

Quarterly Newsletter of the Federal Planning Bureau

Short Term Update (STU) is the quarterly newsletter of the Federal Planning Bureau. It is published four times a year in English. It contains the main conclusions from the publications of the FPB, as well as information on new publications, together with an analysis of the most recent economic indicators.

HEADLINES BELGIAN ECONOMY

Belgian GDP grew by 2.9% in 1997. GDP growth should hardly be reduced this and next year: the FPB expects a growth rate of 2.8% in 1998 and 2.6% in 1999.

So far, the FPB expected the negative impact of the Asian crisis to be neutralised by a more dynamic domestic demand. While exports do actually slow down, it seems that domestic demand more than compensates for this.

The good figures for domestic demand in 1998 concern mainly private consumption. They are influenced by the concentrated purchases of cars after the biannual Motor Show but also by a number of other special factors positively affecting household disposable income. These will not be present in 1999 so that smaller growth rates for real disposable income as well as private consumption are expected.

Employment creation should contribute substantially to the income growth of households during 1998 and 1999. For both years, employment should increase by about 45,000 people (or about 1.2%), which is considerable compared to the past seven years.

About a quarter of the job creation can be attributed to special programmes, which are mainly taking place in enterprises. Moreover, wage moderation, as well as further cuts in employers' contributions to social security contribute to a more labour-intensive growth and an improvement of competitiveness.

The business investment rate should continue to climb, but remains relatively low compared to the end of the 80's.

The wage evolution in 1999 remains dependent on the "Wage norm". Wage moderation in the neighbouring countries constraints the wage evolution in Belgium. Gross hourly wages in the private sector are expected to increase by 1.2% in real terms in 1999. The risk of wage inflation is therefore limited, even though labour market shortages could emerge.

Somewhat stronger import price increases and a slightly positive output gap lead to a small rise in the inflation rates in 1999 (1.3%, compared to 1.1% in 1998). Interest rates should also slightly increase in the Euro zone as well as in Belgium.

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FPB activities are primarily focused on macro-economic forecasting, analysing and assessing policies in the economic, social and environmental fields.



Table of Contents

Special Topic	3
Declining replacement rates in the legal pension scheme for wage-earners	
Economic Forecasts	5
Economic forecasts 1998-99	
Summary of Economic Forecasts	7
Economic Forecasts by the Federal Planning Bureau	
Economic forecasts for Belgium by different institutions	
Recent Economic Evolution	8
General economic activity	
Private consumption	
Business investment	
Housing investment	
Stockbuilding	
Foreign Trade	
Labour market	
Prices	
Interest rates	
Exchange rates	
Fiscal indicators	
Recent Publications	19
Participation of Belgian firms in the globalisation process	
Macro-economic determinants of employment	
Economic and budgetary effects of a reduced VAT rate for certain services	
News	22
Other Recent Publications	
Forthcoming Publications	
Economic Policy Measures	23
Recent history of major economic policy measures	
Abbreviations	24

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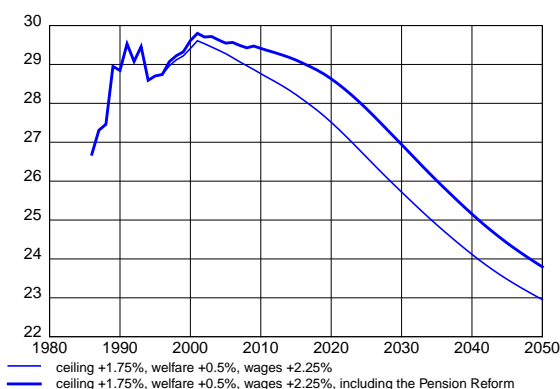
Declining replacement rates in the legal pension scheme for wage-earners

Last December the FPB presented a general study¹ about the financial impact of demographic ageing on the long-term evolution of social security expenditure and public indebtedness in Belgium. Projections performed in business-as-usual scenarios led to the following conclusion: the budgetary cost of ageing in the first half of the 21st century seems weaker than expected on the basis of demographic dependency ratios, at least if the long-term macro-economic performance does not deteriorate significantly.

This relatively modest impact of demographic ageing on primary public expenditure is mainly due to three major factors: declining public expenditure² for young generations, higher activity- and employment rates, and declining replacement rates³. In particular, the replacement rate in the legal pension scheme for wage-earners (excluding civil servants) plays an important part. This paper looks at the factors that will make this declining replacement rate unavoidable, even when social policy is assumed to upgrade the generosity to some extent.

Graph 1 displays the replacement rate of the legal pension scheme for salaried workers including and excluding the 1996 Pension Reform (Law of 26 July 1996).

Graph 1 - Replacement rate in the legal pension scheme



The pension benefit for a wage-earner who is entering retirement is related to the average wage (based on a 40- to 45- year career) via a 60% or 75% rate. The 75% rate, called family rate, is applied to pensioners head of a one income family (householders) and the 60% rate in all other cases (entitlement patterns). The nominal wages taken into account are revalued to the current purchasing power, but submitted to a wage ceiling.

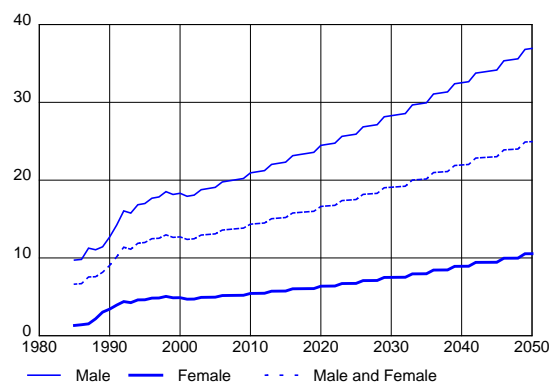
The declining replacement rate is determined by four factors: the impact of the ceiling on the pension benefit of the entering retirees, the rate of linking pensions to welfare, the shift in the average age of retirees, and the changes in entitlement patterns. This paper will focus on these four factors.

Impact of the wage ceiling on the pension benefit when entering retirement

In general, as the pension benefit is based on the wages earned during a 40 to 45-year career before entering retirement, the average pension benefit will grow parallel to the average (over the career) wages of successive generations.

However, these wages are submitted to a wage ceiling with a different evolution than wages. Before 1982 the ceiling was on average linked to the wage rate. From 1982, the ceiling was only linked to price inflation; for high salaries, the percentage of the wage exceeding the ceiling - which is not taken into account for the calculation of pension benefits - began to increase. Also, the number of wage-earners with salaries above the ceiling increased from 7% in 1985 to 13% today.

Graph 2 - Share of salaried workers earning more than the wage ceiling, in %



The average pension in this group will increase at the same rate as the ceiling, generating a maximum pension benefit growing slower than the average wage. Therefore, if the ceiling remains too long disconnected from wages, the earnings-related pension scheme becomes in the long run a flat basic pension scheme.

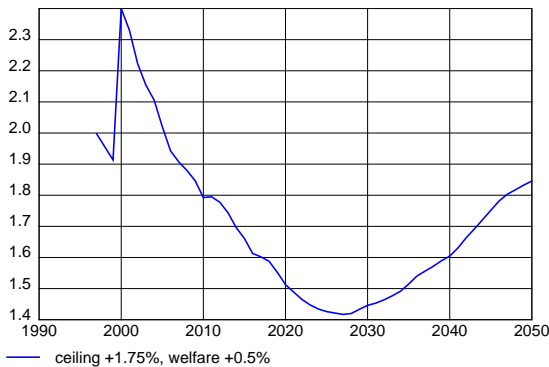
To strengthen the legitimacy of the legal pension scheme, the Pension Reform links the wage ceiling to conventional wages from 1999 onwards. Graph 2 illustrates that even with a full adaptation of the ceiling to conventional wages⁴ the proportion of wage-earners above the ceiling keeps growing - although at a slower

1. M. Lambrecht, "Population ageing: From the analysis of developments in population to the risk of making hasty conclusions". M. J. Festjens, "Public Pension Reform: A new generation entering into a new pension contract". N. Fasquelle, S. Weemaes, "Financial outlook for Social Security for the year 2050", Planning Papers 81 82 83.
2. In this paper, the public expenditure is regarded in GDP terms.
3. Ratio between social benefits and gross wages.

pace than during the past 17 years. Indeed the average wage should grow faster than the conventional wage, because of the shift towards better-paid jobs (wage drift).

Graph 3 depicts the impact of the indexation of the ceiling in line with conventional wages from 1999, on the yearly increase of the average pension benefit for male retirees. This impact is rather modest the first 25 years ahead. Indeed, the fixed ceiling during the past 17 years, without any catch-up, will reduce the growth of the average benefit as the concerned generations retire. It takes 45 years before the linked ceiling has a full-grown effect on the benefit of new retirees, and another 15 years before new generations become preponderate.

Graph 3 - The average pension benefit for male retirees, annual increase in %



Impact of the welfare indexation of pension benefits

As shown in graph 3, the introduction of annual welfare adjustments (0.5% from 2000), in contrast to the last two decades, has an important immediate but temporary effect on the increase of the average pension benefit. Once successive generations of retirees have received yearly welfare adjustments during their pension time, the impact of welfare adjustments on the average growth rate disappears.

Nevertheless, the difference between welfare adjustments and the rate of increase of benefits for new generations retirees, do affect the standard of living at the various stages of a pensioner's life. A 1.75% rise of the ceiling, combined with a 0.5% rise of the welfare adjustments results in a spread of 13 percentage points between the youngest and the oldest pensioner. This spread will slow down as welfare adjustments advance towards the rising rate of benefits for new generations retirees.

4. The wage assumptions of this long-term outlook are: 2.25% productivity growth and real wage rate, 0.5% wage drift, 1.75% growth rate of conventional wages.

Impact of the average age of retirees

If the indexation of pension benefits to welfare is stable over time, the indexation has no influence on the growth rate of the average benefit in each age group: a 75-year-old pensioner in 2020 receives the benefit of a 75-year-old pensioner of the year 2019, increased by the ceiled wage rate before retirement, whatever the level of the rate of indexation to welfare (10 successive indexations between the age of 65 and 75 in both cases).

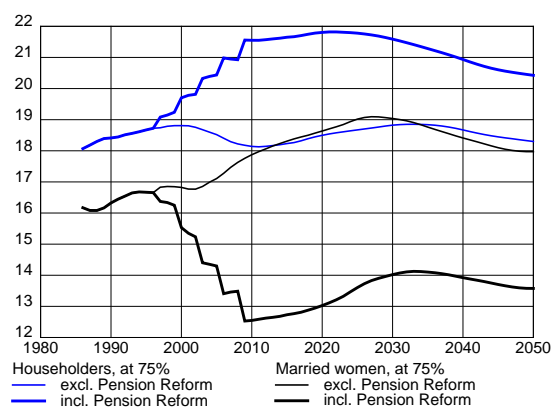
Nevertheless, increasing longevity among the aged will increase the average age of pensioners, reducing the average replacement rate, if benefits are not fully adjusted to welfare.

The baby-boom generation will cause some shocks in this long-term evolution, first when retiring after 2010 (with benefits higher than on average), later when becoming older (with benefits below average).

Impact of changes in entitlement patterns

The rising number of women in work since the mid-sixties, building up a longer and better paid career, will entitle more women to their own pension. Therefore, an increasing number of new retirees will prefer pensions for both spouses (each at 60%) instead of one family pension (at 75%) based on the working career of the householder. Although this couple enjoys a higher retirement income than the family amount, the average pension benefit will for this reason decrease.

