

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 line with the international business cycle, qoq GDP growth in Belgium slightly decelerated from 0.7% in the first quarter to 0.5% in the third and the fourth quarter. This year, quarterly growth should be between 0.4% and 0.5%. On a yearly basis, economic growth should slow down from 2.7% in 2007 to 1.9% in 2008.

In 2007, the Belgian economy was driven by domestic demand. This year, domestic demand growth should decline markedly. Private consumption growth is expected to weaken as the slowdown in job creation, the more modest increase in wages before indexation, and the acceleration in inflation should all limit the growth of real disposable income. This will also affect housing investment, together with the increased mortgage rates. Business investment growth should also slow down in view of less favourable demand perspectives.

Export growth should be almost as strong in 2008 as in 2007 despite a slowdown in the growth of the relevant export markets. As a consequence, Belgian exports will keep on losing export market shares, but to a lesser extent. The combination of real import growth exceeding export growth and deteriorating terms of trade should reduce the Belgian current account surplus to 2.5% of GDP in 2008 as compared to 2.9% last year.

After a net gain of about 68,000 persons in 2007, employment is expected to record an average increase of 46,600 persons this year. As employment will increase faster than the labour force, the broad administrative unemployment rate is expected to decline from 12.7% in 2007 to 12.2% in 2008. The harmonised Eurostat unemployment rate (based on labour force surveys) should fall from 7.6% last year to 7.3% in 2008.

According to our inflation update of March, the increase in the national index of consumer prices should accelerate to 3.5%, after 1.8% in 2007. This acceleration is mainly due to substantial price increases in energy products and in processed food items (especially cereal and milk products).

Editorial Board

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DTP & Web Publishing

Adinda De Saeger
Geert Bryon
Dominique van der Wal

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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>).

Are Belgian price stability and purchasing power at stake?

Belgian inflation increased from 1.1% in August 2007 to 3.6% in February 2008 due to a combination of energy price and food price rises. Consequently, concerns surfaced about households' purchasing power on the one hand, and about the possible threat of Belgian automatic indexation to price stability and external competitiveness on the other hand. This Special Topic sheds some light on these issues and briefly assesses some measures meant to alleviate the impact of the increase in energy prices.

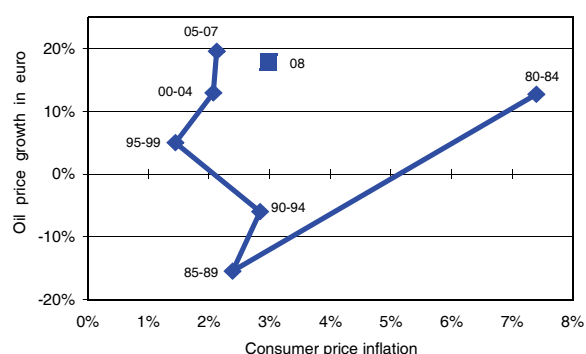
Current inflation rates in a historical perspective

The graph below provides an overview of the evolution of oil prices (expressed in local currency) and Belgian consumer price inflation¹. As many factors determine the evolution of inflation, this graph provides only a partial insight. However, it allows a split of inflation developments since 1980 into three periods, each with different characteristics. In the first part of the eighties, the Belgian economy suffered from a combination of low economic growth and high inflation caused by the oil price hike in 1979-1980. Average inflation was far lower during the second period (1985-1994). This was due to the decline in oil prices and to a significant decline in underlying inflation², to which the policy of wage restraint that accompanied the devaluation of the Belgian franc in 1982 contributed. Since 1995, average inflation has been lower than between 1985 and 1994, despite the continuous increase in oil prices. This is due to a further decrease in underlying inflation that has been kept in check remarkably well over the last ten to fifteen years, in view of oil price developments.

Inflation should reach 3% on average in 2008³, the highest rate since 1991. This does not imply a return to the situation of the first half of the nineties. In that period, inflation amounted to almost 3%, while oil prices were on a downward path. Compared to the average of the period 2005-2007, however, the anticipated inflation rate for 2008 seems higher than one should expect on the basis of the oil price evolution. This is due to three factors that will each add 0.2%-points to inflation in 2008. Firstly, prices of (processed) food should increase substantially faster than during previous years. Secondly,

distribution tariffs for gas and electricity went up considerably in January 2008. Thirdly, the two most important gas suppliers raised their tariffs in the last quarter of 2007. It should be stressed that the impact on inflation of the last two factors is not directly related to the rise in crude oil prices. As the acceleration of inflation in 2008 is mainly explained by these factors, inflation should - in the absence of strong oil price fluctuations - return to a level that is close to underlying inflation in 2009.

Graph 1 - Relationship between inflation and oil prices



Source: FPS Economy, Datastream, FPB

Automatic indexation and purchasing power

Belgium and Luxembourg are the only European countries that have a generalised automatic indexation of wages and social benefits. In Belgium, this system was modified in 1994 by linking wages and social benefits to the so-called health index (which does not take into account the price evolution of alcoholic beverages, tobacco products and motor fuels) instead of the CPI.

From a macro-economic point of view, households' purchasing power is influenced by evolutions in employment and unemployment, real increases in wages and social benefits, price effects and other factors such as taxes and property income. An automatic indexation of wages and social benefits offers the advantage that this part of households' purchasing power is only slightly affected by unexpected price movements.

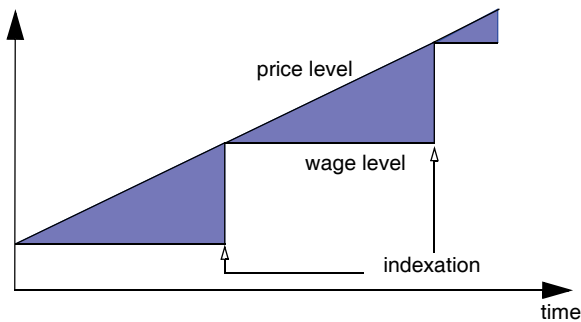
The existing indexation mechanisms do not entirely protect purchasing power for three reasons. Firstly, as the health index takes prices of energy products for heating and lighting into account but neglects prices of motor fuels, losses of purchasing power typically appear in periods of oil price rises⁴. Between 1994 and 2007, the annual increase in the health index was on average 0.15%-points lower than the CPI, resulting mainly

1. Inflation is calculated as the (average) annual percentage change in the national consumer price index.
 2. To calculate underlying inflation, products subject to administrative price changes and products with a volatile price evolution - such as energy products - are excluded from the national consumer price index.
 3. Note that inflation forecasts for 2008 are taken from the economic forecasts of January 2008 (see page 5). The latest inflation developments are discussed on page 15.

4. Purchasing power gains can be registered when oil prices decline.

from the rise in oil prices during that period (by 11% per year on average). The year 2008 will not be exceptional from this point of view as the health index should increase 0.2%-points less than the CPI. Secondly, the Belgian CPI and health index are based on the expenditure pattern of “an average household”. It does not come as a surprise that the poorest households, compared to richer households, spend relatively more on basic goods (such as food, heating, lighting etc.) and less on luxury goods (such as cars, cultural activities etc.). Even with an automatic indexation mechanism, the increases in prices of food and energy (for heating and lighting) between August 2007 and January 2008 reduced the purchasing power of the poorest 20% of households by 0.2%, while purchasing power of “an average household” should not generally be affected by these factors. Thirdly, various indexation mechanisms exist in Belgium¹, but they are all discontinuous. This implies that households suffer losses of purchasing power between two points of indexation. In the graph below, these losses are indicated by the blue triangles².

Graph 2 - Discontinuity of indexation mechanisms



Automatic wage indexation and competitiveness

In as far as wages in competing countries are not automatically indexed to prices, Belgian automatic wage indexation can be detrimental to external competitiveness in the case of an unanticipated acceleration of inflation. Nevertheless, Belgium adopted a unique system in 1996 to prevent and correct competitiveness losses that are due to wage developments: the so-called “Law on employment promotion and preventive safeguarding of competitiveness”. This law states that Belgian nominal wages should develop in line with the average of our three neighbouring countries. To achieve this, the CRB/CCE provides a yearly report in which Belgian private sector wage developments are monitored and compared to those in our neighbouring countries. On the ba-

sis of these reports, the social partners set an indicative wage norm once every two years at the start of wage negotiations at sectoral and firm level. Moreover, so-called “all-in agreements”, which are becoming more popular in sectoral wage negotiations, provide another way to deal with unexpected wage pressures that could endanger the export competitiveness of Belgian firms. These agreements introduce a corrective mechanism if indexation turns out to be higher than anticipated during the wage negotiations. At the end of this year, the CRB/CCE will have to evaluate to what extent the current acceleration in inflation has deteriorated Belgian external competitiveness and, if necessary, propose a correction to the social partners.

Measures to protect Belgian households against energy price increases

The average Belgian household’s purchasing power is protected against price increases in gas, electricity and fuel oil for heating through automatic indexation. Due to their consumption pattern, low income households suffer more from energy price hikes than high income households (cf. supra). In reaction to the continuous increase in oil prices, the Belgian government decided to set up a fuel oil fund in January 2005 that provides financial support to low income households to buy fuel oil for heating. The conditions for having access to the fund have been eased from January 2008 onwards. The fund offers the advantage that it is targeted at the income groups that suffer most from energy price increases at a relatively low budgetary cost (around 45 million euro per year). Certain low income groups that use electricity or gas for heating have the right to consume these energy products at the social tariff (i.e. the lowest tariff that is in use in Belgium).

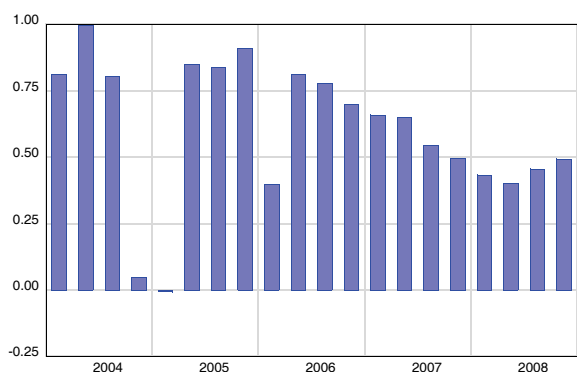
Some assess these targeted measures as insufficient and argue for a reduction of VAT tariffs levied on energy products for heating from 21% to 6%. As this measure would not be targeted at specific income groups, it would have a positive effect on the purchasing power of all households, even “the average household”, for which purchasing power should be protected by the automatic indexation mechanism. A simulation with the HERMES model for the year 2008 shows that such a measure would increase households’ purchasing power by 0.2% and lower wage indexation by 0.8%; the latter reducing companies’ wage costs and improving Belgian external competitiveness. These factors would have a slightly positive impact on GDP (0.1%), but the measure would imply a significant worsening of the government budget of somewhat more than 500 million euro. This measure would also lead to an increase in energy consumption, which seems highly undesirable in an era characterised by policies aimed at reducing greenhouse gas emissions.

