SHORT TERM UPDATE

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Quarterly Newsletter
March 2009

Headlines Belgian Economy

Special Topic in this issue

The crisis makes Belgian public finances vulnerable

Federal
Planning Bureau
Economic analyses and forecasts

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Quarterly Newsletter of the Federal Planning Bureau

Short Term Update (STU) is the quarterly newsletter of the Belgian Federal Planning Bureau. It contains, in English, 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

In 2008Q4, the financial crisis and the recession faced by the main trading partners took their toll and caused Belgian GDP to fall by 1.3% qoq. According to our February forecast, Belgian economic activity should continue to contract in the course of 2009 and only stabilise in the fourth quarter. As a consequence, Belgian GDP is projected to fall by 1.9% in 2009, after an increase of 1.1% in 2008. Despite the considerable downward revision of Belgian GDP growth for 2009 (last September a positive economic growth of 1.2% was forecast), the uncertainty surrounding this forecast remains exceptionally large and downside risks are likely to be greater than upside risks.

Belgian exports should fall by 4.6% this year, after an increase of 2.2% in 2008. Imports should decrease less than exports. Despite the drop in oil prices and the appreciation of the euro, the current account balance should remain negative and reach -1.8% of GDP in 2009.

In 2008, private consumption increased by 0.9%. The negative growth of private consumption in 2009 (-0.4%) is mainly due to historically low consumer confidence and negative wealth effects caused by the drop in asset prices. This should lead to a strong rise in the households' savings rate (up to 15.8%). Worsened demand prospects, the decline in business profitability, falling capacity utilisation rates and tightened lending conditions should exert a drag on business investment in 2009, which should fall by 4.6%. Household investment growth should also turn negative in 2009 (-1.6%), although this contraction will be mitigated somewhat by a temporary VAT reduction. Only public consumption and public investment growth rates are expected to remain positive.

This year, an average (net) loss of 24 700 jobs should be registered. Job losses in the course of 2009 will be far worse than appears from the annual averages: in 2009Q4, employment should be 59 100 persons lower than in 2008Q4. The harmonised Eurostat unemployment rate (which is based on labour force surveys) is expected to reach 8.2% in 2009, compared to 7.1% in 2008.

Despite high underlying inflation during the first half of 2009, total inflation, as measured by the yoy increase in the national index of consumer prices, should continue to decrease and even become slightly negative during summer. Only in the second half of this year should the expected oil price increase be reflected in inflation evolution. According to our inflation update of March, average inflation should decline from 4.5% in 2008 to 0.5% in 2009.

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The Federal Planning Bureau (FPB) is a public agency under the authority of the Prime Minister and the Minister of Economy and Reform. The FPB has a legal status that gives it an autonomy and intellectual independence within the Belgian Federal public sector.

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

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The crisis makes Belgian public finances vulnerable

The current crisis makes Belgian public finances vulnerable in three ways: the heightened risk resulting from the government's interventions aimed at supporting financial institutions, the budgetary impact of the economic slowdown, and the hardly reversible character of some of the measures contained in the recovery plan. The weakening of Belgian public finances appears in a context of continued concerns as to the sustainability of public finances in the long term and uncertainty surrounding the future of fiscal federalism in Belgium.

Widening yield spread on public debt securities

Every year, given the schedule of securities in circulation, around 10% of the long-term public debt needs to be refinanced, as does the entire short-time debt and the current year's deficit. This leads to considerable amounts of issuing because of the size of the debt, which reached EUR 308bn at the end of 2008 (about 80% of which was long-term), i.e. 89% of Belgium's GDP. Thus, the interest rate at which the state borrows is an important variable in fiscal policy.

The financial crisis induced a flight to safety and liquidity by investors. The states, which are considered as debtors with an almost endless solvency because of their possible recourse to taxpayers, did not have to face the same tightening of credit conditions as financial or non-financial businesses. Nevertheless, the yield spread for securities issued by the various states has widened considerably: the states that are considered as more risky debtors because of the level of their debt or deficit are required to pay higher interest rates. In the euro area, this particularly affects Greece, Ireland, Portugal and Italy, followed by Belgium and Austria.

Over the 2003-2007 period, the gap between the rates for 10-year bonds issued by the Belgian state and the German Bund never exceeded 10 basis points on an average annual basis. By mid-February 2009, this gap had widened to more than 120 basis points. This gap can be seen, at least partly, as the risk premium requested by investors who take the view that Belgian public finances have become more vulnerable.

Government support for financial institutions

Since autumn 2008, many European states have intervened to support their financial sector, either through recapitalizations, takeovers or guaranteeing. Those interventions are deemed necessary to avoid a failure in payments systems and to limit credit contraction, which weighs on economic activity.

The financial sector is strongly developed in Belgium. Furthermore, since the 1990s, it has gone through a number of mergers and acquisitions: four groups (Fortis, Dexia, KBC and ING) account for 82% of all bank deposits and 44% of all insurance premiums (2004 figures), a situation that increases the systemic risk in the event of bank failure. Both the size of the financial sector and its level of concentration are factors that may undermine public finances as the government intervenes to support the sector.

Public funds injected in Belgian financial institutions have been collected mainly through borrowing (and, for the lesser amounts, through sales of assets or available cash in the case of the interventions by the Regions). If those interventions have been made at (efficient) market value, the state's net assets are unchanged. On the liabilities side, the various transactions amount so far to EUR 23bn (of which EUR 20bn are at the federal level), i.e. 6.5% of the 2009 GDP forecast. Over a full year, interest charges roughly amount to EUR 1bn, i.e. 0.3% of GDP. As opposed to these charges, which are certain and predictable, the counterpart on the assets side - shares in Fortis, Dexia, KBC and Ethias - are unsure investments, both for yields and capital.

Moreover, the state now guarantees inter-bank loans subscribed by systemically important Belgian banks, subject to a fee reflecting the advantage obtained. To date, the state has committed to covering a maximum amount of EUR 241bn, i.e. 69% of the 2009 GDP forecast, of which EUR 50bn are already effectively guaranteed (on March 4th). Furthermore, the state also guarantees up to EUR 100 000 on private bank deposits and life insurance contracts. The state's exposure in this area is potentially significant: for reference, in 2007, the total amount of private customers' deposits in credit institutions under Belgian law amounted to 86% of GDP. Finally, the law of 15 October 2008 gives the National Bank of Belgium a state guarantee for loans aimed at supporting financial stability, which enables the BNB to provide - possibly very high amounts of - liquid assets to banks in difficulties.

The risk exposure of the state assets has therefore increased. The amounts involved greatly exceed the annual state budget and even the GDP, which ultimately forms the financing basis of a state through taxation.

Economic downturn

The financial crisis has rapidly affected the real economy through loss of confidence, negative wealth effects and a credit squeeze for households and businesses.

Consequently, demand, notably for durable goods, investments and exports, has dropped. The economic downturn is increasing budget deficits through automatic stabilizers: tax revenue falls because it is linked to the evolution of the various tax bases, while expenditure either rises because of the crisis - for example unemployment expenditure - or evolves independently from the economic cycle.

In October 2008, the government drew up its 2009 budget on the basis of GDP growth of 1.2%. This scenario, now viewed as much too optimistic, would in any case have led to difficulties in balancing the budget as this growth rate of GDP remains below the normal growth rate of a large part of public expenditure, e.g. social expenditure and civil servants' pay. The FPB now expects negative growth in 2009 (-1.9%), followed by almost zero growth in 2010. Hence, the public deficit (including the recovery plan) should amount to more than 3% of GDP in 2009 and about 4.5% in 2010. Those figures are all the more negative because no budget surpluses were built up in good times.

Recovery plans

In view of the recession, states are taking countercyclical policies in order to mitigate the economic downturn, to prevent the bankruptcy of non-financial businesses and to limit the scale of restructuring. Those policy measures should respect the Stability and Growth Pact, which authorizes budget deficit deepening through the 'exceptional circumstances clause'. In November 2008, the European Commission invited Member States to undertake coordinated actions which should be timely so as to answer today's challenges, targeted in order to obtain maximum stabilization from the limited budgetary resources, and temporary to prevent a structural deterioration of the budgets (this implies that the policies are reversible).

In Belgium, both the regional plans and the federal plan include measures to facilitate access to credit and venture capital and the front-loading of public and public-private investment schemes. At the federal level, the stimulus package includes measures to foster housing investment, improve the cash accounts of businesses and support households' purchasing power, as well as labour cost reduction initiatives. The initiatives aimed at reducing labour costs represent nearly half of the budget of the federal plan (about 0.3% of GDP out of a total of 0.6%). They facilitated the conclusion of the Inter-professional Agreement 2009-2010 as they seek to lower, by means of the budget, the Belgian structural competitiveness problem that existed before the crisis. Consequently, those initiatives will not be so easy to reverse. A structural negative impact on the budget can be worrisome within a context of unsustainable public finances.

Fiscal sustainability and fiscal federalism

With the first assessments in the nineties of the ageing cost, the sustainability problem became noticeable. A 'front-loading'-type strategy aimed at facing the ageing cost was officially adopted by the Belgian authorities, and laid down in the successive Stability Programmes and in the Ageing Act through the creation of an Ageing Fund. This Fund was supposed to be fed by resources obtained from the federal debt reduction, i.e. from margins resulting from lower interest payments. It was created to finance the future increase in pension expenditure without having to resort to an increase in taxation or to a reduction in the provisions of the welfare state.

In reality, this strategy has never been followed. Since 2000, the reduced interest payments have been fully absorbed by the structural decline in the primary surplus (down from almost 7% of GDP to 3.5% of GDP in 2007). This resulted in a balanced budget, by and large, during two legislative terms. Despite the amounts paid here and there to the Ageing Fund (coming from one-shot measures), this fund has so far proved useless: it would only have made sense if structural budget surpluses had been achieved. The laxer budgetary policy and, accordingly, the slowdown in debt reduction, lead to an increase of the gap between the structural primary surplus and the level at which it could ensure long term sustainability: in June 2008, the Federal Planning Bureau estimated this 'sustainability gap' at 1.7% of GDP.

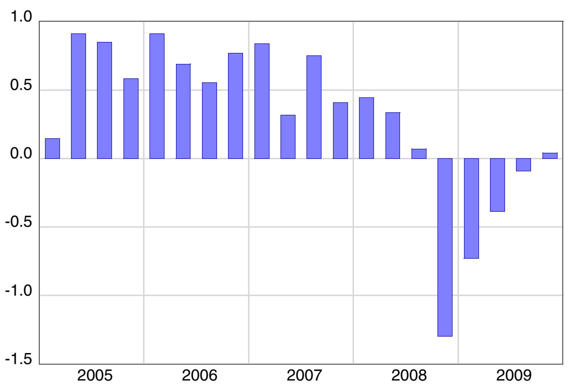
A recent update, of February 2009, revised the sustainability gap to 3.8% of GDP. This worsening is due to a downward revision of the medium-term potential growth, to structural budgetary measures that were taken in the meantime and, to a lesser extent, to the impact of bank recapitalizations on the gross debt. A fiscal scenario without correcting measures would not be sustainable: the deficit would never fall below 3% of GDP; the debt would set off on an explosive trajectory from 2020 onwards, leading it to more than 200% in 2050. In case of further or more lasting decline of the potential growth than supposed here, the outlook for sustainability at constant policy should be even more pessimistic.

The question remains when and to what extent sustainability policies will regain priority, while the crisis has put stabilization policies in the forefront. Furthermore, the Belgian sustainability strategy will inevitably have to be revised: no margin can be expected from a decrease in interest charges by a structurally in deficit federal government. The social partners, as well as the federated entities, will necessarily be involved in a redefinition of the long-term strategy, within the framework of an overhaul of fiscal federalism in Belgium, including the question of the financial relationship between the federal government and social security.

