Belgium: Multiple challenges ahead

Like most economies, Belgium is experiencing an unprecedented health and economic shock. Despite the accurate assessment of the losses incurred during the lockdown period, the recovery trajectory is still very uncertain. Yet it is in this economic context that a new government will have to be found

Belgian Prime Minister Sophie Wilmes for the reopening of the Atomium touristic attraction in Brussels

Source: Shutterstock

The illusion of a recovery

In the first quarter, Belgium's central bank forecasted that the country's GDP contracted by 3.6% compared to the previous quarter.

Given the activity losses during the lockdown, obviously the second quarter of the year will be marked by a much sharper contraction of activity. Moreover, the central bank's weekly surveys show that, despite the widespread easing of lockdowns, activity in the private sector is still more than 20% below normal. As a consequence, we expect a contraction of more than 10% in activity compared to the first quarter. If we consider the level of activity in the last quarter of 2019 at level 100, the second quarter would then be marked by a level of activity of only 83.

At the end of 2020, we think economic activity would still only be at 96% of what it was at the end of 2019

Assuming we don't see a second wave of the pandemic, we should see a recovery in the second half of the year, but it is likely to be just as unprecedented like the initial shock.

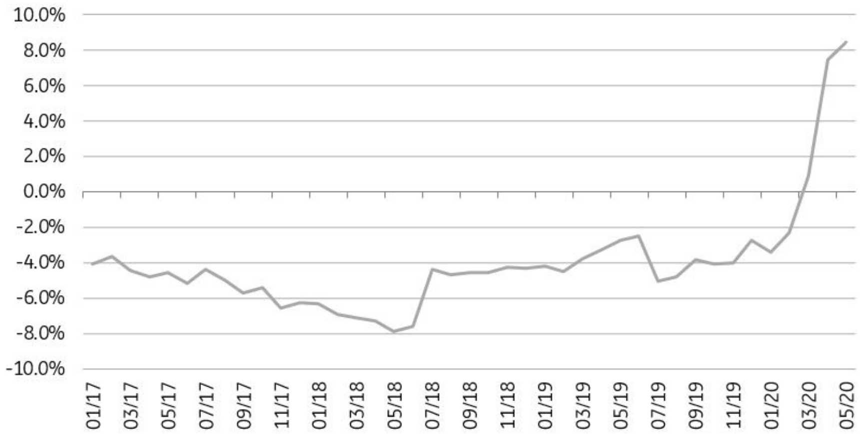
First of all, the drop in activity was very sharp, most of the variables that normally move in parallel with the activity did not have time to adapt. This applies to the number of bankruptcies or the labour market for example. However, the loss of activity will have consequences: while a very short lockdown would have gone unnoticed in most other economic variables, it is highly likely that this prolonged containment will strongly influence them in the coming months. In the labour market, we are already seeing a sharp increase in unemployment (+9% YoY in May), but this is probably the beginning of a long adjustment process. Indeed, we expect nearly 120,000 net job losses this year, which would raise the unemployment rate from 5.4% in 2019 to 7.5%. Belgium will, therefore, is in a paradoxical situation, where activity will increase, but at the same time, other variables will reveal the true face of the economy.

In addition, we shouldn't forget that prolonged lockdown has profoundly modified the behaviour of economic agents. One-third of households have reported a loss of income.

As a consequence, durable goods consumption can, therefore, be expected to be postponed. The same is likely to be true for households that have not suffered any loss of income: fears of a return of the pandemic may change their consumption behaviour. At the corporate level, two-thirds of companies say they have postponed their investment projects, which will also influence activity. Finally, supply constraints due to supply chain disruptions are not going to be quickly resolved.

For all these reasons, we fear that while the recovery will be strong in the second half of the year, it will not allow a return to pre-crisis levels of activity. At the end of 2020, we think economic activity would still only be at 96% of what it was at the end of 2019.