1. Social benefits are adjusted to the higher cost of living when the health index reaches a threshold. Wages are adjusted at fixed intervals (once every year, once every six months, etc.) for 60% of employees, while 40% of employees get a wage indexation when the health index reaches a threshold.
2. Indexation mechanisms are generally based on a moving average of the health index, which is an additional source of purchasing power losses.

Economic forecasts 2008

After a rather strong performance during the first half of 2007, Belgian GDP growth slightly decelerated during the last two quarters of 2007 in the wake of the economic slowdown in the US and in Europe. This year, quarterly growth should be between 0.4% and 0.5%, bringing the annual rate to 1.9% (compared to 2.7% in 2007).

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



After an exceptionally strong performance in 2006 and 2007, European growth should slow down this year.

In 2006, the euro area recorded strong GDP growth (2.8%). Last year, growth in the euro area experienced a modest deceleration (2.6%) but exceeded US economic growth for the first time since 2001. This was mainly due to the dynamics of domestic demand in Europe, whilst in the US there was a strong weakening of the housing market. This year, US GDP growth should stabilise, while growth in the euro area is expected to slow down considerably (1.9%). This scenario supposes that the mortgage crisis will have a temporary and limited impact on US private spending. If the current crisis has a larger impact on the US economy - for instance via a sharp decrease in private consumption - or lasts longer than expected, the slowdown in the European economy may turn out to be more severe than currently anticipated.

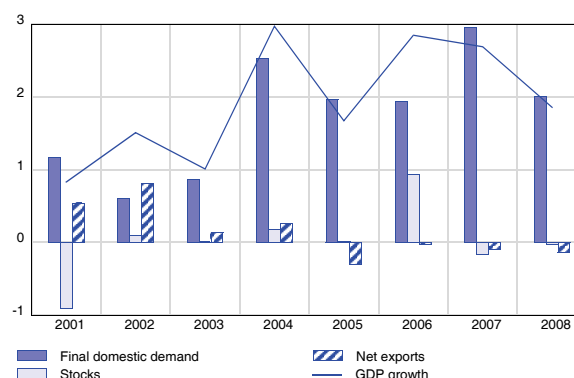
Financial markets expect a further easing of monetary policy in the US. As a consequence, the exchange rate of the euro against the dollar should remain at a high level (1.44 USD/euro on average in 2008), thus further weakening the competitiveness of European exports. Finally, prices of crude oil should drop by only a limited extent from its record price at the beginning of 2008 and should average around USD 90 per barrel in 2008 (compared to USD 72.5 in 2007).

In 2007, the Belgian economy showed strong growth performance driven by domestic demand. This year, consumer and business demand are expected to be less dynamic.

Export growth should be almost as strong in 2008 as in 2007 (4.5% and 4.6% respectively) despite a slowdown in the growth rate of the relevant export markets (6.0% in comparison with 7.1%). As a consequence, Belgian exports will keep on losing export market shares, but at a pace closer to the historical trend. In addition, real import growth should exceed export growth and the terms of trade should deteriorate by 0.2%. This should reduce the Belgian current account surplus to 2.5% of GDP as compared to 2.9% in 2007.

This year, domestic demand growth is expected to decline markedly due to both private consumption and business investment. Domestic demand should only increase by 2.1% in 2008, compared to 2.9% last year.

Graph 2 - Decomposition of real GDP growth
contributions to GDP growth in percentage points



Contrary to 2006, the personal income tax reform no longer provided a boost to disposable income in 2007. Nevertheless, purchasing power still increased by 2.1% due to a further rise in employment, a wage increase and higher property income (due to higher interest rates). This favourable economic situation was reflected in consumer confidence, which remained high during the first half of the year. Private consumption was particularly dynamic during the first three quarters of 2007 and grew by about 2.5% over the year, pushing the savings rate downwards. In 2008 the slowdown in job creation, the more modest increase in wages before indexation and the higher inflation rate - more specifically the increase in fuel prices, which are not taken into account in the health index - should limit real disposable income growth to 1.3%. Nevertheless, private consumption is expected to grow by 1.8% as a result of a slight fall in the savings rate.

In this scenario, the cumulated rise in the nominal hourly wage cost in 2007 and 2008 should exceed the margin provided for in the interprofessional agreement that was signed in February 2007 by 0.9%-points. This deviation from the norm is due to higher inflation (and thus to wage indexation) in 2008 and to a stronger increase (1.0%) in gross hourly wages before indexation in 2007 than was initially anticipated. In 2008 gross hourly wages before indexation should rise by 0.6%.

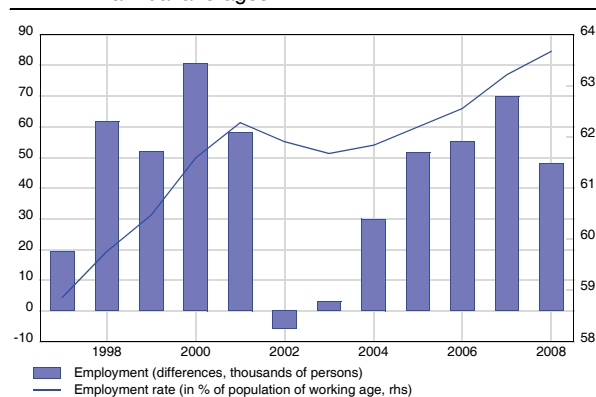
During the first half of 2007, business investment (corrected for purchases of public buildings) and private consumption were the driving forces behind economic growth. In view of the less favourable demand outlook from mid-2007 onwards, investment growth slowed down slightly. Thanks to a strong performance at the beginning of the year, the average yearly growth of business investment is expected to have reached 7.0%. This year, it should amount to 3.4% and thus exceed GDP growth for the fifth consecutive year. Quarterly growth in housing investment strongly accelerated until the third quarter of 2006, but slowed down afterwards due to the increase in mortgage rates (which raised financing costs) and the deceleration in real disposable income growth. Consequently, real housing investment growth should weaken to 1.0% in 2008 (compared to 5.1% in 2007). The growth path of public investment is largely determined by local authorities' infrastructure works in view of the local elections in October 2006. If the sales of public buildings are not taken into account, public investment rose by 5.9% in 2006 and fell back sharply in 2007 (-7.9%). This year it should almost stabilize (-0.7%).

Strong employment growth pushes back employment

The annual rise in domestic employment is estimated at 68,100 persons for 2007. The sustained growth in employment is stimulated by rather limited increases in wage costs, an upward trend in the number of self-employed workers and the further extension of the government-subsidized voucher system for domestic-type services.

In 2008, employment should again register a considerable increase (46,600 persons). As a consequence, the employment rate should rise from 62.2% in 2006 to 63.7% in 2008. As employment is increasing faster than the labour force, the number of unemployed (broad administrative definition) diminished by 56,800 in 2007 and is expected to drop by 21,600 persons this year. The harmonised Eurostat unemployment rate (which is calculated by means of labour force surveys) is expected to fall from 8.2% in 2006 to 7.3% in 2008.

Graph 3 - Evolution of employment and employment rate annual averages



Inflation climbs to 3.0% in 2008 due to energy and food prices¹

Inflation, as measured by the national index of consumer prices (NICP), amounted to 1.8% in 2007 and is estimated at 3.0% for this year. An important part of this acceleration is due to the recent increase in oil prices. Whereas the average price of a barrel of Brent (expressed in euro) remained almost unchanged in 2007 compared to 2006, it is expected to increase by almost 20% in 2008. Moreover, in 2007, there was a downward pressure on prices caused by the liberalisation of the gas and electricity markets in the Brussels and the Walloon Regions, as well as by the new registration method for gas and electricity prices in the consumer price index. This year, however, there is an upward pressure on prices as a result of the price increases by the two main gas suppliers and the higher distribution costs for gas and electricity.

As in 2007, underlying inflation should amount to 2% this year. The appreciation of the real effective exchange rate of the euro and the limited increase in wage costs over the last few years are expected to counterbalance the substantial increases in prices of processed food items such as cereal and milk products.

In 2007, the health index, which is not affected by price fluctuations for motor fuels, tobacco products and alcoholic beverages, grew at the same pace as the NICP (1.8%). As the health index is less influenced by price fluctuations for oil products than the NICP, it should increase less rapidly (2.8%) than inflation this year. The previous pivotal index was exceeded in December 2007. Its current level (108.34) is expected to be exceeded in May 2008.

“Economische begroting 2008 – Budget économique 2008”, INR/ICN, January 2008.

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

Economic forecasts for Belgium by the Federal Planning Bureau

Changes in volume (unless otherwise specified) (cut-off date of forecasts: 8 January 2008)

	2005	2006	2007	2008
Private consumption	1.3	2.0	2.5	1.8
Public consumption	-0.2	0.0	2.6	2.6
Gross fixed capital formation	6.7	4.2	5.1	2.4
Final national demand	2.1	3.0	2.9	2.1
Exports of goods and services	3.6	2.6	4.6	4.5
Imports of goods and services	4.2	2.7	4.9	4.8
Net-exports (contribution to growth)	-0.3	0.0	-0.1	-0.1
Gross Domestic Product	1.7	2.8	2.7	1.9
p.m. Gross Domestic Product - in current prices (bn euro)	301.97	316.62	330.47	345.51
National consumer price index	2.8	1.8	1.8	3.0
Consumer prices: health index	2.2	1.8	1.8	2.8
Real disposable income households	-0.1	2.6	2.1	1.3
Household savings ratio (as % of disposable income)	12.2	12.5	12.1	11.7
Domestic employment (change in '000, yearly average)	51.1	52.7	68.1	46.6
Unemployment (Eurostat standardised rate, yearly average) [1]	8.4	8.2	7.6	7.3
Current account balance (BoP definition, as % of GDP)	2.6	2.7	2.9	2.5
Short term interbank interest rate (3 m.)	2.2	3.1	4.3	4.5
Long term interest rate (10 y.)	3.4	3.8	4.3	4.4

[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
	2007	2008	2007	2008	2007	2008	
Federal Planning Bureau [1]	2.7	1.9	1.8	3.0 ¹	.	.	01/08
INR/ICN [1]	2.7	1.9	1.8	3.0	.	.	01/08
National Bank of Belgium [2]	2.6	1.9	1.8	2.9	-0.1	-0.3	12/07
European Commission [2]	2.7	2.1	1.7	2.1	-0.3	-0.4	11/07
OECD [2]	2.6	1.9	1.7	2.3	-0.2	-0.4	12/07
IMF [2]	2.6	1.9	1.8	1.8	.	.	10/07
ING [1]	2.7	1.6	1.8	2.8	-0.2	0.0	02/08
Fortis Bank [2]	2.7	1.9	1.8	2.6	-0.2	-0.4	02/08
Dexia [1]	2.6	1.7	1.8	2.7	.	.	02/08
KBC Bank [1]	2.6	1.7	1.9	2.2	-0.3	-0.3	12/07
Petercam [1]	2.5	1.75	2.0	1.75	-0.2	-0.5	11/07
IRES [1]	2.7	1.7	1.8	3.1	-0.1	-0.6	01/08
Consensus Belgian Prime News [2]	2.6	1.8	1.8	2.4	-0.1	-0.3	01/08
Consensus Economics [2]	2.4	1.9	1.8	2.6	.	.	02/08
Consensus The Economist [2]	2.7	1.9	1.8	2.4	.	.	03/08
Consensus Wirtschaftsinstitute [2]	2.7	2.2	1.5	1.8	-0.1	-0.1	10/07
Averages							
All institutions	2.6	1.9	1.8	2.5	-0.2	-0.3	
International public institutions	2.6	2.0	1.7	2.1	-0.3	-0.4	
Credit institutions	2.6	1.8	1.8	2.4	-0.2	-0.3	

[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 upwards. See page 15 for more information.