Economic forecasts 2009

During the first three quarters of 2008, quarterly economic growth weakened from 0.4% to 0.1%. In the fourth quarter, the financial crisis and the recession faced by Belgium's main trading partners took their toll and caused its GDP to fall by 1.3%. In line with the European business cycle, Belgian economic activity should continue to contract in the course of 2009 and only stabilise in the fourth quarter. As a consequence, Belgian GDP is projected to fall by 1.9% in 2009, after an increase of 1.1% in 2008. This implies a significant downward revision in comparison with the September 2008 forecasts, which were finalised just before the start of the financial crisis in Europe. In those forecasts the Belgian economy was projected to grow by 1.2% in 2009.

Graph 1 - Quarterly GDP growth
qoq growth rates, corrected for seasonal and calendar effects



The Western economies are facing a serious recession

The GDP growth forecasts published by the European Commission on 19 January have been taken into account in drawing up the international economic scenario. This year, euro area GDP should decrease by 1.9%, following 0.9% growth in 2008, while the US economy should shrink by 1.6% in 2009. Both the US and the European economies moved into a recession in 2008, but their GDP should contract most sharply in 2008Q4 and 2009Q1, as a consequence of the financial crisis. The drop in oil prices, as well as expansionary monetary and fiscal policies should progressively support economic activity. However, only in the second half of 2009 should US and euro area GDP growth become slightly positive.

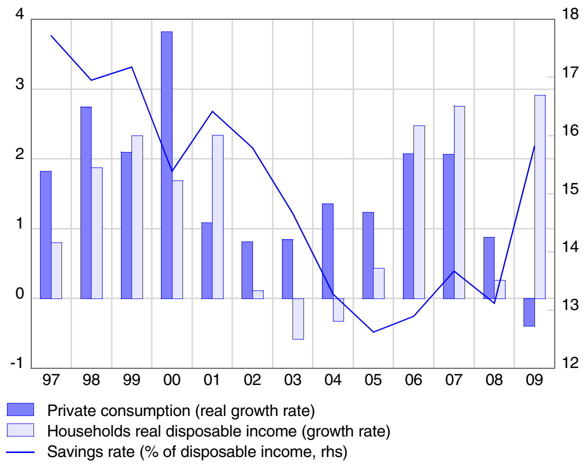
The exchange rate and oil price hypotheses are based on future market quotations given in mid-January. The exchange rate of the euro should amount to 1.34 USD/EUR on average in 2009, compared to 1.47 USD/EUR last year. Crude oil prices should fall from USD 96.9 per barrel in 2008 to USD 52.5 in 2009. The international outlook is exceptionally uncertain, especially regarding the duration and the intensity of the financial crisis, as well as its impact on the real economy.

The Belgian economy should contract in 2009 due to the negative growth of both exports and domestic expenditures.

Belgian exports are affected by the European recession and have shown negative growth rates from 2008Q3 onwards. The volume of exports should stabilise towards the end of 2009, in line with the international business cycle. After an increase of 2.2% in 2008, Belgian exports should fall by 4.6% this year. This fall is sharper than that registered in foreign export markets (-3.1%, against 3.5% in 2008), implying a further loss of export market shares. In fact, exports should be hampered by the appreciation of the effective exchange rate of the euro and by rising labour costs in Belgium.

Imports should decrease less than exports. Despite the drop in oil prices and the appreciation of the euro, the current account balance should remain negative and reach -1.8% of GDP in 2009.

Graph 2 - Private consumption and savings rate



In 2008, real disposable income growth was limited to 0.3% in spite of a substantial rise in employment. This meagre performance is explained by the strong increase in energy prices. As energy prices are only partially taken into account in the health index, which serves as the basis for the indexation of public sector wages and social benefits, the health index increase in 2008 was less pronounced than total inflation. Moreover, indexation mechanisms react with a certain delay to the evolution of the health index, so that wage indexation should be lower in 2008 than the increase in the health index. Because of this delay, the wage indexation for 2009 (2.8%) partially reflects the high inflation of 2008 and largely exceeds the rise in the consumer price index in 2009

(0.7%). This evolution, combined with an increase in gross wages before indexation that is estimated to be 0.6%, explains the strong increase in households' real disposable income in 2009 (2.9%).

In 2008, private consumption increased by 0.9%, which went hand in hand with a decline in the savings rate (13.1% against 13.7% in 2007). Indeed, households tend to save a smaller part of their income when the growth of their real disposable income is weak and to compensate for that by increasing their savings rate in years with stronger growth in their real disposable income. That partially explains the strong rise in the savings rate in 2009 (up to 15.8%), although the negative growth of private consumption (-0.4%) is mainly due to the historically low consumer confidence and negative wealth effects caused by the drop in asset prices.

With an increase of 6.4%, business investment was the main driving force of the Belgian economy in 2008. Nevertheless, investment activity contracted in the second half of the year because of worsened demand prospects, the decline in business profitability, falling capacity utilisation rates and the increase in interest rates on external financial resources (because of a higher risk premium). This will continue to exert a drag on business investment in 2009, which should stabilise only by the end of the year. Overall, business investment should fall by 4.6% in 2009.

Housing investment clearly lost momentum over the previous two years (growth of 1.3% and 0.9% in 2007 and 2008, respectively) as a result of, amongst other factors, increased financing costs. Indicators from the architects' survey, which provide a good indication of the future evolution of residential building activity, point to a contraction, which, however, should be mitigated somewhat by the VAT reduction announced for residential building. Household investment growth should turn negative in 2009 (-1.6%).

The increase in public consumption and public investment partially compensates for the reduction in household and business expenditure.

Further decline in the unemployment rate in 2008, followed by a strong increase in 2009

In 2008, net job creation still amounted to 71,600 persons on average. This year, an average (net) loss of 24,700 jobs should be registered due to the recession. Job losses in the course of 2009 will be far worse than appears from annual averages: in 2009Q4, employment should be 59,100 persons lower than in 2008Q4. The employment rate is expected to fall from 63.6% in 2008 to 62.8% in 2009.

In 2009, the negative growth in domestic employment (-0.6%) is expected to be less pronounced than that in economic activity (-1.9%). Indeed, many employers do not immediately adjust their number of employees to an economic downturn, and initially prefer a reduction in working hours per employee, e.g. by appealing to the temporary unemployment scheme. In these forecasts, the number of temporary unemployed should rise by an average of 16,100 persons this year (compared to an increase of 2,400 persons in 2008).

Within the context of a further increase in the labour force, the number of unemployed will increase faster in 2009 than the number of jobs that are lost. Unemployment should increase by 64,400 units (broad administrative definition). The harmonised Eurostat unemployment rate (which is calculated by means of labour force surveys) is expected to reach 8.2% in 2009, compared to 7.1% in 2008.

After reaching almost 6% by mid-2008, inflation should cool down to 0.7% on average in 2009[1]

The strong increase in headline inflation (as measured by yoy growth in the national index of consumer prices) between August 2007 and July 2008, as well as the subsequent marked decrease, can be mainly explained by the price evolution of food and energy products.

From mid-2008 onwards, underlying inflation has clearly accelerated as a result of higher commodity prices and strong unit labour cost growth, affecting prices of non-energy goods and services. Underlying inflation should stabilise during the following months and weaken in the second half of the year.

Despite high underlying inflation during the first half of 2009, total inflation should continue to decrease and even become slightly negative during summer as it will take some time before natural gas and electricity prices entirely reflect the decrease in oil prices. Only in the second half of this year should the expected oil price increase, which stems from future market quotations, be reflected in the evolution of inflation. On a yearly basis, inflation should decline from an average of 4.5% in 2008 to 0.7% in 2009.

The slowdown in the growth rate of the health index (from 4.2% in 2008 to 1.4% in 2009) should be less pronounced than the reduction in headline inflation as the health index is not influenced by developments in petrol and diesel prices.

"Economische begroting 2009 / Budget économique 2009", INR/ICN, February 2009.

1. Inflation forecasts were recently revised downwards. See page 15 for more information.

Summary of Economic Forecasts

Economic forecasts for Belgium by the Federal Planning Bureau

	2006	2007	2008	2009
Private consumption	2.1	2.1	0.9	-0.4
Public consumption	0.1	2.3	2.3	1.9
Gross fixed capital formation	4.7	6.2	4.5	-3.0
Final national demand	3.1	3.3	2.3	-0.6
Exports of goods and services	2.6	4.0	2.2	-4.6
Imports of goods and services	2.7	4.6	3.6	-3.2
Net-exports (contribution to growth)	0.0	-0.4	-1.1	-1.3
Gross domestic product	3.0	2.8	1.1	-1.9
p.m. Gross domestic product - in current prices (bn euro)	318.22	334.92	346.24	350.51
National consumer price index	1.8	1.8	4.5	0.7
Consumer prices: health index	1.8	1.8	4.2	1.4
Real disposable income households	2.5	2.8	0.3	2.9
Household savings ratio (as % of disposable income)	12.9	13.7	13.1	15.8
Domestic employment (change in '000, yearly average)	58.1	77.4	71.6	-24.7
Unemployment (Eurostat standardised rate, yearly average) [1]	8.3	7.5	7.1	8.2
Current account balance (BoP definition, as % of GDP)	2.0	1.7	-2.1	-1.8
Short term interbank interest rate (3 m.)	3.1	4.3	4.6	2.0
Long term interest rate (10 y.)	3.8	4.3	4.4	3.8

[1] Other unemployment definitions can be found on page 14

Economic forecasts for Belgium by different institutions

	GDP-growth		Inflation		Government balance		Date of update
	2008	2009	2008	2009	2008	2009	
Federal Planning Bureau [1]	1.1	-1.9	4.5	0.7[1]			02/09
INR/ICN [1]	1.1	-1.9	4.5	0.7			02/09
National Bank of Belgium [2]	1.1	-1.9	4.5	0.5	-1.1	-3.3	02/09
European Commission [2]	1.3	-1.9	4.5	1.1	-0.9	-3.0	01/09
OECD [2]	1.5	-0.1	4.6	1.9	-0.7	-1.3	11/08
IMF [2]	1.4	0.2	4.6	2.8	-0.4	-1.3	10/08
ING [1]	1.1	-1.9	4.5	0.9	-1.1	-3.4	02/09
Fortis Bank [2]	1.4	-0.5	4.5	1.7	-0.9	-2.0	12/08
Dexia [1]	1.2	-1.7	4.5	0.7			02/09
KBC Bank [1]	1.4	-0.5	4.3	0.6	-0.6	-1.6	12/08
Deutsche Bank	1.1	-3.0	4.5	0.9	-0.7	-4.6	02/09
IRES [1]	1.4	-0.9	4.5	1.1	-0.8	-2.5	01/09
Consensus Belgian Prime News [2]	1.3	-0.6	4.5	1.5	-1.0	-1.9	01/09
Consensus Economics [2]	1.3	-1.4	4.5	1.6	.	0.0	02/09
Consensus The Economist [2]	1.3	-1.3	4.5	1.4	.	0.0	02/09
Consensus Wirtschaftsinstitute [2]	1.5	0.3	4.8	3.4	-0.6	-0.9	10/08
Averages							
All institutions	1.3	-1.2	4.5	1.3	-0.8	-2.3	
International public institutions	1.4	-0.6	4.6	1.9	-0.7	-1.9	
Credit institutions	1.3	-1.4	4.5	1.1	-0.9	-2.7	

[1] Inflation forecasts based on the evolution of the national index of consumer prices

[2] Inflation forecasts based on the evolution of the harmonised index of consumer prices

1. Inflation forecasts were recently revised downwards. See page 15 for more information.

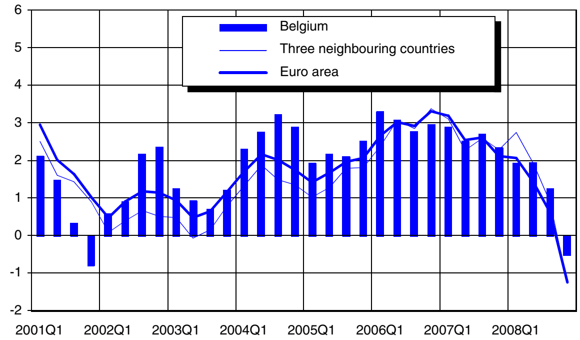
General economic activity

Table 1 - GDP growth rates, in % [1]

