Article

Economic projections for Belgium-June 2023

NBB economic review

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NBB Economic Review

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Economic projections for Belgium – June 2023

NationalBank OF BELGIUM
Eurosystem

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Introduction

The macroeconomic projections for Belgium described in this article form part of the Eurosystem projections for the euro area. These projections are based on a set of technical assumptions and forecasts for the international environment drawn up jointly by participating institutions, namely the ECB and the national central banks of the euro area. The cut-off date for the Belgian projections was 31 May 2023. This article discusses the baseline projections for Belgium in detail; the last section provides a risk assessment for the baseline. As usual, the projections take into account only government measures that have been decided and are likely to pass the legislative process and that had been announced in sufficient detail by the cut-off date.

1. The global economy remains resilient despite headwinds

After the sharp post-pandemic rebound, the global economy started 2023 on strong footing. The lifting of the zero-Covid policy in China put an end to the regular lockdowns affecting industrial hubs and contributed to the further normalisation of global supply chains. Against this backdrop, global input price pressures moderated, which, together with the spectacular fall in the international price of natural gas, provided some breathing room for the world economy. Specific headwinds, such as the financial turmoil caused by the liquidity problems affecting certain financial institutions or the US debt ceiling negotiations, have so far not had a lasting impact on financial markets and have definitely not derailed the economic upturn. The latter is still mostly fuelled by the services industry, as the manufacturing industry continues to struggle.

That being said, the international environment remains challenging. Central banks worldwide have drastically tightened monetary policy in order to avoid high inflation rates pushing up longer-term inflation expectations and becoming entrenched. Higher interest rates have curbed lending growth, affected asset valuations and cooled demand, in particular on real estate markets. However, the global economy has shown significant resilience, thanks in part to robust labour markets. While headline inflation is now falling in most areas, underlying price pressures and food inflation remain uncomfortably high.

Survey data currently point to a broadly stable outlook for economic activity in the short run, despite further strains on manufacturing. According to the Eurosystem assumptions used for these projections, global growth is quite stable over the projection horizon. In annual terms, global economic growth (excluding the euro area) is projected to slightly exceed 3 % this year and in the coming years.

One specific observation pertains to the recent weakness in global trade which has been much more sluggish than world GDP. As there are no indications of increasing barriers to trade and, for example, shipping costs have in fact continued to fall, this is thought to mostly reflect a demand composition effect. Post-pandemic consumption patterns, in particular, are still somewhat overweighted in less trade-intensive services, while higher interest rates and less dynamic lending could dent more-traded investment goods somewhat. In 2023, global trade (excluding the euro area) is expected to expand at a clearly weaker pace than global activity. Looking ahead, global trade should return to more normal levels and, for 2024 and 2025, is projected to increase by just over 3 %, in line with the growth rates for global activity.

As usual, the profile of world trade determines the outlook for euro area foreign demand and Belgian export markets, with the latter being an important factor for the medium-term macroeconomic projections for Belgium. Based on the assumptions, Belgian export markets are expected to expand steadily throughout the remainder of the projection period, by 0.8 % on average per quarter. Compared to the December 2022 projections, the annual figure for Belgian export market growth in 2023 is much weaker, but this is mostly due to (the carry-over effect from) observations in the past.

Table 1

The international environment

(annual percentage changes)

	2021	2022	2023 e	2024 e	2025 e
World (excluding euro area) real GDP	6.7	3.3	3.1	3.1	3.3
World (excluding euro area) trade	12.9	5.3	1.3	3.4	3.4
Euro area foreign demand [1]	11.2	6.3	0.5	3.1	3.1
Belgium's relevant export markets [1]	9.4	7.6	0.9	3.2	3.1

Source: Eurosystem.
1 Calculated as a weighted average of imports of trading partners.

Turning to the technical and financial assumptions underlying the current Eurosystem projections, the exchange rate is assumed to remain constant throughout the projection period. The euro has become stronger since the last autumn and was trading at around $ 1.09 at the cut-off date.

As usual, oil-price and interest-rate assumptions are based on market expectations. At the cut-off date for the common Eurosystem assumptions (26 May), a barrel of Brent crude oil was priced near € 72 and expected to trend gradually down to € 64 by the end of 2025. Gas prices have already come down much more strongly than what was included in the autumn projections, to less than € 30 per megawatt hour. As usual, the expected prices going forward are based on information from futures. Gas prices are expected to temporarily edge up somewhat in the coming winters, but price levels remain well below what was observed over the past year.

As regards financial conditions, the markets currently expect the three-month interbank deposit rate to peak at 3.8 % in the second half of 2023, before falling slightly to 2.9 % on average in 2025. Correspondingly, the average interest rate on business loans is also expected to peak in 2023, at 4.5 %. It should then come down slightly to just over 4 % by 2025. The average mortgage rate has clearly moved up over the past year, from 2 % in 2022 to 3.6 % this year. It is expected to edge up slightly more, to reach 4.1 % on average in 2025.

Table 2

Eurosystem technical assumptions

(annual averages; in %, unless otherwise stated)

	2021	2022	2023 e	2024 e	2025 e
EUR/USD exchange rate	1.18	1.05	1.08	1.09	1.09
Oil price (US dollars per barrel)	71.1	103.7	78.0	72.6	70.4
Interest rate on three-month interbank deposits in euro	–0.5	0.3	3.4	3.4	2.9
Yield on ten-year Belgian government bonds	0.0	1.7	3.1	3.2	3.4
Business loan interest rate	1.6	2.0	4.5	4.4	4.1
Household mortgage interest rate	1.5	2.1	3.6	4.0	4.1

Source: Eurosystem.

2. Economic growth in the euro area turns positive again

As expected last autumn, the euro area economy slid into a short and shallow recession in the last quarter of 2022 and the first quarter of 2023. However, the economy is expected to expand again in the coming quarters as (energy) inflation has come down, supply bottlenecks have almost disappeared and household purchasing power is set to rebound. In annual terms, euro area GDP grows by 0.9 % in 2023. In 2024-25, actual growth is expected to stabilise slightly above potential, at 1.5 % and 1.6 % respectively.

Headline inflation has come down from double-digit rates recorded last autumn, to 6.1 % in May. It should continue to decline in the course of the projection period as, on the basis of the future markets, energy prices should go down further and as food inflation moderates. On average, headline inflation should fall from 5.4 % on average in 2023 to 2.2 % in 2025. Core inflation is still being driven by pipeline cost pressures but should weaken as of the second half of this year, even if it remains above its historical average due to higher-than-usual wage growth. Profit margins are expected to partly absorb these costs in the medium-term.

The labour market has already surprised on the upside again at the start of the year and is expected to remain robust throughout the projection period. The unemployment rate continues to decline, down to 6.3 % in 2025.

