Economic projections for Belgium – Spring 2009

Introduction

At the time of compiling these projections for 2009 and 2010, the world economy is going through a recession of unprecedented severity in post-war history. The financial crisis, the first signs of which emerged in the United States in 2007, took a serious turn for the worse during the autumn of 2008. It hit all the markets, with investors' mistrust in banking institutions leading them, just like enterprises and households, to increasingly show their preference for security and liquidity. These developments on the financial markets did not spare the real economy either, since a large proportion of industrial activity and, consequently, of business-related services too, was suddenly paralysed from the fourth quarter of 2008 onwards. Through the channel of international trade, this phenomenon spread very rapidly to all the developed economies – in particular the euro area, which has a high degree of openness – and to the emerging economies.

The release of statistics made it possible to gradually gauge the extent of the drop in GDP at the end of 2008 and in the first quarter of 2009, which was unprecedented in speed and scope. It turned out to be considerably more dramatic than had originally been expected. Consequently, week after week from autumn 2008 onwards, economic forecasts were revised downwards sharply. This was particularly the case for Eurosystem and ECB projections for the euro area, and those of the Bank for Belgium. Departing from its quarterly publication schedule, the Bank presented interim projections in February 2009, which pointed to a fall in GDP of 1.9 p.c. in 2009, as the forecasts that had been published two months earlier in the December 2008 Economic Review were by then already out of date. Now it seems that these interim forecasts further underestimated the extent of the deterioration in the economy.

The authorities swiftly took resolute action on both the monetary and fiscal fronts in order to prevent the financial sector from collapsing and to cushion the effects of the recession. Some signals, notably from the financial markets and from the indicators compiled from business surveys, point more to a stabilisation of the factors that had triggered the crisis than to any clear turnaround in demand prospects. Indeed, at the same time, there is still a great deal of financial tension, and the scale of the recession will necessitate heavy adjustments in the areas of employment, investment and the banking institutions' own positions. According to these projections, these adjustments could delay the economic recovery until 2010 and then further restrain it.

It is against this rather depressed and uncertain backdrop that the 2009-2010 economic projections for Belgium are presented in this article. The first chapter gives a broad overview of recent developments and prospects for the international environment, as well as the results for the euro area of the Eurosystem central banks' projections. The technical assumptions made in the framework of this joint exercise are presented in a box. Chapter 2 sets out the results for economic activity, employment and demand components in Belgium, while chapter 3 deals with inflation and changes in labour costs. Chapter 4 then focuses on general government sector accounts. In this respect, it should be recalled that the public finance figures have been compiled taking account only of measures that have been formally decided by the authorities, in the context of the fiscal stimulus packages, for instance. Besides, they depend on more recent outcomes, on changes in expenditure based on an assessment of historical trends and on the endogenous effect of the macroeconomic environment. Finally, the last chapter analyses the main risk factors likely to affect these projections, and sums up the findings of the other institutions.

The projections were closed on the basis of information available as at 20 May 2009.

1. International environment

1.1 The global economy

By the end of 2008, the international financial crisis had turned into a widespread economic recession, unprecedented in post-war history in terms of severity and the extent to which it spread. International trade collapsed at the end of last year and at the beginning of this year, causing the economic crisis to spread and giving it a highly synchronised character.

The United States and the euro area had already entered into recession during the course of 2008. The decline in activity was particularly marked in the fourth quarter, reaching respectively 1.6 and 1.8 p.c. compared with the previous quarter. In the United States, the continued correction of the residential property market, negative wealth effects, stricter borrowing conditions and the deterioration of the labour market weighed heavily on domestic demand. In the euro area, private consumption held up better, but investment was badly affected and exports collapsed at the end of the year.

The rest of the world has also been heavily hit by the collapse of international trade, so this is a major channel through which the economic crisis has spread throughout the world. The Japanese economy sank ever deeper into recession at the end of 2008, while the emerging economies and the developing countries were increasingly badly affected by the crisis. In this respect, the growing international integration of production processes observed over the last few decades, which has helped boost the volume of trade much more than the value of final production, amplified the effect of falling demand on export markets. This aggravated the decline in exports from some of the emerging economies in Asia, and in particular in China, a country which plays a vital role in the Asian production chain. Moreover, the growing shortage of trade finance may also have reinforced the downward trend in trade flows.

As well as being adversely hit by the significant decline in international trade, some emerging economies, particularly in central and eastern Europe, were also exposed to the effect of the sudden turnaround in international investor sentiment, which led to financing flows towards these economies largely drying up against a backdrop of increased risk aversion. And countries like Russia whose economy is strongly dependent on exports of oil or other raw materials, had to cope with the impact of falling commodity prices.

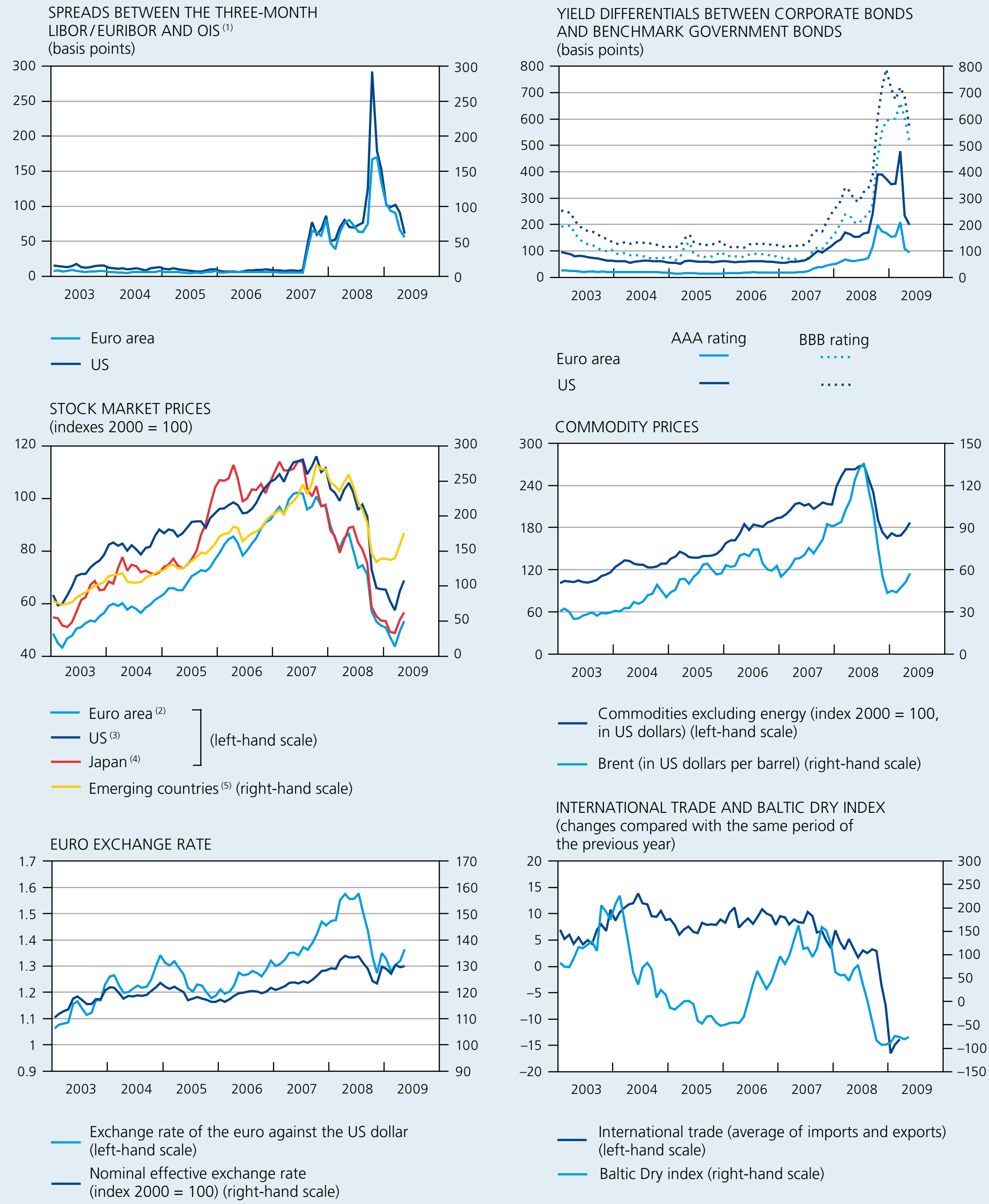
The deterioration of the global economic situation resulted in a significant weakening in demand for commodities in the second half of 2008 and, consequently, a sharp reduction in their prices. Thus, oil prices, which had reached a peak of 145.7 dollars a barrel of *Brent* in July 2008, stood at around 40 dollars at the end of December, corresponding to a drop of around 70 p.c. Prices of other commodities also came down over this period, albeit to a lesser extent with a decline of around 40 p.c. The fall in commodity prices brought with it a positive effect in that inflation came down considerably from mid-2008 onwards, notably in the advanced economies, something which was beneficial for households' purchasing power.

Labour markets have deteriorated significantly in recent months. Job creation in major advanced economies has been affected in construction and in industry, in an environment marked by a decline in trade in goods and by a sharp drop in industrial production.

The international financial crisis, which intensified in the second half of 2008, and the marked deterioration in the economic situation prompted a rapid economic policy response, based on past experience. Thanks to vigorous capital injections, governments were able to prevent the international financial system from collapsing and managed to stabilise the financial markets. Monetary policy-makers relaxed their monetary policy considerably. The US Federal Reserve continued its move towards lower interest rates and cut its target for the federal funds rate to within a range from 0 to 0.25 p.c. in December 2008, while the Bank of Japan reduced its key interest rate in stages to 0.1 p.c. The ECB brought its own central rate down to 1 p.c. in May 2009, when it was still as high as 4.25 p.c. at the beginning of October 2008. Furthermore, the central banks took various measures – sometimes non-standard – and resorted to a wide range of policy instruments with a view to ensuring ample supply of liquidity and shore up the financial markets. In addition, governments announced a wave of ambitious fiscal measures to stimulate the economy. In the United States, for instance, the measures that were adopted under the *Emergency Economic Stabilization Act*, the *American Recovery and Reinvestment Act* and the *Financial Stability Plan*, among others, aim to put the financial sector on a sounder footing, stabilise the property market and support the labour market. In line with the European Economic Recovery Plan approved at the December 2008 summit, the Member States of the European Union took important initiatives to boost domestic demand and safeguard jobs. On the international front, the G-20 drew up an extensive action

CHART 1 DEVELOPMENTS ON THE FINANCIAL AND COMMODITY MARKETS AND IN INTERNATIONAL TRADE

(monthly averages)



Sources : Bloomberg, CPB, HWWI, Thomson Financial Datastream.