Graph 4 - Share of householders and married women in total number of retirees, in %



The current Pension Reform will gradually increase the pensionable age of women from 60 to 65, i.e. the same age as for men. Early retirement can be applied for but conditional on a minimum number of years worked. This alignment of the pensionable age postpones the declining of the replacement rate (see graph 1), due to the reduced number of retirees (-7%), mainly women (see graph 4) with low benefits due to their incomplete careers.

The FPB prepares Economic forecasts for the Institute for the National Accounts. In accordance with its terms of reference, the Institute adopts the final figures. A scientific committee has expressed its approval of the Economic forecasts. The figures are used in preparing the Federal Budget 1999. The forecasts were completed on 7 July 1998. Data available up to this date have been used in compiling the text which follows.

GDP is expected to grow by 2.8% in 1998 and 2.6% in 1999. These relatively strong growth rates find their origin in four factors: faster than expected growth in the first quarter in 1998; a more balanced composition of growth; a gradual improvement in employment growth and continued strong foreign demand. These four factors will be looked at in turn, starting with the last.

Growth and its composition

International trade continues to grow strongly, albeit somewhat less than in 1997. The impact of the Asian crisis on world trade is significant, but stronger growth in the United States and Europe is influencing Belgian export markets positively.

Moreover, it seems that the negative effect of the Asian crisis is so far more than compensated by an increased growth in domestic demand. The results for the first quarter of 1998 and some second-quarter estimates indicate that domestic demand, and private consumption in particular, have improved significantly in Belgium and also in the economies of the main trading partners. The improvement in Belgium is explained by the biannual Motor Show, but also to a large extent by the growth in real disposable income and some further falls in the saving rate. The sharp increase in the consumer confidence index confirms this.

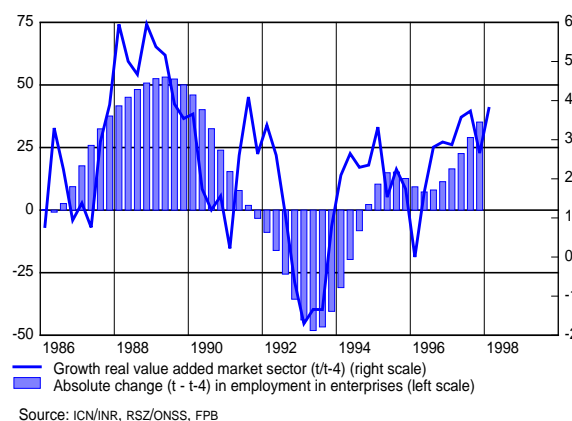
It is assumed that the Asian crisis will have a limited impact in two senses: the effect is mainly contained to 1998 and the impact will not widen beyond the countries already affected. It is clear that the evolution in this area and in Japan in particular is very uncertain and forms a clear risk to the forecasts.

Labour market

The dynamism of growth is to a large extent dependent on the employment evolution. The real wage rate remains constrained by the "Wage norm" (linking the evolution of labour costs in Belgium to the evolution in Germany, France and the Netherlands), making employment creation even more essential. While job

creation has gradually become stronger (+1% of employees in enterprises in 1997), it has been stronger than the employment creation observed during the previous (1994) upturn (see graph 1)

Graph 1 - Growth in employment and real GDP.



For 1998 and 1999, employment creation should be considerable (+45,000 in both years). About a quarter of the jobs created in enterprises can be attributed to special employment initiatives, mainly active labour market measures. Hourly labour productivity growth should be between 1.5% and 2% per year.

The participation ratio is continuing its upward trend, making the reduction in unemployment smaller than the jobs created. The standardised (Eurostat) unemployment rate should fall from 9.3% in 1997 to 8.0% in 1999. This remains, however, considerably higher than the 6.5% obtained early 1991. The number of unemployed should remain high (470,000 according to the administrative definition of registered job-seekers). The risk of wage inflation due to labour market tightness is significantly reduced by the existence of a legal framework that limits wage increases.

Taking into account the compensation per employee in the business sector in the three neighbouring countries, forecast by the OECD in June, the wage cost rate per hour, including employers' contributions, should grow in Belgium by 2.3% in 1998 and 2.2% in 1999. Excluding employers' contributions, this corresponds to 1.5% and 1.2% respectively in real terms. Employers' contributions will be further reduced by 16 billion in 1998 and 10 billion in 1999.

Competitiveness

The "Wage norm" was first applied for the 1997-98 period. From the available statistics, it seems that the

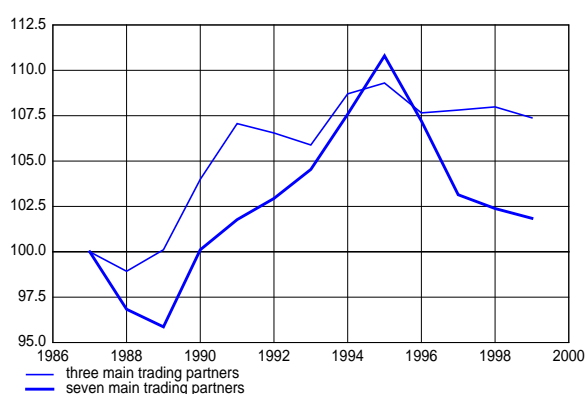
wage increases remain below the maximum growth rate set by the Government at that time and in line with the wage evolution in the neighbouring countries. They also seem to be lower than the maximum that could be calculated on the basis of the figures in the most recent OECD Economic Outlook (June 1998).

A new maximum increase will be set before the end of the year for the 1999-2000 period. Taking the average growth rate for Germany, France and the Netherlands into account, the gross (i.e. exclusive of employers' contributions) hourly wage rate should increase by 2.6% in 1999.

Comparing these growth rates with the likely evolution in the seven main trading partners, the competitive position of Belgium should further improve in 1998-1999, both in terms of labour cost per head and unit labour cost. The improvement *vis-à-vis* the three main trading partners is less spectacular (see graph 2).

The improvement in competitiveness masks probably different evolutions. The gain *vis-à-vis* the Netherlands is probably going to be the largest. The state of the Dutch economy, seen from the unemployment rate and its output gap, makes wage and price increases much more likely. This might be less the case *vis-à-vis* Germany where wage moderation is likely to be continued given the high unemployment rate.

Graph 2 - Real Effective Exchange Rate (1987=100)
(relative ULC in total economy in common currency)



The strength of the dollar and the pound offer most of the explaining power for the improvement of competitiveness *vis-à-vis* the seven main trading partners.

Apart from this, the appreciation of the BEF *vis-à-vis* the currencies of East Asia should be mentioned. Even though the weights in total Belgian competitiveness of these countries are small, the very large depreciations in these countries neutralise some of the gains *vis-à-vis* the other countries.

Investment

Wage moderation restricts household income but increases business profitability. Business investment is positively influenced by this and also by strong demand prospects and by low interest rates. Investment increases faster than GDP as has been the case since the beginning of 1995, leading to a higher investment rate. The NBB survey on investment intentions in the manufacturing sector indicates a (nominal) growth rate of 12% in 1998. The overall growth in business investment remains too modest, however, to lead to substantial increases in capacity. The degree of capacity utilisation in the manufacturing sector is historically high and will probably drop slightly in the near future.

Investment in housing should benefit from all the fundamentals: low nominal interest rates, increasing household income and job security. Furthermore, considerable increases in the stock market should also favour housing investment. The impact of the end of a stimulus from a VAT reduction on activity should be limited in the short term.

Prices and interest rates

Consumer price inflation remains subdued. Oil prices contribute significantly to a fall in the inflation rate in 1998. Consequently, the "health index" (excluding oil prices, alcohol and tobacco) increases somewhat faster (1.3%). For 1999, the underlying inflation rate is expected to increase slightly from a current 1.25% to 1.45% by the end of 1999, mainly reflecting the upturn in the economy. The output gap should become positive in 1999 for the first time since 1991. Profit margins could increase somewhat.

The contribution of unit labour costs in domestic inflation remains limited during the next two years. Due to a drop in oil prices, import prices should increase only slightly in 1998, but somewhat faster in 1999.

Interest rates remain in line with German rates. Slightly higher inflation rates, reflecting the strength of the economy, should be translated in small increases in short and long term nominal rates by 1999.

All in all, low inflation and interest rates have a beneficial effect on confidence levels of both producers and consumers. The decrease in long term interest rates in Europe, partly as a result of the financial Asian crisis indicate that the financial markets consider Europe as a more stable market.

Economic Forecasts by the Federal Planning Bureau

Changes in volume (unless otherwise specified)				
	1996	1997	1998	1999
Private consumption	1.3	2.1	2.8	2.1
Public consumption	1.8	1.1	1.1	1.6
Gross fixed capital formation	0.6	5.4	4.8	3.5
Final national demand	1.1	2.2	3.0	2.3
Exports of goods and services	3.2	5.9	5.1	5.0
Imports of goods and services	2.8	5.1	5.5	4.9
Net-exports (contribution to growth)	0.4	0.8	-0.1	0.4
Gross Domestic Product	1.5	2.9	2.8	2.6
p.m. Gross Domestic Product - in current prices (bn BEF)	8305	8673	9042	9403
Traditional consumer price index	2.1	1.6	1.1	1.3
Consumer prices: "health" index	1.7	1.3	1.3	1.4
Real disposable income households	-0.4	0.8	2.4	1.8
Households saving rate (as % of disposable income)	16.3	15.2	14.8	14.6
Domestic employment (change in '000, situation on June 30th)	14.8	18.5	45.5	45.8
Unemployment (Eurostat standardised rate, yearly average) [1]	9.8	9.3	8.6	8.0
Current account balance BLEU/UEBL (as % of GDP)	4.9	5.4	5.7	6.0
General Government borrowing requirement (as % of GDP)	3.2	1.8	1.6	1.3
Short term interest rate (3 m.)	3.2	3.4	3.7	4.0
Long term interest rate (10 y.)	6.5	5.8	5.0	5.3

[1] Other unemployment definitions can be found on page 14 (table 7).