			YoY growth rates, in %					QoQ growth rates, in %				
	2007	*2008*	*2007Q4*	*2008Q1*	*2008Q2*	*2008Q3*	*2008Q4*	*2007Q4*	*2008Q1*	*2008Q2*	*2008Q3*	*2008Q4*
Germany	2.6	1.0	1.7	2.8	2.0	0.8	-1.6	0.3	1.5	-0.5	-0.5	-2.1
France	2.1	0.7	2.2	2.1	1.2	0.6	-1.0	0.4	0.4	-0.3	0.1	-1.2
Netherlands	3.5	2.0	4.2	4.0	3.3	1.7	-0.7	1.6	0.5	-0.1	-0.3	-0.9
Belgium	2.6	1.1	2.3	1.9	1.9	1.2	-0.5	0.4	0.4	0.3	0.1	-1.3
Euro area	2.6	0.7	2.1	2.1	1.4	0.6	-1.3	0.3	0.7	-0.2	-0.2	-1.5
United States	2.0	1.1	2.3	2.5	2.1	0.7	-0.8	0.0	0.2	0.7	-0.1	-1.6
Japan	2.4	-0.7	2.2	1.4	0.6	-0.2	-4.6	1.1	0.2	-0.9	-0.6	-3.3

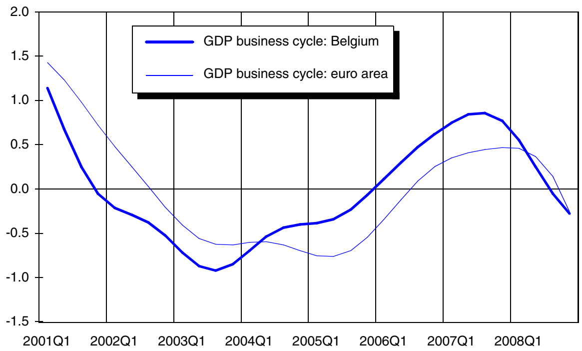
[1] Adjusted for seasonal and calendar effects
Source: INR/ICN, National sources, Eurostat

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



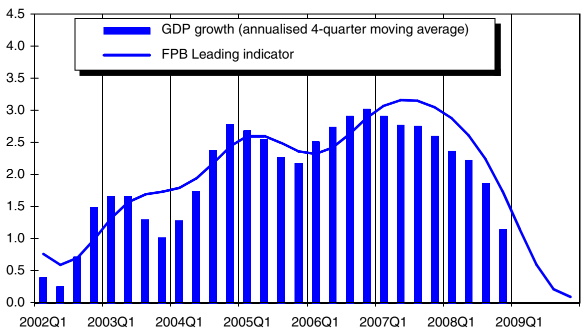
Source: INR/ICN, National sources, Eurostat

Graph 2 - GDP business cycle



Source: INR/ICN, Eurostat, FPB

Graph 3 - GDP growth and leading indicator



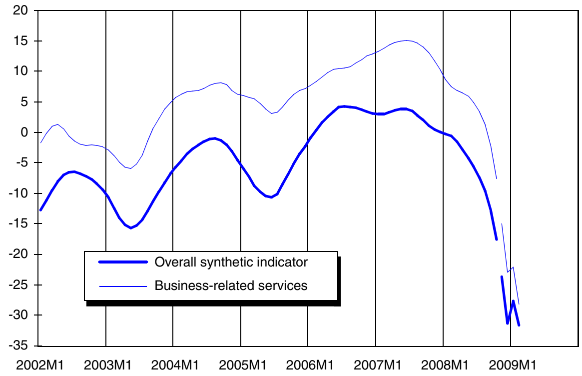
Source: INR/ICN, FPB

US economic activity dropped by 1.6% in the final quarter of 2008. The decline stemmed from plummeting private consumption, investment and exports. Inventories were cut for the fifth consecutive quarter. The steep decline in consumer and business confidence, the loss of more than two million jobs over the last four months and continuously declining house prices bode ill for economic growth in the first half of 2009. Moreover, the impact of the USD 787bn government stimulus package will not be felt until the second half of this year.

Japanese economic growth plunged by 3.3% in 2008Q4, following negative growth rates of 0.9% and 0.6% in the previous two quarters. The collapse in growth was led by a stunning 13.9% fall in exports. The Japanese economy, which is very export oriented, is suffering from plunging demand for its goods from the US and Asia, while the strong appreciation of the yen has weighed on its competitiveness. Business investment (hampered by high financing costs and strongly deteriorated demand prospects) and consumer spending (depressed by rising unemployment fears and the strong decline in stock prices) have also weighed on economic activity.

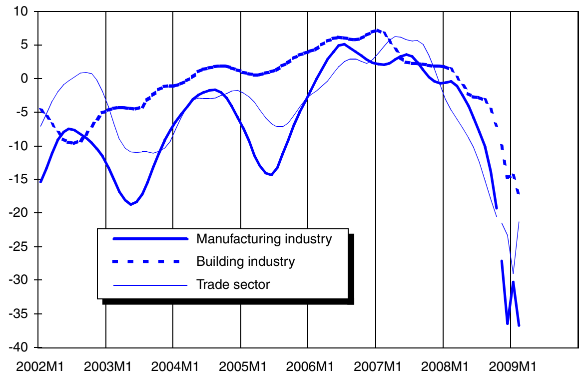
The euro area economy contracted at its fastest ever rate in 2008Q4 (-1.5%), following a decline of 0.2% in each of the previous two quarters. The decline in 2008Q4 was led by a 2.1% drop in economic growth in Germany, which has been especially badly hit by the collapse in international demand. Economic activity fell almost as fast in Italy (-1.8%), but substantially less in France (-1.2%) and Spain (-1%). Belgian economic growth, which remained positive until 2008Q3, also fell strongly in 2008Q4 (-1.3%). Economic activity in Belgium is expected to continue to decline throughout most of 2009.

Graph 4 - Business cycle: global evolution



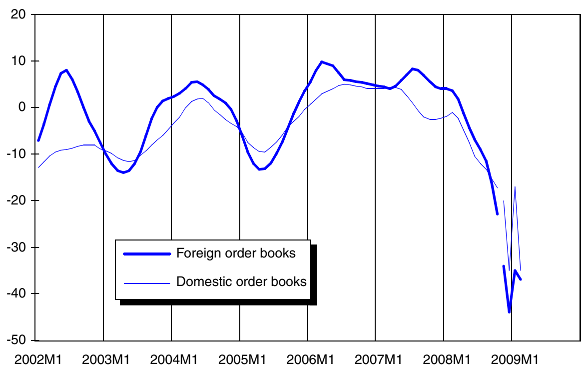
Source: NBB

Graph 5 - Business cycle: sectoral evolution



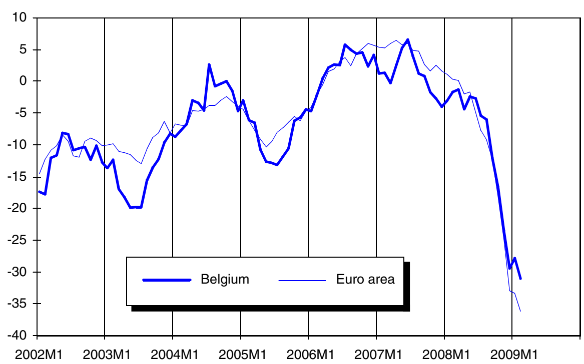
Source: NBB

Graph 6 - Manufacturing industry: order books



Source: NBB

Graph 7 - Industrial confidence: international comparison



Source: European Commission

Belgian business confidence started to deteriorate in the first half of 2008 due to soaring commodity prices and the strong appreciation of the euro. In the second half of the year, and especially from September onwards, confidence plummeted as the worldwide financial crisis erupted in full force. This led to a steep rise in firms' financing costs, plunging asset prices and a rapid deterioration of economic activity at both the European and the global level. From August 2008 to February 2009, consensus estimates (from The Economist's poll of forecasters) for euro area economic growth in 2009 declined from +1.2% to -2.1%. It should hence not come as a surprise that Belgian business confidence declined to its lowest level since the start of the series in 1980.

The evolution of business confidence is generally most closely related to confidence in the export-oriented manufacturing sector. While confidence declined to the same extent in the trade sector, the fall in sentiment in the building industry was somewhat less marked.

The worsening of sentiment in the manufacturing industry in 2008Q4 was especially driven by company directors' assessments of the current situation, while their assessment of prospects worsened to a lesser extent. The weakening of domestic orders was initially less pronounced than that of foreign orders. In February, however, domestic order books fell to the same extent as foreign order books. Price pressures in the sector, which had soared to a very high level in the first half of the year (owing to the surge in commodity prices), have now all but dissipated, and are leading to a fall in price expectations to their lowest level ever.

The softening in building industry confidence was fairly broad based, although the deterioration of prospects was somewhat more marked than that of current activity. In February, there was also a noticeable drop in the sector's employment prospects.

The decline in the trade sector was led most of all by the worsening of demand and of foreign orders. Sentiment in businesses-related services, which is not taken into account in the overall synthetic indicator, registered about the same decline as the overall indicator.

Since the beginning of 2008, industrial confidence in the euro area has dropped more rapidly than in Belgium. Furthermore, the slight, tentative improvement of Belgian confidence in January was not seen in the euro area. This is consistent with the evolution of economic growth. While Belgian economic growth remained slightly positive in 2008Q2 and 2008Q3, euro area GDP contracted by 0.2% in both quarters. Also in 2008Q4, the decline in economic activity was somewhat less pronounced in Belgium (-1.3%) than in the euro area (-1.5%).

Private consumption

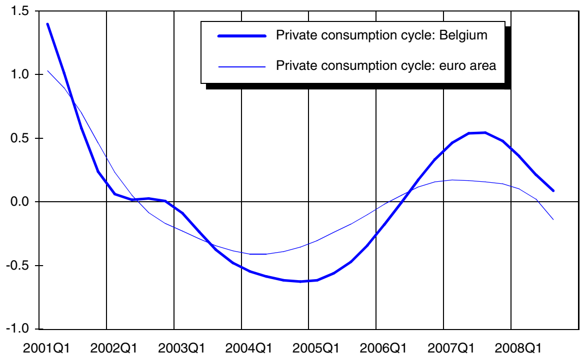
Table 2 - Private consumption indicators

	2007	2008	2008Q1	2008Q2	2008Q3	2008Q4	2008M9	2008M10	2008M11	2008M12	2009M1	2009M2
Turnover (VAT) - retail trade [1]	4.9	.	6.7	6.5	8.0	.	8.2	7.0	1.2	.	.	.
New car registrations [1]	-0.3	2.1	3.7	11.2	-0.1	-10.3	3.4	-6.8	-16.4	-7.8	-16.1	.
Consumer confidence indicator [2]	-1.2	-11.3	-4.0	-9.0	-11.0	-21.3	-9.0	-17.0	-22.0	-25.0	-20.0	-24.0

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

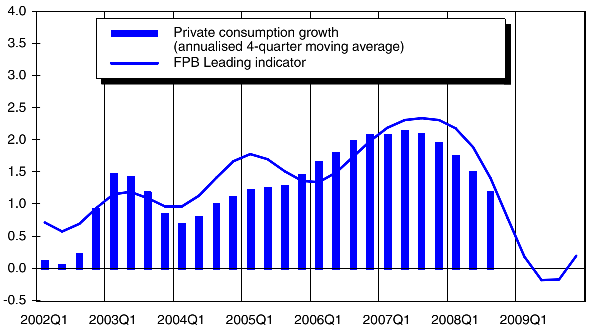
Source: DGSB, NBB, Febiac

Graph 8 - Private consumption cycle



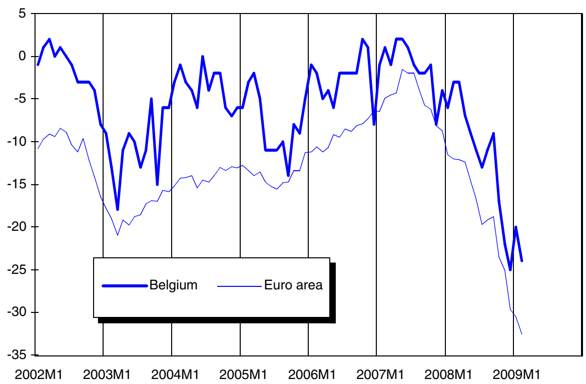
Source: INR/ICN, Eurostat, FPB

Graph 9 - Private consumption growth and leading indicator



Source: INR/ICN, FPB

Graph 10 - Consumer confidence: international comparison



Source: NBB, European Commission

Both the Belgian and the euro area consumption cycles started to decline in the second half of 2007. This evolution was also seen in consumer confidence and was initially mainly due to the steep rise in raw material prices, which had a negative impact on consumers' purchasing power. In 2008Q4, however, the economic downturn reinforced the fall in consumer confidence despite plummeting raw material prices.

