prices. As a result, overall inflation should drop back below 2 p.c. in the second half of 2007. Taking an annual average, it will fall from 2.5 p.c. in 2005 to 2.4 p.c. in 2006, an upward revision of 0.1 point compared to the autumn 2005 forecast. Inflation in 2007 is projected at 1.9 p.c.

Apart from its direct effect, the increase in the energy price has had hardly any significant repercussions so far on the general price movement. On the contrary, the underlying trend in inflation has steadily eased, from an average of 2.1 p.c. in 2002 to 1.4 p.c. in 2005. However, it began to edge upwards during last year and, according to the projections, should continue to do so since the underlying trend in inflation is expected to reach 1.6 p.c. by the end of 2007. This change is due to the accelerating import price rises observed in 2005, previously curbed by the euro's appreciation. Apart from energy, the price increases of imported commodities were particularly significant, and that is expected to contribute towards a progressive increase in the prices of industrial goods. However, that effect is restrained by the growing competition generated by the globalisation of trade. In services, price increases are expected to be limited to around 2 p.c., following the moderation of inflationary pressures of domestic origin.

In 2006 and 2007, the increase in total domestic costs incorporated in the overall output of goods and services, as reflected in the GDP deflator, is expected to remain below 2 p.c., the main factor being the moderate contribution of labour costs, in the order of 0.5 point, in line with the picture seen in 2003 and 2004. This contribution was slightly above 1 point in 2005, the acceleration having been largely absorbed by a smaller rise in the operating surplus.

The acceleration in unit labour costs seen in 2005 was also apparent in the business sector, where the increase came to 1.6 p.c. It was due to the temporary decline in the growth of productivity, which fell to just 0.2 p.c. owing to the downturn in business activity at the beginning of the year. In a context of a more balanced economic growth, productivity is expected to increase at an average annual rate of 1.4 p.c. in 2006 and 2007, close to its trend rate. In both of those years the rise in unit labour costs is expected to drop to 0.8 p.c.

According to the data now available for 2005 and the developments expected in 2006, hourly labour costs will rise by 4.2 p.c. over the two years together. Despite the impact of higher indexation than was expected at the time of the central pay negotiations at the end of 2004, that increase should be less than the nominal 4.5 p.c. norm adopted by the government for 2005-2006. Among the factors contributing to that outcome, the introduction of the new health index in January 2006 has the technical effect of reducing automatic wage indexation in that

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

	2003	2004	2005 e	2006 e	2007 e
Labour costs per hour worked	1.5	1.9	1.8	2.4	1.9
Collectively agreed wages ⁽¹⁾	1.8	2.4	2.4	2.4	
Real agreed adjustments	0.4	1.0	0.4	0.6	
Indexations	1.5	1.4	2.0	1.9	
Wage drift ⁽²⁾	-0.6	-0.1	-0.1	0.0	
Employers' social security contributions	0.3	-0.4	-0.5	0.0	
Labour productivity ⁽³⁾⁽⁴⁾	1.3	1.9	0.2	1.6	1.1
Unit labour costs	0.2	0.0	1.6	0.8	0.8

Sources: FPS Employment; Labour and Social Dialogue; NAI; NBB.

(1) Wage increases set by the joint committees.

(2) Increases and bonuses granted by enterprises, over and above those under central and sectoral collective agreements, wage drift resulting from changes in the structure of employment, and errors and omissions.

(3) Value added at constant prices per hour worked by employees and the self-employed.

(4) Calendar adjusted data.

year.⁽¹⁾ In addition, the wage drift has been less than in the past, probably because of structural changes in the structure of employment. Additional cuts in employers' social contributions also curbed the increase in labour costs in 2005, as they had in the previous year. Measures aimed at reducing the tax burden were also introduced for shift workers and scientific researchers, plus measures aimed at cutting the tax wedge on overtime pay. According to the national accounts conventions, they are recorded as subsidies paid to the companies and not as a component of labour costs. Nonetheless, despite this slower rise in labour costs during 2005-2006, the handicap in relation to the three neighbouring countries – Germany, France and the Netherlands – has probably increased. The downward revision in those countries is likely to have been greater than that in Belgium.

For 2007, the 1.9 p.c. rise in hourly costs assumed for this exercise is of the same order of magnitude as in previous years, and broadly corresponds to the expected indexation effect.

(1) The interested reader will find an explanation for that effect in point 3.5 of the article published in this review on the new national consumer price index.

