

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

Due to a deceleration in the worldwide business cycle, Belgian economic growth weakened from the fourth quarter of 2004 onwards. Although the high level of oil prices remains an important factor of uncertainty, economic activity should gain momentum during the second half of this year. As a result, GDP growth should fall from 2.6% last year to 1.4% in 2005 and to 2.2% in 2006.

This year, net exports as well as domestic demand should contribute less to economic growth than in 2004. While Belgian exports suffer from the slowdown in European economic growth, domestic demand is hampered by the poor performance of private and public consumption that is only partially compensated for by an acceleration in investment growth.

Economic growth in 2006 will mainly depend on domestic demand. Private consumption growth should increase as disposable income is boosted by the personal income tax reform and investment growth should remain strong. Combined with robust export growth, this implies an acceleration of imports, resulting in a zero contribution of net exports to economic growth.

After a net gain of 23,600 persons last year, employment is expected to record an average annual rise of 28,800 and 30,300 persons in 2005 and 2006 respectively. The unemployment rate should remain stable this year and next year.

The rise in oil prices has pushed up underlying inflation since the beginning of this year. Together with price increases in oil-related products, this should raise headline inflation from 2.1% in 2004 to 3% in 2005 and 2.9% in 2006.

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



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All FPB publications, mentioned in this STU, can be obtained either by sending a fax (+32 2 5077373) or by filling in the necessary form on our Internet site (<http://www.plan.be>).

Impacts of tax shifting operations

For many years, the Federal Planning Bureau (FPB) has been studying the macroeconomic effects of various ways of reducing social security contributions as well as the impact of different types of alternative sources of financing. Last year, the FPB updated its usual simulation exercises¹ at the request of the “Conseil Supérieur de l’Emploi”. Hereafter we present the main findings of these updated exercises.

Description of the simulation exercises

The short- and medium-term effects (from years t to $t+7$) of the considered measures have been projected using HERMES, the FPB’s macroeconomic sectoral medium-term model. All the simulation exercises have been calibrated so that the *ex ante* decrease or increase in government receipts is equivalent to 0.5 % of GDP over the whole period (which corresponds to 1.5 billion euro in the first year of the simulation and 1.9 billion euro in the last year).

Furthermore, these simulation exercises were carried out using the following assumption regarding wage formation²: the change in employment (as well as in productivity) generated by a measure has an impact on wage bargaining and therefore influences real gross wage evolution, labour supply remaining unchanged.

The selected simulation exercises were as follows:

Three types of measures aimed at reducing employers’ social security contributions (ESSC) were tested: a general proportional reduction in the implicit contribution rate, a reduction targeted at low-wage workers and a lump sum reduction (identical for every full-time equivalent job).

Moreover, six types of alternative financing measures were selected, which can be classified into three categories: increased indirect taxes, increased direct taxes, and new taxes. Indirect taxation was examined in terms of an increase in Value Added Tax (VAT) and an increase in excise duties on motor fuels and tobacco. Direct taxation was examined in terms of an increase in income tax and an increase in corporate tax. Finally, two new taxes calculated on very wide bases were examined:

- a “value added contribution (VAC)” based on the value added of all firms and obtained by multiplying this base with a single rate (0.83 %);
- a “general social contribution (GSC)” calculated on a very wide income base (wages, self-employed earnings, company earnings, replacement income and family benefits, capital income of the households, rents and other sources of household income) and for which the rate would be 1.17 %.

The results presented hereafter must be considered with caution. This warning applies in particular to the effects of the new taxes for which, by definition, many uncertainties remain. Moreover, the implementation of those new taxes could create practical or socio-political problems. It could also generate redistributive disparities. Those problems and disparities have not yet been examined, although they clearly should be before any political decision is taken. Note also that the results of all the tested measures must be considered as a general approximation of the impacts of the measures (and not as specific effects resulting from a specific way of implementing a measure).

A summary of the results of the single simulation exercises is shown in Tables 1 and 2. Table 1 displays the effects of the social security contribution reduction measures while Table 2 gives the impacts of the measures considered to compensate the decrease in receipts. The expected results of combined simulation exercises (eighteen combined exercises are theoretically possible – 3×6) can approximately be derived from Table 1 and Table 2. One example of results from a combined simulation is presented at the end of this special topic.

Main findings

The reduction of social security contributions targeted at low wages is the most favourable in terms of both job creation and public finances: the budgetary cost per created job would be limited to about 25,000 euro in the case of this targeted measure, whereas this cost would be, after a few years, at least twice as much in the other scenarios. However the highest GDP increase over the medium term seems to be obtained with a lump-sum reduction of ESSC. It is also worth mentioning that the option which is chosen to reduce social security contributions is not neutral in terms of sectoral impacts.

1. See Planning Paper 97: “Variantes de réduction des cotisations sociales et de modalités de financement alternatif” - “Socialezekerheidsbijdrageverminderingen en alternatieve financiering van de sociale zekerheid: simulaties van beleidsvarianten”, Federal Planning Bureau, January 2005.

2. Note that two other assumptions regarding wage formation were also considered in Planning Paper 97 and that the results can significantly be influenced by the choice of the wage formation scenario.

Table 1 - Reductions of employers' social security contributions
differences in % w.r.t. the baseline, unless otherwise stated

	GDP		Employment (in thousands)		Consumer Prices		General government financing capacity (% of GDP)		Budgetary cost per created job (thousand of euro)	
	t	t+7	t	t+7	t	t+7	t	t+7	t	t+7
Proportional reduction of ESSC	0.11	0.18	7.22	15.85	-0.14	-0.20	-0.33	-0.28	133.6	67.5
Targeted reduction of ESSC on low wages	0.13	0.18	10.44	34.04	-0.22	-0.46	-0.36	-0.23	98.9	25.7
Lump sum reduction of ESSC	0.12	0.21	7.83	17.56	-0.16	-0.24	-0.34	-0.27	126.4	58.1

As far as compensating modalities are concerned, conclusions are less clear-cut and depend highly on the 'efficiency' criterion that is considered. The VAT increase is the measure that would generate the smallest decrease of GDP in the medium term; however, it is also the measure that would create the smallest public finance surplus and would destroy the biggest number of jobs. In terms of created jobs, the other measure of indirect taxation increase, increased excise duties on fuel and tobacco, performs much better and is the compensating measure that seems to destroy the smallest number of jobs. However, it would generate only a poor increase of public financing capacity. If the increase in public finances is chosen as a criterion, the increase in corporate tax seems

to be the best option. However, this maximum public financing surplus is associated with the biggest fall of GDP growth and with significant job losses. Comparatively, the other measure that reduces the profitability of firms, the implementation of VAC, seems to lead to a quasi-equivalent number of job losses, to a smaller decrease in GDP, but also to a smaller surplus of public finances. Finally the two measures mainly focused on a decrease in the disposable income of households seem to produce quite similar effects, even if the implementation of GSC seems to perform somewhat better than the personal income tax increase in terms of growth, employment and public finances.

Table 2 - Optional financing modalities to compensate employers' social security contribution reductions
differences in % w.r.t. the baseline, unless otherwise stated

	GDP		Employment (in thousands)		Consumer Prices		General government financing capacity (% of GDP)	
	t	t+7	t	t+7	t	t+7	t	t+7
VAT increase	-0.13	-0.08	-9.29	-7.43	0.66	0.76	0.27	0.12
Excise increase (tobacco, motor fuels)	-0.17	-0.10	-5.96	-0.36	0.75	0.66	0.21	0.17
Personal income tax increase	-0.17	-0.20	-3.77	-1.69	-0.03	-0.29	0.38	0.45
Corporate tax increase	-0.05	-0.27	-0.35	-4.56	0.07	0.51	0.49	0.58
Implementation of VAC	-0.08	-0.21	-1.06	-4.81	0.11	0.45	0.41	0.50
Implementation of GSC	-0.13	-0.17	-2.83	-1.66	-0.02	-0.16	0.46	0.50

Example of tax-shifting

A combined simulation can be worked out by adjusting the size of the alternative financing measure so as to respect the principle of budget neutrality, *ex post*. This is, for example, the case when combining a targeted reduction of ESSC on low wages (reduction equivalent to 0.5% of GDP *ex ante*, from t to t+7) with the introduction of a value added contribution (VAC).

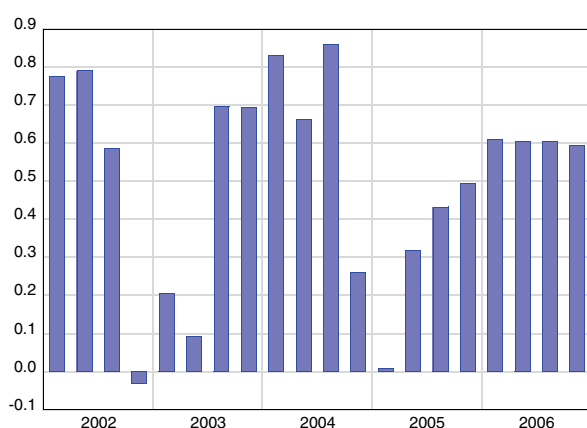
To obtain budget neutrality (for General Government), the VAC must be equal *ex ante* to 61 % of the targeted reduction of ESSC. This gives a VAC rate of 0.51 %. Thanks to the feedback effects generated by the two measures involved in this tax-shifting operation, budget neutrality can thus be respected by implementing a compensating measure that only costs 61 % of the initial measure.

Therefore, respecting the principle of budget neutrality *ex post*, this tax-shifting would allow the creation of about 31,000 jobs in the medium term. The tax-shifting would also stimulate growth (slightly, +0.05 % with respect to the baseline scenario in the medium term) and reduce inflation (-0.19 %).

Economic forecasts 2005-2006

In 2004, Belgian economic activity increased on a yearly basis by a reasonable 2.6% (GDP at constant prices). Nevertheless, as early as the last quarter of 2004, Belgian economic growth experienced a slowdown due to the slackening of worldwide economic activity. After stabilisation in the first quarter, then an increase of 0.3% during the second quarter of 2005, economic activity should gain momentum in the second half of this year, with an increase of 0.4% in the third quarter rising to 0.5% in the last quarter. In 2006, quarterly growth should stabilise at approximately 0.6%. On a yearly basis, this implies a real GDP growth rate of 1.4% in 2005 and 2.2% in 2006.

Graph - Quarterly GDP at constant prices
 qoq growth rates, seasonally adjusted and corrected for calendar effects



A limited slowdown of the world economy in 2005

Compared to 2004, worldwide economic growth weakened this year, although to a limited extent. Yet the business cycle shows clear geographical differences. US economic growth is gradually slowing down to its trend growth, the Japanese economy is picking up and China is still posting record growth figures. In contrast, the euro area economy recorded rather low growth rates in the first half of 2005. However, it seems that the euro area economy is currently recovering due to the recent depreciation of the euro, which has stimulated foreign orders and boosted business confidence.

Crude oil prices remain an important factor of uncertainty

The combination of strong growth in worldwide demand for energy products and capacity problems in the oil industry has resulted in record prices for oil products and a substantially higher energy bill for households and companies. In August, crude oil prices exceeded 60 dollars per barrel (compared to 40 dollars at the beginning of 2005). Meanwhile, the small supply surplus entails highly volatile prices that are difficult to predict. The outlook for oil prices is, as usual, based on forward market quotations. The annual average Brent oil price should go up from 57 dollars per barrel this year to 67 dollars in 2006 (compared to 38 dollars in 2004).

