Economic projections for Belgium – Autumn 2012

Introduction

After the revival at the end of the great recession of 2008 and 2009, activity growth clearly began to run out of steam by the beginning of 2011, both in Belgium and in the euro area. This cyclical downturn is proving to be sharper and more prolonged than various national and international institutions, including the Bank, had predicted in the spring of 2012.

The fragile economic upturn seen in Belgium in the first quarter of this year did not herald a more sustained recovery. While the spring projections already pointed to a slowdown in the growth of activity in the ensuing months, output in fact contracted sharply. In relation to the first quarter, this decline was more marked in Belgium than in the euro area.

The further cyclical slowdown in 2012 came against the backdrop of the worsening crisis in the euro area. While there has undoubtedly been progress towards better governance and the correction of the macroeconomic imbalances, a final solution has yet to be found for what has now become an institutional crisis. That remains an important source of uncertainty concerning the external environment

Regarding the expenditure components of GDP in Belgium, the particularly sluggish domestic demand is striking. Thus, the volume of household expenditure, be it for private consumption or investment in housing, has been falling almost continuously quarter after quarter for quite some time. This decline is linked to the reduction in households' real disposable income over the past two years even though this was largely caused by the erosion of property incomes, for which households have partially compensated by cutting their average propensity to save. Furthermore, the uncertain national and international outlook may also depress household and business expenditure.

The autumn brought a further deterioration in the economic indicators and, above all, mounting pessimism over the outlook for employment. This gloom is being fuelled by a spate of announcements of closures or restructuring of mainly industrial companies, which will be accompanied by substantial job losses. Business leaders are mainly concerned about a slump in demand for their products. Those fears are attributable to the marked slowdown in activity during the closing months of 2012 on the main neighbouring export markets, especially Germany. In this context, it therefore seems highly likely that the Belgian economy will also continue to slacken pace, and that it will take a few more months before the business cycle turns around. The deterioration of the economic situation in 2012 and the relatively pessimistic estimate for the growth of activity in late 2012 and early 2013 are also weighing quite heavily on the annual growth forecast for 2013. Even if the economy recovers as expected in the spring of 2013, annual growth will still be very meagre.

The economic projections for 2013 discussed in this article were finalised as at 23 November 2012. They were drawn up on the basis of the Eurosystem's technical assumptions decided on 16 November, the main ones being described in the box in section 1. As usual in the case of these exercises, the projections for public finances presented in section 5 only take account of measures which have been – or are very likely to be – formally approved by the government and specified in sufficient detail at the cut-off date for the exercise.

In this connection, it was impossible to take account of the political agreement concluded on 20 November 2012 in relation to the federal government budget and the measures to restrain the rise in nominal wages, in the absence of precise, detailed information on those decisions. Therefore, in order to avoid presenting outdated figures, the estimates for public finances in this article do not go beyond 2012. The last section lists some of the risk factors surrounding these projections. Obviously, besides the great uncertainty about the international environment, the measures announced recently could also influence activity growth in 2013.

1. International environment and assumptions

The slowdown in global activity and trade during 2012 was more pronounced than had been expected in the spring. The advanced countries recorded only very modest growth, and some of them actually slumped back into recession. Activity growth was hampered by the continuing public and private sector debt reduction, the strict financial conditions prevailing in certain countries and the constant uncertainty due mainly to the euro crisis. Economic expansion equally slowed down in the emerging countries, owing to the combined effects of sluggish export markets and the loss of dynamism in domestic demand following the tightening of economic policies in 2011.

Global economic activity had gained momentum in early 2012, supported in particular by a number of temporary factors such as the restoration of global production chains after the floods which hit Thailand in the autumn of 2011, and an unusually mild winter in the northern hemisphere. More favourable sentiment was evident on the financial markets in the initial months of the year, thanks to the improvement in the economic climate combined with a series of monetary policy measures, such as the two special longer-term refinancing operations (three-year LTROs) conducted by the ECB.

Nonetheless, most markets were still operating far from normally, and in the second half of March the situation deteriorated again after a renewed flare-up of the euro crisis. The latter mainly concerned Spain, Italy and Greece, and long-term spreads on the government securities of those countries thus widened considerably in the spring. Tensions on those markets and the close link between public finances and banks' positions caused a growing fragmentation of credit conditions in the euro area, thus hindering the proper transmission of monetary policy in some euro area countries. Financial market confidence also deteriorated during the second quarter owing to the publication of weaker economic figures as a result of the disappearance of the temporary factors underpinning growth, and the rising cost of commodities at the beginning of 2012. Even countries which had previously recorded strong growth, such as Germany and the emerging countries, faced a slowdown and economic activity in the euro area contracted in the second quarter. The euro area crisis infected other regions via international trade, financial markets and confidence effects. Outside the euro area, however, several other factors inhibited growth, such as the impact of the measures to tighten economic policy introduced by China in 2011 and the incipient uncertainty over the future fiscal policy of the United States.

From the summer on, the euro area and other countries adopted a series of important economic policy measures in response to the growth slowdown and the persistence of the euro crisis. At the European summit at the end of June 2012, the heads of state or government of the euro area stressed the need to break the vicious circle of debt between banks and governments. They agreed to establish a common bank supervision mechanism. Once this mechanism is set up, the European Stability Mechanism (EMS) will be able to recapitalise banks directly, subject to certain conditions. According to the European Commission's proposals, the ECB will carry the ultimate responsibility for supervision. As regards the Eurosystem, the main key interest rates were initially cut by 25 basis points at the beginning of July. Then, at the end of that month, the ECB president announced that all necessary measures would be taken to protect the euro. That statement produced a significant announcement effect, triggering a narrowing of yield spreads and an appreciation of the euro.

Subsequently, the financial markets very warmly welcomed the ECB's decision at the beginning of September 2012 to permit Outright Monetary Transactions (OMTs) on sovereign debt secondary markets. Those transactions are intended to ensure the correct transmission of monetary policy and the uniformity of the policy signals. The fact that the German Constitutional Court did not object to the ratification of the ESM Treaty (the ESM finally becoming operational on 8 October) was also well received. Moreover, in September and October, policies pursued outside the euro area provided further support for the financial markets. The Federal Reserve, the Bank of England and the Bank of Japan decided to expand their programmes for the purchase of securities. The main emerging countries postponed or cancelled the tightening of economic policy which they had initially planned.

Economic growth stabilised at a low level in the third quarter, and the outlook remains very uncertain. The factors of uncertainty centre mainly on the further development of the euro area crisis, but also on the mounting concern over the situation regarding public finances in the United States. That concern is essentially due to the "fiscal cliff", the fiscal tightening that the US authorities will face in 2013 at unchanged policy, as certain tax cuts expire and increases in spending have to be curbed. Another major factor of uncertainty concerns the progress of activity in the emerging countries, and more particularly the risk of structurally weaker growth in those economies.

Commodity prices have fallen on average since the end of 2011, but there were divergences between the main commodity categories. Food commodity prices increased owing to disappointing harvests, while industrial commodity prices declined. In mid-November 2012, the price of Brent crude oil was much the same as at the end of 2011, at $ 108 per barrel. However, during the year the price fluctuated between $ 90 and $ 126, owing to cyclical and geopolitical factors.

