Belgium Q4: Puzzling confidence

The Belgian economy continues to recover, but a negative trend in business confidence could put an end to further acceleration

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Economy: The first half of 2017

The first half of 2017 has been satisfactory for the Belgian economy and the government led by Charles Michel, pictured. GDP has grown by 1.0% since the end of 2016, mainly thanks to growing private consumption (+1.0%) and investment (+2.2%). The recovery in private consumption is related to fairly strong job creation, at ten to fifteen-thousand jobs per quarter. Over the last two years, more than 110,000 new jobs have been created.

> *The investment dynamic is interesting too*

That investment is supported by a higher capacity utilisation rate and by easy financing conditions, corporates continue to invest, even after three years of strong investment growth. As a consequence, the investment rate (as a percentage of value added) of private non-financial companies is now well above its long-term trend.

Even if the net contribution of external trade was negative in the second quarter of this year, export and import flows continue to grow fast; in the second quarter export growth reached 4.1% YoY, bringing more activity in all sectors related to international trade. From a demand point of view, the only weakness is from public spending not contributing to GDP growth. That is not really surprising, as the government tries to limit public spending in order to keep the budget on track.

1% GDP growth since end-2016

Satisfactory first half of 2017

Is there further recovery in store?

Looking ahead, any further recovery of the Belgian economy is likely to rely on two main pillars:

1. The positive economic context in the euro area is playing a positive role, as Belgium is strongly integrated in intra-eurozone trade. This is confirmed by Belgian external trade data, showing an acceleration of the flows of goods exchanged with the majority of Eurozone countries, including countries like Spain or Italy.
2. Solid consumer confidence and growing disposable income for households are likely to support domestic demand in coming quarters.

Taken together, the expected evolution of external trade and consumption allow optimism in terms of Belgian activity growth.

Puzzling business confidence

The negative trend in business confidence is puzzling. Over the nine months of the year so far, business confidence (published every month) has deteriorated six times, and the index is now far below its end-2016 level. With the exception of the retail trade sector, all sectors of the economy have seen a deterioration, although the overall level of confidence remains high and consistent with positive growth. The acceleration of the economy seems to have come to an end.

Even if Belgian business confidence has in the past been considered as a leading indicator for the Eurozone business cycle, we don't believe that the current deterioration is alarming. Its explanation is certainly to be found in the Belgian economy: first, the austerity imposed by the current government in order to reduce the public deficit is likely to affect economic activity slightly. Second, there were two wage indexations over the last 18 months, at the price of a potential deterioration in Belgian corporate competitiveness. On top of that, one cannot exclude that the negative trend of business confidence is just a normalisation after a period of "euphoria".

Our expectations

All in all, we expect Belgian GDP growth to reach 1.7% this year and in 2018. This is certainly around the potential growth of the country, but also slightly below the Eurozone average. This is probably linked to all the efforts made by the government to reduce the budget deficit. On top of that, one shouldn't forget that Belgium's recovery after the great recession had been faster than the European average. In that regard, it is no surprise that the rest is now catching up.

1.7%

Belgian GDP growth

For 2017 and 2018

What about austerity?

Even if austerity measures have a negative impact on activity, the better-than-expected economic context combined with the measures taken by the government should reduce the budget deficit from 2.6% in 2016 to 2.0% this year. Moreover, the government has reached an agreement to continue the deficit reduction effort in 2018.

Unfortunately, some measures taken in the past have not brought the targeted income, and population ageing is starting to weigh on total public spending. As a consequence, any positive budget balance is not expected at least before 2020. Nevertheless, measures taken should be sufficient to see the debt ratio decrease in coming years.

Inflation highs continue

Inflation continues to be quite high in Belgium, compared with the Eurozone average. It increased slightly again in September to 2.0%, a direct consequence of higher oil prices on international markets and a positive base effect. On top of this, other consumer price index components support inflation, notably transport services (train and flight ticket) and alcoholic drinks. All in all, even if the headline inflation rate is expected to decline somewhat in coming months, it could once again reach 2.0% on average this year, above the Eurozone average. Next year, it is likely to decrease to 1.7%.

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