Business Cycle Monitor

June 2024

Belgian economy expected to grow by 0.4% in the second quarter of 2024[1]

- According to the latest statistics, Belgian economic activity expanded by 0.3% in the first quarter of 2024. This is very close to the estimate in the March 2024 Business Cycle Monitor (BCM) and in line with the NAI's earlier flash estimate.
- Household consumption growth slowed in the first quarter, against the backdrop of softening consumer sentiment. Fundamentals are, at least temporarily, somewhat weaker and household consumption growth is expected to remain moderate in the second quarter of 2024. Beyond the near term, however, fundamentals should strengthen again as the expected recovery in employment and the decline in inflation will fuel real income growth.
- In real terms, first-quarter business investment grew markedly but this was mostly due to exceptional sales of investment goods abroad in the last two quarters. Cost-cutting in many firms is affecting investment spending and while underlying firm investment growth should stay positive, it is expected to remain moderate in the current quarter. A rise in residential investment in the first quarter came as a welcome surprise, but growth is expected to be muted, at best, in the second quarter and, indeed, could turn negative once again.
- Government consumption should decelerate somewhat in the second quarter. Government investment growth should continue to be boosted by the roll-out of specific investment programmes and the electoral cycle.
- Net exports (excluding the exceptional sales of investment goods abroad) increased activity growth in the first quarter. An expansion of world trade and the gradual improvement in Belgian competitiveness should support export growth in the near term. The underlying contribution of net exports to GDP growth should remain positive in the current quarter.
- The NBB's BREL and R2D2 nowcasting models currently estimate growth in the second quarter of around 0.3%, while the median of the one-indicator models came in at 0.5%.
- All in all, a growth rate of 0.4% in the second quarter of 2024 currently appears to be the most plausible estimate. Risks to this nowcast are skewed slightly to the upside and are mostly related to a more favourable growth contribution from inventories, after their negative impact in the first quarter. If the recovery in manufacturing sentiment leads firms to increase inventories at a faster pace, growth could surpass current expectations in the second quarter.

[1] This is a short-term NBB estimate which 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 each quarter). This estimate is based on nowcasting models and expert judgment and incorporates information up to 4 June 2024. Like all estimates and forecasts, it is subject to a degree of uncertainty.

Euro area economic activity should expand at a moderate pace again in the current quarter

According to the latest statistics, the euro area economy experienced a modest recovery in the first quarter of 2024 after a long period of stagnation. Euro area activity had essentially been flatlining since the final quarter of 2022 but grew by 0.3% in the first quarter of 2024, bringing real GDP to 0.4% above the level of the first quarter of 2023. However, this figure includes the notoriously volatile Irish GDP statistics. Irish real GDP rebounded somewhat in the first quarter of 2024, following sharp declines throughout 2023. Such large fluctuations are likely not to be an accurate reflection of the underlying developments in the Irish economy.[2] Excluding Ireland, the economic performance of the euro area improves somewhat, with a year-on-year growth rate of 0.6%.

Table 1

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

	Quarter-on-quarter change				Year-on-year change
	2023Q2	2023Q3	2023Q4	2024Q1	2024Q1
Euro area (EA)	0.1	-0.1	-0.1	0.3	0.4
p.m. EA excl. Ireland	0.2	0.0	0.1	0.3	0.6
Germany	-0.1	0.1	-0.5	0.2	-0.2
France	0.6	0.1	0.1	0.2	1.1
Italy	-0.2	0.4	0.1	0.3	0.7
Spain	0.5	0.5	0.7	0.7	2.4
Netherlands	-0.4	-0.3	0.3	-0.1	-0.5
Belgium	**0.3**	**0.3**	**0.3**	**0.3**	**1.3**
p.m. Ireland	-0.1	-2.5	-3.4	*1.1*	*-4.9*
EU	0.1	0.0	0.0	0.3	0.4
UK	0.0	-0.1	-0.3	0.6	0.2
US	0.5	1.2	0.8	0.3	2.9
Japan	1.0	-0.9	0.0	-0.5	-0.4

Sources: EC, US Department of Commerce, Cabinet Office Japan.