The euro area budget deficit budget should continue to decrease, particularly in 2023 and 2024, and to reach 2.5 % of GDP at the end of the projection horizon. The government debt ratio is on a declining path throughout the projection period, reaching 87 % of GDP in 2025. Nevertheless, in 2025, both the deficit and the debt ratio are projected to remain above pre-pandemic levels.

Eurosystem staff assesses risks to growth as being slightly tilted to the downside. At the same time, risks to inflation continue to be assessed as being somewhat on the upside. The possibility of a stronger wage-price spiral, as well as an upward shift in inflation expectations, represent domestic upside risks to inflation.

Table 3

Eurosystem projections for the euro area

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

	2020	2021	2022	2023 e	2024 e	2025 e
Real GDP (contributions in percentage points)	–6.2	5.3	3.5	0.9	1.5	1.6
of which:						
Domestic demand (exclude changes in inventories)	–5.3	3.7	3.4	0.4	1.5	1.5
Net exports	–0.6	1.3	–0.2	0.7	0.1	0.1
Inflation (HICP)	0.3	2.6	8.4	5.4	3.0	2.2
Core inflation [1]	0.7	1.5	3.9	5.1	3.0	2.3
Domestic employment	–1.5	1.4	2.3	1.3	0.5	0.4
Unemployment rate [2]	7.9	7.7	6.7	6.5	6.4	6.3
General government financing requirement (–) or capacity [3]	–7.1	–5.3	–3.6	–3.2	–2.6	–2.5
Public debt [3]	97.2	95.4	91.4	89.1	87.9	87.3

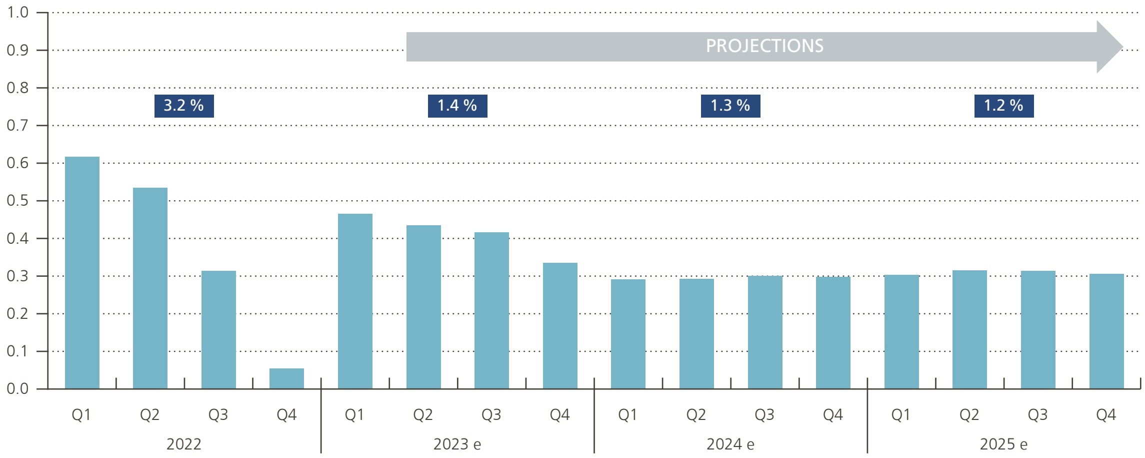
Source: ECB.
1 Measured by the HICP excluding food and energy.
2 In % of the labour force.
3 In % of GDP.

3. Belgian growth should gradually edge down to potential

Chart 1

Belgian economic growth has rebounded but should edge down gradually

(quarter-on-quarter growth of real GDP, percentages, seasonally and working-day adjusted; the numbers in the boxes refer to annual growth)



Sources: NAI and NBB.

According to the NBB’s December 2022 projections, the Belgian economy was expected to essentially flatline over the winter of 2022-2023. However, the economic environment proved to be more favourable than what was assumed with international gas prices plummeting faster than expected by market participants last autumn. While the economy indeed slowed significantly at the end of 2022, a decline in activity was narrowly avoided and the slowdown was shorter than anticipated. In fact, there was already a strong rebound in activity in the first quarter of this year. According to the most recent NAI statistics, the Belgian economy grew by 0.5 % in that quarter, i.e. broadly in line with the NBB’s March 2023 Business Cycle Monitor.

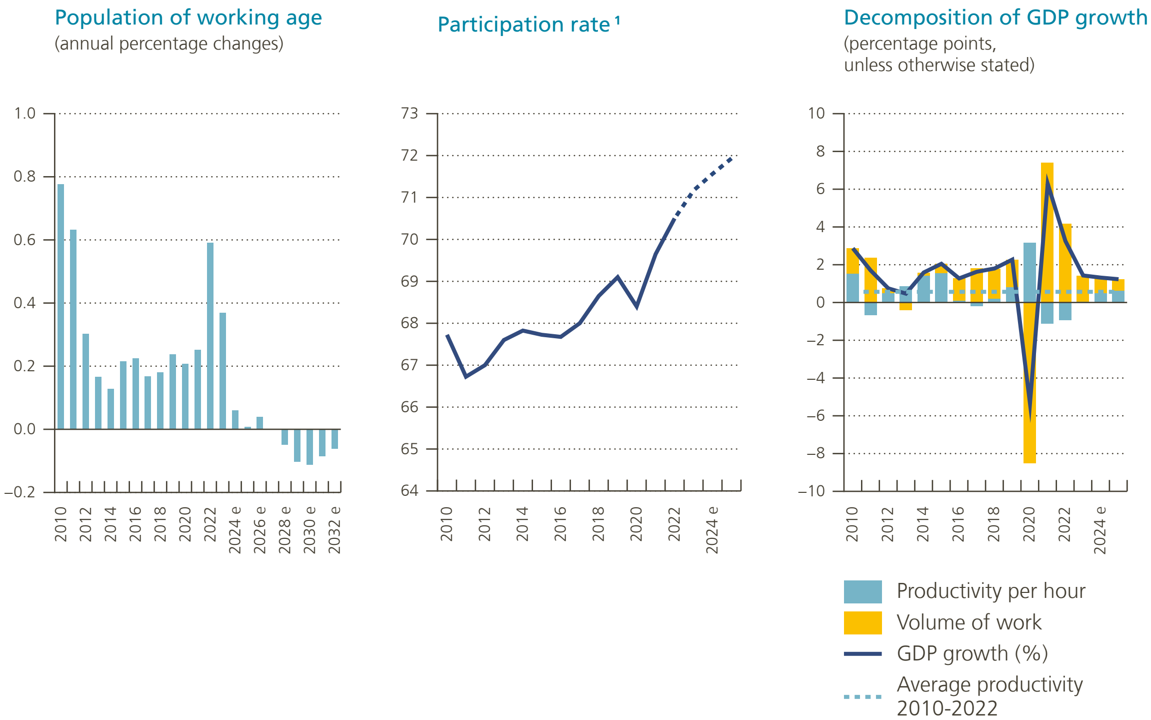
Turning to the near-term outlook, sentiment indicators have clearly improved since the autumn of 2022. While both business and consumer sentiment appeared to level off somewhat in May, a strong decline in activity growth does not seem likely at the time of writing. A broad assessment based on information from the NBB’s business intelligence network, as summarised in the Business Echo published on 5 June, suggests that a roughly stable growth rate is the most plausible scenario. The current nowcast points to 0.4 % growth in the second quarter.