General economic activity

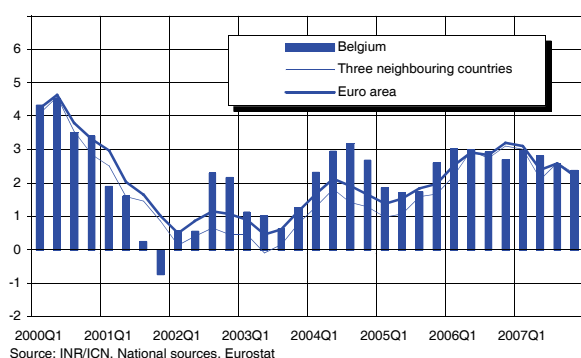
Table 1 - GDP growth rates, in % [1]

			YoY growth rates, in %					QoQ growth rates, in %				
	2006	2007	2006Q4	2007Q1	2007Q2	2007Q3	2007Q4	2006Q4	2007Q1	2007Q2	2007Q3	2007Q4
Germany	3.1	2.6	3.9	3.7	2.6	2.5	1.7	1.0	0.6	0.2	0.7	0.3
France	2.2	1.9	2.1	1.9	1.3	2.2	2.1	0.5	0.6	0.3	0.8	0.3
Netherlands	3.0	3.5	2.9	3.2	2.4	3.9	4.3	0.7	1.0	0.3	1.9	1.2
Belgium	2.9	2.7	2.7	3.0	2.8	2.6	2.4	0.7	0.7	0.6	0.5	0.5
Euro area	2.9	2.6	3.2	3.1	2.4	2.6	2.2	0.8	0.8	0.3	0.7	0.4
United States	2.9	2.2	2.6	1.5	1.9	2.8	2.5	0.5	0.2	0.9	1.2	0.2
Japan	2.4	2.1	2.4	2.9	1.7	1.9	1.8	1.0	1.0	-0.4	0.3	0.9

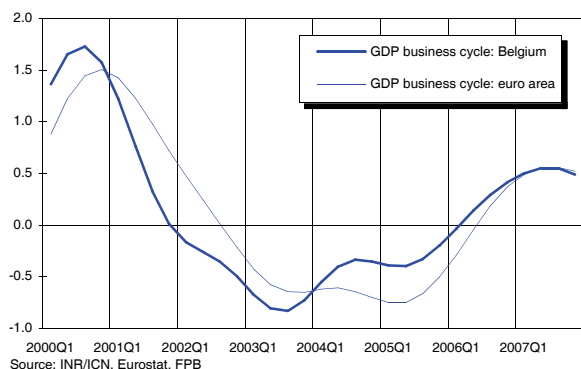
[1] Adjusted for seasonal and calendar effects

Source: INR/ICN, National sources, Eurostat

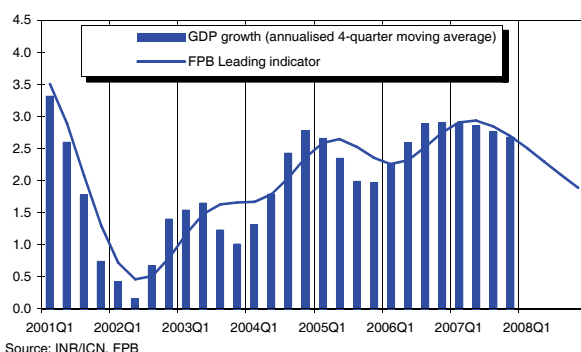
Graph 1 - GDP-growth (t/t-4), in %



Graph 2 - GDP business cycle



Graph 3 - GDP growth and leading indicator

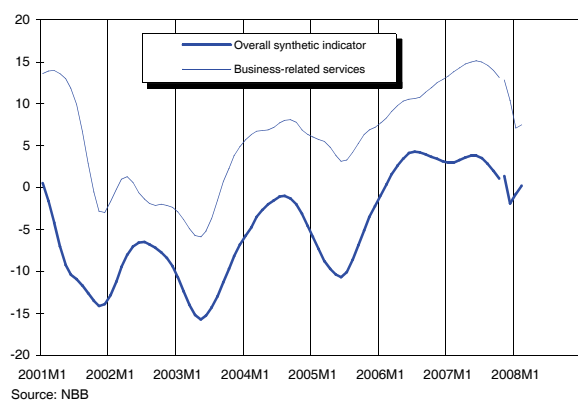
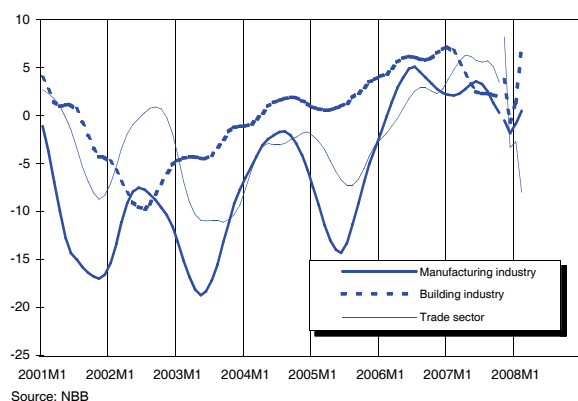
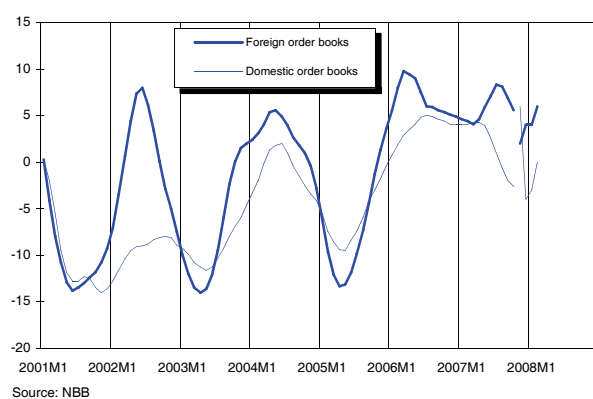
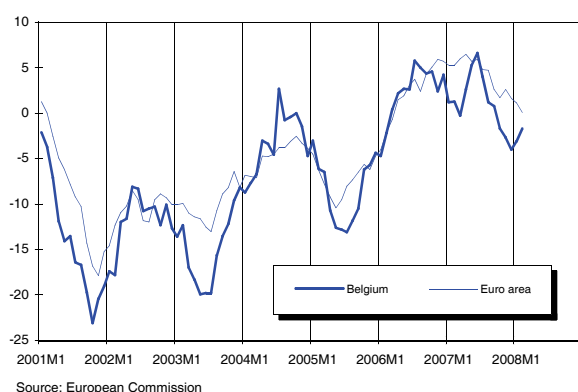


After robust economic growth in 2007Q2 and 2007Q3 (0.9% and 1.2% respectively), US growth slowed down sharply to 0.2% in the final quarter. Residential investment declined for the eighth consecutive quarter and the growth of the other expenditure components (especially exports and private consumption) started to decelerate. Consumer spending, which accounts for 70% of GDP, is slowing due to negative wealth effects, high energy prices and weaker labour market conditions. Therefore the US economy might weaken further in the beginning of 2008.

The Japanese economy rebounded in the second half of 2007 (qoq growth rates of 0.3% and 0.9%) after a downturn in 2007Q2. Economic activity was driven by business investment and exports, offsetting a downturn in residential investment. The latter could prove to be a temporary phenomenon, reflecting a tightening of construction regulations, which make the construction approvals process more time-consuming.

Euro area growth was volatile last year, with strong qoq growth rates in 2007Q1 and 2007Q3. In 2007Q2 growth was dragged down by the stagnation of gross fixed capital formation and government consumption. For 2007Q4, a deceleration of both private consumption and export growth is behind the slowdown. The quarterly figures for the euro area largely correspond with the growth paths of France and Germany. The Netherlands posted even more volatile GDP growth rates due to gas production volumes, which recovered strongly in 2007H2 after a downturn in 2007H1.

In this context, Belgian qoq growth appears somewhat atypical, as it slowed very gradually from 0.7% in 2007Q1 to 0.5% in 2007Q4 (the FPB leading indicator reached a turning point in 2007Q2). Nevertheless, this resulted in GDP growth of 2.7% in 2007. Belgian growth is expected to remain moderate in the first half of 2008 and should regain some strength afterwards.

Graph 4 - Business cycle: global evolution**Graph 5 - Business cycle: sectoral evolution****Graph 6 - Manufacturing industry: order books****Graph 7 - Industrial confidence: international comparison**

Belgian business confidence (shown as the overall synthetic indicator in Graph 4) reached a peak in July 2006 and remained at a high level until mid-2007. In the second half of the year it deteriorated considerably as companies feared that the strong slowdown of the US economy would lead to a deceleration of euro area economic growth and weigh on their future export performance. The rise in confidence in the first two months of this year suggests that entrepreneurs' strongly increased pessimism at the end of 2007 was probably somewhat overdone. Business-related services confidence, which is not taken into account in calculating the overall synthetic indicator, has also declined substantially over the last half year.

The evolution of business confidence is generally most closely related to confidence in the export-oriented manufacturing sector. During the first two months of this year, the developments in the other two sectors covered by the NBB business survey cancelled each other out: confidence in the building industry rose quite strongly, while it plunged in the trade sector.

The deterioration of manufacturing sentiment since mid-2007 was caused by a decline in production and less well-filled foreign and domestic order books. The weakening of domestic orders was more pronounced than that of foreign orders, but both bounced back in February. Price pressures in the sector were at their highest level in almost ten years owing to a surge in both food and crude oil prices.