(1) Fixed rate paid by the counterparty of a interest rate swaps receiving the overnight rate for a three months term (Eonia for the euro area, effective federal funds rate for the United States).

(2) *Dow Jones Euro Stoxx Broad* index.

(3) *Wilshire 5000* index.

(4) *Topix* index.

(5) *MSCI Emerging Markets* index.

programme designed to facilitate a sustainable return to financial stability and establish an appropriate framework for the recovery of economic activity worldwide, including by strengthening financial regulation, through better international coordination of economic policies and by rejecting protectionism. It was agreed to triple the International Monetary Fund's lending capacity, by raising it to 750 billion dollars, and to back a new allocation of special drawing rights, of 250 billion dollars, to make it easier for the Fund to help countries to brave the financial crisis.

The financial markets progressively stabilised in the early months of 2009. The extreme risk aversion and the tensions on the interbank market gradually eased – even though the latter is still not functioning normally –, while signs of investor confidence returning appeared from March onwards. However, the situation on the financial markets remains fragile and bank lending to households and enterprises continues to slow down.

Besides the developments observed on the financial markets, global economic activity, international trade and confidence indicators further deteriorated or remained at all-time lows, which shows that the economic recession is continuing. In the United States, provisional estimates point to a drop in GDP of 1.5 p.c. in the first quarter of 2009. In the euro area, the reduction in activity is estimated at 2.5 p.c. Furthermore, in Japan, the economic situation worsened further during the first few months of the year, while, in China, activity has barely expanded on a quarterly basis.

However, some signs of improvement are gradually beginning to emerge, here and there. In this respect, international trade does no longer appear to be shrinking at such a high pace. In the United States, private consumption has picked up somewhat in the first quarter of 2009, and some encouraging signals are emerging on the residential property market. In the euro area, the confidence indicators recovered in April and May from a historically low level. In China, faltering signs suggest that economic activity could regain momentum over the next few quarters. Commodity prices also started to rise at the end of the first quarter, although partly on account of a reduction in oil production. Overall, these positive signals nevertheless remain patchy and hardly alter the global picture depicting persistent sluggishness of activity, which shows up widely through the economic indicators.

Consequently, the forecasts for the year 2009 as a whole remain bleak. The sharp reduction in activity in the final quarter of 2008 and the first three months of 2009 will already be weighing heavily on the year-on-year economic growth rate in 2009. Moreover, the prospect of a prolonged weakness of demand, excess production capacity throughout the world, the continued correction on the residential property markets, persistently strict borrowing conditions and the continued vulnerability of the financial system are all factors that will keep economic activity in check during the course of 2009.

On the other hand, the rapid decline in inflation over the year 2009 and the subsequent improvement in real disposable income of households should bolster private consumption. In addition, the wide-ranging economic stimulus measures should have an effect on production. But the situation on the labour market, which usually follows trends in economic activity with a certain time lag, is likely to get considerably worse, and this in turn will dampen private consumption.

Overall, global GDP is expected to drop by almost 1.5 p.c. in 2009, according to the latest forecasts drawn up by various international organisations. Trade in goods and services is projected to fall back dramatically, by around 11 p.c. compared with 2008, and is therefore likely to remain the principal channel via which the economic crisis is spreading throughout the world.

Negative GDP growth of almost 3 p.c. is forecast in the United States. Despite some signs of improvement, the situation is still worrying in the residential building sector. Private consumption is expected to remain sluggish, not only because of the impact of heavy losses of wealth incurred in 2008, but also because of the sharp deterioration of the situation on the labour market predicted for 2009. Investment and exports are also projected to drop substantially. In Japan, economic activity is expected to slow down even more markedly, falling by just over 5 p.c. according to the EC's Spring forecasts. In 2009, this country is expected to be faced once again with a situation of deflation, in a context of steeply declining exports and investment. For China, on the other hand, projections point to a continued rise in GDP, of a little more than 6 p.c. The expansion of economic activity in China, as well as in India, thus, is a major exception to the general trend of declining activity. Growth projections for China nevertheless also imply a marked slowdown compared with the previous years, exports from this countries being to a large extent penalised by the weakening of international trade.

Overall, the economic slowdown is gradually expected to decelerate during the course of 2009 and global economic growth should pick up in 2010. On account of a supportive macroeconomic policy, progressively less strict financial conditions, stabilisation of residential property markets and a recovery of international trade, especially in the emerging economies, world GDP should expand

TABLE 1 PROJECTIONS FOR THE MAIN ECONOMIC REGIONS EXCLUDING THE EURO AREA
(percentage changes compared to the previous year, unless otherwise stated)

	2008	2009	2010
	Actual	Projections	
GDP in volume			
World	3.1	–1.4	1.9
of which:			
United States	1.1	–2.9	0.9
Japan	–0.7	–5.3	0.1
United Kingdom	0.7	–3.8	0.1
China	9.0	6.1	7.8
India	7.2	4.3	5.0
Russia	5.6	–3.8	1.5
Brazil	5.1	–1.4	2.2
p.m. Global imports	*2.7*	*–10.6*	*0.9*
Inflation (1)			
United States	3.8	–0.7	0.3
Japan	1.4	–1.0	–0.5
United Kingdom	3.6	1.0	1.3
Unemployment rate (2)			
United States	5.8	8.9	10.2
Japan	3.9	5.8	6.3
United Kingdom	5.6	8.2	9.4

Source: EC (Spring forecasts, May 2009).
(1) Consumer price index.
(2) Percentages of the labour force.

once again by nearly 2 p.c. in 2010. Nevertheless, developments on the financial markets and general economic conditions remain highly uncertain.

1.2 Eurosystem projections for the euro area

Already substantially weakened by the financial tensions and, in some countries, by the marked deterioration of the property market, the euro area was hit directly by the repercussions of the synchronised collapse in demand from most of its trading partners, at the end of 2008 and at the beginning of 2009. After having slipped back slightly during the two previous quarters, GDP fell by 1.8 p.c. in the fourth quarter of 2008 and by 2.5 p.c. in the first three months of 2009. At the same time, inflation has fallen back from 4 p.c. in July 2008 to 0.6 p.c. in April 2009, mainly on account of the drop in commodity prices [1].

The unexpected magnitude of these movements led to a major revision of growth and inflation forecasts, not only in comparison with the Eurosystem projection exercise published in December 2008, but also, as far as economic activity is concerned, with the ECB's interim projections issued in March 2009. Overall, after having shown a small increase of 0.6 p.c. in 2008, real GDP is expected to fall by between 5.1 and 4.1 p.c. in 2009. In 2010, growth is likely to range between –1 and 0.4 p.c. Inflation is forecast to drop from 3.3 p.c. on average in 2008 to a rate between 0.1 and 0.5 p.c. in 2009 and between 0.6 and 1.4 p.c. in 2010.

Against the backdrop of generalised recession, persistently tight borrowing conditions and low levels of business and consumer confidence, the euro area is thus confronted

(1) According to Eurostat's flash estimate, inflation stood at 0 p.c. in May

TABLE 2 EUROSYSTEM PROJECTIONS

(percentage changes compared to the previous year)

	Euro area			*p.m. Belgium*		
	2008	2009	2010	*2008*	*2009*	*2010*
Inflation (HICP)	3.3	0.1 / 0.5	0.6 / 1.4	*4.5*	*0.1*	*1.3*
GDP in volume	0.6	–5.1 / –4.1	–1.0 / 0.4	*1.0*	*–3.5*	*–0.2*
of which:						
Private consumption	0.3	–1.3 / –0.5	–1.1 / 0.3	*0.8*	*–0.9*	*0.2*
Public consumption	2.0	1.4 / 2.0	0.9 / 1.7	*2.1*	*1.2*	*1.8*
Investment	–0.3	–12.3 / –10.1	–6.1 / –2.1	*5.1*	*–5.2*	*–2.7*
Exports	0.8	–16.6 / –14.0	–2.0 / 1.0	*2.1*	*–16.0*	*–2.3*
Imports	0.9	–13.8 / –11.2	–3.0 / 1.4	*3.3*	*–14.9*	*–2.0*

Sources: ECB, NBB.

with the prospect of an extended period of economic sluggishness. On the demand side, exports – and along with them investment too – should decline sharply in 2009. Private consumption is also expected to drop in 2009 and is likely to remain weak in 2010. Purchasing power should of course be boosted temporarily by the slowdown in inflation, but increasingly bleak income prospects and capital losses sustained on both financial and property assets are likely to encourage households to rein in their expenditure. In particular, adjustments that companies are having to make in terms of jobs are likely to continue in 2010, leading to an increase in the unemployment rate over the whole period covered by the projections.

