Economic projections for Belgium – Spring 2014

Introduction

After several quarters of zero or even negative growth, the Belgian economy began to pick up in the spring of last year. As expected at the time of the autumn projections, that recovery gradually gathered momentum during the second half of the year, with quarterly growth of 0.3 %, and at the beginning of 2014. However, according to the statistics currently available, the expansion of activity will come to only 0.2 % in 2013 owing to a negative level effect. According to the NAI's flash estimate, quarterly growth again gathered pace slightly in the first quarter of 2014 compared to the rate recorded in the second half of 2013.

At global level, too, the recovery clearly continued. Although in all probability growth weakened slightly in the first quarter of this year, notably owing to bad weather in the United States, global activity seems to have picked up since the second half of last year. However, the picture is not the same in the various regions of the world. Thus, the widespread slowdown seen in the emerging countries since mid-2003 was offset by higher growth rates in a number of advanced countries such as the United States and the United Kingdom, but also in the euro area where the recovery has become more balanced : most of the peripheral euro area countries are now recording positive growth rates. Nevertheless, there are still some major risks confronting the global economy : in addition to the persistent uncertainty over the decline in growth in the emerging countries, there are now the recent geopolitical tensions surrounding the conflict in Ukraine.

On the financial markets, calm has been restored. In the euro area, tensions concerning the peripheral countries have eased considerably, as is evident from the sharp fall in interest rates on their government bonds and the return of several countries to market financing. Nominal interest rates have likewise continued falling in Belgium – in May 2014, yields on ten-year government bonds were at an unusually low level of less than 2 % – although it is necessary to bear in mind the very low level of inflation. In the advanced countries, stock market prices continued to rise despite occasional jitters, due notably to the gradual withdrawal of the monetary stimulus in the United States and the recent geopolitical tensions.

In that context, the current spring projections set out in this article are very similar to the autumn projections published in December 2013. They still report a continuation of the revival in activity in a low inflation environment. While the current statistics on growth in 2013 are perfectly in line with the autumn projections, the growth estimate for 2014 was revised slightly upwards to 1.3 %, an increase of around 0.2 percentage point. The common technical and external assumptions on which the Eurosystem forecasts are based, the main ones being described in the box in chapter 1 of this article, are marginally less favourable overall than those underlying the December 2013 estimates. The slight downward revision of market growth and the relative appreciation of the euro weigh on export growth in that respect. The minor negative impact of these new assumptions is, however, more than offset by two other factors. First, according to the said flash estimate, the expansion of economic activity in the first quarter of 2014 was slightly stronger than expected in the autumn projections. Second, the growth of general government expenditure (both consumption and investment) was revised upwards for 2014. That is due partly to the existing budget procedures which set nominal levels for many expenditure categories : lower than expected inflation then automatically results in higher volume growth.

Over the next two years, on the basis of the current assumptions, activity should continue to expand steadily and be fuelled to a greater extent than in 2013 and 2014 by more noticeable growth of domestic demand. Annual growth is then forecast at around 1.6-1.7 %, corresponding to the long-term average since 2000 but exceeding most estimates of the potential growth of the Belgian economy, which is not unusual in a recovery phase.

The recovery is also taking shape on the labour market. In the end, there were almost 10 000 further job losses last year. That is slightly lower than the figure suggested in the autumn projections because the labour market turned around slightly sooner than forecast, namely before the end of the year. According to the current projections, a net total of almost 12 000 jobs should be created this year. This job creation is expected to continue in subsequent years, with more than 20 000 net jobs in 2015 and over 30 000 in 2016. However, in view of the expansion of the labour force, it will be 2015 before these new jobs can bring down the annual unemployment rate.

As everywhere in the euro area, inflation will be unusually low in 2014, although in Belgium that is due partly to the cut in VAT on household electricity consumption which took effect in April 2014. After adjustment for volatile components, however, prices will rise a little faster than in 2013. According to the current projections, this underlying inflation will also continue to rise steadily to just below 2 % at the end of 2016.

Turning to public finances, the budget deficit is likely to remain unchanged this year before increasing again slightly from next year. This means that new and substantial fiscal consolidation efforts are needed to achieve the targets set in the stability programme. In this respect it should be pointed out that, in accordance with the rules applicable to the Eurosystem projection exercises, account is taken only of measures which have been formally adopted by the government – or which are very likely to be approved – and for which the implementing arrangements have been specified in sufficient detail on the cut-off date for the forecasting exercise, in this case 21 May. In addition, estimates of the budgetary impact of certain measures, such as those designed to combat fraud, may differ from the amounts included in the budget. At the same time, the big difference between the current estimates and the targets is a major risk for the macroeconomic projections, because the new federal and regional governments are likely to adopt significant additional measures. However, as stated in the article entitled "Is government spending the key to successful consolidation ?", published in this same Economic Review, the macroeconomic impact of the consolidation measures depends very much on the exact type of measure and on certain circumstances. Moreover, these consolidation efforts may be accompanied by new structural reforms. It is therefore impossible at this stage to quantify precisely the effects of a policy aimed at achieving the fiscal targets.

For the first time, the projection period covered by this article extends to year t+2, i.e. 2016. The Bank is thus conforming to the new publication format applicable to euro area forecasts by the ECB and the Eurosystem. From this year onwards, these projections in fact cover a two-year period. Thus, a forecast relating to 2016 was published for the first time in the ECB's March 2014 Monthly Bulletin. It is understood that the margins for error are greater for later years, notably because of the increased uncertainty surrounding the international environment and the technical assumptions. Moreover, it should be noted that for later years the estimates take account only of the economic policy which is currently known. That applies not only to fiscal policy, as stated above, but also to monetary policy and structural reforms. Deviations from the forecasts presented here may therefore result from future changes to economic policy. In that connection, it should be noted that the effects of the ECB's monetary policy decision dated 5 June 2014 could not be taken into account in this projection exercise.

1. International environment and assumptions

1.1 Global economy

In 2013, the rather general slowdown in activity in the emerging countries led to a deceleration in the growth of the global economy. Conversely, the contribution of the advanced economies increased during the year, as a result of the economic recovery in the United States, more vigorous growth in Japan, and a slow recovery in the euro area. On average, international trade continued to record weak growth but gathered pace in the second half of the year, driven by the recovery in the advanced countries. Recent indicators show a mixed picture for the international environment. Thus, global growth slowed again in the final quarter of 2013 and world trade remained stable in the initial months of 2014. Nonetheless, the international institutions expect world growth to strengthen gradually overall in 2014 and 2015, with a marked expansion in world trade.

In the advanced economies, temporary factors such as the harsh winter in the United States may have played a role in the moderate growth of activity at the beginning of the year. For those countries, the international institutions in fact predict that economic growth will almost double during 2014 and 2015. In the United States, factors likely to support economic activity are a fiscal policy which is less tight and – thanks to recent political agreements on the budget and the debt ceiling – less uncertain, continuing favourable financing conditions, the improvement in the labour market and the rise in property prices and stock market prices. In Japan, the expansion fostered by government measures is set to weaken gradually, notably owing to the need for fiscal consolidation. Following years of deflation, consumer prices in Japan edged upwards in 2013, thanks to government recovery measures and the strong depreciation of the yen. For 2014, inflation is actually expected to increase considerably, though that will be due partly to the consumption tax hike ; in 2015, prices should then resume a more moderate upward trend.

In the euro area, according to the EC's latest projections, the recovery in 2014 and 2015 is set to continue strengthening and should become less uneven across the Member States. The outlook is also better for the most fragile countries : only Cyprus is projected to see a further contraction in its economic activity in 2014. Growth should also become more broad-based, supported by the recovery of domestic demand, as the labour market situation is gradually improving and the restraint on demand exerted by macroeconomic adjustments and debt deleveraging is expected to diminish gradually. Domestic demand is also likely to be bolstered by a less tight fiscal policy and favourable financial market conditions, although bank lending remains weak. In that respect, the fragmentation between Member States in regard to bank lending conditions remains significant. In the context of the progressive revival of the global economy, export growth in the euro area as a whole is projected to strengthen. However, import growth is also likely to increase as a result of the quickening pace of domestic demand so that net exports – which were a major factor in the recovery in previous years – will therefore gradually reduce their contribution to growth.