Economic forecasts for Belgium by different institutions

	GDP-growth		Inflation		Government deficit		Date of update
	1998	1999	1998	1999	1998	1999	
Federal Planning Bureau	2.8	2.6	1.1	1.3	1.6*	1.3*	7-7-98
INR/ICN	2.8	2.6	1.1	1.3	.	.	7-7-98
National Bank of Belgium	2.7	.	1.2	.	1.3	.	10-7-98
European Commission	2.8	3.0	1.3	1.5	1.7	1.4	4-98
OECD	2.7	2.8	1.0	1.2	1.7	1.6	4-98
IMF	2.6	2.8	1.7	1.8	1.7	1.6	3-98
BBL	2.7	2.8	1.3	1.7	1.7	1.5	9-6-98
Generale Bank/Générale de Banque	2.8	2.8	1.3	2.0	1.7	1.4	18-5-98
Gemeentekrediet/Crédit Communal	2.5	2.5	1.4	1.5	1.5	1.5	26-6-98
Kredietbank	2.8	2.8	1.3	1.7	1.6	1.1	19-6-98
J.P. Morgan	2.6	2.6	1.3	1.7	1.9	1.8	30-6-98
Morgan Stanley	2.6	2.4	0.9	1.5	1.7	1.6	6-7-98
Artesia Bank	2.7	2.6	1.3	1.6	1.7	1.4	18-5-98
Petercam	2.7	2.6	1.1	1.4	1.6	1.3	18-5-98
IRES	2.5	2.7	1.3	1.7	1.4	1.0	7-98
DULBEA	3.0	2.8	1.5	1.8	1.5	1.0	18-5-98
Averages							
All institutions	2.7	2.7	1.3	1.6			
International institutions	2.7	2.9	1.3	1.5			
Credit institutions	2.7	2.6	1.2	1.6			
Consensus The Economist	2.8	2.8	1.4	1.8			4-7-98

Collaborating institutions for The Economist: ABN Amro, Bankers Trust, Deutsche Morgan Grenfell, EIU, Goldman Sachs, HSBC Securities, IBJ, Kredietbank, Long-Term Credit Bank, Merrill Lynch, J.P.Morgan, Morgan Stanley, Nordbanken, Paribas, Primark Decision Economist, Royal Bank of Canada, Salomon Smith Barney, SBC Warburg Dillon Read, Scotiabank

* See FPB, "Medium Term Economic Outlook 1998-2003", April 1998

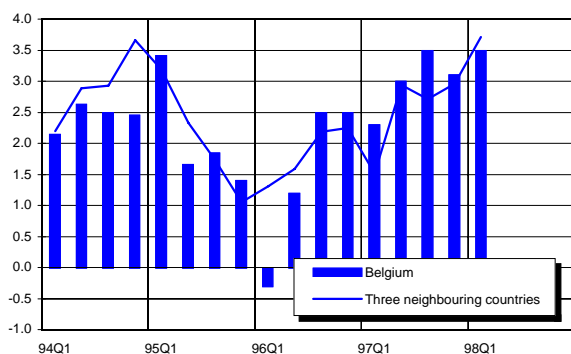
General economic activity

Table 1 - GDP: change compared to the same period in the previous year, in %

	95	96	97	96Q1	96Q2	96Q3	96Q4	97Q1	97Q2	97Q3	97Q4	98Q1
Germany	1.9	1.0	2.2	0.0	1.1	2.3	1.8	1.0	3.0	2.4	2.4	3.8
France	2.2	1.4	2.3	1.1	0.8	1.4	2.3	1.2	2.5	2.6	3.1	3.5
Netherlands	2.3	3.3	3.4	3.7	3.5	3.0	3.0	2.9	3.4	3.4	3.8	3.9
Belgium	2.1	1.5	2.9	-0.3	1.2	2.5	2.5	2.3	3.0	3.5	3.1	3.5

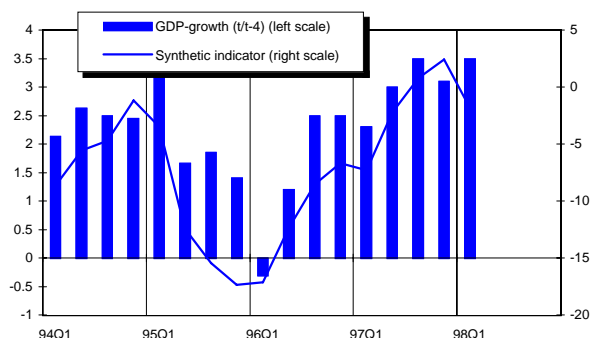
Source: National sources, INR/ICN

Graph 1 - GDP-growth (t/t-4), in %



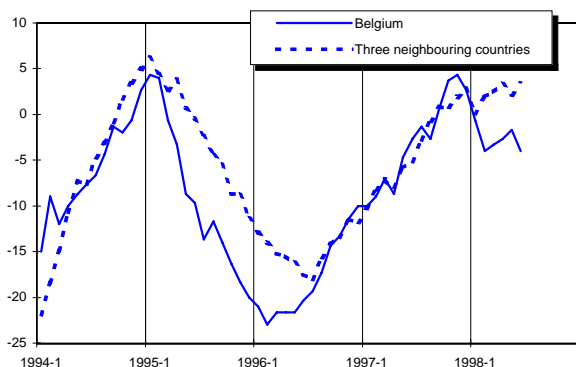
Source: INR/ICN, National sources

Graph 2 - Belgian GDP-growth and synthetic indicator



Source: INR/ICN, NBB

Graph 3 - Industrial confidence: international comparison



Source: European Commission

The Institute for National Accounts (INR/ICN) started publishing quarterly national accounts in April. Figures for 1997 were obtained from the four quarters of 1997. These figures, as well as those for the first quarter of 1998 have been integrated in this publication.

Economic activity remains strong in Belgium and in its neighbouring countries in the second half of 1997. GDP increased by around 3% in Belgium as well as in the economies of its three trading partners. The figures for the first quarter of 1998 have been equally positive. The 3.5% year-on-year growth rate for GDP observed in Belgium is the highest quarterly growth rate since the beginning of 1990.

The somewhat smaller growth rate during the last quarter of 1997 was not so much due to weaker growth in domestic demand but rather to a negative contribution from net exports. The growth rate of exports has indeed fallen while imports have grown faster. During the first quarter of 1998, this picture has become even more pronounced: strong growth in domestic demand and consequently in imports, while export growth remains the same.

The synthetic NBB survey indicator has dropped since the end of last year. Only the manufacturing sector is responsible for this evolution. Compared to the three neighbouring countries (Germany, France and the Netherlands), the drop has come earlier and has been more profound. This could possibly be attributed to the impact of the Asian crisis. Because of the openness and the Belgian economy's specialisation in semi-finished products, this could have had a more immediate and stronger effect on the manufacturing sector than in the three neighbouring countries.

For 1998-99 growth should remain dynamic with growth rates for GDP of 2.8% in 1998 and 2.6% in 1999.

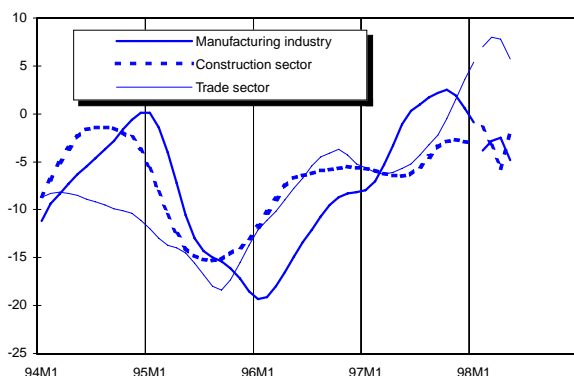
Table 2 - Monthly business surveys [1]

	96	97	97Q2	97Q3	97Q4	98Q1	97M12	98M1	98M2	98M3	98M4	98M5
Synthetic indicator	-11.2	-1.6	-2.3	0.8	2.4	-1.8	2.1	-2.3	-1.8	-1.3	-1.4	-2.8
Manufacturing industry	-13.3	-0.3	-0.2	2.9	3.8	-3.4	2.8	-3.6	-3.8	-2.8	-2.5	-4.8
Construction sector	-7.0	-5.1	-7.1	-5.1	-3.5	-2.6	-5.7	-3.0	-1.4	-3.3	-5.7	-1.9
Trade sector	-5.8	-4.0	-7.0	-3.3	1.9	6.5	6.3	4.5	7.0	8.0	7.8	5.7

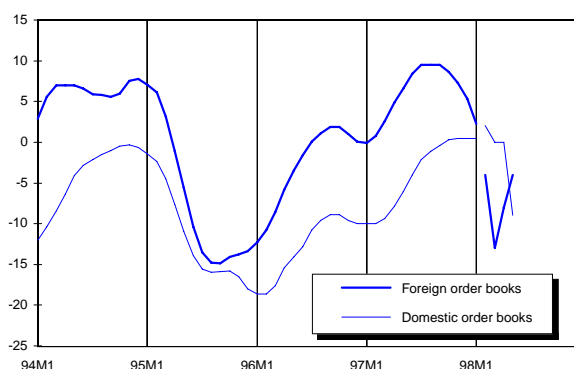
[1] Qualitative data

Source: NBB, FPB

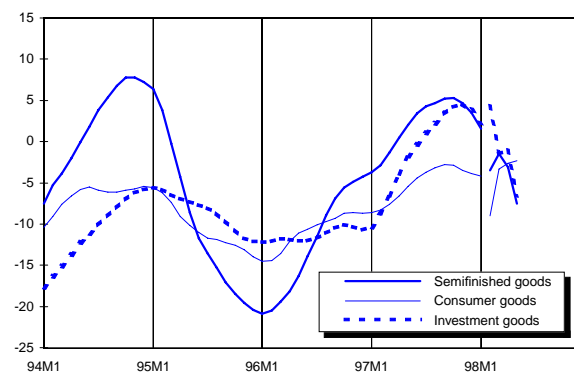
Graph 4 - Business cycle: sectoral evolution



Graph 5 - Manufacturing industry: order books



Graph 6 - Manufacturing industry: different types of goods



Source: Business cycle survey NBB

The manufacturing sector remains the most volatile sector in the present upturn. Following stronger international demand and improved competitiveness, the Belgian manufacturing sector has surged since the beginning of 1996. The Asian crisis has had a marked impact on export orders since October 1997, pulling the industrial confidence index downwards. Comparing the export evolution (see page 13) with the export orders index, it seems that exporting companies have overreacted to the Asian crisis. A further drop of the export orders index is therefore unlikely.

More important in the current part of the cycle is the evolution of the trade sector, the production of consumer goods and domestic orders. From the survey results, it is clear that the trade sector has made a remarkable recovery since the second half of 1997. The synthetic indicator would have been significantly lower without this improvement. It is likely that the trade sector will continue to keep its strength during the months ahead.

The indicator of order books are particularly volatile. The more basic trend indicates that domestic order books stabilise at a rather high level. This is also the case for the manufacturing of consumer goods.

The improvement of the construction sector in 1997 was less pronounced. During the most recent months, the indicator stabilised, pointing probably to continued, albeit relatively small, growth rates.

