# Economic projections for Belgium – Spring 2012

## Introduction

While the economic situation in the world's main economic regions has improved slightly in the past six months, that in the euro area continues to give serious cause for concern, even though the measures taken by the ECB since December 2011, and primarily the provision of longer-term liquidity, have bolstered confidence in the financial institutions and reduced the risk of a credit crunch. Together with some of the measures adopted at EU level and intended to strengthen the emergency funding and financial stabilisation mechanisms, the actions of monetary authorities and governments contained the financial tensions which had again become very acute in November 2011.

However, while they may limit the contagion effects and offer some respite, these measures are no panacea for solving the underlying structural problems facing the euro area economies. Apart from the establishment of stricter economic and fiscal governance in the EU and in the euro area, it is the countries' ability to implement decisive policies which is crucial here, to provide a basis for the expectations of economic agents. Depending on the case, it is a question of pursuing the consolidation of public finances, restructuring financial institutions and/or boosting the competitiveness and growth potential of the economies.

Now that the safeguard measures have been largely defined and are in the process of being implemented, it is the structural challenges – which vary in scale from one country to another – which are the focus of attention for the financial markets, sometimes in a context of political instability. Thus, on some sovereign debt markets the tension has intensified again. Moreover, global demand also experienced a new phase of weakness at the turn of the year from 2011 to 2012, and oil prices have remained high, notably because of the geopolitical uncertainties surrounding supplies.

These various factors cast a shadow over the economic outlook at the time the new Eurosystem projections were set, whose results for the euro area are published in the June 2012 ECB Bulletin. On the assumption that the financial tensions do not intensify, the projections suggest a slow improvement in the economic situation during 2012 which should strengthen slightly in 2013. Taking account of the necessary adjustments in many countries, the improvement will initially be supported by demand from the rest of the world, but also by Germany. There are in fact significant divergences within the euro area, even though some progress has been made in removing macroeconomic imbalances, and that is expected to continue.

In Belgium, the slowdown in activity was relatively limited at the end of 2011, and according to the NAI's initial estimate, GDP grew by 0.3 % in the first quarter of 2012, whereas it stagnated in the euro area. More fundamentally, in comparison with previous periods, the installation of a government with full powers on 6 December 2011 reduced the political uncertainty which had prevailed for several years. While the fiscal consolidation measures adopted by the new government do depress incomes and demand slightly in the short term, when combined with the structural reforms now in progress concerning unemployment and pensions they form a vital step towards establishing permanent, sound foundations for the economy. They have also helped to improve the position of Belgian government securities on the financial markets in recent months.

Announced after the cut-off date for the previous exercise, these various measures could not be taken into account in the December 2011 projections for 2012. A brief update was therefore published in mid-February 2012, though without revision of the forecasts for the international environment or the technical assumptions. The new projections presented in this article relate to 2012 and 2013. They were finalised on 24 May 2012, on the basis of the Eurosystem's assumptions as at 15 May. Those assumptions are described in a box in section 1, which offers a more extensive account of the international environment and the projections for the euro area. The next three sections deal with the results for Belgium. Section 2 shows that domestic demand will continue to apply the brakes to the growth of activity in Belgium in 2012 and to a lesser extent in 2013. In that context, unemployment is expected to rise slightly. However, at 0.6 % in 2012 and 1.4 % in 2013, GDP growth is expected to exceed the figure for the euro area. Inflation (section 3), starting from a high level in 2011 and early 2012, is set to diminish gradually as the effects of the oil price rise fade away. Taking account of the assumption adopted for this exercise of a very moderate real increase, labour costs should mirror that trend. In regard to public finances (section 4), the deficit is projected at 2.8 % in 2012 and 3.1 % in 2013. Here, it should be noted that the projections for public finances take account only of measures which have been formally adopted by the government and for which the implementing arrangements have been specified in sufficient detail. The last section draws attention to the risk factors applicable to the economic outlook. In the current context, they are particularly significant; they essentially concern the definition and application of measures which are absolutely vital in the euro area to contain and alleviate the sovereign debt crisis and the resulting fall-out affecting financial institutions. Belgium is directly exposed to the hazards facing its European partners. Moreover, the efforts to restore the public debt to a sustainable path in the long term must continue, as must work on restructuring the financial institutions and strengthening the economy's growth potential and competitiveness.

## 1. International environment

### 1.1 The global economy

The modest economic recovery which set in after the Great Recession of 2008-2009 continued in 2011, albeit at a slower pace. The expansion of activity was curbed, in particular, by the disappearance of the positive effect of restocking in 2010 and by a fiscal policy increasingly geared to consolidation. From the spring, a series of temporary factors, such as the surge in commodity prices in the first four months of the year, which dampened the purchasing power of households and restrained their consumption, and the earthquake and tsunami in Japan, also led to a decline in economic activity and international trade. The growth slowdown was more marked from the summer, owing to the escalating financial market turbulence and the erosion of confidence. This renewed nervousness was due to doubts about the political leaders' ability to solve the problems relating to public debt sustainability. The debate over raising the ceiling on the federal public debt in the United States and the discussions surrounding the establishment of safeguard mechanisms for euro area countries beset by financing problems heightened that uncertainty.

On the financial markets, this public debt crisis caused tensions which were concentrated mainly on the sovereign bonds of euro area Member States. These developments had, once again particularly in the euro area, a serious impact on financial institutions, which hold large portfolios of public securities. Concerns about the sustainability of public finances and fears relating to the soundness of financial institutions became closely intertwined, and many of those institutions had difficulty in raising finance on the interbank markets. There were worries about the adverse effect which these problems might have on lending to businesses and households, and on economic activity. The financial market tension peaked in November 2011, with fears of a euro area break-up and a systemic financial institution defaulting.

In the face of the heightened tension, several central banks took measures to resolve the liquidity problems in the euro area and to support lending to businesses and households. In this connection, the measures announced by the ECB following its 8 December meeting merit particular mention. Apart from the adoption of two exceptional longer-term refinancing operations with a maturity of 36 months according to a full allotment procedure, it announced the extension of the range of assets accepted as collateral by the Eurosystem central banks and the reduction in the compulsory reserve ratio for credit institutions from 2 to 1 % (1). Just before that, six leading central banks had decided on a coordinated 50-basis-point cut in the interest rate applied under the temporary US dollar liquidity swap, and extended the period for which this financing is available.

In addition to the central bank measures, a series of political initiatives eased the political uncertainty and

(1) The measures taken by the ECB are discussed in the article entitled "Monetary policy in the United States and in the euro area during the crisis".

improved the climate on the financial markets. First, at the European Council in early December, the Heads of State or Government of the EU Member States, with the exception of the United Kingdom [1], agreed on a new Fiscal Compact. The obligation concerning the structural budget balance is a key part of that agreement [2]. In addition, in February 2012, the Greek government concluded an agreement with private creditors on the restructuring of the country's public debt (PSI), and a second aid programme for Greece amounting to € 130 billion was approved by the Eurogroup. Furthermore, the combined maximum lending capacity of the European Financial Stability Facility (EFSF) and the European Stability Mechanism (ESM) was raised to € 700 billion, and additional resources were mobilised for the IMF. Finally, several countries took additional fiscal or structural measures. Those measures led to a gradual restoration of confidence and a decline in risk aversion. The flight to investments regarded as secure thus slowed down and a gradual improvement became apparent on the financial markets from the end of 2011. Yield spreads on sovereign bonds vis-à-vis the German Bund narrowed, the bank funding markets were partly reopened, the euro exchange rate appreciated and share prices rallied. Coinciding with this improvement on the financial markets, the economic climate became a little better with a revival in international trade and in a series of confidence indicators.

Despite this improvement, most markets were far from operating normally, and the economic and financial situation remained fragile. While the measures mentioned above did bring some respite, they did not offer a structural solution to the problems (property market bubbles, loss of competitiveness, the build-up of public and private sector debt) facing a number of euro area countries. That was confirmed when the financial market situation began to deteriorate again during March 2012, owing to renewed uncertainty over the economic forecasts and Spain's public finances. This was the factor that triggered a resurgence of the public debt crisis in the euro area and a new flight to investments deemed secure. The political uncertainty in Greece further intensified the tension from the end of April. These developments dented confidence and depressed the economic outlook in the second quarter of 2012.

The movement in commodity prices since the end of 2011 largely reflects the pattern of economic activity and the forecasts. After having fallen during 2011, commodity prices picked up from the end of that year. Crude oil recorded the steepest rise. Specific supply-side factors such as the geopolitical tension in a number of Middle Eastern and North African countries (Iran, South Sudan, Libya, Yemen, etc.) and the decline in North Sea output played a major role. Prices of other commodities also rose. However, in March, those prices began falling owing to less favourable economic figures and – in the case of crude oil – a series of moves to increase supplies.

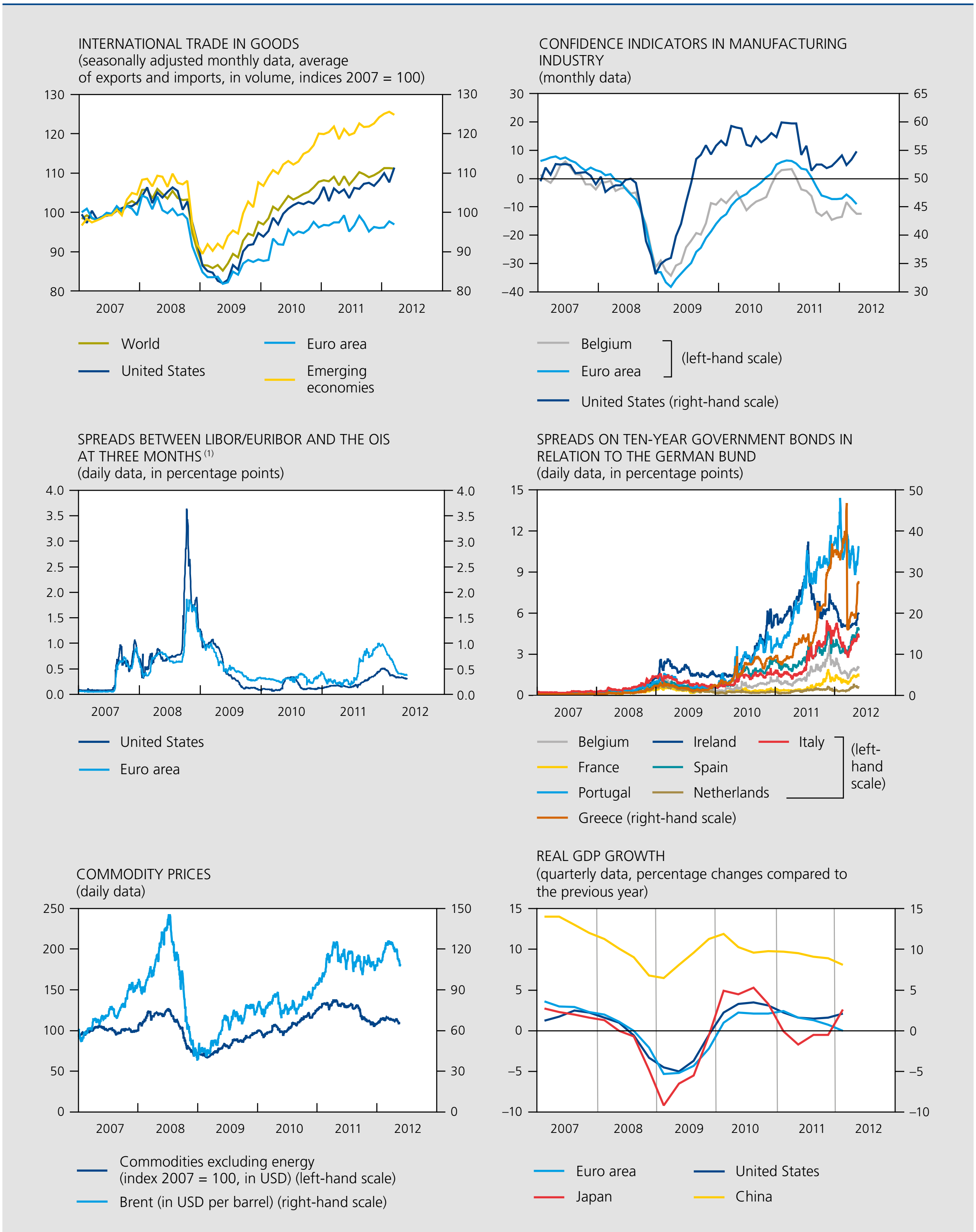
Consumer price inflation slackened pace worldwide from the second half of 2011, largely as a result of the movement in commodity prices. Monetary policy could therefore become more accommodating. Thus, via two 25-basis-point cuts in November and December, the ECB reduced the interest rate on the main refinancing operations to 1%. The central banks of the United States, the United Kingdom and Japan stepped up their non-standard measures to support the economy. Several emerging countries also eased their monetary policy. From the end of 2011, the Chinese central bank reduced the compulsory reserve ratio of the major banks in three stages, from 21.5 to 20%. India and Brazil also relaxed their policy. So long as inflation expectations are firmly anchored, monetary policy can probably remain accommodating in the coming months in order to maintain support for the fragile economic recovery. The budget deficit cuts necessary to ensure the sustainability of the public debt, and the repair of private sector balance sheets in a number of countries, will continue to restrain demand during the period covered by these forecasts.

