

# Business Cycle Monitor

March 2022

## Belgian economic activity is expected to increase by 0.6 % in the first quarter of 2022<sup>1</sup>

- Belgian real GDP increased by 0.5 % in the fourth quarter of 2021. This is better than the estimate in the previous Business Cycle Monitor (+0.2 %) and slightly stronger than fourth-quarter growth in the euro area (+0.3 %).
- The breakdown into the demand components was not fully in line with our expectations. While the decrease in private consumption and investment spending by firms did not come as a surprise, the broad-based decline in domestic demand was unexpected. Only significant positive contributions coming from inventories and net exports kept growth in positive territory in the fourth quarter.
- Private consumption growth should be sluggish at best in the first quarter of 2022. The improving health situation and the gradual removal of nearly all restrictive measures should support growth in this demand component, but the sharp increase in uncertainty in the second half of the quarter, as well as the new spike in energy prices will dampen consumer spending.
- Faced with headwinds such as rising input prices and supply-chain bottlenecks, the overall business sentiment indicator continues on its downward trend. Business investment growth will remain weak in the first quarter but less so than in the previous two quarters (when it was likely held back to an important extent by supply chain bottlenecks that have now started to unwind). Similarly, housing investment should expand but at a very modest pace.
- Government consumption growth should also return to positive territory in the first quarter, while the roll-out of investment plans ensures that government investment expands at a moderate pace. The growth contribution of net exports should fall significantly in the first quarter.
- The NBB nowcasting model “BREL” predicts a quarterly growth rate of close to 0.5 % in the first quarter of 2022, while the “R2D2” model is clearly more optimistic with a growth rate of 1.0 %. However the uncertainty of these nowcasting models is exceptionally large as the massive shocks since the start of the COVID-19 crisis constitute a challenge for the estimation of standard time-series models. Moreover, the potential economic fallout from the war in Ukraine is not yet fully captured by the indicators used in these models.
- More generally, the improvement in the health situation coupled with the start of the normalisation of the supply chains, should have pushed up growth in the first half of the quarter. This beneficial impact is likely to be partially offset by the new spike in energy prices and the war in Ukraine that could significantly reduce growth as of March. All in all, the most plausible point estimate for growth in the first quarter would appear to be 0.6 %.

<sup>1</sup> 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 7 March 2022. As all estimates and forecasts, it comes with a degree of uncertainty.

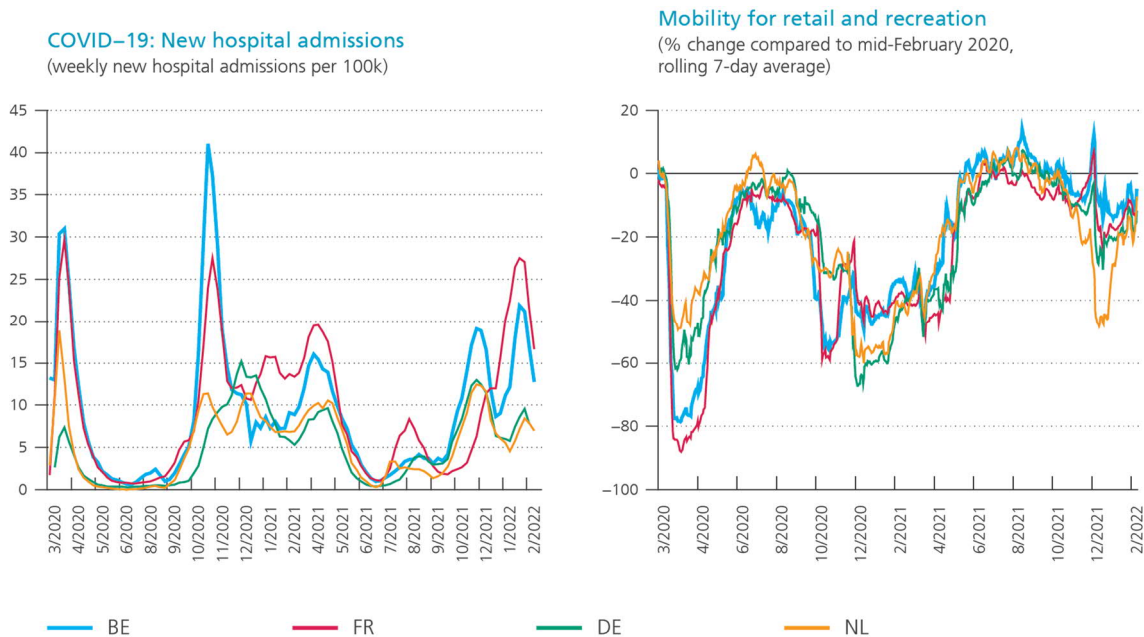
## The impact of the pandemic is declining but the war in Ukraine is clouding the economic outlook

The previous Business Cycle Monitor was written against the background of the resurgence of the pandemic and the emergence of the omicron variant. This created a lot of uncertainty as there was a risk that the highly contagious nature of the latter could cripple health care systems. Hence, at the time of writing, stricter containment measures were being implemented or contemplated in many countries. We assumed that this would constitute an important headwind for the Belgian economy as well, either through tighter measures or increasing absenteeism from work due to illness or quarantines.