Building industry confidence started to deteriorate earlier than overall business confidence, but bottomed out during the second half of last year. Over the last few months, it registered a quite erratic evolution, but the stabilisation does not seem to be under threat. Expectations for the coming months deteriorated, which probably reflects the rise in mortgage rates. This might seem odd as long-term market interest rates have declined in the course of last year (see chapter on interest rates on page 16), but mortgage rates always react with a lag of a few months.

The decline of sentiment in the trade sector and business-related services stems mostly from a worsening of current activity, while the expected deterioration of activity in the coming months is more moderate.

Industrial confidence in the euro area has declined much less than in Belgium in the second half of 2007. Within the euro area, industrial confidence declined most in Germany and Italy, while Dutch and French sentiment remained almost unchanged. Both the Belgian and the euro area cycles appear to be approaching their trough.

Private consumption

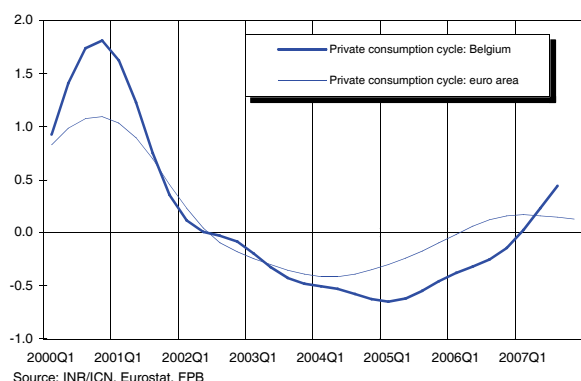
Table 2 - Private consumption indicators

	2006	2007	2007Q1	2007Q2	2007Q3	2007Q4	2007M9	2007M10	2007M11	2007M12	2008M1	2008M2
Turnover (VAT) - retail trade [1]	3.2	4.9	5.2	5.1	3.3	6.2	3.3	6.7	6.3	5.7	.	.
New car registrations [1]	9.6	-0.3	-7.8	-2.2	6.5	9.3	4.6	11.2	4.8	12.9	1.8	14.5
Consumer confidence indicator [2]	-2.6	-1.2	-0.3	1.7	-1.7	-4.3	-2.0	-1.0	-8.0	-4.0	-6.0	-3.0

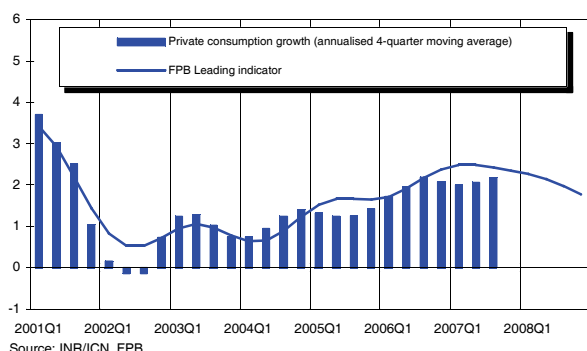
[1] Change (%) compared to same period previous year; [2] Qualitative data

Source: DGSSB, NBB, Febiac

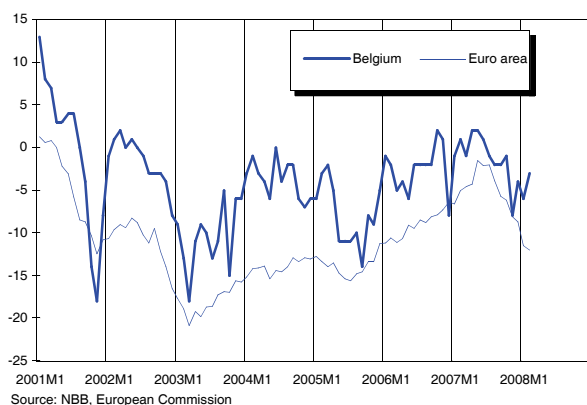
Graph 8 - Private consumption cycle



Graph 9 - Private consumption growth and leading indicator



Graph 10 - Consumer confidence: international comparison



In the national accounts, of which the yearly figures were published in September and the quarterly profiles in October 2007, private consumption growth was revised significantly upwards for 2005 and downwards for 2006. As a result, the private consumption cycles of Belgium and the euro area are now more in line with each other. During the first three quarters of 2007, however, private consumption clearly grew more strongly (0.9% per quarter on average) than its trend in Belgium, while it developed more in line with its trend (0.4% per quarter on average) in the euro area.

The solid performance of Belgian private consumption over the last two years went hand in hand with an acceleration in growth in households' real disposable income, which exceeded 2% in 2006 and 2007 after a stabilisation (on average) between 2002 and 2005. These strong growth rates were mainly due to strong employment growth and the implementation of the last phase of the fiscal reform (in 2006).

The decline in Belgian consumer confidence since June 2007 results from some counteracting factors. On the one hand, consumers have become more pessimistic about the state of the Belgian economy and their own financial situation. This probably results from fears about the effect of the worldwide deceleration in economic growth on the Belgian economy and from the significant increase in consumer prices that generated worries about households' purchasing power. On the other hand, consumers' labour market expectations have continued to brighten up, which is probably related to the ongoing decline in the unemployment rate and increasing labour shortages in some industries. Over the last few months, consumer confidence has tended to bottom out somewhat in Belgium, while it continued a steep downward path in the euro area. Other, more contemporaneous private consumption indicators, such as car registrations and retail sales were remarkably resilient during 2007Q4. All in all, these developments confirm the image drawn by the FPB leading indicator that points to a slight deceleration of private consumption growth in 2008.

Business investment

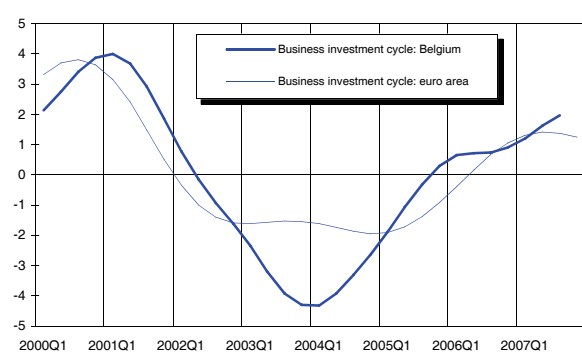
Table 3 - Business investment indicators

	2006	2007	2008	2007Q1	2007Q2	2007Q3	2007Q4	2007M8	2007M9	2007M10	2007M11	2007M12
Investment (VAT) [1]												
Industrial companies	6.6	12.3	.	15.5	7.0	13.2	13.6	19.2	8.4	15.8	-2.6	24.5
Non-industrial companies	1.6	12.9	.	13.0	15.3	10.5	12.6	13.4	4.9	15.5	15.7	9.0
Total companies	3.6	13.0	.	14.0	13.0	11.7	13.3	15.6	6.4	16.2	9.6	14.1
Investment survey [1]	3.3	13.1	7.2									
Capacity utilisation rate (s.a.) (%)	83.4	83.2	.	82.7	82.7	83.5	83.9					

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

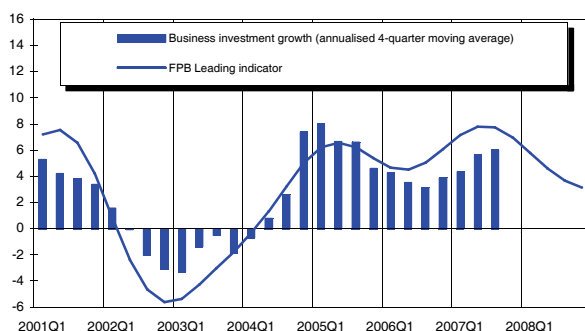
Source: DGSD, NBB

Graph 11 - Business investment cycle



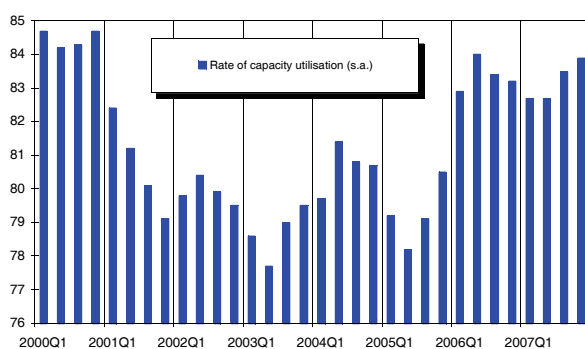
Source: INR/ICN, Eurostat, FPB

Graph 12 - Business investment growth and leading indicator



Source: INR/ICN, FPB

Graph 13 - Capacity utilisation in manufacturing industry



Source: NBB

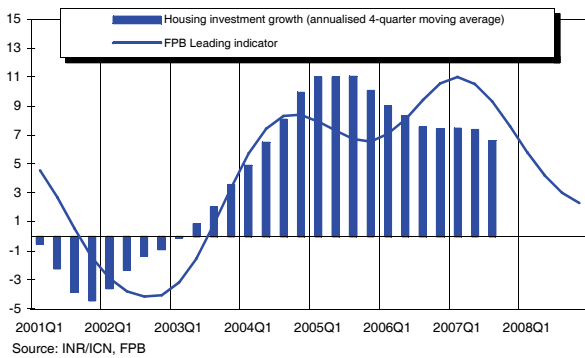
During the previous three years, the business cycles in Belgium and the euro area (see Graph 2 on page 8) developed roughly in the same way: a trough was reached by mid-2005 and followed by an upturn that levelled off in the course of 2007. However, the respective business investment cycles exhibited somewhat different evolutions. While the euro area investment cycle followed the business cycle closely, the Belgian investment cycle continued its increase - which started in 2004Q2 - in the course of 2005, levelled off in 2006 and resumed its upturn in 2007.

The Belgian investment rate (business investment as a percentage of GDP at current prices) increased from 12.6% in 2003 to 13.3% in 2006. This was, among other reasons, due to increasing business profitability that resulted from a moderation in wage growth. For 2007, the investment rate is expected to have increased further. According to the latest quarterly national accounts, business investment at current prices registered an average yoy growth rate of 7.1% during the first three quarters of 2007 (compared to 4.3% for GDP at current prices). VAT-based investment statistics show that this strong growth rate was seen in industrial as well as in non-industrial companies.

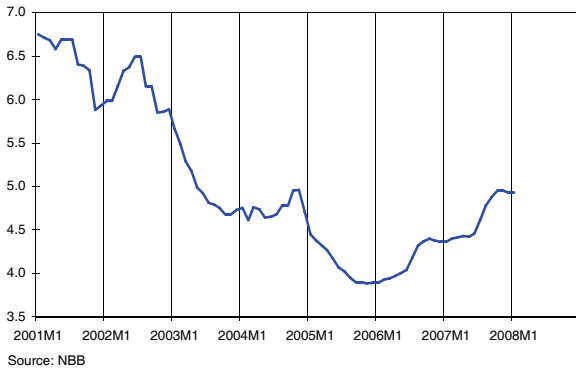
The FPB leading indicator also confirms the strong performance of business investment in 2007, but points to a deceleration in the course of 2008. This evolution is confirmed by most indicators, apart from the rise in capacity utilisation rates during the second half of 2007, which seems at odds with other business cycle indicators. Indicators from the NBB survey related to activity in the investment goods industry have all weakened somewhat in the course of 2007. The latest investment survey (held in autumn 2007) also points to a deceleration in investment growth (from 13.1% in 2007 to 7.2% in 2008 at current prices) in the manufacturing industry in 2008. Moreover, company directors tend to be overly optimistic in their investment predictions. The slowdown in investment growth could be more pronounced than one should expect on the basis of this survey.