Private consumption

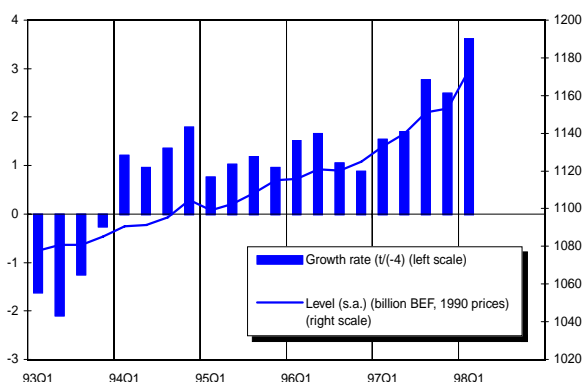
Table 3 - Private consumption indicators

	96	97	97Q3	97Q4	98Q1	98Q2	98M1	98M2	98M3	98M4	98M5	98M6
Turnover (VAT) - retail trade [1]	3.5	3.5	6.1	3.6	5.2	.	4.7	8.2	3.2	7.0	.	.
New car registrations [1]	7.8	-5.7	1.7	-0.4	5.1	10.0	2.1	4.5	9.1	11.5	10.3	7.9
Consumer confidence indicator [2]	-22.5	-21.7	-21.7	-16.0	-7.0	-4.7	-10.0	-6.0	-5.0	-4.0	-5.0	-5.0

[1] Change (%) compared to same period previous year; [2] Qualitative data

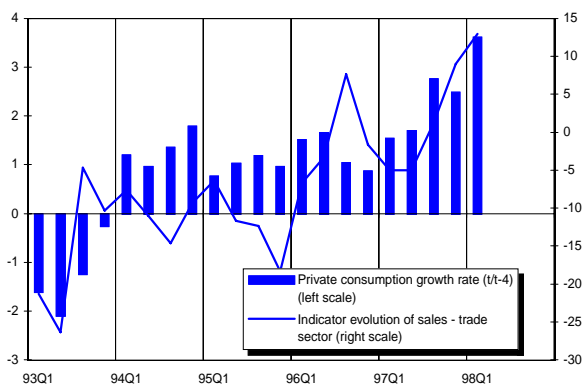
Source: NIS/INS, Eurostat, Febiac, FPB

Graph 7 - Private consumption at constant prices



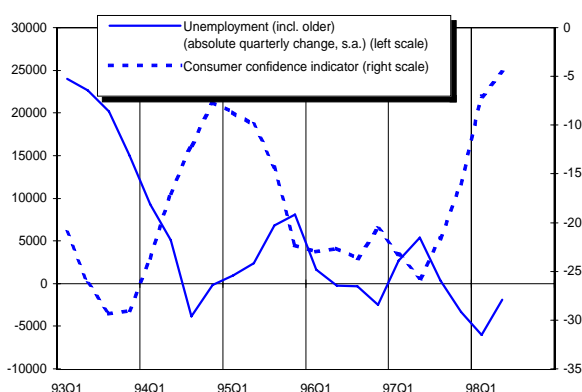
Source: INR/ICN

Graph 8 - Private consumption and related survey indicator



Source: INR/ICN, NBB

Graph 9 - Consumer confidence and unemployment



Source: RVA/ONEm, Eurostat, FPB

Short-term indicators show that the growth in private consumption increased markedly since the middle of 1997. For the first time since 1992, real quarterly growth rates above 2% were noted. The trend of turnover in the retail trade sector (derived from VAT statistics) confirms this: its growth rate (t/t-4, at current prices) doubled during the second half of 1997 (almost 5%) compared with the first half of the year.

The evolution of the NBB survey indicators for the trade sector and the consumer confidence index point to the same conclusion: these have been on a rather steep upward path since the middle of 1997.

According to the quarterly national accounts, private consumption grew by 3.6% (t/t-4) during the first quarter of 1998. This implies that consumption growth is continuing and even becoming stronger.

However, a continuation of consumption growth at this pace during the whole year is not very likely. In the first six months of this year, new car registrations were about 7.5% higher than during the same period in 1997, with growth rates above 10% in April and May. As the effect of the Motor Show will gradually die out, private consumption growth rates are expected to decrease during the last two quarters of 1998. The NBB survey indicators for the trade sector reached a peak level in the first quarter of 1998, but fell back slightly in April and May.

All in all real private consumption growth should be 2.8% this year and 2.1% next year. Factors contributing to the favourable consumption climate are: the rise in employment, households' disposable income and consumer confidence, the positive news concerning public finances and the bullish stock market.

Business investment

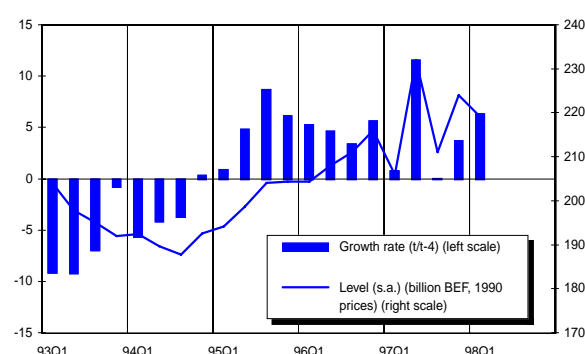
Table 4 - Business investment indicators

	96	97	98	97Q2	97Q3	97Q4	98Q1	97M12	98M1	98M2	98M3	98M4
Investment (VAT) [1]												
Industrial companies	9.3	1.7	.	4.2	-2.8	8.0	5.1	12.0	-3.7	9.1	9.9	5.5
Non-industrial companies	3.1	11.2	.	22.7	7.2	8.7	10.0	11.3	18.4	15.7	-0.6	18.7
Total companies	5.5	7.4	.	15.4	3.1	8.5	8.1	11.6	8.2	13.3	3.9	12.9
Investment survey [1]	5.1	5.6	12.4									
Capacity utilisation rate (s.a.) (%)	79.9	82.0	.	82.0	82.5	82.3	83.4					

[1] Change (%) compared to same period previous year

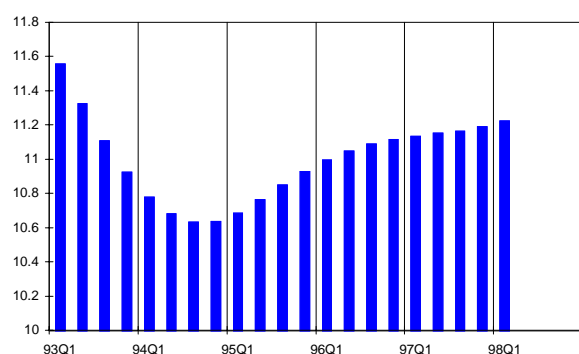
Source: NIS/INS, NBB, FPB

Graph 10 - Business investment at constant prices



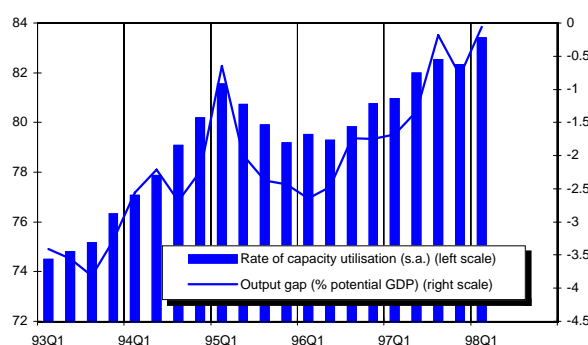
Source: INR/ICN

Graph 11 - Business investment rate (in % of GDP, smoothed)



Source: INR/ICN, FPB

Graph 12 - Business investment indicators



Source: INR/ICN, FPB

In 1997 real business investment growth (4.1%) was positive for the third successive year. The quarterly pattern of investment was somewhat erratic. The contribution of business investment to real economic growth amounted to 0.5%, almost equal to the contribution in 1995 and 1996.

The NBB investment survey in the manufacturing industry dating from May of this year resulted in an upward revision of the investment prospects for 1998 compared to the November 1997 survey. At current prices, investment by industrial companies should increase by 12% this year (against only 9% forecast in November), compared to 6% in 1997.

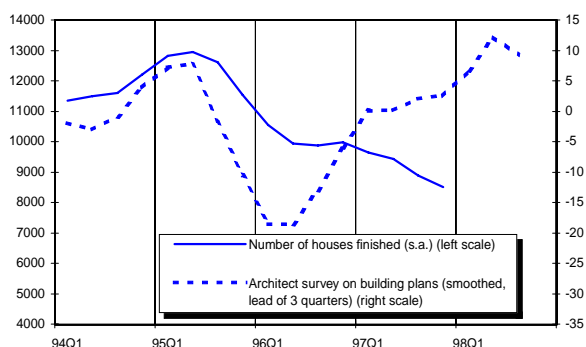
These strong investment prospects in the manufacturing industry are fully in line with its high degree of capacity utilisation. Capacity utilisation rates are expected to decrease somewhat in the course of this year, as export growth weakens and investment plans are realised.

In 1998 and 1999 business investment should grow by 5.2% and 4.0% in real terms. The investment climate continues to be favourable. Nominal long-term interest rates are at historic lows and are not expected to rise in the coming months. Business profitability has been on an upward path since 1996 and will increase further up to 1999. In spite of this past and expected upward trend, business profitability remains significantly lower than its peak level reached at the end of the eighties. In spite of the pick-up in business investment since the end of 1994, the investment rate (in % of GDP) only rose by about 0.5% (from 10.6% at the end of 1994 to 11.2% at the end of 1997). A further rise in profitability would allow the investment rate to climb up to the levels observed between 1989 and 1992.

In 1997, the output gap was negative and this should also be the case for 1998 as a whole. By the end of 1998, however, the output gap should become slightly positive. Strong investment growth should increase potential output and should thus diminish the risk of inflationary pressure generated by a positive output gap.

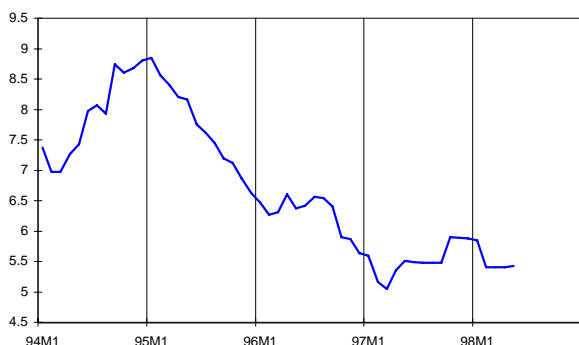
Housing investment

Graph 13 - Activity in the residential housing sector



Source: NIS/INS, NBB, FPB

Graph 14 - Mortgage rate (in %)



Source: NBB

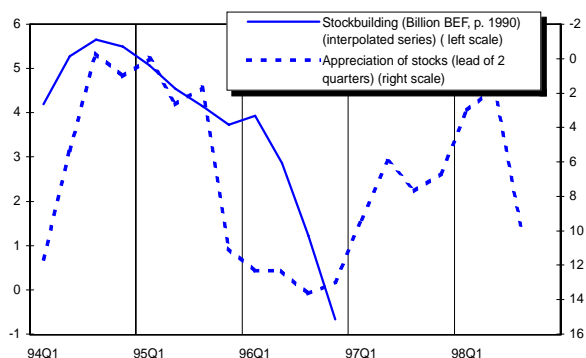
Housing investment dropped during all quarters of 1995 and reached its turning point in the second quarter of 1996. In 1997 housing investment grew by 4.9% in real terms. This relatively high growth rate in 1997 was positively influenced by the low starting level in 1996 and the strength of the upward trend in the course of 1997.

As the indicator of the number of houses started (registered by local authorities) has been subject to administrative changes, an assessment of the recent evolution of activity in the residential housing sector has become more difficult. On the other hand, some qualitative indicators are still available: the results of the quarterly survey among architects concerning the volume of building plans and the monthly business survey in the construction sector. These indicators suggest that the positive trend should continue until the middle of 1998 and could afterwards slow down.

As mortgage rates are low (and should remain so) and households' real disposable income should increase markedly faster in 1998 and 1999 than during the past five years, housing investment growth should this and the next year be positive, albeit rather moderate (3.5% in 1998 and 3% in 1999).

Stockbuilding

Graph 15 - Stockbuilding and related indicator



Source: INR/ICN, NBB, FPB

By the middle of 1998, there has been a reversal in the appreciation of stocks. The global contribution of stockbuilding to economic growth for 1998 is, therefore, still uncertain.