Smaller contributions of net exports and domestic expenditures to economic growth in 2005

Compared to last year, the Belgian economy is dealing with a weakening of foreign demand and – to a smaller extent – of domestic demand, as a result of which GDP growth should almost halve to 1.4%. The European cyclical slowdown is affecting Belgian exports, which should only increase by 2.2%, as compared to 6.2% in 2004. Imports should grow faster than exports, leading to a negative contribution of net exports to economic growth (-0.4 percentage points, after +0.1 percentage points in 2004). Together with a worsening of the terms of trade, this has caused the current account surplus to shrink to 3.1% of GDP.

In the course of this year, domestic demand should increase by only 1.9%, as compared to 2.6% in 2004. The boost in business and public investment can only partly compensate for the weakening of growth in private and public consumption. Moreover, the contribution of stock building to GDP growth, which was still positive in 2004, has disappeared.

Still in 2005, the growth rate of private consumption should be limited to 1.3%. Because of weak employment growth and high oil prices, the increase in purchasing power amounts to barely 0.9%. Moreover, since May, the consumer confidence indicator has dropped due to the uncertain economic situation. As a result, the savings rate has been on the rise during the course of 2005, although it remained on average 0.3 percentage points under the level of 2004 (as the year 2004 was characterized by a strong decrease in the savings rate). The fall in public consumption can be attributed to health care expenditure. In 2004, those expenses increased at a faster pace than budgeted, but are expected to meet the budgetary goal in 2005.

Business investment is more dynamic than last year, especially in the first half of this year. The better performance may be partly the result of a catching-up movement for the period 2003-2004, when a boost in profit margins went hand in hand with weak investment growth. A lack of improvement in foreign demand prospects, a relatively low industrial capacity utilisation rate, as well as high oil prices and the resulting deterioration of profit margins should lead to more modest investment growth during the second half of 2005 and in 2006.

The profile of growth in public investment is determined by spending on public works by local authorities in the run up to the local elections in 2006, and by an expected sharp fall in sales of public buildings to the private sector (in the national accounts, sales of public buildings are treated as a shift from public investment to business investment). Both factors push up real growth in public investment to almost 19%.

In the course of 2006, the economic recovery should be sustained by domestic demand

Belgian export growth should accelerate to 5.1%. The recovery of exports that started in mid-2005 will provide a more favourable starting point in 2006. Moreover, the stabilisation of the euro exchange rate is preventing a further loss of competitiveness. Robust growth in exports and in domestic demand stimulates imports to an extent that net exports should contribute very little to economic growth. The current account surplus continues its downward path to 2.6% of GDP as a result of a persistent unfavourable evolution in terms of trade.

In 2006, economic growth should, to a large extent, be supported by domestic demand, which should register a growth of 2.2%. Business investment remains quite dynamic (+2.9% after 3.9% in 2005) and public consumption resumes a pace of growth that reflects the budgeted rise in health care expenditure. Real disposable income of households should increase by 2%. The loss of purchasing power that is due to the stronger rise in the consumer price index than in the 'health index' should be compensated for by the personal income tax reform and the increase in employment. Private consumption growth should be somewhat more subdued (1.6%) as the savings rate rises to 12.7%. This would mean the end of the fall in the households' savings rate on a yearly basis, which was one of the driving forces behind economic growth from 2002 onwards. This can be explained by consumer confidence, which is expected to remain hesitant due to unfavourable labour market developments (the unemployment rate is not expected to decrease) and high oil prices. Public investment will still be on a rising path, for the same reasons as in 2005.

Insufficient job creation to reduce unemployment in 2005 and 2006

In 2004, net job creation amounted to 24,000 persons on average. Since the labour market responds to a cyclical slowdown with a delay of about two quarters, employment growth declined significantly during the second quarter of 2005. Job creation should only start to accelerate from the fourth quarter onwards. Boosted by the favourable dynamics of 2004, employment should increase on average by nearly 29,000 persons in 2005, which implies limited labour productivity growth. In 2006, quarterly growth of employment should continue to rise and more than 30,000 new jobs should be created. The employment rate should rise slightly from 61.7% in 2004 to 61.9% in 2005 and 62.1% in 2006. However, job creation is not sufficient to meet the increase in the labour force, resulting in a slight increase in the level of unemployment. The annual average unemployment rate is expected to remain stable in 2005 and 2006.

Oil prices to push up inflation to 3% in 2005 and 2.9% in 2006

Headline inflation, as measured by the yoy growth rate of the national consumer price index, should amount to 3% in 2005 and 2.9% in 2006, compared to 2.1% in 2004. Owing to the rise in oil prices, inflation on a monthly basis should increase to roughly 4% at the beginning of 2006, followed by a slowdown. The Brent oil price, expressed in euro, should rise by 48% this year and 17% in 2006 (in 2004, an increase of more than 20% was seen). Underlying inflation, which represents the fundamental trend in consumer prices, dropped during the course of 2004, but should rise in 2005 and 2006 as higher oil prices are passed on to prices for other goods and services. As a result, underlying inflation remains stable in 2005 on a yearly basis, but should go up in 2006. As in the two previous years, the 'health index', which is not affected by changes in the price of fuel for transport, should increase at a slower pace than the national consumer price index (2.2% in 2005 and 2006). Nevertheless, the 'health index' shows a stronger increase than in 2004, mainly due to the acceleration in the prices of heating oil and gas, which are part of it.

The pivotal index for the public sector was crossed in July 2005. As a result, social benefits were adjusted by 2% to the higher cost of living in August 2005 and public wages were adjusted in September 2005. According to our monthly forecasts for the 'health index', the pivotal index (currently standing at 118.47) should be exceeded in May 2006.

"Economische begroting 2006 - Budget économique 2006", INR/ICN, September 2005.

Economic forecasts for Belgium by the Federal Planning Bureau

Changes in volume (unless otherwise specified) (cut-off date of forecasts: 30 September 2005)

	2003	2004	2005	2006
Private consumption	0.9	1.5	1.3	1.6
Public consumption	2.5	2.0	1.0	2.2
Gross fixed capital formation	-0.7	4.2	4.6	3.9
Final national demand	1.0	2.6	1.9	2.2
Exports of goods and services	2.9	6.2	2.2	5.1
Imports of goods and services	3.1	6.4	2.7	5.2
Net-exports (contribution to growth)	-0.1	0.1	-0.4	0.1
Gross Domestic Product	0.9	2.6	1.4	2.2
p.m. Gross Domestic Product - in current prices (bn euro)	274.58	288.09	299.08	312.81
National consumer price index	1.6	2.1	3.0	2.9
Consumer prices: health index	1.5	1.6	2.2	2.2
Real disposable income households	-1.0	-0.2	0.9	2.0
Household savings ratio (as % of disposable income)	14.3	12.8	12.5	12.8
Domestic employment (change in '000, yearly average)	-3.3	23.6	28.8	30.3
Unemployment (Eurostat standardised rate, yearly average) [1]	7.9	7.8	7.8	7.8
Current account balance (BoP definition, as % of GDP)	4.4	3.9	3.1	2.6
Short term interbank interest rate (3 m.)	2.3	2.1	2.1	2.2
Long term interest rate (10 y.)	4.1	4.1	3.4	3.3

[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
	2005	2006	2005	2006	2005	2006	
Federal Planning Bureau	1.4	2.2	3.0	2.9	.	.	09/05
INR/ICN	1.4	2.2	3.0	2.9	.	.	09/05
National Bank of Belgium	1.4	2.4	2.2	1.9	-0.5	-1.4	06/05
European Commission	2.2	2.3	2.0	1.8	-0.2	-0.6	04/05
OECD	1.3	2.4	2.2	1.6	-0.5	-1.2	05/05
IMF	1.2	2.0	2.3	1.9	-0.8	-2.0	09/05
ING	1.3	2.2	2.8	2.0	-0.2	-1.0	10/05
Fortis Bank	1.5	2.4	2.4	1.8	-0.3	-0.5	09/05
Dexia	1.6	2.3	2.9	2.0	-0.2	-0.8	09/05
KBC Bank	1.2	1.4	2.7	2.1	-0.5	-1.3	09/05
Morgan Stanley	1.2	2.3	10/05
Petercam	1.25	1.75	2.75-3.0	2.0	-0.5	-0.9	10/05
IRES	1.1	1.8	2.4	1.8	-0.7	-1.5	06/05
Consensus Belgian Prime News	1.4	2.0	2.6	1.9	-0.2	-0.8	09/05
Consensus Economics	1.4	1.8	2.4	2.0	.	.	09/05
Consensus The Economist	1.2	1.9	2.4	2.0	.	.	09/05
Consensus Wirtschaftsinstitute	2.1	1.9	2.4	2.0	.	.	04/05
Averages							
All institutions	1.4	2.1	2.5	2.0	-0.4	-1.0	
International public institutions	1.6	2.2	2.2	1.8	-0.5	-1.3	
Credit institutions	1.3	2.0	2.7	2.0	-0.3	-0.9	

Collaborating institutions for The Economist: ABN Amro, Deutsche Bank, Economist Intelligence Unit, Goldman Sachs, HSBC Securities, KBC Bank, J.P. Morgan Chase, Morgan Stanley, Decision Economics, BNP Paribas, Royal Bank of Canada, Citigroup, Scotiabank, UBS.

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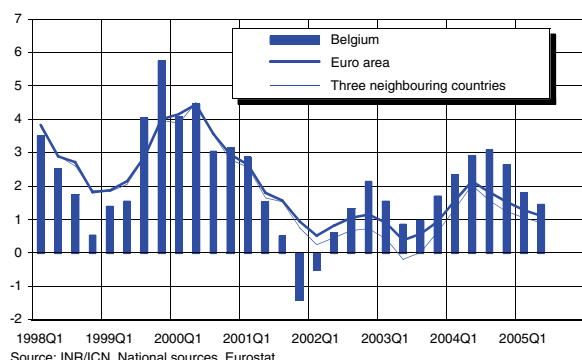
General economic activity

Table 1 - GDP growth rates, in %

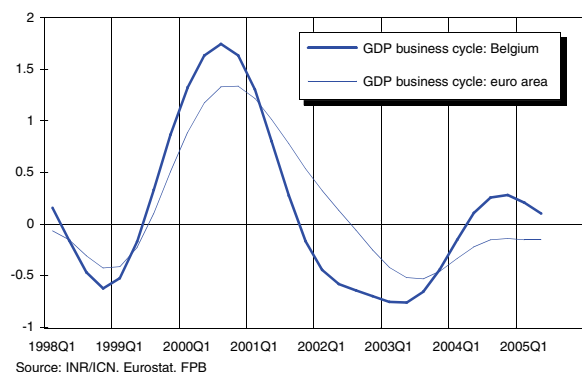
	2003		2004		YoY growth rates, in %					QoQ growth rates, in %				
	2003	2004	2004Q2	2004Q3	2004Q4	2005Q1	2005Q2	2004Q2	2004Q3	2004Q4	2005Q1	2005Q2		
Germany	-0.2	1.6	1.6	1.1	0.5	0.8	0.6	0.2	-0.1	-0.1	0.8	0.0		
France	0.9	2.1	2.8	1.8	2.1	1.9	1.3	0.8	0.1	0.6	0.4	0.1		
Netherlands	-0.1	1.7	1.8	2.3	1.7	0.1	1.0	0.3	0.6	0.1	-0.8	1.2		
Belgium	1.3	2.7	2.9	3.1	2.6	1.8	1.4	0.7	0.9	0.3	0.0	0.3		
Euro area	0.7	2.1	2.1	1.8	1.5	1.3	1.1	0.5	0.3	0.2	0.4	0.3		
United States	2.7	4.2	4.6	3.8	3.8	3.6	3.6	0.9	1.0	0.8	0.9	0.8		
Japan	1.4	2.7	3.1	2.4	0.9	1.0	2.2	-0.4	-0.1	0.1	1.4	0.8		