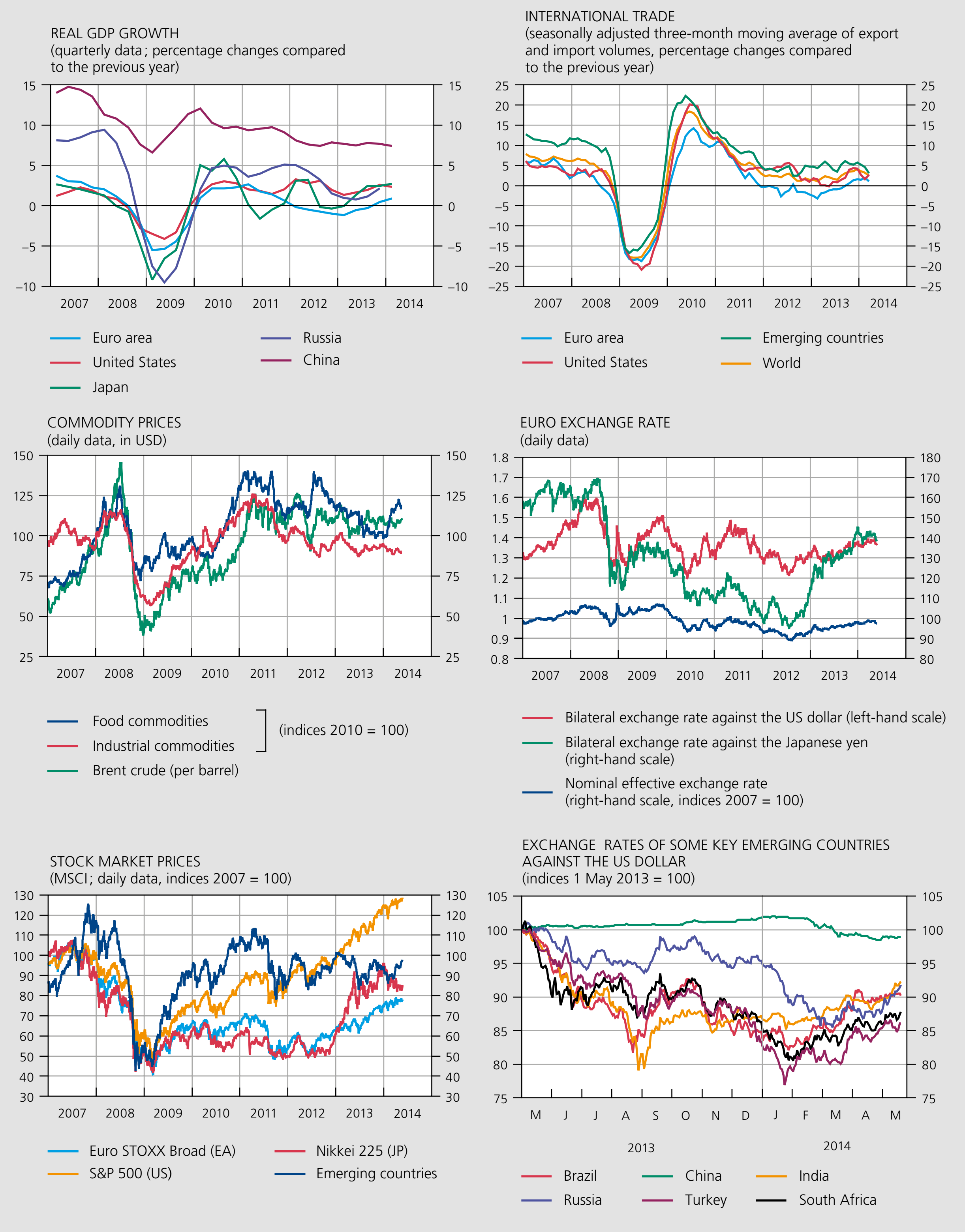
Conversely, there was a growth slowdown in the emerging economies from 2012, particularly in a few large countries such as China, which had a negative effect on the other economies. In mid-2013, that effect was compounded by stricter financing conditions following the announcement by the US central bank of its intention to adjust its securities purchases ; that triggered serious turmoil on the financial markets of several major emerging countries, which flared up again at the end of 2013 and in early 2014. The situation differs widely across the various emerging economies some of which have weak fundamentals, but overall the international institutions expect growth in these countries as a whole to stabilise in 2014. In China, where growth is slowly moving away from exports and is becoming based more on domestic sources, the pace of expansion is projected to decelerate gradually. In Russia, economic activity growth was considerably slower in 2013, one reason being the marked deceleration in private investment. According to provisional indicators, growth continued to weaken in the first quarter of 2014, and that is no doubt linked to the tensions concerning the conflict in Ukraine. Moreover, the uncertainty over the Russian forecasts was greatly increased.

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

	2013	2014	2015
	Actual figures	Projections	
Real GDP			
World	2.9	3.5	3.8
of which :			
Advanced countries	1.2	2.2	2.5
United States	1.9	2.8	3.2
Japan	1.5	1.5	1.3
European Union	0.1	1.6	2.0
Emerging countries	4.6	4.7	5.1
China	7.7	7.2	7.0
India	3.9	4.7	5.4
Russia	1.3	1.0	2.0
Brazil	2.3	2.6	2.9
p.m. World imports	*2.2*	*4.4*	*5.7*
Inflation (1)			
United States	1.5	1.7	1.9
Japan	0.4	2.5	1.6
European Union	1.5	1.0	1.5
China	2.6	2.4	2.4
Unemployment (2)			
United States	7.4	6.4	5.9
Japan	4.0	3.8	3.8
European Union	10.8	10.5	10.1

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

CHART 1 GLOBAL ECONOMIC ACTIVITY AND DEVELOPMENTS ON FINANCIAL AND COMMODITY MARKETS



Sources: ECB, OECD, CPB, Thomson Reuters Datastream.

From the closing months of 2013, the general fall in commodity prices – which had persisted for two years and partly reflected the growth slowdown in the emerging countries – came to a halt. Brent crude oil prices hovered around 109 dollars per barrel from October to May, and industrial commodity prices did not exhibit any clear trend during that period. Food commodities actually increased sharply in price from the beginning of 2014, owing to bad weather in certain food commodity producing countries and concern about the situation in Ukraine, which is a major exporter of cereals. In view of these developments and excess production capacity, price rises in the advanced economies were moderate. In the euro area, the appreciation of the euro was also a contributory factor.

In January 2014 the euro lost ground, but in a context of positive investor sentiment it then resumed its appreciation that had begun from mid-2012. However, the euro depreciated again in May, both bilaterally in relation to the Japanese yen and the US dollar, and in nominal effective terms. Overall, in mid-May the weighted average euro exchange rate was slightly below the level prevailing at the end of December 2013. The depreciation against the yen is linked to the apparent turnaround, from the beginning of 2014, in that currency's general sharp depreciation since mid-2012.

The potential impact of the gradual reduction in the monetary stimulus in the United States on the international financial markets, particularly those of the emerging economies, and the uncertainty surrounding the Chinese economy are risks for the global economy in the years ahead. Moreover, the geopolitical risk has also been heightened by the events in Ukraine, with potential consequences for growth, primarily in central and eastern Europe.

Box 1 – Assumptions adopted for the projections

The macroeconomic projections for Belgium described in this article are the result of a joint Eurosystem exercise for the euro area. That projection 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.

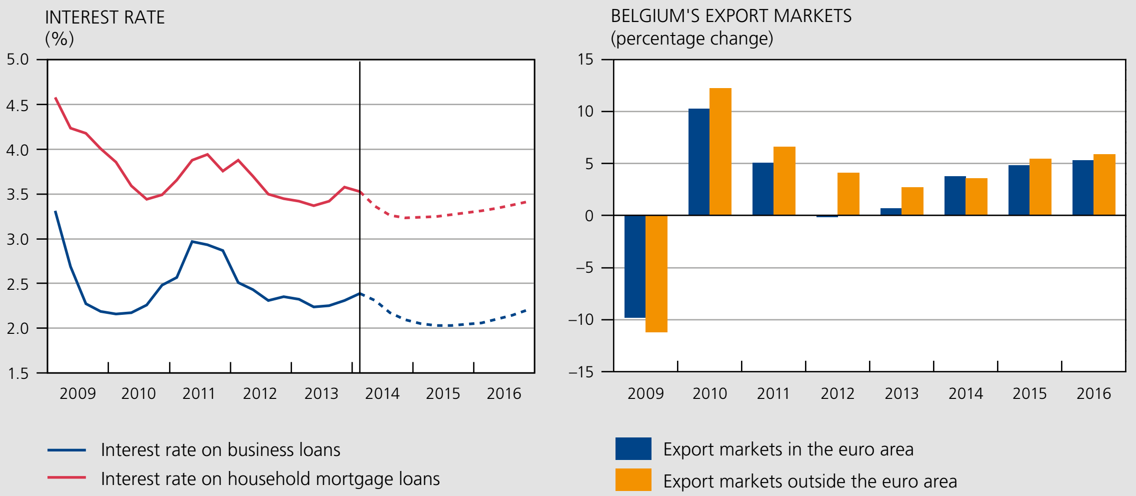
In the projections, it is assumed that future exchange rates will remain throughout the projection period at the average levels recorded in the last ten working days before the cut-off date of the assumptions on 15 May 2014. In the case of the US dollar, the exchange rate then stood at $ 1.38 to the euro, a marked appreciation against the average of $ 1.33 to the euro in 2013.

As usual, in regard to oil prices, account is taken of market expectations as reflected in forward contracts on the international markets. In mid-May 2014, this indicator suggested that the price per barrel of Brent could decline gradually over the projection horizon, from an average of $ 108 in the first quarter of 2014 to $ 97 in the last quarter of 2016.

The interest rate assumptions are likewise based on market expectations in mid-May 2014. The three-month interbank deposit rate remained at an unusually low level of 30 basis points in the first quarter of 2014. A comparable level is expected for the end of 2015, followed by a rise to 54 basis points by the end of 2016. The level of long-term interest rates in Belgium is also expected to rise gradually, from 2 % in the second quarter of this year to an average of 2.8 % in 2016. It is mainly the long-term interest rate that has been revised downwards quite considerably for 2014 and 2015, compared to the assumptions made in the latest autumn projections.

