Belgian activity growth is expected to remain broadly constant at 0.2 % in the third quarter of 2019[1]

- Belgian GDP growth edged down slightly to 0.2 % (q-o-q) in the second quarter of 2019. This is equal to the growth rate in the euro area as a whole.
- A breakdown of the current data on the demand components of GDP shows that Belgian growth in the second quarter of 2019 was supported by positive contributions of private and public consumption, business and public investment and net exports. On the other hand, housing investment decreased and inventories contributed negatively to activity growth, the latter suggesting that firms have recently curbed their stock-building or increased the rate of stock depletion. Looking at the production side, the increase in value added was entirely driven by the business-related services, while output decreased in the manufacturing industry for the second quarter in a row.
- We expect private consumption growth to remain broadly stable in the third quarter of 2019 as the signals coming from survey indicators are mixed, fundamentals remain relatively strong and car registrations have increased. Business investment growth would decrease in the third quarter as headline business confidence and demand expectations continued to deteriorate in the business services and, especially, the manufacturing industry. However, we do expect a rebound in housing investment, as mortgage interest rates are at historically low levels, income prospects remain strong and confidence indicators in the building industry remain relatively stable at elevated levels. Finally, the contribution of net exports to GDP growth is expected to be negative in the third quarter. The UK stockpiling effect ahead of the end-of-October Brexit deadline is not likely to offset the impact of the worsened foreign demand indicators on export growth, while import growth is expected to remain more robust, in line with domestic demand.
- While the median forecast of several one-indicator bridge models based on survey and financial data as well as the prediction of the NBB's BREL nowcasting model suggest that GDP growth could increase marginally to 0.3 % in the third quarter, the forecast of the NBB's other nowcasting model is markedly more pessimistic and points to a contraction. However, this R2D2 factor model is particularly sensitive to developments in manufacturing, that are usually indicators of turning points in overall GDP growth, while, according to the current statistics, the manufacturing recession still coincides with positive (albeit moderate) overall real GDP growth. The lasting resilience in the services industry and domestic demand can still be expected to shore up GDP growth in the third quarter as well, even if, looking further, the Belgian economy is likely to lose further steam and even contract if the dismal external and manufacturing outlook does not improve. All in all, a stable growth of 0.2 % appears to be the most plausible estimate for the third quarter at the current juncture, even though it comes with clear downside risks.

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[1] This is a short-term NBB estimate and should not be confused with the official statistics published by the National Accounts Institute (such as the flash GDP estimate which is released one month after the quarter has ended). This NBB estimate is based on nowcasting models, as well as expert judgment and incorporates information up to 4 September 2019. As all estimates and forecasts, it comes with a degree of uncertainty. Finally, the business cycle monitor of the NBB is fully independent of the Eurosystem staff Broad Macroeconomic Projection Exercise (BMPE) and the ECB staff Macroeconomic Projection Exercise (MPE) and does not represent the Eurosystem/ECB staff views.

Euro area GDP growth slowed in the second quarter of 2019

After a rebound in the first quarter, euro area GDP growth slowed in the second quarter of 2019, to 0.2 % with the year-on-year growth rate decreasing to a six-year low of 1.1 %. While economic growth remained stable in the Netherlands, it fell in all other main euro area countries and was slightly negative in Germany and zero in Italy. However, part of the second-quarter decrease in euro area growth could be attributed to the unwinding of the preceding surge in import demand from the UK in the first quarter with a view to increasing critical inventories prior to the initial March 29 deadline, which could have constituted a chaotic no-deal Brexit.