Source: INR/ICN, National sources, Eurostat

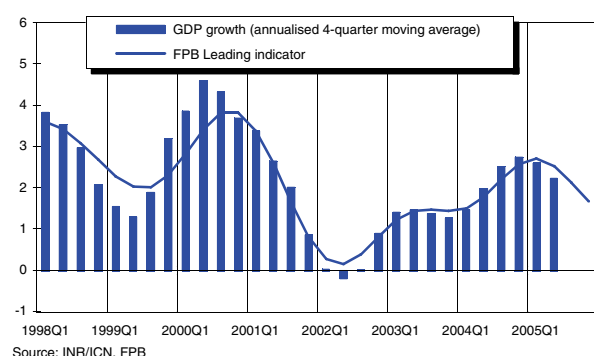
Graph 1 - GDP-growth (t/t-4), in %



Graph 2 - GDP business cycle



Graph 3 - GDP growth and leading indicator



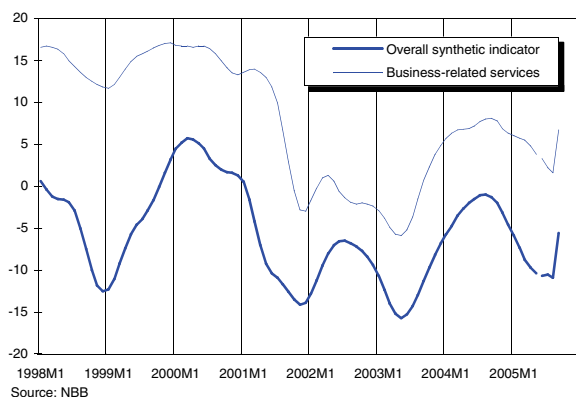
US economic growth (qoq) slowed down slightly from 0.9% in 2005Q1 to 0.8% in 2005Q2. The fall in growth, despite a surge in net exports, was caused by much weaker inventory increases than in the previous quarter. As inventories appear to be too low in view of strong demand growth, inventories should once again contribute positively to growth in the next quarter. Hurricane Katrina will probably have a negative effect on economic growth in the second half of 2005 (less tourism and lower retail sales in the affected region), but should have a positive effect in 2006 when the rebuilding begins.

After the surge in economic growth in 2005Q1 (+1.4% qoq), the Japanese economy grew by 0.8% in 2005Q2. The higher contribution of net exports was more than compensated for by slower inventory growth and weaker private consumption. Despite this slowdown, the outlook for the Japanese economy is very good. Unemployment is decreasing, deflation is easing, firms have shed overcapacity and debt, and wages are finally starting to rise.

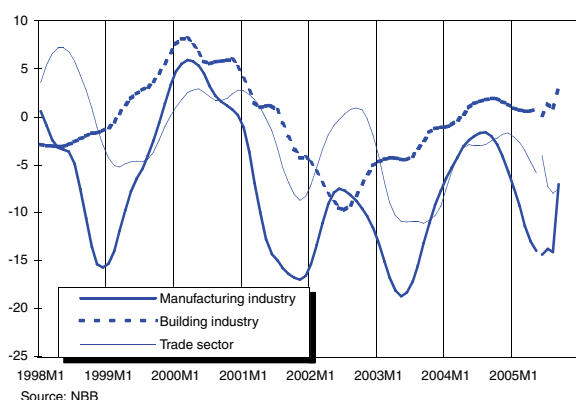
Economic growth in the euro zone slowed down to 0.3% qoq in 2005Q2 (from 0.4% in the previous quarter). Private consumption growth turned negative and the contribution of net exports fell to 0% (versus +0.3% in 2005Q1). This was almost compensated for by stronger investment growth and a stronger contribution from inventories. Economic growth is expected to increase in the coming quarters, as the acceleration of world trade should support export growth. Domestic demand, however, stays very weak.

In 2005Q2, Belgian GDP growth accelerated to 0.3% qoq, from 0% in 2005Q1. The German and French economy did even worse, growing by 0 and 0.1% respectively, while Dutch economic growth surged by 1.2%. The FPB leading indicator has declined in the last quarters and is now pointing to a deceleration of economic growth to about 1.5% this year (from 2.6% last year).

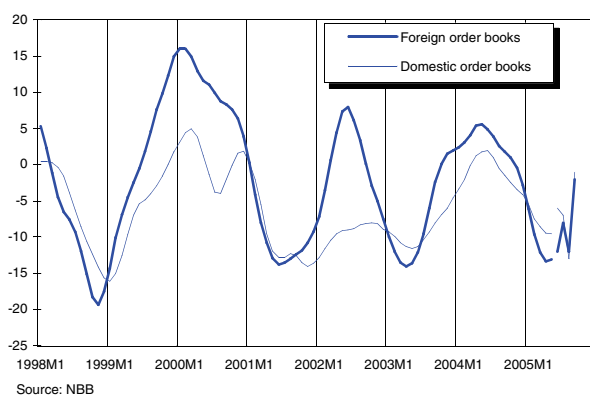
Graph 4 - Business cycle: global evolution



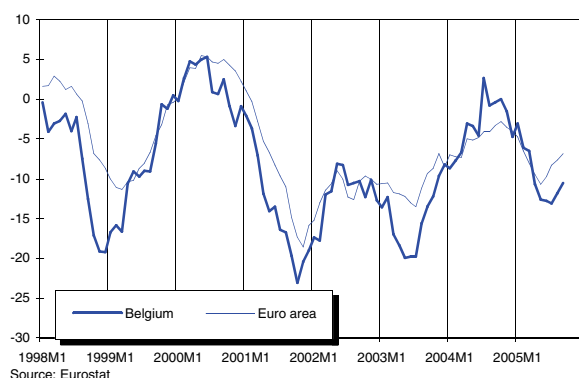
Graph 5 - Business cycle: sectoral evolution



Graph 6 - Manufacturing industry: order books



Graph 7 - Industrial confidence: international comparison



The worsening of Belgian business confidence (shown as the overall synthetic indicator in graph 4) which started in 2004Q4, continued in the first half of 2005, reaching a low of -12.4 in May. In the following 3 months, the indicator stabilised at around -10.5, but then surged to -5.6 in September, the best outcome since the start of the year despite the peak oil prices. Although the September outcome still has to be confirmed in the coming months, a swing of this magnitude nevertheless points to an improvement in the business climate.

The deterioration in business confidence in the first and second quarter was largely due to a significant drop in manufacturing confidence, hit by the past appreciation of the euro, high oil prices and weak world trade growth. In addition, confidence of the trade sector deteriorated somewhat in 2005Q2. The recent recovery of the business climate was rather broadly based, as all four sectors (manufacturing, construction, trade and business-related services) covered by the NBB business survey improved. The bulk of the improvement, however, came from the manufacturing sector (from -14.1 to -7). The positive outcome in September seems to confirm an upturn of economic growth in the second half of 2005.

Within *manufacturing* sentiment, all subcomponents improved in September, but the biggest rise was seen in domestic and foreign order books (see graph 6). For the first time in 8 months, the optimism of entrepreneurs regarding the employment outlook increased, which indicates that the recovery is not expected to be short-lived.

The indicator for the *trade sector* improved only marginally in September, as the strong increase in foreign demand was more or less balanced by a decline in sales. At the moment, the indicator for the trade sector is still below its average in 2005Q2.

The *building industry* indicator has been quite volatile in the last year or so. Despite these fluctuations, the trend is clearly upwards, as the quarterly average rose from -0.7 in 2005Q1 to 1.4 in 2005Q2, and to 1.8 in 2005Q3.

The *business-related services* cycle is not taken into account in the overall synthetic indicator. Services sentiment reached a two-year low in August, especially due to a drop in demand and employment prospects. In September, however, the indicator improved sharply (from 1.6 to 6.7), thanks to a strong improvement in current and anticipated activity.

The rise in industrial confidence has so far been less pronounced in Belgium than in the euro area (see graph 7). Moreover, the recovery of industrial confidence came later in Belgium than in the euro area; this is atypical, as Belgium tends to lead the European business cycle.

Private consumption

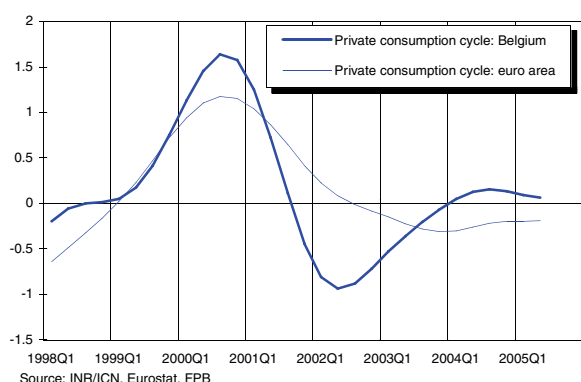
Table 2 - Private consumption indicators

	2003	2004	2004Q4	2005Q1	2005Q2	2005Q3	2005M4	2005M5	2005M6	2005M7	2005M8	2005M9
New car registrations [1]	-1.9	5.7	-1.5	-6.1	2.1	6.9	-9.8	6.1	13.1	4.1	11.7	5.3
Consumer confidence indicator [2]	-10.8	-3.3	-3.3	-3.2	-8.7	-11.8	-4.3	-10.6	-11.3	-11.1	-10.1	-14.1

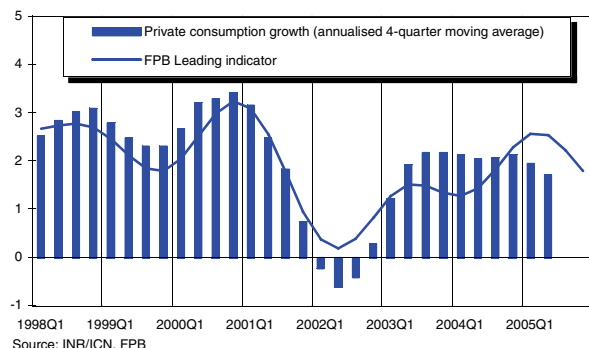
[1] Change (%) compared to same period previous year; [2] Qualitative data

Source: European Commission, Febiac, FPB

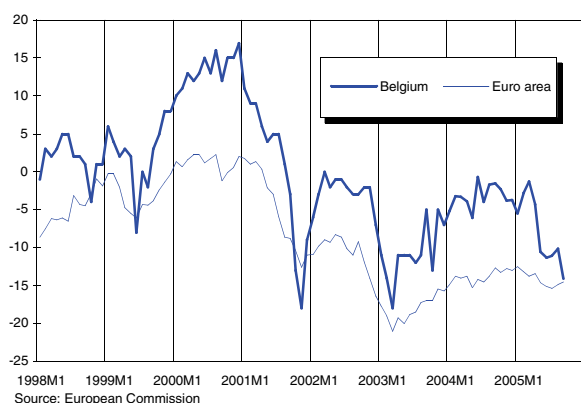
Graph 8 - Private consumption cycle



Graph 9 - Private consumption growth and leading indicator



Graph 10 - Consumer confidence: international comparison



The Belgian as well as the euro area private consumption cycles have been stable since the first quarter of 2004. This means that average qoq growth rates between 2004Q1 and 2005Q2 (0.5% in Belgium and 0.3% in the euro area) have been close to trend growth. The euro area consumption cycle has not witnessed a clear upturn over the last four years, in contrast to the Belgian cycle, which recovered between mid-2002 and mid-2004.