4. Public finances⁽²⁾

4.1 Summary

According to provisional figures published by the NAI in April 2006, Belgian public finances recorded a small surplus of 0.1 p.c. of GDP in 2005.⁽³⁾ However, according to the projections the budget should show a deficit again from 2006, limited to 0.3 p.c. of GDP this year but reaching 1.2 p.c. of GDP in 2007. These projections, which were based on the macroeconomic context described above, take account only of budget measures

(2) The projections for public finances allow for calendar effects on the macroeconomic variables. According to that calculation, real growth of GDP was 1.2 p.c. in 2005, 2.6 p.c. in 2006 and 1.9 p.c. in 2007, compared to 1.5 p.c., 2.5 p.c. and 2.0 p.c. respectively for calendar adjusted GDP.

(3) In April 2006, Eurostat announced that it had reservations about the NAI's statistical treatment of the BNRC restructuring on 1 January 2005. In Eurostat's opinion, the incorporation of the BNRC's historical debts in the Rail Infrastructure Fund should have been included in government expenditure as a capital transfer. As a result, the 2005 budget would have shown a deficit of 2.4 p.c. of GDP rather than a surplus of 0.1 p.c. of GDP. However, the Belgian government has announced that it will introduce legislation to annul this transaction with retroactive effect and the way in which it is eventually recorded therefore requires further examination. It should be pointed out that this is a one-off transaction and that its exact statistical treatment in no way influences the budget projections described in this article for the period from 2006 to 2007.

TABLE 8 BUDGET PROJECTIONS: OVERVIEW⁽¹⁾
(Percentages of GDP)

	2003	2004	2005	2006 e	2007 e
Public revenue	51.2	49.4	50.1	49.4	48.7
Primary expenditure	45.8	44.6	45.6	45.6	45.9
Primary balance	5.4	4.8	4.5	3.9	2.8
Interest charges	5.3	4.8	4.4	4.2	4.0
Financing balance	0.1	0.0	0.1	-0.3	-1.2
Change in the financing balance		-0.1	0.1	-0.4	-0.9
due to changes ⁽²⁾ in:					
interest charges		0.6	0.4	0.2	0.2
cyclical component ⁽³⁾		-0.2	-0.3	0.3	0.0
GDP growth		0.3	-0.4	0.3	-0.1
composition effects		-0.6	0.1	-0.1	0.1
non-recurrent factors		-0.5	-0.3	0.0	-0.6
structural primary balance ⁽⁴⁾		0.0	0.2	-0.8	-0.5
Public debt	98.5	94.7	93.3	90.4	88.7

Sources: NAI, NBB.

(1) According to the methodology used in the excessive deficit procedure (EDP). This methodology differs from that of the ESA 95 which was adjusted in 2001 to exclude from the calculation of the financing balance and interest charges the net interest gains on certain financial transactions, such as swaps and forward rate agreements (FRAs).

(2) A positive (negative) figure improves (deteriorates) the financing balance.

(3) According to the methodology described by Bouthevillain C., Ph. Cour-Thimann, G. van den Dool, P. Hernández de Cos, G. Langenus, M. Mohr, S. Momigliano and M. Tujala (2001), *Cyclically adjusted budget balances: an alternative approach*, ECB Working Paper Series, n° 77 (September). A less technical description of this methodology can be found in Box 6 *Cyclically adjusted budget balances: calculation method used by the ESCB* in the NBB Report 2003 (Part 1), pp. 83-84.

(4) Balance adjusted for cyclical and non-recurrent factors.

which have already been announced and are sufficiently detailed; they obviously disregard the effect of possible future decisions, e.g. at the time of an additional budget review in 2006 and the preparation of the 2007 budget. In accordance with the ESCB methodology, the actual budget targets, such as the zero balance for this year and a small surplus for 2007, laid down in the December 2005 stability programme, are not taken into account.

The movement in the budget balance is due to the influence of four different factors.

During the projection period, the financing balance should continue to benefit from the decline in interest charges. Although the forecasts are based on the assumption of rising short and long-term interest rates, the average implicit rate on the public debt should continue to fall, albeit at a less sustained rate than in recent years. This further fall is due to the low proportion of debt securities tied to short-term interest rates, and the fact that when long-term loans are repaid, they can still be refinanced at lower rates. Combined with the additional decline in the debt ratio, this should reduce interest charges by 0.2 p.c. of GDP per annum in 2006 and 2007.

The revival of economic activity is also favourable for public finances. This year in particular, activity should expand by more than the trend growth rate. Viewed overall, the business cycle should improve the financing balance by 0.3 p.c. of GDP during the period considered.

However, the influence of lower interest charges and the favourable business cycle is likely to be more than offset by the disappearance of non-recurrent factors and, above all, the structural decline in the primary surplus.