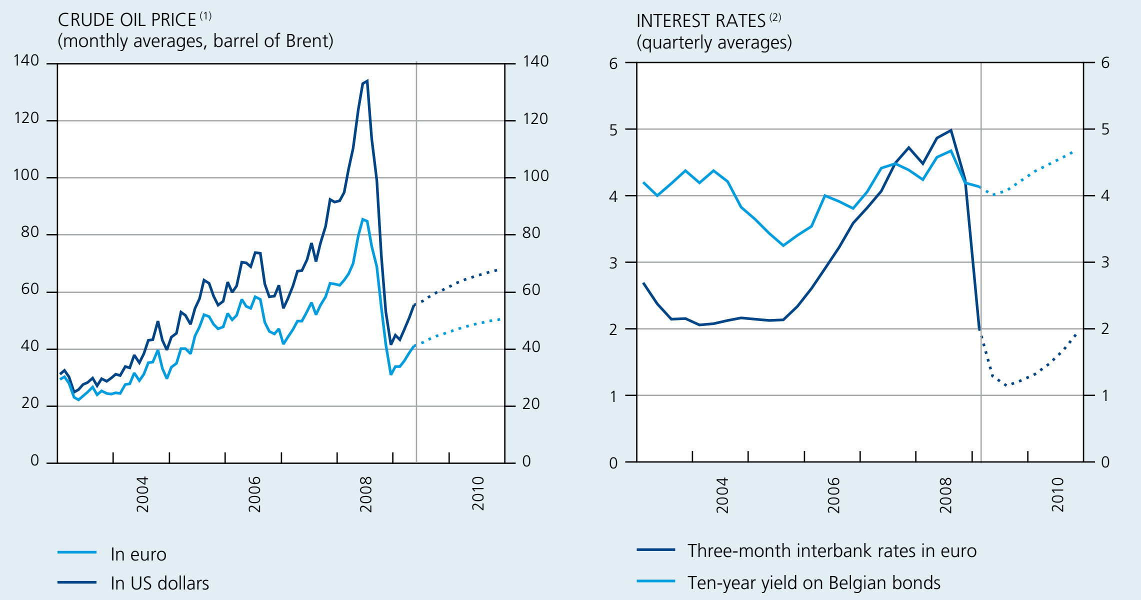
The recent slowdown in inflation is also expected to continue in the short run. Inflation is even likely to be negative for a few months, on account of significant base effects related to the high oil prices a year before. Since this only has a temporary impact, inflation is expected to return to positive figures at the end of 2009 and in 2010. It is nevertheless likely to remain low, in the absence of wage pressure, against a backdrop of persistently weak economic activity and the worsening employment market.

Box 1 – Eurosystem assumptions

The Eurosystem's economic projections for the euro area, and the Bank's corresponding forecasts 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 expected to come down from 4.6 p.c. in 2008 to 1.4 p.c. in 2009, and then rise again to 1.6 p.c. in 2010. This trend assumes a normalisation of spreads in relation to the ECB's key interest rate and the overnight money market rate, which had emerged on account of the financial tensions. Rates on ten-year Belgian government bonds are estimated at 4.4 p.c. in 2008, 4.1 p.c. in 2009 and expected to rise to 4.5 p.c. in 2010. Compared to these reference rates, the assumptions also include a supplementary increase in the cost of financing corporate and household investment of respectively some 10 and 30 basis points;
- the bilateral euro exchange rates are kept constant at their value as at mid-May 2009, namely 1.34 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 54.5 dollars in 2009 and 65.5 dollars in 2010, against 97.7 dollars in 2008;

ASSUMPTIONS WITH REGARD TO CRUDE OIL PRICE AND INTEREST RATE



Source: ECB.
(1) Actual figures up to April 2009, assumption from May 2009.
(2) Actual figures up to the first quarter of 2009, assumption from the second quarter of 2009.

– in 2008, Belgium's export markets, measured as the weighted total of the volume of imports of the trading partners, including those in the euro area, only expanded by 2.3 p.c., while they had posted an annual average growth rate of close to 7 p.c. over the five previous years. They are likely to shrink by 11.3 p.c. in 2009, owing to the collapse in world trade observed at the end of 2008 and at the beginning of 2009, and should only rise by 0.2 p.c. in 2010;

ASSUMPTIONS FOR THE EUROSYSTEM PROJECTIONS

	2008	2009	2010
		(annual averages)	
Three-month interbank rates in euro	4.6	1.4	1.6
Ten-year Belgian government bond yields	4.4	4.1	4.5
Euro exchange rate against the US dollar	1.47	1.33	1.34
Oil price (US dollar per barrel)	97.7	54.5	65.5
		(percentage changes)	
Export markets relevant to Belgium	2.3	–11.3	0.2
Export competitors' prices	2.2	–2.6	–0.3

Source: ECB.

– the export prices of competitors are forecast to fall by 2.6 p.c. in 2009 and by 0.3 p.c. in 2009;
– as is usual according to Eurosystem conventions, the figures for public finances are calculated taking account of the macroeconomic environment and measures which have already been announced and are specified in sufficient detail.

2. Activity, employment and demand in Belgium

2.1 Activity and employment trends

The slump in the euro area at the end of 2008 and at beginning of 2009 hit economic activity in Belgium head on. Both industrial production and foreign trade in goods plummeted from October 2008 onwards, their year-on-year decline reaching around 15 p.c. in February 2009. Industrial production had by then fallen back to its level of 2002. More broadly speaking, the downswing in the economy also affected the transport and business-related services branches of activity, in the wake of the deteriorating business climate and efforts undertaken by enterprises to cut back their operating costs, as well as trade and hotels and restaurants, reflecting consumer restraint in a highly uncertain economic outlook.

Overall, real GDP fell back by 1.7 p.c. in the fourth quarter of 2008, then by a further 1.6 p.c. in the first quarter of 2009, a pace of economic contraction not seen since the Second World War. The extent of the fall in the the Bank's synthetic business indicator between September 2008 and March 2009 and the decline in the rate of production capacity utilisation in the manufacturing industry – from 82.4 p.c. in October 2008 to 70.1 p.c. in April 2009 – also bear witness to the unprecedented abruptness of the drop in economic activity. While the business indicators have been showing some signs of stabilisation of in Belgium since April, as in other countries, the level of these indicators points to more negative growth in the short term, albeit less marked than in the two previous quarters.

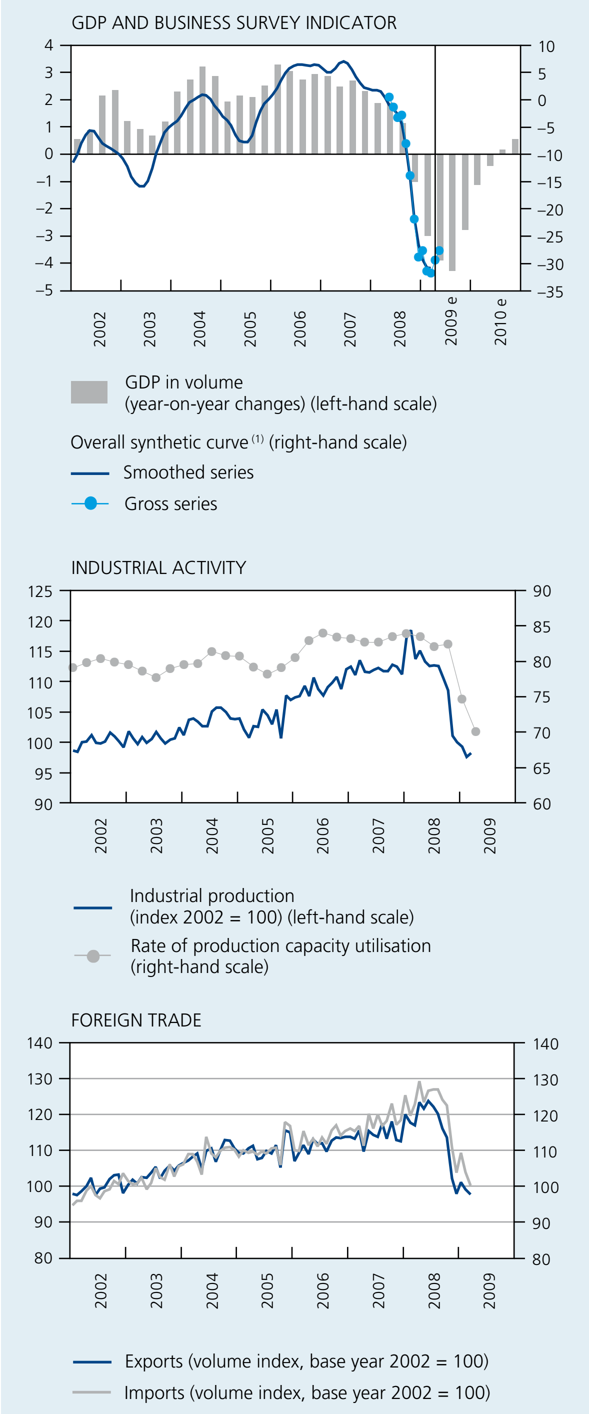
Even though these projections tend to be based on the assumption of a gradual easing of the financial tensions and strengthening of the global economy, the changes that still need to be made by financial institutions to get back on a firm footing and, more generally, the adjustments in terms of investment and employment that the economic recession will trigger within enterprises should continue to restrain the upturn in economic growth. This recovery is not expected until the beginning of 2010, and then only on a limited scale. In annual average terms, after having grown by 1 p.c. in 2008, GDP is expected to contract by 3.5 p.c. in 2009 and by 0.2 p.c. in 2010.

In the face of the sudden drastic cutback in a large part of economic activity at the turn of this year, enterprises reacted first and foremost by activating the flexibility levers in the use of labour. In 2008, they cut back on temporary work, among both white-collar and blue-collar staff, although to a larger extent for the latter. For this category of workers, they also resorted much more widely to temporary lay-offs for economic reasons. In March 2009, the NEO – the public office responsible for paying out the allowance compensating for the loss of income during the period of inactivity – recorded around 313,000 persons concerned by this scheme, out of a potential total of 1.3 million bluecollar workers in Belgium. In April, the number of temporary unemployed fell by almost 100,000 units from the previous month's peak, largely for seasonal reasons. However, the year-on-year rise still comes to more than 75 p.c.

By reducing the volume of labour while preserving staffing levels in enterprises, this measure implicitly cuts the average number of hours worked per employee. Initially, it enables hourly productivity to be maintained within firms and helps curb the rise in unemployment. Thus, in Belgium, the harmonised unemployment rate remained stable, hovering around 7 p.c., until the first quarter of 2009, whereas there was already an upward trend in the number of jobless within the euro area as a whole. As part of the wider economic stimulus measures, the government decided in late April 2009 to set up a temporary scheme for suspending execution of the employment contract for white-collar workers. This measure will run from 1 July to 31 December 2009, although this period may be extended until mid-2010 following an opinion from the National Employment Council. Its implementation at firm level is subject to conditions, notably as regards the extent of the drop in activity justifying the measure.