While the number of infections indeed surged to unprecedented levels by the end of January, it also became apparent that ‘omicron’ symptoms were often milder and hospitalisations remained below the levels seen in previous waves (see Chart 1, left-hand graph). The containment measures were stepped up somewhat at the beginning of the new COVID-19 wave but significantly less than in certain other countries or than what was expected. Mobility indicators (see Chart 1, right-hand graph) point to a steady decline after the summer but, despite the omicron variant, mobility remained far above the troughs reached in the previous waves. In addition, it was less affected in Belgium than in other countries. As COVID-19 is now considered to be endemic, most remaining restrictions were gradually withdrawn in the current quarter, including the mandatory working from home rule, as well as the use of the COVID Safe Ticket (CST) as of 7 March. Mobility still remains somewhat below pre-pandemic levels but is on the rise.

### Chart 1

#### COVID-19 hospitalisations and google mobility data



Sources: Google, Sciensano.

However, while the health situation has clearly improved, geopolitical uncertainty in Europe increased spectacularly in February. In response to the invasion of Ukraine Western countries have implemented unprecedented economic sanctions against Russia, such as a ban on most transactions with the Russian Central Bank and a SWIFT ban for several Russian banks. Non-energy trade with Russia is grinding to a halt and most Western companies are pulling out of the country. Although the exact fallout of the sanctions is not yet clear, prices of commodities such as gas and oil, but also grain have already sharply increased. This alone already represents a significant drain for the European economy. The Belgian economy has a rather limited direct exposure to Russia but indirect effects (e.g. via financial markets or uncertainty) could be larger and specific supply chains in manufacturing may be disturbed. In addition, inflation in Belgium is typically affected relatively more by hikes in energy prices than that in the euro area and, hence, the recent increases could worsen the impact on purchasing power and, in a later stage, firm competitiveness (through the wage indexation mechanisms). All in all, this geopolitical component may to some extent already adversely affect activity in the last month of the quarter beyond what is currently visible in the available hard and soft data. However, if the crisis drags on or worsens, the impact is likely to be larger in future quarters.

**Any economic forecast, including our estimate for the short term, still comes with particularly large margins of uncertainty.** As mentioned in earlier BCMs, a specific technical problem is that the traditional indicators and models used for forecasting are currently still likely to give unreliable signals. Models have typically been estimated on the basis of past observations and correlations and may be less accurate in the current context. Hence, additional information and an increased reliance on judgment calls are necessary to estimate economic growth.

## Euro area GDP increased by 0.3 % in the fourth quarter of 2021 and growth should remain moderate in the first quarter of 2022

Following the rebound in the second and the third quarter of 2021, supply chain issues and the resurgence of COVID-19 caused economic activity in the euro area to decelerate markedly in the final quarter. GDP increased by just 0.3 % in volume terms compared to the fourth quarter. The year-on-year growth rate reached 4.6 %.

Table 1

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

	Quarter-on-quarter change				Year-on-year change	Gap vs pre-COVID-19 level <sup>1</sup>
	2021Q1	2021Q2	2021Q3	2021Q4	2021Q4	2021Q4
Euro area	-0.2	2.2	2.3	0.3	4.6	0.0
Germany	-1.7	2.2	1.7	-0.3	1.8	-1.1
France	0.1	1.3	3.1	0.7	5.4	0.9
Italy	0.3	2.7	2.6	0.6	6.4	-0.5
Spain	-0.7	1.2	2.6	2.0	5.2	-4.0
Netherlands	-0.8	3.8	2.1	0.9	6.1	2.8
<b>Belgium</b>	<b>1.2</b>	<b>1.7</b>	<b>2.0</b>	<b>0.5</b>	<b>5.6</b>	<b>1.0</b>
Austria	-0.4	4.2	3.8	-1.5	5.6	-0.9
EU	0.0	2.1	2.2	0.4	4.8	0.4
UK	-1.2	5.6	1.0	1.0	6.5	-0.4
US	1.5	1.6	0.6	1.7	5.6	3.2
JP	-0.5	0.6	-0.7	1.3	0.7	-0.2