Despite the sharp fall in most consumption-related indicators at the end of the year, Belgian private consumption performed relatively well in 2008, even though there was a quasi-stabilisation of purchasing power. Car registrations, which benefited from the Brussels motor show that is organised once every two years, have never been higher than in 2008. Retail sales also posted quite high yoy growth rates during the first three quarters of 2008 (7% on average), although it should be kept in mind that retail sales are registered at current prices and that the acceleration in comparison to 2007 (growth of 4.9%) was mainly driven by the increase in inflation. All in all, estimates for the year 2008, as a whole, point to an increase in consumption volume of 0.9%, which was accompanied by a fall in the savings rate.

Since 2008Q4, consumption indicators have plummeted due to the outbreak of the financial crisis on the European continent. Car registrations have started to register negative yoy growth rates. The car market is expected to experience one of the most significant contractions since 1980. The decline in inflation explains part of the drop in yoy retail sales growth, but it does not explain it entirely, implying a downturn in consumption volume growth. Consumer confidence also suffered seriously from massive lay-offs in (mainly) the industrial economic sectors, while consumers' opinion about their own financial situation seems to have suffered less from the current crisis. Most indicators thus point to a significant further weakening in private consumption. This is confirmed by the FPB leading indicator, which predicts a growth rate close to zero for private consumption in 2009, implying a large increase in the savings rate.

Business investment

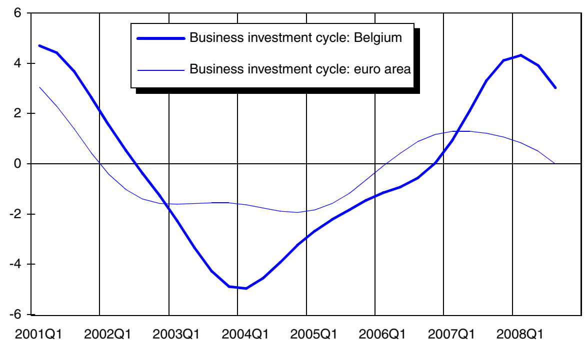
Table 3 - Business investment indicators

	2007	2008	2009	2008Q1	2008Q2	2008Q3	2008Q4	2008M7	2008M8	2008M9	2008M10	2008M11
Investment (VAT) [1]												
Industrial companies	12.2	.	.	5.2	5.8	-0.7	.	1.8	-8.6	4.6	3.4	11.6
Non-industrial companies	12.4	.	.	12.6	19.5	7.5	.	14.2	0.5	7.1	10.9	2.9
Total companies	12.7	.	.	10.3	15.5	5.4	.	11.1	-2.1	6.7	9.3	6.1
Investment survey [1]	12.1	-3.1	3.0									
Capacity utilisation rate (s.a.) (%)	83.2	80.6	.	83.5	82.1	82.4	74.7					

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

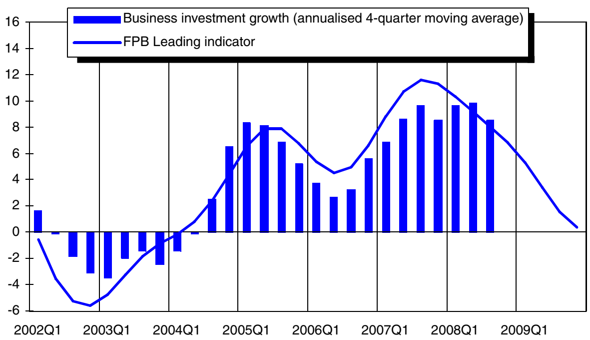
Source: DGSB, NBB

Graph 11 - Business investment cycle



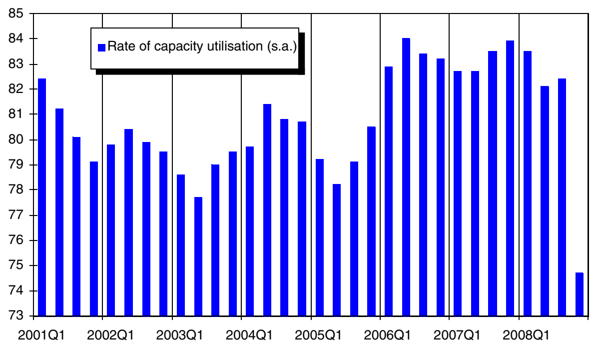
Source: INR/ICN, Eurostat, FPB

Graph 12 - Business investment growth and leading indicator



Source: INR/ICN, FPB

Graph 13 - Capacity utilisation in manufacturing industry



Source: NBB

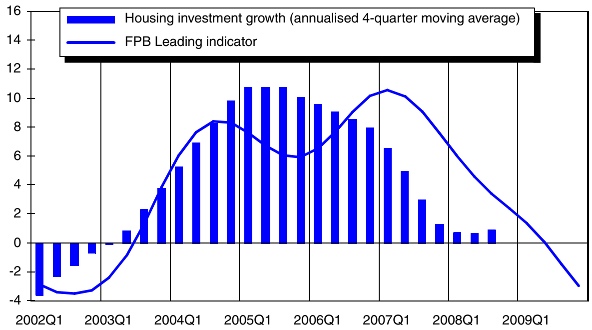
While the business investment cycle in the euro area started to weaken in the course of 2007, the upturn in the Belgian investment cycle gained strength. Although there are no obvious reasons that explain this difference, VAT-related investment statistics show that the acceleration in business investment growth was seen in most sectors of the Belgian economy. The current investment cycle is also more pronounced in Belgium than in the euro area. This is related to opposing evolutions in the investment cycles in different euro area Member States that result in a smoothing of the cycle for the area as a whole.

During the first half of 2008, average qoq business investment growth decelerated to 1.6% (compared to 3% during the second half of 2007) causing a downturn in the investment cycle. This evolution went hand in hand with a downturn in qoq economic growth from 0.6% on average in the second half of 2007 to 0.4% in the first half of 2008. In 2008Q3, the volume of business investment declined (-1%) and this development is expected to persist due to the current crisis, which has already been announced by the recent evolution in investment indicators. In fact, the capacity utilisation rate in the manufacturing industry registered its strongest quarterly fall since 1980 (from 82.4% in 2008Q3, which is above its historical average of 79%, to 74.4% in 2008Q4). At the same time, indicators for investment goods sectors from the NBB business survey have plummeted since October 2008. Consequently, the FPB leading indicator points to a pronounced downturn in business investment that will probably be reinforced by a contemporaneous increase in the cost of capital (due to a large increase in the risk premium on interest rates charged to firms), which is not explicitly taken into account in the FPB indicator.

All in all, business investment should have continued to grow faster than GDP in 2008, bringing the investment rate (part of business investment at current prices in GDP) to its highest level (15.1%) since 1990. In 2009, investment should decline far more than economic activity, which will inevitably reduce the investment rate.

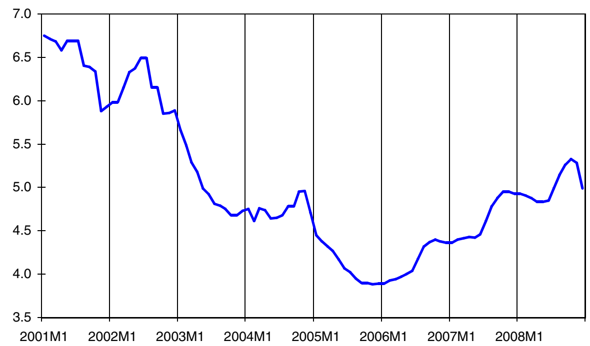
Housing investment

Graph 14 - Housing investment growth and leading indicator



Source: INR/ICN, FPB

Graph 15 - Mortgage rate (%)



Source: NBB

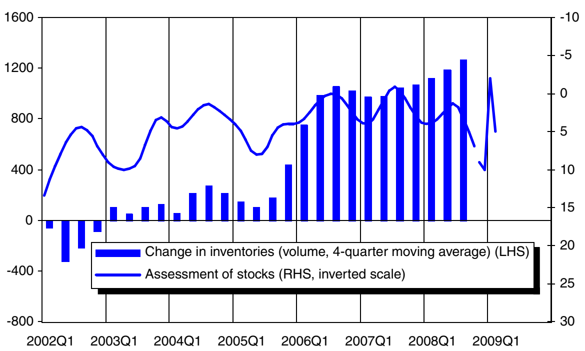
Housing construction boomed during the period 2003-2006, which resulted in an average volume growth of 7.8%. In the course of 2007 and 2008, residential investment growth lost momentum. According to the latest quarterly accounts, housing activity stagnated in 2008Q2 and 2008Q3. Nevertheless, its share in nominal GDP remained at 5.8% last year (as in 2006 and 2007), which exceeds the historical average of 4.3% over the period 1980-2005.

Mortgage rates increased from a historically low 3.9% at the end of 2005 to 5.3% in September 2008, but lowered again somewhat to 5% at the end of last year. Together with weak real disposable income growth in 2008, this put downward pressure on housing investment. In 2009, housing is expected to contract, but to a much lesser extent than the euro area average as Belgian house prices have been relatively less overvalued. Moreover, the contraction should be mitigated somewhat in Belgium thanks to the (temporary) VAT reduction on residential construction.

The downturn in housing investment is largely confirmed by the FPB leading indicator, which correctly predicted the turning point in housing investment growth in the beginning of 2007. Most of the housing investment indicators, such as the total amount of mortgage applications and indicators from the architects' survey, have gone down since mid-2006. They all lead the development of housing investment by about four quarters.

Stock building

Graph 16 - Stock building indicators



Source: INR/ICN, NBB

According to the quarterly national accounts, the gradual weakening of economic growth between 2007Q3 and 2008Q3 did not lead to a deceleration in stock building. Due to a positive carry-over from 2007, the contribution of stocks to economic growth should have amounted to 0.3% in 2008. However, since September 2008, the number of company directors willing to reduce their stock levels has increased considerably. This should not come as a surprise as Belgium currently faces a recession, which reduces the probability of unexpected rises in demand. Therefore, the contribution of stocks to economic growth should turn negative this year.