In 2005, non-recurrent factors improved the financing balance by 0.5 p.c. of GDP. This year, the impact of those factors should be broadly similar. New real estate sales, mainly via a real estate investment fund with fixed capital (SICAFI) set up for the purpose, should raise over 700 million euro. In addition, the government would again arrange the securitisation and sale of tax arrears in 2006.⁽¹⁾ This concerns indirect taxes and the proceeds are estimated at 600 million euro. However, the net impact of these securitisation operations on the 2006 budget is lower: the operation carried out in 2005 will have the effect of reducing revenues in the ensuing years, as the arrears concerned accrue to the purchasers of the underlying securities on collection. Revenues are expected to be around 160 million euro lower in 2006. In addition, the projections take account of the government's estimate of the revenue from a new operation to settle unpaid taxes which, unlike the

TABLE 9 MAIN NON-RECURRENT FACTORS⁽¹⁾
(Millions of euro, unless otherwise stated)

	2005	2006 e	2007 e
Shift between withholding tax on earned income and assessments	205	0	0
Sales of real estate	171	711	0
Capital transfers in return for taking over pension liabilities ..	503	0	0
Tax regularisation operations ..	0	400	0
Securitisation of tax arrears ..	439	440	-336
Repayment of charges levied or payment of arrears following judicial decisions ...	224	0	0
Energy consumption rebate ..	-145	-97	0
Total	1,397	1,454	-336
<i>p.m. Percentages of GDP</i>	<i>0.5</i>	<i>0.5</i>	<i>-0.1</i>

Sources: NAI, NBB.

(1) A positive (negative) figure improves (deteriorates) the financing balance.

one-off tax regulation applied in 2004, is also applicable to businesses. Finally, the temporary rebate granted in 2006 on household consumption of natural gas is expected to cost almost 100 million euro. For 2007, the estimates only take account of the negative impact on that year's tax revenues of the two securitisation operations mentioned earlier.

Adjusted for the influence of cyclical and non-recurrent factors, and following a small increase over the last two years, the primary surplus is expected to fall by 1.4 p.c. of GDP during 2006-2007.

Despite the budget deficits predicted for 2006 and 2007, the debt ratio should continue to decline during those years. In contrast to 2005, when the reduction in the debt ratio had been seriously curtailed by the debt-increasing impact of the BNRC restructuring, no major adjustments between the deficit and the debt are expected either this year or next. At the end of 2006, the debt ratio should come to 90.4 p.c. of GDP. In 2007, the public debt should continue to fall, dropping to 88.7 p.c. of GDP.

(1) Eurostat will further clarify the statistical treatment of the securitisation operations carried out by the government.

4.2 Revenue

In both 2006 and 2007, public revenues are expected to contract sharply in relation to GDP, by 0.6 and 0.7 p.c. of GDP respectively. This decline is due to the disappearance of non-recurrent measures which boosted revenues in 2005, and measures which, in net terms, reduce the burden of taxes and parafiscal levies.

As regards these last measures, the personal income tax reform will continue to have a significant impact on the tax assessments, especially in 2006 – of almost 1.4 billion euro – as a number of aspects of the reform which came into force in 2004 were not taken into account in the withholding tax on earned income. Moreover, social

security contributions will be further reduced. For 2006, this primarily concerns an extra reduction in the personal contributions for the lowest wages, whereas the cuts in employers' contributions for young workers and older workers, introduced via the Generation Pact, should mainly depress revenues in 2007. Overall, social security contributions would be cut by 650 million euro over the two years. Finally, revenues should also be reduced, although to a lesser extent, by the decision to grant a corporation tax allowance for taxes paid to the regions and subsidies received from them, the increase in the tax allowance for pension savings in the calculation of personal income tax, the gradual abolition of the compensatory excise duty on diesel cars, the reduction in levies on drinks in non-returnable packaging and the reduction in personal income tax planned in the Flemish Region for 2007.

TABLE 10 STRUCTURAL MEASURES RELATING TO PUBLIC REVENUES

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

	2006	2007
Taxes	-572	-441
Personal income tax reform ⁽¹⁾ ...	-1,356	-146
Increased tax allowance for pension savings	-8	-66
Flemish Region tax abatement ..	0	-125
Withholding tax on income from certain capitalisation funds	235	0
Tax allowance for regional taxes and subsidies	-149	0
Tax on class 21 and class 23 insurance products	220	0
Reduction in levies on drinks in non-returnable packaging ...	-97	0
Gradual abolition of the compensatory excise duty on diesel cars	-44	-89
Fight against fraud and more efficient collection	480	0
Other	147	-15
Social security contributions	-323	-332
Reduction in employers' contributions	-38	-332
Reduction in employees' contributions	-361	0
Fight against fraud and more efficient collection ⁽²⁾	76	0
Total	-895	-773
<i>p.m. Percentages of GDP</i>	<i>-0.3</i>	<i>-0.2</i>

Sources: FPS Finance, NSSO, budget documents.