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

1. The pre-COVID-19 reference is 2019Q4

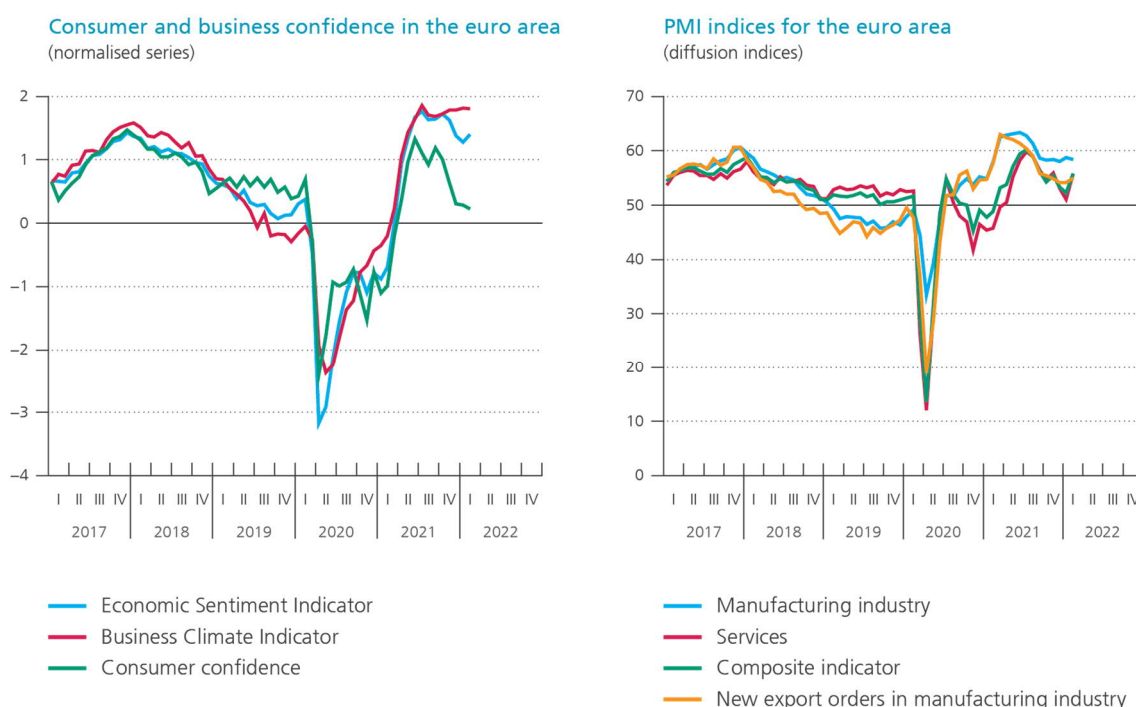
Growth rates within the euro area were mixed. Economic activity expanded vigorously in Spain, which outpaced the euro area average by 1.7 pp. Most countries posted much more moderate, but still above-average growth. Among these, the 0.9 % growth of the Netherlands is remarkable, given the strict containment measures that were imposed in December. Germany and Austria, on the other hand, recorded negative growth rates. The euro area economy as a whole has now closed the gap with its pre-pandemic output level. Following a decline in activity in the last quarter, Austria has now joined Germany, Italy and Spain in the group where output is still below the 2019 level. France, Belgium and, in particular, the Netherlands, on the other hand, have exceeded their pre-crisis output levels. Among the major economies outside the euro area, the US economy expanded by 1.7 % in the fourth quarter of 2021 and output in the USA is now 3 % above pre-crisis levels. Quarterly growth was also solid in the UK and Japan but this was not yet sufficient for these countries to close the gap with their pre-COVID-19 output levels.

Turning to the soft indicators, the EC’s overall economic sentiment indicator (ESI), reflecting both the business climate and consumer sentiment in the euro area, improved slightly in February. It had been coming down from the very high levels over the summer, when it reached a historic maximum (see Chart 2, left-hand graph). The improvement of the overall indicator was mostly due to mounting confidence in services and retail trade as restrictions were eased, and, to a lesser extent, construction. Confidence remained virtually unchanged but high in the manufacturing industry. The business climate indicator (BCI), improved marginally in February and remains near its high from the previous summer. However, consumers’ outlook on the general economic situation over the next 12 months, on the other hand, deteriorated again, as it has since November 2021. This may reflect a combination of factors but surging energy prices certainly play a role.

The PMI composite indicator for the euro area (see Chart 2, right-hand graph) improved as well in February, after two months of decline. It remains clearly in expansionary territory (i.e. at a level above 50). The improvement can mainly be traced back to rebounding sentiment in services, whereas confidence remained more or less stable in the manufacturing industry. The new export orders index for the manufacturing industry improved slightly and remains near levels that were last seen in early 2021. Nevertheless, constraints and supply chain issues remain a significant cause for concern, as evidenced by the elevated PMI supplier delivery times index. All in all, the current level of the PMI composite indicator remains consistent with further moderate growth of the euro area economy in the first quarter of 2021.

## Chart 2

### Sentiment indicators for the euro area



Sources: Markit, EC.

Note: the original series in the left graph are normalised around their historical averages and divided by their standard deviation.