Against this backdrop, the outlook for the growth of economic activity in 2012 and 2013 has been revised downwards in recent months for most economies. Growth is projected to slow down further in 2012, and a recovery is only expected in the course of 2013. The EC's autumn forecasts indicate moderate world GDP growth, amounting to 3.1 % in 2012 and 3.3 % in 2013. In 2012 in particular, growth is forecast to be considerably stronger in the United States and Japan than in the European Union and in the euro area, where negative growth of 0.3 and 0.4 % respectively is forecast. The weak link in global economic growth seems to be Europe in general, and the euro area in particular, although there are wide disparities between the Member States. In the main emerging countries, growth is also set to slacken in 2012 before picking up in 2013. While unemployment will continue to fall in the United States, in the European Union it will persist at a high level owing to the weak business climate, and could even increase further.

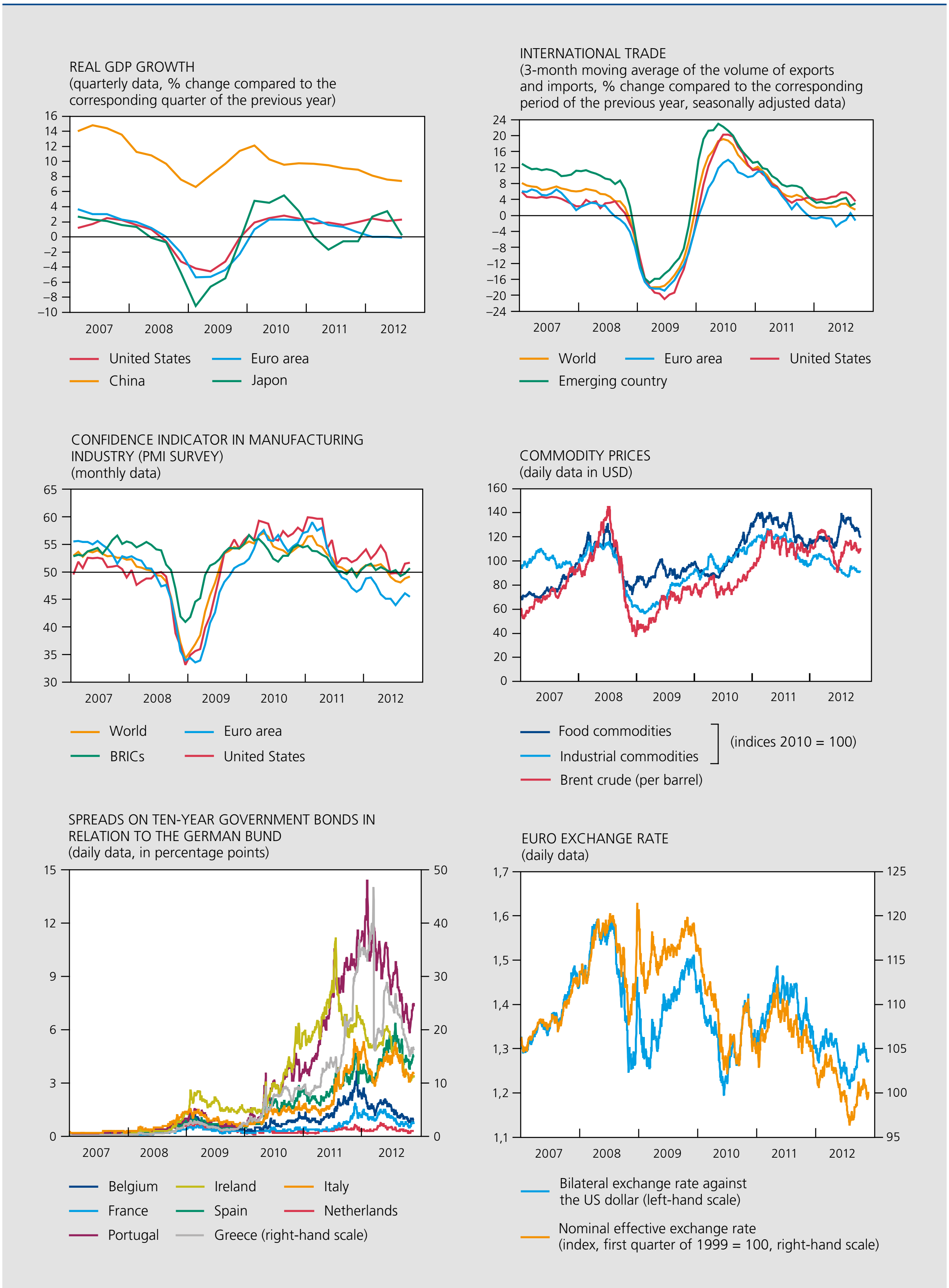
TABLE 1 PROJECTIONS FOR THE MAIN ECONOMIC REGIONS

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

	2011	2012	2013
	Actual figures	Projections	
Real GDP			
World	3.8	3.1	3.3
of which:			
United States	1.8	2.1	2.3
Japan	–0.8	2.0	0.8
European Union	1.5	–0.3	0.4
China	9.2	7.7	7.7
India	7.2	5.0	5.8
Russia	4.3	3.7	3.9
Brazil	2.7	1.5	3.9
p.m. World imports	*7.7*	*3.5*	*4.3*
Inflation (1)			
United States	3.2	2.1	2.0
Japan	–0.3	–0.2	–0.1
European Union	3.1	2.7	2.0
China	5.4	3.0	3.0
Unemployment (2)			
United States	8.9	8.2	7.9
Japan	4.6	4.8	4.7
European Union	9.7	10.5	10.9

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

CHART 1 GLOBAL CYCLICAL MOVEMENTS AND DEVELOPMENTS ON FINANCIAL AND COMMODITY MARKETS



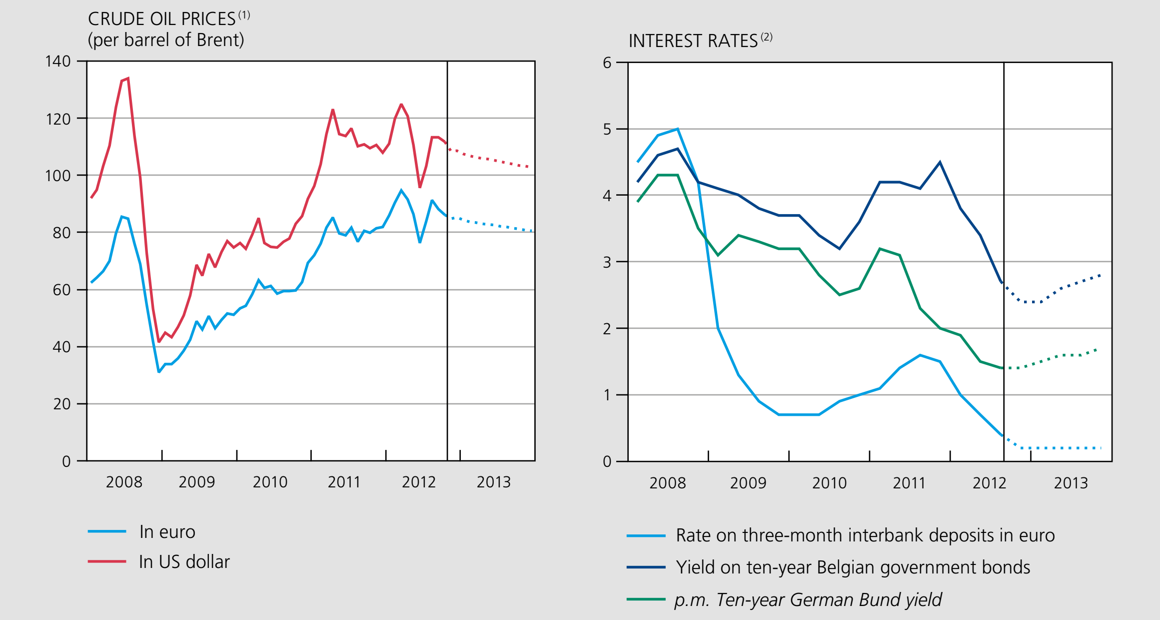
Source : Thomson Reuters Datastream.