Growth rates picked up in most euro area member states, but the composition of GDP growth was far from uniform. The German economy expanded by 0.2% following a significant contraction of 0.5% in the last quarter of 2023. The uptick in GDP was mostly due to an increase in private investment and a positive contribution from net exports. Despite the moderation in inflation, German household consumption demand did not recover in the first quarter of 2024. Year-on-year, German GDP is still down by 0.2%. In France, a modest but broad-based expansion in domestic demand was weighed down by negative growth in net exports and inventory drawdowns, resulting in a growth rate of just 0.2%. The reverse was true in Italy, where a positive contribution from net exports to GDP growth was offset by a contraction in domestic demand. Quite surprisingly, as per initial statistics, Dutch economic activity declined marginally, with robust household consumption growth and government spending not entirely compensating for a drop in net exports. Lastly, Spain continued to outpace all other large euro area countries with quarterly growth reaching 0.7% again.

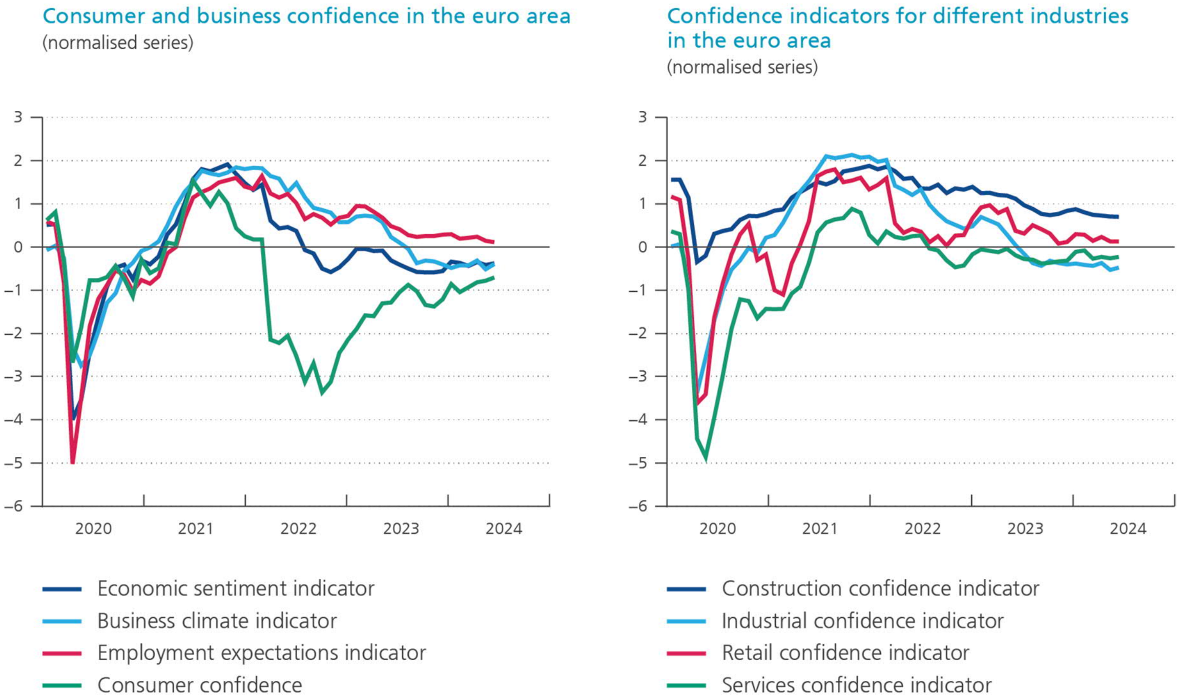
[2] The volatility in Irish GDP statistics is mostly due to operations involving intangible assets. These transactions usually do not reflect the Irish or euro area business cycle and are related to tax optimisation by large foreign-owned multinationals. See Andersson *et al* (2023) for a detailed discussion.

Among the major developed economies outside the euro area, the US economy is slowing down. Activity growth came in at 0.3% on a quarterly basis, the most sluggish pace since mid-2022. Nevertheless, over the past four quarters, the US economy grew by about 3%. Real GDP expanded by 0.6% in the UK, after contracting in each of the two preceding quarters. In annual terms, growth in the UK is now positive again, at 0.2%. The Japanese economy experienced a weak second half of 2023 and contracted again in the first quarter of 2024. Year-on-year, first-quarter GDP growth is currently at -0.4%.