More generally, activity should continue to be supported by household consumption growth in 2023 as disposable income rebounds sharply. While rising interest rates and a decline in mortgage lending are impacting residential investment, business investment should generally be more resilient.

Beyond the near term, activity growth should gradually lose traction as the expansion of purchasing power and, hence, household consumption growth normalises. The slowdown in consumption will not be entirely offset by accelerating investment. Net trade is expected to continue to reduce growth throughout the projection period, also due to the worsened cost competitiveness of Belgian firms. Throughout 2024 and 2025, the economy should expand at a stable quarterly rate of about 0.3 %, which is more in line with potential growth. In the outer

Chart 2

Belgian economy to hit (labour supply) limits



Sources: FPB, NAI and NBB.
1 Labour force divided by the working age population (15-64 years).

years of the projection period, growth will be increasingly held back by labour shortages in particular. According to the current demographic outlook, the working age population will actually start to decline in 2025. Even though the participation rate should continue to edge up and productivity growth should recover, the return to potential growth means that the economy should lose some traction in the following years.

In annual terms, growth is estimated to come in at 1.4 % in 2023 and to edge down to 1.2 % in 2025. Compared to the NBB autumn 2022 projections, this implies a strong upward revision for the near term and, hence, annual growth in 2023 and a downward revision for 2024 and 2025.

4. Domestic demand and household consumption continue to drive growth

Household consumption has been very buoyant recently: since the spring of last year consumption growth has remained well above its long-term average. This is remarkable given that consumer confidence fell to its lowest level since 1985 in September of last year. The worsening sentiment should be viewed against a backdrop characterised by high uncertainty, also fuelled by media reports related to steep energy bills, but does not seem to have affected actual consumer spending that much. More generally, very high inflation rates eroded purchasing power last year. However, due to the specific way in which energy inflation is captured [1], the actual increase in the cost of living could have been more moderate than suggested by the official (health) inflation index. This could help to explain the resilience of household consumption. Also, as the income shock was correctly considered as temporary, households have resorted to some consumption smoothing.

With consumer confidence clearly on the mend over the past couple of months and taking into account the strong increase of household purchasing power this year, household consumption growth is expected to remain solid throughout the year. Indeed, household purchasing power is temporarily boosted by the delayed impact of automatic price indexation which will continue to push up wage growth strongly in 2023, at a time when actual inflation is already coming down rapidly. Moreover, this year's purchasing power is also supported by tax reductions that partly undo bracket creep due to high inflation: the personal income brackets were indexed on 1 January 2023 based on 2022 inflation figures, while tax settlements will be more favourable for households as taxes withheld on income in 2022 did not yet reflect this indexation. Strong disposable income growth (topping 3.5 % in real terms in 2023) will continue to fuel consumption growth, which is expected to remain above the average rate throughout 2023. As income growth slows to more normal levels, household consumption growth gradually loses traction as well and returns to its long-term average rate. Overall, after shrinking in 2022, purchasing power is expected to grow by a solid 6.4 % over 2023-2025, or just over 5 % in per capita terms.

The savings ratio has dropped to 12 % in 2022, as household consumption growth remained very robust despite declining purchasing power. It is expected to recover slightly to 13 % from 2023. With interest rates on the rise, incentives to save gradually become stronger and the share of capital income – which is typically saved more – in total household income increases.

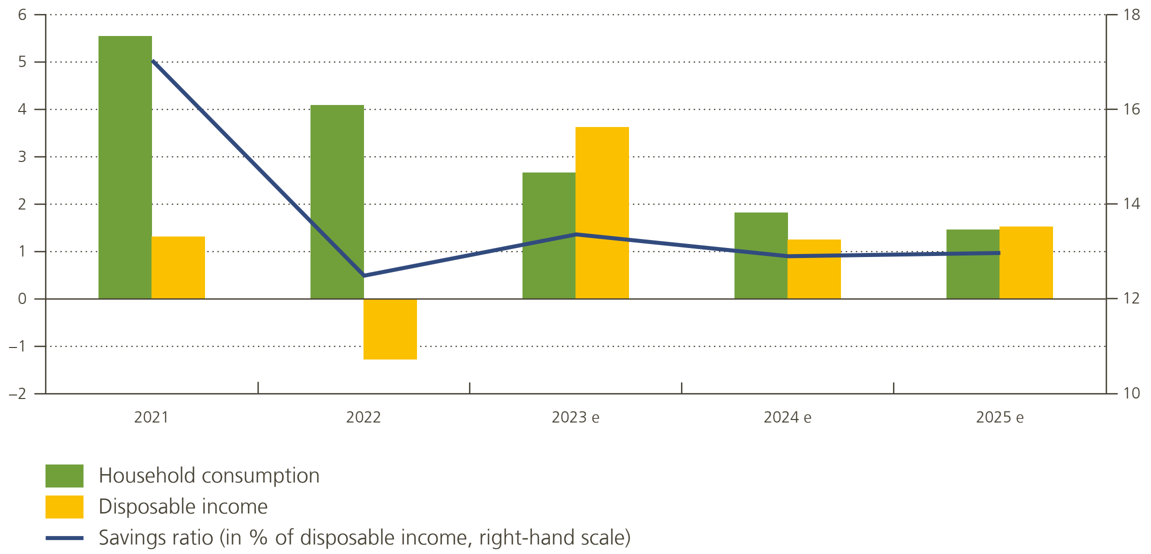
Rising mortgage rates and high building costs have been dragging down residential investment since the second quarter of 2022. We expect residential investment to shrink for a few more quarters, before returning to positive territory in the course of 2024. Even then, however, growth is expected to average no more than 0.2 % per quarter, which is clearly more subdued than what was observed in the post-pandemic rebound or in the decade before the pandemic, characterised by lower interest rates.

1 Please see Box 2 in the NBB's 2022 annual report.

Chart 3

Household consumption, purchasing power and saving ratio

(volume data[1], percentage change compared to the previous year, unless stated otherwise)



Sources: NAI and NBB.
1 Data deflated by the household consumption expenditure indicator.

In this connection, it should also be noted that the European Green Deal sets the transition to an energy-efficient building stock as an objective for the Member States. In Belgium, all three Regions have committed to aim for an energy-efficient housing stock with an average EPC rating of A by 2050. This will require a huge renovation wave over the next decades, which should benefit residential investment. However, we expect this effect to mainly affect the years beyond the forecasting horizon. To this end, numerous barriers will need to be tackled, such as capacity constraints and lack of workers in the construction industry, as well as clearer incentives or lack of financial means for households to renovate.