During the second half of 2004 and the first quarter of 2005, consumer confidence has been rather stable. In April and May 2005, consumers' expectations with respect to the economic outlook and unemployment prospects deteriorated heavily, which made consumer confidence decline to its lowest level since October 2003. From June to August, consumer confidence stabilised at a low level, but in September a new drop was recorded as consumers started to worry about their own financial situation following the spectacular increase in oil prices between June and September. This evolution was counterbalanced by more positive employment prospects until August, but in September a considerable deterioration in three out of four components of consumer confidence was seen. The downturn in car sales that started around the second half of 2000, came to an end in the second half of 2003. No clear signs of a reversal in car sales growth have emerged up to now.

Belgian private consumption is expected to weaken somewhat during the second half of this year as higher oil prices will negatively affect households' purchasing power. This scenario is confirmed by the FPB leading indicator.

Comparing Belgian and euro area consumer confidence shows that, notwithstanding the greater volatility of the Belgian indicator, both have deteriorated since the beginning of this year. This indicates that both private consumption cycles (graph 8) will probably not record a new rise during the remainder of the year.

Business investment

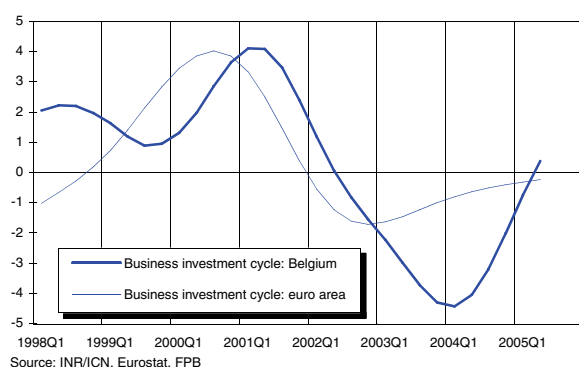
Table 3 - Business investment indicators

	2003	2004	2005	2004Q4	2005Q1	2005Q2	2005Q3	2005M5	2005M6	2005M7	2005M8	2005M9
Business survey, capital goods [2]												
Synthetic indicator	-13.3	-2.6	.	-3.1	-6.1	-5.5	-2.7	-4.9	-2.8	-1.1	-7.0	-0.1
Order book appraisal	-30.5	-16.3	.	-13.0	-13.0	-12.0	-3.7	-11.0	-8.0	-2.0	-9.0	0.0
Demand forecasts	-3.7	10.4	.	5.7	1.3	5.0	1.0	4.0	2.0	0.0	-3.0	6.0
Investment survey [1]	-4.2	-9.9	7.8									
Capacity utilisation rate (s.a.) (%)	78.8	80.7	.	80.7	79.2	78.2	.					

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

Source: NBB, FPB

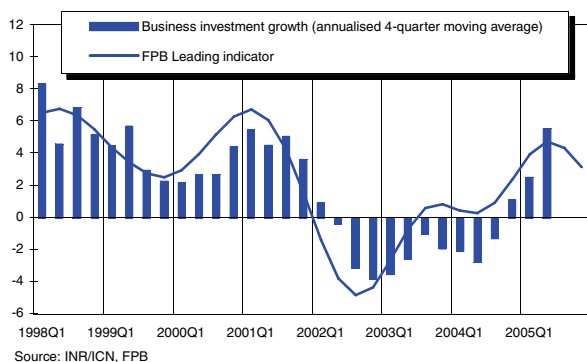
Graph 11 - Business investment cycle



While the Belgian business investment cycle continued its steep upward path, the euro area investment cycle showed some signs of levelling off during the last two quarters. Contrary to euro area investment, Belgian business investment was slightly above its trend level in the second quarter of 2005.

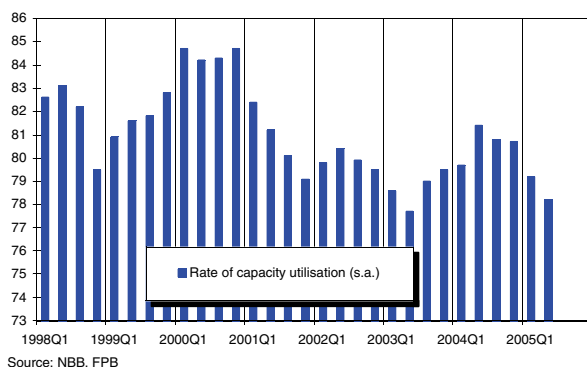
During the first two quarters of this year, business investment growth recorded qoq growth rates of respectively 0.7% and 4.8%. The figure for the first quarter seems rather low, but this is due to an accounting technicality in recording sales of government buildings to the private sector. Correcting for this factor, corporate investment increased by 4.7% in 2005Q1.

Graph 12 - Business investment growth and leading indicator



The results of surveys in the area of business investment point to relatively strong growth rates in the quarters ahead. The latest NBB investment survey, showed that entrepreneurs in the manufacturing industry are planning to invest 7.9% more (at current prices) this year than in 2004. This figure is reached even after the negative influence of the chemical industry, in which the figures for 2004 were inflated by a large investment project that will not be repeated this year. In most other sectors, investment is therefore expected to record even stronger increases. The synthetic indicator for the capital goods sector from the NBB business survey strengthened in the third quarter of 2005 due to increased optimism regarding current as well as future demand. The only factor that could weigh on business investment is the decline in capacity utilisation over the last four quarters. It is however expected that the recent recovery of the business climate will lead to a higher capacity utilisation rate in 2005Q3.

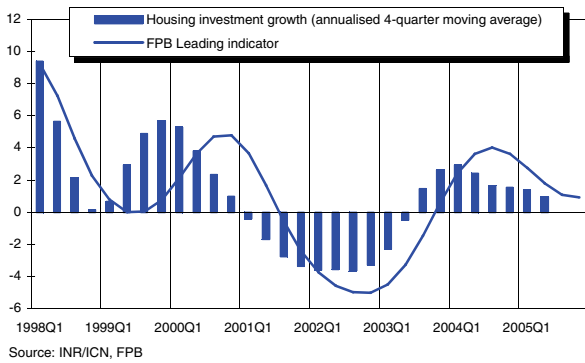
Graph 13 - Capacity utilisation in manufacturing industry



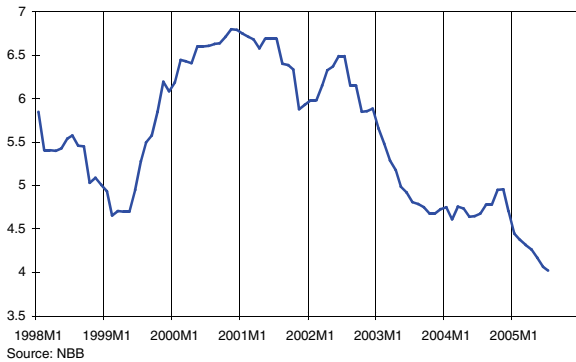
Despite the increase in profitability and improving financing conditions since 2002, business investment only started to increase again in 2004, after two years of negative growth. This year and next year, corporate investment is expected to grow faster than GDP, which should raise the investment rate at constant prices to 14% in 2006, compared to 13.5% in 2003.

Housing investment

Graph 14 - Housing investment growth and leading indicator



Graph 15 - Mortgage rate (%)



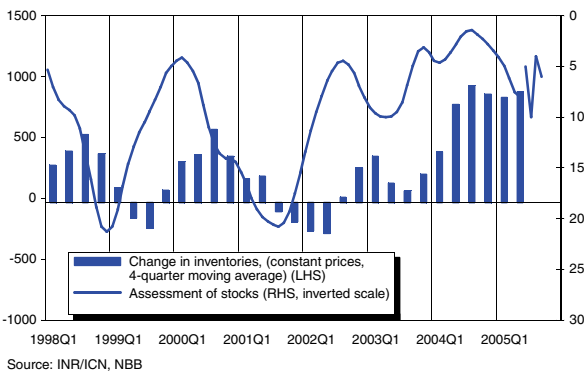
According to the latest quarterly national accounts, housing investment growth has been rather subdued during the first two quarters of this year, with qoq growth rates of only 0% and -0.1% respectively. Growth rates are expected to accelerate during the next quarters as most indicators point out that the trough should have been reached by mid-2005.

The FPB leading indicator points to a bottoming out of housing investment growth in the second half of this year and an acceleration in 2006. In fact, the evolution of the indicators taken from the survey among architects - which have a lead of about one year - has been quite hopeful since mid-2004. Architects' forecasts as well as their assessment of the current situation improved markedly during the second half of last year and remained on a high level during the first half of 2005. Mortgage applications and indicators from the NBB survey of the building industry were also on a rising path during the last few quarters and confirmed the results of the survey among architects.

The decline in mortgage rates that started in August 2002, seemed to be reversed by the end of last year. At the beginning of this year, however, mortgage rates fell further and were almost one percentage point lower in July 2005 (4%) compared to November 2004. This historically low level should also support housing investment during the coming quarters.

Stock building

Graph 16 - Stock building indicators



The weakening of business confidence and economic growth between the last quarter of 2004 and the second quarter of 2005 has not yet led to a marked deceleration in stock building, despite an increase in the number of entrepreneurs considering their level of inventories as excessive. This indicates that the increase in the level of stocks of the last few quarters was mainly unintentional and probably the consequence of demand turning out to be lower than expected.

Recently the opinion of entrepreneurs on their level of stocks stabilised, which is related to an acceleration in domestic and foreign demand resulting in better-filled order books. All in all, changes in inventories are not expected to have a significant effect on economic growth in the coming quarters.