Survey indicators suggest that, while economic sentiment in the euro area remains quite subdued, it is slowly edging up. The EC's Economic Sentiment Indicator (ESI) for the euro area pointed to some gains in confidence in the fourth quarter of 2023 but the indicator has been flat since then and remains below its long-term average. The latest observations, in May, show a slight but broad-based uptick in both business and consumer confidence. Looking at specific industries, confidence improved slightly in services and manufacturing, while sentiment among managers in retail trade and construction was mostly stable. Euro area consumer confidence continued to exhibit a gradual upward trend but it is still below its long-term average (see Figure 1). Meanwhile, the outlook for the labour market has been weakening somewhat: the employment expectations index, which tracks expectations regarding net hiring, continued to soften in May although it remains above its long-run average.

Figure 1

Sentiment indicators for the euro area



Source: EC.
Note: The original series are normalised around their historical averages and divided by their standard deviations.

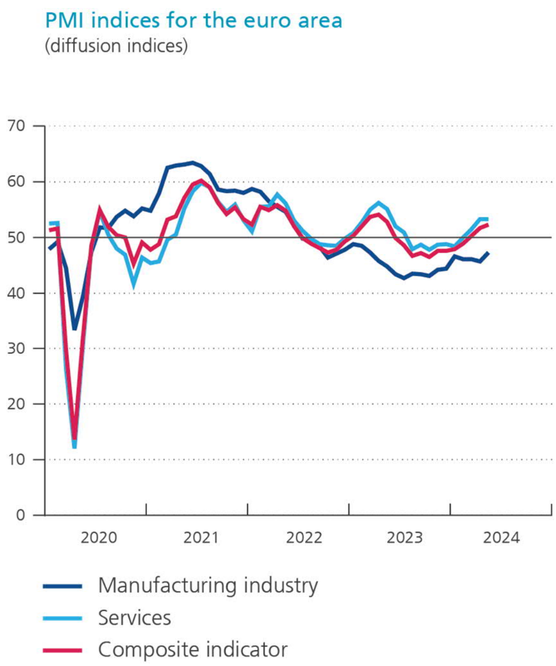
Taking a detailed look at the sub-indicators that make up the composite business confidence indicator reveals that the improvement in May is mainly due to a recovery in the assessment of current and expected demand. In the manufacturing industry, overall confidence remains downbeat, but order books have stabilised and recent production trends have improved. Managers in the services industries reported an improvement in recent and expected demand. In the retail sector, there was a worse assessment of the recent business situation, which was offset by an improvement in the outlook. Confidence in the construction industry continued to wane in May, as the evaluation of order books deteriorated.

The PMI indicators for the euro area have recently shown a trend increase and continue to improve in the current quarter. The composite indicator began to recover in the second half of 2023 and has been trending upwards since, surpassing the 50-point mark in March, which indicates a shift from contraction to expansion (see Figure 2, left-hand graph). This suggests that overall euro area activity should increase again in the second quarter. The recent upward trend in the composite PMI has largely been driven by improved sentiment in the services industries. However, while overall conditions in the manufacturing industry remain challenging and industrial activity is expected to continue to decline, the manufacturing PMI has gradually been edging up. In fact, much of the improvement in the composite indicator in May was due to the uptick in confidence in the manufacturing industry.

Price pressures have largely normalised. The PMI for manufacturing input prices has been trending upwards over recent months and now sits just below the 50-point mark, indicating that input prices may still slip downwards somewhat but that the decline should be bottoming out (see Figure 2, right-hand graph). Although energy prices have decreased recently, they remain higher in the euro area than in the US and much of Asia, posing ongoing structural challenges for energy-intensive manufacturing activities in Europe. That being said, the decline in export orders that started in the second quarter of 2022 has largely come to an end: the PMI for new export orders in the manufacturing industry began to recover in mid-2023 and is now approaching the 50-point mark. **Overall, sentiment indicators suggest that there should be a continued gradual recovery in euro area economic activity in the second quarter of 2024, with GDP growth expected to remain moderately positive.**

Figure 2

PMI indices



Source: HCOB.

The Belgian economy grew by 0.3% in the first quarter

According to the latest statistics, Belgian economic activity growth remained stable at 0.3% in the first quarter of 2024, slightly above the euro area average. Before rounding, this figure is in fact just below 0.35% and, hence, close to the 0.4% March BCM estimate.