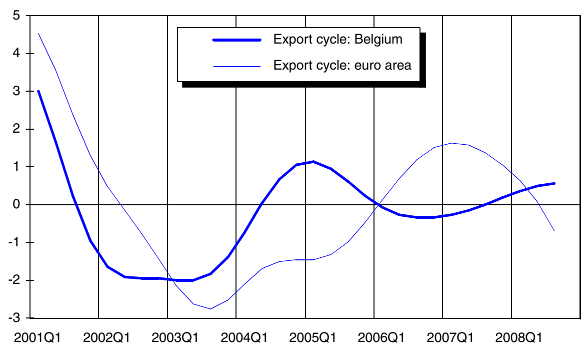
Foreign Trade

Table 4 - Belgium - Trade statistics (goods, intra/extrastat, national concept)

	2006	*2007*	*2007Q4*	*2008Q1*	*2008Q2*	*2008Q3*	*2008M6*	*2008M7*	*2008M8*	*2008M9*	*2008M10*	*2008M11*
Exports - value [1]	5.9	5.7	6.1	7.8	15.1	10.4	14.7	14.0	2.5	13.8	2.2	-12.1
Imports - value [1]	7.0	6.0	11.2	14.1	20.6	18.4	22.4	18.6	13.9	22.3	7.4	-7.2
Exports - volume [1]	0.9	2.7	1.7	2.8	9.6	3.8	7.8	7.4	-4.3	7.5	-3.5	-14.6
Imports - volume [1]	2.1	4.0	4.4	3.9	10.1	6.8	8.6	6.4	3.0	10.6	-0.4	-10.7
Exports - price [1]	5.0	2.9	4.3	4.9	5.0	6.4	6.3	6.1	7.1	5.9	5.9	2.9
Imports - price [1]	4.9	2.0	6.6	9.9	9.5	10.9	12.6	11.5	10.6	10.5	7.8	4.0

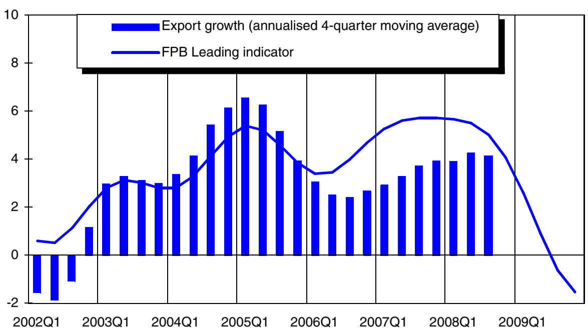
[1] Change (%) compared to same period previous year
Source: INR/ICN

Graph 17 - Export cycle



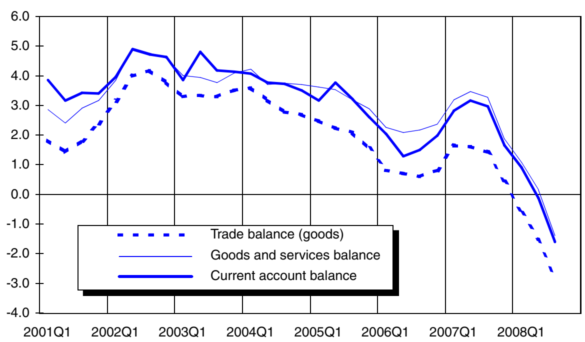
Source: INR/ICN, Eurostat, FPB

Graph 18 - Export growth and leading indicator



Source: INR/ICN, FPB

Graph 19 - Belgian foreign balances (4 quarters cumul,% of GDP)



Source: INR/ICN, NBB, FPB

The revisions for export volumes in the latest quarterly national accounts revealed that exports performed better than previously thought. In fact, the Belgian export cycle remained on a slightly rising path until 2008Q3. The euro area export cycle has moved in the opposite direction to the Belgian cycle since 2005. In 2007Q1, it peaked and has been declining rapidly since then. The downturn in euro area exports was mainly driven by German exports, as was also the case during the upturn in 2004-2006.

Belgian quarterly export growth was quite erratic during the previous two years and a clear pattern of deceleration or acceleration did not emerge. Nevertheless, there can be no doubt about the coming downturn in Belgian exports as economic activity in both the euro area, the US and Japan plunged in the last quarter of 2008. World trade growth nose-dived as well in 2008Q4 and leading indicators point to a further strong decline in the first quarter of this year. The Dutch CPB expects this year to be the worst for world trade since it started tracking it (in 1991). Monthly trade statistics (see table 4) also point to a severe weakening in 2008Q4. This pessimism is confirmed by the FPB leading indicator and by the pronounced downturn of sentiment in the export-oriented manufacturing sector. With exports expected to stabilise (qoq) only by 2009Q4, they should drop by 4.6% this year, following increases of 4% in 2007 and 2.2% in 2008.

The Belgian trade and current account balance has deteriorated very rapidly since 2007Q3, going from a surplus to a substantial deficit. This has been the result of both import volume growth outpacing export volume growth and a strong deterioration in the terms of trade (mainly due to the surge in commodity prices). The rapid fall in commodity prices should result in an improvement in the terms of trade in the course of 2009, but as import volumes are expected to drop less rapidly than export volumes, the current account balance should remain in deficit.

Labour market

Table 5 - Labour market indicators

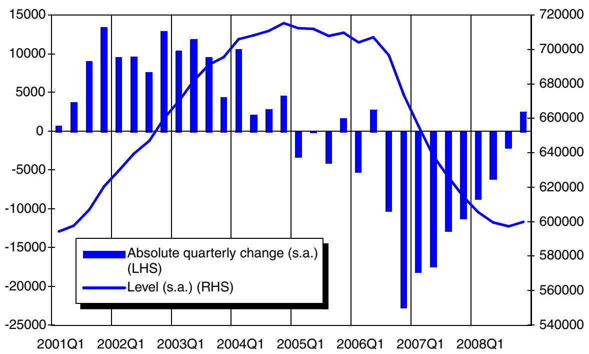
	2007	2008	2008Q1	2008Q2	2008Q3	2008Q4	2008M8	2008M9	2008M10	2008M11	2008M12	2009M1
Unemployment [1][2]	633.5	600.5	605.6	599.4	597.3	599.7	597.7	595.6	596.6	601.7	606.6	611.5
Unemployment rate [2][3]	12.5	11.8	11.9	11.8	11.7	11.7	11.7	11.7	11.7	11.8	11.9	12.0
Unemployment rate-Eurostat [3][4]	7.5	7.1	7.1	7.0	7.2	7.1	7.3	7.3	7.1	7.1	7.1	7.2

[1] Level in thousands, s.a.; [2] Broad administrative definition; [3] In % of labour force, s.a.

[4] Recent figures are based on administrative data and may be subject to revision

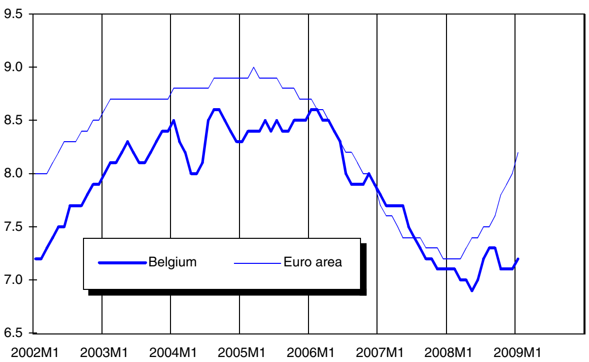
Source: RVA/ONEM, FPS Employment, Eurostat, FPB

Graph 20 - Evolution of unemployment (incl. older)



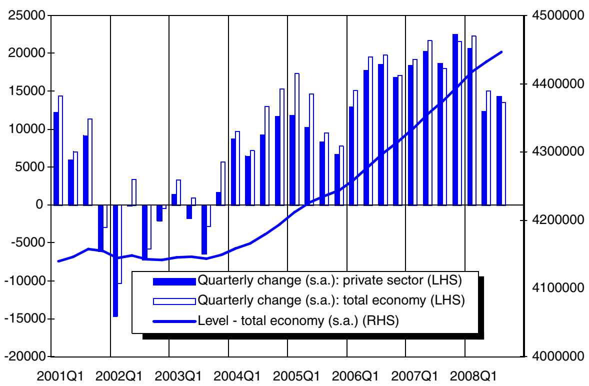
Source: RVA/ONEM

Graph 21 - Harmonised unemployment rates (% of labour force)



Source: Eurostat

Graph 22 - Evolution of domestic employment



Source: INR/ICN

Even before the breakout of the financial crisis in September last year, qoq activity growth in the market sector had already slowed down considerably. It dropped from 0.7% in the first quarter to 0.4% in the second and turned slightly negative (-0.1%) in the third quarter, before collapsing (-1%) in the fourth quarter. In comparison, employment growth held out rather well throughout the first three quarters, qoq growth decelerating from 0.6% in the first quarter to 0.4% in the next two quarters.

The slowdown in activity was, however, already having a relatively larger impact on the evolution of total hours worked. After an unexpected boost in average hours worked per person during the first quarter (qoq growth of 0.3%), partly attributable to one-off developments in the construction industry, working time decreased considerably during the next two quarters (-0.4% in each quarter). Moreover, there is clear evidence that the sharp decrease in activity during the fourth quarter was accompanied by substantial additional labour hoarding. For instance, a rapidly growing number of (mainly manufacturing and construction industry) firms is making recourse to the government subsidized system of 'temporary unemployment' that gives employers the possibility to temporarily reduce working time for blue collar workers, the latter being compensated with partial income support through the unemployment agency.

Furthermore, although unemployment growth turned positive in the fourth quarter, the increase is still rather moderate considering the strength of the recession, suggesting that employment growth decreased further during this quarter, but may have remained slightly positive (0.1% growth). The full impact of the crisis on employment is only expected to materialise from the first half of this year onwards. In yearly average figures, market sector employment growth was almost as strong last year (2.0%) as in 2007 (2.2%), the loss of pace in activity growth (1.5% versus 2.8%) being compensated by a decrease in apparent labour productivity growth (-0.5% versus +0.6%), in its turn largely attributable to a reduction in average hours worked (-0.7% versus +0.2%).

Prices

Table 6 - Inflation rates: change compared to the same period in the previous year, in %

	2007	2008	2008Q1	2008Q2	2008Q3	2008Q4	2008M9	2008M10	2008M11	2008M12	2009M1	2009M2
Consumer prices: all items	1.82	4.49	3.83	5.05	5.59	3.49	5.46	4.72	3.14	2.63	2.32	1.93
Food prices	3.62	5.82	5.48	6.58	6.80	4.46	6.32	5.56	4.19	3.64	3.94	3.64
Non food prices	1.01	5.95	5.07	7.41	7.78	3.57	7.50	5.93	2.86	1.97	1.09	0.04
Services	1.89	2.01	1.36	1.25	2.36	3.06	2.66	3.00	3.08	3.08	3.11	3.64
Rent	1.79	1.90	1.79	1.91	1.90	1.98	1.92	1.84	2.06	2.04	2.24	2.00
Health index	1.77	4.22	3.25	4.46	5.10	4.07	5.15	4.80	3.89	3.54	3.34	2.80
Brent oil price in USD (level)	72.5	96.9	96.8	121.5	114.7	54.8	98.1	71.9	52.6	39.8	43.4	43.0

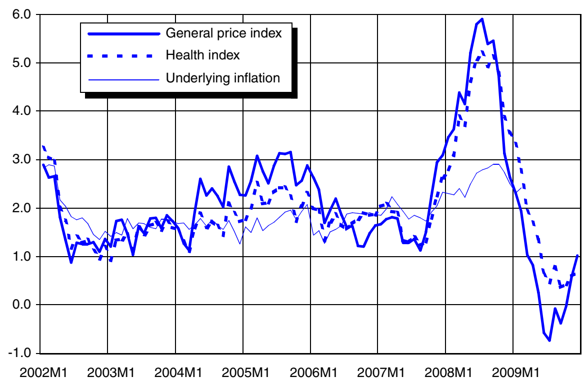
Source: FPS Economy, Datastream

Table 7 - Monthly inflation forecasts

	2008M1	2008M2	2008M3	2008M4	2008M5	2008M6	2008M7	2008M8	2008M9	2008M10	2008M11	2008M12
Consumer prices: all items	108.84	109.62	110.42	110.67	111.66	112.28	112.87	112.18	112.36	112.16	111.49	111.25
Consumer prices: health index	107.85	108.71	109.32	109.49	110.20	110.62	111.22	110.88	111.15	111.29	111.09	111.24
Moving average health index	107.10	107.73	108.33	108.84	109.43	109.91	110.38	110.73	110.97	111.14	111.10	111.19
	2009M1	2009M2	2009M3	2009M4	2009M5	2009M6	2009M7	2009M8	2009M9	2009M10	2009M11	2009M12
Consumer prices: all items	111.36	111.74	111.56	111.58	111.94	111.63	112.04	112.10	111.93	112.15	112.16	112.39
Consumer prices: health index	111.45	111.75	111.44	111.36	111.69	111.31	111.72	111.75	111.55	111.76	111.75	111.98
Moving average health index	111.27	111.38	111.47	111.50	111.56	111.45	111.52	111.62	111.58	111.69	111.70	111.76