However, the interest rates that the banks are forecast to charge on business investment loans and household mortgage loans take account of the transmission generally apparent in relation to market rates, but since December the adjustments to these retail rates offered by the banks have generally been downwards. In the first quarter of 2014, the average mortgage interest rate stood at around 3.5 %, very similar to the level prevailing a year earlier. That interest rate level is expected to continue falling by a further 30 basis points in 2014 before

INTEREST RATES AND VOLUME GROWTH OF EXPORT MARKETS
(%)



Source: Eurosystem.

picking up in 2015. In comparison with the December 2013 assumptions, only a small downward revision was made for 2015. The average interest rate on business loans, which is closer to the short-term segment, exhibits more or less the same tendency: it is likely to fall further in 2014 to just over 2 % in the final quarter, and maintain that level in general throughout 2015 before beginning to edge back up during 2016.

Global economic growth has been revised downwards slightly since the December 2013 autumn projections. However, growth is not slackening everywhere, since the United States and the United Kingdom are actually likely to see more vigorous growth than those projections predicted. The main downward revision concerns Russia and its neighbouring countries, one reason being the geopolitical tensions caused by the conflict in Ukraine.

Taking account of the slight downward revision of global growth, disregarding the euro area, and the presumed lower elasticity of trade to GDP, the year-on-year growth of the foreign markets relevant to Belgium underwent a slight downward adjustment in 2014 and 2015.However, over the projection horizon, foreign markets in general display a clearly positive trend, as the projections expect 3.7 % growth in 2014, rising to 5.5 % in 2016. Belgium's markets expanded in 2014, mainly owing to the influence of export markets in the euro area, which recovered sooner than originally expected, thanks to the economic revival in the euro area countries. The growth of Belgium's export markets outside the euro area was revised downwards in relation to the assumptions made for the December 2013 projections, and that applies to the whole projection period. Nonetheless, from 2015 export markets outside the euro area are forecast to outpace the growth of those in the euro area once again.

The trend in Belgian exports is determined not only by the growth of these markets but also by changes in market shares, and therefore Belgium's competitiveness. In regard to cost-related competitiveness aspects, one important factor is the movement in the prices which competitors charge on the export markets. Those prices have been falling since the last quarter of 2012: in 2014, competitors' prices on the export markets are forecast to decline by 1.5 %, after already having fallen by 1.7 % on average in 2013. For both 2015 and 2016, the projections expect prices to rise by more than 1 %. This is a sharp downward revision, especially for 2014 (down by 1.9 percentage points), in comparison with the autumn projections, a revision which is due partly to the appreciation of the euro as measured on the basis of the real effective exchange rate.

EUROSYSTEM PROJECTION ASSUMPTIONS
(in %, unless otherwise stated)

	2014	2015	2016
		(annual averages)	
EUR/USD exchange rate	1.38	1.38	1.38
Oil price (US dollars per barrel)	107.16	102.24	98.22
Interest rate on three-month interbank deposits in euro	0.26	0.25	0.43
Yield on ten-year Belgian government bonds	2.14	2.37	2.75
Corporate loan interest rate	2.24	2.04	2.13
Household mortgage interest rate	3.34	3.26	3.36
		(percentage changes)	
Export markets relevant to Belgium	3.7	5.1	5.5
Export competitors' prices	–1.5	1.1	1.4

Source: Eurosystem.

1.2 Estimates for the euro area

According to the Eurosystem's spring projections, the recovery which began in the euro area in the spring of 2013 should become more vigorous. In 2014 the euro area's economy is likely to grow by 1 % and growth should gain further momentum during the ensuing two years. In that regard, the growth contribution of net exports is forecast to decline, giving way to a rise in domestic demand which will become by far the main engine of growth during the projection period. Factors supporting that rise in domestic demand include the waning of uncertainty, the accommodative monetary policy, and the steady growth of incomes in a low inflation environment. However, the need for both governments and the private sector to proceed with further debt reduction in a good many countries continues to depress the growth outlook.

After having fallen to an unusually low level in the spring of 2014, inflation is also set to begin rising gradually, driven by stronger demand, to reach around 1.5 % in the last quarter of 2016. Underlying inflation – i.e. inflation excluding volatile movements in prices of energy and food – is expected to rise gradually to an average of around 1.5 % in 2016.

Although the growth of output will initially be supported to some extent by the improvement in productivity and the number of hours worked per person, employment is forecast to exhibit a clear upward trend from 2014. Unemployment, which still stood at 12 % in 2013, should therefore fall by around one percentage point in 2016.

The average budget deficit in the euro area is projected to decline by more than 1 % of GDP over three years to just 1.9 % of GDP in 2016. However, that improvement is attributable mainly to the revival in economic activity, the disappearance of several one-off factors weighing on the deficit, and the decline in interest charges. Fiscal policy is expected to remain fairly neutral during the period considered, because new consolidation efforts in some countries will be largely offset by an easing of fiscal policy in other countries.

TABLE 2 EUROSYSTEM PROJECTIONS FOR THE EURO AREA

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

	2014 e	2015 e	2016 e
Real GDP	1.0	1.7	1.8
Final consumption expenditure of households and NPIs	0.7	1.5	1.6
Final consumption expenditure of general government	0.4	0.4	0.4
Gross fixed capital formation	1.7	3.1	3.5
Exports of goods and services	3.6	4.8	5.3
Imports of goods and services	3.6	4.8	5.5
Inflation (HICP)	0.7	1.1	1.4
Underlying inflation (1)	1.0	1.2	1.5
Employment	0.3	0.5	0.7
Unemployment rate (2)	11.8	11.5	11.0
General government financing requirement (–) or capacity (3)	–2.5	–2.3	–1.9

Source: ECB.
(1) Measured by the HICP excluding food and energy.
(2) In % of the labour force.
(3) In % of GDP.

2. Activity and demand

As had been predicted in the Bank's autumn forecast, the economic recovery which began in the spring of 2013 continued to strengthen in the second half of the year to reach a growth rate of 0.3 % per quarter. According to the first complete statistics for the full year available since the end of April, it is evident that the recovery was largely maintained. From the second half of the year, the quarterly growth of value added became clearly positive in most of the main branches of activity. The same applies to the growth contribution of all the expenditure components except for the change in inventories, which maintained its negative impact on real GDP in the third and fourth quarters of last year. In that regard, following a marked strengthening in the first half of the year, private consumption flagged slightly, recording a lower growth rate. In contrast, investment in housing returned to positive growth slightly sooner than expected in the autumn projections.

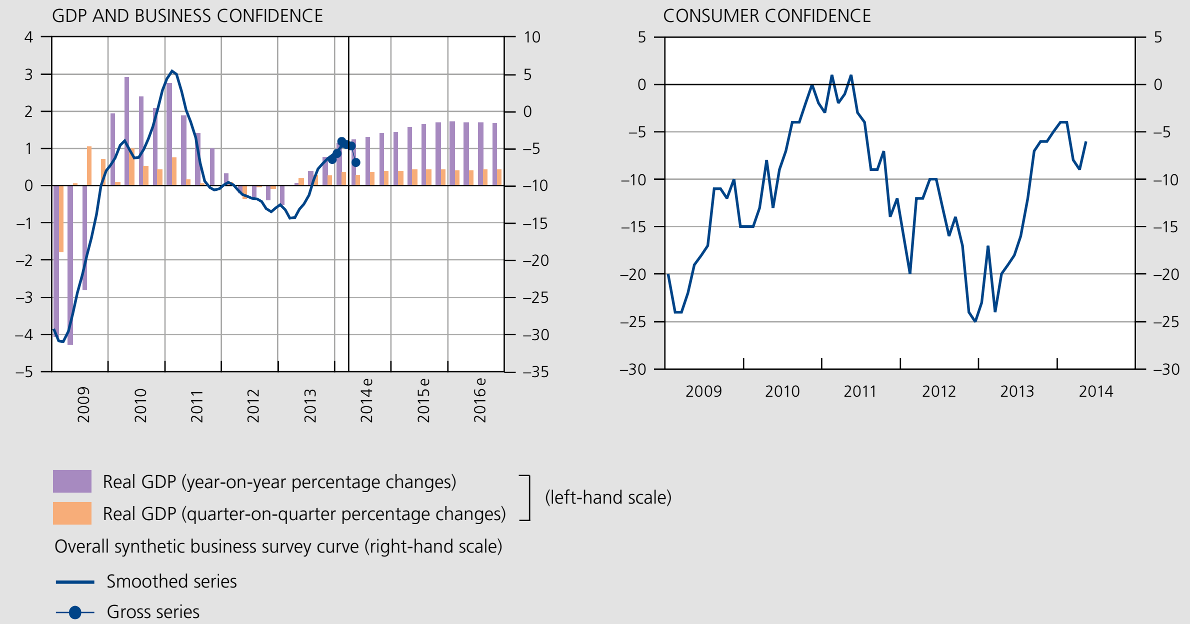
This picture is in line with that seen in the rest of the euro area. In other European countries, too, including many peripheral countries, the economic recovery is continuing. However, it remains fragile, and the quarterly growth rates are still very low, at between 0.1 and 0.2 % for the euro area as a whole. In the first quarter of this year, according to the initial flash estimates published by Eurostat, the euro area again recorded 0.2 % growth. However, it should be noted that the growth rates of individual countries vary widely, with a marked increase in Germany and confirmation of the recovery in Spain, lower than expected growth – virtually zero – in France and Italy, and a sharp fall in the Netherlands and Portugal. This wide dispersion is probably due largely to certain specific factors: thus, the extremely mild winter stimulated the German construction industry, while in the Netherlands and France it tended to depress the production and consumption of energy, and hence growth. Despite the volatility of the quarterly growth rates, according to the initial analyses the underlying trend still indicates continuation of Europe's economic recovery.