Our March 2024 BCM expectations were also reasonably accurate for most demand components. Household consumption growth moderated in the first quarter and business investment returned to positive growth, in line with our expectations. Investment was again affected by the sale of ships by a domestic company to a foreign counterparty: a significant deal that had already affected statistics in the fourth quarter. As stated in the previous BCM, such transactions do not affect GDP growth but reduce business investment and increase exports to the same extent. After correcting for these sales in both affected quarters, business investment growth looks to have remained moderately positive in the first quarter. The underlying contribution of net exports to GDP (excluding the aforementioned sales) came in clearly positive, which is in line with the improvement we expected.

The continued growth of government-driven components was also accurately anticipated: government consumption continued to expand and the anticipated boost in the run-up to local elections led government investment growth to contribute positively to GDP growth. As always, it should be noted that quarterly statistics on government spending, in particular, are prone to significant revision.

One unexpected and welcome development regarding the latest statistics concerns the moderate expansion in housing investment, after three consecutive quarters of significant contraction. While we knew that the turning point for the real estate market was imminent, based on the recent bottoming out of survey indicators and the increasing number of transactions on the market, the uptick in the first quarter is a positive surprise.

Finally, emphasis should be given to the fact that the contribution of inventories significantly reduced GDP growth in the first quarter of 2024. While we typically do not provide an explicit assessment of the growth contribution of stock building in the BCM, the large negative contribution of the past quarter could precede a recovery in inventory dynamics that may support growth in the near term.

Turning to the production approach to GDP, activity growth was again mainly driven by services, which were up by 0.4% quarter-on-quarter. While both market and non-market services contributed positively, the gradual deceleration of activity in market services continued. Activity contracted by 0.2% in the construction industry, which is quite remarkable given the aforementioned rises in residential and government investment. Value added in the manufacturing industry, on the other hand, returned to marginally positive growth, bringing an end to the decline in activity that began in the final quarter of 2022.

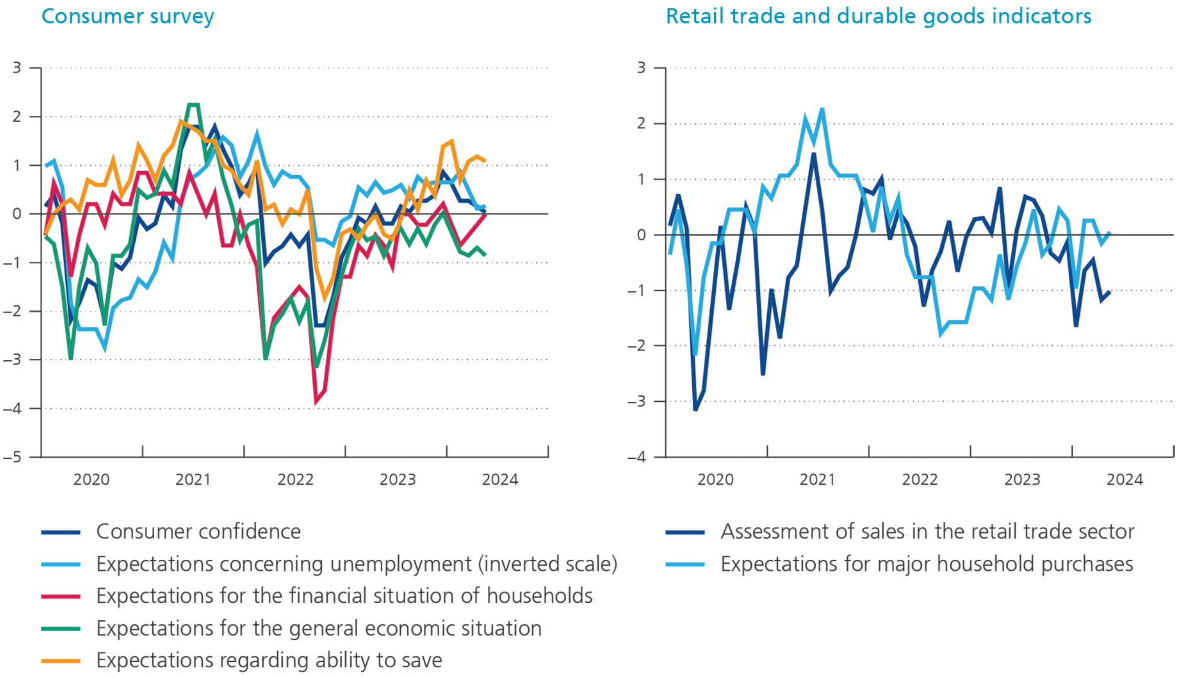
Household consumption growth should remain moderate in the second quarter