Box – Projection assumptions

The economic projections for Belgium described in this article are part of the Eurosystem's joint exercise for the euro area. That exercise is based on a set of technical assumptions and forecasts for the international environment drawn up jointly by the participating institutions, namely the ECB and the national central banks of the euro area.

In particular, the projections are based on exchange rates held constant at the average levels recorded in the last ten working days before the cut-off date for the projections, in mid-November 2012. In the case of the US dollar, the exchange rate stood at $ 1.28 to the euro, which corresponds to the average for 2012.

ASSUMPTIONS CONCERNING OIL PRICES AND INTEREST RATES



Source: ECB.
(1) Actual figures up to mid-November 2012, assumptions from mid-November 2012.
(2) Actual figures up to the third quarter of 2012, assumptions from the fourth quarter of 2012.

In the case of oil prices, account is taken of market expectations as reflected in the forward contracts concluded on the international markets. In mid-November 2012, this indicator suggested a gradual decline in the price per barrel of Brent over the projection horizon, from $ 109.6 on average in the last quarter of 2012 to an average of $ 103.2 in the last quarter of 2013.

The interest rate assumptions are also based on market expectations in mid-November 2012. Three-month interbank deposit rates, which had fallen to an unusually low level of just 20 basis points in the last quarter of 2012, are projected to remain stable up to the last quarter of 2013. The average annual level of interest rates in the short-term segment of the market is therefore expected to fall further by around two-thirds compared to that in 2012.

The expected movement in rates charged by banks on business investment loans and private mortgage loans takes account of the transmission which usually occurs in relation to market interest rates. For the purpose of the Eurosystem projection exercise, the rates charged by each country's banks have been modelled as a function of the market rates to which they are most closely linked, and their projections are based on the ones for those benchmark rates.

Thus, it is evident that, since the start of the financial crisis (and more particularly the sovereign debt crisis), mortgage interest rates in Belgium have been greatly influenced by the Euribor ten-year swap rates rather than by government bond yields. The rates charged on corporate loans generally depend on shorter-term interest rates.

At the end of 2013, the long-term mortgage interest rate is predicted at 3.4 %, compared to 3.5 % in September 2012. The interest rate on short-term corporate loans would drop from 2.2 % to 2 %. The slight fall in these bank interest rates reflects the expected reduction in market interest rates up to the end of 2012 or even early 2013.

Another important assumption concerns the foreign markets relevant to Belgium. During 2012, imports by Belgium's trading partners decelerated sharply. Over the year as a whole, the export market volume is estimated to expand by barely 1.4 % (against 5 % in 2011). The decline is more marked for sales within the euro area – which is undoubtedly connected with the widespread slowdown in economic activity there – but is also affecting markets outside the euro area, though to a lesser extent. Export market growth is estimated at 2.2 % in 2013. The growth of Belgian exports depends not only on the expansion of those markets but also on the movement in market shares, and consequently Belgium's competitiveness. The evolution of prices charged by competitors on the export markets has an impact on Belgium's cost competitiveness. In that respect, the projections assume very modest price increases : in 2013, the prices charged by competitors on the export markets are forecast to rise by less than 2 %, well below the increase from 2011 to 2012.

Obviously, developments on the export markets relevant to Belgium are inextricably linked with global economic growth. The Eurosystem projections are based on two key assumptions in that respect. First, it is assumed that the budget negotiations in the United States will not derail the economic policy : the projections assume a renewal of

EUROSYSTEM PROJECTION ASSUMPTIONS

	2011	2012	2013
		(annual averages)	
Interest rate on three-month interbank deposits in euro	1.39	0.57	0.18
Yield on ten-year Belgian government bonds	4.2	3.1	2.6
EUR/USD exchange rate	1.39	1.28	1.28
Oil price (US dollars per barrel)	111.0	111.7	105.0
Mortgage interest rate	3.9	3.6	3.3
Corporate loan interest rate	2.8	2.2	1.9
		(percentage changes)	
Export markets relevant to Belgium	5.0	1.4	2.2
Competitors' export prices	4.2	4.0	1.8

Source : ECB.

around 60 % of the expiring tax cuts and expenditure increases. The tightening of US fiscal policy in early 2013 will therefore remain limited to around 1.6 % of GDP. The second assumption is that the current policy pursued in response to the euro crisis will continue up to the end of the projection horizon. That implies that the institutional problems will not be finally resolved, but also that there will be no serious adverse shock to confidence which could heavily affect economic activity in the euro area.

In view of the rapid deterioration in the business climate, the Eurosystem slashed its projections for GDP growth in the euro area. Following a marked contraction in economic activity in 2012, of between 0.4 and 0.6 %, real growth is projected to remain very weak in 2013. The growth estimate for that year actually ranges between –0.9 % and 0.3 %. Although the downward revision in the euro area growth projections is general, and also affects the countries whose economic activity has been least affected by the euro crisis, the estimates still diverge widely from one country to another. The countries that need to make more effort to consolidate their public finances and restore their competitiveness are also the ones likely to see an above-average decline in economic activity in 2013.

Inflation in the euro area is still forecast at an average of 2.5 % in 2012, but it is declining. This profile is mainly attributable to the movement in oil prices, which rose strongly in the first quarter before dropping back. Pressure originating from domestic costs – especially labour costs – remains under control. For 2013, the Eurosystem considers that, taking account of the assumed further decline in commodity prices, inflation should range between 1.1 and 2.1 %.

2. Activity and demand

At the beginning of 2012, there was every reason to believe that the economic slowdown had come to an end. Activity growth was surprisingly positive in the first quarter of the year, after stagnating in the second half of 2011. However, it was followed by an unusually steep decline in output in the second quarter, with the economy contracting by 0.5 % quarter-on-quarter. According to the NAI's initial estimates, growth was again zero in the third quarter. In addition, the economic climate clearly deteriorated again at the end of that quarter.

Taking account of this last factor, the Bank's new projections point to a fairly gloomy outlook for growth in the last quarter of 2012 and in early 2013. There are two reasons for this. First, several indicators, such as those concerning confidence in the manufacturing industry, show a marked cyclical slowdown in Belgium's neighbouring countries.