CHART 2 CYCLICAL DEVELOPMENTS IN ACTIVITY

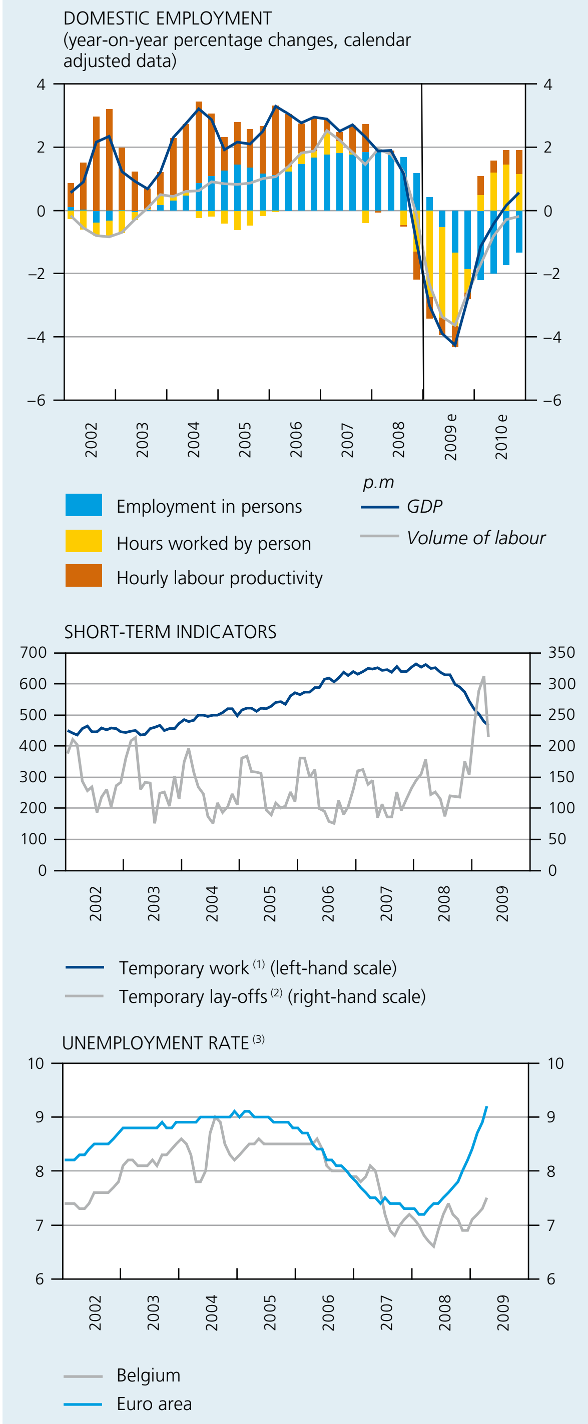
(seasonally and calendar adjusted data, unless otherwise stated)



Sources: DGSEI, NAI, NBB.
(1) Seasonally adjusted data.

CHART 3 LABOUR MARKET DEVELOPMENTS

(seasonally adjusted data, unless otherwise stated)



Sources: EC, FEDERGON, NAI, NEO, NBB.
(1) Thousands of hours worked by temporary agency workers.
(2) Thousands of persons (concept of physical units), non-seasonally adjusted data.
(3) Harmonised, percentages of the labour force.

TABLE 3 LABOUR SUPPLY AND DEMAND

(calendar adjusted data, annual averages)

	2006	2007	2008	2009 e	2010 e
	(percentage changes)				
GDP	3.0	2.6	1.0	–3.5	–0.2
Volume of labour	1.5	2.0	1.2	–3.0	–0.8
Domestic employment (persons)	1.4	1.8	1.6	–0.8	–1.8
	(changes in thousands of persons)				
Domestic employment	58.1	77.4	71.2	–36.5	–79.6
Employees	50.8	69.4	64.1	–33.4	–74.0
of which : branches sensitive to the business cycle	35.4	53.7	44.7	–44.8	–85.2
Self-employed	7.3	8.0	7.1	–3.1	–5.5
Frontier workers	2.5	1.0	0.7	0.3	0.1
Total employment	60.6	78.4	71.8	–36.2	–79.5
Unemployed job-seekers	–8.1	–55.4	–27.6	67.8	111.1
Labour force	55.2	25.1	46.0	33.3	33.2
p.m. Harmonised activity rate (1)	*66.5*	*67.1*	*67.1*	*66.7*	*66.8*
Harmonised employment rate (1)	*61.0*	*62.0*	*62.4*	*61.2*	*59.8*
Harmonised unemployment rate (2)	*8.3*	*7.5*	*7.0*	*7.7*	*9.2*

Sources : EC, NAI, NEO, NBB.
(1) Percentages of the population of working age (15-64 years).
(2) Percentages of the labour force.

Despite this recent extension to white-collar workers, these schemes only enable fluctuations in production to be cushioned temporarily. In view of the deep-seated and lasting nature of the downturn in activity, there is likely to be increasing evidence of a reduction in the number of people in employment over the course of 2009 and again in 2010. In parallel with the forecast 3.5 p.c. decline in GDP in 2009, the volume of employment, measured by the total number of hours worked in the economy, is projected to fall by 3 p.c. this year, and then by 0.8 p.c. in 2010. In turn, the drop in the number of persons in paid employment is expected to be no more than 0.8 p.c. in 2009, before rising to 1.8 p.c. the following year, giving net losses of respectively 36,000 and 80,000 jobs as an annual average. While the number of persons employed continued to grow until the end of 2008, job losses are now likely to exceed, for the first time in more than five years, new job creations from the first quarter of 2009 onwards. The bulk of the job losses are nevertheless expected later in the year and at the beginning of 2010. All in all, 140,000 jobs are likely to be lost between the end of 2008 and the end of 2010.

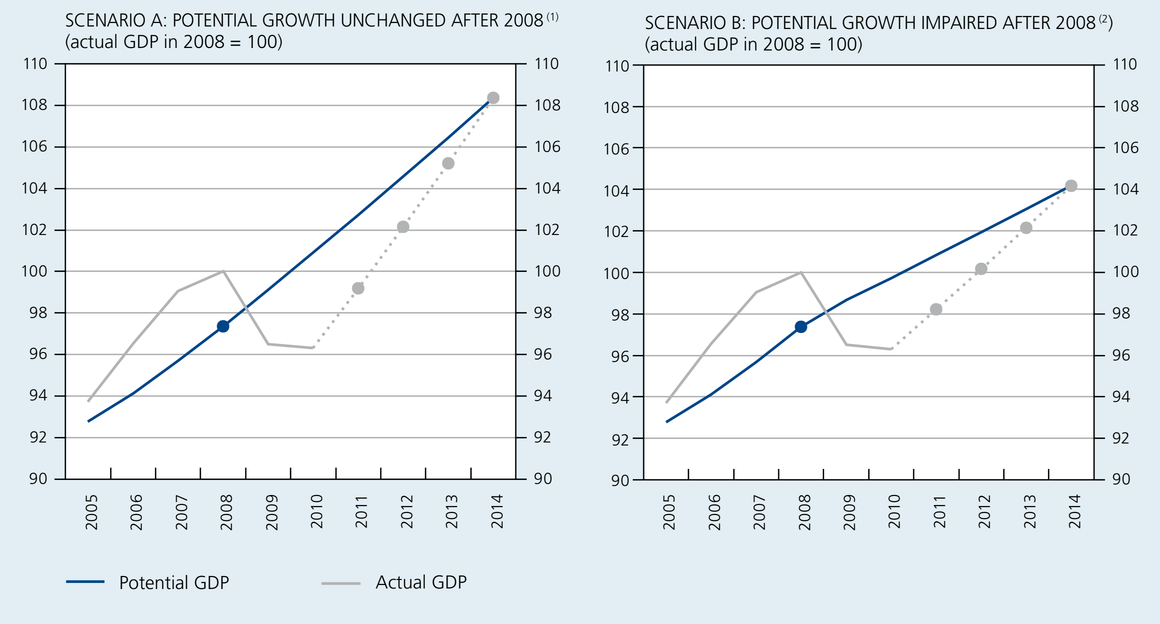
The reduction in employment, together with an estimated growth of the labour force by 33,000 persons each year, will lead to a cumulative increase in the number of unemployed job-seekers of 179,000 units over the two years covered by the projections. The average unemployment rate is forecast to rise from 7 p.c. in 2008 to 9.2 p.c. in 2010. It is expected to reach 9.7 p.c. by the end of 2010.

Box 2 – Could the recession affect the economy's potential growth path ?

Whether the current crisis may or may not have a permanent impact on economic growth is a crucial question for future prosperity. The present projections indicate a hesitant growth revival during 2010, though growth will be well below its average rate, and nowhere nearly strong enough to compensate for the contraction in economic activity recorded in 2009. Such a slow recovery suggests that the crisis could also depress economic growth in the longer term.

The long-term growth projections are based on potential growth, i.e. the maximum growth attainable using the available production factors – capital and labour – and the total productivity of those factors in the production process, without generating tensions on the product and labour markets. In the short term, there might be a discrepancy between potential growth and the figure actually recorded, constituting the output gap. At present that gap is decidedly negative. On the basis of that situation, two scenarios are possible : either the economy regains the potential growth path prevailing prior to the crisis, a scenario which would require an economic boom lasting several years (scenario A), or the crisis depresses potential growth (scenario B), thus putting a permanent brake on the rise in the standard of living.

POTENTIAL AND ACTUAL GDP GROWTH SCENARIOS IN BELGIUM IN THE CONTEXT OF THE MARKED DECLINE IN ACTIVITY



Source : NBB.
(1) This chart shows the growth of actual GDP needed in order to close, over a four-year period, the negative output gap which emerged in 2009-2010, assuming that potential growth remains unchanged at 1.8 p.c. after 2008. In that case, actual annual GDP growth would have to average 3 p.c. from 2011.
(2) This chart shows the growth of actual GDP needed in order to close, over a four-year period, the negative output gap which emerged in 2009-2010, assuming that potential growth drops to 1.1 p.c. from 2010. In that case, actual annual GDP growth would have to average 2 p.c. from 2011.