The slowdown in household consumption growth in the first quarter took place against the backdrop of softening consumer sentiment. The latter slipped from its peak late in the fourth quarter of 2023 (see Figure 3, left-hand graph) and continued to worsen in April and May. Much of the recent decline in consumer confidence can be traced back to unemployment expectations, i.e. the component of consumer confidence that normally has the greatest predictive power for actual consumption. Since the end of the first quarter, unemployment expectations have clearly turned more pessimistic. However, this may not fully reflect the underlying trend, and may rather be due to the extensive media coverage of the closure of a large company and the significant number of associated redundancies. In recent months, consumer assessments of the economic situation have remained broadly stable. In addition, expectations regarding their own financial situation have actually improved somewhat. Hence, on its own, a worsening in the sentiment indicator does not necessarily point to a further slowdown in private consumption in the near term.

Sales of durable goods can be expected to hold up quite well, as the survey indicator on households' expectations for major purchases in the next twelve months has remained close to its long-term average since mid-2023. However, indicators for the consumption of non-durables, which account for the bulk of total household consumption, are deteriorating. The assessment of sales in the retail industry has been trending downwards since mid-2023 (see Figure 3, right-hand graph). The synthetic indicator for retail trade has remained effectively flat, and at a low level, since early 2023 (see Figure 4, left-hand graph). In interviews undertaken for the May 2024 Business Echo, a number of manufacturing firms reported downtrading and a decline in production volumes for some segments of fast-moving consumer goods. Moreover, managers from a broad range of consumer-oriented services firms indicated that business conditions were increasingly difficult, which is in line with the deceleration in market services observed in the first quarter.

Figure 3

Indicators of household consumption growth
(normalised series)



Source: NBB.
Note: The original series are normalised around their historical average.

In addition, fundamentals are, at least temporarily, somewhat weaker. Purchasing power growth has now moderated after climbing robustly in 2023 (which was mostly due to the usual time lag in the indexation of incomes). Employment growth has lost traction. Finally, inflation has increased again. Even if the saving ratio is likely to edge down somewhat, this may keep consumption growth low. Beyond the near term, fundamentals should strengthen again as the expected recovery in employment and the decline in inflation will fuel real income growth. At any rate, purchasing power should continue to expand at a relatively healthy pace.

All in all, we expect household consumption growth to remain moderate in the second quarter of 2024.

Private investment growth should remain very moderate in the second quarter

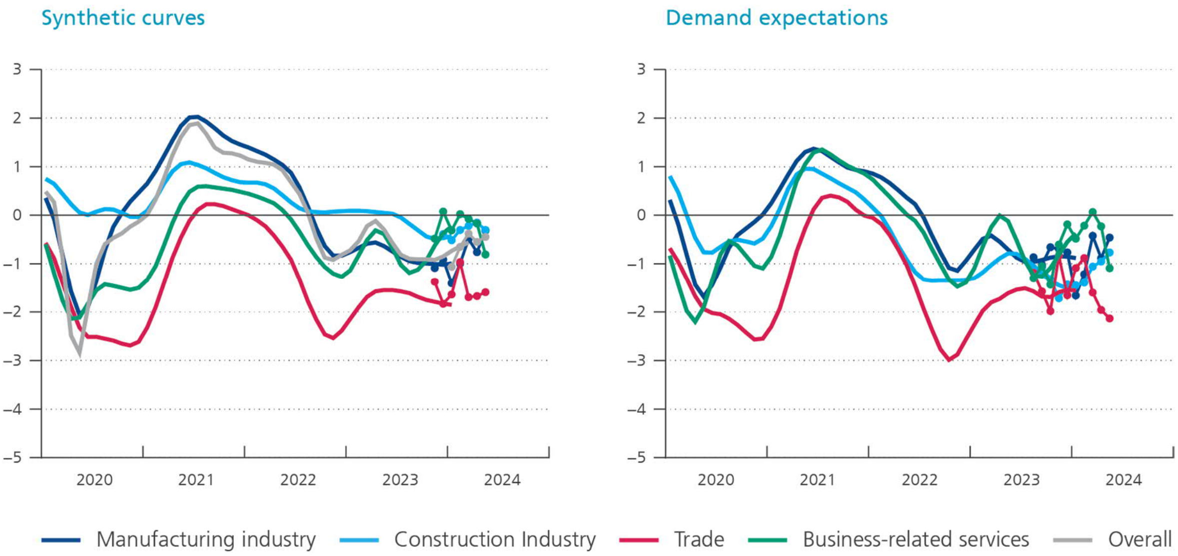
After correcting the investment series for the exceptionally large sales of ships in the past two quarters, business investment expanded at a moderate pace in the first quarter of 2024. Growth rates are normalising after the volatility in 2023, with a remarkable surge in investment that ended abruptly in the final quarter of the year. This corresponds with recent business intelligence: firms report that cost-cutting has been leading to a curtailing of investment spending. Current investments were said to (still) be primarily focused on the modernisation of production processes or facilities, the seeking of efficiency gains through digitalisation and automation to offset the large rise in wage costs, and the greening of production processes. The latter is often driven by regulatory requirements, for example in the context of the renewal of operating permits.