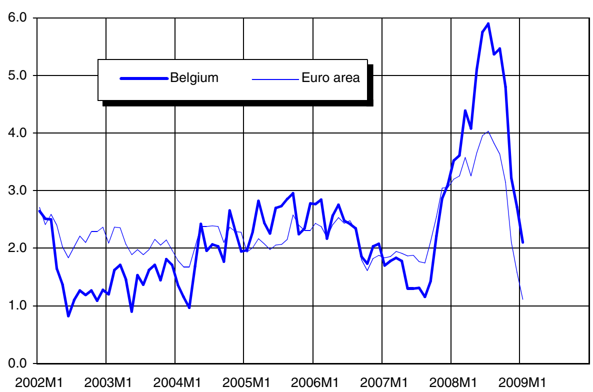
Source: Observations (up to 09M2): FPS Economy; forecasts: FPB

Graph 23 - Monthly inflation evolution in % (t/t-12)



Source: FPS Economy, from 09M3 on: forecasts FPB

Graph 24 - Harmonised inflation rates in % (t/t-12)



Source: Eurostat

Belgian inflation, as measured by the yoy increase in the national index of consumer prices, reached 5.9% in August 2008, its highest level since 1984. Since September, however, inflation has come down considerably (to 1.9% in February) due to plummeting commodity prices. The Brent crude oil price declined from more than USD 140 in August to less than USD 40 per barrel in December. The downward effect of oil prices on Belgian inflation was mitigated somewhat by the contemporaneous depreciation of the euro against the dollar, but during the first half of 2009, oil prices expressed in euro are expected to be, on average, 50% below their level in the first half of 2008. Only during the second half of this year should yoy growth rates of oil prices start to exert upward pressure on inflation.

The upturn in underlying inflation since 2007Q4 was initially related to the acceleration in food prices. Since 2008Q4, however, food prices have eased and the so-called 'second round effects' related to the recent acceleration in inflation have surfaced, resulting altogether in a stabilisation of, and recently even a decline in, underlying inflation.

Belgian headline inflation is expected to fall from 4.5% in 2008 to 0.5% this year. The profile of the health index should be somewhat less pronounced (increase of 4.2% in 2008 and 1.2% in 2009) as it is not influenced by the price evolution of, amongst other things, motor fuels. The current pivotal index for public wages and social benefits (112.72) should not be exceeded this year.

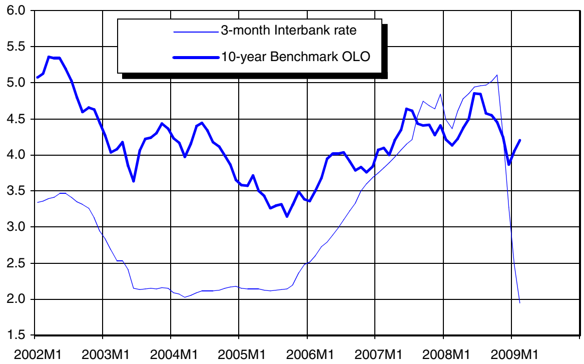
Interest rates

Table 8 - Interest rates

	2007	2008	2008Q1	2008Q2	2008Q3	2008Q4	2008M9	2008M10	2008M11	2008M12	2009M1	2009M2
Short-term money market rates (3 months)												
Euro area (Euribor)	4.28	4.63	4.49	4.86	4.98	4.21	5.02	5.11	4.24	3.27	2.48	1.94
United States	5.27	2.97	3.23	2.76	3.06	2.82	3.59	4.32	2.36	1.77	1.02	1.16
Japan	0.76	1.05	0.90	0.95	0.91	1.44	0.92	1.48	1.50	1.35	0.77	0.63
Long-term government bond rates (10 years)												
Belgium	4.32	4.40	4.19	4.58	4.66	4.19	4.55	4.45	4.24	3.87	4.05	4.21
Germany	4.23	3.99	3.93	4.26	4.27	3.49	4.10	3.89	3.54	3.04	3.08	3.15
Euro area	4.31	4.24	4.08	4.44	4.52	3.94	4.40	4.25	3.98	3.60	3.72	3.76
United States	4.63	3.65	3.65	3.87	3.85	3.22	3.68	3.78	3.49	2.40	2.46	2.85
Japan	1.67	1.48	1.39	1.61	1.51	1.42	1.49	1.50	1.46	1.30	1.24	1.29

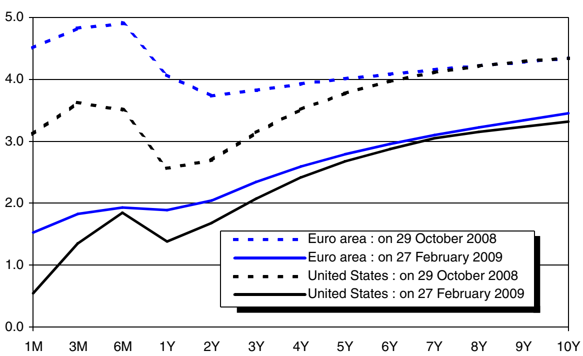
Source: Datastream

Graph 25 - Interest rate levels in Belgium, %



Source: NBB

Graph 26 - Yield curves for the euro area and the US



Source: Datastream, data based on interest rate swaps

In order to halt panic in financial markets and to address the rapid and heavy downturn in the economy, the Federal Reserve cut interest rates from 2% in September 2008 to a range of 0-0.25% in December. The Fed furthermore resorted to unconventional measures (e.g. providing massive liquidity, purchasing agency debt and mortgage backed securities) in an attempt to push interest rates (charged to consumers and firms) down. The Fed is even considering purchasing US treasury bonds.

The ECB cut its policy rate in the same period by 225 basis points to 2%. The ECB has refrained from bringing its policy rate closer to 0% (for now) and from making more use of unconventional measures. Additional interest rate cuts in the coming months nevertheless seem very likely as the economic situation is continuing to deteriorate very rapidly. The risk premium paid on the interbank market has come down considerably owing to governments' capital injections into banks and state guarantees for bank loans.

The rapid deterioration of the economic outlook, the steep fall in inflation and the extreme risk aversion of investors led to a sharp drop of US long term interest rates in 2008Q4. European long term interest rates followed this evolution, but to a lesser extent. This has to do with the possibility that the Fed might start buying US treasury bonds. Meanwhile, the spread between government bond rates in the euro area countries and those in Germany has increased substantially as German Bunds are benefiting from the strong preference of investors for liquidity. Furthermore, markets are worried about the budgetary consequences of the stimulus packages, capital injections and bank loan guarantees. Since the start of this year, long term interest rates have started to rise again because of the huge expected extra issuance of government bonds this year.

Exchange rates

Table 9 - Bilateral exchange rates

	2007	2008	2008Q1	2008Q2	2008Q3	2008Q4	2008M9	2008M10	2008M11	2008M12	2009M1	2009M2
USD per EUR	1.371	1.471	1.499	1.562	1.503	1.318	1.435	1.328	1.274	1.353	1.327	1.279
UKP per EUR	0.685	0.797	0.758	0.793	0.795	0.843	0.798	0.786	0.831	0.911	0.919	0.888
JPY per EUR	161.3	152.3	157.7	163.5	161.7	126.6	153.1	133.1	123.4	123.3	119.8	118.8

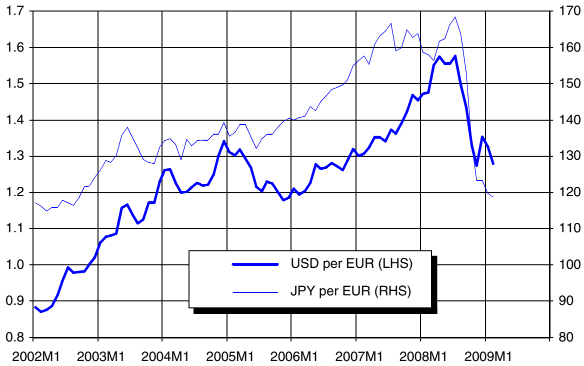
Table 10 - Nominal effective exchange rates (2000=100)

	2007	2008	2008Q1	2008Q2	2008Q3	2008Q4	2008M8	2008M9	2008M10	2008M11	2008M12	2009M1
Euro	128.1	136.3	135.2	140.0	138.5	131.3	138.3	135.9	130.2	128.9	134.8	135.0
Growth rate [1]	5.3	6.4	2.3	3.6	-1.1	-5.2	-2.2	-1.8	-4.2	-1.0	4.6	0.1
US dollar	79.9	77.0	74.5	73.6	76.2	83.7	76.6	78.3	82.8	85.2	83.0	82.2
Growth rate [1]	-4.7	-3.7	-1.9	-1.2	3.5	9.8	4.0	2.2	5.8	2.9	-2.5	-1.0
Japanese yen	76.3	86.9	82.4	82.1	81.9	101.3	80.6	85.0	95.7	101.8	106.3	105.2
Growth rate [1]	-5.0	13.9	6.5	-0.4	-0.3	23.7	0.6	5.5	12.5	6.5	4.4	-1.0

[1] Change (%) compared to previous period

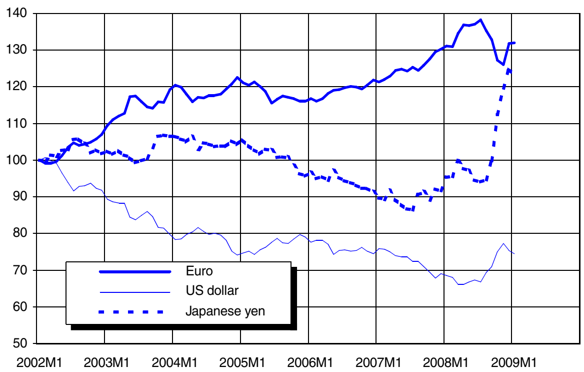
Source: BIS, NBB

Graph 27 - Euro-dollar and euro-yen bilateral exchange rates



Source: NBB

Graph 28 - Nominal effective exchange rates (2001M1=100)



Source: NBB, BIS

The euro appreciated considerably against the dollar in the first eight months of 2008 as US growth forecasts declined rapidly and US policy rates were slashed. A reverse movement was noticeable in the remainder of the year as the economic situation in the euro area deteriorated rapidly as well and as the ECB loosened monetary policy considerably. The interest rate differential between euro area and US policy rates was reduced from 275 basis points at the end of October to 175 basis points in January, with further reductions in the offing. Moreover, the dollar benefited from its safe haven status during the financial turmoil.

The British pound shed a lot of value against the euro in the last few months of 2008 as the outlook for the British economy deteriorated even more sharply than that for the euro area. In contrast to most euro area countries, the British economy is suffering from a collapse in the housing market, while the financial heart of the UK has been hit particularly badly by the financial crisis.

Over the last few years, borrowing funds in yen (at very low interest rates) and using these funds to invest in securities of higher yielding currencies (thereby selling the yen) has been a very popular investment strategy that made the yen depreciate against most currencies. The financial turmoil and the extreme risk aversion have now led to a massive unwinding of this carry trade strategy, leading to a strong appreciation of the yen against almost all currencies.

In spite of the depreciation in the second half of 2008, the nominal effective euro exchange rate increased by 2.2%, owing to its appreciation in the first half of 2008 and a positive carry-over from 2007.