Table 1 Real GDP growth rate
(percentages, adjusted for seasonal and calendar effects)

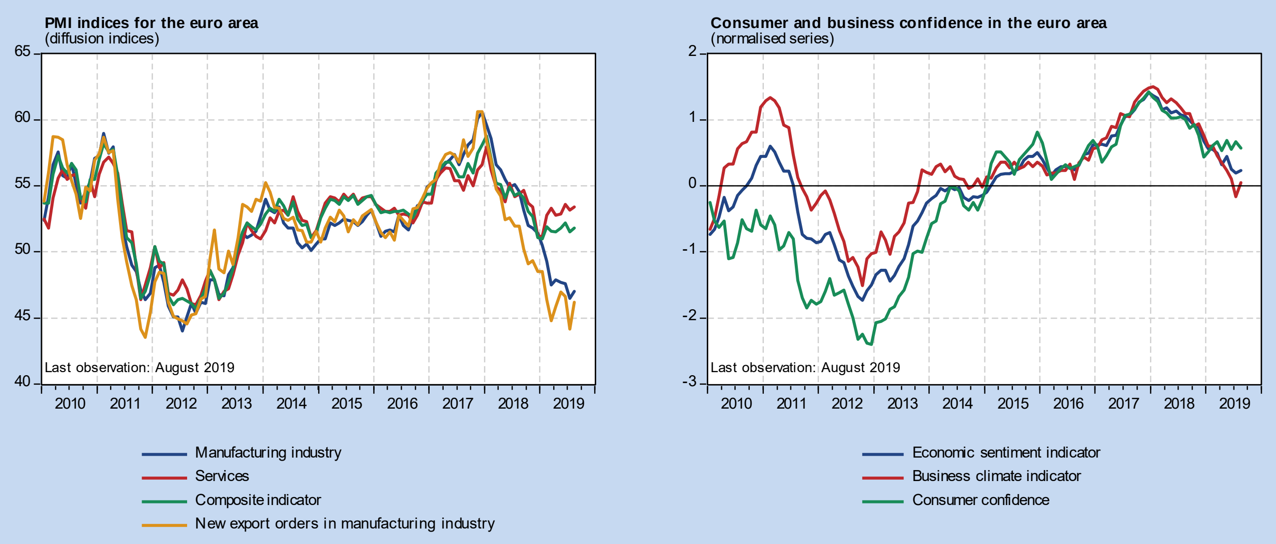
	Quarter-on-quarter change				Year-on-year change
	2018 Q3	2018 Q4	2019 Q1	2019 Q2	2019 Q2
Euro area	0.2	0.2	0.4	0.2	1.1
Germany	-0.1	0.2	0.4	-0.1	0.4
France	0.3	0.4	0.3	0.2	1.3
Italy	-0.1	-0.1	0.1	0.0	-0.0
Spain	0.5	0.6	0.7	0.5	2.3
Netherlands	0.2	0.5	0.5	0.5	1.8
Belgium	0.3	0.4	0.3	0.2	1.2
Austria	0.2	0.6	0.4	0.2	1.6
EU	0.3	0.3	0.5	0.2	1.3
UK	0.7	0.2	0.5	-0.2	1.2
US	0.7	0.3	0.8	0.5	2.3
JP	-0.5	0.4	0.7	0.4	1.1

Sources: EC, U.S. Department of Commerce, Cabinet Office Japan.

Looking forward, the recent survey indicators suggest that the underlying growth momentum in the euro area may further decline in the third quarter of 2019. The EC's business climate indicator (see Chart 1, right graph) worsened further in July, falling to a six-year low, and only slightly increased in August. Consumer sentiment has been broadly stable this year after the steep fall in the course of 2018 and the overall economic sentiment indicator, that reflects both the business climate and consumer sentiment, is at a three-year low. The PMI indicators (see Chart 1, left graph) continue to point to a **strong divergence between the manufacturing and services industry**. After having plummeted in 2018 and the first months of 2019, the manufacturing PMI indicator and, especially, its new export orders component, further deteriorated to a six-year low in July. Even though they marginally edged up in August, they still remain substantially below the 50 % threshold that marks zero growth. On the other hand, the services PMI indicator has continued to recover since early 2019 and remains well above the 50 % mark. Finally, another UK stockpiling effect could push up exports ahead of the new end-of-October Brexit deadline but the impact on third-quarter euro area growth is likely to remain limited. Against this background, euro area growth is not likely to rebound and it would remain subdued in the third quarter.