Previous episodes have indicated that recessions often tend to impair the economy's potential growth as a result of the indirect effects which the fall in demand exerts on total supply via various channels : via the production factor labour, by generating higher structural unemployment, via a slower accumulation of capital, and finally via weaker productivity growth. Potential growth may be curbed just for a few years, but also in the longer term, witness the example of Japan since the early 1990s. The effect on potential growth depends on the scale of the recession and its characteristics. In that regard, the current recession calls for particular attention: first, it is the most severe recession since the end of World War II, and second, it is accompanied by a financial crisis which could have a direct effect on the supply side of the economy. Moreover, it should be noted that potential growth is also determined by factors unconnected with the crisis, such as the expansion of the labour force (labour supply), which is already likely in itself to act as a brake in the coming years, owing to population ageing.

The present projections forecast a marked rise in unemployment, which is likely to come close to the peak seen in the early 1980s. In the past, strong increases in unemployment, particularly during the 1970s, were largely structural in character: thus, the unemployment rate hardly declined at all, or only very gradually, when activity picked up, and exerted downward pressure on potential growth. Although the current rise in unemployment is smaller and the risk of such hysteresis effects may have diminished in Europe, owing to slower growth of the available labour supply and a more active labour market policy, the current crisis will pose a decisive test for the operation of the labour market. The labour supply will probably be less in line with demand, in view of the fairly marked decline in activity in certain branches, such as financial services and some industrial sectors. That situation could reinforce the structural character of unemployment. In that regard, a number of studies have indicated that Belgium is particularly vulnerable: the percentage of job seekers who have still not found suitable employment after one year is in fact significantly higher in Belgium than in the euro area (Hobijn and Sahin, 2007).[1] The labour market policy has a key role to play here, particularly in regard to placement and training services.

It also seems that the current recession could affect potential growth via a slowdown in investment and hence weaker growth of the capital stock.

The sudden, sharp downturn in activity has depressed the capacity utilisation rate in manufacturing industry, taking it to a record low of 70.1 p.c. in April 2009. That decline suggests that, even given a significant rise in activity, firms will show little readiness to increase their capital stock. In some ways, that situation might correspond to a correction of possible excess investment in the past. The financial crisis could augment the downward pressure on investment via increased risk premiums or by financial institutions tightening the other lending conditions which drive up the cost of capital. Existing investments would then be less swiftly replaced by new ones, or part of the capital stock could become obsolete and therefore less productive. In particular, that scenario is plausible in branches of activity experiencing a substantial decline in the capacity utilisation rate.

Past observations indicate that the impact of the recession on total factor productivity (TFP) is uncertain. Thus, if the allocation process is disrupted in both the labour and capital markets, in an economy facing structural shifts, both between certain branches of activity and between the private and public sectors, that would have an adverse influence on productivity. Moreover, given the liquidity problems and the resulting rise in the debt ratio, the recession could inhibit corporate investment in R&D and government investment in education and infrastructure, a phenomenon which could in turn be amplified by tighter financing conditions. Conversely, the example of the three Nordic countries shows an increase in productivity following the financial crisis of the early 1990s (Haugh et al., 2009).[2] That increase could be triggered by a creative destruction process, as the least productive firms disappear from the market, or by the implementation of essential structural reforms, a route more readily accepted in times of crisis.

The potential growth projections are subject to a margin of uncertainty: not only is short-term GDP growth still unknown, potential growth – which cannot be directly measured – also has to be calculated on the basis of statistical models. Therefore, bearing these points in mind and being guided by notable episodes from the past, it

(1) Hobijn B. and A. Sahin (2007), *Job finding and separation rates in the OECD*, Federal Reserve Bank of New York Staff Paper, n° 298.
(2) Haugh D., P. Ollivaud and D. Turner (2009), *The macroeconomic consequences of banking crises in OECD countries*, OECD, Working Paper 683.

POTENTIAL GROWTH

	Belgium (NBB)			Euro area (EC)		
	2006-2008	2009	2010	2006-2008	2009	2010
Actual GDP growth (1)	2.2	–3.5	–0.2	2.1	–4.0	–0.1
Contribution to potential growth (2)	1.6	1.3	1.1	1.5	0.7	0.7
Labour	0.4	0.0	0.0	0.2	–0.2	–0.1
Capital	0.9	1.0	0.7	0.8	0.5	0.4
TFP	0.4	0.4	0.4	0.4	0.4	0.4
p.m. Potential growth						
Federal Planning Bureau	*1.8*	*1.2*	*1.2*			
EC	*1.8*	*1.0*	*1.0*			

Sources: EC, Federal Planning Bureau, NBB.
(1) Percentage annual changes.
(2) In percentage points.

is unlikely that we shall see a return to pre-crisis potential growth. Thus, the Bank's projections, estimated on the basis of a production function, indicate a deceleration of potential growth, down from around 1.8 p.c. in 2008 to 1.1 p.c. in 2010. These percentages are very similar to those published by the Federal Planning Bureau and the EC, which expect potential GDP growth to decline to 1.2 and 1 p.c. respectively in 2010. According to the EC, potential growth is actually set to fall to 0.7 p.c. in the euro area, essentially because the volume of labour and the capital stock will be harder hit than in Belgium. Productivity growth there is expected to stabilise, as in Belgium, at around 0.4 p.c. However, since productivity is derived as a residual figure following estimation of a model, the figures must be treated with caution.

Although these estimates are open to question, they are vital for macroeconomic policy, which aims to encourage a return to potential growth, and for structural policy, which aims to stimulate that growth. The estimate of potential growth also influences the calculation of the public sector's structural financing balance.

The indications that the current crisis could cause a permanent reduction in the growth potential of the Belgian economy reinforce the importance and urgency of instituting structural reforms, in accordance with the Lisbon agenda, with the aim of increasing productivity and achieving efficient, flexible product and labour markets, so as to be able to respond as flexibly as possible to the consequences of the crisis and the in-depth restructuring facing certain branches of activity and the financial markets. The initiatives aimed at expanding the use of labour must also continue, because permanently weaker growth would compromise the already impaired sustainability of public finances, and more generally, in the longer term, would herald a significantly attenuated rise in the standard of living.

2.2 Main expenditure categories

The slump in global demand and the effects of the financial crisis have a major direct or indirect impact on the principal factors driving demand. Thus, the contribution of domestic demand excluding stocks to GDP growth is expected to decline from 2 percentage points in 2008 to –1.4 percentage point in 2009. The changes in stocks and in net exports are also set to depress growth, by 1.1 and 1 percentage point respectively. In 2010, the contribution of net exports is projected at –0.3 percentage point, and that of the other components should be close to zero.

In Belgium, as in neighbouring countries, producers were hit by the sudden and unprecedentedly steep decline in foreign demand in late 2008 and early 2009. That trend should moderate so that foreign markets will begin expanding again during 2010, albeit far more slowly than before the crisis. Overall, the volume of Belgium's exports of goods and services is expected to contract by 16 p.c. in 2009 and 2.3 p.c. in 2010. At the same time, the volume of imports is set to decline to a similar extent, by almost 15 and 2 p.c. respectively. Actually, in the absence of support from domestic demand, the pattern of imports is largely dependent on the trend in exports, owing to the close international integration of the production chains.

The marked deterioration in global economic activity and in the demand outlook explains for a large part the sharp fall in business investment in 2009. According to the quarterly survey of manufacturing industry, the capacity utilisation rate declined steeply, causing many firms to postpone their investment spending. Moreover, firms which nevertheless wish to invest face adverse developments affecting the financing of their projects. The fall in demand indeed has a negative impact on the capacity of firms to generate sufficient financial resources. Thus, after six years of sustained growth, the gross operating surplus of companies was 0.7 p.c. down in 2008 and is set to contract by a further 5.5 p.c. in 2009. Although firms could take advantage of the fall in import prices to increase their gross operating margin per unit of sales, that would not be sufficient in itself to offset the negative effect of the decline in the volume of sales of around 10 p.c. Moreover, external funding became much more expensive in 2008, and that situation will only improve gradually during 2009. Although the banks are largely passing on to their customers the interest rate cuts introduced by the ECB, thus reducing the interest rates on bank loans to the low level recorded during the period 2003-2005, at the same time they are tightening the other credit conditions. The Eurosystem's bank lending survey shows that the banks are demanding more collateral and granting smaller loans. The reason for this tightening is that the banks are taking account of an increased risk of default in the context of the current economic crisis. The banks have also tried to restrain their lending in response to their own balance sheet and liquidity problems. Issuance of listed shares and corporate bonds is also expected to remain considerably more expensive in 2009 than before the outbreak of the financial crisis, although some slight improvement is expected for these financing channels compared to the situation in 2008. The weighted average overall cost of external financing will therefore remain relatively high in 2009. All these negative factors should gradually disappear during 2010. Thus, both foreign and domestic demand are expected to pick up little by little, the gross operating surplus of enterprises should increase, and the availability and cost of external financing are expected to return towards normal. Nonetheless, though these movements could sustain corporate investment from mid-2010, the annual growth of that investment is expected to remain negative at 3.3 p.c.

TABLE 4 GDP AND THE MAIN EXPENDITURE CATEGORIES

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

	2006	2007	2008	2009 e	2010 e
Final consumption expenditure of individuals	2.1	2.0	0.8	–0.9	0.2
Final consumption expenditure of general government	0.1	2.3	2.1	1.2	1.8
Gross fixed capital formation	4.8	6.1	5.1	–5.2	–2.7
Housing	7.9	1.3	1.0	–3.4	–2.7
General government	–10.6	3.4	1.5	6.2	2.1
Enterprises	5.6	8.5	7.1	–7.1	–3.3
p.m. Total final domestic expenditure (1)	*2.1*	*2.8*	*2.0*	*–1.4*	*0.0*
Change in stocks (1)	0.9	0.1	0.0	–1.1	0.1
Net exports of goods and services (1)	0.1	–0.3	–1.0	–1.0	–0.3
Exports of goods and services	2.7	3.9	2.1	–16.0	–2.3
Imports of goods and services	2.7	4.4	3.3	–14.9	–2.0
GDP	3.0	2.6	1.0	–3.5	–0.2

Sources: NAI, NBB.
(1) Contribution to the change in GDP.