Number of jobseekers is already increasing (year-on-year growth, %)

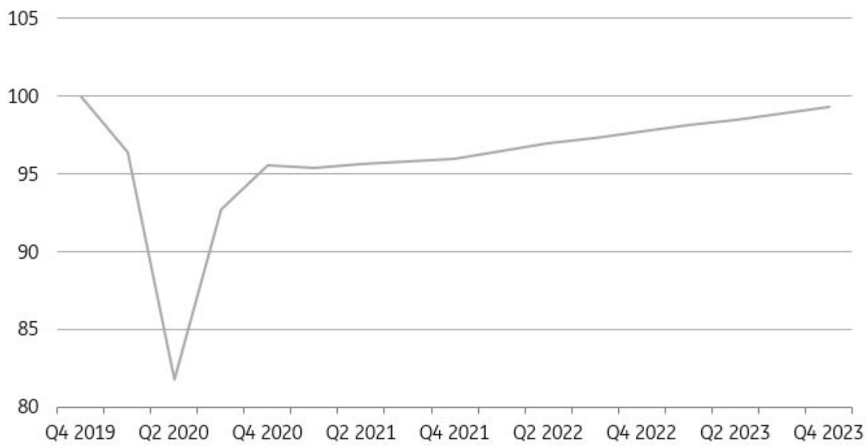


Source: Refinitiv Datastream

Going back to normal takes time

Thereafter (in 2021), the economic recovery will continue, but the process is likely to remain slow. Of course, the recovery plans in Europe and neighbouring countries will help the economy to recover. A possible Belgian recovery plan could also help. This being said, (i) the damage caused by the coronavirus crisis to the economy, (ii) the limited room for maneuver in terms of public finances and (iii) too slow a recovery of international trade in a context of growing protectionism will slow down activity on a lasting basis. The recovery will therefore be fundamentally slow, and it is only in the course of 2023 that the Belgian economy will return to its pre-crisis level of activity.

The shape of the recovery (Real GDP, Q4 2019 = 100)



Source: ING

A challenge for public finances

Of course, this crisis is leaving its mark on public finances, which are suffering a double blow. On the one hand, expenditure is exploding as a result of the management of the crisis and its social consequences. On the other hand, as activity is reduced, tax revenues also fall. In the case of Belgium, this is expected to result in a deficit of more than €42 billion in 2020, or 9.5% of GDP. Next year, this deficit should be reduced thanks to the economic recovery, but we are still expecting a deficit of well over 4% of GDP in 2021. It therefore goes without saying that public finances will be at the heart of the economic and political debate in the coming years. Nevertheless, Belgium's sovereign rating remains strong.

Political crisis ensues

After the fall of the government in December 2018, a caretaker government took over until the elections in May. However, these elections have so far failed to produce a new parliamentary majority and the entire year of 2019 was spent under a caretaker government. This government is composed of only three parties (the French-speaking and Dutch-speaking Liberals and the Dutch-speaking Christian Democrats) which together have only 38 seats in parliament out of 150.

As the caretaker government's powers in terms of taxation and spending are limited, efforts to consolidate public finances were not pursued. This handicapped the budget deficit and debt dynamics, but paradoxically, it also helped to stimulate the economy in 2019.

At the beginning of 2020, given the coronavirus health crisis, Belgian political parties showed pragmatism in the face of this emergency and a large proportion of the political parties agreed to give parliamentary support to the caretaker government and granted special powers to manage the crisis, which will be in place until the end of June and can be extended until September if the situation requires.

That said, it is clear that this situation cannot last. New discussions are currently starting to form a new government with a majority in parliament. If these discussions fail, elections would have to be held, with the likelihood to see extreme right (in Flanders) and extreme left (in Wallonia and Brussels) parties gaining seats, making the formation of a stable majority government even more difficult.

The Belgian economy in a nutshell

	2018	2019	2020F	2021F
GDP	1.5	1.4	-7.8	4.5
Private consumption	1.5	1.1	-9.8	4.3
Investment	4	3.2	-12.5	3.5
Government consumption	0.9	1.6	-1.1	0.8
Net trade contribution	-0.7	-0.1	0.4	0.8
Headline CPI (HICP)	2.1	1.4	0.5	1.6
House prices (%YoY)	3.6	4.4	-2	0
Unemployment rate	6	5.4	7	7.8
Budget balance as % of GDP	-0.8	-1.9	-9.5	-4.5
Government debt as % of GDP	99.8	98.6	115	113.2

Source: Refinitiv Datastream, National Bank of Belgium. All forecasts ING estimates

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