Outside the euro area, quarterly GDP growth also clearly decreased in Japan, the United States and, especially, the United Kingdom, where it turned negative. Furthermore, due to the ongoing trade tensions, international organisations have revised down their global growth and trade projections, which are projected to bottom out in 2019 and to pick up again in 2020.

CHART 1 SENTIMENT INDICATORS FOR THE EURO AREA



Sources: Markit, EC.
Note: the original series in the right graph are normalised around their historical averages and divided by their standard deviation.

Belgian growth edged down in the second quarter and was supported by investment, consumption and net exports

According to the current estimate of the National Accounts Institute (NAI), **Belgian real GDP growth decreased to 0.2 % in the second quarter of 2019,** which is equal to the euro area average. This is in line with the initial flash estimate by the National Accounts Institute but marginally below the June 2019 prediction of the Business Cycle Monitor (0.3 %). In a year-on-year comparison, real GDP growth decreased to 1.2 %, a five-year low.

Second-quarter growth was supported by positive contributions of private and public consumption, business and public investment and net exports. On the other hand, housing investment and, especially, inventories contributed negatively to activity growth, the latter suggesting that firms have recently curbed their stock-building or increased the rate of stock depletion. Looking at the production side, the increase in value added was entirely driven by the business-related services, while output decreased in the manufacturing industry for the second quarter in a row.

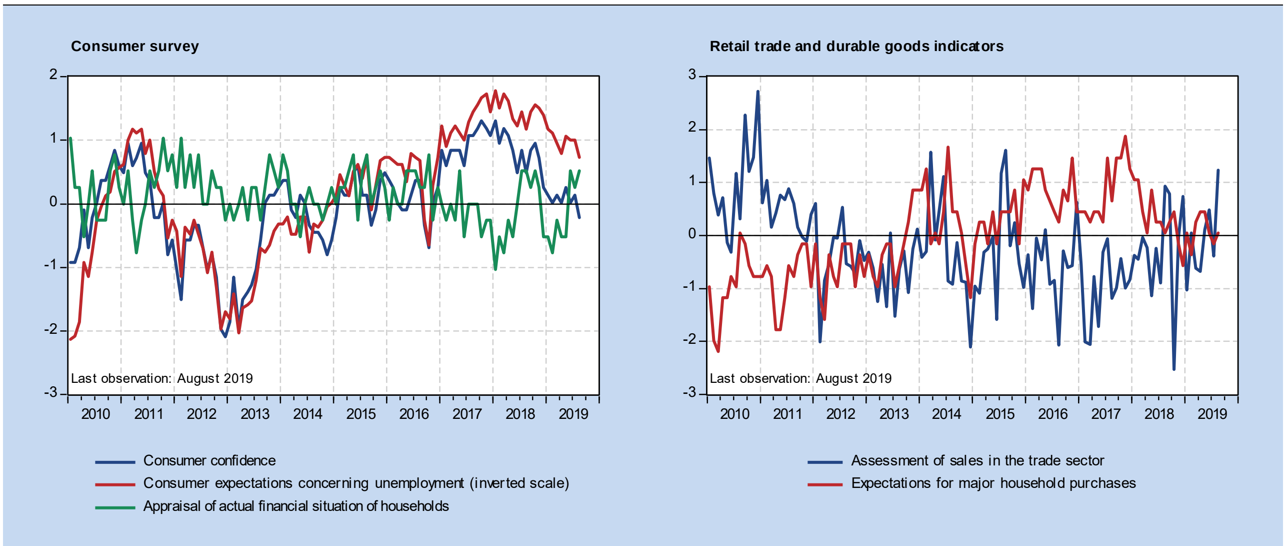
Private consumption growth would remain stable in the third quarter, even though consumer confidence has softened

Private consumption growth remained stable at 0.3 % in the second quarter of 2019. The year-on-year growth slightly increased to 0.5 %, which however remains close to the four-year low reached last quarter. While non-durable consumption, which accounts for the bulk of total private consumption, increased by 0.4 %, this was partly offset by a decrease of 0.9 % in durable consumption, which is down 5 % year-on-year. The recent negative growth in durable consumption has been caused by the introduction, as of September 2018, of the Worldwide Harmonised Light Vehicle Test Procedure (WLTP), a new standard to measure fuel consumption and CO2 emissions for passenger cars, which has led to a spike in car sales in the months before September 2018 and a slump afterwards.