With firms facing a high-cost environment, growth in business investment is projected to remain moderate, albeit positive, in 2023. At the same time, the high lending rate is generally not considered to be a strong impediment to investment, as financing conditions remain favourable from a historical perspective and firms have ample liquidity and, hence, business investment may be less dependent on external financing. In addition, firm investment should still return to its pre-pandemic trend and certain types of investment are actually increasing strongly. Business intelligence suggests that companies heavily invest in the "greening" of their production processes in order to reduce exposure to energy price volatility and comply with environmental regulations. Second, many companies are speeding up digitalisation and automation efforts in response to increased wage costs and, especially, labour shortages. All in all, business investment should remain clearly more resilient than housing investment and gradually gain traction over the projection horizon.

Turning to public expenditure, public consumption is projected to grow rather moderately over the projection horizon, at about 1 % on average per year. Public investment growth is more volatile throughout the projection period as it follows the usual local election cycle (with a particularly strong boost in 2023 and 2024, also due to specific investment programmes).

Belgian export growth is largely determined by foreign demand, as discussed in Section 1. However, due to worsened cost competitiveness (related to relatively high wage cost growth, as discussed in Section 6), Belgian firms are expected to lose export market share in the coming years. As Belgian labour cost growth moderates, the market share loss will return to its long-term average by 2025 and export growth should pick up somewhat. Import growth is expected to slightly outpace export growth over the projection period as a result of strong domestic demand. All in all, the contribution of net exports to GDP growth is slightly negative in all years of the projection period.

Table 4

GDP and main expenditure categories

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

	2021	2022	2023 e	2024 e	2025 e
Household and NPI final consumption expenditure	5.5	4.1	2.7	1.8	1.5
General government final consumption expenditure	5.0	3.2	1.1	0.6	1.1
Gross fixed capital formation	5.1	−0.8	2.5	2.7	2.1
General government	7.6	−1.3	12.3	7.7	−4.2
Housing	7.9	1.3	−3.2	−0.8	0.6
Businesses	3.9	−1.4	2.8	2.9	3.7
p.m. Domestic expenditure excluding the change in inventories [1]	*5.2*	*2.6*	*2.2*	*1.8*	*1.6*
Change in inventories [1]	0.4	0.5	−0.3	0.0	0.0
Net exports of goods and services [1]	0.7	0.2	−0.5	−0.4	−0.3
Exports of goods and services	11.3	5.1	−0.1	2.0	2.3
Imports of goods and services	10.7	4.9	0.4	2.5	2.6
Gross domestic product	6.3	3.2	1.4	1.3	1.2

Sources: NAI and NBB.
1 Percentage point contribution to the change in GDP compared to the previous year.

5. After a brief slowdown, job creation has picked up and should remain solid

Following the strong post-pandemic recovery, employment growth slowed in the second half of 2022 and almost flatlined in the last quarter. At the same time, unemployment rose and temporary work decreased somewhat. The labour market is still very tight: the vacancy rate also fell slightly in the last quarter of 2022 but remains historically high and the lack of available workers continues to weigh on economic activity, as indicated by various surveys.

However, as broadly expected, job creation picked up again in the first quarter of 2023. Employment prospects have also improved, as suggested by the latest business surveys. The more favourable recent growth out-turn and near-term outlook should support demand for labour. The use of short-term work schemes is close to its pre-pandemic level and average working hours have also recovered. Increased demand for labour is therefore likely to translate mostly into new hirings, rather than further increases in average working time.

The Belgian economy is currently expected to add 54 000 jobs this year and around 40 000 in the following years. This is much less than the 2022 record of 101 000 new jobs, which was largely due to the post-pandemic recovery, but similar to annual job growth in the period 2010-2019. As a result, the employment rate will rise by

1.5 percentage points, to 73.4 %, by 2025, which is still quite short of the 80 % target. Unemployment, which was increasing partly due to the inflow of Ukrainian refugees, is expected to start falling again in 2024, and the unemployment rate should reach 5.5 % at the end of the projection horizon, compared to 5.8 % in 2023.

The inflow of Ukrainian refugees had a positive effect on the working age population and labour force in 2022 which, due to statistical carry-over effects, has continued in 2023. However, according to current demographic projections, the working age population should essentially stop growing as of 2024, due to population ageing. For the time being, the labour force is still growing mostly due to several structural trends – increasing levels of education and increased participation of women and older workers in the labour force – that have a positive effect on the participation rate.

Table 5

Labour supply and demand

(seasonally adjusted data ; change in thousands of persons, unless otherwise stated)

	2021	2022	2023 e	2024 e	2025 e
Working age population [1]	18	44	27	4	0
Labour force	61	91	71	35	30
Domestic employment	91	101	54	42	35
Employees	66	87	45	32	25
Sectors sensitive to the business cycle [2]	44	62	22	19	14
Administration and education	13	11	7	4	2
Other services [3]	10	14	17	9	9
Self-employed	25	15	9	10	10
Unemployed job-seekers	–30	–11	16	–6	–5
p.m. Harmonised unemployment rate [4, 5]	*6.3*	*5.6*	*5.8*	*5.6*	*5.5*
Harmonised employment rate [4, 6]	*70.6*	*71.9*	*72.4*	*73.0*	*73.4*

Sources : FPB, NAI, NEO, Statbel and NBB.
1 Population aged 15-64 years.
2 Agriculture, industry, energy and water, construction, trade, hotels and restaurants, transport and communication, financial activities, property services and business services.
3 Health, welfare, community, public social services, personal services and domestic services.
4 Based on data from the labour force survey.
5 Job-seekers as a % of the labour force aged 15-64 years.
6 Persons in work as a % of the total working age population (20-64 years).

6. Inflation pushes up labour cost growth to unprecedented levels but is projected to moderate

6.1 Surging wage costs still weigh on competitiveness

Nominal wage costs are skyrocketing in 2023 : hourly wage costs in the private sector are currently expected to grow by more than 8 %, after the already very high increase of 5.5 % posted in 2022. Nominal wage growth should slow significantly to a rate of just over 3 % in both 2024 and 2025. These growth rates can be almost entirely traced back to automatic indexation, as collectively negotiated wages remain constant and wage drift is limited.

Due to this institutional feature, nominal wages in Belgium increased at a much faster pace than in neighbouring countries in 2022. This continues to be the case in 2023, with the increase being even more pronounced this year given the usual lags in the application of indexation mechanisms. Close to one-third of private-sector employees had their wages indexed only in January 2023, for example. Thus, the wage gap between Belgium and its main trading partners (Germany, France and the Netherlands) is increasing sharply again. In this context, according to the Competitiveness Act, there is no room for real collectively negotiated wage growth in 2023-2024. The current projections are based on the assumption that this will also be the case for 2025, in view of the remaining wage gap. In other words, growth in negotiated wages should be zero throughout the projection period.