Tax indicators

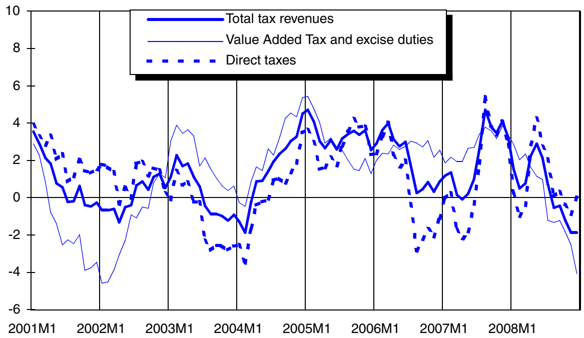
Table 11 - Tax revenues (1)

	2007	2008	2008Q1	2008Q2	2008Q3	2008Q4	2008M7	2008M8	2008M9	2008M10	2008M11	2008M12
Total [2], of which:	5.1	2.5	-5.7	11.6	3.0	-0.4	2.8	4.2	2.0	-0.4	-0.4	-0.4
Direct taxes, of which:	4.8	4.5	-10.2	16.6	4.9	3.3	8.5	1.1	1.5	0.3	3.5	5.9
Withholding earned income tax (PAYE)	4.4	5.5	5.7	0.5	6.6	9.9	15.3	0.8	-0.2	11.8	6.5	10.9
Prepayments	6.5	-1.7	.	11.5	0.6	-13.2	-1.2	.	.	-10.4	.	-15.5
Value Added Tax and excise duties	5.3	0.2	1.0	4.0	1.7	-5.2	-5.2	9.2	3.8	-2.0	-1.6	-9.3

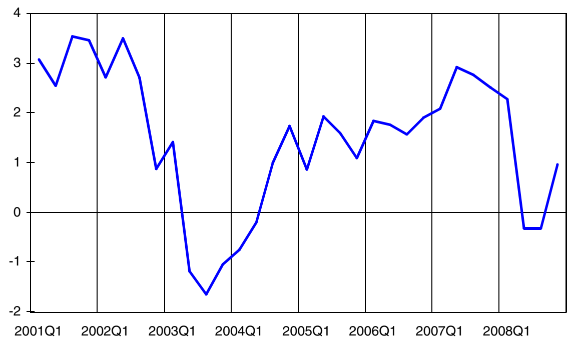
[1] Change (%) compared to same period previous year; [2] Total received by federal government, excl

Source: FPS Finance

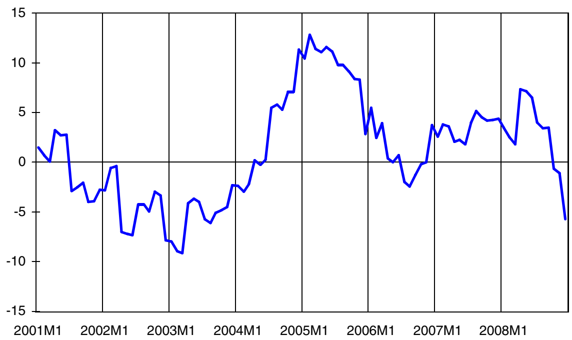
Graph 29 - Real tax revenues (3)



Graph 30 - Real withholding earned income tax (PAYE) (4)



Graph 31 - Real prepayments (3)



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

[4] Change (%) over past 4 quarters, compared to previous 4 quarter period, deflated by consumer price index

Total tax revenues recorded a nominal annual increase of 2.5% in 2008. This is a very limited increase in view of the strong acceleration in inflation. Corrected for the evolution in consumer prices, total tax receipts decreased by 1.9% in 2008 (Graph 29). The quarterly profile of yoy tax revenue growth is quite erratic and mainly determined by the development of direct taxes. In fact, both refunds and collections of taxes collected by means of assessment were accelerated in 2007, influencing yoy growth rates of these taxes in 2007 as well as in 2008.

The deceleration in yoy growth rates of indirect taxes throughout 2008 is partly related to the business cycle downturn, which strongly affected private consumption and housing investment. It should be noted, however, that the worsening of growth in VAT receipts has been stronger than can be explained on the basis of macroeconomic developments.

Growth of direct taxes kept up rather well in 2008 due to PAYE personal income tax revenues that reflected strong wage growth. Nominal wages have been supported by high wage indexation and the fact that employment is generally affected with a time-lag by business cycle developments. Despite a rather high increase during the first half of 2008, advance payments registered a decline in 2008 as a whole due to a significant drop in 2008Q4. This is probably related to business profitability turning out to be lower than anticipated earlier in the year. Taxes on dividends grew firmly in 2008, the 2008 dividends being mainly related to 2007 profits.

Prospects for tax revenue in the coming months are gloomy in the absence of a rapid economic recovery. Moreover, the stimulus package decided on by the authorities may weigh on revenues. It includes an extension of the 6% reduced VAT rate for the housing sector, labour cost reductions in the form of exemptions from payments of the withholding tax on wages, and temporary payment facilities to businesses allowing them to be in arrears in payments of taxes and social contributions without penalty.

Impact of the EU Energy and Climate Package on the Belgian energy system and economy

In order to prepare for the negotiations on the EU Energy and Climate Package (E/C Package), the Federal Planning Bureau was asked by the Belgian federal and regional authorities to conduct a study on the impact of the European Commission's proposal of January 2008. In the course of the study, various scenarios and sensitivity analyses were run. Next to a baseline, two main alternative scenarios were scrutinized: the 20/20 and 30/20 target scenarios, standing for an EU reduction of, respectively, 20% and 30% of greenhouse gas (GHG) emissions in the year 2020 compared to the level of 1990, and a mandatory 20% EU-wide share for renewable energy sources (RES) in Gross Final Energy Demand in 2020. The report then includes an analysis of the impact of both scenarios on the Belgian energy system and economy as well as on GHG emissions.

The study uses four models to scrutinize the impact that the E/C Package, proposed by the European Commission in January 2008 and adopted by the European Parliament in December 2008, may have on the Belgian energy system and its economy and sectors. The models used are the PRIMES model developed by ICCS/NTUA (energy system and CO_2), the GAINS model of IIASA (non-CO_2 GHG), the FPB's HERMES model (macroeconomic impact) and the NEMESIS model (effects on the Belgian export market and on import and export prices).

Regarding the impact on the Belgian energy system, the main conclusions are that the energy system will respond to the twin targets by implementing energy savings and by developing RES. In the 20/20 target scenario, a decrease in gross inland consumption of 5.3% and in final energy demand of 5.7% can be noted compared to the baseline, in which no specific efforts or additional policies to constrain damaging greenhouse gases or develop renewables other than those already implemented by the end of 2006 are planned. The share of RES in Belgian gross final energy demand, stipulated at 13% in the E/C Package, should reach 12.3%, leaving room for a 0.7% deficit to be filled by flexible mechanisms. In terms of GHG emissions, this scenario will lead to a domestic reduction of 0.5% in 2020 compared to 2005 emissions. Compared to the baseline, however, GHG emissions in Belgium are expected to decrease by 12%.

These changes in the energy system and the reductions in non-energy-related GHG emissions will give rise to economic costs. The evaluation of these economic costs involves two complementary approaches. The first approach relies on the assessment of the direct cost, which encompasses the additional (compared to the baseline) energy equipment costs, fuel purchase costs, 'disutility' costs and non-CO_2 GHG mitigation costs, as well as the costs related to flexibility and to distribution of auctioning rights in ETS (Emission Trading System). This direct cost is estimated to be EUR 3.5bn in 2020. The second approach takes the feedback effects on the Belgian economy and its sectors into account. The results depend on the way the new potential public revenues are recycled in the economy. The macroeconomic impact lies in a range between 0.45% and 0.07% for real GDP reduction, translating into an employment impact ranging from a loss of about 16 000 jobs to a gain of approximately 25 000 jobs in 2020.

"Impact of the EU Energy and Climate Package on the Belgian energy system and economy ",
F. Bossier, D. Devogelaer, D. Gusbin, F. Verschueren,
Working Paper 21-08, December 2008

Assessing adequacy of pensions

In the context of the European-funded sixth framework project, "Adequacy of Old-Age Income Maintenance in the EU (AIM)", a dynamic microsimulation model has been developed for Belgium, Germany and Italy. This model, called MIDAS, simulates future developments in the adequacy of pensions in Belgium, Italy and Germany, following wherever possible the projections and assumptions of the Ageing Working Group.

Europe faces large demographic changes in the coming decades, changes that will have economic and budgetary consequences. The Economic Policy Committee (EPC) established the Ageing Working Group (AWG), one of whose tasks is to assess the long-term sustainability of public finances. It does so by presenting a set of public expenditure projections for all Member States, including for pensions. The sustainability and adequacy of pensions, however, are two sides of the same coin, and this project aims to assess the consequences of the AWG projections and assumptions on the adequacy of pensions. For this reason, the dynamic microsimulation model, MIDAS, has been developed for Belgium, Germany and Italy. MIDAS starts from a cross-sectional dataset representing a population of all ages at a certain point in time; in the Belgian case, the PSBH dataset for Belgium in 2002. The life spans of individuals in the dataset are then simulated up to 2050, together with their interactions.

The Belgian version of MIDAS simulates first-pillar old-age pension benefits for private sector employees, civil servants, and the self-employed. Furthermore, it simulates the Conventional Early Retirements (CELS) benefit, the disability pension benefit for private sector employees, and - finally - the widow(er)s' pension benefit, again for private sector employees, civil servants, and also the self-employed.

The model produces all kinds of prospective indicators of pension adequacy in Belgium, Germany and Italy. The report presents the individual replacement rate, and various indicators of poverty, inequality and redistribution that are based on equivalent household income.

In Belgium, the replacement rate of men and women entering retirement should decrease until about 2040. After that, a limited recovery will set in. This development is explained by the decreasing importance of household pensions relative to individual pensions, the link between wages and pensions, and the development of the wage ceiling. The replacement rate for women is higher than that for men, but they converge throughout the simulation period.

In general, the inequality of retirement benefits is expected to be considerably lower than that of earnings. Furthermore, the simulation results suggest that this redistribution will increase after 2020. This is a long-term consequence of the reinforced linkage between wages and benefits in the simulation period, compared to the situation before 2002.

Those individuals that live in households with only retirement benefits generally have a higher risk of and intensity of poverty. The development of poverty risks and intensities will increase between 2002 and roughly 2010, and decrease again during the 2030s. It should finally increase again during the 2040s. This evolution is mainly explained by the evolution of household structure, combined with the evolution of the composition of household earnings.

An international comparison of the simulation results suggests that the impact of parametric reforms in Belgium and Germany and the systemic reform in Italy on (re)distribution and poverty should go into the same direction, but that the magnitudes will differ. Indeed, this impact is expected to be stronger in Italy than in Belgium and Germany.

"What are the consequences of the AWG projections for the adequacy of social security pensions? An application of the dynamic micro simulation model, MIDAS, for Belgium, Italy and Germany",
H. Buslei, M. Cozzolino, G. Dekkers, R. Desmet, J. Geyer, D. Hofmann, M. Raitano, V. Steiner, P. Tanda, S. Tedeschi, F. Verschueren,
final report of the AIM project , December 2008.

The impact of offshoring on employment in Belgium

Worries about massive job losses have prompted a fast-growing literature on offshoring and its impact on employment in advanced economies. This paper examines the situation for Belgium. The offshoring intensity is computed as the share of imported intermediate inputs in output, based on a series of constant price supply-and-use tables for 1995-2003. Estimations of static and dynamic industry-level labour demand equations augmented by offshoring intensities, do not reveal a significant impact of either materials or business services offshoring on total employment for Belgium between 1995 and 2003, but this does not preclude a differential impact by skill-level.

The fears raised by offshoring used to be focused on manufacturing, but now they also extend to certain kinds of services, mainly business services that have become increasingly tradable and thereby subject to offshoring. In this paper, we present evidence on both materials and services offshoring for Belgium. The offshoring intensities are computed for the period 1995-2003 as imported intermediate inputs, drawn from constant price supply-and-use tables, divided by output. It does not come as a surprise that the levels of the offshoring intensities are very different for materials and business services: they are high for the former and still relatively low for the latter, even in 2003. In terms of the growth rates, the intensity of materials offshoring stagnates, whereas the intensity of business services offshoring is on the rise. Offshoring to high-wage and low-wage countries is also addressed through a split-up according to the origin of the imported intermediates. This is done by combining detailed trade data by country of origin with the data on imported intermediate inputs. The split-up shows that for materials it is offshoring to high-wage countries that drags the growth rate down. The highest growth rates for both materials and services can be observed for offshoring to Central and Eastern European countries.