The growth outlook therefore indicates moderate expansion of global GDP with – according to the EC – a further slowdown in activity in 2012 to 3.3 % and a slight revival in 2013 to 3.7 %. Growth in the United States and Japan, especially in 2012, is likely to be well above the figure expected in the European Union and in the euro area, where growth is forecast at zero and –0.3 % respectively. The weak link in regard to the outlook for economic activity is Europe in general, and the euro area in particular. A gradual recovery is expected in the euro area during the year, driven by external demand, the low level of interest rates and the measures to support the economy. That prediction still masks substantial variations between Member States. Some countries, the most important being Germany, are expected to record positive albeit modest growth in 2012 and 2013. Conversely, in other countries, including Greece and Spain, GDP is forecast to contract during that period. These divergences reflect serious underlying imbalances which have arisen in the euro area since it was created in 1999, the importance of which was not fully appreciated until after the eruption of the economic and financial crisis.

(1) In the end, the new intergovernmental treaty was only ratified by 25 EU countries, and not by the United Kingdom and the Czech Republic.

(2) For a more detailed description of the initiatives taken in the EU at the institutional level, see the article on "New developments in the economic governance of the European Union".

**CHART 1** FINANCIAL MARKET DEVELOPMENTS, BUSINESS CONFIDENCE, INTERNATIONAL TRADE AND CYCLICAL DEVELOPMENTS




Source: Thomson Reuters Datastream.

(1) Spreads between the 3-month Libor/Euribor and the fixed rate paid by the counterparty on an interest rate swap receiving the overnight interest rate for a period of three months.

Since then, the peripheral euro area countries, in particular, have proved to be less dynamic, their activity growth being hampered by substantial adjustments to public and private sector balance sheets. The progress achieved in recent years in improving competitiveness and reducing excessive debt levels has been patchy, and needs to be maintained to secure balanced economic development which is sustainable in the long term. These adjustments will continue to depress activity in these economies, widening the performance gaps between the various countries. Consequently, in contrast to the situation in the United States and Japan, unemployment in the European Union will remain high, and could even rise further.

**TABLE 1** **PROJECTIONS FOR THE MAIN ECONOMIC REGIONS**

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

| | 2011 | 2012 | 2013 |
|---|---|---|---|
| | Actual figures | Projections | |
| **GDP in volume** | | | |
| World | 3.7 | 3.3 | 3.7 |
| of which: | | | |
| United States | 1.7 | 2.0 | 2.1 |
| Japan | –0.7 | 1.9 | 1.7 |
| European Union | 1.5 | 0.0 | 1.3 |
| China | 9.2 | 8.4 | 8.2 |
| India | 6.9 | 6.8 | 7.5 |
| Russia | 4.3 | 3.6 | 3.8 |
| Brazil | 2.7 | 3.1 | 4.2 |
| *p.m. World imports* | *6.8* | *4.1* | *5.7* |
| **Inflation** (1) | | | |
| United States | 3.2 | 2.5 | 2.0 |
| Japan | –0.3 | –0.3 | 0.8 |
| European Union | 3.1 | 2.6 | 1.9 |
| China | 5.4 | 3.3 | 3.0 |
| **Unemployment** (2) | | | |
| United States | 9.0 | 8.2 | 8.0 |
| Japan | 4.9 | 4.8 | 4.7 |
| European Union | 9.7 | 10.3 | 10.3 |

Sources: EC, IMF.
(1) Consumer price index.
(2) In % of the labour force.

## 1.2 Eurosystem projections for the euro area

After declining in the fourth quarter of 2011, activity stagnated in the euro area as a whole in the first quarter of 2012. However, that outcome conceals significant divergences within the euro area, with negative GDP growth in the countries undergoing substantial adjustments.

According to the Eurosystem projections, activity will only pick up slightly in the second half of 2012 before starting to expand a little more strongly in 2013. Thus, following an increase of 1.5 % in 2011, GDP growth is projected to be between –0.5 and 0.3 % in 2012 and to accelerate by between 0 and 2% in 2013.

The inertia in 2012 is due to the weakness of domestic demand within the euro area. As had already been the case in 2011, high inflation, the general uncertainty and the direct effects of fiscal consolidation, particularly via public consumption, are all affecting private consumption. In that context, investment is set to contract in 2012, in the case of both housing and investment by businesses and governments. However, since anaemic domestic demand is seriously curbing imports, net exports should make a positive, though insufficient, contribution to GDP growth. Exports of goods and services are likely to expand during the year after having been affected by the temporary sluggishness of external demand in late 2011 and early 2012.

A rebalancing of growth sources is projected to begin in 2013, thanks to low interest rates, the favourable effect on purchasing power of the expected fall in inflation, and some easing of the uncertainty. The projections are in fact also based on the assumption that the financial crisis does not intensify.

Inflation remained above 2.5 % throughout 2011 and in the first four months of 2012. It was fuelled largely by the persistent elevated level of oil prices on the international markets – an effect accentuated by the depreciation of the euro against the dollar –, but also by the indirect tax increases which a number of countries included in their fiscal consolidation plans. Those effects should gradually ebb away, causing inflation to slow down. Overall, inflation is put at between 2.3 and 2.5 % in 2012 – a figure close to the previous year's 2.7 % – and between 1 and 2.2 % in 2013.

**TABLE 2** EUROSYSTEM PROJECTIONS
(percentage changes compared to the previous year)

| | Euro area | | | *p.m. Belgium* | | |
|---|---|---|---|---|---|---|
| | 2011 | 2012 | 2013 | *2011* | *2012* | *2013* |
| Inflation (HICP) | 2.7 | 2.3 / 2.5 | 1.0 / 2.2 | *3.5* | *2.6* | *1.5* |
| GDP in volume | 1.5 | –0.5 / 0.3 | 0.0 / 2.0 | *2.0* | *0.6* | *1.4* |
| of which: | | | | | | |
| Private consumption | 0.2 | –0.7 / –0.1 | –0.4 / 1.4 | *0.9* | *0.5* | *0.7* |
| Public consumption | –0.3 | –0.7 / 0.3 | –0.7 / 0.7 | *0.6* | *0.4* | *1.6* |
| Investment | 1.6 | –3.2 / –1.0 | –0.8 / 3.8 | *5.2* | *0.8* | *1.4* |
| Exports | 6.3 | 1.2 / 5.0 | 1.1 / 8.9 | *4.4* | *0.0* | *4.5* |
| Imports | 4.1 | –0.7 / 2.9 | 0.9 / 7.9 | *5.1* | *0.3* | *4.1* |

Sources: ECB, NBB.

## Box 1 – Assumptions adopted for the projections

Produced as part of a joint exercise, the Eurosystem's economic projections for the euro area, like the Bank's projections for Belgium, are based on a set of technical assumptions and forecasts for the international environment drawn up jointly by the ECB and the national central banks of the Eurosystem.

In the projections, exchange rates are assumed to remain unchanged at the average level recorded in the last ten working days before the cut-off date of 15 May 2012. On that basis, the euro is worth 1.30 US dollars.

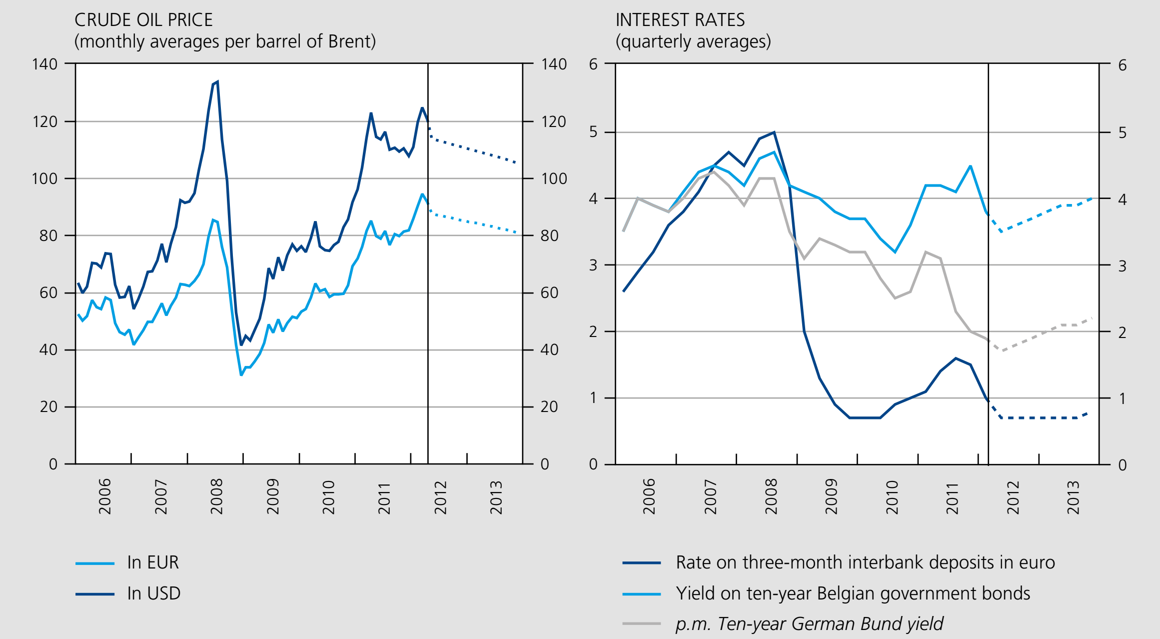
In accordance with the implicit prices in forward contracts on the international markets, the price per barrel of Brent crude oil, which peaked at an average of $ 124.9 in March 2012, is forecast to subside to an average of $ 114.6 over the year as a whole, before a further slight fall to $ 107.9 in 2013.