## The Belgian economy expanded by 0.5 % in the fourth quarter

After having returned to its pre-pandemic level in the third quarter, Belgian GDP expanded by 0.5 % in the fourth quarter. While this constitutes the expected sharp deceleration of economic activity, growth is still higher than the potential rate. The exceptional boost to growth stemming from the gradual reopening of the economy and the corresponding improvement in economic sentiment in the first half of 2021 had run its course by the end of the third quarter. Moreover, supply chain issues intensified, and the second half of 2021 was marred by escalating energy price developments and the resurgence of the pandemic. These factors weighed on confidence and dampened investment and spending. Nevertheless, the 0.5 % QoQ growth is somewhat stronger than the 0.2 % that was expected in the December Business Cycle Monitor. This is mostly because, contrary to our earlier expectations, no macroeconomically relevant (further) pandemic containment measures were implemented.

According to the current quarterly NAI statistics, fourth-quarter GDP growth was only driven by external demand and changes in inventories. Domestic demand excluding stocks, on the other hand, declined. Remarkably, private consumption was down by 0.7 % compared to the third quarter. Consumption of durable goods, in particular, was affected by continuing supply chain issues and hit its lowest point since mid-2020. It now stands about 5 % below pre-crisis levels. Non-durable goods consumption also declined slightly but remains above pre-crisis levels. Public spending and investment were also down from the previous quarter. Business investment had already declined by 2.7 % in the third quarter and decreased further, by almost 3 %, in the fourth quarter. Firms' investment plans have likely been affected again by the aforementioned supply chain issues and increased caution in a context of high and volatile input prices, while the rapidly tightening labour market presents an additional challenge in the form of worker shortages.

The production approach to GDP shows fourth-quarter growth to be mainly driven by the manufacturing industry, which posted a stronger-than-expected 3.4 % growth in quarterly terms. Market services, which are more consumer-oriented, grew by only 0.9 %. Non-market services declined by nearly 1 % in the fourth quarter after posting strong growth in the previous quarter. Activity in the construction industry decreased marginally.

## High energy prices and uncertainty should keep consumption growth muted, even as health restrictions are eased

Private consumption declined by 0.7 % in the fourth quarter of 2021 and actually fell back below its pre-crisis level. This drop seems bigger than what can be traced back to the worsening health situation alone, as the restrictive measures were in the end relatively mild and the minor decline in mobility indicators is not consistent with a strong spending crunch. Hence, concerns about the actual or potential impact of skyrocketing energy prices on consumers' purchasing power most likely also played a role, as we had expected. The increase in the spot price for gas on the European market was nothing less than spectacular in the past months, going from €20 per megawatt-hour (Mwh) in May 2021 to over €100 in October and even peaking at over €180 in December. Given that many households in Belgium have energy contracts with variable pricing, warnings to consumers of higher bills have been widespread. Moreover, producers are announcing price hikes for many other goods in an effort to pass their higher input costs through to consumers. This is likely to have led to an increase in precautionary saving. Lower-income households, in particular, tend to spend a larger share of their income on gas and electricity than the average weights for the whole population that are used in the indexation systems. As the indexation of their income then only partly offsets the increase in the energy bills (and anyway comes with a certain delay), they may have been inclined to cut back on spending.

Turning to the soft indicators, the drop in household consumption is consistent with the evolution of consumer confidence that declined markedly throughout the fourth quarter (see Chart 3, left-hand graph). The fall was driven by households' assessment of the economic situation and, toward the end of the quarter, the labour market situation over the next 12 months. The steep increase in energy prices probably also contributed to the decline in the assessment of the current financial situation since the summer, which had long been very high and is now stabilizing slightly above pre-crisis levels.