Durable consumption is likely to rebound in the third quarter of 2019. While the survey indicator related to forecasts of major purchases of households for the next twelve months has remained broadly stable since early 2018 (see Chart 2, right graph), new car registrations have surged again in July and especially August, according to the seasonally adjusted data of the automobile federation Febiac. This surge is again mostly related to the WLTP-regulation: the remaining stocks of cars that were tested using the old NEDC testing procedure had to be registered, given that these cars can no longer be registered in the European Union as of September 2019. However, the link between the Febiac data on new car registrations and private consumption is partly blurred because of the substantial fraction of new car registrations made by companies, including car dealers. Still, even though it is possible that an important fraction of the recent new car registrations was made by car dealers, the recent surge in car registrations is expected to be also driven by an increase in new car registrations by private persons, hence pointing at a rebound in durable consumption in the third quarter.

More generally, consumer sentiment fell substantially in August to a three-year low, after having remained relatively stable and close to its historical average during the preceding months of 2019 (see Chart 2, left graph). The decrease in August is mainly driven by a further deterioration of the expectations regarding the economic situation and unemployment. On the other hand, the assessment by households of their current financial situation in the consumer survey has recovered since June. Finally, the assessment of sales by company managers in the trade sector improved in 2019 and reached a four-year high in August (see Chart 2, right graph).

CHART 2 INDICATORS FOR PRIVATE CONSUMPTION GROWTH
(normalised series)



Source: NBB.
Note: the original series are normalised around their historical averages and divided by their standard deviation.

Turning to the fundamentals, consumption is likely to be supported by the prospect of increasing purchasing power. Real wage growth is expected to remain strong in the following years, even though it has been slightly below the Bank's Spring 2019 macroeconomic projections for the first half of 2019. In addition, the new phase of the tax shift has increased take-home pay as of January 2019 and, while expected to slow gradually, employment growth would remain solid for some time. Finally, oil prices have come down from their previous peak reached in May.