The interest rate assumptions are also based on market expectations as at mid-May 2012. The euro three-month interbank deposit rate is forecast to remain low, at an average of 0.8 % in 2012 and 0.7 % in 2013. Yields on ten-year Belgian government bonds are set to decline from 4.2 % in 2011 to 3.6 % in 2012, a particular factor being the narrowing of the spreads in relation to German Bund yields at the end of 2011 and in early 2012. In 2013, Belgian bond yields are projected at 3.9 %. The differential in relation to Bunds is held constant at 180 basis points over the whole projection period.

The rates which banks charge on loans to their private customers allow for these expected movements in market interest rates. They are set to rise slightly on mortgage loans, which are mainly long-term contracts, and remain stable on loans to non-financial corporations, such loans generally having a shorter initial maturity.

Having virtually stagnated at the end of 2011 and the beginning of 2012, mainly as a result of the weakness of demand within the euro area, Belgium's export sales should pick up steadily in 2012. The annual average volume growth of the export markets is put at 2.3 % in 2012 and 5.2 % in 2013, thus regaining a rate of expansion similar to that seen in 2011 (+4.9 %).

## ASSUMPTIONS CONCERNING THE MOVEMENT IN OIL PRICES AND INTEREST RATES




Source: ECB.

Regarding public finances, the projections are based – in accordance with the Eurosystem conventions – on the macroeconomic environment and policy measures that have already been announced and specified in sufficient detail by governments, and which have been or are likely to be passed by parliament.

## EUROSYSTEM PROJECTION ASSUMPTIONS

| | 2011 | 2012 | 2013 |
|---|---|---|---|
| | | (annual averages) | |
| Interest rate on three-month interbank deposits in euro | 1.4 | 0.8 | 0.7 |
| Yield on ten-year Belgian government bonds | 4.2 | 3.6 | 3.9 |
| EUR/USD exchange rate | 1.39 | 1.30 | 1.30 |
| Oil price (US dollars per barrel) | 111.0 | 114.6 | 107.9 |
| | | (percentage changes) | |
| Export markets relevant to Belgium | 4.9 | 2.3 | 5.2 |
| Competitors' export prices | 4.2 | 4.2 | 1.8 |

Source: ECB.

## 2. Activity, employment and demand

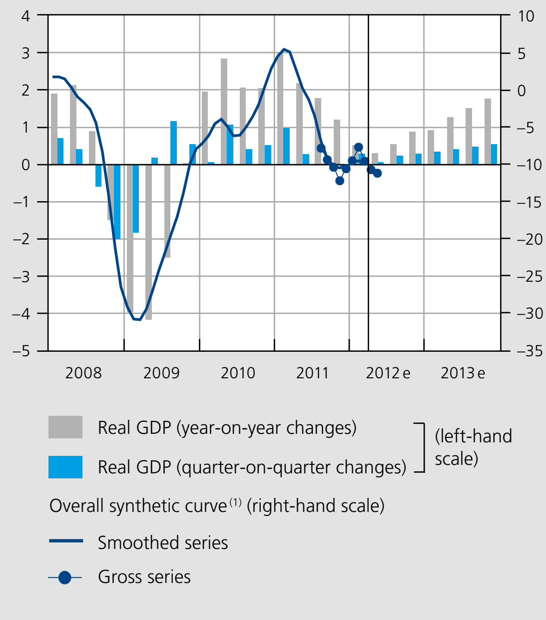
### 2.1 Activity and employment

Since mid-2011, the Belgian economy has felt the effects of the escalating financial tension and deteriorating economic climate in the euro area. Thus, after two years of robust volume growth, GDP stagnated in the third quarter of 2011 before shrinking very slightly by 0.1 % in the fourth quarter. The NAI's "flash" estimate recorded 0.3 % GDP growth in Belgium in the first quarter of 2012, compared to 0% in the euro area as a whole. That finding needs to be confirmed in the coming months, since non-recurring factors could affect the quarterly figures and, more fundamentally, in view of the renewed deterioration in the economic situation in the euro area since March. However, it bears out the finding that, following in Germany's footsteps, activity in Belgium is currently exhibiting some resilience, as it did during the 2008-2009 recession.

Nonetheless, the general uncertainty and the weakness of demand in the euro area will continue to have a strong restraining effect on growth in 2012. Growth is forecast to gain momentum in 2013 when these inhibiting factors are likely to weaken progressively. Overall, according to the Bank's new projections, GDP growth will amount to 0.6 % in 2012 and 1.4 % in 2013. In 2011, it came to 2 %. These figures are higher than those for the euro area as a whole. In fact, in the absence of very significant macroeconomic imbalances, domestic demand in Belgium has not experienced the impact of radical adjustments such as those that some European countries are having to make.

**CHART 2** GDP AND THE BUSINESS SURVEY INDICATORS

(data adjusted for seasonal and calendar effects, unless otherwise stated)




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

The slackening pace of activity in 2012 followed by a moderate recovery in 2013 is reflected immediately in the change in the volume of labour. After having expanded by 1.7 % in 2011, the total number of hours worked in the economy will increase by only 0.1 % in 2012, before a 0.8 % rise in the following year.

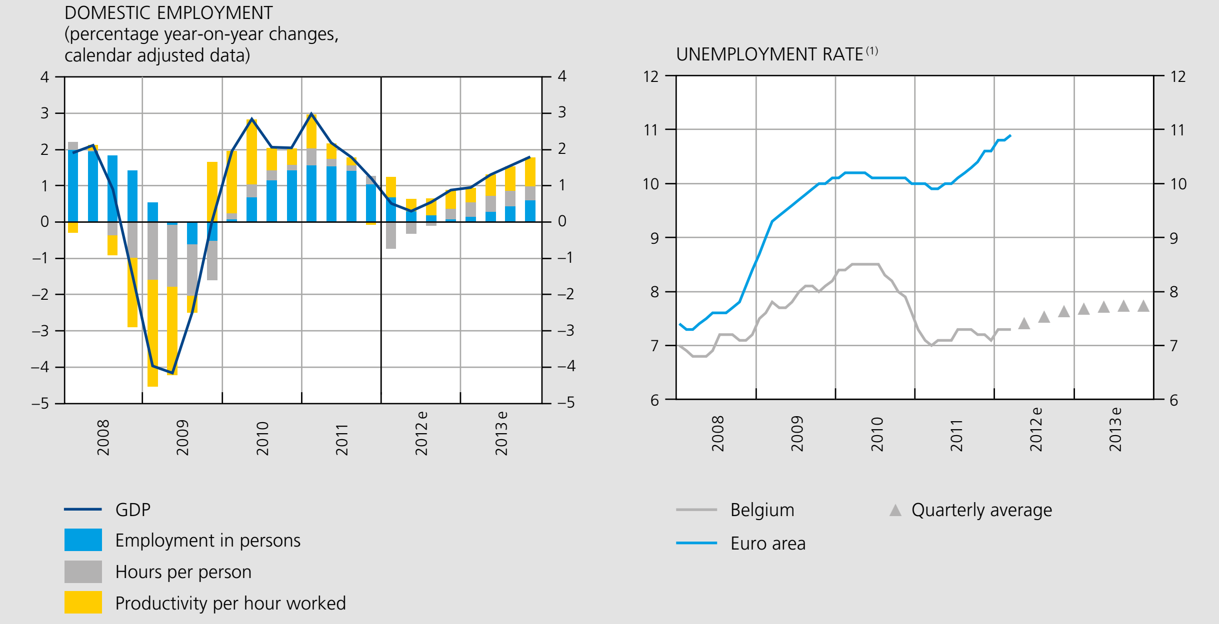
As usual, these cyclical fluctuations in activity are attenuated slightly at the level of employment in persons by adjustments to the implicit average working time per employee. This flexibility in the organisation of labour is due in particular to the use of the system of temporary lay-offs, in varying degrees, depending on the state of economic activity. Thus, the pace of employment expansion is estimated to remain virtually stable from 2012 to 2013 at 0.3 and 0.4 % respectively, as the revival in activity will initially lead to absorption of the under-utilisation of the available workforce before being reflected in net job creation.

While the average annual number of net job creations is similar in 2012 (+14 300) and 2013 (+16 600), it nevertheless masks bigger fluctuations during the year. In fact, the average net job creation figure for 2012 gains a strong boost from the dynamism of the previous year, considering that only 3 300 additional jobs are expected to be created during the year. Conversely, in net terms, more than 27 000 jobs should be created during 2013.

Apart from the impact of a less buoyant economy, the decline in the number of jobs created in comparison with trends in preceding years is also due to measures to restrict the federal government and health care budgets in 2012 and 2013. Their impact is estimated at around 13 000 job cuts by the end of 2013.

Taking account of the combined effects of the slower pace of net job creation and the steady rise in the number of persons entering the labour market, the stabilisation of the unemployment rate in 2011, at around 7.2 % of the labour force, will be converted to a slight increase during the two years covered by the projections, at 7.5 % in 2012 and 7.7 % in 2013.

**CHART 3** EMPLOYMENT AND UNEMPLOYMENT




Sources: EC, NAI, NEO, NBB.
(1) Harmonised unemployment rate, as a percentage of the labour force.