Foreign Trade

Table 5 - Belgium - Trade statistics (intra/extrastat)

	96	97	97Q2	97Q3	97Q4	98Q1	97M11	97M12	98M1	98M2	98M3	98M4
Exports - value [1]	4.9	13.0	12.6	17.7	12.3	11.4	10.1	16.0	11.1	8.5	14.3	1.6
Imports - value [1]	7.7	10.7	11.7	12.1	12.2	10.7	12.4	15.2	9.1	10.4	12.4	4.0
Exports - volume [1]	2.1	7.4	7.9	10.5	6.1	6.9	3.6	9.8	5.9	4.7	9.9	-1.5
Imports - volume [1]	4.2	4.3	5.1	4.0	6.4	8.8	6.3	10.0	5.6	8.1	12.5	2.7
Exports - price [1]	2.8	5.3	4.4	6.5	5.8	4.2	6.3	5.7	4.9	3.7	3.9	3.2
Imports - price [1]	3.4	6.1	6.2	8.0	5.4	1.8	5.8	4.7	3.4	2.1	-0.1	1.2

[1] Change (%) compared to same period previous year

Source: INR/ICN, FPB

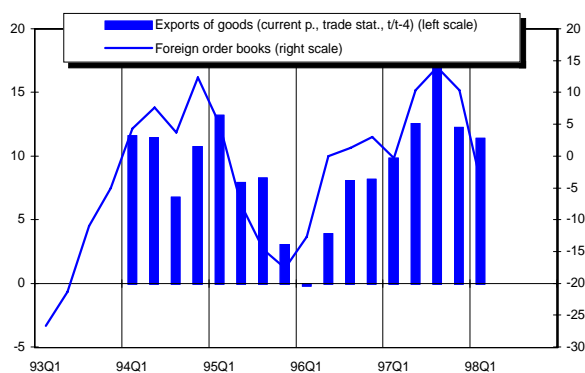
Table 6 - Belgium - Balance of payments statistics

	96	97	97Q2	97Q3	97Q4	98Q1	97M10	97M11	97M12	98M1	98M2	98M3
Exports - goods [1]	5.2	12.2	9.9	17.9	13.4	6.8	6.6	13.0	21.1	4.6	3.5	12.3
Imports - goods [1]	5.6	12.3	9.1	16.4	14.8	7.5	11.9	12.1	20.0	7.1	1.9	13.5
Trade balance [2]	328	360	102	106	79	69	25	31	23	33	23	14
Exports - goods and services [1]	4.8	12.3	9.2	17.5	14.8	7.5	8.9	14.1	21.5	4.6	4.8	13.1
Imports - goods and services [1]	5.2	12.0	9.3	16.5	14.7	8.5	11.9	12.3	19.5	8.5	2.9	14.0
Goods and services balance [2]	327	380	98	89	99	87	33	37	29	34	33	19
Exports - current transactions [1]	1.8	10.6	7.8	14.8	13.3	8.0	8.3	13.3	18.3	5.2	6.1	12.6
Imports - current transactions [1]	1.9	10.2	7.3	14.3	12.5	8.8	10.0	11.0	16.3	8.5	4.3	13.4
Current account [2]	340	403	93	93	131	79	32	54	45	29	33	17

[1] Change (%) compared to same period previous year; [2] Level in Billion BEF

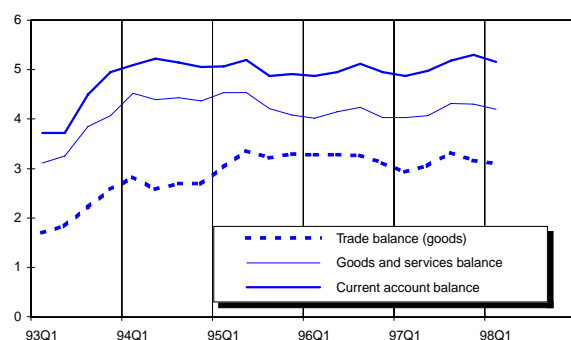
Source: NBB, FPB

Graph 16 - Growth of exports and related indicator



Source: NBB, INR/ICN, FPB

Graph 17 - BLUE/UEBL foreign balances (4 quarters cumul, % of GDP)



Source: NBB, FPB

The cyclical profile of Belgian exports of goods in value (according to trade statistics) shows that a maximum growth of more than 17% was reached in Autumn 1997 and has declined since then to a level close to 11% during the first quarter 1998. While exports are still kept up by strong economic growth in the United States and Europe, exports to Asia have dropped dramatically during the first quarter of 1998. The extension of the financial crisis to other emerging markets could possibly have further damaging effects on Belgian exports.

Imports, on the other hand (nearly 11% increase in value terms during the first quarter of this year), have been positively influenced by a strengthening domestic demand and by low import prices. While preliminary estimates show that exports in volume were growing at a slower pace than imports during the first quarter of 1998 (around 7% increase for exports and almost 9% for imports), the trade balance remains positive and is still increasing (142 billion BEF versus 122 billion for the first quarter of 1997, according to trade statistics). This difference is due to important terms of trade gains explained by the fall in oil prices and the depreciation of Asian currencies. With domestic demand and therefore import growth slowing down during the second half of 1998, real net exports should have a small negative impact on economic growth on an annual basis.

Labour market

Table 7 - Labour market indicators

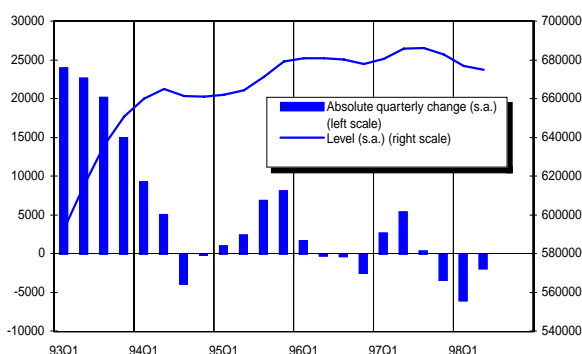
	96	97	97Q3	97Q4	98Q1	98Q2	98M1	98M2	98M3	98M4	98M5	98M6
Unemployment (excl. older) [1]	588.3	570.0	598.1	568.7	551.8	514.5	561.3	554.1	539.9	526.3	511.8	505.3
Unemployment (incl. older) [1]	679.9	683.9	714.1	688.6	674.8	644.5	683.2	677.0	664.0	655.0	642.0	636.4
Unemployment rate-FMTA/MfET[2]	13.7	13.2	13.9	13.2	12.8	11.9	13.0	12.9	12.5	12.2	11.9	11.7
Unemployment rate-Eurostat [3]	9.8	9.3	9.3	9.0	9.0	8.9	9.0	9.0	9.0	8.9	8.9	8.8

[1] Level in thousands; [2] In % of labour force of June 1996, not seasonally adjusted

[3] Seasonally adjusted, in % of labour force (Eurostat standard); recent figures of unemployment rate are based on administrative data and can be revised.

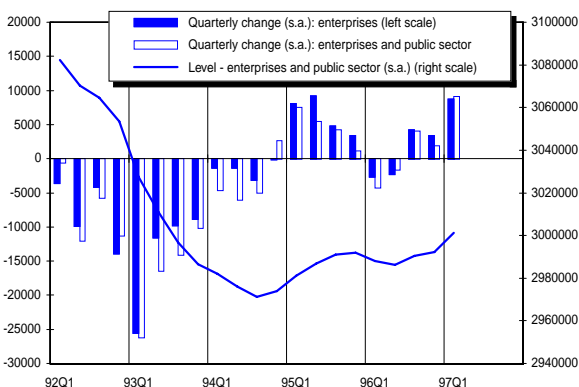
Source: RVA/ONEm, FMTA/MfET, Eurostat, FPB

Graph 18 - Evolution of unemployment (incl. older)



Source: RVA/ONEm, FPB

Graph 19 - Evolution of employment



Source: RSZ/ONSS, FPB

Employment creation has gradually become stronger since the beginning of 1997. The quarterly figures of the RSZ/ONSS (snelle ramingen, estimations rapides) indicate that employment in the private sector has increased by 17,000 during the third quarter of 1997 (year-on-year changes) and by 34,000 in the fourth quarter. Job creation might even become somewhat stronger in the first half of 1998 and should then decrease somewhat.

These figures indicate that employment is increasing faster than in the previous upturn (1994) but still less than in the 1988-90 cycle. Some of the jobs created can be attributed to special programmes, most of them in the private sector. But most of the employment creation is linked to above-trend growth rates for GDP and also to the beneficial impact of wage moderation on competitiveness. Moreover, the further developments of part time labour contribute to this job creation measured in number of people.

The labour force seems to have increased faster than anticipated. The number of people taking early retirement is decreasing, which is consistent with the job creation observed among people over 50.

With a labour force increasing, unemployment is not decreasing at the same pace as job creation. Unemployment, in its broad definition, has fallen by 18,000 from June 1997 to June 1998, while employment is expected to have increased by 45,000.

Prices

Table 8 - Inflation rates: change compared to the same period in the previous year, in %

	96	97	97Q3	97Q4	98Q1	98Q2	98M1	98M2	98M3	98M4	98M5	98M6
Consumer prices: all items	2.06	1.63	1.79	1.29	0.73	1.65	0.42	0.74	1.03	1.50	1.86	1.59
Food prices	0.62	2.20	3.27	3.29	2.06	4.59	0.95	1.81	3.46	5.09	4.85	3.85
Non food prices	2.37	1.50	1.55	0.44	-0.79	-0.08	-0.98	-0.80	-0.59	-0.33	0.13	-0.04
Services	2.35	1.48	1.36	1.18	1.97	2.38	1.74	2.19	1.98	2.11	2.52	2.51
Rent	2.48	1.69	1.59	1.64	1.29	1.16	1.27	1.34	1.26	1.21	1.16	1.11
"Health" index	1.65	1.32	1.42	1.20	0.96	2.00	0.56	0.99	1.32	1.80	2.24	1.96
Brent oil price in USD (level)	20.5	19.1	18.3	18.7	14.3	13.3	15.3	14.3	13.3	13.7	13.9	12.4

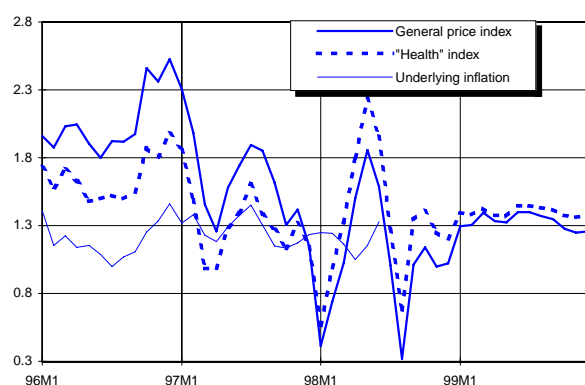
Source: MEZ/MAE

Table 9 - Monthly inflation forecasts

	98M1	98M2	98M3	98M4	98M5	98M6	98M7	98M8	98M9	98M10	98M11	98M12
Consumer prices: all items	101.99	102.19	102.02	102.48	102.99	102.89	103.12	102.62	102.89	103.00	103.13	103.06
Consumer prices: "health" index	101.83	102.08	101.95	102.44	102.99	102.89	103.13	102.57	102.84	102.92	103.06	102.97
Moving average "health" index	101.71	101.86	101.90	102.08	102.36	102.57	102.86	102.89	102.86	102.86	102.85	102.95
	99M1	99M2	99M3	99M4	99M5	99M6	99M7	99M8	99M9	99M10	99M11	99M12
Consumer prices: all items	103.31	103.53	103.45	103.85	104.35	104.33	104.57	104.03	104.27	104.32	104.42	104.36
Consumer prices: "health" index	103.25	103.50	103.40	103.85	104.40	104.37	104.62	104.04	104.29	104.33	104.46	104.38
Moving average "health" index	103.05	103.19	103.28	103.50	103.79	104.01	104.31	104.36	104.33	104.32	104.28	104.37

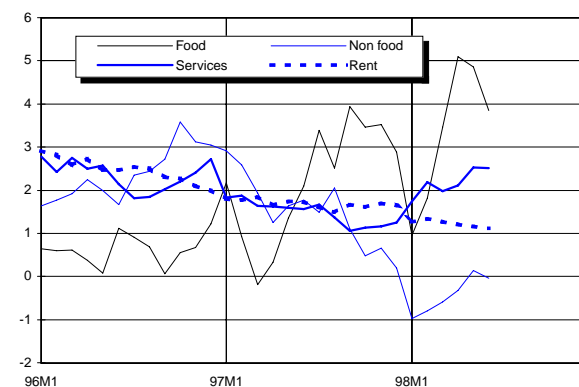
Source: Observations (up to 98M6): MEZ/MAE; forecasts: FPB

Graph 20 - Monthly inflation evolution in % (t/t-12)



Source: MEZ/MAE, from 98M7 on: forecasts FPB

Graph 21 - Inflation rates in % (t/t-12): decomposition



Source: MEZ/MAE

In January 1998 a new price index computation started (base year 1996 and new basket of products). Although this adjustment has no significant impact on average inflation in 1998, it does have an effect on the monthly pattern of the year-on-year inflation observed this year.