The economic upturn during 2013 took place in the context of a strong improvement in producer and consumer confidence. According to the Bank's surveys, these two confidence indicators have been rising in Belgium since the spring of 2013. At the start of this year they were clearly above their long-term average. Since then the restoration of confidence has, at the very least, been slightly eroded. Thus, in recent months there has been hardly any improvement in producer confidence, and some deterioration in May, and consumer confidence clearly weakened from February onwards, not regaining its year-end 2013 level until May.

In Belgium, it seems that activity growth likewise slightly outpaced that of the euro area in the first quarter of

CHART 2 GDP AND CONFIDENCE INDICATORS

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



Sources: NAI, NBB.

2014. The Bank's current forecasts are based on the assumption of a continuation of the economic revival with growth clearly positive again in the second quarter. That assumption is based partly on the estimates supplied at the forecast cut-off date by the short-term forecasting models (nowcasting models) used by the Bank, particularly the BREL model, described in another article in this Economic Review. According to the current projections, activity will then expand by an average of around 0.4 % in the coming quarters. However, annual growth for 2014 will be limited to 1.3 % overall, though it is expected to increase to 1.6 or even 1.7 % over the next two years. Once again, it is necessary to bear in mind the very high degree of uncertainty inherent in estimates for later years. As usual, as the recovery progresses, economic growth will gradually gain more support from domestic spending and less from net exports, which were still making a large contribution to growth in 2013. The change in inventories continues to depress annual growth in 2014, but that is due solely to a substantial level effect resulting from the downward trend in 2013. Although we must certainly not rule out the possibility that firms might reduce their inventories at a slower pace in the near future, or speed up their stock building, the technical assumption made for all quarters in the period covered by the projections was that the change in inventories would be neutral for growth, again because of the greater statistical uncertainty surrounding this concept.

The growth contribution of net exports is expected to remain positive this year, but in both 2015 and 2016 imports are likely to rise faster than exports, making that contribution slightly negative. The projections predict that export growth will fall slightly short of market expansion since it is assumed that Belgium will lose market shares. The movement in these market shares is fairly volatile year-on-year, and according to the national accounts and the available statistics on the growth of demand for imports from partner countries, Belgian exporters have seen their market shares increase in real terms over the most recent period, namely from 2011 to 2013. Measured over a slightly longer period, however, the Belgian economy suffers from a tendency to lose market shares, the main reason being a lack of competitiveness, attributable to both costs and non-cost factors. According to the forecasts, those losses will be less than the long-term average and should diminish towards the end of the projection period. It is mainly thanks to the recent measures aimed at limiting wage increases, as the first move towards reducing the competitiveness gap in relation to neighbouring countries, that labour costs are set to rise more slowly in Belgium than in the euro area as a whole,

TABLE 3 GDP AND MAIN EXPENDITURE CATEGORIES

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

	2011	2012	2013	2014 e	2015 e	2016 e
Final consumption expenditure of households and NPIs	0.2	–0.3	0.8	1.1	1.3	1.6
Final consumption expenditure of general government	0.4	1.7	0.6	1.5	1.7	1.5
Gross fixed capital formation	4.0	–2.0	–1.4	2.0	2.7	2.9
general government	5.4	2.5	–5.0	–0.6	3.9	1.2
housing	–3.2	–3.2	–2.5	0.9	1.3	1.7
enterprises	7.3	–2.1	–0.5	2.9	3.2	3.6
p.m. Domestic expenditure excluding change in inventories	*1.1*	*–0.1*	*0.3*	*1.4*	*1.7*	*1.8*
Change in inventories (1)	1.0	–0.5	–0.6	–0.3	0.0	0.0
Net exports of goods and services (1)	–0.3	0.5	0.5	0.3	–0.1	–0.1
Exports of goods and services	6.4	1.8	1.9	3.3	4.2	4.9
Imports of goods and services	6.9	1.3	1.4	3.1	4.3	5.1
Gross domestic product	1.8	–0.1	0.2	1.3	1.6	1.7

Sources: NAI, NBB.
(1) Contribution to the change in GDP compared to the previous year, percentage points.

though another factor is a marked acceleration in wage growth in Germany in particular. Although, as mentioned in section 4, the increase in corporate margins implies a further slight attenuation of the effect of this more moderate wage growth on the movement in prices in the domestic market, export prices will nevertheless rise more slowly in comparison with those of foreign competitors. That is likely to support export growth even if the effects will perhaps only be fully apparent in the longer term.

In general, the volume growth of exports should therefore steadily accelerate to just below 5 % in 2016. However, as in the case of exports, the increase in domestic demand is set to relate partly to foreign production, so that in the end import growth will slightly outstrip the growth of exports.

While the autumn projections were still expecting zero real growth in 2013, domestic demand (excluding the change in inventories) ultimately increased a little faster than forecast, and volume growth already reached 0.3 % last year. During the projection period, that growth is likely to continue rising to reach almost 1.5 % this year, before gaining a little more momentum during the following two years.

As in 2013, private consumption is again the main engine of growth. Despite the still relatively unfavourable economic situation and the limited growth of their purchasing power, households began to step up their consumption from the beginning of 2013, thus ending an unusually long period of decline in the volume of private consumption. The revival of consumer confidence during 2013, and in particular the waning of uncertainty over the employment outlook, played a decisive role here.

Despite the dip in confidence at the end of the first quarter of 2014, private consumption is expected to continue to recover during the forecast period. Although the nominal growth of incomes is limited by the wage moderation decided by the government, the initially still slow improvement in the labour market, and the erosion of property incomes due to the very low level of interest rates, low inflation is boosting purchasing power. In real terms, the growth of household disposable incomes should therefore accelerate as job creation continues to rise, and the growth of property incomes will strengthen slightly from 0.6 % to around 1 % in 2014 and 1.5 % or more in 2015 and 2016.

This income picture is likely to be reflected to a large extent in private consumption. According to the forecasts, there will only be a very moderate rise in the savings ratio. The proportion of property incomes, which are allocated more to savings, relatively speaking, is set to rise slightly at the end of the period under review, and many households which have had to contend with liquidity constraints in recent years will take advantage

CHART 3 EXPORT MARKETS AND EXPORTS OF GOODS AND SERVICES

(volume data adjusted for seasonal and calendar effects, percentage changes compared to the previous year)

Sources: NAI, NBB.

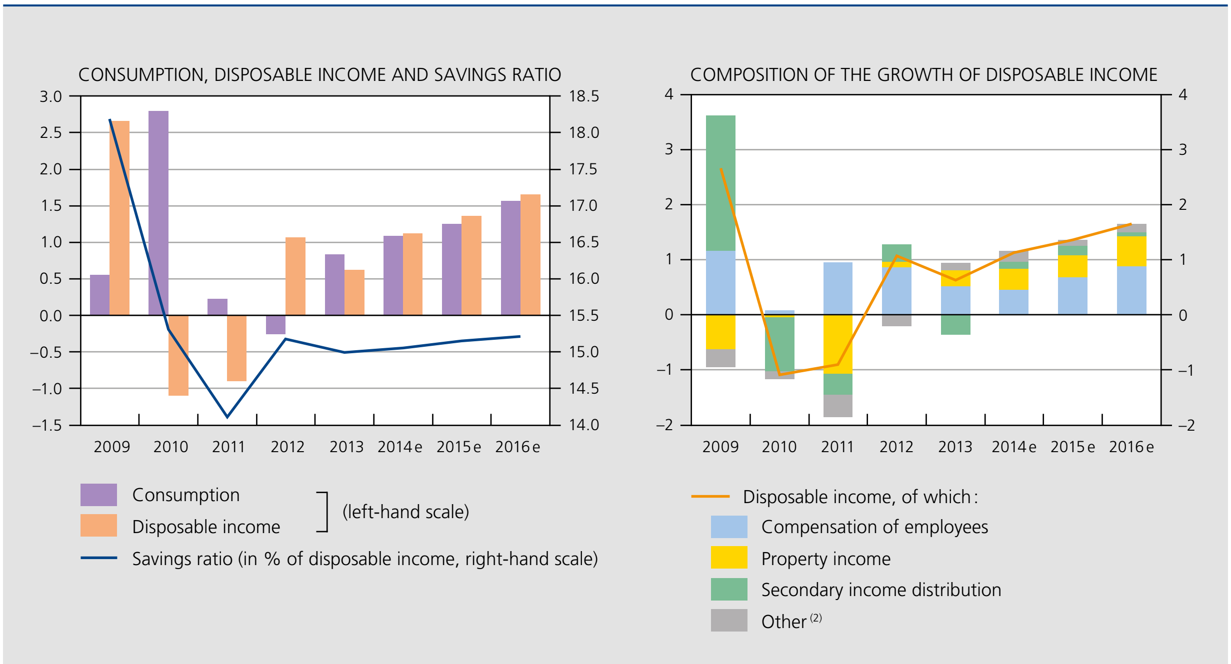
of the economic recovery to top up their reserve savings. Conversely, the easing of uncertainty will probably lead to a new decline in precautionary savings, and the return on savings will remain at a historically low level. This last factor is the main reason why the expected increase in the household savings ratio will remain very meagre overall, and why the savings ratio will still be well below its long-term average at the end of 2016.

The restoration of consumer confidence was also accompanied last year by a still very limited revival in investment in housing. After having deteriorated for almost three years, that investment recorded positive volume growth in the second half of 2013. As suggested, in particular, by the strong rise in applications for building permits, which has yet to be reflected in a marked increase in the number of housing starts, the forecasts now indicate the continuation of a moderate revival in the construction of new housing over the whole projection period.