Foreign Trade

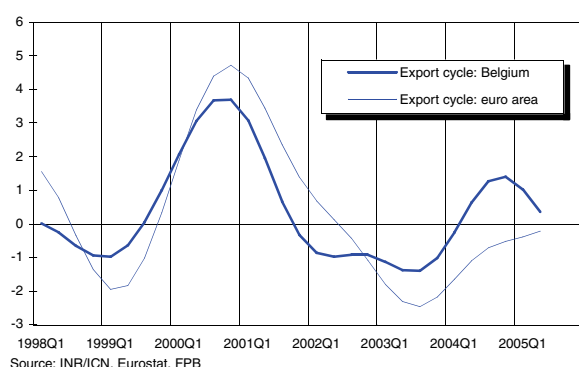
Table 4 - Belgium - Trade statistics (goods, intra/extrastat, national concept)

	2003	2004	2004Q3	2004Q4	2005Q1	2005Q2	2005M1	2005M2	2005M3	2005M4	2005M5	2005M6
Exports - value [1]	1.2	8.9	10.5	11.7	9.3	9.7	10.8	9.6	7.9	10.2	11.0	8.1
Imports - value [1]	1.5	10.5	13.9	12.5	11.4	14.0	12.3	13.5	8.8	15.8	17.7	9.4
Exports - volume [1]	3.4	6.6	6.4	6.5	2.1	3.5	4.1	2.2	0.3	3.7	5.2	1.9
Imports - volume [1]	4.1	7.0	7.5	5.2	3.5	7.5	5.0	6.2	0.0	10.9	10.9	1.7
Exports - price [1]	-2.0	2.1	3.9	4.9	7.1	6.0	6.4	7.2	7.6	6.2	5.6	6.1
Imports - price [1]	-2.4	3.2	5.9	6.8	7.5	6.0	7.0	7.0	8.7	4.4	6.1	7.6

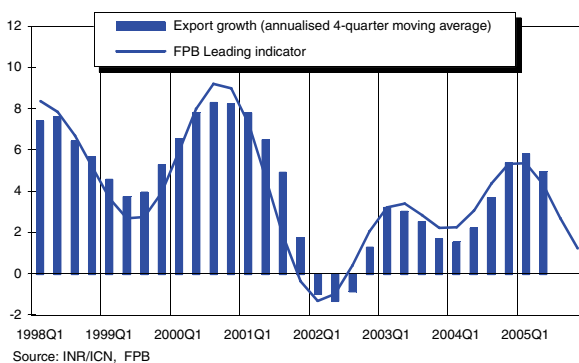
[1] Change (%) compared to same period previous year

Source: INR/ICN, FPB

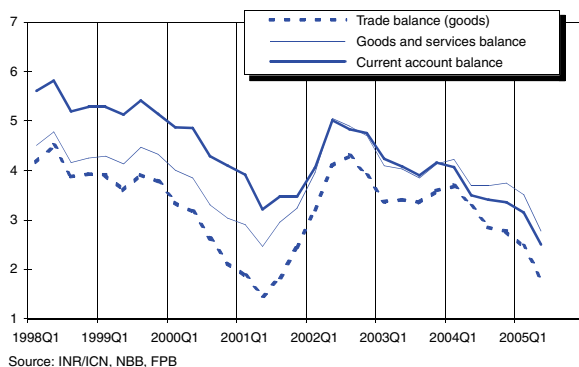
Graph 17 - Export cycle



Graph 18 - Export growth and leading indicator



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



The Belgian export cycle, which accelerated considerably between mid-2003 and 2004Q4, began to level off in the first half of this year, due to extremely weak qoq export growth in the first half of 2005. Belgian exports are now close to their trend level. The improvement in the euro area export cycle has slowed down somewhat in 2005H1, but has nevertheless continued to increase (especially due to the strong German export performance).

The strong fall in Belgian export growth in 2005Q1 (-2.8%) was no surprise, as world trade growth turned negative (-0.4%) and as Belgian exporters were suffering from the effect of the past appreciation of the euro exchange rate. Strangely enough, export growth was negative again in 2005Q2 (-1.8%) despite a surge in world trade growth (+4%) and a depreciation of the euro. The lower euro exchange rate is, however, expected to stimulate exports in the coming quarters. Moreover, as the Dutch Centraal Planbureau forecasts strong world trade growth in the second half of the year, and as the economic growth of Belgium's main trading partners (Germany, France, the Netherlands) should accelerate, Belgian export growth should be quite vigorous in 2005H2. Despite this acceleration, export growth will slow down considerably on an annual basis (from 6.2% in 2004 to 2.2% this year).

Import price growth is still very high, driven by the surge in oil prices. Export price growth has accelerated rapidly over the last few quarters, catching up with import price growth. On an annual basis, however, import prices will still grow faster than export prices, resulting in a further deterioration in the terms of trade (-0.6% versus -0.5% in 2004).

The Belgian current account surplus, expressed as a percentage of GDP, has decreased strongly in the last few years, from 5.6% in 2002 to 3.9% in 2004. This year, the deterioration in the terms of trade, and import growth outpacing export growth, will result in a further decline of the current account surplus to 3.1% of GDP.

Labour market

Table 5 - Labour market indicators

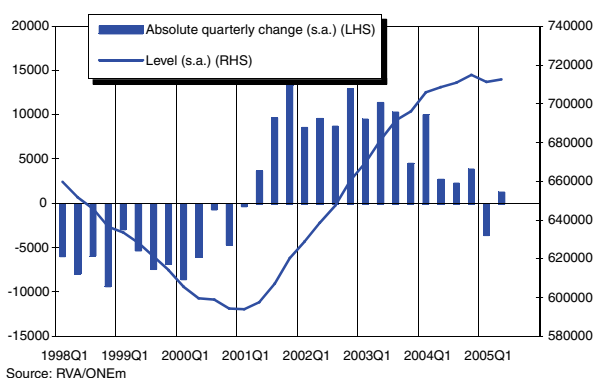
	2003	2004	2004Q3	2004Q4	2005Q1	2005Q2	2005M3	2005M4	2005M5	2005M6	2005M7	2005M8
Unemployment [1][2]	684.6	710.1	710.9	714.8	711.2	712.5	711.1	712.7	713.7	711.1	711.0	708.1
Unemployment rate [2][3]	14.0	14.4	14.4	14.4	14.4	14.4	14.4	14.4	14.4	14.3	14.4	14.3
Unemployment rate-Eurostat [3][4]	8.0	7.8	7.7	8.0	8.0	8.1	8.0	8.0	8.1	8.1	8.0	8.0

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

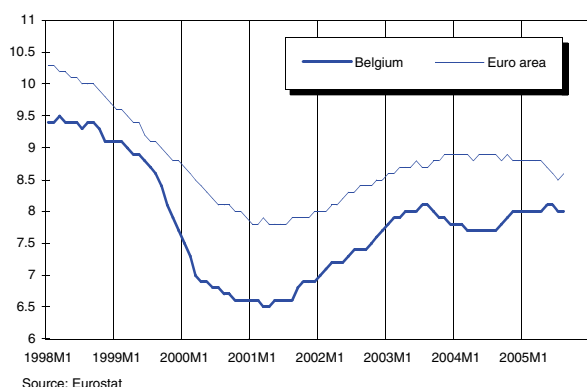
[4] Recent figures are based on administrative data and may be subject to revision

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

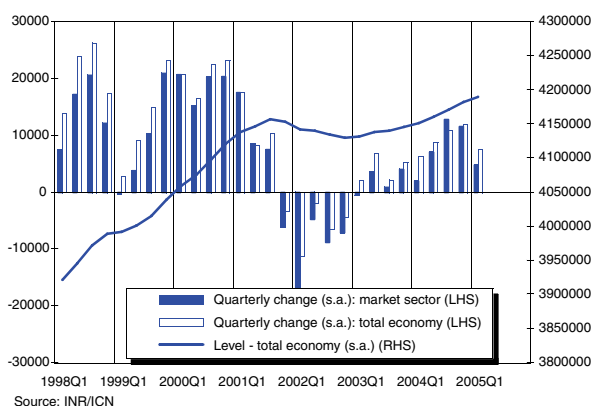
Graph 20 - Evolution of unemployment (incl. older)



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



Graph 22 - Evolution of domestic employment



Growth in jobs accelerated throughout the first three quarters of 2004, but levelled off during the fourth quarter. The latest information from the national accounts indicates that, on average, domestic employment increased by 0.57% last year, which is slightly below (roughly 0.1%) earlier estimates. However, in view of the considerable growth in the population of working age (0.34% on a yearly basis), this implies only a modest rise in the overall employment rate (from 61.6% to 61.7%).

Following the slowdown in business activity growth, job growth has decreased during the first quarter of 2005. It is expected to have decreased further during the second and third quarter, but should gradually pick up again towards the end of the year. Notwithstanding these sluggish quarter-to-quarter dynamics, on a yearly-average basis, job growth in 2005 still benefits from a positive spill-over effect from significant job creation in 2004 and is currently expected to reach 0.69%, with the employment rate thus rising to 61.9%.

Unexpectedly, the anticipated weakening of employment growth during 2005 did not translate into increased unemployment figures. Seasonally adjusted broad administrative unemployment has actually decreased significantly during the first quarter of 2005 - after fifteen consecutive quarterly increases - and during the summer. However, it is worth stressing again that, due to statistical re-alignments, the interpretation of published unemployment figures has become rather hazardous. In particular, the figures for the third quarter still require confirmation through direct information on the evolution in the number of people receiving unemployment benefit.

In other words, the above picture of recent and current labour market evolutions implies that growth in the labour force would have been exceptionally weak during the first three quarters of 2005. This would be in sharp contrast to the observed trend in recent years, and surprising in view of the strong underlying socio-demographic forces that have been boosting overall labour supply.

Prices

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

	2003	2004	2004Q4	2005Q1	2005Q2	2005Q3	2005M4	2005M5	2005M6	2005M7	2005M8	2005M9
Consumer prices: all items	1.59	2.10	2.56	2.63	2.71	3.14	2.76	2.51	2.87	3.14	3.11	3.16
Food prices	2.04	1.53	1.41	2.08	2.28	1.67	2.26	2.53	2.03	1.57	2.17	1.26
Non food prices	1.18	2.23	3.39	3.01	3.41	4.63	3.73	2.80	3.72	4.60	4.30	4.98
Services	1.75	2.36	2.34	2.64	2.17	2.20	1.85	2.22	2.43	2.38	2.21	2.02
Rent	2.22	1.88	1.78	1.79	1.85	2.06	1.89	1.75	1.90	1.94	2.07	2.17
Health index	1.45	1.63	1.90	2.10	2.18	2.36	2.09	2.13	2.32	2.42	2.41	2.25
Brent oil price in USD (level)	28.8	38.2	44.1	47.5	51.7	61.5	51.8	48.7	54.5	57.6	64.1	62.9

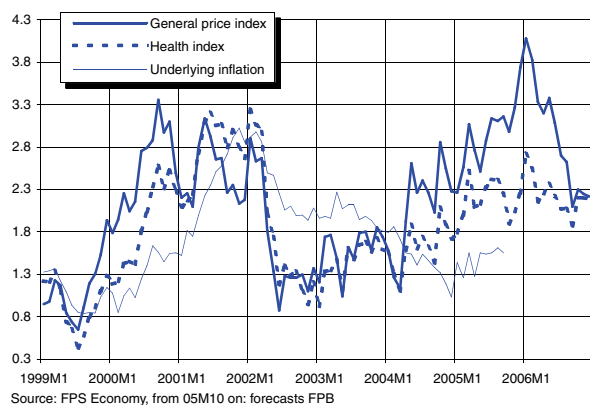
Source: FPS Economy, Datastream

Table 7 - Monthly inflation forecasts

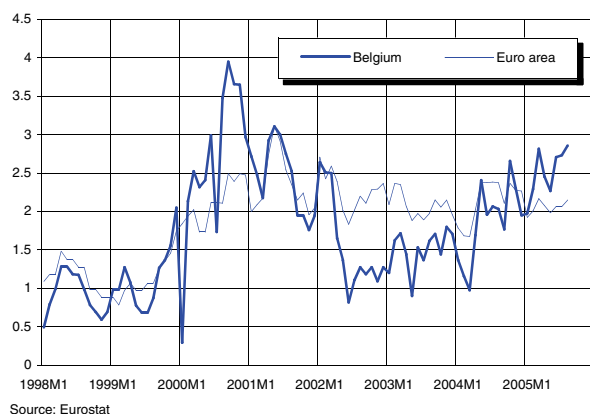
	2005M1	2005M2	2005M3	2005M4	2005M5	2005M6	2005M7	2005M8	2005M9	2005M10	2005M11	2005M12
Consumer prices: all items	115.88	116.66	117.41	117.68	117.85	118.21	118.92	119.03	119.17	119.54	119.73	119.88
Consumer prices: health index	114.68	115.28	115.90	115.87	116.09	116.29	116.76	116.78	116.65	116.66	116.81	116.83
Moving average health index	114.48	114.67	115.03	115.43	115.79	116.04	116.25	116.48	116.62	116.71	116.73	116.74
	2006M1	2006M2	2006M3	2006M4	2006M5	2006M6	2006M7	2006M8	2006M9	2006M10	2006M11	2006M12
Consumer prices: all items	120.61	121.12	121.32	121.44	121.83	121.86	122.13	122.15	121.67	122.29	122.42	122.53
Consumer prices: health index	117.80	118.22	118.40	118.48	118.84	118.87	119.18	119.20	118.83	119.23	119.38	119.39
Moving average health index	117.03	117.42	117.81	118.23	118.49	118.65	118.84	119.02	119.02	119.11	119.16	119.21

Source: Observations (up to 05M9): FPS Economy; forecasts: FPB

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



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



During the last few months, inflation continued its upward trend as a consequence of the uninterrupted rise in oil prices. The Brent oil price rose from less than 50 dollars per barrel in May to almost 65 dollars in August. Expressed in dollars as well as in euro, crude oil prices have been around 50% higher than in the previous year. Despite reductions of excise duties on some transport fuels, inflation rose to more than 3.1% in September. During the last quarter of this year and the first months of 2006, yoy growth rates of crude oil prices should rise further, which will push up inflation to around 4% at the beginning of 2006. It should be noted that this increase will be dampened somewhat during the last quarter of 2005 due to the exceptional reimbursement of part of the VAT on fuel oil for domestic heating. In 2006, inflation should decrease to around 2% at the end of the year.