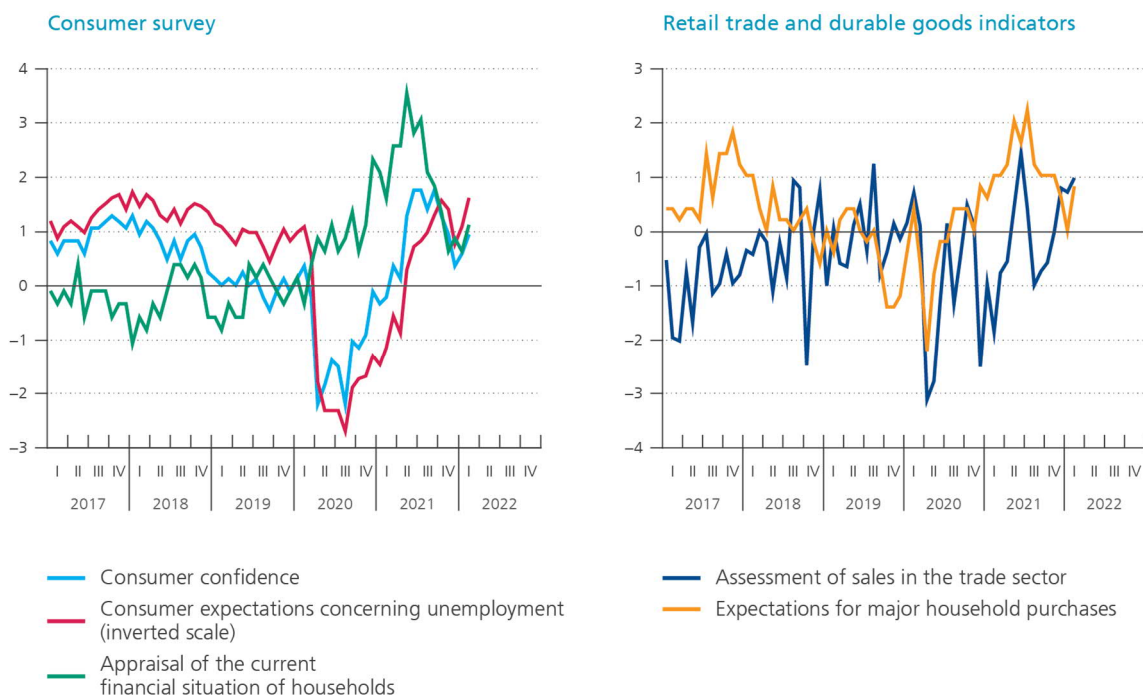
In January and February consumer confidence strengthened somewhat, as energy prices dropped back in the first half of the quarter and the health situation improved. Other indicators (see Chart 3, right-hand graph) also seem to point to a tentative recovery of consumer spending in the first weeks of the year. The company managers' assessment of sales in the trade sector has actually trended up since the summer of 2021. This reflects the aforementioned fact that the impact of the resurgence of the pandemic on the spending on non-durables was, all in all, relatively limited. The larger drop in spending on durable consumer goods is witnessed by the significant decline in the expectation regarding major household purchases in the next twelve months observed since the summer. Both indicators are up since the turn of the year, with a strong rebound for planned major purchases. However, this improvement of the survey indicators should be interpreted with caution as the consumer survey is typically organised at the beginning of the month. Hence, the February results do not yet reflect the major shock related to the war in Ukraine, as well as the new spike in energy prices.

Fundamentals for private consumption such as the outlook for personal income remain solid. Domestic employment now already exceeds the pre-COVID-19 level by about 2 %, after posting another solid 0.4 % quarter-on-quarter expansion in the fourth quarter of 2021. At the same time, the use of temporary unemployment is declining. According to the most recent figures for December 2021, about 5 % of salaried workers were still in the system and often just on a part-time basis. The workers leaving the system of temporary unemployment seem to mostly return to regular employment (either to their existing jobs or to new ones). Employment growth may moderate somewhat (also due to the tightness of the labour market) but is set to continue over the coming quarters. As gas and electricity are in the health index, the indexation mechanisms should mostly shield consumers' purchasing power and real wages should continue to rise moderately. In addition, certain government measures (such as the energy cheques and the planned stepwise phasing-out of the special social security contribution) provide a minor additional boost to purchasing power.

However, the various ramifications of the war in Ukraine should weigh heavily on consumption growth, not least through the observed or announced impact on energy and food prices. While the bulk of the impact could be for the next quarter, spending is likely to decelerate sharply in the second half of the current quarter already. In that connection, we expect a sharp decline in consumer confidence and the other survey indicators in March. This effect may offset much of the improvement seen in the first half of the quarter.

### Chart 3

#### Indicators for private consumption growth (normalised series)



Source: NBB.

Note: the original series are normalised around their historical averages.

**All in all, we expect private consumption growth to be sluggish at best in the first quarter of 2022.** The improving health situation and the gradual removal of nearly all restrictive measures should support growth in this demand component, but the sharp increase in uncertainty in the second half of the quarter and the new spike in energy prices should dampen consumer spending.

### Investment growth should at least pick up somewhat in the first quarter

**Total gross fixed capital formation in the Belgian economy decreased rather strongly by 2.6 % in the fourth quarter of 2021** and is slightly below its pre-crisis level again. Business investment continued to decline, by nearly 3 % in the fourth quarter, which is a more than was expected. Investment in housing was down slightly. Government investment dropped by 4.5 % but this partly reflected the unwinding of a temporary factor. At the same time, stock-building accelerated sharply and accounted for almost 1 % of activity growth according to the current statistics.