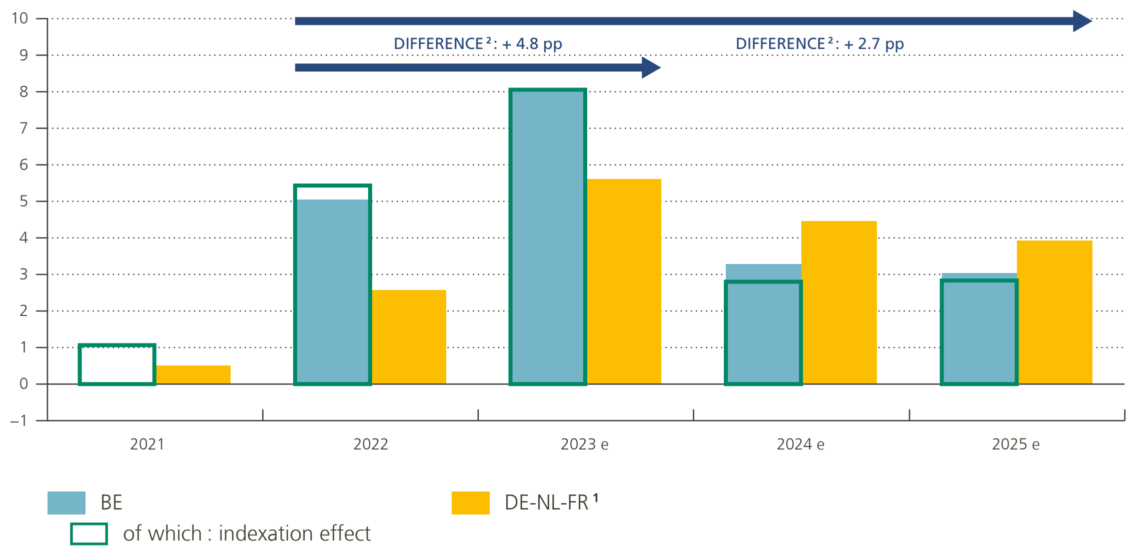
Wage drift, which relates to bonuses and other pay components not included in real collectively negotiated wages as well as changes in composition effects affecting all employees, is expected to be firmly positive in 2023. This partly reflects the expected effect of the purchasing power bonus, i.e. the possibility for companies with high or very high profits to grant a tax-free bonus of up to € 500 or € 750 per worker, respectively, in 2023. The bonus should be paid before the end of the year. However, current business intelligence suggests that this payment could replace in part other bonuses, meaning the uptick in wage drift should remain limited, with the latter returning to its normal long-term average by 2025.

With a view to mitigating the worsening cost competitiveness of Belgian firms, the federal government has taken specific measures to significantly reduce social security contributions for the first two quarters of 2023. However, as the measures only apply to these two quarters, contributions will increase again in the second half of the year. In the annual figures, these measures yield a decrease in 2023 and, due to carry-over effects, an increase in 2024.

Chart 4

Hourly wage growth in the private sector: Belgium versus main trading partners

(percentage change compared to the previous year)



Sources: Eurosystem, NAI and NBB.
1 Weighted average wage cost growth in neighbouring countries, based on current Eurosystem projections.
2 The difference in wage cost growth between Belgium and neighbouring countries shown here is not necessarily identical to the official assessment by the Central Economic Council.

All in all, the Eurosystem projections continue to point to a strong increase of the gap between the hourly wage cost in Belgium and those of its main trading partners (DE, FR, NL) of 4.8 % in the 2022-23 period. In neighbouring countries, wage increases are expected to kick in more forcefully as from 2024, at a time when Belgian wage growth should fall markedly. Hence, the gap is expected to gradually narrow by the end of the projection horizon, amounting to 2.7 % over the period 2022-2025.

Hourly labour productivity declined significantly in the two previous years. This should be seen against the backdrop of very buoyant post-pandemic job creation which brought back relatively more low-productivity jobs. According to the current projections, productivity will recover gradually, staying almost unchanged in 2023, with

Table 6

Cost and price indicators

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

	2021	2022	2023 e	2024 e	2025 e
Private sector labour costs [1]:					
Labour costs per hour worked	−0.2	5.5	8.2	3.3	3.1
of which:					
Real conventional wages	0.4	0.4	0.0	0.0	0.0
Wage drift and other factors	−1.0	−0.4	0.3	0.1	0.2
Indexation	1.1	5.4	8.1	2.8	2.8
Social security contributions	−0.5	−0.3	−0.4	0.4	0.0
Wage subsidies	−0.1	0.4	0.2	0.1	0.1
p.m. Labour costs per hour worked according to the national accounts [2]	*0.0*	*5.1*	*8.0*	*3.3*	*3.0*
Labour productivity [3]	−2.3	−0.9	−0.2	0.4	0.6
Unit labour costs [3]	2.1	6.5	8.4	3.0	2.4
Total inflation (HICP)	3.2	10.3	1.9	4.3	1.8
Core inflation [4]	1.3	4.0	6.2	2.7	1.9
of which:					
Services	1.6	3.8	6.4	3.2	2.3
Non-energy industrial goods (NEIG)	0.8	4.2	5.7	1.9	1.1
Energy	22.4	57.9	−30.8	16.1	−0.9
Food	0.9	8.3	12.0	3.8	3.0
p.m. Inflation according to the national index	*2.4*	*9.6*	*3.8*	*3.6*	*1.7*
Health index [5]	2.0	9.3	4.3	3.8	1.7

Sources: EC, FPS Employment, Labour and Social Dialogue, Statbel, NAI and NBB.

1 Labour costs are defined here not according to the national accounts concept but rather according to a broader concept which includes reductions in social security contributions for target groups and wage subsidies. This concept provides a better picture of the true labour cost for firms.

2 Excluding wage subsidies and reductions in social security contributions for target groups.

3 Value added in volume per hour worked by employees and the self-employed.

4 As measured by the HICP, excluding food and energy.

5 As measured by the national consumer price index, excluding tobacco, alcoholic beverages and motor fuels.

growth approaching its historical average by 2025. All in all, unit labour costs are projected to worsen by 14 % over the projection period.

6.2 Inflation continues to fall: does this signal a return to normal?

Year-on-year HICP headline inflation peaked in October 2022 and started falling, more or less as projected, from November 2022 onwards. In May 2023, HICP inflation came in at 2.7 % or one-fifth of its peak level of 13 %. On a monthly basis, average prices have actually already decreased, even though this is mostly driven by plummeting gas and electricity prices. The rapid decline in inflation is projected to continue and, in the fall, even the year-on-year numbers should turn negative. This means that prices will on average be lower than one year earlier.