Underlying inflation declined gradually during the past three years from 3% in February 2002 to 1% in December 2004. Since the beginning of this year, underlying inflation has started to rise again as the appreciation of the euro, which exerted a downward influence on import prices, has come to an end and higher oil prices are passed on in prices of other goods.

All in all, average NICP inflation should be 3% this year and 2.9% next year, while the so-called 'health index' should record an increase of 2.2% in both years. According to our monthly forecasts for the 'health index' the next pivotal index threshold (118.47) should be exceeded in May 2006.

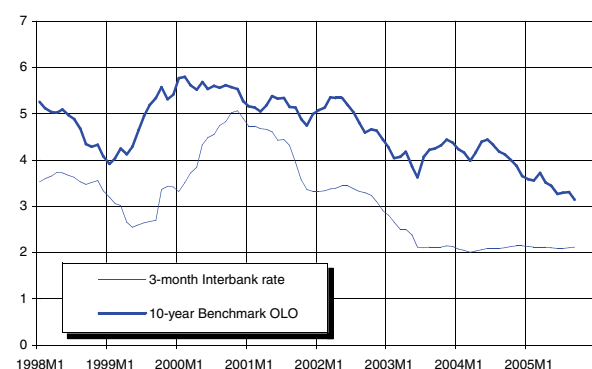
Interest rates

Table 8 - Interest rates

	2003	2004	2004Q4	2005Q1	2005Q2	2005Q3	2005M4	2005M5	2005M6	2005M7	2005M8	2005M9
Short-term money market rates (3 months)												
Belgium	2.31	2.08	2.14	2.12	2.10	2.11	2.12	2.11	2.09	2.10	2.11	2.12
Euro area (Euribor)	2.33	2.11	2.16	2.14	2.12	2.13	2.14	2.13	2.11	2.12	2.13	2.14
United States	1.15	1.56	2.25	2.78	3.23	3.74	3.09	3.22	3.38	3.57	3.77	3.87
Japan	-0.03	-0.03	-0.01	0.00	0.01	0.01	0.02	0.01	0.01	0.01	0.01	0.02
Long-term government bond rates (10 years)												
Belgium	4.14	4.13	3.84	3.62	3.40	3.25	3.51	3.44	3.26	3.30	3.31	3.14
Germany	4.09	4.06	3.79	3.62	3.34	3.19	3.51	3.33	3.19	3.23	3.25	3.09
Euro area	4.13	4.10	3.82	3.64	3.38	3.23	3.55	3.38	3.22	3.26	3.29	3.14
United States	3.99	4.26	4.16	4.29	4.16	4.21	4.33	4.15	3.99	4.16	4.27	4.18
Japan	0.99	1.49	1.43	1.38	1.25	1.34	1.29	1.26	1.20	1.24	1.41	1.35

Source: NBB, ECB

Graph 25 - Interest rate levels in Belgium, %

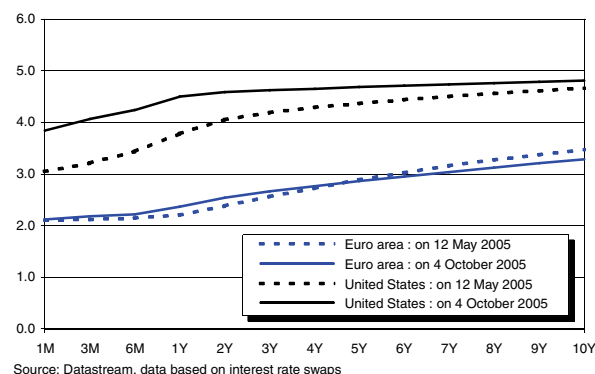


Source: NBB

In September, the Federal Reserve raised interest rates by 0.25% for the sixth time this year. Since the beginning of the tightening cycle (June 2004), it has brought interest rates from a low of 1% to 3.75%. The tightening of monetary policy has probably not yet come to an end, as the Federal Reserve recently stated that inflationary pressures are mounting.

The European Central Bank has not changed its refinancing rate since June 2003. Financial markets do not expect the ECB to raise its refinancing rate before 2006Q4, as upward pressures on core inflation remained limited despite the oil price increases of the last few months. Moreover, euro area economic growth fails to accelerate.

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



Source: Datastream, data based on interest rate swaps

US long-term interest rates rose by some 50 base points in June and July, as economic activity proved strong in the second quarter and expectations for the third quarter were also optimistic. However, in August, especially due to the possible negative effects of Hurricane Katrina on economic growth, long-term rates declined again. US long-term interest rates are currently about 0.3% higher than they were three months ago, but are at about the same level as in the beginning of the year. It is surprising that long-term rates are now lower than when the Fed started to raise interest rates, while in the past, long-term rates tended to rise when monetary policy was tightened. Euro zone long rates have not changed much over the last few months and are significantly lower than in the beginning of the year (3.7%). This implies another widening of the spread between US and euro zone long rates, which seems logical in view of the divergence in economic activity in the two zones. In the euro zone, the yield curve hardly changed over the last three months, while in the US, the yield curve flattened considerably.

Exchange rates

Table 9 - Bilateral exchange rates

	2003	2004	2004Q4	2005Q1	2005Q2	2005Q3	2005M4	2005M5	2005M6	2005M7	2005M8	2005M9
USD per EUR	1.132	1.244	1.297	1.310	1.259	1.219	1.294	1.268	1.216	1.204	1.230	1.225
UKP per EUR	0.692	0.679	0.695	0.693	0.678	0.683	0.683	0.684	0.669	0.687	0.685	0.677
JPY per EUR	131.0	134.4	137.1	137.0	135.4	135.6	138.8	135.3	132.2	134.7	136.0	136.1

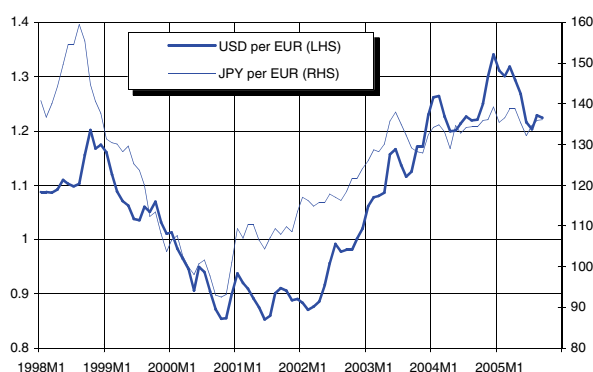
Table 10 - Nominal effective exchange rates (1990=100)

	2003	2004	2004Q3	2004Q4	2005Q1	2005Q2	2005M4	2005M5	2005M6	2005M7	2005M8	2005M9
Euro	90.9	93.8	93.1	95.6	95.7	93.6	95.1	94.0	91.7	92.6	93.2	92.9
Growth rate [1]	11.0	3.2	1.0	2.6	0.1	-2.2	-0.9	-1.1	-2.4	1.0	0.6	-0.3
US dollar	107.5	99.7	101.0	96.0	94.7	97.0	95.9	96.7	98.4	99.7	98.2	98.1
Growth rate [1]	-10.4	-7.3	-1.1	-4.9	-1.3	2.4	1.7	0.8	1.8	1.3	-1.5	-0.1
Japanese yen	140.1	142.8	141.7	142.6	142.4	140.4	139.3	141.1	140.7	137.9	138.1	137.9
Growth rate [1]	-0.1	2.0	-0.8	0.6	-0.1	-1.4	-1.0	1.3	-0.3	-2.0	0.1	-0.1

[1] Change (%) compared to previous period

Source: BIS, NBB

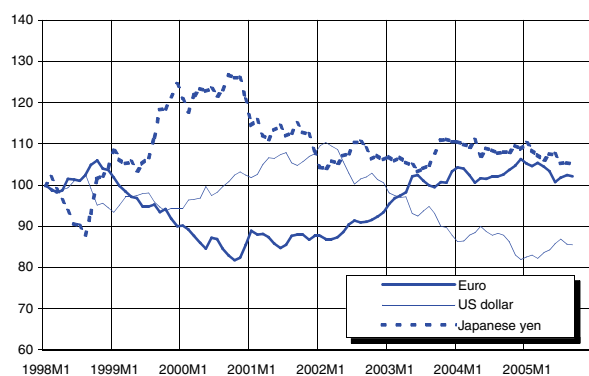
Graph 27 - Euro-dollar and euro-yen bilateral exchange rates



Source: NBB, before 1999M1: ECU instead of EUR

From May to July, the euro depreciated considerably from a level of about 1.30 euros per dollar to 1.20, driven by the increasing interest rate divergence between the US and the euro zone, making dollar investments more attractive. Furthermore, the rejection of the European constitution in France and the Netherlands weighed on the euro. At the beginning of August, the better-than-expected economic indicators pushed the euro temporarily higher again. Since then, the euro once again lost ground versus the dollar, partly due to the outcome of the German elections, which raised fears that the reforming process in Germany and the rest of the euro zone might be stalled now.

Graph 28 - Nominal effective exchange rates (Jan. 98=100)



Source: NBB, BIS

Over the last few months, the Japanese yen appreciated against the euro, following a substantial depreciation in April and May. The yen is currently some 2.5% higher versus the euro than in the beginning of the year, while it depreciated by more than 8% vis-à-vis the dollar in the same period.

The British pound depreciated almost continuously against the euro in the first 6 months of the year, but bounced back in June despite the slowdown in economic growth as a consequence of the uncertainty about the EU's future. In August, however, this appreciation of the pound stopped as the Bank of England lowered its base rate by 0.25%, and as markets anticipate that the short term interest rate differential between the UK and the euro zone will continue to be narrowed.

After almost 4 years of appreciation, the nominal effective euro exchange rate started levelling off in the beginning of this year. Since January, the nominal effective exchange rate has depreciated by 2.6%.