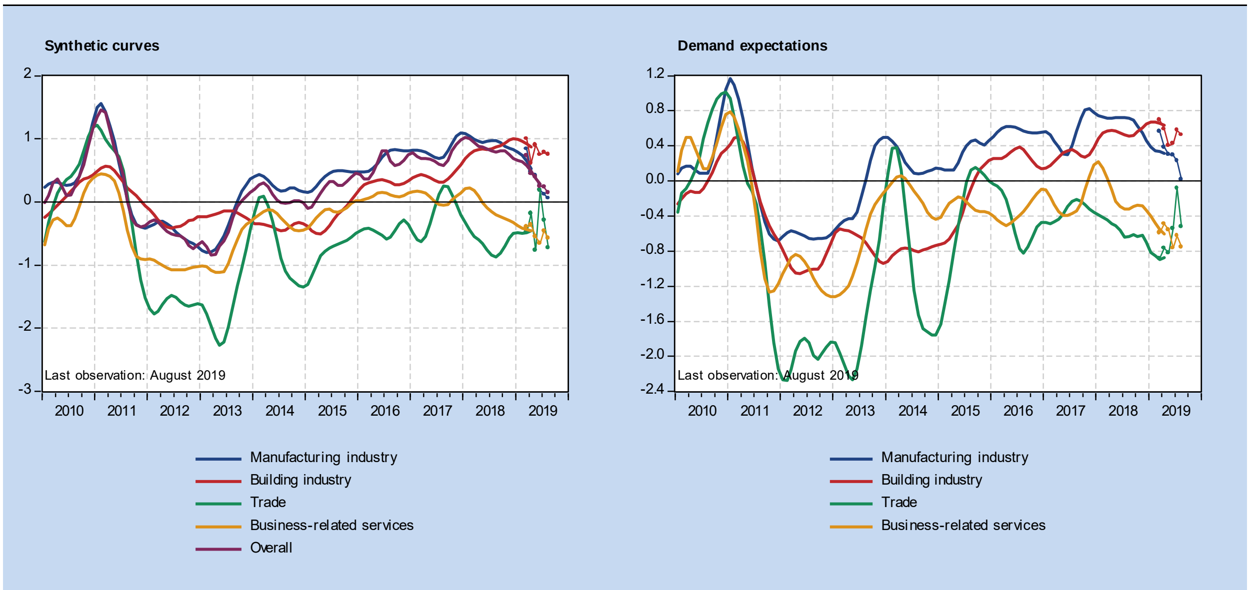
All in all, we expect private consumption growth to remain broadly stable for now, as the signals coming from survey indicators are mixed, fundamentals remain relatively strong and car registrations have increased. However, weaker consumer sentiment and higher unemployment expectations, in particular, could weigh on consumption in the longer term and, more generally, point to the risk that domestic demand cannot be isolated much longer from the worsening external environment and the recession in manufacturing.

Business investment expected to decelerate, while housing investment would rebound

Total investment expanded by 0.5 % in the second quarter of 2019. While housing investment decreased by 0.6 %, business and public investment increased by 0.8 % and 0.7 %, respectively.

Headline business sentiment continued to deteriorate in July and August, dropping to a four-year low (see Chart 3, left graph). Sentiment has worsened substantially since early 2018 in the business-related services and the manufacturing industry and it further declined in July and August in the latter industry, while it stabilised in the former industry. On the other hand, sentiment remained at an elevated level in the building industry and it also remained broadly stable over 2019 in the trade industry even though it fell in July and August. As regards the sub-indicators, demand expectations in the business-related services and, especially, demand expectations in the manufacturing industry, which is among the more relevant early predictors of GDP growth, substantially worsened since early 2018 and fell again in August (see Chart 3, right graph). On the other hand, demand expectations have increased since June in the building and the trade industry. More generally, the worsened international economic outlook is likely to weigh on investment, which may also decline due to increasing labour costs that dampen profit growth. In addition, even though capacity utilisation in the manufacturing industry slightly edged up again to 80.4 % in July, it remains well below its peak level reached in 2017, which, together with the worsened global outlook, should make expansion investment less urgent. **Overall, we expect business investment to decelerate in the third quarter of 2019.**

CHART 3 BUSINESS SENTIMENT AND DEMAND EXPECTATIONS
(normalised series)



Source: NBB.
Note: the original series are normalised around their historical averages and divided by their standard deviation.

After having expanded strongly since the beginning of 2018, housing investment declined by 0.6 % in the second quarter of 2019. **We expect a rebound in housing investment in the third quarter of 2019,** as the environment remains very supportive for real estate investment. Mortgage rates have further declined to historically low levels and income prospects remain strong in the medium term. The favourable outlook for residential investment is also in line with the aforementioned elevated business confidence and demand expectations in the building industry.

All in all, given the predominance of business investment, investment is expected to provide weaker support for GDP growth in the third quarter of 2019.