Core inflation (i.e. excluding food and energy) continues to rise, however, although the average monthly increases are clearly on a downward trend. According to current projections, year-on-year core inflation should peak in the summer and gradually decline thereafter. This is consistent with the information gleaned from surveys and business intelligence and reflects declining input cost pressures (with costs now often falling rather than increasing), as well as past appreciation of the euro, Nevertheless, core inflation should remain above its long-term average of about 1.5 % until the end of the projection horizon.

Both sub-components of core inflation, i.e. services and non-energy industrial goods, have been affected by rapidly rising inflation rates since mid-2021. In the case of goods, soaring energy prices and other input costs, as well as accelerating wage costs, fueled price increases. Now, however, supply chain problems and commodity prices have strongly declined and should support a downward trend in goods inflation going forward. Services as well have seen substantial price increases since the start of 2022. Wage increases in particular (notably due to automatic wage indexation in Belgium), but also increases in other (energy and non-energy) commodity prices, have gradually fed through to services inflation. Moreover, the prices of certain services are typically directly linked to – or at least determined by – past inflation (rent, railway and bus tickets, some types of insurance, etc.), which leads to a greater persistence of services inflation. Nonetheless, the inflation rate for services should also start declining in the summer of 2023.

Turning to energy inflation, the projections take into account the impact of numerous government measures to curb the increase in household energy bills, such as a reduction in the VAT rate on electricity and gas to 6 %[1], lower excise duties on motor fuels, the extension of the social tariff for natural gas and electricity, and various one-off subsidies. The measure which has had the greatest impact on energy inflation is the so-called "basic energy package", which reduced household monthly energy bills by about € 200 (€ 61/month for electricity and € 135/month for gas) from November 2022 to March 2023. In line with the statistical rules, this was taken into account in the inflation measure as a temporary reduction in the price of household gas and electricity consumption spread over 12 months. This also implies that, as from the end of 2023, discontinuation of the measure will push up officially measured energy prices progressively until March 2024. All in all, energy inflation is projected to turn positive again next year due to the technical impact of the unwinding of energy support measures and the fact that, according to the futures contracts used as a reference point, market prices will no longer be declining.

Finally, food inflation appears to have peaked in the first quarter of 2023 and is already decelerating. The prices of food commodities on international markets have started to decline and various input price pressures are now easing as well. Nonetheless, food prices could remain somewhat volatile in the coming years due to adverse

1 The reduction in the VAT rate to 6 % on gas and electricity is permanent. To compensate for this loss of government revenue, a new excise duty on gas and electricity was put in place as from April 2023 and should be increased in July 2023. This system will allow the government to act more quickly when energy prices rise.

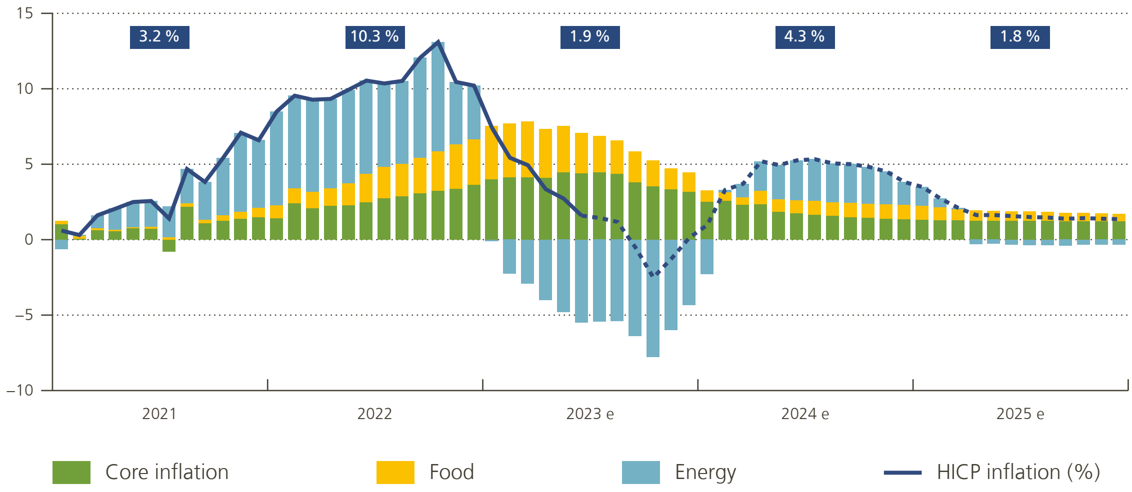
weather conditions. However, this constitutes a difficult-to-predict risk factor which is not taken into account in the baseline projection.

All in all, average yearly inflation should drop substantially to below 2 % this year, from more than 10 % in 2022. The projected uptick in 2024 is a one-off technical effect which primarily relates to the unwinding of government measures. In the last year of the projection horizon, the annual inflation rate should be back below 2 %.

Chart 5

Inflation and contributions

(contribution in percentage points, unless stated otherwise)



Sources: Eurostat and NBB calculations.
Note: dotted lines correspond to the forecast period.

The national consumer price index (NICP) shows a slightly different evolution than the HICP (3.8 % versus 1.9 %, respectively, in 2023). This can be explained, for the most part, by methodological differences which strongly (and mainly) affect energy inflation, especially in 2023 and 2024. First, the weighting system is different, with the HICP based primarily on the national accounts whereas the NICP is derived mainly from the Household Budget Survey. For example, components that have fallen or are expected to fall, such as liquid fuels, gas and electricity, are weighted more in the HICP than in the NICP. This results in a larger drop in energy inflation in the HICP in 2023. Similarly, the upward impact of the discontinuation of government measures, mostly the "basic energy package", from the end of 2023 has a larger impact on the HICP than the NICP. Second, for heating oil, the HICP considers the current month's prices, whereas a weighted average of rates for the past twelve months is used by the NICP, based on annual bills effectively paid by consumers. Heating oil is therefore a more volatile component in the HICP, which more closely reflects fluctuations in the price of Brent crude oil.