The NBB business survey reveals that overall business confidence bottomed out in the fourth quarter of 2023 and has been gradually trending upwards in 2024 (see Figure 4, left-hand graph). Much of the recent improvement in the overall synthetic indicator stems from the manufacturing industry, even though manufacturing confidence still remains relatively subdued. In the construction industry, confidence is still up compared to the fourth quarter of 2023 but the recovery seen in early 2024 stalled in April, with sentiment declining again in May. Business-related services reported robust confidence over the past two quarters, but sentiment significantly weakened in the current quarter, with a sharp decline in May. This was echoed in interviews carried out for the Business Echo. Confidence edged up in the trade industry but, zooming out, has been nearly flat, and at low levels, since early 2023.

Firms' demand expectations show a similar dispersion. The outlook in the manufacturing industry seems to have bottomed out in the first quarter and is now improving. The construction industry is also reporting an upward trend in demand expectations. However, the demand outlook for business-related services and trade deteriorated significantly over the most recent months (Figure 4, right-hand graph). Alongside growing consumer price-consciousness, our business intelligence indicates that the decline in the outlook for services is due to cost-cutting measures affecting some business-to-business activities. These trends are likely to persist in the near term.

Figure 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 deviations.

Needs for (additional) production capacity remain at low levels. Business leaders interviewed for the NBB Business Echo saw current production capacity as sufficient to meet demand, with structural factors cited as reasons not to expand production capacity in Belgium. This was confirmed in the latest quarterly NBB survey on production capacity utilisation in the Belgian manufacturing industry: capacity utilisation fell further in April, to 73.8%. This is clearly below the long-run average of around 80%.

Turning to financial conditions, the NBB's quarterly survey on the assessment of financing conditions shows that, despite interest rates remaining at relatively elevated levels, the 'credit constraint perception' reported by firms in January 2024 eased to levels last seen in mid-2022 and remained at similar levels in April. The consensus among Business Echo respondents is that external financing remains accessible, with no widespread reluctance from banks to provide funding. That being said, many firms indicate that investments are traditionally financed through (intra-group) cash flows and that recent margin pressures have led to cost-cutting and a re-assessment of investment plans. **Overall, we expect business investment (corrected for the effects of exceptional transactions in previous quarters) to post moderately positive growth in the second quarter of 2024.** Investment budgets have been reduced, but the drive for productivity gains through automation and digitalisation, as well as the greening of production processes should continue.

Residential investment exceeded expectations in the first quarter of 2024, posting moderately positive growth after a whopping 7% decline over the course of 2023. Investment fell last year due to the sharp rise in interest rates and increased prices for building materials. While transaction volumes and short-term indicators suggest that housing investment may have passed its low point, any pick-up in activity is likely to be slow and tentative. Closely related industries such the construction and building-materials industries, report a continued lack of confidence. **In sum, we anticipate continued weakness in residential investment, with growth that could turn negative again in the second quarter of 2024.**

Taken together, the expected subdued growth in firm investment coupled with the slump in residential investment is expected to result in only very moderate private fixed investment growth this quarter.

Government investment, on the other hand, grew by 3.3% in the first quarter of 2024. **The implementation of recovery plans and the regular electoral cycle should continue to support government investment in the near term.**

Government consumption growth could moderate slightly

Government consumption growth in real terms in the first quarter came in at 0.7%, thereby exceeding the long-run average of approximately 0.4%. **We expect government consumption growth to continue its expansion in the second quarter of 2024, but growth is likely to moderate slightly.** As always, it should be underlined that the quarterly statistics on demand components, and for government spending in particular, are often subject to subsequent revisions.