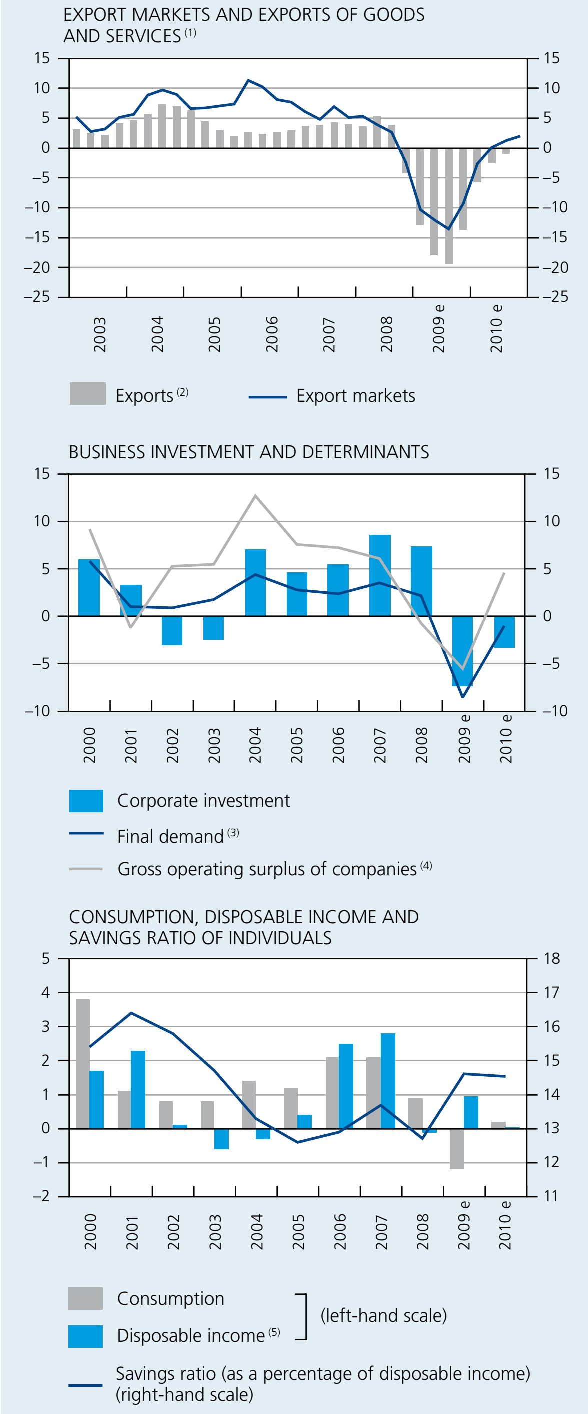
Although the contraction of investment in housing is less marked than the fall in corporate investment, the growth profile is broadly comparable. Notwithstanding the lower mortgage interest rates – due to rate cuts by the ECB and smaller margins applied by the banks – investment in housing this year is expected to be 3.4 p.c. below the 2008 figure. That fall is due mainly to the limited growth in the nominal disposable income of households, the adverse employment outlook and the – albeit small – reductions in prices expected on the secondary housing market. In 2010, the stagnation of the disposable income of households and higher mortgage interest rates are likely to continue curbing investment in housing, leading to a negative growth figure of around 2.7 p.c.

The movement in private consumption expenditure also partly reflects the limited growth of household purchasing power. During the period 2008-2010, the real disposable income of individuals is expected to rise by only 0.3 p.c. as an annual average, compared to growth of 1.1 p.c. per annum during 1995-2007. That limited increase is actually largely due to the exceptionally low level of inflation in 2009. In nominal terms, primary incomes will fall by 1.7 p.c. in 2009, as all the various components are affected by the deterioration in the economy. While the gross mixed incomes of self-employed persons will feel the effects of the downturn in activity, property incomes will be eroded mainly by the sharp fall in interest rates. Finally, the decline in workers' remuneration will be due to the sharp reduction in the number of hours worked in 2009, since hourly labour costs will rise by a further 2.6 p.c. However, the decline in primary incomes will be largely neutralised by the fact that individuals will pay less tax – thanks to a series of tax cuts approved at federal and regional level – and will receive more social benefits following the increase in the numbers of unemployed or temporarily laid off. Thus, by allowing the automatic stabilisers to operate in full, the government cushions the impact of the economic crisis on individuals. In conjunction with overall inflation well below the level of income indexation – particularly the indexation of wages and social benefits – the real disposable income of individuals should increase by 1 p.c. in 2009. However, it will not rise further in 2010. In particular, the deterioration in the labour market is likely to continue depressing earned incomes owing to both the decline in the volume of labour and a limited rise in hourly compensation. Property incomes will probably be underpinned by rising interest rates, and current net transfers to other sectors will continue to fall.

Generally speaking, the outlook for household incomes is uncertain in the medium term. In that context, consumers are likely to view the increase in their real disposable

CHART 4 MAIN EXPENDITURE CATEGORIES

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



Sources: ECB, NAI, NBB.
(1) Seasonally adjusted data; percentage changes compared to the corresponding quarter of the previous year.
(2) Calendar-adjusted data.
(3) Excluding changes in stocks.
(4) At current prices.
(5) Data deflated by the private final consumption expenditure deflator.

TABLE 5 GROSS DISPOSABLE INCOME OF INDIVIDUALS, AT CURRENT PRICES

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

	2006	2007	2008 e	2009 e	2010 e
Gross primary income	4.5	5.8	4.7	–1.7	0.5
of which:					
Wages and salaries	4.8	5.8	5.0	–0.6	–0.4
Remuneration per hour	3.1	3.6	3.7	2.6	0.6
Number of hours worked	1.6	2.1	1.2	–3.1	–1.0
Non-wage incomes	3.8	5.8	4.0	–4.4	2.9
Current transfers to other sectors (1)	0.8	6.6	7.0	–14.1	–3.9
of which:					
Current taxes on property incomes	–0.1	3.9	7.4	–5.5	1.2
Gross disposable income	5.4	5.6	4.2	1.1	1.3
p.m. In real terms (2)	*2.5*	*2.8*	*–0.1*	*1.0*	*0.0*
Consumption expenditure	4.9	4.9	5.2	–1.1	1.5
Savings ratio (3)	12.9	13.7	12.7	14.6	14.5

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) Data deflated by the private final consumption expenditure deflator.
(3) Gross savings, as a percentage of gross disposable income, these two aggregates being taken inclusive of the change in the net claims of households on pension funds.

income in 2009 as a temporary windfall, and will take advantage of it to boost their savings. This increased propensity to save is also due to the fall in share prices since the summer of 2007. Although wealth effects have been relatively limited so far in Belgium, the decline in the net financial assets of individuals, caused by share prices plunging by around 60 p.c. between October 2007 and March 2009, will probably continue to exert substantial downward pressure on consumption in 2009, because individuals will try to make up part of their losses by saving more and therefore consuming less. The savings ratio is therefore estimated to increase from 12.7 p.c. of disposable income in 2008 to 14.6 p.c. in 2009 and 14.5 p.c. in 2010.

The growth of public consumption expenditure is expected to slow in real terms, to 1.2 p.c. in 2009, before regaining momentum in 2010 to reach 1.8 p.c. However, the recovery projected for 2010 is due exclusively to a more favourable movement in prices. In nominal terms, the growth of public consumption is likely to continue to slow down. Public investment is predicted to increase substantially in 2009, growing by 6.2 p.c. in real terms, before expanding by a further 2.1 p.c. in 2010. That pattern is entirely in line with the electoral cycle of public investment.

3. Prices and costs

After having peaked at 5.9 p.c. in July 2008, inflation in Belgium rapidly subsided, dropping to 0.7 p.c. in April 2009. It had thus reverted more or less to the level recorded for the euro area as a whole, whereas in mid-2008 it had exceeded that figure by 1.9 percentage points. (1)

The recent moderation in the rate of consumer price rises, like the strong acceleration in the preceding twelve months, is largely due to the "energy" and "food" components of the HICP. According to the projections, inflation should continue to fall in the short term, thus becoming negative for a time. This situation, likely to last for only a few months, is due mainly to base effects related with the record prices of petroleum products during the summer of 2008. According to the assumption adopted for the purpose of this exercise, the oil price will continue to increase gradually from its lowest level of 41.6 dollars per barrel of Brent, recorded in December 2008, since it stood at 55 dollars in May 2009 and is expected to reach 68 dollars by the end of 2010, but these levels are still well below the peak of more than 140 dollars, recorded in July 2008.

(1) In May, inflation was running at –0.2 p.c. in Belgium.

Once these base effects have faded away, inflation is expected to return to positive figures at the end of 2009, though remaining low up to the end of the projection period. In all, as an annual average, inflation is forecast at 0.1 p.c. in 2009 and 1.3 p.c. in 2010, having reached 4.5 p.c. in 2008. The health index, used as the reference for the indexation of wages and social benefits, in particular, is projected to rise by 0.8 p.c. in 2009 and 1.1 p.c. in 2010.

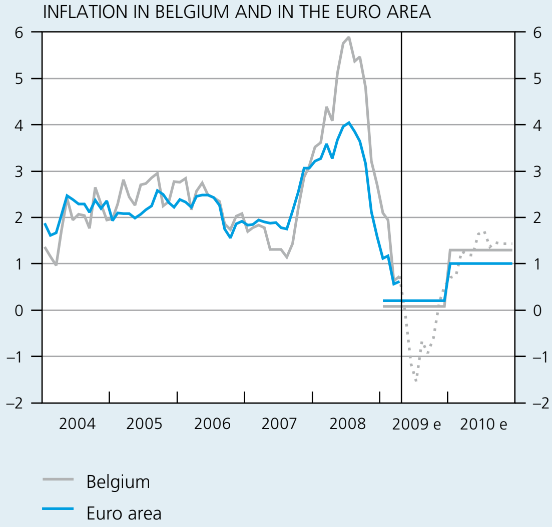
The low inflation predicted up to the end of the projection period is mirrored in the expected movement in the prices of each of the two main components of the HICP, namely non-energy industrial goods and services, even though inflation in these two product categories will initially be higher in Belgium than in the euro area as a whole. In general, the easing of underlying inflation is due to the rapid attenuation of inflationary pressure resulting from the widespread weakness of demand. That effect is exerted both via import prices, from 2009 onwards, and via domestic labour costs, principally in 2010. In particular, the import deflator is projected to fall by 3.1 p.c. in 2009, before rising by 1 p.c. in 2010, driven mainly by the expected increase in commodity prices. Unit labour costs in the private sector are set to continue rising at a sustained pace of 2.9 p.c. in 2009, but should decline by 0.1 p.c. in 2010.