**TABLE 3** LABOUR SUPPLY AND DEMAND

(calendar adjusted data, annual average changes in thousands of units, unless otherwise stated)

| | 2009 | 2010 | 2011 | 2012 e | 2013 e |
|---|---|---|---|---|---|
| GDP [(1)] | –2.7 | 2.2 | 2.0 | 0.6 | 1.4 |
| Total volume of labour [(1)] | –1.6 | 1.1 | 1.7 | 0.1 | 0.8 |
| Domestic employment in persons [(1)] | –0.2 | 0.8 | 1.4 | 0.3 | 0.4 |
| Domestic employment | –7.6 | 37.0 | 62.2 | 14.3 | 16.6 |
| *p.m. Change during the year* [(2)] | *–23.2* | *63.4* | *46.7* | *3.3* | *27.1* |
| Employees | –12.1 | 31.0 | 52.0 | 8.1 | 12.1 |
| of which branches sensitive to the business cycle | –36.0 | 6.0 | 33.1 | 1.1 | 1.1 |
| Self-employed persons | 4.5 | 6.0 | 10.2 | 6.2 | 4.5 |
| Frontier workers | 1.1 | 0.7 | 0.1 | 0.0 | 0.0 |
| National employment | –6.5 | 37.8 | 62.3 | 14.3 | 16.6 |
| Unemployed job-seekers | 50.6 | 13.7 | –19.8 | 24.4 | 23.5 |
| *p.m. Change during the year* [(2)] | *59.8* | *–10.0* | *–10.8* | *37.5* | *12.8* |
| Labour force | 44.1 | 51.5 | 42.5 | 38.7 | 40.1 |
| *p.m. Harmonised activity rate* [(3)] | *66.9* | *67.7* | *66.7* | *66.9* | *67.2* |
| *Harmonised employment rate* [(4)] | *67.1* | *67.6* | *67.3* | *67.1* | *67.0* |
| *Harmonised unemployment rate* [(5)] | *7.9* | *8.3* | *7.2* | *7.5* | *7.7* |

Sources: EC, NAI, NEO, NBB.
(1) Annual percentage changes.
(2) Difference between the fourth quarter of the year considered and the fourth quarter of the previous year.
(3) In % of the population of working age (15-64 years), non calendar adjusted data.
(4) In % of the population aged 20-64 years, non calendar adjusted data.
(5) In % of the labour force aged 15 years and over, non calendar adjusted data.

### 2.2 Demand components

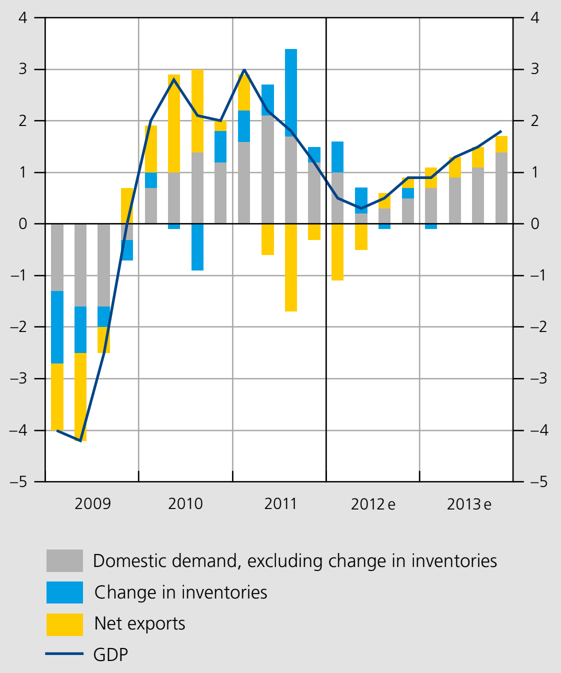
While the various sources of demand all participated to one degree or another in the GDP growth revival in 2010, that movement was reversed in the course of 2011, even though the average results recorded for that year reflect a favourable starting position. In regard to foreign trade, exports lost all their dynamism following the serious deterioration in the economic climate in the euro area and a slowdown on markets elsewhere. While imports remained steady – notably because they form a significant part of inventory building – net exports depressed GDP growth.

Among the other components of domestic demand, private consumption rapidly stagnated in 2011, initially owing to high inflation and, more generally, to a rise in the savings ratio. The revival in residential investment in 2010 also fizzled out. After that, the expansion of business investment, which had been particularly vigorous in the second quarter of 2011, ground to a complete halt. Only public expenditure continued to rise throughout the year.

According to the projections, this widespread weakness of demand is likely to persist in early 2012, even spreading to public consumption. A gradual improvement is predicted in the second half of the year and in 2013, under the impetus of exports and business investment. However, the contribution of domestic demand – constrained by the legacy of the 2008-2009 economic recession, via the continuing adjustments which that entails for governments,

**CHART 4** MAIN DEMAND COMPONENTS

(contributions to annual GDP growth in percentage points; data adjusted for seasonal and calendar effects)




Sources: NAI, NBB.

**TABLE 4** GDP AND MAIN EXPENDITURE CATEGORIES

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

| | 2009 | 2010 | 2011 | 2012 e | 2013 e |
|---|---|---|---|---|---|
| Private consumption expenditure | 0.8 | 2.3 | 0.9 | 0.5 | 0.7 |
| General government consumption expenditure | 0.7 | 0.3 | 0.6 | 0.4 | 1.6 |
| Gross fixed capital formation | –7.9 | –1.0 | 5.2 | 0.8 | 1.4 |
| Housing | –9.2 | 1.6 | –2.8 | –2.1 | 0.4 |
| General government | 10.5 | –3.1 | 6.1 | 6.9 | –9.7 |
| Enterprises | –9.3 | –1.6 | 8.8 | 1.3 | 3.2 |
| *p.m. Total final domestic expenditure* | *–1.2* | *1.1* | *1.7* | *0.3* | *1.1* |
| Change in inventories (1) | –0.8 | 0.0 | 0.8 | 0.3 | 0.0 |
| Net exports of goods and services (1) | –0.7 | 1.2 | –0.5 | –0.3 | 0.4 |
| Exports of goods and services | –11.3 | 9.9 | 4.4 | 0.0 | 4.5 |
| Imports of goods and services | –10.6 | 8.7 | 5.1 | 0.3 | 4.1 |
| GDP | –2.7 | 2.2 | 2.0 | 0.6 | 1.4 |

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

companies and households alike – is likely to be small compared to the pre-crisis years and to the economy's growth potential.

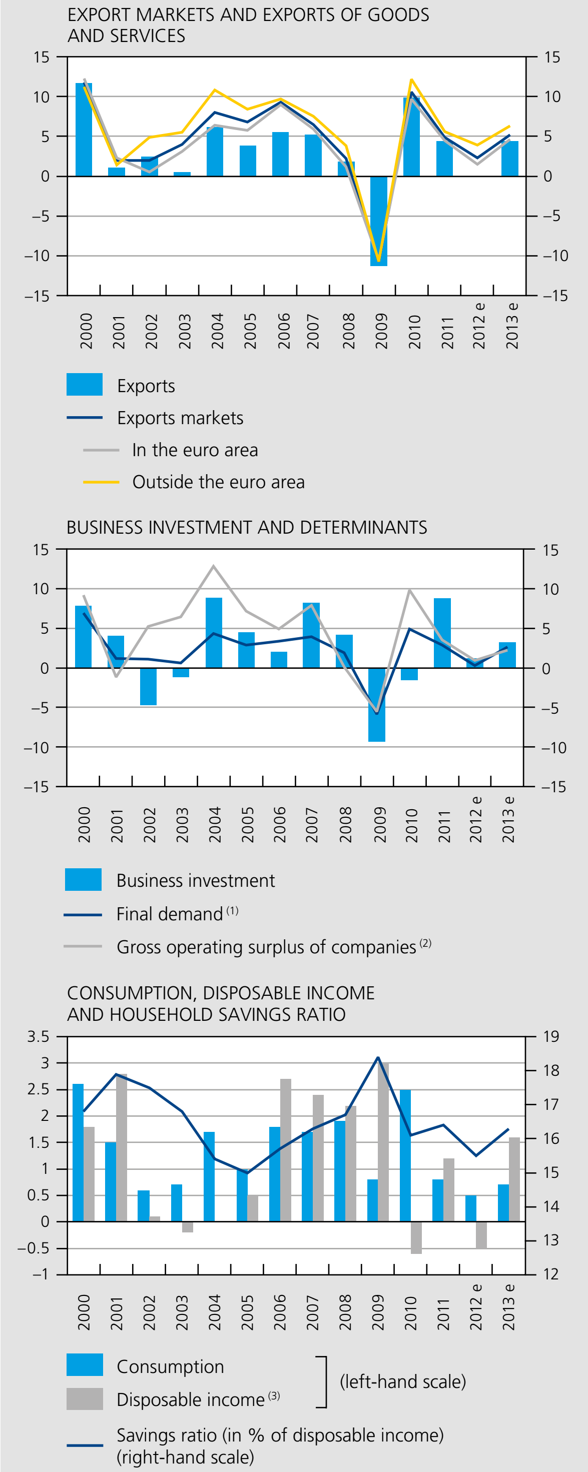
Following a strong upsurge in 2010 and at the beginning of 2011, the dynamism of external demand was seriously eroded by the deteriorating economic situation in the main economic regions during the second half of the year. The deceleration was particularly noticeable in the euro area, where markets contracted in the fourth quarter. Starting from this low point, Belgium's export markets are expected to begin expanding again from the first quarter of 2012, though at a slower pace than before the worldwide recession of 2008-2009. According to the Eurosystem's assumptions, their expansion rate will decline from 4.9 % in 2011 (it was 9.9 % in 2010) to 2.3 % in 2012, before picking up to 5.2 % in 2013. The movement in the volume of Belgium's exports is expected to lag behind the markets but exhibit a similar profile, since – following a 4.4 % growth in 2011 – annual average exports of goods and services are likely to stagnate in 2012, before rising by 4.5 % in 2013. The inertia in 2012, like the more significant losses of market share for that year – in the order of 2.3 %, against 0.5 % in 2011 – largely reflect the results at the end of 2011. The latest indicators, derived from foreign trade statistics and business surveys, suggest that Belgium's exports of goods picked up at the beginning of 2012, though the recovery was still weak.

After a sharp acceleration in the previous year which also helped to boost average growth in 2011, the sluggishness of private consumption seen during that year is likely to persist in 2012. However, the causes are different since, instead of being due to a rise in the savings ratio, as had been the case in 2011 in a context of great uncertainty over both the sovereign debt crisis in the euro area and the protracted political stalemate in Belgium, it is due this time to the expected fall in household disposable incomes, amounting to 0.4 % in real terms. Conversely, the savings ratio is set to fall, dropping from 16.4 % of disposable income in 2011 to 15.6 % in 2012, so that the volume of private consumption should rise by 0.5 %. Apart from the continuing high inflation, the reduction in purchasing power is due to the combined effects of the deteriorating economic conditions on employment, and hence on labour incomes, self-employed incomes and property incomes – both dividends and interest in view of the low level of interest rates – and to the measures adopted under the 2012 budget.

In 2013, these various effects are expected to wane rapidly with the forecast fall in inflation, the revival of activity and the absence of significant budget measures announced so far, even though such measures are necessary

**CHART 5** **DEVELOPMENTS IN DEMAND CATEGORIES**

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




Sources: ECB, NAI, NBB.
(1) Excluding changes in inventories.
(2) Non calendar adjusted value data.
(3) Non calendar adjusted data deflated by the private consumption deflator.

to attain the targets for the budget balance. Thus, disposable income is projected to rise by 1.7 %. Nonetheless, just as households, in their consumption behaviour, will partly disregard the decline in their disposable income in 2012, they will use the extra income to step up their savings in 2013. The savings ratio is forecast to revert to 16.4 %, with private consumption up by 0.7 %.

In a still highly uncertain context, household investment in housing is likely to decline again by around 2 % in 2012, thus continuing the downward trend which had begun in 2008 but was suspended temporarily in 2010, owing to the measures to revive the construction industry, particularly via a cut in the VAT rate on the first project tranche of executed work. A very slight rise in residential housing investment is expected in 2013.