(1) Including the secondary effects on municipal taxes.

(2) Including the levies on company cars.

However, the impact of these reductions in charges should be partly offset by other measures. Thus, specific measures will be taken to further step up the battle against tax and social contribution fraud. In this connection, the estimates take into account the additional revenue of more than 550 million euro expected by the government, including that generated by more efficient collection of social contributions on the private use of company cars. In addition, the levies on certain financial products were increased in 2006. On the one hand, this concerns a new 1.1 p.c. tax on premiums for various insurance products. On the other hand, the share of the surplus value resulting from interest recorded by certain capitalisation investment funds is made subject to the 15 p.c. withholding tax on income from movable property, while the stock market tax on the sale of these funds has been increased. These two tax increases together should bring in around 455 million euro.

Overall, the new measures should lead to a reduction in taxes and parafiscal levies of 0.3 and 0.2 p.c. of GDP respectively in 2006 and 2007.

In addition, structural shifts in the macroeconomic framework are also expected to curb the growth of public revenues. The trend increase in labour incomes, which are taxed at a relatively high rate, would indeed be considerably below the increase in GDP, which automatically reduces revenue as a percentage of GDP.

4.3 Primary expenditure

The estimates of primary expenditure in 2006 take account of the budget of the federal authorities, including the social security budget, and the budgets of the communities and regions. The relatively rapid growth in

2006 is due to the strong expansion of certain categories of expenditure. Thus, after a particularly modest increase in 2005, the real growth of health care spending should once again be well above the trend increase in activity. Moreover, the investment expenditure of the local authorities should continue to rise strongly, as is usual in a municipal and provincial election year. In addition, expenditure in 2006 will be swollen by the increase in the budget earmarked for the service vouchers and by the measures in favour of shift work, the employment of researchers, and overtime working which, in accordance with the ESA 95, are recorded as subsidies.

It is obviously difficult to estimate the growth of primary expenditure for 2007, since no budget is available as yet for that year. The estimates are therefore based on a relatively neutral spending policy, whereby the increase in primary expenditure, adjusted for cyclical and non-recurrent factors, should be close to the trend growth of activity. The impact of the relatively steep rise in health care spending would be offset here by the decline in investment expenditure on the part of the local authorities, typical in a year following the municipal and provincial elections.

5. Assessment of the uncertainty of the projections

The economic projections for Belgium discussed in this article were prepared at a time of significant changes in various ambient factors, namely recent developments in

economic activity and movements on the international financial markets, that could distort the outlook. In the short term, the current upturn in the cycle, which accounts for the 0.3 point upward revision of GDP growth in 2006, could prove a little stronger than expected. All things considered, the strong and rapid improvement in business confidence during the initial months of the year might also suggest a more dynamic expansion in activity. However, confidence could rapidly subside, as attested in recent times.

These projections indicate a gradual slackening of the growth rate, as oil prices remain steady at a high level, with stable exchange rates at their level of mid-May 2006 – following the euro's appreciation during the preceding weeks – rising interest rates and gradually weakening foreign demand. In the current situation, these assumptions – and hence the projections themselves – are subject to a considerable margin of uncertainty.

In view of the continuing sustained demand and tensions on the supply side, which are also fuelled by geopolitical factors, the movement in oil prices, as in prices of other commodities, remains particularly uncertain. Any additional increase in the cost would depress consumption and investment demand via the decline in real household incomes and the operating surplus of businesses. It would curb world growth, and hence export demand. Beyond the direct effect exerted by the energy component of the price index, it would also be liable to rekindle inflationary pressure. Conversely, a degree of

TABLE 11 COMPARISON OF THE FORECASTS FOR BELGIUM
(Percentage changes compared to the previous year)

	Real GDP		Inflation ⁽¹⁾		Publication date
	2006	2007	2006	2007	
NBB – Spring 2006	2.5	2.0	2.4	1.9	June 2006
<i>p.m. Autumn 2005</i>	2.2	n.	2.3	n.	December 2005
Federal Planning Bureau (FPB)	2.4	2.1	2.4	1.8	May 2006
IMF	2.1	2.4	2.4	1.8	April 2006
EC	2.3	2.1	2.4	2.1	May 2006
OECD	2.5	2.4	2.2	1.9	May 2006
Belgian Prime News	2.2	1.9	2.1	1.6	March 2006
Consensus Economics	2.3	2.1	2.3	1.9	May 2006
Economist's Poll	2.2	1.9	2.1	1.8	May 2006
<i>p.m. Actual figures 2005</i>		1.5		2.5	

(1) HICP, except FPB: deflator of private consumption.