Housing investment

Graph 14 - Housing investment growth and leading indicator



Graph 15 - Mortgage rate (%)



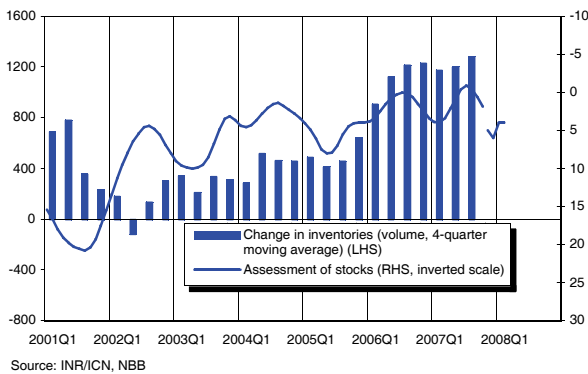
With an average growth of 7.2% in the last five years, housing investment was a propellant for economic growth. However, according to the latest quarterly accounts, housing activity has slowed considerably from an impressive 2.7% qoq growth rate in 2006Q3 to 0.6% in 2007Q3. The strong average annual growth rate in 2007 (5.1%) is partially due to a favourable carry-over effect.

A comparison of Graphs 14 and 15 shows that the decline in mortgage rates has played an important role in the housing investment boom from 2003 to 2006. In 2006, mortgage rates began to climb. The increase accelerated in the second half of 2007 due to the subprime mortgage crisis. Together with weakening real disposable income growth in 2008, this will put additional downward pressure on housing investment. As the subprime crisis is mainly an American problem, its impact on the Belgian housing market should, apart from the impact on mortgage rates, remain limited.

This evolution 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, went down between mid 2006 and 2007Q3. They all lead the development of housing investment by about four quarters. Moreover, the yoy growth rate of the number of dwellings for which construction has started dropped further from -9% in 2007Q1 to -20% in 2007Q3.

Stock building

Graph 16 - Stock building indicators



The gradual weakening of economic growth between 2007Q1 and 2007Q3 did not lead to a deceleration in stock building. The number of company directors that considered their level as excessive even decreased, so the level of stocks was mainly intended. By the end of the year, the number of company directors willing to reduce their stock levels started to rise again, which is in line with the expected deceleration in economic growth and, accordingly, a decreased probability of unexpected rises in demand.

Foreign Trade

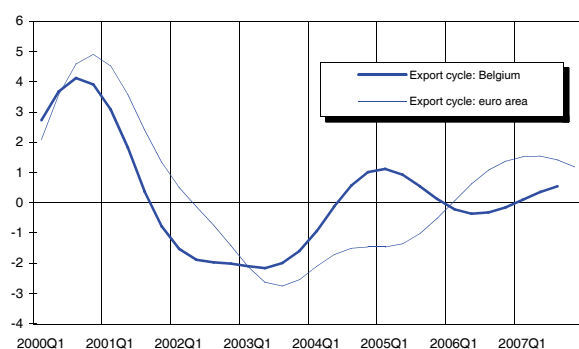
Table 4 - Belgium - Trade statistics (goods, intra/extrastat, national concept)

	2005	2006	2006Q4	2007Q1	2007Q2	2007Q3	2007M6	2007M7	2007M8	2007M9	2007M10	2007M11
Exports - value [1]	7.0	5.9	4.3	4.5	5.1	8.6	5.3	12.4	11.4	3.0	10.5	2.3
Imports - value [1]	8.9	7.1	3.0	-0.4	5.2	11.7	5.0	18.5	13.3	4.3	14.3	10.1
Exports - volume [1]	0.4	0.8	1.1	3.4	1.7	5.6	2.1	8.9	9.9	-0.8	6.1	-2.0
Imports - volume [1]	1.2	2.2	2.7	3.3	4.1	9.0	4.7	14.2	13.2	0.6	8.0	4.0
Exports - price [1]	6.5	5.1	3.1	1.0	3.4	2.8	3.2	3.2	1.4	3.8	4.1	4.4
Imports - price [1]	7.6	4.7	0.2	-3.6	1.1	2.5	0.3	3.8	0.1	3.7	5.8	5.9

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

Source: INR/ICN

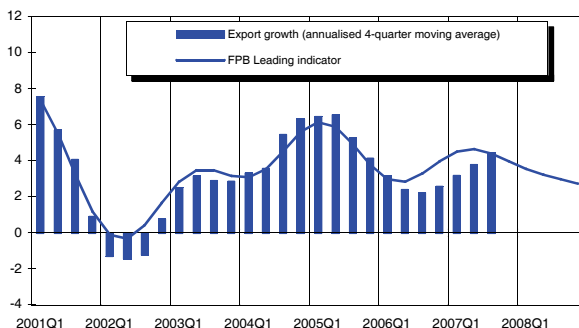
Graph 17 - Export cycle



Source: INR/ICN, Eurostat, FPB

Contrary to earlier indications (STU 3-07), the Belgian export cycle stayed on a rising path in 2007, as export volumes were revised upwards in the latest national accounts. All in all, the Belgian export cycle remained close to zero over the last three to four years, which indicates that exports fluctuated around their trend level. The euro area export cycle reached a peak during the first half of 2007. Euro area export growth continues to outpace Belgian export growth. Within the euro area, exports were especially strong in Germany, the Netherlands and Spain, while Italian exports continue to suffer from competitiveness losses and an unfavourable product mix.

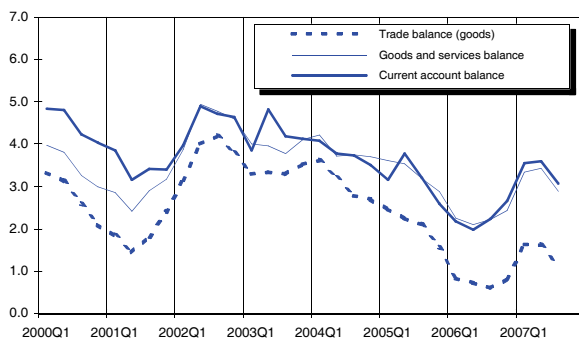
Graph 18 - Export growth and leading indicator



Source: INR/ICN, FPB

Belgian qoq export growth slowed down markedly in the first half of 2007, but then bounced back in the second half of the year owing to a significant acceleration of world trade growth. During the course of 2008, export growth should weaken because of a slowdown in worldwide economic growth. Furthermore, the effective exchange rate of the euro continues to appreciate (see Graph 28 on page 17) and is thus hampering exports through a worsening of price competitiveness.

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



Source: INR/ICN, NBB, FPB

This less favourable outlook for Belgian exports is confirmed by the FPB composite leading indicator, which also points to a deceleration in 2008. Nevertheless, annual export growth in 2008 should come in close to the growth rate seen in 2007 because of a positive carry-over effect.

The strong increase in international oil prices pushed import price growth above export price growth again. This deterioration in the terms of trade, which is expected to continue for a while, in combination with import volumes growing faster than export volumes, should lead to a decline in the current account surplus from 2.9% in 2007 to 2.5% this year.

Labour market

Table 5 - Labour market indicators

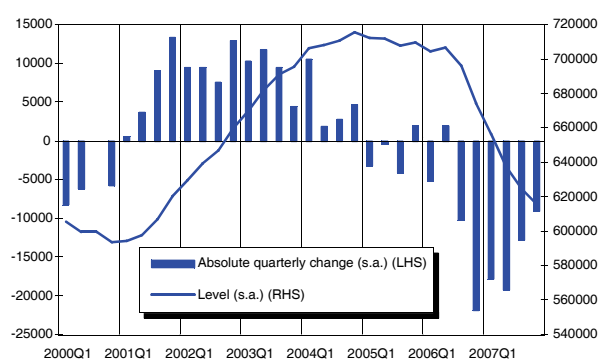
	2006	2007	2007Q1	2007Q2	2007Q3	2007Q4	2007M8	2007M9	2007M10	2007M11	2007M12	2008M1
Unemployment [1][2]	695.4	633.5	656.5	637.3	624.6	615.5	627.6	616.1	617.3	614.0	615.1	612.7
Unemployment rate [2][3]	13.8	12.6	13.0	12.7	12.4	12.2	12.5	12.2	12.2	12.2	12.2	12.1
Unemployment rate-Eurostat [3][4]	8.2	7.5	7.8	7.7	7.3	7.2	7.3	7.1	7.2	7.1	7.1	7.0

[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

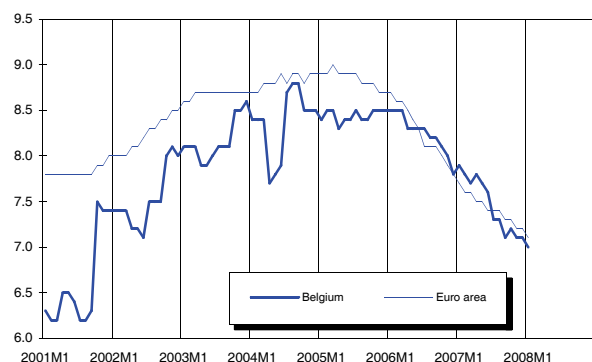
Source: RVA/ONEM, FPS Employment, Eurostat, FPB

Graph 20 - Evolution of unemployment (incl. older)



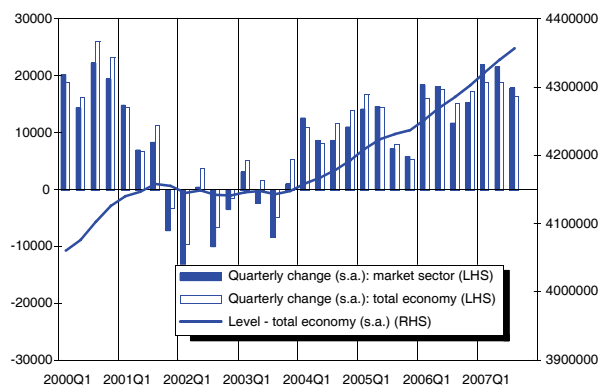
Source: RVA/ONEM

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



Source: Eurostat

Graph 22 - Evolution of domestic employment



Source: INR/ICN

Employment growth in the market sector was particularly strong in the first two quarters of last year (over 0.6% qoq). However, information from social security records indicates that the deceleration in economic growth had already started to have an adverse impact on the evolution of average hours worked per person as early as the second quarter. Employment growth, as such, fell back slightly during the third quarter (0.5% qoq) and may have been losing pace further during the fourth quarter. The latter claim is supported by the observed slowdown in the decrease of broad administrative unemployment.