To determine the impact of offshoring on employment in Belgium, standard neoclassical labour demand equations have been defined and augmented by the offshoring intensities. Both static and dynamic versions of these equations have been estimated for 58 manufacturing industries and 35 service industries. They fail to reveal a substantial impact of the offshoring intensities on total employment in these industries. In all specifications, the employment impact is found to be either non-significant or very small. This is true for both materials and service offshoring. These results are in line with previous findings in the literature. The main conclusion to be drawn is that these results show that, at the industry level, offshoring did not massively depress employment over 1995-2003. We believe that this is consistent with the view that materials offshoring is mature and no longer rising strongly, while services offshoring still remained at low levels in Belgium during this period despite substantial growth rates. Moreover, our estimation results are in line with the argument put forward by many observers that the number of jobs lost because of offshoring remains small compared to total job turnover in an economy. Nonetheless, these are results at the industry level and they do not mean that there are no jobs lost due to offshoring. These results may indeed hide disparities in demand for different skill categories, which is influenced by offshoring, as well as differences in trends at the level of the firms. Both these issues deserve to be carefully examined in future research for Belgium.

"The impact of offshoring on employment in Belgium",
B. Michel,
Working Paper 1-09, January 2009.

System of Innovation in Wallonia

This Working Paper evaluates the performance of the system of innovation in Wallonia for the most recent available period. Like the previous paper, this paper is based on the analysis of indicators reflecting the six main components of a system of innovation: knowledge development, human resources, valorisation of R&D, absorption capacity of innovation, entrepreneurship and innovation financing. A country's performance depends not only on the relative strength of each individual element but also on how effectively the components interact. These six components are evaluated from a European perspective: Wallonia is compared with European countries and European regions with similar socio-economic characteristics.

The analysis confirms some strong and weak points highlighted in the last year's report and gives a new perspective on the valorisation and absorption capacity, with use at the regional level of the data from the Community Innovation Survey (CIS).

Compared with the previous year, the analysis shows a reinforcement of some strong points in four components of the innovation system: knowledge development, human resources, valorisation of R&D and absorption capacity. The knowledge development component is characterised by an increase in total R&D expenditure and in business R&D expenditure - in particular in high technology sectors - by the high level of financing by foreign businesses and by the beginning of an increase in public financing. The human resources pillar reveals a relatively high, and rising, level of skilled people (with tertiary education) in the population. The component valorisation capacity is consolidated by the progression - since the previous innovation survey - of the percentage of innovative companies in the manufacturing and services sector. This improvement is particularly visible for small businesses. Finally, the pillar absorption capacity shows that innovative Walloon companies, and in particular small businesses, are efficient at obtaining public funding, from European or regional authorities.

Next to these initially positive signs for the Walloon policies in favour of R&D and innovation, however, the diagnosis reveals that efforts have to be made in some areas of the innovation system, which have constituted the weak points of the Region for several years. These efforts are necessary to maintain the comparative advantages of the Walloon system of innovation.

In the human capital component, the proportion of new graduates in science and engineering remains too low, despite the growing demand. This weak point is intensified by an insufficient participation of adults in lifelong learning. The valorisation capacity is characterised by a weak, and diminishing, relative importance of high-tech manufacturing and services sectors in terms of nominal value added. R&D and innovation efforts have not yet led sufficiently to new activities that could assure the industrial restructuring of the Region and strengthen the resilience of the Walloon economy to the current shock. The pillar absorption capacity shows a weakness in knowledge diffusion between basic research and industrial research and in the collaboration between the different stakeholders in innovation. However, the available data covers the period before the effective implementation of the competitiveness poles promoting these transfers. The lack of regional data on innovation financing does not allow a diagnosis to be given for the Walloon Region concerning this component of the innovation system.

"Le système d'innovation en Wallonie",
B. Biatour, C. Chatelain, C. Kegels,
Working Paper 2-09, January 2009.

Long term transport projections for Belgium

An efficient transport system is essential for the economic development of Belgium. Today it is clear that transport not only contributes positively to welfare, but also causes negative effects. Witness to this are the many traffic jams on the roads and the problems caused by air pollution. By sketching an image of what the future might bring, this Planning Paper aims to present elements that can support the formulation of transport policies. The time horizon of the study is 2030.

The reference scenario builds upon a continuation of the current transport pricing policies and on the implementation of existing European directives that impose new emission standards and efficiency standards for vehicles, together with an increase in the use of biofuels. Based on the latest energy projections of the European Commission, it assumes that the crude oil price will be 63% higher in 2030 than in 2005. As regards the infrastructure policy, the scenario assumes a constant capacity for the road infrastructure. For rail transport and inland navigation, a constant speed is assumed.

Given these assumptions, the reference scenario projects a substantial growth in both freight and passenger transport in Belgium.

The total number of passenger km will increase by 30% between 2005 and 2030. The highest increase (35%) is recorded for 'other' purposes (shopping, leisure, etc.), followed by school trips (29%) and commuting (18%). The study considers six transport modes for passenger transport: non-motorized transport, rail, car with 1 occupant, car with at least 2 occupants, bus/tram/metro and motorcycle. In 2005 the car was dominant for all trip purposes, with a share of approximately 84%. This share is not expected to change by 2030. However, the share of cars with at least 2 occupants should fall, while that of cars with 1 occupant should rise. The share of rail should grow slightly, while that of bus/tram/metro should fall. The other modes should remain relatively unimportant.

The total number of ton km transported in Belgium by means of road, rail and inland navigation will increase by 60% between 2005 and 2030. The highest growth should take place for international transport to and from Belgium, which is expected to increase by 99% and 73%, respectively. Transit should grow by 52%, while national transport should rise by 40%. There should be a shift from the road modes (trucks and vans) to rail and inland navigation. The road modes will remain dominant, however, with a share at 71% in 2030.

The implementation of environmental policies will be successful in reducing direct emissions of the traditional air pollutants (CO, PM, NMVOC, NO_X and SO_2), even when taking into account the growth in transport. Greenhouse gas emissions will increase, however, by 18% between 2005 and 2030. In this case the increased fuel efficiency of the vehicles should be offset by the growth in transport.

The projected growth of passenger and freight transport should further deteriorate traffic conditions in Belgium. This is reflected in a projected fall in average road speed. In 2030, the average road speed in the peak period should be 31% lower than in 2005; in the off-peak period it should fall by 17%. This implies a strong increase in the marginal external congestion costs. Since the study assumes a constant road infrastructure capacity, the projected evolution of the congestion costs should be seen as an upper limit. However, even with an expansion of capacity, congestion is expected to grow. Therefore, new measures are required. Economic theory suggests that it is best to aim at a better correspondence between taxes and external costs via a change in transport pricing.

"Langetermijnvooruitzichten voor transport in België: referentiescenario - Perspectives à long terme de l'évolution des transports en Belgique: projection de référence",
B. Hertveldt, B. Hoornaert, I. Mayeres,
Planning Paper 107, March 2009.

Recent history of major economic policy measures

January 2009

The ECB lowered its main policy rate by 50 basis points to 2.0%.

The Flemish government injected EUR 2bn capital into KBC in the form of debt securities.

December 2008

The federal government has revised its public finances objectives, given the deterioration in macroeconomic conditions (economic growth below zero in 2009) and the budgetary cost of a stimulus package decided upon to supplement the role of the automatic stabilizers. In 2009, the general government is expected to record a maximum deficit of 2% of GDP. The deficit should be reduced to 1% of GDP in 2010. A balanced budget is expected in 2011, turning into a surplus of 1% of GDP in 2012.

The stimulus package agreed at the federal level costs about 0.6% of GDP (about EUR 2 billion a year) and aims at reducing the cost of labour, supporting purchasing power and fostering investment.

Labour cost reductions (in the form of exemptions from payments of the withholding tax on wages) will be increased by EUR 455 million in 2009 and by an additional EUR 600 million in 2010. The rate of the reduction for night-time and shift-organised labour will be raised from 10.7% to 15.6% as of 2009. The reduction for overtime work will apply to 130 overtime hours instead of the current 65 hours. Reductions for researchers will also be increased. The rate of the across-the-board wage subsidy introduced in 2007 will be raised from 0.25% to 0.75% in June 2009 and to 1% in January 2010.

The cash accounts of businesses will also benefit from temporary payment facilities in 2009, allowing them to be in arrears in payments of taxes and social contributions without penalty. Moreover, the government has decided to accelerate the refund of VAT in 2009 and to speed up payments on the invoices it receives.

To support households' purchasing power, employers in the private sector will be allowed to pay, free of tax or social security contributions, a lump sum wage bonus of maximum EUR 125 in 2009 and EUR 250 in 2010 per worker, on top of the wage norm agreed in the interprofessional agreement for 2009-2010. Both the replacement rate and the ceiling of unemployment benefits for temporary lay-offs will be increased. In 2009, the government will grant a one-off EUR 30 lump sum reduction on the electricity bill of all households.

Housing investment will be fostered through an extension of the 6% reduced VAT rate to the first tranche of the building costs of a new house, to the cost of rebuilding after demolition in all areas in Belgium (and not only in specific areas as is currently the case) and to the construction of public social housing. The personal income tax reduction for building insulation will be broadened. The government will speed up public investment in the railways or other public infrastructure.

The Walloon government adopted an "anti-crisis plan" (Plan d'actions anti-crise). Its financing largely relies on public-private partnership arrangements. The principal decisions relate to an increase in the funding of the public investment companies by drawing on households' savings through a tax reduction, the front-loading of investments in local public transport and road infrastructure, measures to facilitate access to credit, and initiatives in the Region's area of competence in labour policy.

In the electricity sector, Electrabel and E.ON will swap 1,700 MW of production capacity. This will make E.ON the third largest producer in Belgium, with a 12% share of capacity. The transaction should stimulate competition and fits into the 'pax electrica' agreement concluded in 2006 by the then federal government and Electrabel parent company Suez. In air transport, the European Court of Justice ruled that the facilities given to Ryanair by the Walloon authorities are not unlawful state aid. In 2004, the European Commission had imposed a EUR 4 million fine on Ryanair for supposed unlawful state aid.

The ECB lowered its main refinancing rate by 75 basis points to 2.5%

A more complete overview of "Recent history of major economic policy measures" is available on the FPB web site (http://www.plan.be)

Abbreviations for names of institutions used in this publication

BIS	Bank for International Settlements
CPB	Netherlands Bureau for Economic Policy Analysis
CRB/CCE	Centrale Raad voor het Bedrijfsleven / Conseil Central de l'Economie
DGSB	FPS Economy - Directorate-General Statistics Belgium
EC	European Commission
ECB	European Central Bank
EU	European Union
FEBIAC	Fédération Belge des Industries de l'Automobile et du Cycle "réunies"
FPB	Federal Planning Bureau
FPS Economy	Federal Public Service Economy, S.M.E.s, Self-employed and Energy
FPS Employment	Federal Public Service Employment, Labour and Social Dialogue
FPS Finance	Federal Public Service Finance
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
NBB	National Bank of Belgium
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

BoP	Balance of Payments
CPI	Consumer Price Index
EUR	Euro
GDP	Gross Domestic Product
JPY	Japanese yen
LHS	Left-hand scale
OLO	Linear obligations
qoq	Quarter-on-quarter, present quarter compared to previous quarter of s.a. series
RHS	Right-hand scale
s.a.	Seasonally adjusted
t/t-4	Present quarter compared to the corresponding quarter of the previous year
t/t-12	Present month compared to the corresponding month of the previous year
UKP	United Kingdom pound
USD	United States dollar
VAT	Value Added Tax
yoy	Year-on-year, i.e. t/t-4 (for quarters) or t/t-12 (for months)