TABLE 12 COMPARISON OF THE ASSUMPTIONS

	2006					2007				
	NBB	EC	IMF	FPB	OECD	NBB	EC	IMF	FPB	OECD
Export markets	7.2	7.5	n.	6.6	n.	5.3	5.9	n.	6.2	n.
Oil (dollars per barrel) . . .	70.3	68.9	61.25	66.9	68.0	73.9	71.0	63.0	67.0	70.0
Short-term interest rate . .	3.1	n.	3.0	3.1	2.7	3.9	n.	3.4	3.3	3.4
Long-term interest rate in Belgium	4.0	n.	n.	3.9	4.0	4.2	n.	n.	4.1	4.3
Dollars per euro	1.25	1.22	1.19	1.22	1.24	1.27	1.22	1.20	1.24	1.26

normalisation cannot be ruled out, though the timescale is difficult to define.

The substantial current account imbalances which have persisted for several years, and will tend to increase slightly in 2006 and 2007, could trigger a larger increase in long-term interest rates than was allowed for in the assumptions, or major exchange rate adjustments. A sudden appreciation of the euro would damage the price competitiveness of the euro area and the growth of international trade in goods, variables to which the Belgian economy is particularly sensitive.

In Germany, major changes to indirect taxes are planned for 2007, accompanied in particular by a measure to reduce employers' contributions and to speed up depreciation temporarily under the tax rules. Given the unusual

character of the measures, the effects which they will exert in the short and medium term on the behaviour of the economic agents, and their impact on the neighbouring economies, are difficult to predict with any accuracy.

As regards the pattern of activity, the Bank's projections differ from those of the international institutions and the average views of the private forecasters in that GDP growth is put slightly higher in 2006, with a more marked slowdown in 2007. These differences mainly reflect a more favourable starting situation, as indicated by recent statistical information, and the effect of less favourable medium-term assumptions, particularly for the euro exchange rate and the dollar price of oil. These last two factors largely cancel one another out where inflation is concerned, so that the Bank's projections on that point are similar to those of the international institutions.

Annex

PROJECTIONS FOR THE BELGIAN ECONOMY: SUMMARY OF THE MAIN RESULTS

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

	2003	2004	2005	2006 e	2007 e
Growth (calendar adjusted data)					
GDP at 2000 prices	0.9	2.4	1.5	2.5	2.0
Contributions to growth:					
Domestic expenditure, excluding change in stocks	1.0	2.0	2.8	1.7	1.9
Net exports of goods and services	0.0	-0.3	-0.9	0.4	0.2
Change in stocks	-0.1	0.7	-0.3	0.4	-0.1
Prices and costs					
Harmonised index of consumer prices	1.5	1.9	2.5	2.4	1.9
Health index	1.5	1.6	2.2	1.7	1.9
GDP deflator	1.7	2.3	2.2	1.5	1.9
Terms of trade	-0.1	-0.5	-0.7	-0.6	0.1
Unit labour costs in the private sector	0.2	0.0	1.6	0.8	0.8
Hourly labour costs in the private sector	1.5	1.9	1.8	2.4	1.9
Hourly productivity in the private sector	1.3	1.9	0.2	1.6	1.1
Labour market					
Domestic employment (annual average change in thousands of units)	-3.3	23.7	38.5	38.2	41.6
Harmonised unemployment rate ⁽¹⁾ (p.c. of the labour force) ...	8.2	8.4	8.4	8.2	8.2
Incomes					
Real disposable income of individuals	-1.0	-0.2	1.3	1.8	2.2
Savings ratio of individuals (p.c. of disposable income)	14.3	12.8	13.0	12.7	13.0
Public finances					
Primary balance (p.c. of GDP)	5.4	4.8	4.5	3.9	2.8
Financing requirement (-) or capacity of general government (p.c. of GDP) ⁽²⁾	0.1	0.0	0.1	-0.3	-1.2
Public debt (p.c. of GDP)	98.5	94.7	93.3	90.4	88.7
Current account					
(p.c. of GDP according to the balance of payments)	4.1	3.4	1.7	2.1	2.3

Sources: EC, NAI, NSI, NBB.

(1) "Adjusted series" (Eurostat).

(2) According to the methodology used in the excessive deficit procedure (EDP).