This slight loss in pace occurred despite the incessant impetus to employment growth from strong increases in self-employment (average qoq growth of 0.6% in the first three quarters) and in the number of people that work in the voucher programme for domestic-type services (their share in salaried employment in the market sector increased from 1.5% to 2% in the first three quarters). The former is being boosted by incoming labour migration; the latter is heavily government-subsidized.

At industry level, the most salient features of the economic expansion of the last two years include particularly strong growth in employment in the construction sector (3.3% in 2006; 3.1% on average yoy during the first three quarters of 2007) and a return to positive job growth in the credit and insurance sector after a three-year spell of significant job losses.

Although total domestic employment has increased considerably over the last year and a half (0.4% on average qoq), the drop in the broad administrative unemployment rate (from 14% during the second quarter of 2006 to 12% at the beginning of this year) has been surprisingly large, implying an extremely low increase in the labour force. Over this period, qoq growth in the measured labour force virtually came to a standstill, even though structural forces are boosting activity rates in the older age classes and new evidence of stronger-than-expected growth in the population of working age is available, the latter mainly attributable to strong increases in net incoming migration.

Prices

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

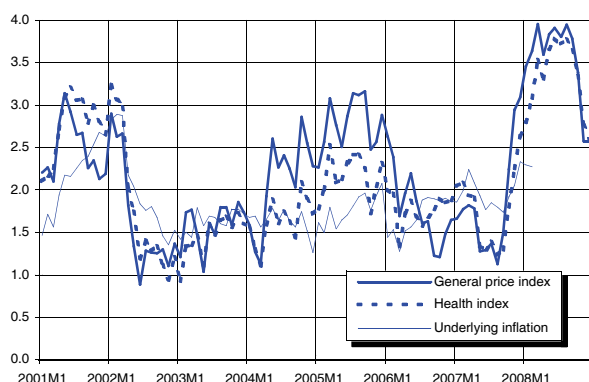
	2006	2007	2007Q1	2007Q2	2007Q3	2007Q4	2007M9	2007M10	2007M11	2007M12	2008M1	2008M2
Consumer prices: all items	1.79	1.82	1.75	1.45	1.33	2.76	1.51	2.24	2.94	3.09	3.46	3.64
Food prices	2.21	3.62	4.02	3.37	2.76	4.35	2.37	3.74	4.02	5.28	5.24	5.31
Non food prices	1.56	1.01	0.63	0.08	0.36	2.99	1.06	2.12	3.61	3.25	4.34	4.80
Services	1.47	1.89	1.99	2.19	1.79	1.60	1.58	1.54	1.51	1.76	1.37	1.23
Rent	3.50	1.79	1.80	1.83	1.74	1.77	1.61	1.88	1.76	1.68	1.64	1.87
Health index	1.77	1.77	2.02	1.52	1.31	2.23	1.29	1.79	2.25	2.64	2.79	3.08
Brent oil price in USD (level)	65.2	72.5	57.8	68.7	74.9	88.8	76.9	82.5	92.6	91.2	92.1	95.0

Source: FPS Economy, Datastream

Table 7 - Monthly inflation forecasts

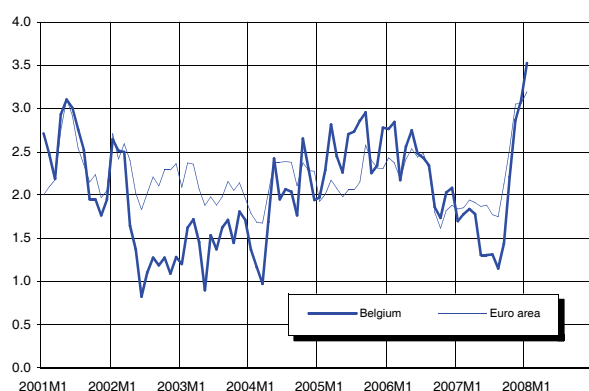
	2007M1	2007M2	2007M3	2007M4	2007M5	2007M6	2007M7	2007M8	2007M9	2007M10	2007M11	2007M12
Consumer prices: all items	105.20	105.77	105.78	106.26	106.13	106.12	106.57	106.44	106.54	107.10	108.10	108.40
Consumer prices: health index	104.92	105.46	105.23	105.58	105.34	105.28	105.70	105.67	105.71	106.19	106.93	107.44
Moving average health index	104.63	104.91	105.07	105.30	105.40	105.36	105.48	105.50	105.59	105.82	106.13	106.57
	2008M1	2008M2	2008M3	2008M4	2008M5	2008M6	2008M7	2008M8	2008M9	2008M10	2008M11	2008M12
Consumer prices: all items	108.84	109.62	109.96	110.08	110.20	110.27	110.62	110.64	110.57	110.72	110.88	111.19
Consumer prices: health index	107.85	108.71	108.95	109.07	109.19	109.27	109.63	109.65	109.56	109.74	109.89	110.23
Moving average health index	107.10	107.73	108.24	108.64	108.98	109.12	109.29	109.43	109.53	109.64	109.71	109.85

Source: Observations (up to 08M2): FPS Economy; forecasts: FPB

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

Source: FPS Economy, from 08M3 on: forecasts FPB

Headline inflation, as measured by the yoy growth rate of the national index of consumer prices, rose from 1.1% in August 2007 to 3.6% in February 2008. Part of this increase is due to oil prices (of which yoy growth rates went up from -9% in August 2007 to 47% in February 2008), although three other factors - which are not directly related to oil prices - also contributed to it. Firstly, the two largest Belgian gas suppliers changed their tariff calculation method during 2007Q4, which resulted in a rise in gas prices. Secondly, distribution tariffs for gas and electricity were raised significantly in January 2008. Thirdly, processed food prices (especially for cereal products, milk, oils and fats) have moved up considerably since September 2007.

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

Source: Eurostat

All these factors pushed up yoy growth rates of consumer prices and will continue to do so for a while. In fact, inflation is expected to drop below 3% only during the last months of 2008. Underlying inflation, which includes processed food, has also risen somewhat during recent months. It should level off in the coming months and start to decline in the second half of this year.

All in all, the NICP should rise by 3.5% in 2008, while the health index should increase less vigorously (3.3%) as it is influenced less by the recent oil price increases. The current pivotal index for public wages and social benefits (108.34) should be exceeded in April 2008.

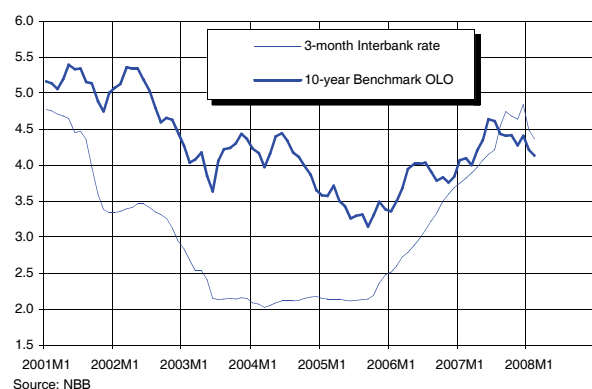
Interest rates

Table 8 - Interest rates

	2006	2007	2007Q1	2007Q2	2007Q3	2007Q4	2007M9	2007M10	2007M11	2007M12	2008M1	2008M2
Short-term money market rates (3 months)												
Euro area (Euribor)	3.08	4.28	3.82	4.06	4.50	4.72	4.74	4.69	4.64	4.84	4.49	4.36
United States	5.15	5.27	5.31	5.32	5.42	5.02	5.46	5.08	4.97	5.02	3.84	3.06
Japan	0.27	0.76	0.59	0.67	0.87	0.93	0.97	0.95	0.88	0.97	0.86	0.87
Long-term government bond rates (10 years)												
Belgium	3.81	4.32	4.05	4.40	4.48	4.37	4.41	4.42	4.27	4.41	4.21	4.13
Germany	3.78	4.23	4.01	4.34	4.35	4.22	4.24	4.29	4.10	4.27	4.04	3.96
Euro area	3.83	4.31	4.07	4.39	4.45	4.32	4.35	4.38	4.22	4.36	4.16	4.07
United States	4.79	4.63	4.68	4.85	4.73	4.25	4.51	4.52	4.14	4.10	3.73	3.73
Japan	1.73	1.67	1.67	1.74	1.71	1.56	1.60	1.65	1.50	1.53	1.43	1.44

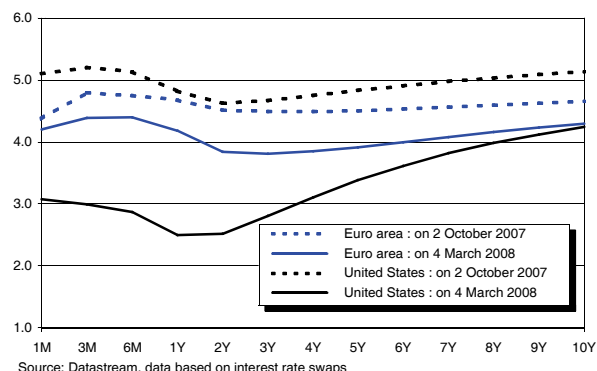
Source: Datastream

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

After a first rate cut of 50 basis points in September last year and a further monetary loosening of 50 basis points in 2007Q4, the Federal Reserve slashed rates by 125 basis points on two separate occasions in January, bringing the Federal Funds rate from 5.25% to 3% in the space of just four months. The deepening of the housing contraction, the softening in labour markets, and the deterioration of financial market conditions were cited as reasons for this unusually fast pace of monetary loosening. The Fed also tried to forestall panic in financial markets. Additional interest rate cuts in the remainder of the year cannot be excluded in spite of rising inflation.

The ECB injected massive amounts of liquidity into the money markets to alleviate tensions on the interbank market, which faced a dramatic increase in the risk premium reflecting commercial banks' fear to lend due to uncertainty about banks exposure to the subprime and credit crisis. In contrast with the Fed, the ECB has kept the refinancing rate stable at 4% so far. The status quo has to do with the fact that the economic slowdown in the euro area is less pronounced than in the US and with the ECB's fear of second round effects (higher wage demands) following the strong rise in inflation (from 1.7% in August to 3.1% yoy in December 2007). Recently the ECB has opened the door to a possible rate cut as the economic outlook for the euro area has become less favourable, reducing the risk of second round effects.