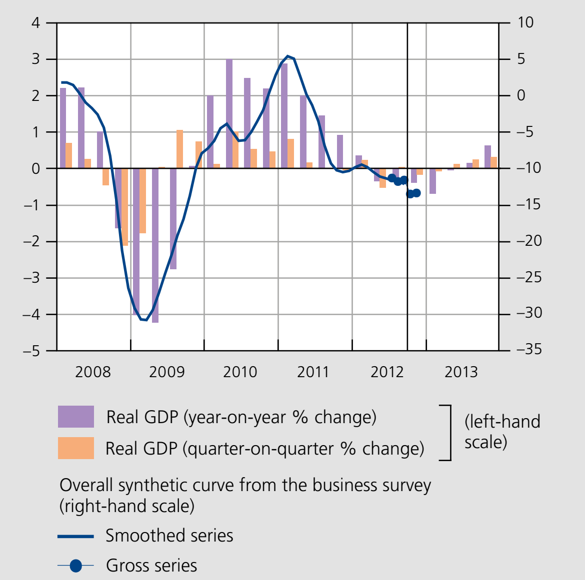
TABLE 2 EUROSYSTEM PROJECTIONS
(percentage changes compared to the previous year)

	Euro area			*p.m. Belgium*		
	2011	2012	2013	*2011*	*2012*	*2013*
Inflation (HICP)	2.7	2.5 / 2.5	1.1 / 2.1	*3.5*	*2.6*	*1.6*
Real GDP	1.5	–0.6 / –0.4	–0.9 / 0.3	*1.8*	*–0.2*	*0.0*
of which:						
Private consumption	0.1	–1.2 / –1.0	–1.1 / –0.1	*0.2*	*–0.7*	*0.0*
Public consumption	–0.2	–0.6 / 0.2	–1.2 / 0.0	*0.8*	*0.5*	*1.5*
Investment	1.6	–4.2 / –3.4	–4.2 / –1.0	*4.1*	*–0.5*	*–1.3*
Exports	6.5	2.1 / 3.7	–0.4 / 5.0	*5.5*	*0.3*	*0.6*
Imports	4.3	–1.1 / 0.3	–1.7 / 3.7	*5.7*	*–0.2*	*0.4*

Sources: ECB, NBB.

CHART 2 GDP AND BUSINESS SURVEY INDICATOR

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



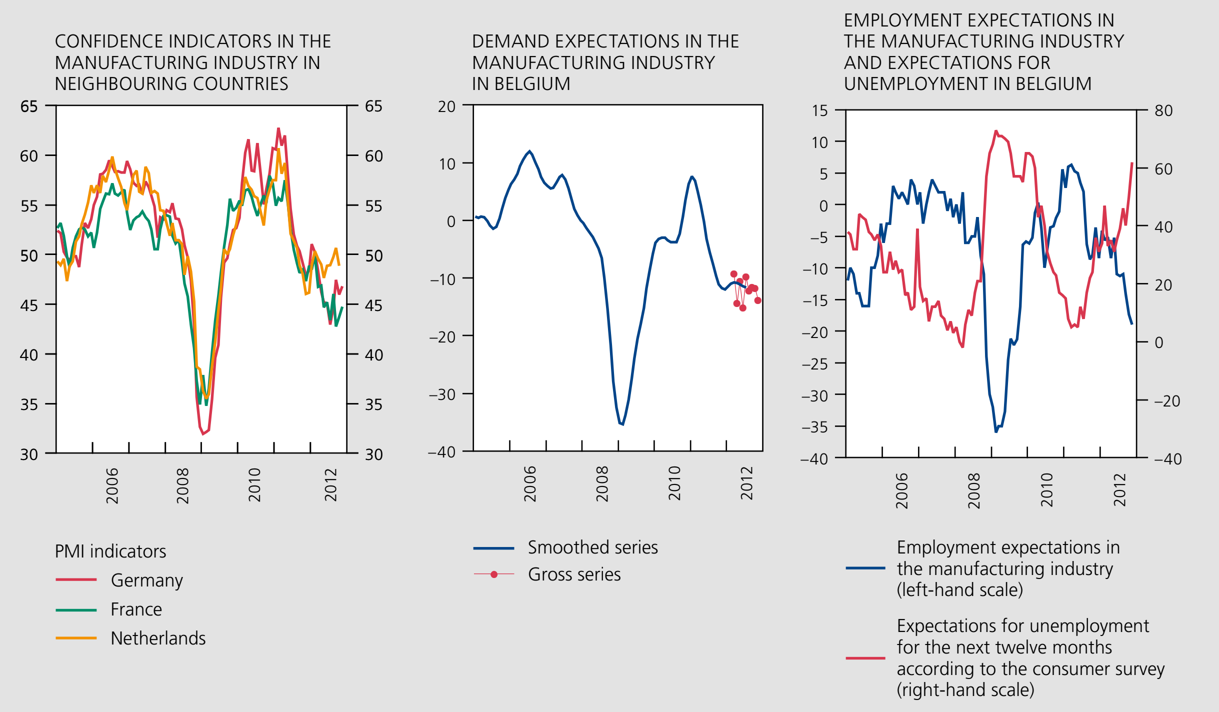
Sources: NAI, NBB.
(1) Seasonally adjusted data.

The weaker or even negative growth expected in the main trading partners will definitely affect Belgium's export performance. Second, the rapid deterioration in the outlook for employment appears to be causing further erosion of consumer confidence. That could curb household spending, *inter alia* because of an increase in precautionary saving.

Owing to the economic slowdown already apparent during 2012 and the further dip expected in the final quarter of the year, the new macroeconomic projections state that annual economic growth will be slightly negative at –0.2 % in 2012. However, 2013 should bring a gradual revival in economic activity. From the second quarter of the year, growth is expected to return to clearly positive territory. Nevertheless owing to the dip expected at the turn of the year, economic activity will remain very weak on an annual basis; the current projections indicate zero growth for 2013.

Regarding the components of expenditure, the contribution of net exports to growth in 2011 was negligible or even slightly negative, as import growth was closely matched by the increase in exports. For both components, that implies a marked deceleration compared to the growth recorded in 2010. In 2011,

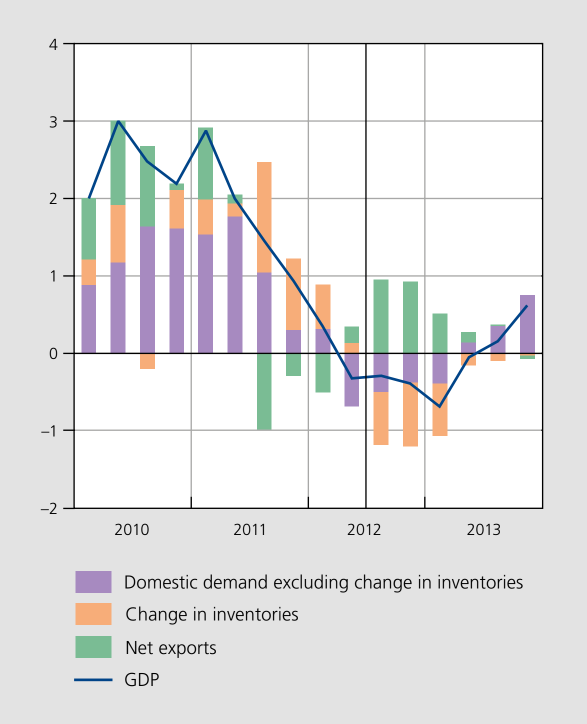
CHART 3 DETERIORATING OUTLOOK FOR ACTIVITY AND EMPLOYMENT



Sources: Markit Economics, NBB.

CHART 4 MAIN EXPENDITURE CATEGORIES

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



Sources: NAI, NBB.

the expansion of activity was therefore driven mainly by domestic demand. Although the contribution of domestic demand, apart from inventories, almost equalled the previous year's figure, its composition was very different. Whereas in 2010 domestic demand still originated almost exclusively from Belgian household expenditure, the growth of that spending had already fallen sharply during 2011. However, that fall was offset by the steep rise in business investment in particular. The change in inventories also contributed significantly to the growth of activity in 2011, accounting for almost 40 % of that growth. The reason for that phenomenon, which was also visible in other euro area countries, may be that the production process was slow to adjust to the deteriorating business climate during 2011.