However, the estimated growth of investment in housing is likely to remain relatively meagre and will only partly offset the sharp contraction which occurred in preceding years: at the end of 2016, the volume of this investment is projected to remain about 13 % below the level prevailing before the great recession. Two specific factors are

CHART 4 HOUSEHOLD CONSUMPTION, DISPOSABLE INCOME [1] AND SAVINGS RATIO

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



Source: NBB.
(1) Data deflated by the household consumption expenditure deflator.
(2) Gross operating surplus and gross mixed income (of self-employed persons).

curbing growth. First, as shown in particular by the bank lending survey, the conditions for obtaining mortgage loans have clearly become tighter in recent years, and interest rates have risen in real terms despite a historically low nominal rate. Also, the uncertainty over the tax treatment of mortgage loans following the transfer of competence from the federal government to the Regions may prompt households to delay their building projects for a while.

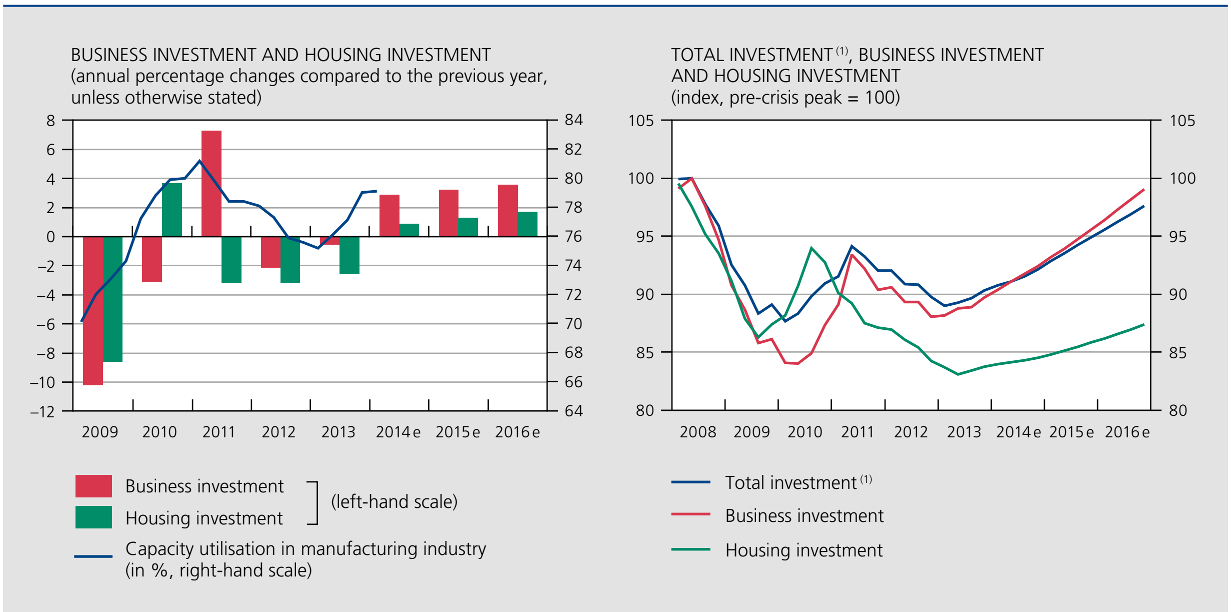
The volume of business investment, too, had already returned to positive growth at the end of 2013. That investment should continue to rise steadily during the period covered, to reach an annual volume growth rate of around 3 % from 2014. During the ensuing two years that growth is expected to strengthen a little more. The business investment revival is of course due to the improvement in the demand outlook in a context of economic recovery. In addition, capacity utilisation in manufacturing industry has again slightly exceeded its long-term average since the beginning of this year. Stronger demand will therefore gradually lead to higher investment in expansion, plus increased replacement investment. The improvement in the gross operating surplus not only boosts the existing cash reserves, it also enhances the firms' scope for internal financing; moreover, according to the bank lending survey, credit conditions became easier for firms during 2013. In contrast to investment in housing, this implies that, at the end of 2016, the volume of business investment should be back to more or less the same level as that prevailing before the great recession.

Despite the consolidation efforts, public consumption is still rising in real terms. Owing to the need to bring the budget deficit down below 3 % of GDP, the growth rate slowed to around 0.6 % in 2013. However, this low public consumption growth rate is likely to pick up again in 2014 and in the ensuing years to around 1.5 %. Conversely, public investment is set to fall a little further in real terms in 2014, in accordance with the usual electoral cycle. The volume growth of this investment is nevertheless expected to become positive again in 2015 and 2016.

3. Labour market

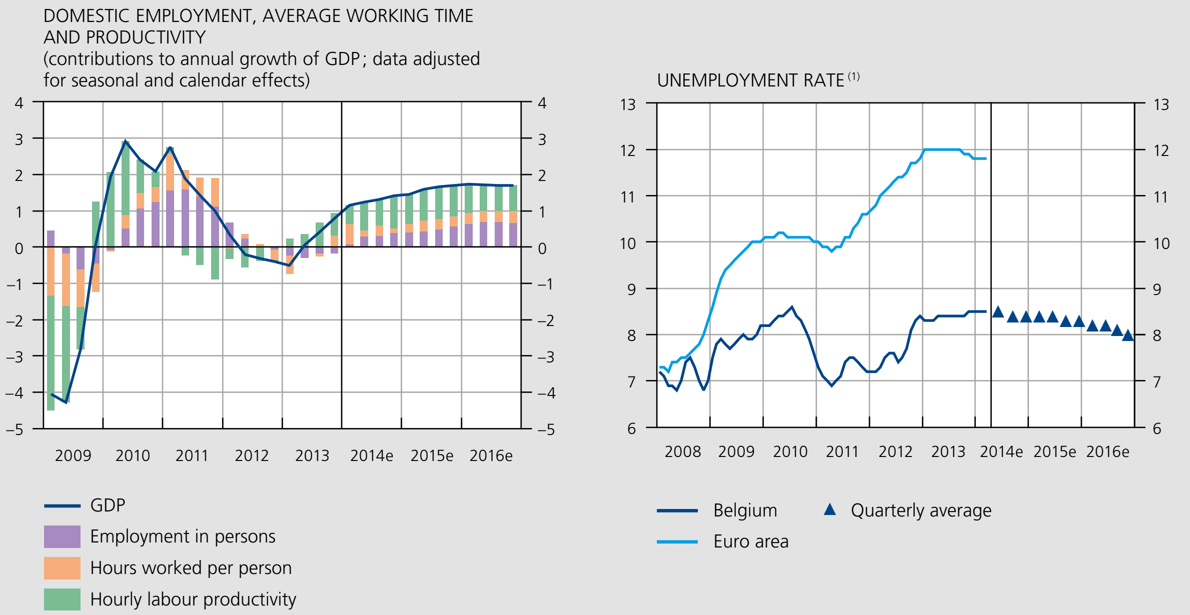
Taking account of the time lag between movements in activity and employment, on the one hand, plus the modest pace of the economic recovery in 2013, on the other, the number of people in work had fallen by 0.2 % in that year after having risen for three years in a row. In 2014, new net job creation is expected, averaging 0.3 % or 12 000 additional workers, which would totally offset the previous year's job losses. That expansion should strengthen in 2015 (0.5 %), and still more so in 2016 (0.7 %), making a cumulative total of 53 000 extra jobs.

CHART 5 PRIVATE INVESTMENT
(volume data)



Sources: NAI, NBB.
(1) Also includes public investment.

CHART 6 LABOUR MARKET



Sources : EC, NAI, NEO, NBB.
(1) Harmonised unemployment rate in % of the labour force aged 15 years and over, data adjusted for calendar effects. Quarterly data over the projection period.

In 2014, hourly labour productivity is still expected to be the main variable for adjusting to demand, with an increase of 0.7 %, while hours worked per person (including self-employed workers) are forecast to rise by 0.3 % and maintain that growth rate in 2015 and 2016, thus regaining the pre-crisis volume, which is not the case if employees alone are considered. The hourly productivity gains are expected to be broadly similar up to the end of the projection period. The increasing growth in the total volume of labour from 2015 would thus be due more to job creation than to an increase in workers' hours.

In 2013, the increase in the labour force came to 15 000 persons, a larger rise than had been expected in the autumn forecasts. In the end, employment began to recover a little sooner – during the second half of 2013 – than had been foreseen during the previous forecasting exercise, and the number of unemployed job-seekers continued to rise, quarter-on-quarter, until 2014. As the activity rate is recovering owing to the favourable impact of the economic situation, and notably certain labour market reforms aimed at limiting early departure from the labour market by people reaching the end of their career, the labour force should increase by 29 000 persons in 2014. The annual expansion of the labour force in 2015 and 2016 is put at around 16 000 persons, with a fairly stable activity rate. We would stress that the population forecasts used were revised downwards in relation to the autumn forecasts owing to the expected decline in the contribution of net immigration.

From 2014, both self-employed workers and employees are expected to make a positive contribution to employment. The growth rate of the number of self-employed persons is set to edge upwards in 2015 and 2016, owing to a more favourable economic climate. While the branches sensitive to the economic cycle may still see a slight reduction in the number of employees in 2014, and the "public administration and education" branch is likely to lose more workers than in 2013, "other services" (including health, in particular) are expected to be the only activities to boost employment, with almost 10 000 additional workers. That pace is forecast to continue in 2015 and 2016. In those two years, branches sensitive to the economic cycle are forecast to take on around 4 000 and 11 000 more employees respectively. Conversely, the public sector should continue to cut jobs, though more slowly than in 2014. It is exceptional to see five consecutive years of declining employment in this sector, a phenomenon due mainly to natural wastage. Finally, jobs subsidised by the service voucher scheme, most of which are in branches sensitive to the economic cycle, should continue to support job creation, albeit to a lesser extent from 2014.