US long-term interest rates rose until the middle of last year, but then started to decline because of a worsening economic outlook that, in combination with the financial turmoil, initiated investors' moves from risky financial products to safe government bonds. Euro area long-term interest rates rose more in the first half of 2007 than in the US and declined less in the second half. As a result, long-term interest rates were 30 basis points higher in the euro area than in the US in February 2008, while they were 70 basis points lower in January 2007.

Exchange rates

Table 9 - Bilateral exchange rates

	2006	2007	2007Q1	2007Q2	2007Q3	2007Q4	2007M9	2007M10	2007M11	2007M12	2008M1	2008M2
USD per EUR	1.256	1.371	1.311	1.348	1.375	1.448	1.391	1.423	1.468	1.455	1.471	1.475
UKP per EUR	0.682	0.685	0.671	0.679	0.680	0.709	0.689	0.696	0.709	0.722	0.747	0.751
JPY per EUR	146.1	161.3	156.5	162.9	161.9	163.8	160.0	164.9	162.8	163.7	158.7	158.0

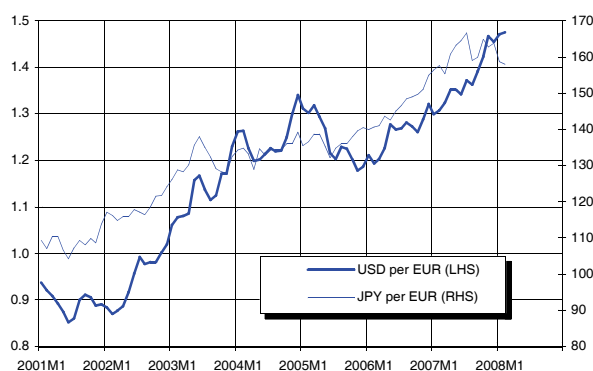
Table 10 - Nominal effective exchange rates (1990=100)

	2006	2007	2007Q1	2007Q2	2007Q3	2007Q4	2007M9	2007M10	2007M11	2007M12	2008M1	2008M2
Euro	121.7	128.1	124.8	127.3	128.1	132.1	128.8	130.5	132.6	133.2	134.1	133.9
Growth rate [1]	0.8	5.3	1.2	2.0	0.6	3.1	1.2	1.4	1.6	0.5	0.7	-0.1
US dollar	83.9	79.9	83.3	81.3	79.3	75.9	78.3	76.6	74.8	76.2	75.5	75.1
Growth rate [1]	-1.2	-4.7	0.3	-2.4	-2.4	-4.3	-1.8	-2.2	-2.3	1.8	-0.8	-0.6
Japanese yen	80.3	76.3	76.8	74.9	76.1	77.4	77.6	75.8	78.4	78.0	81.1	81.3
Growth rate [1]	-6.6	-5.0	-1.9	-2.5	1.6	1.7	0.6	-2.3	3.3	-0.4	3.9	0.2

[1] Change (%) compared to previous period

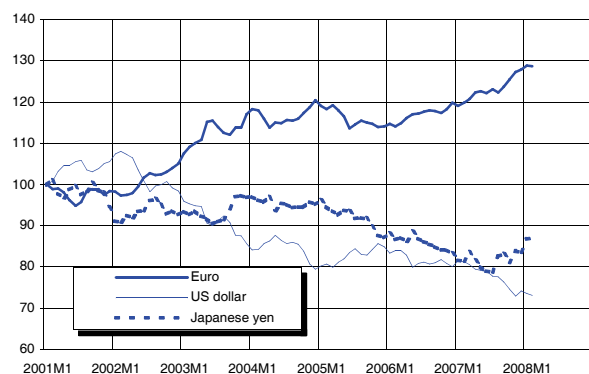
Source: BIS, NBB

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



Source: NBB

Graph 28 - Nominal effective exchange rates (2000M1=100)



Source: NBB, BIS

Last year, the dollar continued to depreciate against the euro (by some 11%), because of a significant weakening of the US economic fundamentals and the substantial narrowing of the short-term interest rate differential (from 175 to 25 basis points) between both economic blocks, which had played for more than two years in favour of the dollar. Moreover, central banks in Asia and the Middle East continued to reduce the weight of the dollar in their monetary reserves in favour of other major currencies, such as the euro. Despite the Fed's strong cutback in official rates in January 2008, the dollar did not slide further as the economic outlook for the euro area started to worsen too. Moreover, the dollar might have been supported recently by foreign investors that bought US financial assets as these had become relatively cheap due to the subprime-related downturn in stock prices and the historically low level of the dollar.

The British pound remained fairly stable against the euro until August last year, after which it started to depreciate at a fast pace as the UK economy was hit harder by the financial turmoil in the US than the euro area. The British economy now also has to deal with declining house prices, a tightening of credit and a substantial deceleration in activity growth, which is fuelling speculation on interest rate cuts by the Bank of England.

The euro also appreciated against the Japanese yen, the Chinese yuan, the Swiss franc and the Swedish krona, but lost ground against the Canadian dollar and the Norwegian krone last year. In nominal effective terms (taking the exchange rate vis-à-vis all trading partners into account) the euro exchange rate appreciated by 5.3% in 2007. Since the low reached in October 2000, the nominal effective euro has appreciated by more than 40%.

Tax indicators

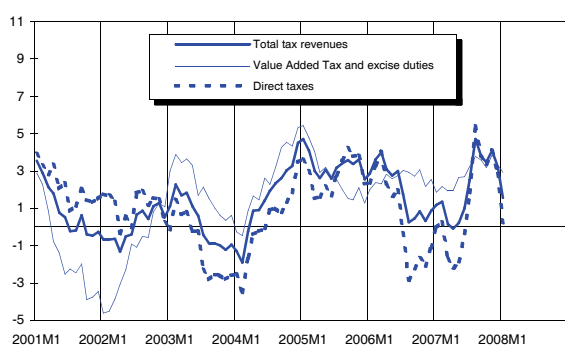
Table 11 - Tax revenues (1)

	2006	2007	2007Q1	2007Q2	2007Q3	2007Q4	2007M8	2007M9	2007M10	2007M11	2007M12	2008M1
Total [2]. of which:	2.6	5.1	4.0	2.9	9.5	4.3	22.1	-3.4	5.3	10.7	0.3	-6.0
Direct taxes, of which:	0.6	4.8	3.7	1.3	11.5	3.7	43.2	-5.8	5.0	13.3	-1.6	-10.1
Withholding earned income tax (PAYE)	3.7	4.4	4.5	6.6	2.3	3.7	-1.8	33.0	-7.8	23.5	2.4	0.3
Prepayments	5.5	6.5	.	-2.7	12.4	12.4	.	.	10.5	.	13.2	.
Value Added Tax and excise duties	4.3	5.3	3.7	6.2	6.2	4.7	8.3	-2.2	3.1	8.0	3.8	-1.0

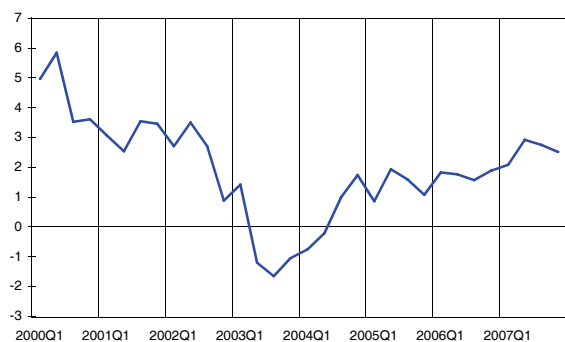
[1] Change (%) compared to same period previous year; [2] Total received by federal government, excl. of death-duties

Source: FPS Finance

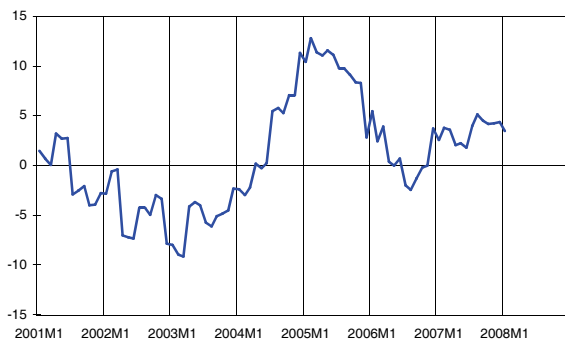
Graph 29 - Real tax revenues (3)



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 revenue from taxes recorded a nominal increase of 5.1% in 2007, which was markedly higher than in 2006 (2.6%). This should not come as a surprise as revenues in 2006 were affected by tax-cutting decisions, especially with regard to direct taxes.

It should be noted that quarterly and monthly figures in 2007 for total direct taxes are difficult to compare with the corresponding data for 2006 because they are largely affected by changes in the seasonality of taxes collected by means of assessment: both refunds/collections of personal income taxes and of corporate taxes were accelerated in 2007.

VAT receipts performed well in 2007 thanks to the dynamism of domestic demand. However, a deceleration was observed by the end of the year because of a downturn that had begun in the business cycle (as well as in the exports and housing investment cycles) and due to an acceleration in VAT reimbursements (delayed). Despite increased duty rates on tobacco at the beginning of 2007, excise duty income has proven to be less dynamic than VAT due to sluggish tobacco and gasoline consumption.

Pay as you earn personal income tax revenue, mainly levied on wages, is still supported by the rise in employment. The 4-quarter moving average growth rate in real terms (Graph 30) has been constantly positive since mid-2004, and has even tended to increase over time.

Real advance payments on a 12-month moving average basis (Graph 31) declined until mid-2006 and recovered slightly thereafter. The decline in 2006 may be related to the introduction of an allowance for corporate equity ("notional interests"). Delayed effects of this measure may have continued to appear in the first and second due dates of 2007 (April and July), which were lower than expected. The third and last due dates (October and December) were stronger, despite the deceleration in the business cycle

Estimating private health expenditures within a dynamic consumption allocation model

In the health economics literature, it is customary to model total (private and public) aggregate health expenditures as a function of income, demographic ageing and a host of other variables. Private health expenditures are rarely modelled separately and if they are, the models are often based on individual data and limited to specific medical services such as physician visits. In this paper we specify a model of aggregate private health expenditures, embedded in a generalisation of Deaton & Muellbauer's Almost Ideal Demand System (AIDS). The main advantage of specifying a complete demand system is that all household consumption decisions, including the ones about the use of health care services, are subject to the same budget restriction.

The data used to estimate the demand system consist of total expenditures, budget shares and price indices of four aggregate consumption categories over the period 1980-2005. They are the broad aggregates: Non-durables, Durables, Health Care and Rent. Following Deaton & Muellbauer's model, the budget shares of these aggregates are explained by total consumption spending and relative prices. The basic model is extended by including two demographic variables expected to capture shifts in consumption patterns related to the changing age composition of the population. The dynamic adjustment of consumption allocation decisions to exogenous shocks are modelled using the familiar 'error-correction mechanism' specification.