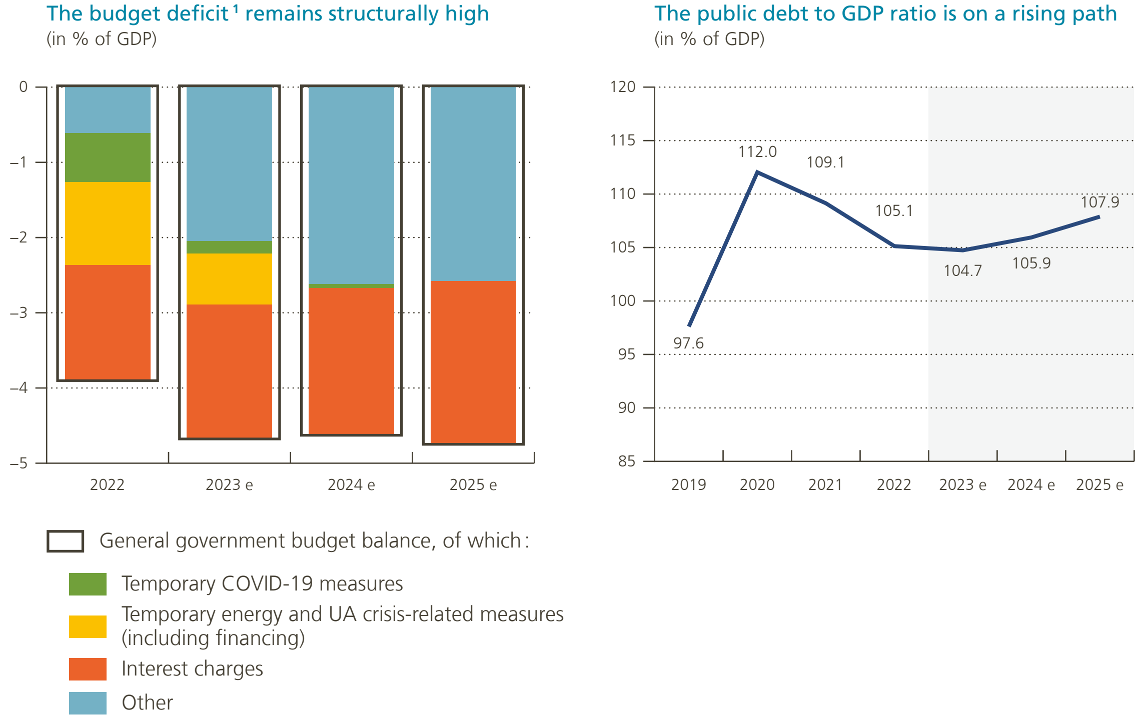
The NICP is used to calculate the health index, which excludes tobacco, alcoholic beverages and motor fuels and serves as a reference for the indexation of wages and replacement income. The pivotal index for the indexation of public wages and social benefits has been exceeded six times since August 2021, namely in December 2021, February 2022, April 2022, July 2022, October 2022 and November 2022. It is currently projected to be exceeded again in November 2023, March 2024 and December 2024.

7. The general government deficit is expected to worsen substantially and the debt ratio to rise

After narrowing to 3.9 % of GDP in 2022, the general government budget deficit is expected to widen to 4.7 % of GDP in 2023. The deficit is then projected to fall slightly to 4.6 % of GDP in 2024 and to reach 4.7 % of GDP again in 2025.

Chart 6

Budget deficit and public debt ratio



Sources : NAI and NBB.

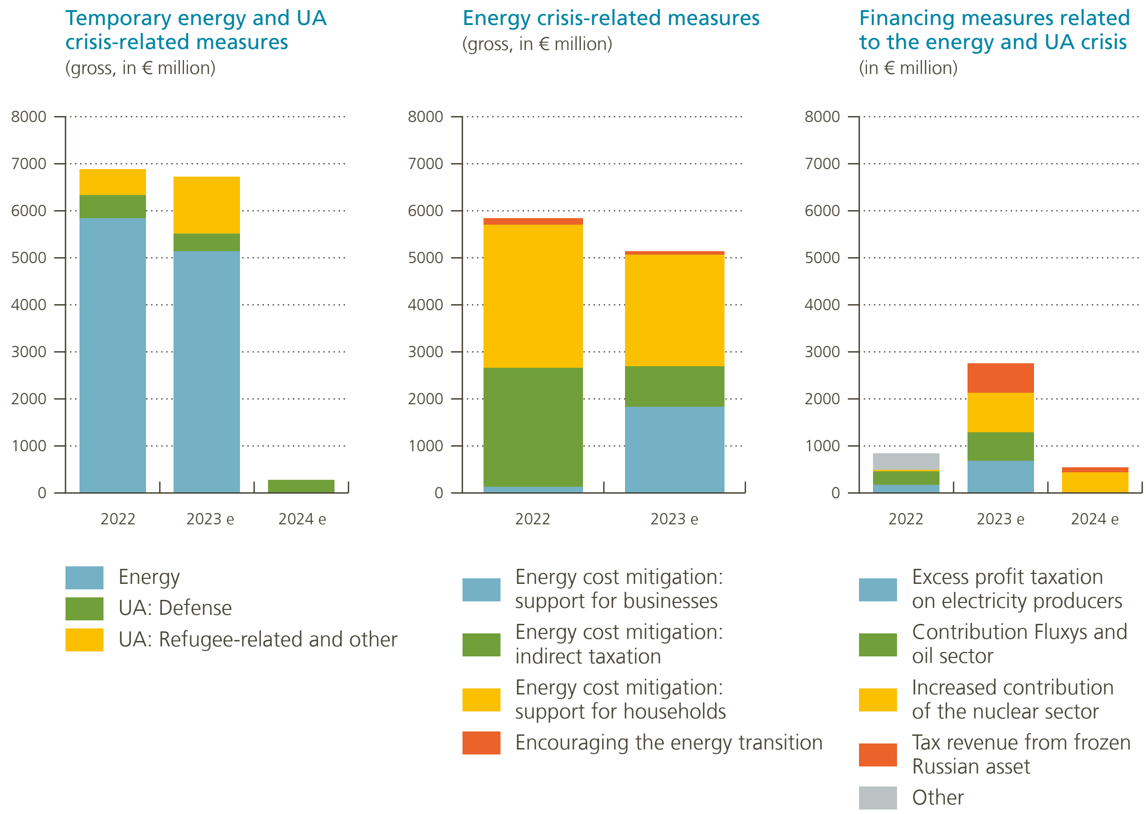
1 These figures do not take into account the implicit deficit of, on average, 0.4 % of GDP annually over the period 2021-2026 due to debt-financed grants to EU Member States from the NGEU programme.

The budget balance in 2023 will nonetheless benefit from the unwinding of temporary pandemic-related measures, amounting to 0.5 % of GDP. In addition, the net cost of temporary measures related to the energy crisis and the war in Ukraine will also be about 0.4 % of GDP lower than in 2022. While the total volume of measures to support household purchasing power (such as the basic energy package), business profitability (for example the temporary exemption from social security contributions) and Ukraine (including support for refugees) remains at the same level as in 2022, the yield from the sources used to finance them has increased sharply. The latter consist mainly of an excess profits tax on electricity producers, an increase in the contribution of the nuclear sector and additional corporate tax revenue from the return on frozen Russian assets in Belgium.