After four consecutive quarters of expansion, the recovery of business investment that started in the second half of 2020 came to a sudden stop in the third quarter of 2021. The latest statistics show that the decline continued in the fourth quarter and business investment in volume terms is now about 4 % below pre-crisis levels again. The recent decline is in line with the worsening of business confidence since the summer of 2021. The headline business confidence indicator has trended down, mainly driven by weaker sentiment in the capital-intensive manufacturing industry (see Chart 4, left-hand graph). There have been some tentative signs of stabilizing sentiment at the end of 2020, but a new decline was recorded in January and February. Business sentiment seems quite stable in the business-related services, while confidence deteriorated very gradually in both the construction industry and in trade in the most recent months, although a slight uptick is observed in February. **Overall, confidence levels remain high, but are gradually trending down.**

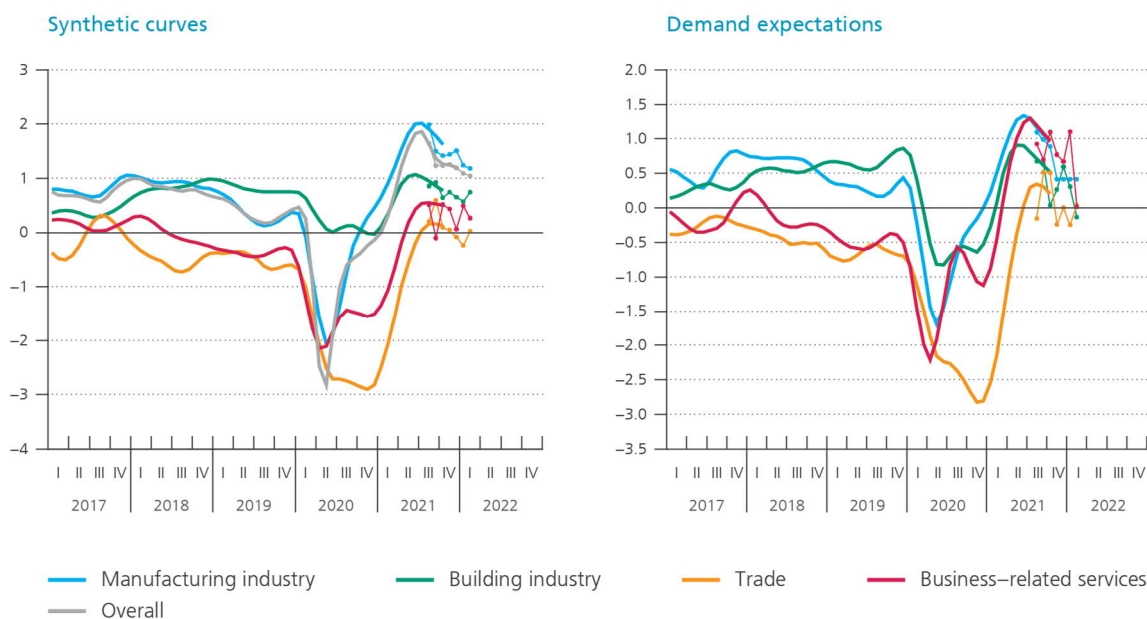
The downward trend is also visible when looking at demand prospects. Short-run volatility aside, the outlook for demand has trended down in all branches of activity. The results for February came in particularly negative for business-related services and the recent decline in the construction industry confirms the existing downward trend. Regarding the latter, the decline in demand prospects should also be seen against the background of gradually rising mortgage rates as sovereign yields have gone up. The demand outlook in manufacturing stabilized in line with pre-crisis levels in the course of the fourth quarter of 2022 and remained broadly unchanged until February. The latest quarterly survey on production capacity also indicates that the capacity utilisation in the manufacturing industry decreased further in January, to 78.5 %, below both the pre-crisis level and the historical average. Together with the new spike in energy prices and the rising uncertainty, this could mean that firm investments are likely to remain weak in the near term.

At the same time, the recent strong decline in business investment is also likely to be related at least to some extent to the bottlenecks in supply-chains that also affected investment goods. Certain survey data, such as the PMI indicators on delivery times, suggest that, while price pressures remain high, supply-chain problems are gradually softening. Even if the sanctions against Russia could raise new issues for specific industries, this may reduce the headwinds for corporate investment somewhat. In addition, the important labour shortages that often prevent a further expansion of production could increase the pressure for some companies or industries to speed up investments that increase productivity.

**Against this background, we expect business investment to remain weak but the growth rate is likely to at least be somewhat less negative than in the two previous quarters.**

#### Chart 4

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.

Residential investment decreased marginally in the fourth quarter, but still exceeds pre-crisis levels by about 3 %. Prices for residential real-estate have risen spectacularly in the recent past, in the context of persistently low mortgage rates. Currently, mortgage rates have started to rise (very) gradually and there are tentative signs that the housing market is cooling down somewhat. However, fundamentals for the real-estate market remain sound: mortgage rates are still historically low, the labour market is tight and households' income prospects are robust. The aforementioned indicator related to the demand outlook in the building industry shows a downward trend but is still at a relatively high level. **Hence, residential investment can be expected to expand slightly in the first quarter of 2022.**



As anticipated, fourth quarter government investment fell, returning to more normal levels after the third quarter figure was boosted by the delivery of two military transportation aircraft, whereas only one was foreseen for the last quarter. Taking into account the roll-out of recovery plans, **government investment should increase at a moderate pace in the coming quarters.**

Finally, the strong positive growth contribution of inventories most likely reflects an involuntary build-up of inventories in the face of slowing demand. Hence, this should not be repeated in the current quarter and the drawdown of inventories should keep activity growth below the increase in demand. While this may partly offset a less negative growth in fixed investment, we still expect that, overall, investment including inventories should post at least record less negative growth than in the previous quarter.