In the first quarter of 1998, the new computation mode had a slight downward influence on observed inflation. In the second quarter the effect was more significant and upward. In the remainder of the year the influence will again play downwards (striking in August).

Average inflation (all items) should be 1.1% this year, markedly lower than in 1997 (1.6%). This fall in inflation is mainly due to the marked fall of world oil prices. The Brent oil price is actually (second quarter of 1998) at 13.3 USD/barrel, compared to 19.1 USD/barrel on average in 1997. The health index (excluding, among other things, fuel prices) should grow by 1.3% this year, a rate comparable to that of 1997.

As the output gap should become slightly positive by the end of 1998, underlying inflation is expected to increase somewhat next year. Moreover, import prices will no longer be influenced by falling oil prices. All in all, inflation as measured by the general CPI and the "health index" should amount to 1.3% and 1.4% respectively in 1999. Public-sector wages and social security benefits will not be adjusted for price changes in 1998. The pivot index for the public sector should be reached in February 1999. This implies that public wages should be adjusted (by 2%) for price changes in April 1999.

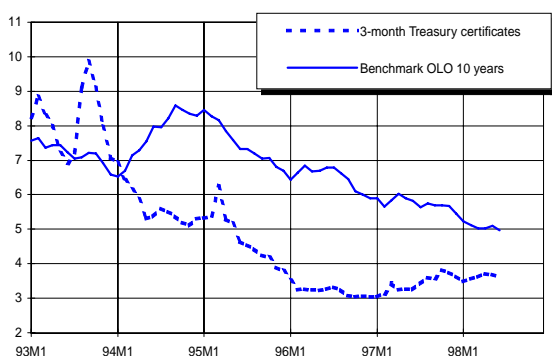
Interest rates

Table 10 - Interest rates

	96	97	97Q3	97Q4	98Q1	98Q2	98M1	98M2	98M3	98M4	98M5	98M6
Short-term rates (3 months)												
Belgium	3.21	3.44	3.54	3.76	3.57	3.68	3.50	3.59	3.63	3.71	3.68	3.64
Germany	3.21	3.26	3.18	3.63	3.48	3.54	3.51	3.45	3.46	3.56	3.57	3.50
Long-term rates												
Belgium: traditional bonds (6+ y)	6.30	5.59	5.50	5.54	5.03	4.96	5.14	5.01	4.95	4.96	5.03	4.90
Belgium: 10 y benchmark OLO	6.49	5.75	5.69	5.61	5.12	5.03	5.22	5.11	5.03	5.03	5.09	4.96
Germany (7-15 y)	6.1	5.5	5.5	5.4	5.0	4.9	5.1	4.9	4.9	4.9	4.9	4.8
Germany: 10 y benchmark	6.22	5.65	5.60	5.49	5.00	4.89	5.12	4.99	4.90	4.90	4.96	4.80

Source: NBB, Frankfurter Allgemeine Zeitung

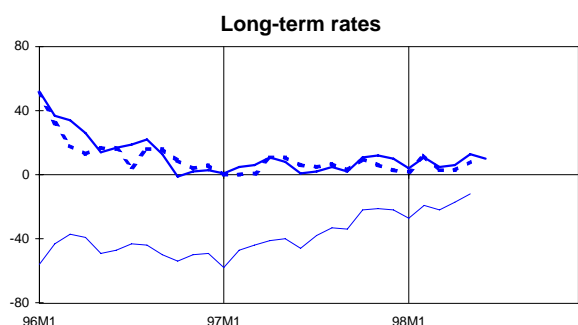
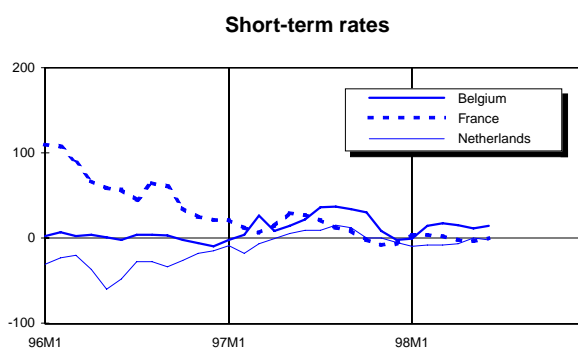
Graph 22 - Interest rate levels in Belgium, in %



Source: NBB

During the second quarter of 1998, financial markets have once again been disturbed by strong uncertainties. Following the depreciation of the yen and its impact on the other Asian currencies and their stock markets, investors have chosen to relocate their financial assets from the emerging markets to western bond markets. With no inflationary anticipation, the US 10-year interest rate dropped to about 5.4% mid June. At the same time, the German 10-year benchmark even reached 4.74%. Low nominal long-term interest rates in most European countries are also explained by further improvement in terms of fiscal consolidation.

Graph 23 - Interest rate differentials with Germany (in basis points)



Source: NBB, Frankfurter Allgemeine Zeitung, Crédit Lyonnais

The Asian crisis has contributed to a further convergence of long-term interest rates in Europe. Short term interest rates, however, remain rather different. The Asian crisis has reduced import price inflation and has helped the Bundesbank not to have to alter its monetary policy. The official interest rates reached 3.3% in Germany where domestic demand is only recovering, and 7% in Ireland where economic activity is buoyant. However, the economic recovery in Germany might induce the Bundesbank to increase its central interest rates before the end of the year, in order to ease the short-term interest rate convergence in the Euro zone.

Short- and long-term interest rates in Belgium continued to follow German interest rates. The long-term spread remained at less than 15 basis points during the second quarter of 1998 despite a slight increase in June. On the money markets, after an increase in April, Belgian and German short term interest rates decreased slightly once the European meeting fixed the bilateral currency parities between the countries taking part to the EMU. The spread with short term German rates reached about 14 basis points in the second quarter 1998.

Exchange rates

Table 11 - Exchange rate (Belgian francs per ...)

	96	97	97Q3	97Q4	98Q1	98Q2	98M1	98M2	98M3	98M4	98M5	98M6
Deutschemark	20.58	20.63	20.64	20.63	20.63	20.63	20.63	20.64	20.63	20.64	20.63	20.63
French franc	6.05	6.13	6.13	6.16	6.16	6.15	6.16	6.16	6.15	6.16	6.15	6.15
Dutch guilder	18.37	18.33	18.33	18.31	18.31	18.31	18.31	18.31	18.30	18.33	18.31	18.30
Italian lira	2.01	2.10	2.12	2.11	2.09	2.09	2.10	2.09	2.10	2.09	2.09	2.09
British pound	48.38	58.59	60.61	60.12	61.76	61.21	61.29	61.40	62.60	62.60	59.98	61.04
American dollar	30.96	35.78	37.31	36.22	37.53	37.01	37.48	37.45	37.67	37.44	36.63	36.96
ECU	38.77	40.41	40.61	40.71	40.81	40.77	40.75	40.75	40.92	40.90	40.64	40.75

Source: NBB

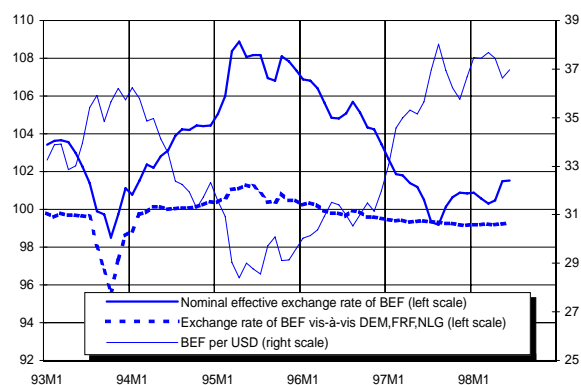
Table 12 - Nominal effective exchange rate of the Belgian franc

	96	97	98	97Q3	97Q4	98Q1	98Q2	98M2	98M3	98M4	98M5	98M6
Level (Jan.92=100)	105.3	100.9		99.5	100.8	100.6	101.2	100.6	100.3	100.5	101.5	101.5
Growth rate [1]	-2.0	-4.2		-5.5	-3.1	-1.5	0.1	-1.3	-1.4	-0.9	0.3	1.0
Id. with constant rate till year end			0.3									

[1] Change (%) compared to same period previous year

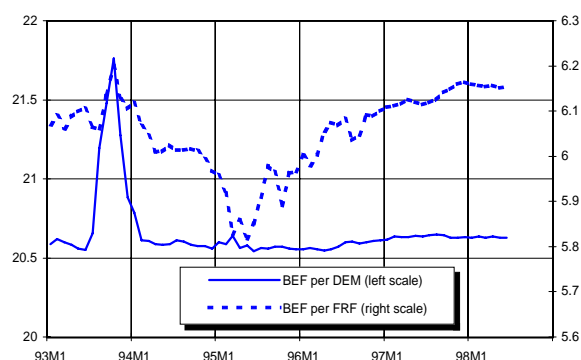
Source: NBB, FPB

Graph 24 - Effective exchange rate (Jan. 92=100) and dollar rate



Source: NBB, FPB

Graph 25 - Belgian francs per French franc and Deutschemark



Source: NBB

During the last week of June, the fear of a Chinese yuan devaluation persuaded the US and Japanese central banks to sell US dollars in order to stop the sharp depreciation of the yen and its spill-over effects to the other east Asian currencies. However, despite this intervention, the yen's weakening seems to persist, mainly reflecting financial markets' lack of confidence in the Japanese economic and financial recovery.

The Asian crisis has two main effects on the US dollar exchange rate; on the one hand, financial markets' uncertainties give the US dollar a role as a «refuge currency», but, on the other hand, the US current deficit is exacerbated by the reduction of US exports to Asia. As a result, during the second quarter of 1998, the dollar exchange rate registered a slight but continued depreciation against the Deutschemark. However, the evolution of the exchange rate of the dollar against the Euro zone currencies remains rather uncertain, and will largely rely on the portfolio allocations that will be realised at the beginning of European Monetary Union.