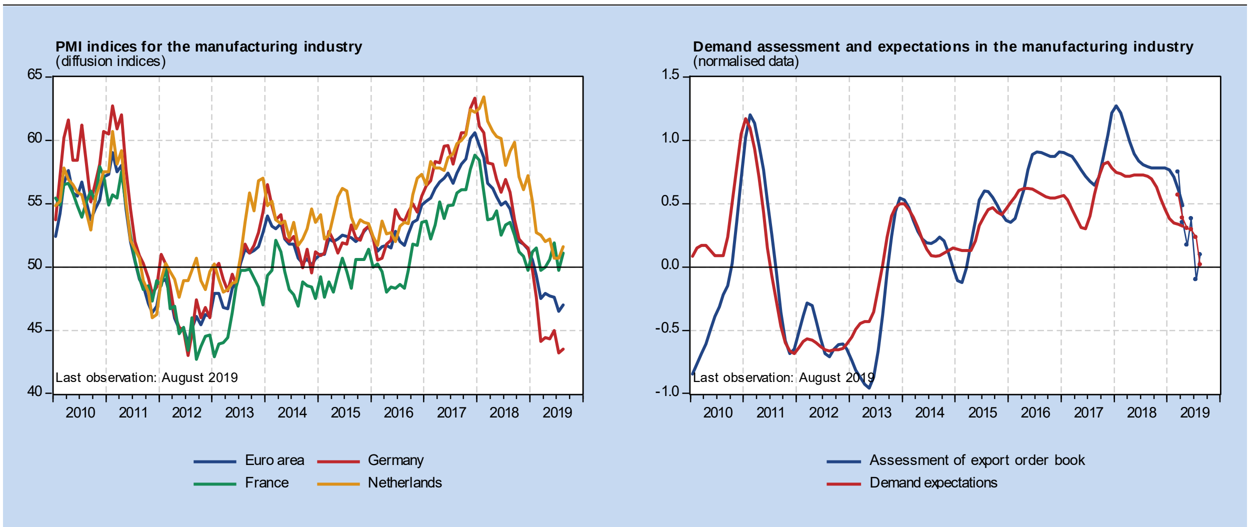
Net exports could weigh on growth in the third quarter due to weaker foreign demand

Exports increased by 0.3 % and imports increased by 0.1 % in the second quarter of 2019, resulting in a positive contribution of net exports to GDP growth of 0.2 percentage point.

Export growth is expected to weaken in the near future as high-frequency indicators of exports have further worsened in line with the deteriorating external environment. Surveys conducted among purchasing managers in the manufacturing industry in several key partner countries for Belgium suggest that potential demand for Belgian exports would decelerate (see Chart 4, left graph). After large declines throughout 2018 and into the first months of 2019, the PMI manufacturing index again weakened in July in the euro area, Germany, France and to a lesser extent the Netherlands, even if it improved somewhat in August, especially in France and the Netherlands. While the index is slightly above 50 % for France and the Netherlands, it is substantially below that zero-growth threshold, reaching a six-year low for the euro area and even a twelve-year low for Germany, pointing to a continuation of the manufacturing recession. Furthermore, accelerating wage growth and the waning impact of past cost competitiveness gains would start to weigh on Belgian export growth. Finally, the worsened prospects for exports are confirmed by a sharp fall in demand expectations and export orders of the Belgian manufacturing industry over the recent months (see Chart 4, right graph).

All in all, the contribution of net exports to GDP growth is expected to be negative in the third quarter. The UK stockpiling effect ahead of the end-of-October Brexit deadline is not likely to offset the impact of the worsened foreign demand indicators on export growth, while import growth is expected to remain more robust, in line with domestic demand.