## Government consumption should grow moderately in the first quarter of 2022

**Government consumption decreased by 1.3 % in the fourth quarter.** This comes after the strong increase in the third quarter that was driven by additional healthcare spending related to the vaccination campaign and the normalisation in non-COVID-19 medical treatments that had been postponed in 2020. The fourth quarter figure thus represents a normalisation, rather than a meaningful decrease in government consumption. **Government consumption growth should return to positive territory in the first quarter in 2022.** It should be stressed that uncertainty is particularly large for this demand component as the early statistics for government consumption are sometimes difficult to interpret and quite prone to large revisions.

## The growth contribution of net exports should fall significantly in the first quarter

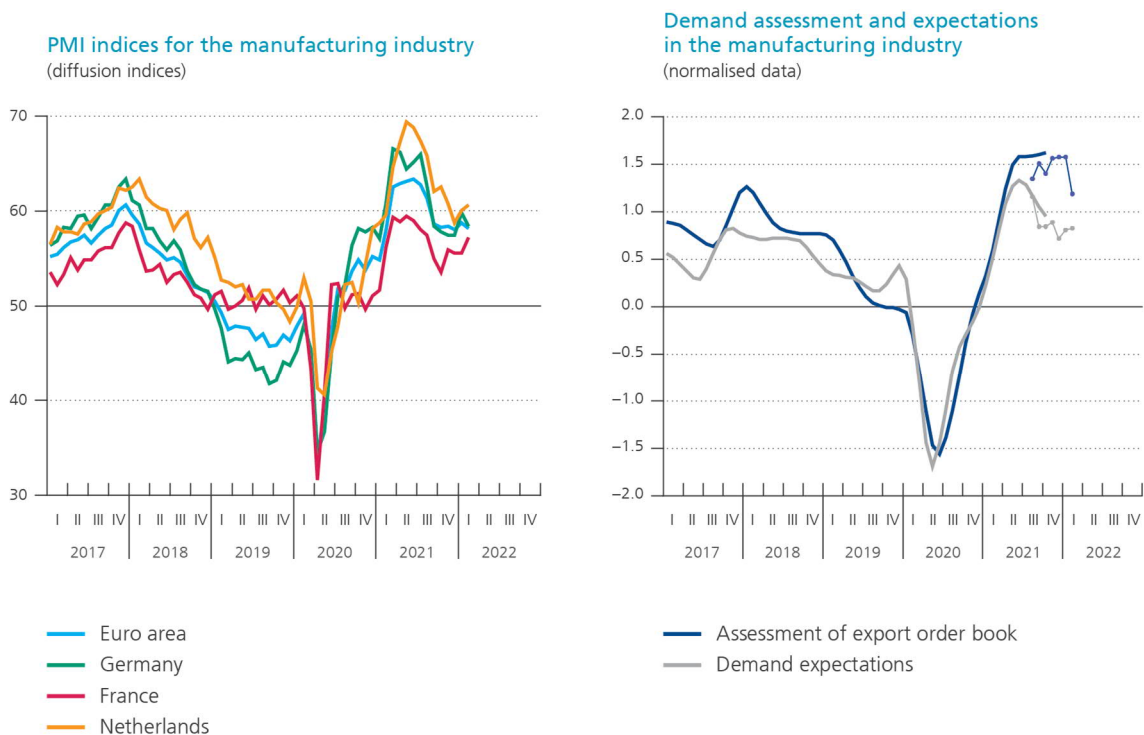
**In the fourth quarter, exports increased by 1.5 %, while import growth came in at just 0.4 %, resulting in an unexpected 1 percentage point positive contribution of net exports to GDP growth.**

Using the PMI manufacturing index as a proxy for foreign demand (see Chart 5, left-hand graph), demand growth for Belgian exports clearly peaked in the second quarter of 2021, before weakening in the third quarter due to expanding supply chain problems affecting international trade. **The euro area average stabilized in the course of the fourth quarter and has remained broadly unchanged, at an above-average level, in the first two months of 2022.** Looking at the most recent data for Belgium's neighbouring countries (and main trading partners), optimism among purchasing managers in the manufacturing industry increased in France and the Netherlands. The picture is somewhat murkier for Germany, with the significant improvement in January being partly undone in February.