The activity revival up to the beginning of 2011, and subsequently, the improvement in the capacity utilisation rate of businesses – up from 70.1 % in April 2009 to 81.2 % in April 2011, or a figure close to the average of the preceding two decades according to the survey of manufacturing industry – in parallel with the strengthening of final demand and the restoration of profitability had resulted in strong expansion of business investment in the first half of 2011. That did not continue thereafter, in view of the downturn in the economic situation. While the outlook for demand in fact weakened sharply, the gross operating surplus of enterprises is forecast to rise by only 1 % in 2012, and the industrial capacity utilisation rate dropped back to 78.1 % in April 2012, the low level of interest rates is the only factor likely to bolster investment. Overall, following an 8.8 % rise in 2011, investment is set to expand by just 1.3 % in 2012, then 3.2 % in 2013. Taking account of the recent developments presented in box 2, these projections disregard any credit tightening effect.

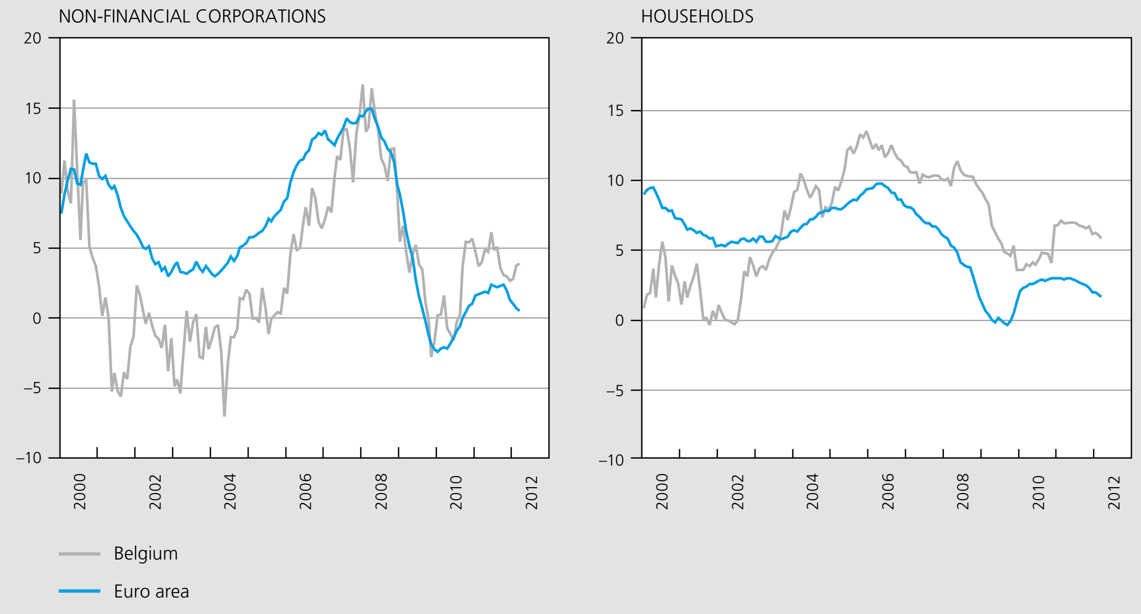
With due regard for the measures described in detail in part 4, government consumption expenditure is projected to rise by just 0.4 % in 2012. In 2013 it will increase again by 1.6 %. As in 2011, government investment is expected to expand strongly in 2012 by almost 7% per annum, owing to the impending local elections. After that, it is likely to drop by almost 10 %.

## Box 2 – Bank lending : recent developments and outlook

Since the start of the financial crisis, bank lending to the non-financial private sector, i.e. households and non-financial corporations, has been closely monitored. The turbulence and the essential structural adjustments in the financial sector have in fact aroused fears of more difficult access to credit for the private sector, and hence the transmission of the financial tensions to the real economy. The sovereign debt crisis, via its impact on bank balance sheets, has also fuelled this anxiety. In that context, this box reports on the current situation concerning credit in Belgium and its determinants. On the basis of a comparison with the euro area it is evident that lending to the non-financial private sector is doing relatively well in Belgium. Since the low point of mid-2012, the growth of lending to both households and non-financial corporations has accelerated sharply again in Belgium. The comparison also reveals that lending in Belgium is expanding at well above the euro area average, particularly in the case of households. Nonetheless, the significant differences in relation to the euro area are due largely to the negative growth of lending in a number of peripheral countries, a factor which is clearly depressing the euro area average; the expansion of credit in Belgium is close to the figure for the main neighbouring countries. There has recently been a further decline in the growth of credit in the euro area, whereas it is tending to stabilise on an annual basis in Belgium, and – in contrast to the euro area – the net monthly flow of new lending remains positive.

In the current context, it is relevant to assess the determinants affecting the pattern of lending. The bank lending survey conducted quarterly on the main banks in the euro area provides information both on supply conditions (excluding interest rates) and on developments in demand for credit. This survey shows that, in Belgium, credit conditions have remained largely unchanged since the end of 2009, both for household credit and for lending to non-financial corporations. For the latter category, however, the banks mention the possibility of lending criteria being tightened in the second quarter of 2012. The survey also looks at the factors which determine those lending criteria. It is evident that factors relating purely to supply, such as the banks' balance sheet structure (i.e. their situation in terms of liquidity and capital) have not recently put stress on the criteria for lending to non-financial corporations. The Eurosystem's liquidity support measures (particularly the three-year longer-term refinancing

BANK LENDING TO NON-FINANCIAL CORPORATIONS AND HOUSEHOLDS IN BELGIUM AND IN THE EURO AREA[1]
(annual percentage changes)




Sources: ECB, NBB.
(1) Lending by resident banks to resident sectors. Data including securitised loans: for Belgium over the period as a whole, for the euro area since January 2010.

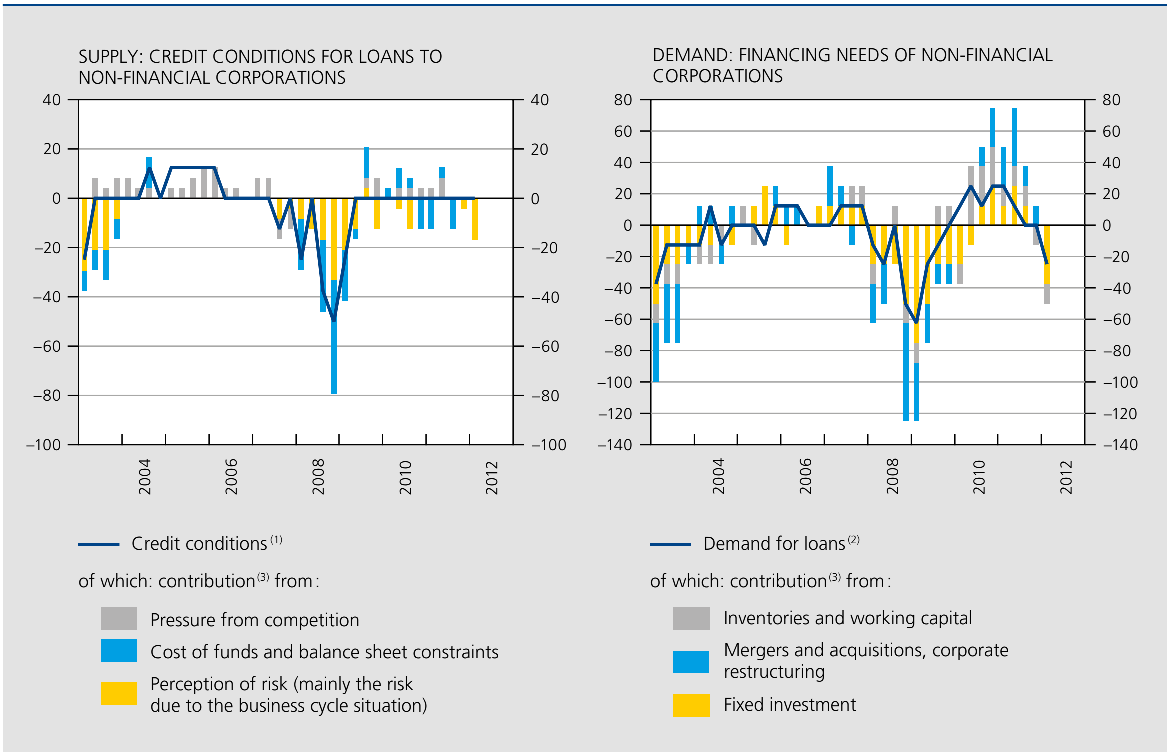
operations) are probably a contributory factor, so that the risk that the balance sheet position of the banks might constrain lending has become less of a threat than in the recent past. This improvement in the banks' balance sheet structure concerns the euro area as a whole. Despite these positive developments, general conditions for lending to non-financial corporations have remained unchanged according to the bank lending survey. The mounting concern over the business cycle situation since the beginning of 2012 accounts for this status quo.

That concern is corroborated by the movement in demand for loans expressed by non-financial corporations, as reported by the banks. The banks have seen that demand rise steadily since 2010, but in the first quarter of 2012 it seems to have declined, owing to the weakened propensity of non-financial corporations to invest in fixed assets. Other investments funded by credit, such as mergers and acquisitions or investment in inventories, also seem to have made a less positive contribution to demand for loans than in the recent past. This analysis therefore shows that any weakening of lending in the near future is likely to be due to (cyclical) factors on the demand side, rather than supply factors. The picture is similar in regard to household credit.

However, that does not mean that the banks' credit policy in the medium or long term cannot depress lending. Banks are actually facing a changing environment in which they need to adjust the focus of their activities, notably in order to satisfy the more stringent liquidity and capital requirements under the new regulations (Basel III). Up to now, however, the transition to these new regulations has not led to any significant contraction in bank lending to the private sector in Belgium, one factor being the Eurosystem's liquidity operations. In their credit policy, the banks also take account of the borrowers' financial health. If they consider that health to be fragile, the supply conditions could be tightened. In this connection, it must be noted that, despite the rise in the Belgian household debt ratio, the financial situation of Belgian households, and of the non-financial private sector in general, is still better than in the euro area.

BANK LENDING SURVEY : CREDIT CONDITIONS AND DEMAND FOR CREDIT IN THE CASE OF NON-FINANCIAL CORPORATIONS

(net percentages)




Source : NBB.

(1) Weighted net percentages of banks reporting whether credit standards have been eased (+) or tightened (–).