As in 2009, the contribution of domestic expenditure to GDP growth is estimated to become negative in 2012: the fall in private consumption is expected to persist, while the expansion of investment will also be curbed by the deteriorating outlook for growth. That is likewise prompting firms to scale down their stock-building. Conversely, the contraction of activity is currently being moderated somewhat by the positive contribution from net exports, resulting from a small rise in exports combined with a similarly minor fall in imports.

The still relatively favourable export growth compared to the other expenditure components is due essentially to the fact that the business climate in Belgium's main export markets began to deteriorate primarily towards the end of the year. An example is the German economy, which was still recording solid growth rates until the third quarter of 2012. According to provisional foreign trade figures, exporters increased the volume of their turnover on foreign markets in the first three quarters of 2012. Although exports are likely to have fallen in the final quarter of 2012, year-on-year growth would remain slightly positive even though the export markets relevant to Belgium have grown considerably more slowly than in 2011. As stated in the box, those markets expanded by 1.4 %, still outpacing Belgium's export growth. This means that Belgian exporters once again lost market share. According to the common assumptions for the Eurosystem projections, export markets should expand a little more strongly in 2013 as a result of the gradual economic revival, which will support exports. According to the Bank's projections, however, export growth will again lag behind the expansion of the markets as a result of further losses of market share.

Household expenditure is forecast to continue falling in both 2012 and 2013. According to the Bank's estimates, real private consumption will continue to be eroded during the rest of the year, following the steep fall in the first half of 2012. On an annual basis, it will decline by 0.7 %. This fall is much steeper and more protracted than the one at the start of the great recession of 2008 and 2009, when real household consumption continued to rise on an annual basis. Moreover, the decline exceeds the fall in households' real disposable income. In 2011, the savings ratio hit a historically low level for Belgium; households are expected to increase that ratio again as a consequence of the uncertainty about the outlook for employment, in particular, and more generally, their purchasing power in the immediate future. According to the Bank's estimates, the real disposable income of households should increase again in 2013, for the first time in three years. However, that increase will not be supported by labour incomes, which will continue to fall slightly in real terms. It will be attributable solely to a rise in other incomes, such as those derived from property. Since such incomes are saved to a relatively greater extent, it could explain why – together with the uncertainty which is likely to continue depressing consumption until early 2013 – private consumption is expected to lag behind household disposable income, and why real consumption will likely remain roughly unchanged in 2013.

TABLE 3 GDP AND MAIN EXPENDITURE CATEGORIES IN CHAINED EURO, REFERENCE YEAR 2010

(percentage changes compared to the previous year, calendar adjusted data)

	2009	2010	2011	2012 e	2013 e
Final consumption expenditure of households and NPIs	0.6	2.7	0.2	–0.7	0.0
p.m. Real gross disposable income (1)	*2.8*	*–1.2*	*–0.8*	*–0.2*	*1.0*
Savings ratio	*18.3*	*15.4*	*14.4*	*14.9*	*15.7*
Consumption expenditure of general government	1.9	0.7	0.8	0.5	1.5
Gross fixed capital formation	–8.4	–1.4	4.1	–0.5	–1.3
Housing	–8.6	3.1	–5.3	–2.9	–1.6
General government	9.7	–3.1	5.3	1.9	–5.1
Enterprises	–10.2	–3.2	8.6	0.3	–0.6
p.m. Domestic expenditure excluding change in inventories (3)	*–1.1*	*1.3*	*1.1*	*–0.4*	*0.1*
Change in inventories (3)	–1.0	0.3	0.7	–0.2	–0.2
Net exports of goods and services (1)	–0.6	0.7	–0.1	0.4	0.2
Exports of goods and services	–11.1	9.6	5.5	0.3	0.6
Imports of goods and services	–10.6	8.9	5.7	–0.2	0.4
GDP	–2.7	2.4	1.8	–0.2	0.0

Sources: NAI, NBB.
(1) Gross data.
(2) In % of gross disposable income in the broad sense, i.e. including the change in households' entitlements to additional pensions accruing in the context of an occupational activity.
(3) Contribution to the change in GDP.

The decline in household spending also concerns investment in housing, which is similarly following a clear downward trend, after having been fostered temporarily in 2010 by the federal government's stimulus policy, particularly via a targeted cut in VAT. Since then, investment has fallen quarter after quarter, except in the first quarter of 2012, despite the historically low levels of interest rates on mortgage loans. Apart from the reduction in household disposable income and the uncertainty, credit restrictions may also be a contributory factor. In that respect, the Bank Lending Survey indicates that financial institutions have already tightened their mortgage lending criteria in the second and third quarters of 2012, and that they will probably do so again in the final quarter. According to the Bank's estimates, modest positive growth in housing investment will probably not be seen until some time in 2013. On an annual basis, real housing investment will therefore continue to decline in 2012 and 2013.

According to the Bank's estimates, business investment will have fallen in the second half of 2012 owing to the deteriorating demand outlook. The capacity utilisation rate in the manufacturing industry, for instance, has fallen sharply since 2011 and the propensity for business investment has apparently suffered as a result of the slowdown in activity. The tightening of lending criteria may also be a factor here, as suggested by the findings of the Bank Lending Survey. Nonetheless, as a result of the strong growth in 2011, which persisted in the first quarter of 2012, the year-on-year growth in real business investment will still be slightly positive in 2012. Owing to the decline which set in during 2012, however, annual growth will be slightly negative in 2013 despite the revival expected around the middle of the year.

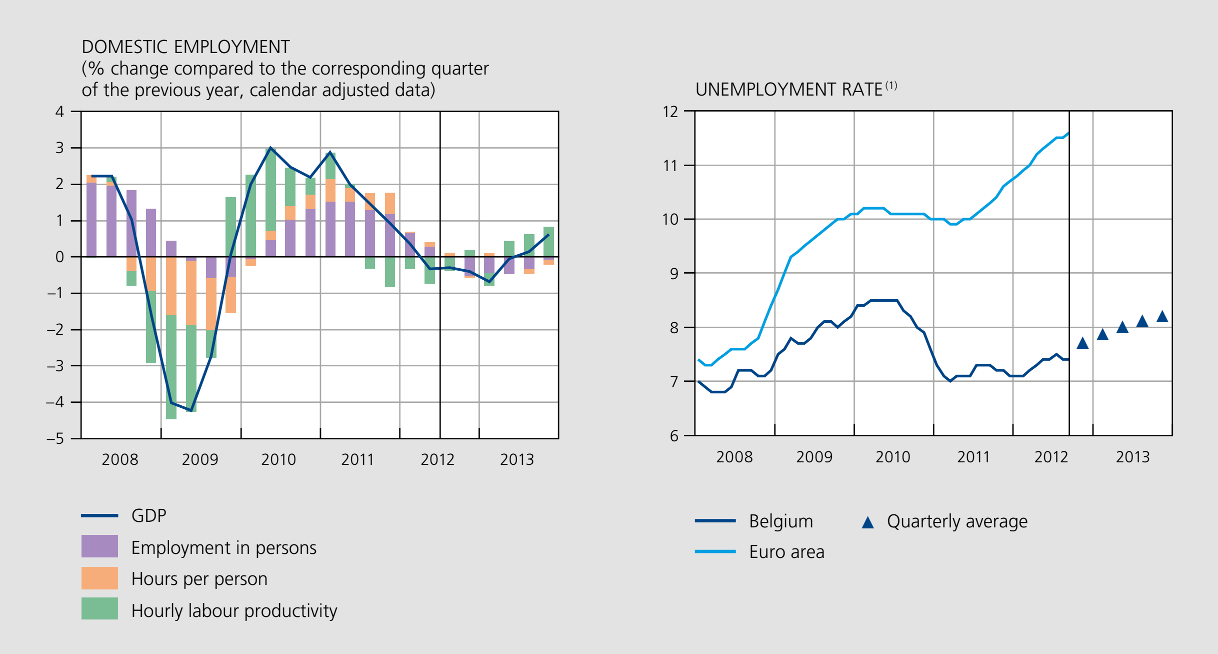
Notwithstanding the consolidation efforts, public spending will continue to support activity growth in 2012. The growth of public consumption will only fall slightly, while public investment will record a higher growth in real terms, as is usual in a local election year.