The most recent business survey data for the Belgian manufacturing industry show a more pessimistic picture. Demand expectations are trending down after their peak in the spring of 2021 and the assessment of the export order book has long remained stable at a high level but declined sharply in February (see Chart 5, right-hand graph). In addition, these indicators do not yet (fully) capture the very recent escalation of the Russia-Ukraine conflict and the repercussions that the ensuing sanctions will have on trade flows and supply chains in the final month of the quarter. All in all, we expect export growth to strongly moderate, but to remain positive in the first quarter of 2022.

## Chart 5

### PMI indicators in neighbouring countries and export orders in manufacturing



Sources: Markit, NBB.

Note: the series in the right graph are normalised around their historical averages and divided by their standard deviation.

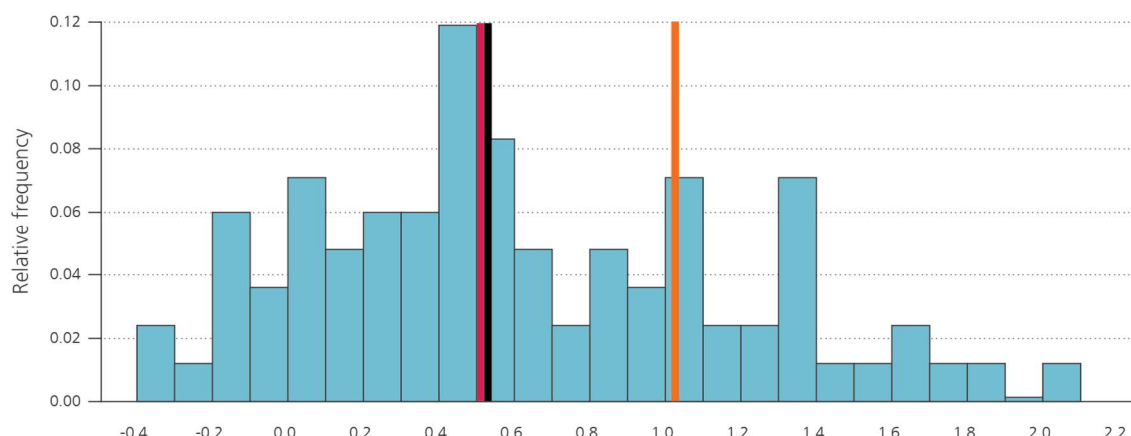
Meanwhile, import growth in the first quarter is supported by domestic demand, which should expand slightly. Hence, **we expect the contribution of net exports to GDP growth to fall significantly in the first quarter.**

## The median value of the mechanical nowcasts points to broadly unchanged GDP growth in the first quarter of 2022

The informational 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. **The median of the different predictions points to a moderately positive growth in the first quarter of 2022** (see Chart 6). The distribution is less wide than it has been in the recent past, but still significant at [-0.4; 1.8] % and skewed towards the left, with a median estimate equal to about 0.5 %. This would imply a constant growth rate compared to the previous quarter. Note that the past forecast performance of these simple models suggests that these individual predictions should be interpreted with caution, even in normal times.

## Chart 6

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 first quarter of 2022



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” and the dynamic factor model “R2D2”, respectively.

## A more elaborate analysis and model nowcasts suggest that quarterly growth could increase marginally to 0.6 %

Of the more elaborate standard NBB nowcasting models, “BREL” predicts 0.5 % quarterly growth in the first quarter, while “R2D2” estimates growth at around 1.0 %. However, as indicated above, the uncertainty of these nowcasting models is exceptionally large as the massive shocks since the start of the COVID-19 crisis constitute a challenge for the estimation of standard time-series models. Moreover, the potential economic fallout from the war in Ukraine is not yet fully captured by the indicators used in these models; while this may mostly affect the following quarters, a sharp decrease in activity growth in March could obviously reduce the growth rate in the current quarter already. Therefore, these model-based estimates need to be complemented with information gathered from other sources, as well as expert judgment.

In more general terms, the improvement in the health situation, coupled with the start of the normalisation of the supply chains, should have pushed up growth in the first half of the quarter. This beneficial impact is likely to be partially offset by the new spike in energy prices and the war in Ukraine that could significantly reduce growth as of March. The latter elements clearly constitute risks for the current nowcast but should only affect the final month of the quarter and, hence, the impact on growth in the current quarter may still be relatively limited. Beyond the near term the overall impact (on both economic growth and inflation) of the war in Ukraine and the sanctions could be much more substantial and could definitely include a negative growth scenario.

**All in all, the most plausible point estimate for growth in the first quarter would appear to be 0.6 %.** This is within the range provided by the two model nowcasts, albeit towards the lower end, and just above the median of the one-indicator models. It should again be stressed that the uncertainty of this nowcast is much higher than usual. The biggest risks to the outlook are related to the ongoing geopolitical tensions and escalating commodity prices.