TABLE 4 LABOUR SUPPLY AND DEMAND

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

	2011	2012	2013	2014 e	2015 e	2016 e
			(percentage changes)			
Real GDP	1.8	–0.1	0.2	1.3	1.6	1.7
Volume of labour	2.1	0.2	–0.3	0.6	0.7	1.0
Domestic employment in persons	1.4	0.2	–0.2	0.3	0.5	0.7
			(changes in thousands of persons)			
Population of working age	45.3	21.9	14.8	13.2	14.6	12.8
Labour force	43.4	25.0	15.0	29.0	16.0	16.3
National employment	63.2	10.5	–9.5	11.9	21.5	31.0
Frontier workers	–0.1	1.1	0.2	0.0	0.0	0.0
Domestic employment	63.4	9.4	–9.7	11.9	21.5	31.0
Employees	53.7	0.5	–16.3	5.8	14.0	22.2
Branches sensitive to the business cycle	31.9	–6.0	–24.1	–1.7	4.1	11.1
Public administration and education	3.7	–0.6	–0.6	–2.5	–1.1	–0.1
Other services	18.1	7.1	8.4	9.9	11.1	11.2
Self-employed persons	9.7	8.9	6.6	6.1	7.4	8.8
Unemployed job-seekers	–19.8	14.4	24.5	17.1	–5.5	–14.8
p.m. Harmonised unemployment rate (1)	*7.2*	*7.6*	*8.5*	*8.6*	*8.5*	*8.2*

Sources : DGSEI, EC, FPB, NAI, NEO, NBB.
(1) In % of the labour force (15-64 years).

The number of job-seekers is forecast to rise by a further 17 000 units in 2014, to peak at 600 000, while the harmonised unemployment rate for persons aged between 15 and 64 years will show a further modest rise, at 8.6 %. It is not until 2015 that the number of job-seekers is expected to fall, slowly at first but then by 15 000 persons in 2016. The reduction in the harmonised unemployment rate is not expected until 2015, but should strengthen in 2016.

From an international perspective, however, it should be noted that the Belgian unemployment rate was 3.3 percentage points below the figure for the euro area in March 2014, whereas before the great recession the figures were similar.

4. Labour costs and prices

In 2014, labour costs will continue to reflect the freezing of real negotiated wages, in accordance with the draft interprofessional agreement for 2013-2014 imposed by the government. Wage moderation is expected to persist in 2015-2016, but modest real increases should progressively emerge, following the gradual appearance of tension on certain labour market segments against the backdrop of economic recovery. Nonetheless, those developments should be partly offset by the measures taken by the government to reduce labour costs. Thus, the measures taken in December 2012 and October 2013 (reduction in employers' social security contributions in 2013 and 2014) were confirmed and extended by the November 2013 Pact for Competitiveness and Employment, which also provides for additional cuts in charges amounting to around € 450 million from 2015 (additional cuts of a similar size are announced for 2017 and 2019). Nevertheless, part of this effort is reflected in reductions in payroll tax which are not taken into account in calculating labour costs according to the national accounts definition.

Furthermore, the Pact for Competitiveness and Employment also provided for a reduction in VAT on households' electricity with effect from 1 April 2014. By curbing inflation, and more particularly the health index, that measure delays the indexation of wages and therefore helps to reduce labour costs in 2014 and 2015. The projections therefore predict that the rise in the health index will continue to slow, with an increase of 0.7 % in 2014, after

TABLE 5 COST AND PRICE INDICATORS
(percentage change compared to the previous year)

	2011	2012	2013	2014 e	2015 e	2016 e
Labour costs in the private sector:						
Labour costs per hour worked	2.4	3.7	2.0	0.9	1.2	2.0
of which: Indexation	2.7	2.8	1.9	0.8	0.9	1.5
Labour productivity (1)	–0.2	–0.7	0.2	0.6	0.8	0.7
Unit labour costs	2.6	4.4	1.8	0.3	0.3	1.3
GDP deflator	2.0	1.9	1.6	1.0	1.4	1.7
HICP	3.4	2.6	1.2	0.9	1.3	1.6
Health index	3.1	2.7	1.2	0.7	1.2	1.7
Underlying inflation trend (2)	1.5	1.9	1.4	1.6	1.5	1.8

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

having fallen from 2.7 % in 2012 to 1.2 % in 2013. It is forecast to remain rather moderate at 1.2 % in 2015 and 1.7 % in 2016. Another point to be stressed is that the health index, like the national price index, is affected by methodological changes in 2013 and 2014. More details are available in the article "The new national consumer price index" in this Economic Review.

The health index profile, once account is taken of the specific characteristics and time lags in the application of the indexation mechanisms by the various joint committees, largely determines the rise in nominal labour costs, which are likely to decelerate significantly to 0.9 % in 2014, compared to 2 % in 2013, before speeding up modestly thereafter until the end of the projection period, reaching 1.2 % in 2015 and 2 % in 2016.

The small rise in hourly labour costs combined with the gradual recovery of labour productivity gains has a beneficial effect on the outlook for unit labour costs in the private sector. Thus, the increase in unit labour costs in the private sector dropped from a peak of 4.4 % in 2012 to 1.8 % in 2013, and is expected to fall to 0.3 % in 2014 and 2015 before climbing back to 1.3 % in 2016. Consequently, Belgian companies' cost competitiveness at the level of wages compared to that of Belgium's three main partner countries, namely Germany, France and the Netherlands, should tend to improve in 2014 and 2015, and to a lesser extent in 2016.

However, according to the projections, this very moderate rise in labour costs, especially in 2014 and 2015, will not be fully reflected in pricing because it will be partly negated by a stronger rise in gross corporate margins. Those margins shrank considerably between 2011 and 2013, and the economic recovery is likely to lead to a restoration of margins as well, which is not unusual in a period in which growth exceeds the potential level and the output gap therefore narrows. During the projection period, prices are therefore expected to rise by more than labour costs.

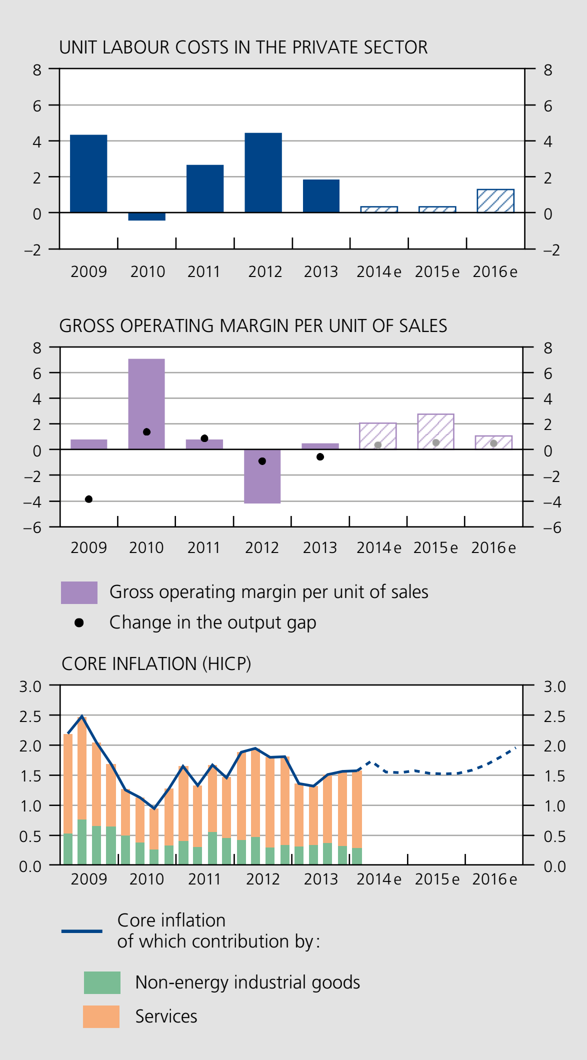
In this context, underlying inflation, which excludes food and energy prices and which had fallen to 1.3 % in mid-2013, but edged up again recently, is therefore unlikely to decline significantly in the coming quarters. In that respect, attention should be drawn to the downward rigidity of underlying inflation in Belgium.

More particularly, it is service prices that are the biggest factor in that rigidity, whereas the movement in prices of non-energy industrial goods has been smaller in recent years. That contrast is due in particular to the indexation of many service prices, but also to the fact that non-energy industrial goods face greater international competition, which tends to restrict the scope for increasing prices and margins.

Nonetheless, the limited movement in labour costs, due to the wage freeze and additional measures relating to the Pact for Competitiveness and Employment, should help to slow down the rise in core inflation during most of 2014 and 2015. From the end of 2015 and up to the end of the projection period, underlying inflation is expected

CHART 7 LABOUR COSTS, GROSS CORPORATE MARGIN AND CORE INFLATION

(percentage changes compared to the previous year)



Sources: EC, NAI, NBB.

to accelerate gradually, owing to the combined effect of the rise in intra-European import prices and labour costs, among other things, while the improvement in margins is likely to become more moderate.