CHART 4 PMI INDICATORS IN NEIGHBOURING COUNTRIES AND EXPORT ORDERS IN MANUFACTURING



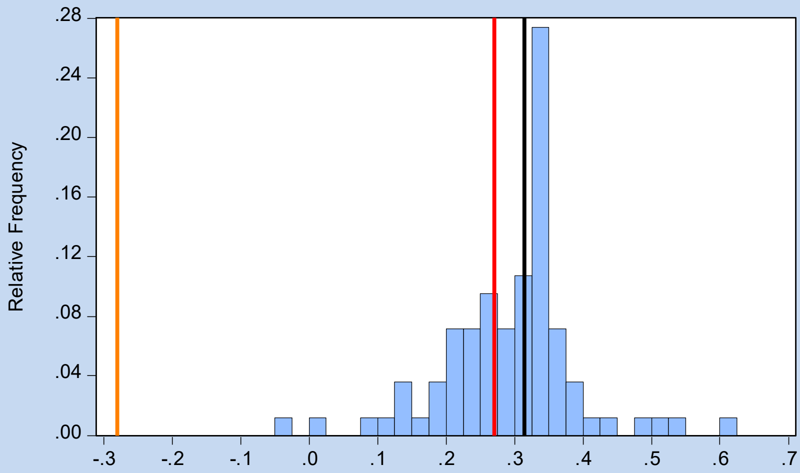
Sources: Markit, NBB.

While the one-indicator models based on survey and financial data predict a slight increase in growth in the third quarter…

The information content in the most recent survey and financial data can be summarised by looking at the range of mechanical GDP predictions using one-indicator bridge models, even if the forecast performance of these simple models suggests that the individual predictions should be interpreted with caution. The histogram in Chart 5 shows the distribution of the GDP growth nowcasts of these different one-indicator bridge models.

The different one-indicator bridge model predictions point to a slight increase in GDP growth in the third quarter of 2019. The predictions have a distribution which is slightly negatively skewed and most frequently lie in the [0.1;0.4] % range, with a median estimate equal to 0.3 %.

CHART 5 HISTOGRAM OF ONE-INDICATOR BRIDGE MODEL PREDICTIONS USING A BROAD SET OF SURVEY AND FINANCIAL DATA AND NBB NOWCASTING MODEL PREDICTIONS FOR REAL GDP GROWTH IN THE THIRD QUARTER OF 2019



Source: NBB.
Note: The black line corresponds to the median of the one-indicator bridge model predictions for the current quarter GDP growth, while the red and the orange lines respectively correspond to the predictions from the bridge model 'BREL'[2] and the dynamic factor model 'R2D2'[3], respectively.

…The unusual divergence in the two NBB nowcasting models points to downside risks

Estimates for activity growth in the third quarter of 2019 produced with the more elaborate standard NBB nowcasting models show an unusually large divergence. While the BREL model predicts a slight increase in growth to 0.3 %, which is in line with the median of the one-indicator bridge model predictions, the R2D2 Dynamic Factor Model forecasts a strongly negative growth (close to -0.3 %). This reflects the current economic situation with the marked divergence between, on the one hand, external demand and the manufacturing output (which is declining) and, on the other hand, domestic demand and the services industry that remain resilient for now. The R2D2 factor model is

[2] Piette, C. (2016), Predicting Belgium's GDP using targeted bridge models, NBB Working Paper 290.

[3] Basselier, R., De Antonio Liedo, D. and Langenus, G. (2018) Nowcasting real economic activity in the euro area: assessing the impact of qualitative surveys, NBB Working Paper 331. The R2D2 model is estimated using the JDemetra+ software, which is publicly available at www.nbb.be/jdemetra.

particularly sensitive to developments in manufacturing, that are typically indicators of turning points in overall GDP growth, while, according to the current statistics, the manufacturing recession still coincides with positive (albeit moderate) overall real GDP growth. The lasting resilience in the services industry and domestic demand can still be expected to shore up GDP growth in the third quarter as well, even if, looking further, the Belgian economy is likely to lose further steam and even contract if the dismal external and manufacturing outlook does not improve. Finally, the further decline in July in the Federgon index on the work volume of temporary agency work could be another indication of decelerating growth, even though this decline could also have been driven by an increased use of permanent contracts, given the current labour market shortages and the reduction in May 2018 of the notice periods applicable at the start of the period of employment.

All in all, a forecast of 0.2 % for the quarterly growth rate in the third quarter appears to be most plausible for now, even though it comes with clear downside risks. This forecast is below the Bank's Spring 2019 macroeconomic projections, that were conditional on the Eurosystem common assumptions that saw trade and world growth improving in the second half of 2019.