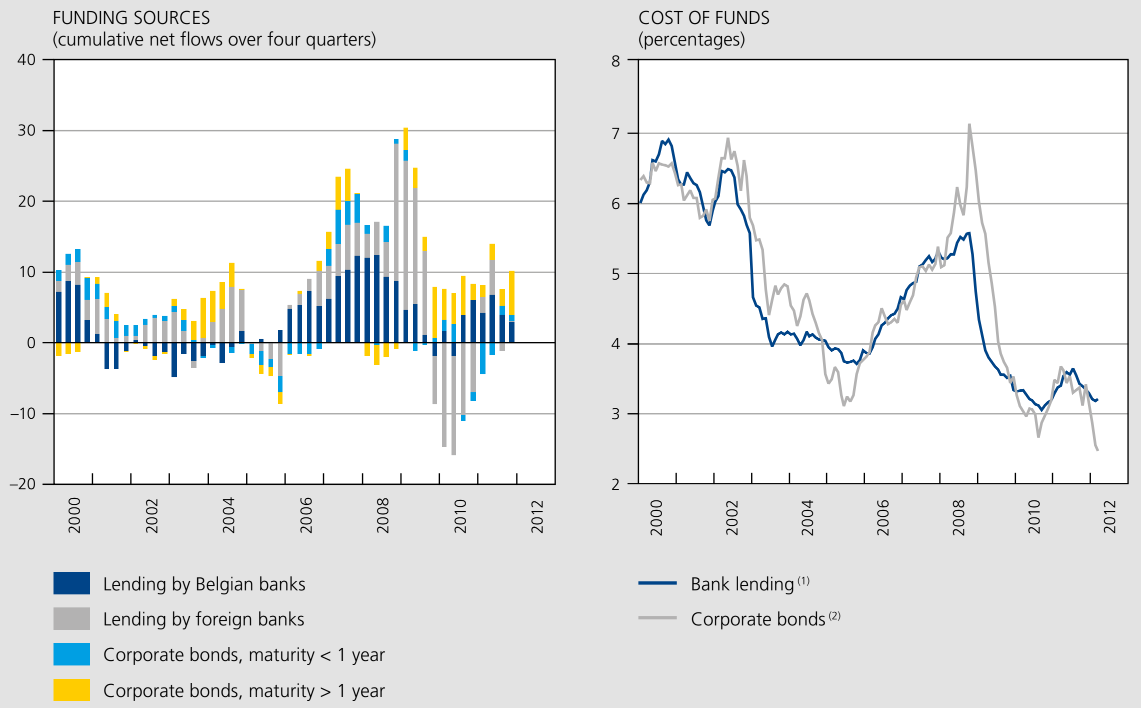
(2) Weighted net percentages of banks reporting whether demand for loans has risen (+) or fallen (–).

(3) Weighted net percentages of banks reporting whether these factors have contributed to the general developments in credit conditions or demand for loans.

Finally, there is a progressive shift taking place in the funding sources of non-financial corporations. Whereas in recent years Belgian non-financial corporations had made greater use of equity financing, two trends have emerged since the financial crisis : a shift from international to national bank lending, and a shift from bank lending to other forms of funding. Thus, it seems that corporations currently have sufficient liquid resources to finance a large part of their investment themselves, and that is probably also depressing bank lending. It also seems that Belgian non-financial corporations are increasingly applying to the bond market. Although this form of funding remains limited in Belgium – since it is often reserved for large, financially sound corporations – in recent quarters there has been greater use of this source, particularly for long-term funds.

This last factor may be connected with the increased appetite for risk on the corporate bond market, which has meanwhile driven down the yields for the capital raised by euro area non-financial corporations to a historically low level, below the weighted average interest rate charged on bank loans in Belgium.

NON-FINANCIAL CORPORATIONS: FUNDING SOURCES AND COSTS




Source: NBB.
(1) Weighted average interest rate charged by Belgian banks on new loans to enterprises.
(2) Yield on an index of euro-denominated bonds issued by euro area non-financial corporations.

## 3. Prices and costs

Standing at 2.9 % in April 2012, the latest reading available on the projection cut-off date, HICP inflation has fallen below 3% for the first time in eighteen months. It had peaked at 4% in July 2011. Inflation should continue to fall in 2012 – to around 2 % by the end of the year – and in 2013, albeit more slowly. Annual average inflation is projected to decline from 3.5 % in 2011 to 2.6 % in 2012 and 1.5 % in 2013. In that last year, it will then be 0.1 percentage point below the inflation forecast for the euro area, after having exceeded that figure by 0.7 and 0.8 percentage point respectively in 2010 and 2011, and by 0.2 percentage point in 2012.

The expected decline in inflation in Belgium and the narrowing of the gap in relation to the euro area, before its reversal in 2013, depend essentially on the predicted movement in oil prices. After rising by 40 % in 2011 compared to the previous year and peaking at 125 dollars in March 2012, prices on the international markets declined in the next two months, dropping to around 110 dollars per barrel. According to the assumptions adopted, the downward trend should continue during the projection period, albeit at a modest pace. Even though it is attenuated by the euro's depreciation against the US currency, the elimination of the negative base effects should cut the increase in the energy costs included in the HICP basket from 17 % in 2011 to 6 % in 2012. In 2013, the base effects should become favourable and the prices of these products should fall slightly, by 0.5 %.

In 2011 and 2012, the impact on inflation's energy component of the substantial rise in the electricity supply tariffs in a large area of Flanders, due to the high cost of the regional subsidies granted for the installation of photovoltaic panels, is estimated at 1 percentage point per annum. As a result of the tariff decisions by CREG, the federal electricity and gas authority, supply costs should hardly increase at all in 2013. The government's decision to block – from April to December 2012 [1] – the gas and electricity price rises which would have resulted from the indexation formulas hitherto applied has only a very small influence on the projections, in view of the expected fall in the reference prices of crude oil. However, it will have greater repercussions in the event of an adverse movement in oil prices or the dollar exchange rate.

While a gradual deceleration resulting from the energy component is expected in 2012, underlying inflation is likely to remain high. As an annual average, it is estimated at 1.9 %, compared to 1.7 % in 2011. That rise broadly corresponds to the effect of specific increases in indirect taxes introduced by the budget, particularly on notaries' fees and digital television subscriptions. In the same context, there has also been an increase in the excise duty on tobacco, a product included in the "food" component of the harmonised index of consumer prices.

Overall, underlying inflation is based largely on movements in the price of services. In the case of this component, price increases are fuelled by adjustments directly linked to inflation or to other reference indices for a range of services, and by the indirect consequences of fuel price increases, e.g. in the case of travel. It is also driven by the strong rise in labour costs. These effects are likely to ebb away rapidly in 2013, so that – in the absence of additional indirect tax increases – underlying inflation should fall to 1.5 %, also contributing to the general slowing of inflation.

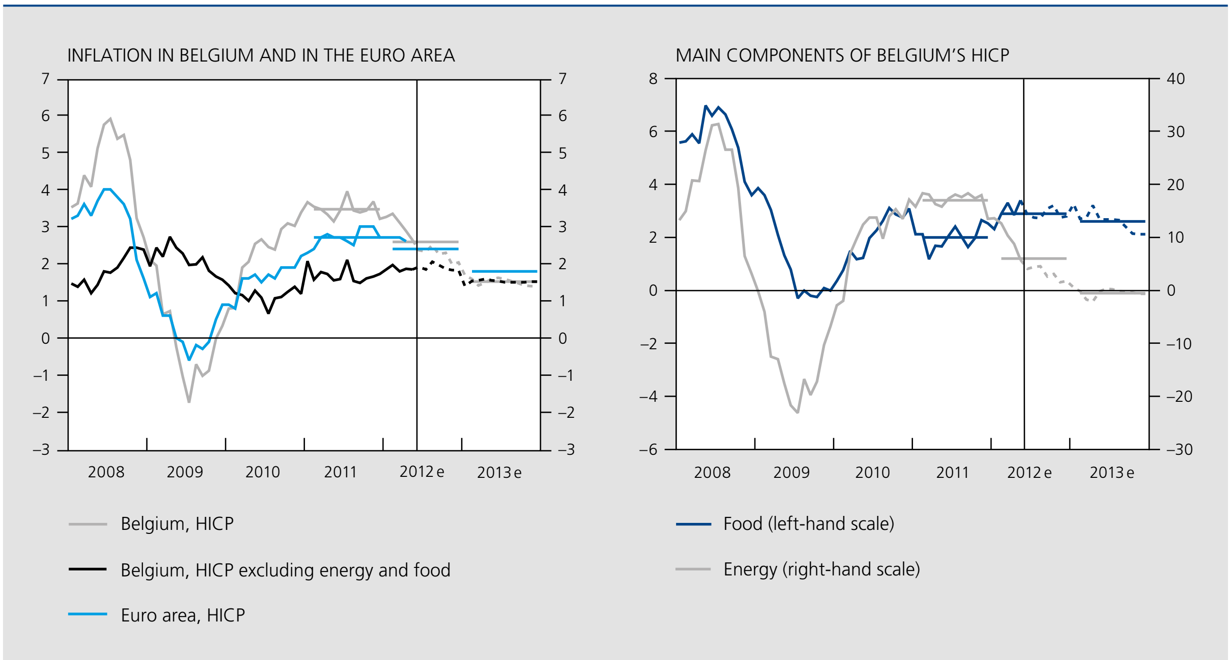
After having already risen by 2.1 % in 2011, unit labour costs in the private sector are set to rise even more sharply in 2012, reaching a figure of 3.1 %. Overall, the cumulative increase of more than 5% recorded for these two years significantly exceeds the figure for Belgium's three main partners, namely Germany, France and the Netherlands, and that is damaging the competitiveness of Belgian producers. According to the assumptions adopted, and taking account of the expected improvement in the business climate, the pace of unit labour cost increases should fall to 1.5 % in 2013.

The rate of labour productivity gains is in fact expected to recover slightly in 2013, after having been curbed by the weakness of activity at the end of 2011 and in 2012. However, these cyclical movements will probably be modest. It is therefore mainly the trend in hourly labour costs that accounts for these movements in unit costs. In the private sector, the increase in hourly labour costs will rise from 2.5 % in 2011 to 3.1 % in 2012, before subsiding to 2 % in 2013. These movements reflect

(1) The price freeze could be lifted sooner, if new formulas for the indexation of electricity and gas prices are adopted, or in the event of force majeure, e.g. owing to exceptional market conditions.

**CHART 6** INFLATION

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




Sources: EC, NBB.

**TABLE 5** PRICE AND COST INDICATORS
(percentage changes compared to the previous year, unless otherwise stated)

| | 2009 | 2010 | 2011 | 2012 e | 2013 e |
|---|---|---|---|---|---|
| HICP | 0.0 | 2.3 | 3.5 | 2.6 | 1.5 |
| Health index | 0.6 | 1.7 | 3.1 | 2.6 | 1.5 |
| Underlying inflation (1) | 2.1 | 1.1 | 1.7 | 1.9 | 1.5 |
| GDP deflator | 1.2 | 1.8 | 1.9 | 2.2 | 1.5 |
| Labour costs in the private sector: | | | | | |
| Labour costs per hour worked | 2.7 | 0.9 | 2.5 | 3.1 | 2.0 |
| of which indexation | 2.5 | 0.5 | 2.7 | 3.0 | 1.8 |
| Labour productivity (2) | –1.0 | 1.0 | 0.4 | 0.1 | 0.6 |
| Unit labour costs | 3.8 | –0.1 | 2.1 | 3.1 | 1.5 |

Sources: EC; FPS Employment, Labour and Social Dialogue; NAI; NBB.
(1) Measured by the HICP excluding food and energy.
(2) Value added in volume per hour worked by employees and self-employed persons.

almost exactly the effects of wage indexation. According to the projections, the health index – which is used as the reference for wage indexation – will rise by 2.6 % in 2012 and 1.5 % in 2013, following a 3.1 % increase in 2011. Taking account of the time lags resulting from the indexation mechanisms in the various sectoral joint committees, the automatic adjustments to wages will still be significant in 2012, even if inflation begins to slow down this year. In 2013, there should be a more marked decline in the indexation effects. Apart from indexation, the assumption concerning the movement in hourly labour costs in the private sector in 2012 allows for the maximum 0.3 % rise in negotiated wages specified in the provisions imposed by the government under the draft central agreement for 2011-2012 and, conversely, a negative movement in the other wage-setting factors, notably on account of smaller bonuses. Pending the outcome of the future wage negotiations for 2013, the assumption concerning the movement in hourly wages in the private sector in 2013 is based mainly on the expected indexation effect. In view of the recent rises in excess of those in neighbouring countries and the continuing sluggishness of economic activity, real increases are expected to be limited.