The contribution of net exports to growth is expected to improve gradually

Despite the resilience of global activity, world trade has been particularly sluggish over the past two years. This mostly reflects a composition effect in private consumption, with the rebound being driven mostly by services that tend to be traded less, as well as the weakness in manufacturing. However, despite geopolitical conditions again affecting shipping lanes, trade growth should improve gradually going forward, in line with the expansion of economic activity. **Current indicators point to positive growth in global goods trade in the first quarter of 2024.** The PMI manufacturing indices for Belgium's main neighbouring countries, which are also its primary trading partners, have bottomed out and are now starting to edge up. This is also the case for the euro area aggregate indicator. Despite the recent improvement, only the indicator for the Netherlands has reached levels that point, in principle, to an expansion (see Figure 5, left-hand graph).

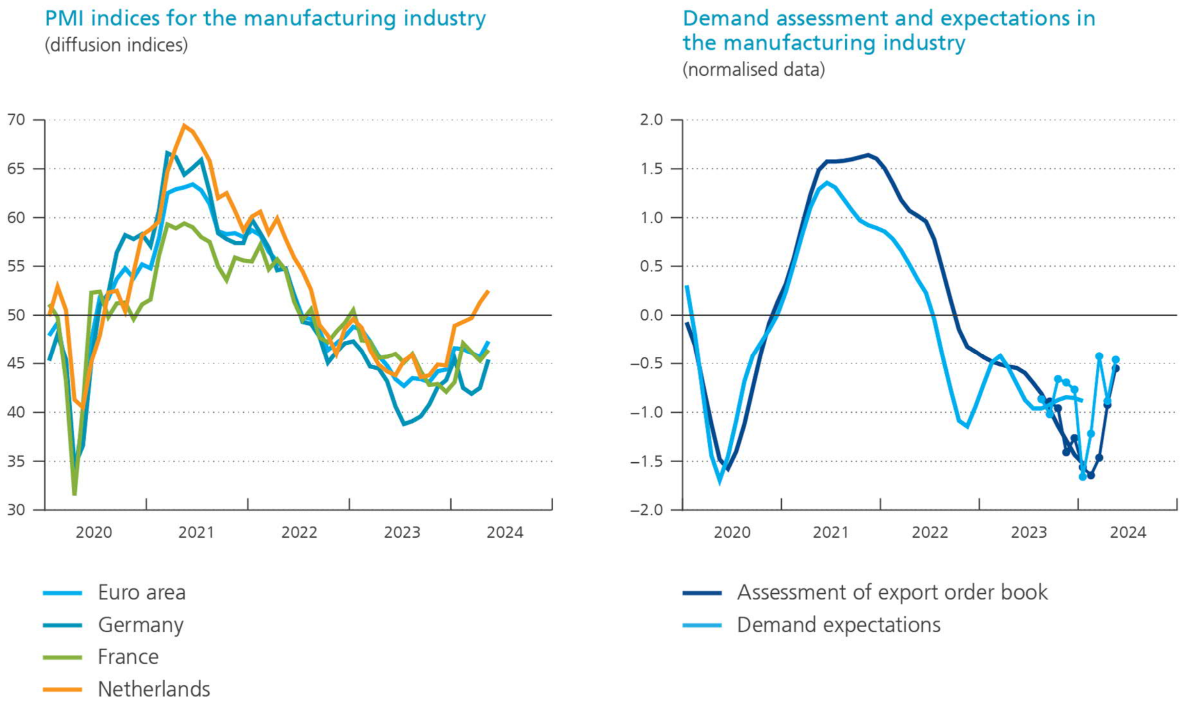
The cost competitiveness of Belgian exporters has deteriorated due to the surge in labour costs and this is only expected to improve gradually. Wage cost growth has now slowed, and many other input costs have declined, but Belgian exporters have accumulated a cost gap with respect to foreign competitors which is weighing on Belgium's export market share. This gap is expected to narrow gradually, particularly as nominal wage cost growth among euro area trading partners is now outpacing that in Belgium.

Turning to the soft indicators, the NBB monthly business survey shows that demand expectations and assessments of export order books have bottomed out and rebounded markedly since the start of the year (see Figure 5, right-hand graph). This was reflected in interviews for the May 2024 NBB Business Echo: respondents from the manufacturing industry clearly pointed to signs of an improvement ahead in terms of foreign demand.