Within the EMS, the bilateral exchange rates between the 11 countries participating in EMU were fixed at the beginning of May, and on the exchange markets, the Belgian franc remained stable against the other Euro zone currencies.

The BEF effective exchange rate increased slightly during the second quarter 1998 due to the small depreciation of the US dollar, the UK pound and the Asian currencies.

Fiscal indicators

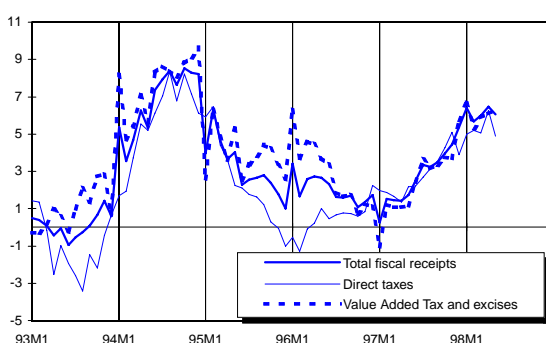
Table 13 - Fiscal receipts (1)

	96	97	97Q2	97Q3	97Q4	98Q1	97M12	98M1	98M2	98M3	98M4	98M5
Total	3.8	7.0	6.2	7.4	9.1	6.7	10.1	11.5	-0.5	8.3	8.7	3.5
Direct taxes	3.2	7.4	6.4	6.6	10.1	5.6	17.1	9.2	-3.8	12.2	7.2	8.2
Withholding earned income tax	4.0	5.5	4.4	4.1	5.6	6.3	-6.8	10.0	-0.5	10.2	45.7	-17.7
Advance payments	4.5	13.5	8.7	15.2	20.4	38.5	26.1	75.6	11.1	7.3	14.2	100.0
Value Added Tax and excises	4.4	5.6	4.8	8.0	5.8	7.4	-1.6	15.3	3.3	2.6	11.9	-2.0
Other	3.5	7.9	6.9	7.1	11.0	6.3	17.9	9.5	-2.3	12.2	7.4	7.1

(1) Change (%) compared to same period previous year

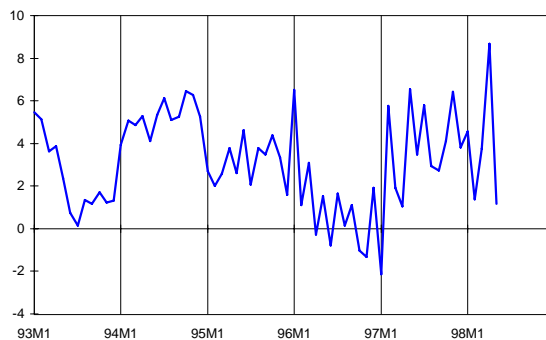
Source: MvF/MdF, FPB

Graph 26 - Real total fiscal receipts (2)



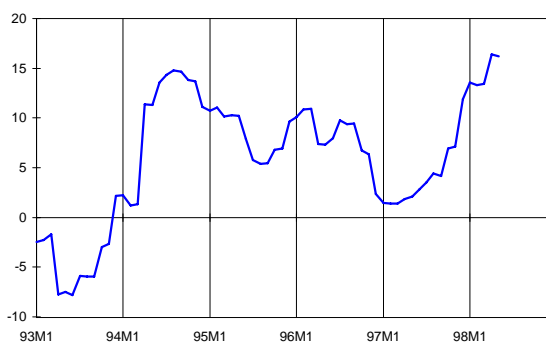
Tax receipts have been growing faster than expected over the first five months of this year. The two main items (withholding earned income tax and value-added taxes) have both contributed to these receipts in a significant manner. This confirms the economic analysis made on earlier pages in this publication: growth remains strong and is pulled now mainly by private consumption and employment growth. The two main tax bases - the wage bill and private consumption - continue to grow strongly.

Graph 27 - Real withholding earned income tax (2)



The third main item explaining the strength of tax receipts is the advance payments (+14% for the first payment in April compared to a year ago), mainly by companies. Companies are penalised if they have not made enough advance payments for their tax base by the end of the year. Conversely, they receive a tax rebate for all advance payments made sufficiently early. Advance payments are therefore a good indicator for expected profits. Advance payments should also take into account changes in the tax system.

Graph 28 - Real advance payments (2)



(2) Change (%) over past 12 months, compared to previous 12 month period, deflated by consumer price index

While total tax receipts have grown at 7% in nominal terms and over 5% in real terms for about 6 months now, it is unlikely that equally strong growth rates will be observed during the second half of the year, due to the dynamism registered during the second half of 1997. Growth rates will, on the other hand, not fall dramatically given the growth composition and its beneficial impact on tax receipts.

Participation of Belgian firms in the globalisation process, through investments abroad and international sourcing, a comparison

This paper is a first publication in the context of the DWTC/SSTC-financed programme for future oriented social and economic research on "Relocation, innovation and employment". This programme, promoted by Herman Van Sebroeck (FPB), joins the efforts of research teams in the FPB, the UCL (prof. dr. H. Sneesens) and the KUL (prof. dr. L. Sleuwaegen). Though the responsibility for this working paper remains exclusively the authors'.

The paper tries to measure the degree by which firms located in Belgium have participated in the globalisation movement in the 1990-96 period by realising foreign direct investments and making use of international sourcing of components and finished products (in the context of outward processing trade). The results are based on a survey answered by a group of 466 firms, organised in the context of the DWTC/SSTC programme on "Relocation, innovation and employment".

The survey has 50% industrial firms and has an over-representation of large and foreign-owned firms. The paper investigates the influence of the position of a firm with respect to other firms, both on its propensity to invest abroad and on that of making use of international sourcing, and studies the type of activities and countries connected with these investments and sourcing.

Almost all firms that present themselves as the *parent company of a group* (86%) have invested abroad in the period 1990-1996. By a long margin, the next investors abroad are the *independent units* (firms not related to a group) (21.2%) and the *affiliates of Belgian parents* (19.6%). The firms with the smallest amount of outward investors are, logically, the *affiliates of foreign parents* (13.6%).

The latter, forming 43% of the sample, and important in the Belgian context, very often do not have the authority to decide on investments abroad (74%) and in Belgium (47%).

Independent units and especially affiliates rely more often on international sourcing than on their own foreign direct investments to organise their production globally. Investments abroad, of which 41% are in distribution and sales, are motivated mainly (69%) by increasing sales in new markets, while for sourcing the most cited motive is profiting from lower wage costs (35%).

In 31% of the firms that relied on international sourcing in 1990-96, (some) production activities have been relocated abroad in the same period.

Most investments and sourcing of the respondents go to Belgium's immediate neighbours and other countries in the European Union. This holds especially for investments in and sourcing of service and sales activities. Outside the EU, Eastern Europe and (North) Africa are more important than Asia and America, for investments in and for sourcing of components or assembly of other than highly technological goods. For the production of highly technological goods the reverse holds.

"Participation des entreprises belges au processus de mondialisation, via leurs investissements et la sous-traitance à l'étranger, une comparaison".

"Deelname door Belgische ondernemingen aan de mondialisering, investeringen in het buitenland en toelevering vanuit het buitenland, een vergelijking". B. Van den Cruyce.

Working Paper 4-98, June 1998

Macro-economic determinants of employment

This working paper summarises recent research at the FPB with respect to the macro-economic factors determining labour demand and with respect to the macro-economic and budgetary impact of labour market policies to encourage job creation. Originally it was drafted as the Bureau's contribution to the 1997 reports on the Belgian labour market that have been prepared by respectively the HRW/CSE and the CRB/CCE.

In the first place, the document offers a broad overview of the main stylised facts concerning employment and its main immediate determinants: growth, productivity, average hours worked and (relative) labour costs. Part I of the working paper summarises the most salient facts for these variables over the long term (1953 onwards).

For the period 1970-94 two dimensions are added to this descriptive overview: on the one hand, the market sector is broken down into two sectors of activity (industry and market services) and, on the other hand, the evolution in Belgium is compared to what has been experienced by our three main trading partners (Germany, France and the Netherlands). Part II of the document goes into more detail as far as the sectoral decomposition is concerned.

One of the main conclusions to emerge from the long-run analysis refers to the declining trend in productivity growth over the period considered, witnessing the fact that growth has never been as intensive in job creation as today. A major characteristic of the Belgian economy appears clearly in the sectoral comparison with the experience abroad.

Ever since the first oil crisis, both real value added and productivity growth are substantially higher than abroad in the industrial sectors and substantially lower than abroad in market services. Labour costs have tended to increase faster in Belgium than abroad for all sectors; in industry this has been (over-) compensated by faster productivity growth than abroad, whereas for

market services the opposite holds.

Second, a comparative synthesis is given of the numerous macro-economic and budgetary impact studies the FPB has made over the last few years concerning various instruments of labour market policy. These instruments are mutually compared as to their measured impact on growth, inflation, productivity, job creation, cost for public finances and (functional) income distribution.

Macro-economic income policies of wage moderation have been tested under two configurations: applied domestically only or mimicked by our main trading partners. Policies of across-the-board imposed working time reduction have been analysed, both in the presence and in the absence of wage compensation.

Various forms of wage subsidies, targeted consumption subsidies directed towards labour-intensive services and alternative modes of financing social security have equally been studied. As for wage subsidies, in Belgium they typically (but not exclusively) amount to reductions in employers' social security contributions. A typology is proposed which cross-classifies wage subsidies along two dimensions: subsidies may be general or specific ("targeted") in nature and they may be either "unconditional" or accorded subject to additional (net) job creation.

Finally, the confrontation of the descriptive analysis and the summary of the impact studies results in a number of policy recommendations that refer to the way Belgian labour market policy may be inscribed in a broader European policy encompassing "economic" and "employment" guidelines.

"Déterminants macro-économiques de l'emploi". Direction générale du BfP.

"Macro-economische determinanten van de werkgelegenheid", Algemene directie van het FPB. Working Paper 5-98, July 1998.

Economic and budgetary effects of a reduced VAT rate for certain services

Fiscal instruments may influence employment. In this context, in November 1997 the European Commission suggested adjusting Europe's legal framework in order to allow EU member states a VAT rate reduction on labour-intensive services. The VAT rate reduction on some services would be an experience limited in time (three years) and followed by an evaluation. This idea was approved in December 1997 by the Council of Ministers at the EU Summit in Luxembourg, and adopted in some national Action Plans for Employment.

The Commission itself expects that the job-creating effects of this kind of tax cut will remain relatively limited. Reductions in employers' social contributions are considered by the Commission to be the most effective employment-creating fiscal instrument.

The FPB has analysed the economic and budgetary effects of a VAT rate permanently reduced from 21% (the rate of the reference scenario) to 6% for a certain number of services, a priori considered to be labour-intensive, *i.e.* repair services on movable tangible property (shoes, furniture, clothing, bicycles but excluding other means of transport), personal services (hairdressers, beauty parlours, body care), laundry and other related services. These categories represent 1.9% of total private consumption. The simulation was realised by means of the macro-sectoral model HERMES for the period 1999-2003.

Ex ante, *i.e.* before feedback effects, the government's yearly loss of indirect tax income amounts to about 12 - 15 billion BEF.