Tax indicators

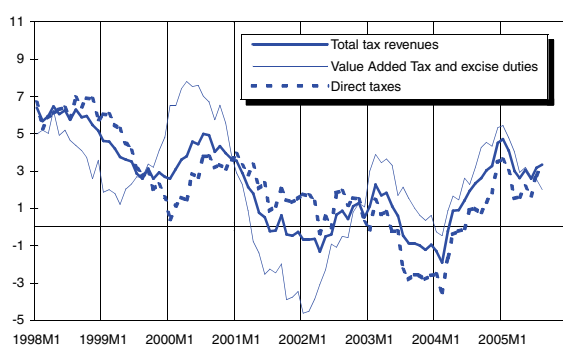
Table 11 - Tax revenues (1)

	2003	2004	2004Q3	2004Q4	2005Q1	2005Q2	2005M3	2005M4	2005M5	2005M6	2005M7	2005M8
Total [2], of which:	0.6	6.7	5.4	8.6	1.7	4.4	2.3	6.3	6.9	-0.4	9.7	11.4
Direct taxes, of which:	-1.1	5.7	1.9	9.9	-0.7	4.6	-4.3	7.8	6.8	-2.2	13.0	17.4
Withholding earned income tax (PAYE)	0.5	3.9	6.1	5.3	1.6	5.1	2.3	5.7	12.1	-1.4	3.8	5.5
Prepayments	-0.8	13.8	22.2	16.6	.	10.0	.	10.2	.	.	14.7	.
Value Added Tax and excise duties	2.2	7.6	8.7	6.8	2.5	2.5	6.5	2.0	5.4	0.7	3.7	5.1

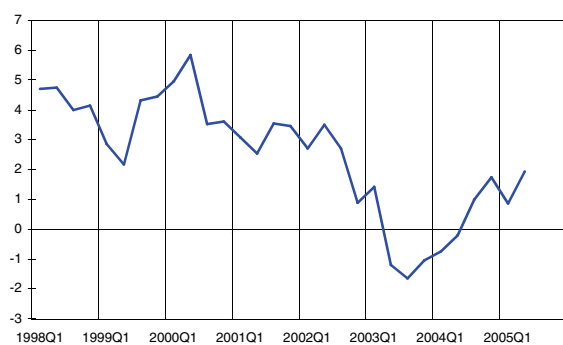
[1] Change (%) compared to same period previous year; [2] Total received by federal government, excl of death-duties

Source: FPS Finance, FPB

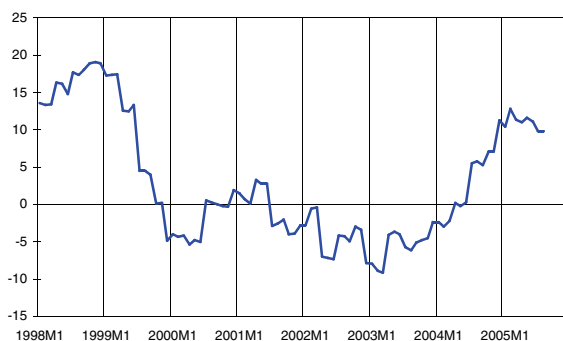
Graph 29 - Real tax revenues (3)



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

Real growth in both direct and indirect taxation, on a yoy 12-month moving average basis, has slowed down since the beginning of 2005. This reflects the weakening in economic growth observed in the first half of 2005. However, though reduced, the growth rate of total tax income still remains positive.

Revenues from indirect taxes are influenced by some counteracting factors. VAT income is affected by the slowdown in private consumption and housing investment. Moreover, due to the deceleration of exports, VAT reimbursements have grown faster than gross collections of VAT in both 2005Q1 and Q2. These factors are counterbalanced by the strong increase in energy prices and the strength of car sales in 2005Q2. Excise duties on fuel for transport are on the rise due to progressive increases in duty rates during the first months of this year. From July onwards, the government has gradually reduced the duty rate on some energy products, in reaction to the boom in oil prices. Most other categories of excise duties, including those on tobacco, are decreasing in nominal terms.

Growth in real PAYE revenue (mainly wage-related) is probably not yet affected by the slowdown in economic activity, as employment reacts with a time-lag to a change in the business cycle. Employment is still on the rise, though at a slower pace than in the previous quarters. It should be noted that households benefit this year from additional repayments related to assessments for the previous period; this delayed effect of the tax reform passed in 2001 will be even stronger in 2006.

The growth profile of the 12-month moving average of total advance payments in real terms continues the positive trend that started two years ago. Advance payments in April (first due date for advance payments) and in July (second due date) rose again at a double-digit rate of growth as compared to the corresponding period in 2004. Growth in taxes on dividend also remains vigorous, which tends to confirm the increase in business profits and dividend pay-outs.

Government participations in Belgian companies: evolution from 1997 to 2003

Public intervention in the market sector through participations remains an important instrument of government authorities. But the context has changed, mainly due to the interference of European authorities. To meet the Maastricht norms in the 90s and the Lisbon objectives in more recent years, member states have had to adopt EU policies. In some cases, privatisation was a means to reducing public debt, and in others it allowed requirements to be met for free competition on equal conditions.

The study reviews the ownership of Belgian authorities in public and private companies in 1997, 2002 and 2003.

Since 1997, the number of participations held by public authorities has changed considerably. In 1997, the government participated in 2 593 companies, and in 2003, this number had risen to 3 023 companies. 1 844 companies were active in both years and 1 179 participations were new. A large number of participations have been stopped in the textile sector. New participations were acquired mostly in financial and other business activities.

In 1997, 11 companies with public ownership were quoted on the stock market in Brussels. In 2003, this number had increased to 25, with Belgacom, Elia and Fluxys among the new quotations. In these companies, the market capitalisation amounted to 12 billion euros or 5.7% of the total market capitalisation in mid-2005.

The weighted share of public companies in the total value added of the non-financial market sector (weights are the government share in the capital) decreased slightly between 1997 and 2003. In 1997, the share was 10.8%, with a decline to 9.3% in 2002 and an increase to 9.8% in 2003. The decline is mainly observed in the case of industrial interests (which were halved). The companies owned by the federal authorities created most of the value added. Seven of these companies created more than 100 million euros of value added in 2003. These companies were the telecom operator Belgacom, the post, the national railway, the national lottery, and in aviation, Brussels Airport (BIAC), DAT Airlines and the air traffic safety service Belgocontrol. On the regional level, public companies have the highest share of value added in the Walloon total value added. The share declined between 1997 and 2003, as did the regional share of the Walloon total value added. On community level, the intercommunales¹ saw their share in value added of total public interests rise to 18% in 2003, which was 1%-point higher than in 1997. These companies are mainly present in the sectors of electricity, gas, water and sewage. In future,

their impact will diminish with the opening of the market.

More than 300 000 full-time equivalents are employed in market-oriented public companies. The number, weighted with the government's share in the capital, corresponds to 233 530 full-time equivalents. This employment level can be divided up as employment in companies with federal authority interests (42% of total employment), local interests (40%) and regional interests (18%).

Compared to other European countries, the role of the Belgian government in the market sector was below average in 1995. However, Belgium was ranked fifth in 1998, the last year for which data are available. Countries such as Italy, Portugal and Germany were involved in major privatisation projects. In Belgium, the total receipts from 1993 to 2005 amounted to 15.8 billion euros. The most important privatisations were in the fields of banking, telecommunications and the steel industry.

The venture capital companies controlled by the government have more involvement in start-ups and high-tech companies than those in the private sector. They are also more involved in labour-intensive companies, but the value added per worker is lower than in the private sector.

The study takes into account all companies in which a public authority has a share of at least 5%. Finding the identities of the public company shareholders was very time-consuming. The quoted companies are obliged to declare the dominant shareholders. The balance sheets contain information on shareholders and subsidiaries, and the Walloon region has a permanent directory on the shareholding of Walloon companies. The websites of public authorities and companies were also used to find out about the shareholding. Other difficulties were encountered while finding out whether companies were still active and what activities they were involved in.

*"Overheidsparticipaties in de marktsector in België, 1997-2003 - Participations publiques dans le secteur marchand en Belgique, 1997-2003",
H.Spinnewyn,
Planning Paper 99, November 2005.*

1. Intercommunales in Belgium are mainly municipalities' cooperations, but provinces and regions can join the intercommunale. There are also mixed intercommunales, which are joint ventures between public and private owners.

A Medium-Term Outlook for the World Economy 2005 - 2011

The *NIME Economic Outlook for the World Economy* presents a 2005-2011 macroeconomic outlook for the major areas of the world. The outlook was produced using NIME, the Belgian Federal Planning Bureau's macroeconomic world model. This issue also features an assessment of the response of the US and euro-area monetary policy to the asset price developments of the last ten years. The major technical assumptions of this outlook, as well as a description of the NIME model, are presented in the appendix.

For many years now, the Belgian Federal Planning Bureau has developed an expertise in preparing short-term forecasts and medium-term macroeconomic projections for the Belgian economy. The wish to improve our understanding of the sometimes intricate functioning of the international economy and its impact on small open economies such as Belgium, has led the Federal Planning Bureau to develop the NIME model, a global macroeconomic model. NIME is now used to carry out both policy-oriented economic analyses and medium-term projections for the world economy.

This is the first issue of the *NIME Economic Outlook for the World Economy*, which is scheduled to come out in January and August of each year. The document will provide readers with a timely and concise insight into the medium-term prospects for the world economy.

The 2005-2011 world economic projection is an analysis based on medium-term economic trends. It does not aim to produce an original short-term forecast for the 2005-2006 period. For 2005, the projection replicates the latest Spring 2005 Economic Forecasts of the European Commission, but adjusts them to reflect the developments in financial markets as well as other more recent growth forecasts made available up to early July 2005. For the 2006-2011 period, the projection provides insights into the world economy on the basis of the NIME model's own dynamics and long-run trend assumptions for such key underlying variables as productivity growth, long-run rates of inflation, equilibrium rates of unemployment, and equilibrium interest rates. The NIME projection for 2006 can therefore diverge significantly from the 2006 forecasts of international institutions, prepared with tools such as quarterly economic models and leading indicators. The Federal Planning Bureau's short-term forecasts for Belgium rely on these tools and on the most recent information concerning cyclical developments in the world economy. This is why

the Belgian Institute of National Accounts' Autumn 2005 'Economic Budget' for Belgium – which uses the Bureau's short-term forecasts – is based on 2005-2006 forecasts for the world economy, which differ from the figures presented in this medium-term projection for the world economy.

Over the 2005-2011 period, euro-area GDP rises at an annual average rate of 1.9 per cent. Net exports fail to make any significant contribution to the area's overall GDP growth, which is based entirely on the evolution of domestic demand. Consumer price inflation averages 1.8 per cent over the 2005-2011 period, but edges up towards the end of the period. The short-term interest rate rises gradually from 2.1 per cent in 2005 to 4.1 per cent in 2011. Assuming there are no further policy slippages, the area's public sector net borrowing requirement is expected to fall from 2.5 per cent of GDP in 2005 to 1.2 per cent of GDP in 2011.

Over the 2005-2011 period, GDP growth averages 2.9 per cent per annum for the United Kingdom, Sweden and Denmark and 3.6 per cent for the new EU member states. The US economy expands at an average annual rate of 2.9 per cent over the period, while prices rise at an average rate of 2 per cent per annum, and fiscal and external imbalances persist. GDP growth in Japan comes out on average at 1.3 per cent per annum and the Japanese economy is expected to move out of deflation in 2006.