Overall, the recovery of world trade and gradually improving cost competitiveness should support export growth in the near term. In addition, the moderation of domestic demand is likely to weigh on import growth and could lead to the growth contribution from net exports staying positive.

Figure 5

PMI indicators in neighbouring countries and export orders in manufacturing



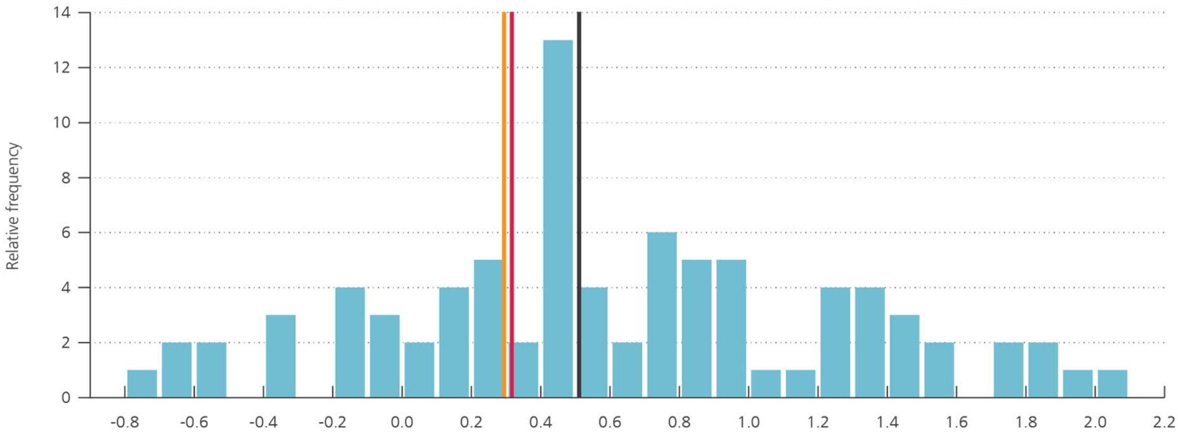
Sources: Markit, NBB.
Note: The series in the right-hand graph are normalised around their historical averages and divided by their standard deviations.

The median value of the mechanical nowcasts points to an acceleration of GDP in the second quarter of 2024

The informational content of 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 various predictions points to positive growth of 0.5% in the second quarter of 2024** (see Figure 6). The range remains broad, at [-0.8;2.2], indicating that uncertainty remains high. The forecast distribution is skewed slightly towards the higher end. It should be noted that the past forecast performance of these simple models suggests that individual predictions should be interpreted with caution, even under normal circumstances.

Figure 6

Histogram of one-indicator bridge model predictions using a broad set of survey and financial data and NBB nowcasting model predictions of real GDP growth in the second quarter of 2024.



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

Economic activity is expected to continue to expand at a broadly stable pace in the second quarter of 2024

Of the NBB's more elaborate standard nowcasting models, both BREL and R2D2 predict positive quarterly growth of 0.3% in the first quarter of 2024. A preliminary estimate using an improved BREL model,[3] recalibrated to take into account of the unusual volatility of the pandemic period, indicates a similar growth estimate, of 0.4%. As always, these model-based estimates should be complemented by information gathered from other sources, as well as expert judgment.

In the current quarter, activity growth is most likely to remain broadly stable. Household consumption and investment growth should remain moderate, while the contribution to GDP growth from net exports may be slightly positive again. The Bank's Spring 2024 macroeconomic projections (to be published on 7 June) also point to relatively steady growth in the second quarter. However, since the cut-off date for those projections, the NAI has published new statistics regarding the first quarter, including a first view on demand components and a slight upward revision of growth (by 0.1 pp, even though the figure remains at 0.3% after rounding) compared to the flash estimate issued at the end of April.

All in all, a growth rate of 0.4% in the second quarter of 2024 currently appears to be the most plausible estimate. This is marginally higher than the average model nowcasts but below the median of the one-indicator models. Risks to this nowcast are skewed slightly to the upside and are mostly related to a more favourable growth contribution from inventories, after their very negative impact in the first quarter. If the recovery in manufacturing sentiment leads firms to increase inventories at a faster pace, growth could surpass current expectations in the second quarter.

[3] Further analysis on the robustness of this improved model is needed. We expect a technical Working Paper on this subject to be published in the second half of 2024.