Overall, year-on-year growth of domestic demand should be modest in 2013. The growth contribution of net exports will likewise be small but positive. In fact, owing to the weakness of domestic demand, imports will rise less than exports.

3. Employment

The less favourable outlook for economic activity also implies a downward revision in the employment projections.

CHART 5 EMPLOYMENT



Sources: EC, NAI, NEO, NBB.
(1) Harmonised unemployment rate in % of the labour force.

On an annual basis, the volume of labour will remain relatively constant in 2012 but is expected to fall in 2013. In contrast to what happened in 2008 and 2009, average working time will absorb the cyclical fluctuations to a lesser extent. The contraction of the labour volume will therefore be more rapidly translated in job losses. Domestic employment, which amounted to 4 562 000 workers at the end of 2011, will fall by 23 000 units by the end of 2012, and will continue to decline in 2013. That fall is due to the underlying trend in paid employment and in the number of self-employed workers.

With regard to employees, the branches of activity sensitive to the business cycle are likely to suffer most from job losses. Employment in general government and education will also contract slightly in both 2012 and 2013. “Other services” form the only branch which could still record positive growth of employees. However, that growth will be insufficient to compensate for losses in other branches in both 2012 and 2013.

Apart from the economic climate, another factor influencing the pattern of paid employment is the change in job creation attributable to programmes which reduce the labour costs of certain target groups, notably via subsidies. Service vouchers will become more expensive, and will be more closely controlled; together with a saturation effect, that presages slower growth in 2013. Similarly, the number of workers benefiting from the Activa “win-win” programme is falling significantly owing to the termination of the scheme on 31 December 2011. For some of those workers, that means a return to unemployment. Another factor explaining the increased impact on employment of the weakening of economic activity is the ending of the crisis measures even though the temporary unemployment scheme for white-collar workers, for instance, has become permanent since January 2012. Moreover, employers making large-scale use of this scheme have been required to pay an accountability contribution since 2012, which will potentially make them slower to resort to this instrument, or encourage them to use it for shorter periods.

In 2012, the decline in employment has been curbed somewhat by a small rise in the number of self-employed persons (up by an average of 5 500). In 2013, that growth will probably continue to weaken against the backdrop of a deteriorating business climate, but should remain positive. Incidentally, that was also the case at the time of the great recession of 2008 and 2009. At that time, the expansion was fostered by institutional factors, such as the transitional rules on the free movement of persons applicable to countries joining the EU in 2004. Abolished in 2009, these rules – which aimed to protect the labour markets of the old EU Member States from a supply

TABLE 4 LABOUR SUPPLY AND DEMAND

(calendar adjusted data, annual averages, unless otherwise stated)

	2008	2009	2010	2011	2012 e	2013 e
			(% change)			
GDP	1.0	–2.7	2.4	1.8	–0.2	0.0
Volume of labour	1.5	–1.6	0.9	1.9	0.1	–0.4
Domestic employment in persons	1.8	–0.2	0.7	1.4	0.1	–0.3
			(change in thousands of persons)			
Domestic employment	78.7	–8.8	30.8	61.6	4.6	–14.9
p.m. Change during the year (1)	*58.8*	*–24.3*	*58.9*	*53.1*	*–23.1*	*–3.3*
Employees	68.7	–13.3	25.0	52.0	–1.0	–17.1
of which:						
Branches sensitive to the business cycle	46.0	–38.1	3.4	34.5	–10.2	–27.0
General government and education	9.9	13.8	6.7	0.8	–2.8	–2.3
Other services	12.8	11.0	14.9	16.8	12.0	12.2
Self-employed persons	10.0	4.5	5.8	9.6	5.5	2.2
Frontier workers	0.5	1.1	0.5	–2.3	–0.4	0.0
Total employment	79.2	–7.7	31.3	59.3	4.2	–14.9
Unemployed job-seekers	–25.7	50.6	13.7	–19.8	16.6	45.4
p.m. Change during the year (1)	*–5.0*	*59.8*	*–10.0*	*–11.1*	*33.8*	*41.1*
Labour force	53.4	42.9	45.0	39.5	20.8	30.6
p.m. Harmonised activity rate (2)	*67.1*	*66.9*	*67.7*	*66.7*	*66.8*	*67.0*
Harmonised employment rate (3)	*68.0*	*67.1*	*67.6*	*67.3*	*67.1*	*66.6*
Harmonised unemployment rate (4)	*7.0*	*8.0*	*8.4*	*7.2*	*7.5*	*8.1*

Sources: EC, NAI, NEO, NBB.
(1) Difference between the fourth quarter of the year concerned and the fourth quarter of the previous year.
(2) Percentages of the population of working age (15-64 years), non calendar adjusted data.
(3) Percentages of the population of working age (20-64 years).
(4) Percentages of the labour force (15-64 years), non calendar adjusted data.

shock – were in fact commonly circumvented by persons setting up businesses on a self-employed basis, that status not being covered by the transition arrangements. Up to 31 December 2013, a similar measure applies to nationals of Romania and Bulgaria, countries which joined the EU in 2007.

The recent reforms concerning unemployment and early retirement are strongly geared towards increasing the incentives to find a (new) job as quickly as possible and remain active for longer on the labour market. In the short term, owing to the slowdown in economic activity and the decline in demand for labour, it will not be possible to absorb the expansion of the labour force, so that unemployment will increase. Moreover, unemployment has been rising since the end of 2011, and is approaching 580 000 persons at the end of 2012. That figure will rise further in 2013. In the 15-64 age group, the unemployment rate, which stood at 7.4 % in the second quarter of 2012, is thus forecast to rise to an average of 8.1 % in 2013.

4. Prices and costs

According to the current projections, consumer price inflation measured by the HICP is estimated at 2.6 % in 2012 – compared to 2.5 % in the euro area – and 1.6 % in 2013. Having exceeded 3 % throughout 2011 – at an average of 3.5 % – the rise in prices remained below that figure from April 2012 on, and should actually drop below 2 % by the beginning of 2013.

