

Belgium: political imbroglio in a slowing growth environment

It is now two months since national elections in Belgium and a new federal government is still not in place. Meanwhile, the economy is slowing while the budget is deteriorating



Since elections on 26 May, not a lot of progress has been made in terms of forming a new federal government. Admittedly, Belgium's institutional set up doesn't make things easy, especially since the election outcome differed significantly between the North and the South of the country. Only in the smaller Brussels region, where a majority is needed in the two language groups, has a coalition been formed between the socialist party (both Dutch and French speaking), the Green party (both Dutch and French speaking), the Dutch speaking liberal party Open VLD and the French speaking Défi. But there has been little progress in coalition talks in Flanders and Wallonia and the same is true at the federal level. The problem is that most parties see both the federal and the regional governments as part of a bigger jigsaw puzzle, making it difficult to make any progress on a regional basis, if there isn't any progress at the federal level.

Difficult coalition talks

In Wallonia, there are now talks between the socialists (PS), the liberals (MR) and the Green party (Ecolo). Initially PS and Ecolo wanted to form a left wing regional government and already agreed

on a programme. Small problem though: they don't hold a majority. Eventually they were forced to invite MR to the talks to reach a majority. It's worth noting that PS and MR together would already have a majority of seats in the Walloon parliament and theoretically, Ecolo is not needed to form a regional government.

In Flanders the biggest party, the Flemish nationalist NV-A, lost quite some seats to the far right Vlaams Belang and felt obliged to hold post-election talks with the party, though the two together don't conduct a majority and no other party is willing to enter a coalition with the far right. Talks with the other more likely coalition partners have yet to start in earnest.

At the federal level, the King appointed two "informers" whose task is to test the waters amongst the main political parties. Their mandate has been prolonged until 9 September. Only this week they managed to organise an initial meeting between the different traditional parties, although Ecolo refused to attend.

Slowing growth

Meanwhile, the economy is slowing. Second quarter GDP came in at 0.2% quarter-on-quarter (0.3% in 1Q) and 1.2% year-on-year. While still decent, growth is probably not strong enough to reach the budget targets and the first indicators for the third quarter point to a further slowdown. In the stability programme, the Belgian government pencilled in 1.3% GDP growth this year and a deficit of 0.8% of GDP. The structural deficit was meant to fall from 0.9% of GDP in 2018 to 0.8% this year and 0.2% in 2020. The slower growth (we see average GDP growth at 1% in 2019) is now likely to trigger higher deficits. But in a recent report, the Monitoring Committee- a committee of public sector managers tasked with the follow-up of public finances- also rang the alarm bell on the structural deficit: it could come in at 1.65% this year. To be sure, with the debt-to-GDP ratio further declining, the situation is still manageable. But a number of structural measures that should assure debt sustainability in the longer term, like pension reform, still have to be finalised. Therefore a long period with only a caretaker government, like in 2010-2011, is not what the country needs right now.

Structural reform

We don't see a rapid breakthrough. At the end of the day, political parties will probably have to abandon the idea that symmetrical governments can still be formed at the federal and regional level. We believe that regional governments will be set up first and that the federal government will probably be just a reflection of the majorities at the regional level, even though they are likely to be different in Flanders and Wallonia. The negative backdrop in that scenario is that the federal government is likely to contain a broad spectrum of parties and ideologies, which would probably make structural reform harder to push through. All of this is not yet particularly worrying for financial markets and the 10-year Belgian yield is even in negative territory. But should the political imbroglio extend beyond 2019 in the wake of a slowing economy, some spread widening would seem logical.

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