Overall, inflation measured by the HICP is put at 0.9 % in 2014, compared to 0.7 % in the euro area, 1.3 % in 2015 and 1.6 % in 2016, against 1.2 % in 2013. These rates of price increases are much lower than in previous years, since inflation had reached 3.4 % in 2011 and 2.6 % in 2012. The deceleration of total inflation is due to fluctuations in food prices, and above all, energy prices. The latter have been falling year-on-year since the beginning of 2013. The current projections foresee a reduction of 5.2 % in 2014 compared to 2013, a year in which these prices had already fallen by an average of 4.6 %. Although the scale of the contraction is expected to diminish gradually, negative year-on-year growth rates are still forecast for 2015 and 2016, with prices down on average by 2 % and 1 % respectively over the year.

These developments are due to petroleum product prices on the international markets and the movement in the euro against the dollar, on the one hand, and to the reduction in VAT on the consumer price of electricity. The price per barrel of Brent is thus expected to fall slightly over 2014 as a whole, the current projections assuming an average of $ 107 per barrel in 2014, compared to $ 109 in 2013. At the same time, the euro/dollar exchange rate is put at 1.38 as opposed to 1.33 in 2013. The lower price of Brent combined with a stronger euro accentuates the weakening of the oil price in euros in 2014 compared to 2013.

5. Public finances

5.1 Overall balance

According to the general government accounts published by the NAI in April 2014, the Belgian public deficit came to 2.6 % of GDP in 2013. In the macroeconomic context described above, the deficit is likely to remain at the same level in 2014, increasing to 2.8 % of GDP in 2015 and 2.9 % in 2016.

The deficits will occur mainly – and in 2014 even exclusively – at federal government level. Social security will again record a small surplus in 2014, but turn into a deficit from 2015. The accounts of the Communities and Regions are expected to end practically in balance again in 2014, but this subsector is likely to record a deficit in 2015 and in 2016. To ensure that the Communities and Regions contribute to the consolidation of public finances, the revenues transferred to them have been reduced, under the sixth State reform, by € 1.25 billion in 2015 and by € 2.5 billion in 2016. Finally, the local authorities' finances will remain close to balance throughout the whole projection period.

During the projection period, the economic situation should have an increasingly favourable influence on public finances. Interest charges should likewise have a beneficial impact on the budget balance in 2014 and 2015, while their effect is expected to become neutral in 2016. In 2014, non-recurring factors such as the revenue from the tax regularisation are likely to exert a significant favourable influence on the overall balance, although their effect will be slightly less than in the previous year. In 2015, the

TABLE 6 GENERAL GOVERNMENT ACCOUNTS [1]

(in % of GDP)

	2011	2012	2013	2014 e	2015 e	2016 e
General government						
Revenue	49.6	51.0	51.8	51.5	51.2	51.1
Fiscal and parafiscal revenue	43.6	44.8	45.6	45.7	45.6	45.5
Other	6.0	6.2	6.2	5.8	5.6	5.6
Primary expenditure	50.1	51.6	51.3	51.0	51.2	51.1
Primary balance	–0.5	–0.7	0.6	0.5	0.1	0.0
Interest charges	3.3	3.4	3.2	3.1	2.9	2.9
Financing requirement (–) or capacity	**–3.8**	**–4.1**	**–2.6**	**–2.6**	**–2.8**	**–2.9**
p.m. Effect of non-recurring factors	*–0.2*	*–0.4*	*0.5*	*0.3*	*0.0*	*0.0*
Overall balance per subsector						
Federal government	–3.5	–3.6	–2.5	–2.6	–2.2	–1.9
Social security	0.1	0.0	0.1	0.1	–0.2	–0.3
Communities and Regions	–0.3	–0.1	0.0	0.0	–0.4	–0.7
Local authorities	–0.2	–0.4	–0.2	0.0	0.0	0.0

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

disappearance of these temporary factors should be a key determinant of the increase in the deficit. Finally, the structural primary balance is expected to remain broadly unchanged in 2014, deteriorating thereafter.

It should be noted that these projections only take account of budget measures which have already been announced and are sufficiently detailed. These projections show that a very substantial consolidation programme will be needed to achieve a structurally balanced budget in 2016. That aim was put forward by the "Public Sector Borrowing Requirement" section of the High Council of Finance in its March 2014 opinion. It was used purely as a guide in Belgium's April 2014 stability programme, which stressed that future governments would have to decide on the budget path and its allocation among the various levels of power, and that they would have to take the measures necessary to achieve the objectives.

5.2 Revenue

After four consecutive years of growth, public revenues expressed as a percentage of GDP are set to fall by 0.4 % in 2014 and a further 0.2 and 0.1 % in 2015 and 2016 respectively.

In 2014, this change of trend will likely be due to non-fiscal and non-parafiscal revenues. The impact of temporary factors, which are down against the previous year, should also lower the volume of revenues. In contrast, structural fiscal and parafiscal measures are expected to be generally favourable to government revenues.

The decline in non-fiscal and non-parafiscal revenues in 2014, amounting to around 0.4 percentage point of GDP, is due mainly to the lower payments made by the financial sector in return for the aid and guarantees granted. In addition, the revenues that the State receives as a shareholder of various financial institutions, will be down sharply.

Whereas temporary factors had made a positive contribution towards government revenues in 2013 amounting to 0.3 % of GDP, they are likely to reduce those revenues by 0.2 % of GDP in 2014. On the one hand, the revenues anticipated from the tax regularisation are expected to be even more substantial than in 2013. On the other hand, two significant factors favourable to revenues in 2013 will no longer apply in 2014. The first concerned a transitional measure which had favoured the payment of substantial dividends in 2013 to avoid higher taxation of liquidation surpluses; that had raised around € 600 million at the time. The second concerned the priority processing of pre-completed tax returns for

TABLE 7 STRUCTURAL MEASURES AND FACTORS CONCERNING FISCAL AND PARAFISCAL REVENUES

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

	2014 e	2015 e	2016 e
Taxes	1 622	977	–373
of which:			
Deduction for energy-saving investment	713	438	56
Taxes on goods and services	93	–107	0
Percentage change in the tax deduction for risk capital	227	561	–429
Measures to prevent tax evasion and to improve collection	250	0	0
Taxes on other incomes and on capital	421	135	0
Social security contributions	–132	–528	–79
Total	**1 490**	**449**	**–452**
p.m. Idem, in % of GDP	*0.4*	*0.1*	*–0.1*

Sources: Budget documents, NBB.

the assessment of personal income tax, which had led to a reduction in refunds in 2013.

Government revenues benefit from a package of structural measures in 2014. Apart from the continuing fight against the evasion of taxes and parafiscal levies, the most important measures concern the abolition of a major part of the tax expenditure in favour of household energy-saving investment, increases in excise duties, and the savings which should be achieved on the notional interest deduction as a result of the reduction in the reference interest rate. Various measures concerning capital and the income which it generates, notably the fairness tax – applicable to certain companies whose distributed profits exceed the basis of assessment for corporation tax – and an increase in the tax on savings deposits will also boost revenues. However, other measures, such as the reduction in VAT on electricity and new reductions in social security contributions, reduce the amounts raised and compensate in part for the effect of the measures generating additional revenues.

The decline in the revenue ratio in 2015 should once again be due to the negative impact of temporary factors, as the amounts raised by the tax regularisation will not recur then. Non-fiscal and non-parafiscal revenues are also likely to continue falling, owing to factors such as the reduction in the remuneration paid by banks for guarantees granted by the State. The reduction in the reference interest rate used to calculate the notional interest deduction and the effect of terminating the allowance for tax expenditure on energy-saving investments should be favourable to government revenues. Conversely, the measures taken under the Pact for Competitiveness and Employment, which will take the form of a considerable reduction in social security contributions for instance, and the residual effect of the reduction in VAT on electricity will limit the generally positive impact of the structural measures on public revenues.

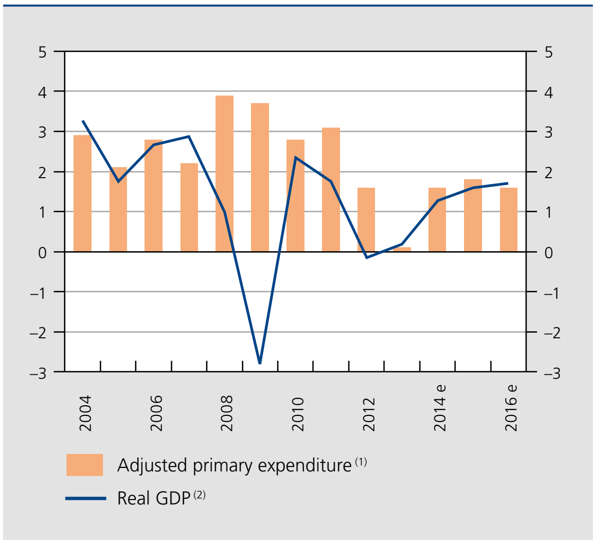
In 2016, the new fall in the revenue ratio will be due essentially to the rise in the reference interest rate used as the basis for calculating notional interest, as only a few other measures having an impact beyond 2015 have already been announced.

5.3 Primary expenditure

As a ratio of GDP, primary expenditure should decline to 51 % in 2014, before climbing back a little in the ensuing two years. That fall would be due in particular to the non-indexation of social benefits and civil service pay, expected in that year. Adjusted for the difference between actual indexation and inflation, but also for the impact of

CHART 8 PRIMARY EXPENDITURE OF GENERAL GOVERNMENT AND GDP

(percentage changes compared to the previous year)



Sources: NAI, NBB.