This issue also assesses whether the economies of the United States and the euro area would have experienced a more balanced growth path over the 1995-2004 period had the monetary authorities of these areas not only targeted contemporaneous consumer price inflation but also changes in asset prices. The simulation results present evidence that such a broader-based interest rate rule would have pushed the euro area's GDP above its historical level by about 0.3 per cent by the end of the 1995-2004 period and would have reduced US GDP by about 0.6 per cent by the end of the same period.

“A *Medium-Term Outlook for the World Economy, 2005-2011. Focus: Monetary Policy, Asset Prices and Economic Growth*”, *The NIME Economic Outlook for the World Economy, August 2005*.

The motives for offshoring business activities

The relocation of business activities abroad, referred to as offshoring, is a subject which receives considerable attention at present. This working paper addresses the motives for offshoring. The study was conducted at the request of the Belgian social partners (represented in the CRB/CCE) and Agoria, the Multisector Federation for the Technology Industry. Based on economic literature, a list of possible motives which could play a role in relocation decisions was drawn up. These motives were then submitted to a panel of entrepreneurs of the Agoria sectors in order to classify them according to their importance.

Globalisation and offshoring

The phenomenon of offshoring should be seen in the context of globalisation, which has been growing over the last decades. During the most recent wave of globalisation, which started in the 90s, the risk of offshoring increased undeniably due to technological developments (notably ICT), the emergence of new economies and the partly policy-induced opening of a number of product markets. Hence, offshoring has become more pervasive both within each sector of the economy and across sectors; it is extending progressively to the whole range of economic activities, including services and research and development (R&D). Moreover, the choice of possible destination areas for offshoring has widened (Central and Eastern Europe, China, India, etc.), and offshoring is no longer considered an issue for big companies only, but also for medium-sized firms.

The standard – narrow – definition of offshoring refers to the closing or scaling down of activities in the home country and the shifting of these activities towards foreign sites, either internally within firms through the establishment of foreign affiliates ('offshore in-house'), or externally, by contracting out parts of the production process to a third-party provider ('offshore outsourcing'). This definition can be broadened by also considering shifts in economic activities as a consequence of choosing not to expand at home (in Belgium) but in rapidly growing markets abroad. This foregone investment can be considered a creeping form of offshoring activities. Moreover, it is often observed that in these new markets, some excess capacity is built up, which can eventually lead to an effective scaling down of production capacity in the home country.

Motives for offshoring activities: general framework

In general, two major types of motives for relocation are identified in the economic literature: cost-driven and market-driven motives. A detailed list of motives was submitted to a panel of entrepreneurs of the Agoria sectors in order to classify them according to their importance. Big and medium-sized firms were both represented in the panel of entrepreneurs. The majority of them were active in the industrial sector (metal products, machinery and equipment construction, electrical and electronic products, motor vehicle construction, etc.), and some were active in the services sector (ICT, industrial automation, etc.). As the panel was too small to be fully representative, the results should be interpreted with some caution.

In practice, the decision to relocate activities is always motivated by a combination of factors; it is therefore useful to consider them separately in order to allow a better understanding of the issue.

The cost of labour is a first motive for offshoring activities that was labelled as 'very important' by the panel. Hourly wage costs for industrial workers in Belgium are among the highest in the European Union. Moreover, offshoring involves mostly a transfer of technology towards the low-wage country, so that the productivity level in the foreign affiliate is generally not lower than in Belgium. As a result, the high Belgian hourly wage costs are (almost) completely reflected in high unit labour costs. Another motivation for offshore relocation of production marked as 'very important' by the panel is to improve access to large new markets.

Three other motives were labelled as 'very important' in the context of relocation decisions: qualitative labour characteristics (labour skills, flexibility, motivation), socio-economic stability and the presence of an infrastructure at an affordable price. On these points, Belgium performs better, although it faces increasing competition from a number of emerging economies in the field of qualitative labour characteristics.

A second category of motives, labelled as 'relatively important', includes factors such as the level of profit taxation, ICT development, proximity of suppliers and the quality of different public services.

Motives for offshoring R&D activities

In addition to this general framework, the study also focuses on the relocation of R&D activities. This issue deserves special attention, as R&D activities have an impact on the innovative force and potential growth rate of an economy. So far, offshoring of R&D activities has remained limited in scope, partly due to considerable sunk costs, but the phenomenon is expected to gain importance in the coming years.

The panel discussions revealed that the cost and availa-

bility of R&D personnel and the availability of networks with universities and research centres play a major role in decisions concerning the location of R&D activities. Another frequently cited factor is the need to adapt products or processes to local market conditions.

“Déterminants de la localisation internationale, avec application aux secteurs Agoria - Determinanten van internationale lokalisatie, met toepassing op de Agoriabranches”, B. Hertveldt, C. Kegels, B. Michel, B. Van den Cruyce, J. Verlinden, F. Verschueren, Working Paper 16-05, September 2005.

Other Recent Publications

Medium Term Economic Outlook 2005 - 2010, April 2005
(available in Dutch and in French).

Planning Paper 98, May 2005
“Réforme de marché dans les industries de réseau en Belgique - Markthervorming in netwerkindustrieën in België”, J. van der Linden

Working Paper 10-05, May 2005
“Hervorming van de spoorwegsector in België. Lessen uit Groot-Brittannië, Duitsland en Zweden”
P. Mistiaen

Working Paper 11-05, May 2005
“Hervorming van de posten in België. Lessen uit Zweden en Nederland”, J. van der Linden

Working Paper 12-05, June 2005
“Analyse van de rubber- en kunststofnijverheid - Analyse de l'industrie du caoutchouc et des plastiques”, B. van den Cruyce

Working Paper 13-05, June 2005
“Innovatie en O&O in de Belgische gewesten in een Europees perspectief - Innovation et R&D dans les régions belges dans un perspective européenne”
J. Fiers

Working Paper 14-05, June 2005
“Quelle énergie pour un développement durable ?”
A. Henry

Working Paper 15-05, July 2005
“De financiële implicaties van langer werken: een Micro-Economisch Pensioenmodel (MEP)”
G. Dekkers

Research in Progress

Transport and mobility

The FPB undertakes research in this area in cooperation with the federal "Transport and Mobility" administration. In particular, transport satellite accounts and a transport model are constructed. The aim is to get a better grasp of the relationship between transport, mobility and the economy and to analyse the impact of transport and mobility policies on the Belgian economy.

contact: dg@plan.be

Health care expenditure

Different research projects concerning the determinants of health care expenditure are currently underway, in collaboration with various agencies and institutions.

contact : mln@plan.be

Social policy and long-term budgetary challenge

The FPB is investigating the impact of the 1996 pension reform and the dynamics of the pension benefits for self-employed and for civil servants, as well as the budgetary impact of adjusting social benefits to welfare.

contact : maltese@plan.be

Public finances and macroeconomic performance

The FPB is complementing its studies into the interactions between macroeconomic performance and different categories of public revenue and expenditure. Tax shift operations are being scrutinized in particular.

contact : fb@plan.be, db@plan.be

Recent history of major economic policy measures

September 2005	The federal government decided to contribute to the cost of fuel oil for heating for private consumers. It will pay the difference between the consumer price and 0.5 euros per litre, with a ceiling of 17.35% of the total price. Furthermore, the so-called 'fuel oil fund' will help people in need to pay their bill.
June 2005	<p>The implementation of the EU package of directives on electronic communication was finalised by the publication of a new telecommunications act. The most significant element of this act is that telecom providers no longer need regulatory authorisation to enter the market. A notification to the regulator is sufficient.</p> <p>As of tax year 2007, financing investments through equities can lead to a reduction in the tax base of corporate income tax, to the amount of the so-called "notional interests". This measure aims at reducing the gap in the tax incentives between different financing vehicles.</p>
May 2005	In accordance with EU legislation, the Walloon government decides to open up the remaining parts of the regional electricity and gas markets in 2007.
April 2005	The federal government confirms the objective of keeping the budget in balance in 2005. To this end, various measures are taken and a very strict system for monitoring expenditure is put in place, particularly for the health care sector.
February 2005	APX Gas has launched a gas exchange at the Zeebrugge Hub in close co-operation with Fluxys subsidiary Huberator. The exchange should give added boost to liquidity at the Zeebrugge Hub and foster competition in the context of the opening up of the European gas markets.
January 2005	<p>The federal government announces that the account for public administrations as a whole is in balance in 2004 for the fifth consecutive year.</p> <p>Representatives of the social partners reach a compromise concerning wage developments for the next two years. The main important decisions refer to:</p> <ul style="list-style-type: none"> • the wage norm: the increase in the nominal hourly wage cost would be limited to 4.5% cumulated over two years (2005-2006), allowing for a 1.2% increase in real terms given the assumed pace of inflation (3.3%); • maximum authorized overtime per employee is raised to 130 hours a year; • various additional reductions in taxes and contributions are provided, in order to decrease the labour cost of overtime, work organised in shifts and low-paid jobs. <p>The agreement was ultimately rejected by some of the social partners but will nevertheless be enforced by the federal government.</p> <p>The federal electricity and gas market regulator (CREG) submitted the 2005-2014 indicative programme for electricity generation for approval to the Ministry of Energy.</p> <p>The national railway company NMBS/SNCB has been split up into a holding company structure. Under this holding company are an operator for infrastructure and an operator for train services. This restructuring fulfills minimum requirements of EU legislation. At the same time the historical debt has been taken over by the federal government, and a supervisory body has been established within the transport ministry. The historic debt amounts to 7.4 billion euros, which is 2.8% of GDP.</p>
November 2004	Two measures were taken in the field of privatisation. Australian investment company Macquarie acquired a 70% share in Brussels airport operator BIAC, the remainder staying in public hands. Postal incumbent De Post/La Poste was allowed to raise private capital (but not to privatise its existing capital).
September 2004	Transport system operator ELIA announces to establish next year a short term electricity exchange. This exchange will cooperate with the Dutch and French electricity exchanges.
July 2004	<p>In accordance with EU legislation, the electricity and gas markets have been opened up for all business customers. This increases the total degree of market opening in both markets to 90%. The remaining captive customers are residential customers in Wallonia and Brussels, who make up less than half of the Belgian population.</p> <p>The federal government has approved a draft bill that will transpose the European package of directives on electronic communications into Belgian law.</p>
May 2004	There were two small but significant commercial developments in telecommunication. In mobile communications, a first commercial UMTS service was introduced, albeit on a limited scale. For the time being, this service will be available to professional customers and in the six largest cities only. In the area of broadband connections, Belgacom has followed Telenet in launching an offer for a light Internet service at a price of less than 30 euros per month and with a limit on the connection speed and download capacity.
April 2004	Two small but noticeable measures relating to renewable energy were taken: one was positive and the other was negative. The positive measure is the provision of a license to build a windmill site in the North Sea. From 2007 onwards this site may produce electricity for 400,000 households. The negative one is the decision by the Government of Flanders to suspend the exemption from network access fees for renewable electricity. It was warned by the European Commission because the exemption did not apply to imported electricity.

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
DULBEA	Département d'Economie Appliquée de l'Université Libre de Bruxelles
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
ECU	European Currency Unit
EMU	Economic and Monetary Union
EUR	Euro
JPY	Japanese yen
LHS	Left-hand scale
NIS	National Innovation System
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)