## 4. Public finances

### 4.1 Overall balance

In 2011, the Belgian government recorded a budget deficit of 3.7 % of GDP. In the macroeconomic context described above, the deficit should fall to 2.8 % of GDP in 2012. According to the projections – which take account only of fiscal measures which have already been announced and are specified in sufficient detail – the deficit will, however, rise again in 2013, to reach 3.1 % of GDP.

The movement in the overall balance of general government is due to four factors, namely the economic situation, changes in interest charges, the impact of temporary factors and, finally, the movement in the structural primary balance.

The economic situation is expected to have a negative effect on the overall balance in 2012. In 2013, its influence should be neutral overall.

Interest charges are expected to increase slightly in 2012, partly because of the decline in swap revenues – particularly high in 2011 – and partly because of the massive State intervention in favour of struggling euro area countries. That is likely to drive up the debt ratio during the period analysed, especially in 2012. However, the adverse impact of the debt ratio on interest charges should be partly offset by a reduction in the implicit interest rate on the public debt, both short- and long-term. In 2013, the continuing decline in the implicit interest rate on the public debt should lead to a further fall in interest charges.

The general government account should improve as a result of non-recurring factors in 2012. In 2011, those factors had in fact had a negative influence on the general government balance, notably because of the measures

**TABLE 6** GENERAL GOVERNMENT ACCOUNTS (1)

(in % of GDP)

| | 2009 | 2010 | 2011 | 2012 e | 2013 e |
|---|---|---|---|---|---|
| Revenues | 48.1 | 48.8 | 49.5 | 50.8 | 50.5 |
| Fiscal and parafiscal revenue | 42.7 | 43.3 | 43.6 | 44.6 | 44.4 |
| Other | 5.3 | 5.6 | 5.9 | 6.2 | 6.1 |
| Primary expenditure | 50.0 | 49.3 | 49.9 | 50.2 | 50.3 |
| Primary balance | –2.0 | –0.4 | –0.4 | 0.6 | 0.2 |
| Interest charges | 3.6 | 3.4 | 3.3 | 3.4 | 3.2 |
| Overall balance | –5.6 | –3.8 | –3.7 | –2.8 | –3.1 |
| *p.m. Changes in the overall balance* (2) | | *1.8* | *0.1* | *1.0* | *–0.3* |
| *due to changes in* | | | | | |
| *interest charges* | | *0.3* | *0.0* | *–0.1* | *0.1* |
| *the cyclical component* | | *0.4* | *0.0* | *–0.4* | *0.0* |
| *GDP growth* | | *0.6* | *0.4* | *–0.3* | *0.0* |
| *composition effects* | | *–0.2* | *–0.4* | *–0.1* | *–0.0* |
| *non-recurring factors* | | *1.0* | *–0.2* | *0.4* | *–0.2* |
| *the structural primary balance* | | *0.1* | *0.3* | *1.0* | *–0.2* |

Sources: NAI, NBB.
(1) According to the methodology used in the excessive deficit procedure (EDP).
(2) According to the methodology described in Bouthevillain C., Ph. Cour-Thimann, G. van den Dool, P. Hernández de Cos, G. Langenus. M. Mohr, S. Momigliano and M. Tujula (2001), *Cyclically adjusted balances: an alternative approach*, ECB Working Paper Series, No 77.

in response to the problems encountered by Holding Communal which, as a major shareholder in Dexia, had felt the full force of the collapse of the Dexia share price. Conversely, in 2012, non-recurring measures relating to government revenues should improve the overall balance. The disappearance of these factors in 2013 is therefore one of the determinants of the increase in the deficit in that year.

Finally, the movement in the structural primary balance is the last factor to single out. In 2012, that balance should improve considerably, reflecting the conduct of a restrictive fiscal policy during the year. That improvement is due to the various measures taken by the federal government and the Communities and Regions in order to achieve their budget targets. For 2013, the projections indicate a slight deterioration in the structural primary balance, the reason being that certain social benefits, such as pensions and health care expenditure, are projected to rise much faster than the trend growth of GDP.

The April 2012 stability programme assumes a deficit of 2.8 % of GDP in 2012, dropping to 2.15 % of GDP in 2013 and declining systematically thereafter to produce a balanced budget in 2015. According to the current projections, the 2012 target should be achieved. Conversely, to meet the targets for 2013 and subsequent years, it will be necessary to make further substantial consolidation efforts.

## 4.2 Revenue

Public revenues are expected to record a further sizeable increase in the period under review, as the expansion amounting to 1.2 percentage points of GDP in 2012 will be only partly negated by the 0.2 percentage point contraction in 2013.

Almost two-thirds of the strong surge recorded in 2012 is due to structural fiscal and parafiscal measures, and one-fifth to temporary factors, the remainder being attributable to non-fiscal and non-parafiscal revenues.

The many structural measures which have been taken can be grouped into a few main categories. The most important ones are aimed at increasing the tax on capital incomes. Thus, harmonisation of the tax on incomes from movable property at 21 % – with a few exceptions –, the levy on stock market transactions and the capital gains tax should generate over a billion in additional revenues. Households will contribute to the budgetary effort via

**TABLE 7** STRUCTURAL MEASURES AND FACTORS CONCERNING PUBLIC REVENUES

(in € million, unless otherwise stated; changes compared to the previous year)

| | 2012 e | 2013 e |
|---|---|---|
| Taxes | 3 534 | 290 |
| of which: | | |
| Capital incomes | 1 078 | 44 |
| Percentage change in the risk capital allowance | 715 | 0 |
| Nuclear levy | 300 | 0 |
| Benefits in kind | 370 | 0 |
| VAT and excise duties | 298 | 79 |
| Measures to prevent tax evasion and improve collection | 380 | 142 |
| Increase in the tax-free allowance | 0 | –120 |
| Allowance for energy-saving investments | 0 | 260 |
| Social security contributions | 47 | –183 |
| Non-fiscal and non-parafiscal revenues | 456 | –108 |
| Total | 4 037 | –1 |
| *p.m. In % of GDP* | *1.1* | *0.0* |

Sources: Budget documents, FPS Finance, NSSO, NBB.

higher taxes on benefits in kind, be it the provision of company cars or accommodation, the increase in indirect taxes on pay-TV and tobacco, and the ending of VAT exemption for notaries and bailiffs. As regards taxation of corporate profits, the notional interest system is to be subject to new limits in the form of a ceiling on the reference interest rate and restrictions on the possibility of carrying forward the resulting concession. This should raise more than € 700 million in extra revenue, compared to leaving the system unchanged. From 2012, the nuclear levy is to increase by € 300 million, which is additional to the previous € 250 million. Late payment of this levy for 2011 will also temporarily benefit revenues in 2012. Finally, the battle against tax evasion and benefit fraud will continue to be stepped up.

Some significant temporary effects also boost revenue growth in 2012. First, there is the advance collection of tax on life insurance reserves formed before 1993, normally due at the end of the contract. Next, the administrative procedures concerning succession should be shortened by one month, thus generating additional revenues for the Regions in the year of the acceleration. Finally, the impact in 2012 of the speeding up of the personal income tax and corporation tax assessments in 2011 should be neutral overall.

Non-fiscal and non-parafiscal revenues should also make a largely temporary contribution to the revenue expansion in 2012. Thus, the payments made by the financial sector in return for the aid and guarantees granted to it should increase by almost € 400 million. The repayment by bpost of state aid incompatible with the European competition rules, received between 2006 and 2010, will generate € 176 million in 2012. Exceptional dividends are also expected, as well as receipts following the cross-border agreements with France and Luxembourg.

The decline in the revenue ratio in 2013 will be due mainly to temporary factors in 2012 which will not recur. However, the restriction of tax allowances for energy-saving investment and the revenues from sales of emission permits, together with other less significant factors, should compensate slightly for the disappearance of these temporary factors.

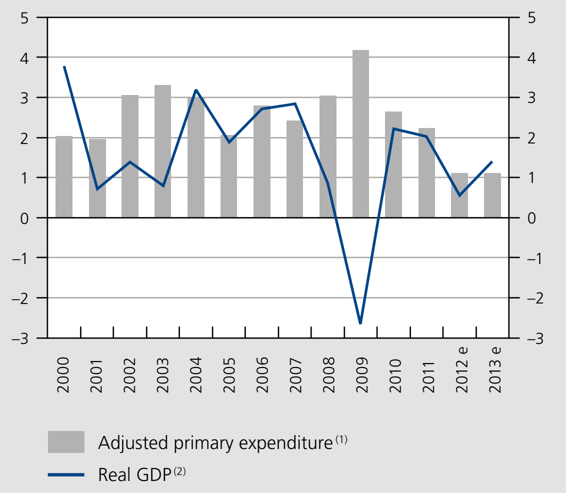
### 4.3 Primary expenditure

Primary expenditure expressed as a percentage of GDP is projected to rise by 0.2 percentage point in 2012 and in 2013, thus reaching a very high level in historical terms. The volume increase is estimated at 0.9 % and 1.7 % respectively over those two years, outpacing real GDP growth in each case. Adjusted for non-recurring and cyclical factors and the effects of indexation, the growth comes to 1.1% in both 2012 and 2013. Real expenditure growth in 2012 is in fact likely to be restrained primarily by non-recurring factors, whereas in 2013 the rise in wages and social benefits due to indexation should exceed the increase in the consumer price index.

The slight increase in primary expenditure expected for 2012 is the outcome of divergent developments in the general government sub-sectors. The federal government is expected to record a relatively large fall in its expenditure owing to a range of economy measures spread across several expenditure categories, decided at the time of the initial budget and the 2012 budget review. Social security expenditure is projected to rise more slowly than in previous years, mainly on account of the cost-cutting measures relating to health care and the structural labour market reforms. The growth of expenditure by the Communities and Regions is also expected to be moderate. Conversely, local authority expenditure is likely to rise considerably, owing to the traditional surge in investment in an election year.