The deceleration is due primarily to energy prices which, after a 17 % surge in 2011, are estimated to have risen by

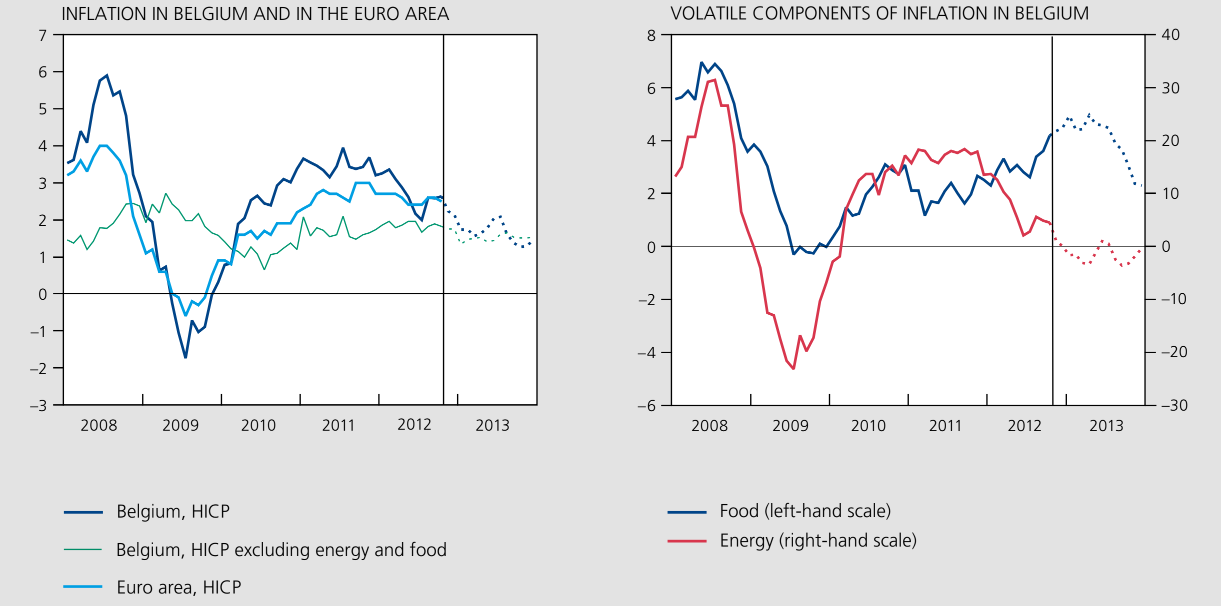
5.9 % on average in 2012. This is mainly attributable to oil prices on the international markets and to the behaviour of the euro in relation to the dollar. In fact, in 2012, the price per barrel of Brent initially continued rising to peak at $ 125 per barrel in March (monthly average), before falling for a brief period, to reach a low point of $ 96 per barrel in June. Since then, the price has risen again so that the 2012 average will be similar to that for 2011 : current projections put the price at $ 112 in 2012 compared to $ 111 in 2011. At the same time, the euro depreciated against the dollar during 2012, dropping to a low point of $ 1.23 in July before recovering quite strongly so that, as an annual average, the euro/dollar exchange rate is estimated at 1.28 compared to 1.39 in 2011. The steadily high price of Brent combined with a weaker euro means that oil prices in euro are higher in 2012 than in 2011, although the rate of increase has been lower than a year ago. In 2013, energy prices should fall year-on-year except during June and July, owing to a base effect caused by the drop in oil prices in the spring of 2012. The effect on inflation of freezing the indexation of gas and electricity prices until the end of 2012 is likely to be limited, and is estimated at –0.1 percentage point on overall inflation measured by the HICP in 2012.

After having benefited from favourable supply conditions in 2011, unprocessed food prices gathered pace in 2012, a year in which the average increase is put at 3.5 %, against merely 0.2 % in 2011. Local weather conditions were particularly unfavourable for fruit and vegetables in the spring and summer of 2012, while supplies of some types of fish were less plentiful than usual. These price increases will continue to influence year-on-year inflation in 2013. Thus, prices of unprocessed food are expected to rise by an average of 3.6 % over that year. The pace of the annual average increase in the price of processed food was stable in 2012 at 3.2 %, against 3.1 % in 2011. However, the 2012 figure conceals a compensation effect between the slower pace of price increases in the second quarter and the steeper rise from August onwards, reflecting a new surge in world prices of food commodities, due partly to the drought in the United States. That acceleration is likely to persist in the first half of 2013, peaking at 4.9 % in April. On average, processed food prices will thus rise by 4.1 % in 2013.

The increases in indirect taxes on services and the price rises in the communications sector in January 2012 account for much of the acceleration in underlying inflation in 2012, with an average figure forecast at 1.8 % compared to 1.7 % in 2011. In 2013, the underlying trend will cease to be influenced by these factors and should decelerate from January on, reverting to an average of 1.5 % for the whole year.

CHART 6 **INFLATION**

(HICP, % change compared to the corresponding period of the previous year)



Sources : EC, NBB.

TABLE 5 PRICE AND COST INDICATORS

(% change compared to the previous year, unless otherwise stated)

	2009	2010	2011	2012 e	2013 e
HICP	0.0	2.3	3.5	2.6	1.6
Health index	0.6	1.7	3.1	2.6	1.7
Underlying inflation trend [1]	2.1	1.1	1.7	1.8	1.5
GDP deflator	1.2	2.0	2.0	2.1	1.9
Labour costs in the private sector					
Labour costs per hour worked	2.7	0.9	2.3	3.2	2.0
of which indexation	2.5	0.5	2.7	2.8	2.0
Labour productivity [2]	–1.1	1.5	0.0	–0.5	0.3
Unit labour costs	3.8	–0.6	2.2	3.7	1.8

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

After having already risen by 2.2 % in 2011, unit labour costs in the private sector are set to accelerate to 3.7 % in 2012. This increase, which outpaces the rise expected for Belgium's three main partners, namely Germany, France and the Netherlands, is damaging the competitiveness of Belgian producers. Nonetheless, according to the assumptions adopted, and given the economic climate, the rate of progression of unit labour costs should subside to 1.8 % in 2013.

This evolution is favourably influenced by the slight improvement in labour productivity gains in 2013, which were adversely affected by the slowdown in activity at the end of 2011, and especially in 2012. However, the movement in hourly labour costs also has a major impact: having risen by 2.3 % in 2011 and 3.2 % in 2012, hourly labour costs in the private sector should increase by only 2.0 % in 2013. These developments largely reflect those of wage indexation. After having risen by 3.1 % in 2011, the health index, which is used as the reference for wage indexation, is projected to rise by 2.6 % in 2012 and 1.7 % in 2013. Taking account of the time lags inherent in the indexation mechanisms in the various joint committees, the effects of the automatic wage adjustment are likely to remain considerable in 2012, even though inflation began to ease this year. In 2013, there will be a more noticeable decline in the impact of indexation. Apart from indexation, the assumption on hourly labour costs in the private sector allows for a 0.2 % increase in negotiated wages which is in line with observed developments for the first three quarters of 2012. That is slightly below the maximum increase of 0.3 % for negotiated wages, specified by the draft central agreement for 2011-2012 imposed by the government. The other wage-setting factors should have a neutral impact in 2012, and then become negative in 2013, particularly as a result of lower bonuses. The assumption concerning the movement in hourly labour costs in the private sector in 2013 is based mainly on the expected outcome of indexation. In fact, taking account of the movement in labour costs in relation to neighbouring countries and a still sluggish economy, it was considered that real increases would remain limited.

5. Public finances

According to the information available on the projection cut-off date, public finances should end the year 2012 with a deficit of 2.8 % of GDP, which is 0.9 percentage point below the figure for the previous year[1]. The target set in the last stability programme will therefore be achieved, cutting the deficit below 3 % of GDP in 2012 in accordance with the Ecofin Council's recommendations.

The marked improvement in the overall balance in 2012 is due to a 1.7 percentage points increase in revenue, concerning all categories and resulting primarily from the consolidation measures initiated by the federal government formed in December 2011. The effect of the structural measures, such as the harmonisation of tax rates on income from movable property or the limitation to 3 % of the interest rate taken as the reference for calculating

(1) This estimate is based on the assumption that the planned increase in Dexia's capital by the government can be regarded as a purely financial transaction. According to Eurostat's preliminary view on the subject – after the finalisation of the projections – that transaction should be recorded as a capital transfer.