Ex post, *i.e.* including feedback effects, the following results are obtained. The consumption price level decreases by 0.2 to 0.3% compared to its baseline level, thereby improving households' purchasing power. It should be noted that the reduction in VAT is supposed to be completely reflected in the consumer prices of the favoured services. If not, it is obvious that the measure will be less beneficiary for employment than described below.

Due to stronger private consumption and the increased demand for market services, 2600 jobs are created in the first year and 6000 four years later (mainly in the market service sector). The better macro-economic prospects

limit the loss of indirect tax revenue to 10 billion BEF, against 15 billion *ex ante*. The loss in VAT revenue deteriorates the social security balance, as alternative financing is based on this taxation. Households income tax and social contributions decrease in nominal terms, despite the additional labour income generated by the new jobs. Corporate income tax rises due to the increased economic activity and reduced nominal wage rates.

As a result, the general government borrowing requirement increases by more than 6 billion in the first year (1999) and still exceeds its medium-term baseline level by more than 5 billion. The VAT measure can be considered as being not neutral in budget terms, although considerable feedback effects occur. About 2/3 of the *ex-ante* cost is compensated by the impact of the measure on economic activity.

The above results should be interpreted with care. HERMES is a sectoral model, but not detailed enough to determine the specific behaviour or features of the favoured activities. Therefore a "risk scenario" was also simulated assuming a somewhat smaller degree of labour intensity. As a result, it was found that job creation could be more limited than in the former scenario, *i.e.* 1800 jobs in the beginning and 4600 jobs in the medium term, compared to the baseline. The budgetary consequences would be more negative.

In both scenarios, the job creations may seem to be quite limited but it should be noted that some services proposed by the European Commission as candidates for the VAT-rate reduction are already benefiting in Belgium from a reduced VAT rate (renovation and repair services on old residential housing, leisure parks), a zero VAT rate (care of the young, disabled and elderly) or other specific measures (e.g. cleaning services provided by the unemployed).

“Effets macroéconomiques et budgétaires de l'application du taux de TVA réduit à certains services”.

“Macro-economische en budgettaire effecten van een BTW-verlaging op bepaalde diensten”.

C. Streef, I. Bracke, M. Saintrain, F. Vanhorebeek.

Working paper 6-98, July 1998

Other Recent Publications

[Medium-Term Economic Outlook 1998-2003](#), April 1998
(available in Dutch and in French).

[Economic Forecasts 1998](#), July 1998
(available in Dutch and in French).

[Working Paper 1-98](#), April 1998.

M. Saintrain, "L'impôt des personnes physiques en Belgique: une analyse macroéconomique".

[Working Paper 2-98](#), April 1998.

F. Bossier, R. Molein, M. Saintrain, C. Streel, F. Vanhorebeek, "Economische en budgettaire effecten van een BTW-verlaging op nieuwe particuliere woningen".

[Working Paper 3-98](#), May 1998.

B. Steyaert, "Environmental external cost of fuel cycles: a policy case study on electricity taxation".

Forthcoming Publications

[Demographic ageing and the financing of social security: a sustainable challenge?](#)

Reports of the two-day conference organised by the FPB, on December 2 and 3 1997, in Brussels.

[The sustainable development project](#): five years after the Earth Summit: Five years after RIO (United Nations Conference on Environment and Development). The study looks at progress made in the project of sustainable development on an international basis. The purpose is to inform public authorities, politicians and also the general public about the concept of "global approach". The study is based on information with regard to progress with the Action 21 programme for sustainable development.

[The 1985 input-output table](#).

In December 1994, the FPB was commissioned to compile input—output tables. Since data for the 1995 table were not available and with a view to gaining experience in this field, a table for 1985 has been drawn up based on a somewhat mechanical method. The publication will describe the framework, the definitions and the estimation methods and will outline various applications of input-output analysis such as the link between final demand and primary inputs, the cost composition of output and the import content of output. A diskette with the data will be included.

[The role of innovation, relocation and firm position in explaining inter-firm differences in employment growth](#).

The paper is part of a series of publications in the context of the SSTC-financed programme for future oriented social and economic research on "Relocation, innovation and employment". It contains an econometric evaluation of the effect of the cited variables on employment growth at firm level, using the results of a survey of 466 Belgian firms. The latter was organised jointly by 3 teams in the FPB, the UCL and the KUL.

[Belgian economic policy in the third stage of Economic and Monetary Union \(EMU\)](#).

This paper presents the main objectives and instruments of the economic and structural policy coordination that is taking place in the European Union, as well as the respective "roles" and efficiencies of the monetary, budgetary and income policies for regulating business cycles during the third stage of EMU. Finally, the consequences of Economic and Monetary Union for the macro-economic and structural policy in Belgium are analysed.

Recent history of major economic policy measures

May 1998	The EU-Brussels Summit has decided that 11 countries will participate in European Monetary Union from January 1999 onwards: Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain. At the same time, the Executive Board of the future European Central Bank has been nominated, with Mr. W. Duisenberg being the first chairman. Part of the agreement was that the Belgian primary surplus should remain close to 6% of GDP in the medium term.
April 1998	The Belgian Government has presented the National Action Plan for Employment to the European Union. Particular attention is given to: (i) an extension of the reduction in employers contribution to social security (an additional 18 Billion BEF per year from 1999 to 2004); (ii) more pronounced active labour market policies and (iii) further measures in the area of training and learning.
March 1998	The Greek drachma was devalued by 13.8 percent while the Irish punt was revalued by 3 percent.
October 1997	The 1998-Budget was presented to the Parliament. Employers' contributions are to be cut by a further 6 billion BEF in 1998, and by 12 billion in 1999. The Justice Department is to receive an extra 4 billion BEF. Three one-off receipts: 8 billion from a third telephone operator; 2.4 billion from pharmaceutical companies and 1.5 billion from electricity producers.
July 1997	<ul style="list-style-type: none"> • Changes in the pension system for the private sector were introduced. Men and women will gradually be treated equally in the calculation of their pension. Anticipated retirement between 60 and 65 will henceforth only be allowed to workers with a career of minimum 20 years. A minimum pension right for every year worked was also introduced. The savings for government of these changes are evaluated by the FPB to be limited in the near future but will amount to 0.25% of GDP in 2010. • The EU-Amsterdam Summit extended the "Stability and Growth Pact" to include an employment chapter. Countries with budget deficits above 3% of GDP could receive fines between 0.2% and 0.5% of GDP unless there are exceptional circumstances (e.g. an economic recession). • The Federal Government extended and changed the criteria for Maribel: reduction of employers' social security contributions are based on the 'blue-collar intensity'^a of each company; the total reduction of contributions is increased from 18 to 25 billion.
December 1996	The Federal Government decided that the maximum increase of the wage cost rate (per hour) would be 6.1% over 1997-98, as the Social partners were unable to reach an agreement earlier.
October 1996	The Federal budget 1997 was presented to Parliament. The major measures were: <ul style="list-style-type: none"> • Increase in excise taxes on petroleum and tobacco products and alcohol - expected impact (excise taxes and VAT on excise taxes included): 1.2 billion in 96 and 13.2 billion in 97-; • Non-indexation of tax brackets in 97 and 98 - expected impact: 5.4 billion BEF in 97-. • Taxes on the delivery of financial products - expected impact: 4 billion BEF in 97-.
August 1996	Three framework laws gave the Government extensive powers to encourage employment and competitiveness, as well as in the area of budgetary policy with a view to joining EMU and modernising the social security system. One of the laws defined a wage norm providing for a minimum and maximum increase of the hourly compensation.
October 1995	Federal Budget 1996 was presented with the main measures as follows: <ul style="list-style-type: none"> • Excise taxes on petroleum products were increased, "tax" on diesel cars • The 20.5% VAT rate was increased to 21% from January 96 onwards; • The withholding tax rate was increased to 15% from January 1996 onwards (after increases from 10% - see January 90 - to 10.3% in July 1993 and 13.39% in the beginning of 1994); • Extension of the number of "low paid workers" entitled to benefit from lower social security contributions to workers with a gross wage of up to 60,000 BEF per month (applied from April 96 onwards).
January 1994	The 19.5% VAT rate was increased to 20.5%. Excise duties on petroleum and tobacco products were also increased.
November 1993	The Federal Government presented its 'Global plan'. The main measures were as follows: <ul style="list-style-type: none"> • A new price-index was defined (the so-called 'health-index') as the CPI excluding: petroleum and tobacco products, alcohol and a new tax on household energy consumption. This price index would be used to link wages, house rents and social expenditure to prices; • A real wage-freeze in 1995-96; • Increase in indirect taxes (see January 1994); • Reduction of social security contributions.
August 1993	<ul style="list-style-type: none"> • The EMS fluctuation bands were widened. • Reduction of employers contributions to social security in the "open sector" (so-called Maribel bis). • Several measures to encourage employment by reducing employers contributions to social security
April 1992	VAT rates were aligned with EU norms
June 1990	The National Bank of Belgium announced that the BEF would be more closely linked with the stronger currencies of the EMS.
January 1990	The withholding tax rate on fixed income investments was reduced from 25% to 10% from March 90 onwards.

Abbreviations for names of institutions used in this publication

BLEU/UEBL	Belgisch-Luxemburgse Economische Unie / Union Economique Belgo-Luxembourgeoise
CRB/CCE	Centrale Raad voor het Bedrijfsleven / Conseil Central de l'Economie
DULBEA	Département d'Economie Appliquée de l'Université Libre de Bruxelles
DWTC/SSTC	Federale Diensten voor Wetenschappelijke, Technische en Culturele aangelegenheden / Services fédéraux des Affaires Scientifiques, Techniques et Culturelles
FEBIAC	Fédération Belge des Industries de l'Automobile et du Cycle "réunies"
FMTA/MFET	Federaal Ministerie van Tewerkstelling en Arbeid / Ministère fédéral de l'Emploi et du Travail
FPB	Federal Planning Bureau
HRW/CSE	Hoge Raad voor de Werkgelegenheid / Conseil Supérieur de l'Emploi
IMF	International Monetary Fund
INR/ICN	Instituut voor de Nationale Rekeningen / Institut des Comptes Nationaux
IRES	Université Catholique de Louvain - Institut de Recherches Economiques et Sociales
MEZ/MAE	Ministerie van Economische Zaken / Ministère des Affaires Economiques
MvF/MdF	Ministerie van Financiën / Ministère des Finances
NBB	National Bank of Belgium
NIS/INS	Nationaal Instituut voor de Statistiek / Institut National de Statistique
OECD	Organisation for Economic Cooperation and Development
RSZ/ONSS	Rijksdienst voor Sociale Zekerheid / Office national de la Sécurité Sociale
RVA/ONEm	Rijksdienst voor Arbeidsvoorziening / Office National de l'Emploi

Other Abbreviations

BEF	Belgian franc
BoP	Balance of Payments
CPI	Consumer Price Index
DEM	Deutschemark
ECU	European Currency Unit
EMS	European Monetary System
EMU	Economic and Monetary Union
FRF	French franc
GDP	Gross Domestic Product
OLO	Obligations linéaires / Lineaire obligaties
s.a.	seasonally adjusted
t/t-4	growth rate between present quarter and the corresponding quarter previous year
t/t-12	growth rate between present month and the corresponding month previous year
UKP	United Kingdom pound
USD	United States dollar
VAT	Value Added Tax