CHART 7 PRIMARY EXPENDITURE OF GENERAL GOVERNMENT AND GDP

(percentage changes compared to the previous year)



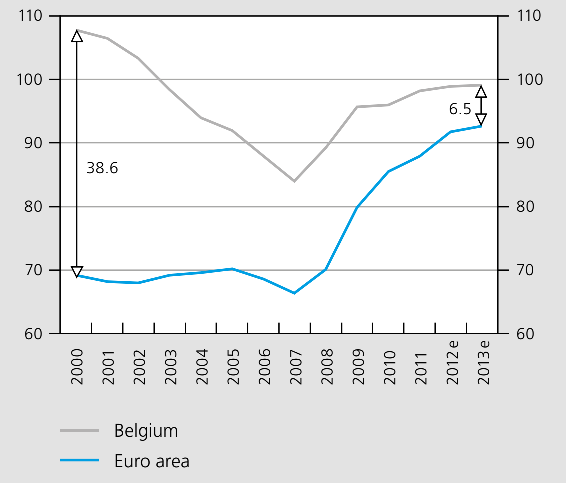

Sources: NAI, NBB.

(1) Primary expenditure deflated by the HICP and adjusted for cyclical, non-recurring and fiscally neutral factors, and for the effect of indexation. The latter is in fact due to the difference between the actual indexation of civil service pay and social benefits and the increase in the HICP.

(2) Calendar adjusted data.

CHART 8 CONSOLIDATED GROSS DEBT OF GENERAL GOVERNMENT

(in % of GDP)




Sources: EC, NAI, NBB.

The growth of primary expenditure in 2013 is obviously hard to estimate since the budgets for that year are not yet available. The estimates for 2013 project a relatively neutral expenditure policy. However, account is taken of the impact of the measures adopted under the federal government agreement for 2012-2014. Those measures are likely to exert slight downward pressure on the real growth of federal government and social security expenditure. In the case of the latter, expenditure growth, though tempered by the pension reform which will have an effect from 2013, will still significantly outpace GDP growth. Local authority expenditure is expected to contract sharply, owing to a marked decline in investment after the elections.

### 4.4 Debt

The general government debt ratio had fallen continuously from 1993 to 2007. In 2008, that decline came to an abrupt halt, as the government had to to inject capital into certain financial institutions during the crisis afflicting that sector. Since then, the debt ratio has continued to rise rather steeply. In 2011, the debt grew by 2.4 percentage points to 98.2 % of GDP, mainly owing to the acquisition of Dexia Bank Belgium (Belfius) for the State and the granting of loans to the Greek, Irish and Portuguese States.

According to the projections, general government debt will record a further significant increase to 98.9 % of GDP at the end of 2012. Once again, exogenous factors are driving up the debt. Thus, the loans granted under the second rescue package for Greece and the planned injection of capital in the European Stability Mechanism will considerably exceed the amount of the expected partial repayment in respect of capital assistance to the financial sector.

In 2013, the debt is expected to continue rising, but more slowly, to reach 99.2 % of GDP.

## 5. Risk factor assessment

The economic developments in Belgium and in the euro area over the past three years, since the Great Recession bottomed out in mid-2009, and the projections for 2012 and 2013 confirm the lessons of past financial crises: the resolution is slow, the recovery uneven and the intensity variable according to the situation of the economies concerned.

According to the results presented in this article, the widespread weakness of demand and activity during the second half of 2011 and at the beginning of 2012, owing to the acute heightening of uncertainty, is only temporary. It should give way to an improvement, although that is likely to be limited. This is the most plausible scenario, given the assumptions taken into account, the most crucial being the absence of major disasters in the coming months. That clearly presupposes that the euro area crisis does not intensify and that it does not have irreparable repercussions on systemic financial institutions. Instead, the measures adopted by governments and monetary authorities in this connection should eventually take effect.

Under these conditions, the technical assumptions adopted – notably the low level of interest rates, the moderate fall in oil prices and the gradual strengthening of external demand – imply an improvement in economic activity, both in the euro area and in Belgium. However, the radical adjustments which are in progress and need to continue in regard to public finances, the position of financial institutions, competitiveness and the strengthening of the general economic potential will mean that the improvement is muted. In this connection, the credibility of the policies adopted and their resolute implementation are decisive for restoring the confidence of the economic agents. In a context of great uncertainty, any doubts on that subject trigger an amplified effect, particularly on the financial markets.

More specifically, the growth and inflation projections for Belgium are largely dependent on the international environment. In that regard, the risks of a gloomier outlook seem to predominate. Outside the euro area, the United States has yet to address the major challenges for public finances, while problems remain on the employment front and on the property market. There is also a question mark over the sustainability of the continuing rapid development of the emerging economies. Finally, while the above factors are likely to depress oil prices, geopolitical tensions could have the opposite effect of driving oil prices higher, and that would be particularly damaging in the current situation, especially in regard to inflation and labour costs in Belgium. Within the euro area, the expected revival of domestic demand in Germany should be a factor supporting activity in the neighbouring economies and encouraging the correction of imbalances in the peripheral economies facing radical adjustments. However, there are many pitfalls along the way.

On the domestic front, the fiscal consolidation of the past six months seems to have had only a limited direct impact on GDP growth, as is evident from the fact that the projections for 2012 are similar to those presented in December 2011, or at least, that impact was offset by more favourable movements in the household savings ratio and in market interest rates. In fact, even though it may exert temporary downward pressure on household and company incomes, the credible and sustainable consolidation of public finances also has the immediate effect of securing the confidence of economic and financial agents, and ultimately reinforcing the foundations of economic growth. To perpetuate the influence of these factors and bring the public debt back down to a path which is sustainable in the long term, it is necessary to maintain the budgetary efforts, as announced in the stability programme. On the basis of the measures which have currently been approved, the Bank's projections for the budget balance show an outcome for 2012 similar to that of the other institutions, notwithstanding a higher growth figure. In 2013, the deficit is expected to increase

**TABLE 8** COMPARISON OF THE FORECASTS FOR BELGIUM
(percentage changes compared to the previous year)

| | GDP in volume | | Inflation (1) | | Budget balance (2) | | Publication date |
|---|---|---|---|---|---|---|---|
| | 2012 | 2013 | 2012 | 2013 | 2012 | 2013 | |
| NBB – Spring 2012 | 0.6 | 1.4 | 2.6 | 1.5 | –2.8 | –3.1 | June 2012 |
| *p.m. Autumn 2011* | *0.5* | *n.* | *2.4* | *n.* | *n.* | *n.* | *December 2011* |
| Federal Planning Bureau (FPB) | 0.1 | 1.4 | 2.9 | 1.9 | –2.6 | –2.8 | May 2012 |
| IMF | 0.0 | 0.8 | 2.4 | 1.9 | –2.9 | –2.2 | April 2012 |
| EC | 0.0 | 1.2 | 2.9 | 1.8 | –3.0 | –3.3 | May 2012 |
| OECD | 0.4 | 1.3 | 2.9 | 1.9 | –2.8 | –2.2 | May 2012 |
| *p.m. Actual figures 2011* | *2.0* | | *3.5* | | *3.7* | | |

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

slightly and therefore deviate from the budget targets, as is also the case in the EC's projections, whereas the IMF and the OECD anticipate that additional measures will lead to a reduction.

So that the financial institutions can continue to play their vital role in financing the economy and safeguarding savings, they must continue their balance sheet consolidation. Taking account, in particular, of the interactions with the sovereign debt crisis in the euro area, the context remains difficult in that regard, despite the support provided by the ECB in granting liquidity.

As already stated, the Bank's inflation projections indicate a significant slowdown in 2013. More marked than in the forecasts by the other institutions, it is triggered by the expected movement in oil prices and enhanced by its transmission to labour costs, assuming very moderate real increases in those costs. That will attenuate the high level of increases in 2011 and 2012, exceeding those of competitors in neighbouring countries. Failing that, there will be a negative impact on activity and employment via exports and investment.

Generally speaking, structural measures should provide long-term support for fiscal consolidation and the improvement in the economy's growth potential and competitiveness. The government measures concerning the labour market and pensions are a vital step in the right direction. They should be reinforced and extended to other operational aspects of the economy so as to augment the stability of the long-term outlook for firms and households, and strengthen the economy's resilience to external shocks.

# Annex

PROJECTIONS FOR THE BELGIAN ECONOMY: SUMMARY OF THE MAIN RESULTS

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

| | 2009 | 2010 | 2011 | 2012 e | 2013 e |
|---|---|---|---|---|---|
| **Growth** (calendar adjusted data) | | | | | |
| GDP in volume | –2.7 | 2.2 | 2.0 | 0.6 | 1.4 |
| Contributions to growth: | | | | | |
| Domestic expenditure, excluding change in inventories | –1.2 | 1.1 | 1.7 | 0.5 | 1.0 |
| Net exports of goods and services | –0.7 | 1.2 | –0.5 | –0.3 | 0.4 |
| Change in inventories | –0.8 | 0.0 | 0.8 | 0.3 | 0.0 |
| **Prices and costs** | | | | | |
| Harmonised index of consumer prices | 0.0 | 2.3 | 3.5 | 2.6 | 1.5 |
| Health index | 0.6 | 1.7 | 3.1 | 2.6 | 1.5 |
| GDP deflator | 3.4 | 1.8 | 1.9 | 2.2 | 1.5 |
| Terms of trade | 2.7 | –1.5 | –1.2 | 0.1 | –0.1 |
| Unit labour costs in the private sector | 3.8 | –0.1 | 2.1 | 3.0 | 1.5 |
| Hourly labour costs in the private sector | 2.7 | 0.9 | 2.5 | 3.1 | 2.0 |
| Hourly productivity in the private sector | –1.0 | 1.0 | 0.4 | 0.1 | 0.6 |
| **Labour market** | | | | | |
| Domestic employment (average annual change in thousands of persons) | –7.6 | 37.0 | 62.2 | 14.3 | 16.6 |
| *p.m. Change during the year, in thousands of persons* (1) | *–23.2* | *63.4* | *46.7* | *3.3* | *21.1* |
| Total volume of labour (2) | –1.6 | 1.1 | 1.7 | 0.1 | 0.8 |
| Harmonised unemployment rate (3) (in % of the labour force) | 7.9 | 8.3 | 7.2 | 7.5 | 7.7 |
| **Incomes** | | | | | |
| Real disposable income of individuals | 3.0 | –0.6 | 1.1 | –0.4 | 1.7 |
| Savings ratio of individuals (in % of disposable income) | 18.5 | 16.2 | 16.4 | 15.6 | 16.4 |
| **Public finances** (4) | | | | | |
| Overall balance (in % of GDP) | –5.6 | –3.8 | –3.7 | –2.8 | –3.1 |
| Primary balance (in % of GDP) | –2.0 | –0.4 | –0.4 | 0.6 | 0.2 |
| Public debt (in % of GDP) | 95.7 | 95.9 | 98.2 | 98.9 | 99.2 |
| **Current account** (according to the balance of payments, in % of GDP) | **–1.6** | **1.4** | **–0.8** | **–1.4** | **–1.0** |

Sources: EC, DGSEI, NAI, NBB.
(1) Difference between the fourth quarter of the year concerned and the fourth quarter of the previous year.
(2) Total number of hours worked in the economy.
(3) In % of the labour force (15-64 years), non calendar adjusted data.
(4) According to the methodology used in the excessive deficit procedure (EDP).