TABLE 6 GENERAL GOVERNMENT ACCOUNTS [1]
(in % of GDP)

	2010	2011	2012 e
Revenue	48.6	49.4	51.1
Fiscal and parafiscal revenue	43.1	43.5	44.8
Other	5.5	6.0	6.4
Primary expenditure	49.0	49.8	50.5
Primary balance	–0.4	–0.4	0.6
Interest charges	3.4	3.3	3.4
Financing requirement (–) or capacity	–3.8	–3.7	–2.8
p.m. Effect of non-recurrent factors	*0.0*	*–0.1*	*0.3*
Consolidated gross debt	95.5	97.8	100.6

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

the risk capital tax allowance, is supplemented by the impact of temporary measures or factors, such as the postponement of the nuclear rent from 2011 to 2012. The increased share of wages in value added also bolstered the rise in the proceeds of personal income tax and social security contributions. Non-fiscal and non-parafiscal revenues were boosted by the increase in revenues collected from financial institutions and by the reimbursement by bpost of subsidies unduly paid out to them between 2006 and 2010, and by bringing forward the collection of the anticipatory advance levy on life insurance. Altogether, the temporary factors generated revenue amounting to 0.3 % of GDP in 2012.

Primary expenditure is estimated to rise by 0.7 percentage point of GDP in 2012, to reach a historically high level. The main source of this rise is the increase in social benefits, particularly pensions, health care and sickness and disability benefits. Interest charges will have risen somewhat in 2012, as the slight reduction in the implicit interest rate on the public debt did not offset the impact of the increase in the debt.

Public debt will exceed 100 % of GDP from 2012 on, owing to the recapitalisation of Dexia, loans to Greece, Ireland and Portugal, and the first capital contributions to the European Stability Mechanism.

6. Risk assessment

The projections described in this article were produced in a context of great uncertainty. The main reason for that is to be found in external developments, as is often the case in regard to Belgium's economic forecasts. Here it should be noted that the projections presented in this article are based on the assumption of a gradual, moderate revival in activity in the main partner countries. In particular, that presupposes the absence of major shocks which could destabilise the financial markets and the state of public finances in the euro area. Similarly, it is assumed that the negotiations which have begun in the United States in order to resolve the problem of the fiscal cliff will not lead to a political deadlock comparable to the one observed in the summer of 2011. However, if world growth were to exceed current expectations, Belgium's growth in 2013 could prove considerably better than in the projections described above.

On the domestic level, the projections take no account of the recent decisions by the federal government, announced in the political agreement of 20 November 2012. As regards the 2013 budget, this wiould pertain to a consolidation effort amounting to € 3.4 billion, or 0.9 % of GDP, according to the government. First, there will be a structural increase in tax revenues of more than € 1 billion. This includes a substantial increase in the withholding tax on income from movable property, from 21 % to 25 %, with restoration of the discharge of this income for the final tax declaration, and a new ceiling on the reference interest rate used to calculate the risk capital allowance in corporation taxes. Next, according to the federal government's calculations, the primary expenditure of the federal departments and social security would be cut by almost € 1.4 billion compared to the Monitoring Committee's estimates in October 2012. These savings will essentially concern health care, expenditure on national defence and development cooperation, and subsidies to the SNCB group and bpost. Finally, other miscellaneous measures corresponding to a total of € 1.3 billion have also been announced, including the sale of licences and emission allowances and, above all, increased revenues expected from measures to combat fraud and a new regularisation of taxes on undeclared income. A limited amount of around € 300 million in 2013 will nevertheless be devoted to a further tax cut on low incomes.

In addition, the federal government announced initiatives aimed at curbing nominal wage increases in the coming years, thus enhancing the competitiveness of the Belgian economy. On the one hand, the composition of the consumer price index will be modified to be more closely aligned on the actual consumption pattern, which implies taking account of periods of sales and changes in prices of major retailers' own brands. On the other hand, the government would make sure that, apart from the wage drift, there will be no increase in real wages in 2013 and 2014.

As the exact details of these fiscal and other measures were not known at the projection cut-off date, it was not possible to take them into account. Without prejudice to the results of a more detailed analysis, it is already possible to assess the extent to which those decisions could influence the macroeconomic outlook. As regards wage increases, the projections for 2013 already take account of zero growth beyond indexation and the wage drift, as stated above. The estimates described above are therefore in line with the measure announced by the government. Regarding the revision of the composition of the consumer price index, the details regarding the application of that measure had not been clearly specified when this article was being written. The consolidation measures should lead to a slight reduction in households' disposable income, increase the price of certain consumer products and erode firms' profit margins. Overall, however, these measures are likely to have only a minor impact on the growth of activity in 2013.

Regarding public finances, the 2013 budget is still based on the growth assumption in the September 2012 Economic Budget. The growth estimate presented in this article is considerably lower. Furthermore, the consolidation effort announced by the federal government falls short of the fiscal consolidation proposed by the Monitoring Committee for general government. It was assumed that a significant part of that effort has yet to be made by Entity II (i.e. the Communities, Regions and local authorities), in addition to the fiscal measures that this Entity has already announced. Thus, according to the current projections, it seems likely that – even taking account of the latest decisions by the federal government – the budgetary target set for 2013 under the previous stability programme, namely a deficit of 2.15 % of GDP, will not be achieved.

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	2.4	1.8	–0.2	0.0
Contributions to growth :					
Domestic expenditure, excluding change in inventories	–1.1	1.3	1.1	–0.4	0.1
Net exports of goods and services	–0.6	0.7	–0.1	0.4	0.2
Change in inventories	–1.0	0.3	0.7	–0.2	–0.2
Prices and costs					
Harmonised index of consumer prices	0.0	2.3	3.5	2.6	1.6
Health index	0.6	1.7	3.1	2.6	1.7
GDP deflator	1.2	2.0	2.0	2.1	1.9
Terms of trade	3.4	–1.6	–1.3	–0.1	0.1
Unit labour costs in the private sector	3.8	–0.6	2.2	3.7	1.8
Hourly labour costs in the private sector	2.7	0.9	2.3	3.2	2.0
Hourly productivity in the private sector	–1.1	1.5	0.0	–0.5	0.3
Labour market					
Domestic employment (average annual change in thousands of persons)	–8.8	30.8	61.6	4.6	–14.9
p.m. Change during the year, in thousands of persons (1)	*–24.3*	*58.9*	*53.1*	*–23.1*	*–3.3*
Total volume of labour (2)	–1.6	0.9	1.9	0.1	–0.4
Harmonised unemployment rate (3) (in % of the labour force)	7.9	8.3	7.2	7.4	8.1
Incomes					
Real disposable income of individuals	2.8	–1.2	–0.8	–0.2	1.0
Savings ratio of individuals (in % of disposable income)	18.3	15.4	14.4	14.9	15.7
Public finances (4)					
Overall balance (in % of GDP)	–5.5	–3.8	–3.7	–2.8	n.
Primary balance (in % of GDP)	–1.9	–0.4	–0.4	0.6	n.
Public debt (in % of GDP)	95.7	95.5	97.8	100.6	n.
Current account (according to the balance of payments, in % of GDP)	–1.4	1.9	–1.4	–0.9	–0.9

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 (people of 15 years or older), non calendar adjusted data.
(4) According to the methodology used in the excessive deficit procedure (EDP).