The deterioration of the balance is nevertheless due to several factors. First, the elimination of temporary costs has been partially offset by measures that increase current primary expenditure, such as a further increase in minimum social benefits at the federal level, additional resources for social policies in Flanders, and additional subsidies and transfers in the context of resilience plans by the Communities and Regions. In addition, current

Chart 7

Energy and Ukraine crisis-related measures



Source: Communities and Regions, FPS Policy & Support, FPS Finance and NBB.

expenditure is rising steadily as a result of population ageing. Second, public investment is rising, driven by federal investment in defence, regional infrastructure projects and local government investment, which is expected to increase in the run-up to the local elections in 2024. Third, direct tax revenue is experiencing the downside of a number of factors which temporarily boosted it in 2022. More precisely, the substantial indexation of tax brackets in 2023, based on 2022 inflation, will depress personal income tax revenue. Last year, the low indexation of tax brackets, compared to that of wages, temporarily provided the government with additional revenue. Moreover, personal income tax receipts were temporarily higher in 2022 due to an administrative deferral of 2021 positive tax assessments. Finally, corporate tax revenue should decline relative to GDP as growth in corporate profits is expected to come to a halt in 2023. A final important factor is the increase in interest expenses on public debt, by over 0.2 % of GDP.

In 2024, the budget deficit should narrow slightly, to 4.6 % of GDP. The temporary energy and Ukraine-related measures, which continue to push up the deficit by 0.7 % of GDP in 2023, will be eliminated. The improvement in the balance is nevertheless expected to remain limited for several reasons. First, aging costs continue to rise steadily and local government investment is expected to peak in the election year. Interest costs will also continue to rise steadily, by 0.2 % of GDP. Finally, a timing mismatch between the indexation of private sector wages and government spending is a key explanation for the change in the balance between 2023 and 2024. While private sector indexation will outpace automatically indexed government spending in 2023, the reverse is expected in 2024. As a result, automatic indexation has a relatively more favourable effect on revenue than on expenditure in 2023, while the reverse will be true in 2024.

In 2025, the deficit should increase slightly, to 4.7 % of GDP. Indeed, interest costs are projected to continue to increase, by 0.2 % of GDP. The increase in aging costs will be tempered that year by the raising of the statutory retirement age from 65 to 66, while investment is expected to fall somewhat after the elections. The 2025 deficit can be considered structural given the absence of temporary measures and economic activity at its potential level.

The general government debt ratio is expected to fall slightly in 2023, to 104.7 % of GDP. In subsequent years, however, high budget deficits will put public debt on a structural upward path, to just below 108 % of GDP in 2025. The temporary decline in 2023 is due to a favourable denominator effect, with nominal GDP growth at 6 %. The normalisation of nominal growth and the steady increase in the implicit interest rate on outstanding public debt should make the interest rate growth dynamics (or snowball effect) less favourable thereafter and insufficient to offset the debt-increasing dynamics of primary budget deficits.

Table 7

General government accounts

(in % of GDP)

	2020	2021	2022	2023 e	2024 e	2025 e
General government						
Revenue	49.9	49.9	49.7	50.1	50.3	50.4
of which : taxes and social contributions	42.9	43.1	42.8	43.3	43.4	43.5
Primary expenditure	57.0	53.7	52.0	53.0	52.9	53.0
Current expenditure	53.4	49.9	48.5	49.3	49.1	49.3
Capital expenditure	3.6	3.8	3.5	3.7	3.8	3.7
Primary balance	−7.0	−3.8	−2.4	−2.9	−2.7	−2.6
Interest charges	1.9	1.7	1.5	1.8	1.9	2.2
Financing requirement (–) or capacity [1]	−9.0	−5.5	−3.9	−4.7	−4.6	−4.7

Sources : NAI and NBB.

1 These figures do not take into account of the implicit deficit of, on average, 0.4 % of GDP annually over the period 2021-2026 due to debt financed grants to EU Member States from the NGEU programme.

8. The baseline projections are still subject to considerable uncertainty

The uncertainty surrounding the baseline economic projections described in this article is still greater than usual, in particular as regards the nominal side (costs and inflation).

Headline inflation has already come down significantly from its peak in October of last year. This indicates how volatile components, such as energy prices, can quickly change the headline numbers. In order for core inflation to moderate, firms will have to (partly) absorb the cost shock into their profit margins, as has been observed in past episodes of increasing wage costs. In this connection, it should be stressed that, according to current statistics, profit margins already started to decline in 2022. Compliance with the provisions of the 1996 Competitiveness and Employment Act as regards restrictions on collectively negotiated wage increases in the future will also be required. Inflation may turn out to be higher or more persistent if external price pressures shoot up again, profit margins do not decline further as currently anticipated or collectively negotiated wages rise faster.

As for the real side, the recent GDP statistics surprised on the upside and were much more favourable than certain observers expected. With confidence indicators on the mend, it seems unlikely that growth will weaken substantially in the near term, even though some professional forecasters remain more pessimistic. As for the medium- to longer-term outlook, we project actual growth to be more in line with potential growth but upward surprises to productivity growth or labour input could push activity growth higher than expected.

Finally, rising interest rates have highlighted the cost of high (public) debt. In the longer term, the unsustainable budget position and spending trends will have to be addressed, which may require consolidation measures in the outer year(s) of the projection period. Depending on the specific measures taken, the growth and budget outlook could be quite different for those years.

Annex

Projections for the Belgian economy: summary of the main results

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

	2021	2022	2023 e	2024 e	2025 e
Growth (calendar adjusted data)	6.3	3.2	1.4	1.3	1.2
Real GDP					
Contributions to growth:					
Domestic expenditure, excluding change in inventories	5.2	2.6	2.2	1.8	1.6
Net exports of goods and services	0.7	0.2	−0.5	−0.4	−0.3
Change in inventories	0.4	0.5	−0.3	0.0	0.0
Prices and costs					
Harmonised index of consumer prices	3.2	10.3	1.9	4.3	1.8
Health index	2.0	9.3	4.3	3.8	1.7
GDP deflator	2.8	5.9	4.5	2.5	1.8
Terms of trade	−1.5	−3.8	2.9	−0.3	0.1
Unit labour costs in the private sector [1]	2.1	6.5	8.4	3.0	2.4
Hourly labour costs in the private sector [1]	−0.2	5.5	8.2	3.3	3.1
Hourly productivity in the private sector	−2.3	−0.9	−0.2	0.4	0.6
Labour market					
Domestic employment (annual average change in thousands of persons)	90.8	101.3	54.1	41.6	35.1
Total volume of labour [2]	7.5	4.2	1.4	0.8	0.6
Harmonised unemployment rate (in % of the labour force aged 15 years and over)	6.3	5.6	5.8	5.6	5.5
Household incomes					
Real disposable household income	1.3	−1.3	3.6	1.2	1.5
Saving ratio (in % of disposable income)	17.0	12.5	13.4	12.9	13.0
Public finances (in % of GDP)					
Primary balance	−3.8	−2.4	−2.9	−2.7	−2.6
Budget balance	−5.5	−3.9	−4.7	−4.6	−4.7
Public debt	109.1	105.1	104.7	105.9	107.9
Current account (according to the balance of payments, in % of GDP)	0.4	−3.6	−0.5	−1.0	−1.2

Sources: EC, NAI, Statbel and NBB.
1 Including wage subsidies (mainly reductions in payroll tax) and targeted reductions in social security contributions.
2 Total number of hours worked in the economy.

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