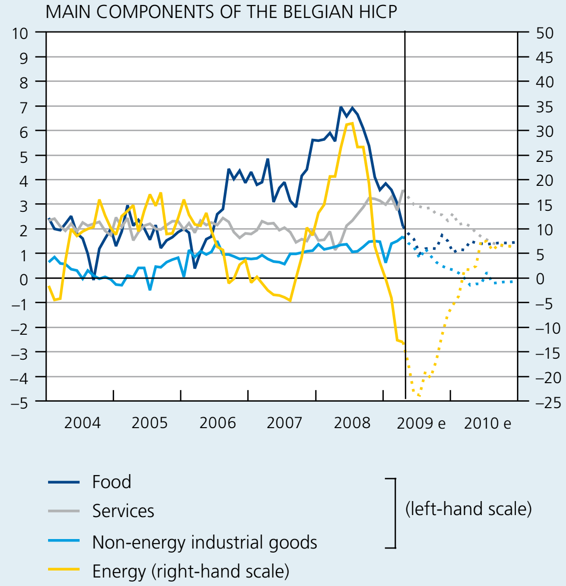
This marked deceleration in unit labour costs between 2009 and 2010 is partly linked to the cyclical profile of labour productivity. As in the previous year, the sudden decline in activity will depress productivity in 2009, but the adjustment in the volume of labour mobilised by firms should gradually take effect in 2010. However, at 0.5 p.c. the growth of hourly productivity is likely to remain modest, in line with the hesitant revival of output.

The increase in hourly labour costs is projected to decline from 2.3 p.c. in 2009 to 0.4 p.c. in 2010, compared to an average annual rise of 3.6 p.c. in the preceding two years. In accordance with the provisions of the central agreement for 2009-2010 concluded in December 2008, the expected movement in labour costs in the private sector takes account of indexation and the possibility of granting, in the context of negotiations at joint sectoral committee level, non-recurring bonuses of 250 euros per worker over the two-year period, of which 125 euros can be paid in 2009. The decision to allow the granting of such a bonus, which will attract favourable tax treatment, rather than setting an indicative norm for a permanent rise, is due to the need for wage negotiations to take account of the sharp decline in competitiveness and the deterioration in the labour market. Moreover, that deterioration is likely to increase the level of redundancy payments and to lead to an endogenous reduction in

CHART 5 **INFLATION**

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





Sources: EC, NBB.

TABLE 6 PRICE AND COST INDICATORS
(percentage changes compared to the previous year, unless otherwise stated)

	2006	2007	2008	2009 e	2010 e
HICP	2.3	1.8	4.5	0.1	1.3
Health index	1.8	1.8	4.2	0.8	1.1
Underlying inflation (1)	1.6	1.9	2.7	2.0	1.0
Labour costs in the private sector:					
Labour costs per hour worked	3.1	3.7	3.5	2.3	0.4
p.m. Including the effects of the reductions in payroll tax (2)	*2.8*	*3.4*	*3.2*	*2.0*	*0.0*
Employers' social contributions (3)	–0.3	0.4	–0.2	0.2	0.1
Gross wages per hour worked	3.4	3.4	3.7	2.1	0.3
of which: indexation	1.8	1.7	2.9	2.4	0.5
p.m. Labour productivity (4)	*1.6*	*0.6*	*–0.4*	*–0.5*	*0.5*
Unit labour costs	1.5	3.1	3.9	2.9	–0.1

Sources: EC; FPS Employment, Labour and Social Dialogue; NAI; NBB.
(1) Measured by the HICP excluding unprocessed food and energy.
(2) This refers to payroll tax reductions granted to firms in the private sector. According to the national accounts methodology, they should be recorded as a subsidy and not as a direct reduction in charges. They therefore cannot be taken into account for calculating labour costs.
(3) Contribution to the change in labour costs resulting from changes in the implicit contribution rates, percentage points.
(4) Value added in volume per hour worked by employees and self-employed persons.

average individual wages, particularly via lower bonuses or the departure of highly-paid staff. In order to offset part of the wage handicap, the payroll tax reductions granted to firms have been extended. Although they help to reduce labour costs, these measures are considered as subsidies rather than as reductions in charges according to the conventions of the national accounts; in that sense, they do not influence the labour costs considered here.

4. Public finances

4.1 Overall balance

According to the provisional figures published by the NAI in March 2009, Belgium's public finances recorded a deficit of 1.2 p.c. of GDP in 2008. That deficit is expected to reach 5.5 p.c. of GDP in 2009 and 6 p.c. in 2010.

The sharp deterioration in the public deficit and the upward revision of the figure compared to the Bank's previous projections are due to the macroeconomic environment described above, which is now being seen as far more adverse. In order to avoid exacerbating the deterioration in the economy, the federal government decided to allow the automatic stabilisers to respond to the repercussions of the crisis. In other words, neither the negative effects of the current severe recession on public revenues nor the upward pressure on unemployment expenditure are being neutralised.

Moreover, the federal government and the regional governments have drawn up economic recovery plans in line with the European Economic Recovery Plan, approved by the European Council on 11 and 12 December 2008. They comprise measures intended essentially to counteract the fall in demand. In Belgium, the scale of the recovery measures is relatively modest, as the high level of the tax burden and the public debt and a clearly increasing deficit narrow the available scope for action. The measures designed to safeguard corporate financing and investment are additional components of the recovery plans.

The interest charges of general government are projected to increase slightly in 2009, for the first time since 1990. That situation is due solely to the strong expansion of public debt in 2008, which will probably continue to rise over the next two years. However, the effect of the rise in public debt is attenuated to some extent by the fall in the average implicit interest rate applicable to it, caused mainly by the extremely low level of short-term market interest rates.

In regard to non-recurrent factors, two court decisions calling on the Belgian government to refund certain taxes are likely to increase the budget deficit in 2009. According

TABLE 7 GENERAL GOVERNMENT ACCOUNTS [1]

(percentages of GDP)

	2006	2007	2008	2009 e	2010 e
Revenues	48.7	48.1	48.7	48.4	48.6
of which: fiscal and parafiscal revenues	43.8	43.3	43.7	43.0	43.0
Primary expenditure	44.5	44.5	46.2	50.0	50.7
Primary balance	4.2	3.6	2.5	–1.6	–2.1
Interest charges	3.9	3.8	3.7	3.9	3.9
Overall balance	0.3	–0.2	–1.2	–5.5	–6.0
p.m. Stability programme targets	*0.0*	*0.3*	*0.0*	*–3.4*	*–4.0*

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

to the ESA 95 methodology, these refunds, which concern corporation tax and personal income tax and amount to around 0.5 p.c. of GDP, are recorded as capital transfers. In 2009 there will also be a one-off reduction in public revenues owing to the small, temporary cut in the rate of VAT on new housing construction, specified in the federal recovery plan. The projections do not include any major non-recurrent factors in relation to 2010.

It should be noted that the projections only take account of budget measures which have already been announced and specified in sufficient detail. They disregard the effect of decisions yet to be taken, e.g. when the 2010 budget will be drawn up. The April 2009 stability programme assumes a return to a balanced budget in 2015. The present projections show that a major consolidation programme will be needed to achieve that aim.

4.2 Revenues

Expressed as a percentage of GDP, public revenues are set to fall by 0.3 p.c. of GDP in 2009 and to increase slightly by 0.2 p.c. of GDP in 2010.

TABLE 8 STRUCTURAL MEASURES RELATING TO PUBLIC REVENUES

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

	2009 e	2010 e
Taxes	–1,236	–116
of which:		
Tax reduction granted by the Flemish Region	–553	0
Increase in the tax-free allowance for workers	–150	75
Increased allowance for energy-saving investments	–273	0
Introduction of the housing bonus	–154	0
Tax-favorable wage increases	–113	–113
Increases in excise duty on petrol and diesel	82	0
Other	–75	–78
Social security contributions	–170	–100
Total	**–1,406**	**–216**
p.m. Percentages of GDP	*–0.4*	*–0.1*

Sources: Budget documents, FPS Finance, NSSO.

The decline in revenues expected in 2009 is due mainly to structural measures, the effects of which should amount to 0.4 p.c. of GDP. Thus, levies on earned incomes will be reduced by the introduction in 2009 of a general lump sum reduction in personal income tax granted by the Flemish Region to its residents, the increase – effective from 1 July 2008 – in the tax-free allowance for low and medium incomes, and the raising of the percentages and the ceiling of the standard allowance for professional expenses. In addition, in 2009 the impact of the increase in the tax allowance for energy-saving investments and the introduction of the housing bonus system is reflected in the personal income tax assessments. Conversely, the revenues generated by excise duties on mineral oils should rise following the reintroduction of the ratchet system for diesel and petrol.

Overall, the impact of the economic recovery plans on revenues is fairly modest. For the government, the decline in revenues is due partly to the award of pay increases in a tax-favourable way, amounting to a maximum of 250 euros per person over 2009 and 2010 as a whole, including a maximum of 125 euros in the first year, laid down in the central agreement, and partly – during the whole of 2009 – to a temporary reduction in the VAT rate from 21 to 6 p.c. for new housing construction, applicable to the first 50,000 euros.

The federal government has also adopted a series of measures aimed at improving the liquidity position of firms and self-employed persons. Thus, employers have an additional three months in which to hand over the payroll tax normally due in March to August 2009. In addition, in 2009, it will be easier for firms and self-employed persons facing liquidity problems to obtain more time to pay their social contributions and VAT. The system whereby the government pays VAT refunds monthly has also been extended. Since these measures simply lead to postponement of the levy or payment, they have no direct effect on the government's budget balance.