(1) Primary expenditure deflated by the GDP deflator and adjusted for cyclical, non-recurring and fiscally neutral factors, and for the indexation effect. The latter is due to the difference between the actual indexation of public sector wages and social security benefits and the rise in the GDP deflator.

(2) Calendar adjusted data.

one-off and cyclical factors, the increase in expenditure is estimated at 1.6 % in 2014, slightly outpacing real GDP growth. The recent moderation of expenditure which had begun in 2012 and became more marked in 2013, should therefore lose some of its momentum.

In 2014, all government subsectors are forecast to record an increase in their primary expenditure. Following a reduction in 2013, the federal government and local authorities should see the virtual stabilisation of their adjusted expenditure. The increase in the expenditure of the Communities and Regions is expected to be slightly higher than GDP growth. Finally, social security expenditure is set to rise by one percentage point more than economic activity, an increase due mainly to pensions and health care.

It is naturally more difficult to estimate the pattern of primary expenditure expected in 2015 and 2016, since the corresponding budgets will only be drawn up by the incoming governments. With no change of policy, adjusted expenditure is expected to grow at much the same rate as economic activity, namely 1.8 % in 2015 and 1.6 % in 2016. These increases should be attributable to the sustained growth of social security expenditure, which will continue to increase as a result of the dynamics of benefits affected by population ageing.

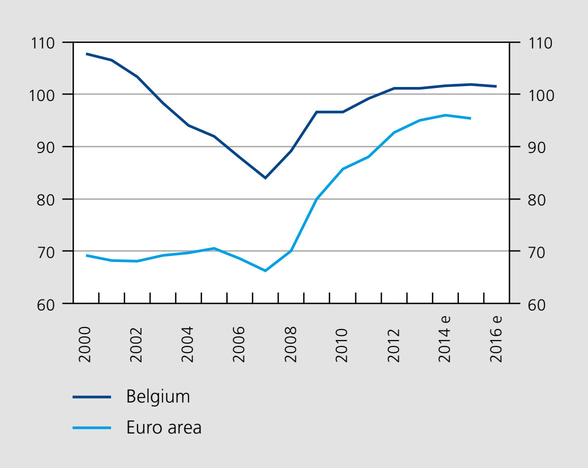
5.4 Debt

Since 2008, the debt ratio has risen steadily, reaching 101.1 % of GDP in 2012. In 2013, the public debt was more or less stable at 101.2 % of GDP.

In 2014, the general government debt is expected to increase by 0.5 percentage point of GDP to 101.7 % of GDP at the end of the year. Endogenous factors should have a negative impact on the debt ratio in 2014 amounting to around 0.3 percentage point of GDP. Their effect is determined partly by the difference between the implicit interest rate on the public debt and nominal GDP growth, and partly by the level of the primary balance. Although nominal GDP growth is expected to improve in 2014, it should remain below the implicit interest rate. Given the estimated level of the primary balance, at 0.5 % of GDP, it will not be possible to avoid the endogenous increase in the debt. The debt will also be driven higher, by around 0.2 percentage point of GDP, by exogenous factors, so called because they influence the debt but not the overall balance. The loans granted via the European Financial Stability Facility (EFSF) and the capital injection planned for the European Stability Mechanism (ESM) are likely to be significantly higher than the amount of the partial refund expected from one bank.

CHART 9 **CONSOLIDATED GROSS DEBT OF GENERAL GOVERNMENT**

(in % of GDP)



Sources: EC, NAI, NBB.

In 2015 and 2016, endogenous factors should have a positive impact on the debt ratio, with forecast nominal GDP growth then exceeding the implicit interest rate. However, owing to the impact of exogenous factors, the debt ratio is likely to continue rising in 2015 to reach 101.9 % of GDP. Conversely, in 2016, the debt ratio should record a fall. It is expected to decline very slightly, to 101.5 % of GDP, solely as a result of endogenous factors.

6. Risk factor assessment

The Bank's current growth forecasts are still similar to those of other institutions even though the OECD, for example, is clearly more optimistic for growth in 2015 whereas, in contrast, the IMF's estimate is lower. The wider range of estimates for subsequent years compared to 2014 illustrates the larger margins of uncertainty. In regard to inflation, the other institutions also expect to see a gradual rise. However, the expected pace of that increase varies: the Bank's forecast is totally in line with that of the EC and the Federal Planning Bureau, while the other institutions expect a slightly more modest increase in inflation in 2015.

The risks relating to the spring projections seem to be mostly tilted to the downside for both activity and inflation. The risks for growth stem from the international environment, though there are also some domestic factors. On this first point, owing to its trade relations the Belgian economy is, of course, heavily dependent above all on the recovery in the other euro area countries, especially Belgium's main trading partners. The fragility of the recovery in Europe,

TABLE 8 COMPARISON WITH ESTIMATES OF OTHER INSTITUTIONS

(in %)

Institution	Real GDP growth				Inflation (HICP)		
	Publication date	2014	2015	2016	2014	2015	2016
IMF	April 2014	1.2	1.2	1.3	1.0	1.1	
EC	May 2014	1.4	1.6		0.9	1.3	
OECD	May 2014	1.5	1.9		0.8	1.0	
Consensus Economics	May 2014	1.2	1.4		1.0	1.5	
Federal Planning Bureau	June 2014 (1)	1.4	1.8	1.7	0.7	1.1	1.5
NBB	**June 2014**	**1.3**	**1.6**	**1.7**	**0.9**	**1.3**	**1.6**

(1) Economic budget (June 2014) and Economic Outlook 2014-2019 (March 2014). The Federal Planning Bureau's inflation figures for 2014 and 2015 are based on the NICP, which may differ slightly from the HICP.

which is again evident from the low growth rates recorded by some countries in the first quarter of 2014, likewise remains a risk factor. Moreover, under-estimation of the scale of the slowdown in the emerging countries – or an incorrect interpretation of its temporary or permanent nature – and a heightening of the geopolitical tensions surrounding the conflict in Ukraine may also depress growth via various channels.

Turning to the domestic risk factors, attention should first be drawn to the competitiveness forecasts. They depend largely on the degree to which the current wage moderation is maintained after 2014, as foreseen in these projections, permitting a reduction in the wage gap in relation to the main partner countries. Another point to be borne in mind is that wage costs are only one aspect of the competitiveness gap. If the movement in Belgium's competitiveness were to prove less favourable than currently expected, which of course also depends on developments in the other countries, that could lead to a bigger loss of market shares, which would therefore result in weaker growth of exports and activity, even if its impact would be apparent mainly in the medium term.

In addition, the continuation of the labour market recovery is also a key factor. Although employment returned to positive growth a little sooner than expected in the autumn projections, the rise in the unemployment rate and the existing mismatch on the labour market, which may have become more acute following the recent crisis, remain a source of concern. There is a risk that the pace of the economic recovery may slow down as it becomes more difficult to fill vacant posts. In that case, bottlenecks could become apparent sooner on the labour market, and the rise in demand (domestic and foreign) could result to a greater extent in growing cost pressure rather than an increase in output.

In addition, supplementary credit constraints could hamper the investment revival in both businesses and households. Finally, it should be remembered that these projections obviously take no account as yet of such factors as future policy changes implemented by incoming federal and regional governments.

In regard to the inflation risks, pressure of competition may imply a slower restoration of corporate margins so that underlying inflation may record a smaller increase. Here, too, what happens in other countries is important: a slower increase in the prices of foreign firms competing with Belgian producers could restrain the expected rise in underlying inflation to a more normal level.

Annex

PROJECTIONS FOR THE BELGIAN ECONOMY: SUMMARY OF THE MAIN RESULTS

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

	2013	2014 e	2015 e	2016 e
Growth (calendar adjusted data)				
Real GDP	0.2	1.3	1.6	1.7
Contributions to growth:				
Domestic expenditure, excluding change in inventories	0.3	1.4	1.6	1.8
Net exports of goods and services	0.5	0.3	–0.1	–0.1
Change in inventories	–0.6	–0.3	0.0	0.0
Prices and costs				
Harmonised index of consumer prices	1.2	0.9	1.3	1.6
Health index	1.2	0.7	1.2	1.7
GDP deflator	1.6	1.0	1.4	1.7
Terms of trade	0.2	0.8	0.1	0.1
Unit labour costs in the private sector	1.8	0.3	0.3	1.3
Hourly labour costs in the private sector	2.0	0.9	1.2	2.0
Hourly productivity in the private sector	0.2	0.6	0.8	0.7
Labour market				
Domestic employment (annual average change in thousands of persons)	–9.7	11.9	21.5	31.0
Total volume of labour (1)	–0.3	0.6	0.7	1.0
Harmonised unemployment rate (2) (in % of the labour force)	8.5	8.6	8.5	8.2
Incomes				
Real disposable income of individuals	0.6	1.1	1.4	1.7
Savings ratio of individuals (in % of disposable income)	15.0	15.1	15.2	15.2
Public finances (3)				
Overall balance (in % of GDP)	–2.6	–2.6	–2.8	–2.9
Primary balance (in % of GDP)	0.6	0.5	0.1	0.0
Public debt (in % of GDP)	101.2	101.7	101.9	101.5
Current account (in % of GDP according to the balance of payments)	–1.6	–0.8	–0.6	–0.5

Sources: EC, DGSEI, NAI, NBB.
(1) Total number of hours worked in the economy.
(2) In % of the labour force (15-64 years).
(3) According to the methodology used in the excessive deficit procedure (EDP).