4.3 Primary expenditure

Primary expenditure which, as a percentage of GDP, had already risen sharply in 2008 to 46.2 p.c., should expand very significantly in 2009 and 2010, to 50 and 50.7 p.c. respectively. This surge is due partly to the fall in the level of nominal GDP compared to 2008, and partly to the sustained growth of primary expenditure.

Part of the reason for that growth lies in non-recurrent or cyclical factors, relating to the effects of the crisis, for instance, and the economic recovery objectives. Thus, unemployment expenditure acts as an automatic stabiliser. Its cyclical component will have an impact on the growth of real primary expenditure amounting to 0.2 percentage point in 2009 and 0.5 point in 2010. Other factors, such as the temporary scheme for suspending execution of the employment contract, enabling employees to qualify for an allowance, apply for a limited time. Also, the delayed effect of inflation – i.e. the effect in a full year which the indexation of 2008 wages and social benefits will exert on expenditure in 2009 – is also likely to fuel the increase in real expenditure.

Deflated by the HICP and adjusted for the influence of the economic cycle, non-recurrent factors and indexation effects, primary expenditure is projected to increase by 2.8 p.c. in 2009 and 2.4 p.c. in 2010, rates comparable to the average for the past ten years but well above the trend growth of GDP.

The increase in expenditure – adjusted for these various factors – projected for 2009 is the outcome of divergent developments in the subsectors which make up general government. At federal government level, the increase will be considerably smaller than in recent years. A new wave of employment-creating measures, such as the general reduction in payroll tax, recorded as subsidies in accordance with the ESA 95, will affect the growth of primary expenditure to a greater extent than in 2008. However, that effect is likely to be more than offset by the decline in the growth of purchases of goods and services. At the same time, the already sustained expansion of social security expenditure is set to accelerate further owing to the expected rise in expenditure under the service voucher system, and the rise in spending on health care, pensions and unemployment benefits. These last two expenditure categories are likely to be influenced in particular by a set of measures adjusting benefits in line with prosperity. In contrast, in the case of the communities and regions and the local authorities, the increase in expenditure should be fairly moderate.

Since no budget is available at present, it is difficult to estimate the rate of increase in primary expenditure in 2010. However, the projections already take account of a set of measures aimed at increasing social benefits: these will drive up social security expenditure to a lesser extent than in 2009. The growth of federal government expenditure is likely to be particularly strong, one reason being the arrival at maturity of the measures approved so far concerning the reduction in payroll tax. In the case of the communities and regions, these projections are largely based on movements seen in the past, adjusted to take account of the influence of the electoral cycle at this level of power on investments, which are likely to decline. Local authority expenditure is expected to revert to growth close to its trend rate, owing to a relatively strong investment revival.

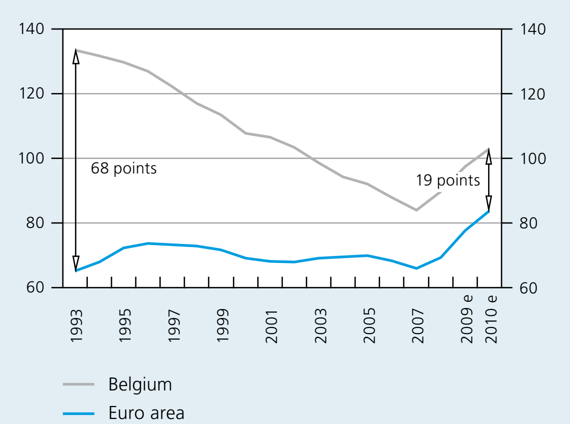
4.4 Debt

Between 1993 – the year when public debt peaked at 133.5 p.c. of GDP – and 2007, the general government debt ratio declined steadily by an average of 3.5 percentage points per annum, mainly as a result of endogenous factors such as the primary surplus, the reduction in the implicit interest rate on public debt, and the growth rate of the economy. At the end of 2007, it represented 84 p.c. of GDP. The gap between Belgium's debt ratio and that of the euro area thus contracted from 68 percentage points in 1993 to 18 points in 2007.

Since then, the trend has been reversed, and public debt has begun rising again. In 2008, it increased by 5.7 percentage points, owing to exogenous factors, mainly the capital injections and credit granted to financial institutions in the context of the crisis afflicting the sector. Since the financial crisis affected Belgium more severely, and sooner, than the euro area as a whole, the surge in the public debt ratio was more marked here.

In 2009 and 2010, the general government debt is projected to record a further strong increase, albeit slightly below the average for the euro area. The main factors behind that increase will be endogenous changes, due to the expected budget deficits and – especially in

CHART 6 CONSOLIDATED GROSS DEBT
(percentages of GDP)



Sources: EC, NAI, NBB.

2009 – to the contraction of GDP. At the end of 2009, the debt ratio is projected at 97.4 p.c. of GDP. In 2010, it is likely to increase further to 103 p.c. of GDP.

5. Assessment of the risk factors

In all respects, not only the global economy but also the economy of the euro area and that of Belgium are experiencing a period of particular uncertainty. The economic agents, governments and monetary authorities face an unprecedented situation in which the effects of their actions are difficult to predict. For them and for the forecasters, too, it is mainly a question of monitoring developments day by day and adjusting their assessment accordingly.

Despite the great uncertainty surrounding the current economic situation, the Bank's figures are similar to recent forecasts issued by other institutions, in terms of both activity growth and inflation. However, it is vital to be aware of the risk factors which could affect those projections.

Thus, the risk of the financial tensions spreading to the real economy, mentioned when the previous projections were published, has materialised in dramatic form in the past six months, with totally unexpected speed and severity. One might hope that the worst is over in terms of the rate of the contraction in demand, that hope being based in particular on the stabilisation of certain indicators which usually act as early signals. However, it remains to be seen whether that early indication will also prove correct in the current context, or whether this time those positive signs will prove false, as owing to its depth and synchronisation in the main economies, the recession will induce a lasting adjustment of employment and investment, which will restrain the revival of domestic demand. Also, financial institutions are generally still under stress, and the direct effects of the financial crisis are now being compounded by the effects of the deteriorating economic situation, as is evident from the rising number of bankruptcies. These factors were included in the projections, but it is particularly hard to quantify the scale and duration of their effects.

According to past observations, beyond the temporary effect resulting from the recent movement in prices of petroleum products, the Bank's projections for Belgium, like those produced by the Eurosystem for the euro area, show a degree of persistence in inflation and wage growth. The widespread weakness of demand is therefore not likely to lead to deflation. That conclusion is based in particular on the expected favourable effect of the cuts

TABLE 9 COMPARISON OF THE FORECASTS FOR BELGIUM

(percentage changes compared to the previous year)

	GDP in volume		Inflation [1]		Budget balance [2]		Date of publication
	2009	2010	2009	2010	2009	2010	
NBB – Spring 2009	–3.5	–0.2	0.1	1.3	–5.5	–6.0	June 2009
p.m. February 2009	*–1.9*	–	*0.5*	–	*–3.3*	–	*February 2009*
Federal Planning Bureau (FPB)	–3.8	–0.0	0.5	1.7	–4.3	–5.6	May 2009
IMF	–3.8	0.3	0.5	1.0	–4.7	–5.6	April 2009
EC	–3.5	–0.2	0.3	1.2	–4.5	–6.1	May 2009
Belgian Prime News	–2.4	0.8	0.7	1.4	–3.3	–3.9	March 2009
Consensus Economics	–3.0	0.1	0.6	1.4	–	–	May 2009
Economist's Poll	–3.0	0.2	0.6	1.4	–	–	May 2009
p.m. Actual figures 2008	*1.0*		*4.5*		*–1.2*		

(1) HICP, except FPB : private final consumption deflator.
(2) Percentages of GDP.

in the central rates and the extension of the granting of liquidity to prevent inflation expectations from sinking too low.

The scale of the recession also raises questions regarding the long-term outlook. Thus, the measures introduced by the monetary authorities and governments are essential at this stage to restore the financial system and cushion the decline in activity, but they will have to be reassessed when the economic situation starts to improve, in order to avoid causing unwelcome levels of inflation and to retain control over public finances. In addition, the potentially adverse effects of the recession on long-term growth must be minimised by measures designed to restore productivity and ensure that a group of the population is not permanently excluded from the labour market.

Annex

PROJECTIONS FOR THE BELGIAN ECONOMY: SUMMARY OF THE MAIN RESULTS

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

	2006	2007	2008	2009 e	2010 e
Growth (calendar-adjusted data)					
GDP in volume	3.0	2.6	1.0	–3.5	–0.2
Contributions to growth:					
Domestic expenditure, excluding change in stocks	2.1	2.8	2.0	–1.4	0.0
Net exports of goods and services	0.1	–0.3	–1.0	–1.0	–0.3
Change in stocks	0.9	0.1	0.0	–1.1	0.1
Prices and costs					
Harmonised index of consumer prices	2.3	1.8	4.5	0.1	1.3
Health index	1.8	1.8	4.2	0.8	1.1
GDP deflator	2.3	2.4	1.7	1.1	1.1
Terms of trade	–0.7	0.5	–2.8	1.0	0.1
Unit labour costs in the private sector	1.5	3.1	3.9	2.9	–0.1
Hourly labour costs in the private sector	3.1	3.7	3.5	2.3	0.4
Hourly productivity in the private sector	1.6	0.6	–0.4	–0.5	0.5
Labour market					
Domestic employment (annual average change in thousands of units)	58.1	77.4	71.2	–36.5	–79.6
Total volume of labour (1)	1.5	2.0	1.2	–3.0	–0.8
Harmonised unemployment rate (2) (p.c. of the labour force)	8.3	7.5	7.0	7.7	9.2
Incomes					
Real disposable income of individuals	2.5	2.8	–0.1	1.0	0.0
Savings ratio of individuals (p.c. of disposable income)	12.9	13.7	12.7	14.6	14.5
Public finances (3)					
Overall balance (p.c. of GDP)	0.3	–0.2	–1.2	–5.5	–6.0
Primary balance (p.c. of GDP)	4.2	3.6	2.5	–1.6	–2.1
Public debt (p.c. of GDP)	87.9	84.0	89.7	97.4	103.0
Current account (p.c. of GDP according to the balance of payments)	**2.0**	**1.7**	**–2.5**	**–2.4**	**–2.5**

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).