The estimation results are plausible, although homogeneity and symmetry restrictions placed on the parameters are rejected. The implied own price elasticities

(which are calculated using the values of the model variables in 2005) indicate inelastic demand for Health and Rent, and elastic demand for Durables and Non-durables. Income elasticities are below unity for Durables, Rent and Health care, and above unity for Non-durables. The elasticities with respect to the demographic variables are positive for Health care and Durables and negative for Rent and Non-durables.

The model is used to project the budget shares of the four aggregates over the period 2006-2050. While this is much longer than the simulation horizon typically used for the medium-term HERMES model (in which a similar consumption allocation model is included), it provides a check that the model is well-behaved. Moreover, it is a time period that is relevant to studying the effects of demographic ageing. In the base run scenario, which uses available demographic projections and autoregressive extrapolations of prices and income, health care spending is projected to reach 5.4% of the household budget in 2050 (up from 4% in 2005). This increase reflects the effect of an increasing share of people aged 75 and more in the population, tempered by the low income elasticity of health care demand. Indeed, the 'pure' demographic effect, obtained in a scenario where income and prices are kept constant, leads to projected health spending close to 6% of total household consumption.

*"Estimating private health expenditures within a dynamic consumption allocation model",
P. Willemé,
Working Paper 4-08, February 2008.*

Budget surpluses to face population ageing: the reality and the prospects

The Working Paper looks at the strategy that has been implemented in Belgium since the beginning of the decade to finance the future increase in public spending due to population ageing. This strategy is laid down in the Stability Programmes and in the Ageing Act and is supported by a broad social and political consensus. It implies building up budget surpluses, which has not been done so far. The paper analyses the long-term effects of such a situation, for example as regards the trade-off between the various policies that could be implemented to face the budgetary challenges posed by ageing populations.

Since 2000, the resources released by decreasing interest charges have been used to compensate for structural cuts in revenue and increases in expenditure. As a consequence, those resources have not been saved up to finance the future cost of ageing. The strategy that has been recommended for several years by the High Council of Finance (HCF) and that is supported by a broad social and political consensus is thus not applied. The principle underlying this strategy consists in pre-financing the ageing cost by saving up the margins resulting from reductions in public debt.

Implementing the HCF's strategy would imply a U-turn in budgetary policy, which has been rather loose over the last years. But a restrictive policy may not be easy to carry out because of political goals and concerns: pressures to cut taxes in the context of globalization, the cost of employment policies, pressures from the social partners to increase social expenditure, and others.

In order to face the consequences of ageing, international organizations usually recommend a three-pronged strategy focused not only on public debt (pre-financing strategy), but also on age-related expenses (reform of the social benefits system) and on employment (structural reform of the labour market). By overlooking a pre-financing strategy, either wholly or partially, the authorities will inevitably be led to reconsider the trade-off between the three prongs of the strategy.

This Working Paper makes a diagnosis of the sustainability of public finances on the basis of the long-term projections (given the same policy scenario) carried out by the Federal Planning Bureau (FPB). It also calculates the effort needed to be done required to implement the budget trajectory that was recommended by the HCF in

March 2007. It assesses to what extent the budgetary adjustment, which is necessary in the short run for a pre-financing strategy, could be reduced if future generations are to finance the non-demographic increase in health care expenses. Moreover, it measures the scale of the reforms that should be carried out to reduce the cost of ageing so that budgetary sustainability is guaranteed in the absence of the budget surpluses recommended by the High Council of Finance. The study also contains a sensitivity analysis of the sustainability diagnosis, checking its sensitivity to productivity, employment and the parameters of social policy. Finally, the study describes the evolution of the sustainability diagnosis in the light of the successive long-term projections that the FPB has published since the early 90's.

*“Begrotingsoverschotten opbouwen om de vergrijzing in België aan te pakken: realiteit en verkenningen / Accumuler des surplus budgétaires pour faire face au vieillissement démographique en Belgique: réalités et perspectives”,
M.Saintrain and S.Weemaes,
Working Paper 5-08, February 2008.*

Recent evolution of the welfare adjustment of social security benefits

Social benefits are adjusted according to increases in the level of prices and are also adjusted – rather irregularly – to the general evolution of welfare. These welfare adjustments can apply to various elements of social legislation or parameters of social policy: the benefit amount, the ceilings used to calculate the benefits, etc. The Act of 23 December 2005 providing for a Solidarity Pact between the Generations establishes a structural mechanism of welfare adjustment for social benefits. The Working Paper analyses the main characteristics of the mechanism and the details of its implementation. It assesses the budgetary effects of the measures that have been taken within this framework and compares the benefit adjustments that have been carried out over recent years with wage growth. Finally, two alternative scenarios of benefit adjustment policy are examined.

Social benefits are adjusted according to increases in the level of prices and are also adjusted to welfare evolution on a yearly basis. The above-mentioned Act lays down the amount of resources to be allocated to the adjustment of benefits. These resources should at least equal the expenditure resulting from a real 1.25% increase in the ceilings used to calculate the social benefits, a 1% increase in lump-sum benefits and a 0.5% increase in no lump-sum benefits. These percentages are largely derived from the social policy scenario described in the annual reports of the Study Committee on Ageing (SCA).

Nevertheless, there are two main differences in comparison with the SCA scenario. First, in the SCA scenario, the social policy parameters are defined within a context of 1.75% productivity and wage growth. The Act provides for fixed percentages that are not linked to the wage growth. Secondly, still in the SCA scenario, the welfare adjustment of no lump-sum benefits is only applied to benefits that were paid for the first time at least one year ago. The SCA does not consider adjusting benefits that started more recently because they are calculated according to the 'last' wage and thus follow the general evolution of welfare. The Act can also be interpreted in a different way, with the welfare adjustment of the no lump-sum benefits then also applied to benefits that were paid for the first time in the course of the year. In this case, the mechanism of benefit adjustment set up by the Solidarity Pact between the Generations is relatively generous, given the current context of wage restraint.

For 2007 and 2008, the revaluation measures concentrate mainly on minimum benefits and the oldest allowances; some replacement ratios have also been increased. On the other hand, ceilings are rising at a slower pace, thereby reducing the insurance character – i.e. the ratio between replacement income and the last earned wages – of the various social security subsystems. The overall cost of welfare adjustment measures planned for the period 2007-2012 (called hereafter “the baseline scenario”)

amounts to 0.44% of GDP in 2012, of which 0.18% is accounted for by measures taken in 2007 and 2008.

Besides, two sensitivity analyses have been carried out. In the first scenario, the welfare package will increase as of 2008 on the basis of a 1% (instead of 0.5%) revaluation of all no lump-sum benefits. The cost of this scenario is 0.1% higher than that of the baseline scenario in 2011. In the second scenario, welfare packages will be reduced starting from 2009. These packages are calculated ac-

ording to an overall growth in the various parameters of social policy equivalent to half the growth of conventional salaries. This last scenario generates a 0.09% saving of GDP in comparison with the baseline scenario.

*“Welvaartsbinding van de sociale zekerheidsuitkeringen: een overzicht van de recente ontwikkelingen”,
N. Fasquelle, M-J. Festjens, B. Scholtus,
Working Paper 07-08, February 2008.*

Elaboration of a regional projection model. A first application of the HERMREG model to the national economic outlook 2007-2012

In January 2008, the results of an initial exercise aimed at breaking down the national economic projections for the period 2007-2012 into regional projections were published. This study is the result of a collaboration between the Federal Planning Bureau, the Brussels Institute for Analysis and Statistics (IBSA), the Research Centre of the Flemish Government (SVR) and the Walloon Institute for Evaluation, Prospects and Statistics (IWEPS).

These four institutions developed an initial version of a macroeconomic, sectoral and regional model (HERMREG) that allows the results of a national economic projection to be disaggregated into projections for the three Belgian regions.

HERMREG is a macroeconometric, multisectoral and multiregional model using a top-down approach. Regionalisation keys are computed and applied to the national medium-term forecast produced by the national HERMES model in order to obtain regional projections. These keys are determined in HERMREG by combining two methods: a shift-share method and multivariate regressions.

More precisely, the shift-share method is used to decompose the growth of a certain variable in a certain branch from a certain region into:

- the national sectoral growth rate of this variable, the medium-term evolution of which is known from the national HERMES model; and
- a (sectoral) differential growth rate, for which the medium-term evolution has to be computed. This differential shift component is attributed to region-specific characteristics and other explanatory variables that are econometrically identified in HERMREG via regression equations. These regression equations then serve to produce forecasts of the differential growth.

The final step consists of rescaling the obtained regional results so that the sum of the regional results matches with the national HERMES forecast¹.

In its present version, the HERMREG model contains about 2,700 equations, of which about 230 are estimated.

The results obtained by using this initial version of HERMREG were presented in January 2008. This first exercise starts from the national economic outlook 2007-2012 published in May 2007. Note that since the publication of this national forecast, the international environment, as well as the national short-term situation has changed, which has induced a not negligible modification of GDP growth for the year 2007. The forecast for 2008 should also change with the new context. Note, however, that the national economic outlook dated May 2007 is the last complete medium-term projection available with a 5 year-horizon.

The results, computed for each region, concern economic growth (regional value added per branch and gross domestic product of each region), regional investments, productivities per head, real wage costs per head, regional employment as well as regional unemployment, net commuting flows, and employment rates. All regional results are presented for the period 2006-2012 and are completely coherent with the national results presented in May 2007.

“Elaboration d’un modèle de projections régionales : une première application du modèle HERMREG aux perspectives économiques nationales 2007-2012. Uitwerking van een regionaal projectiemodel. Een eerste toepassing van het HERMREG model op de nationale economische vooruitzichten 2007-2012”.
D. Bassilière (FPB), F. Bossier (FPB), F. Caruso (IBSA), K. Hendrickx (FPB), D. Hoorelbeke (SVR), O. Lohest (IWEPS),
Report, January 2008.

1. Since some variables are expressed in chain euros, ‘sum’ should not be taken too literally. By adapting the intermediate regional results, they are chain coherent with the national results.

Other Recent Publications

[Economic Forecasts 2008](#), January 2008
(available in Dutch and in French).

[Federal Report on Sustainable Development 2007](#),
December 2007
"De transitie naar een duurzame ontwikkeling versnellen - Accélérer la transition vers un développement durable"

[Planning Paper 102](#), September 2007
"Perspectives énergétiques pour la Belgique à l'horizon 2030 dans un contexte de changement climatique - Energievooruitzichten voor België tegen 2030 in een tijdperk van klimaatverandering"
D. Devogelaer, D. Gusbin

[Working Paper 3-08](#), January 2008
"Formation des salaires et chômage régional en Belgique: un regard macro-économique"
H. Bogaert

[Working Paper 2-08](#), January 2008
"Long-term population projections in Europe: How they influence policies and accelerate reforms"
H. Bogaert

[Working Paper 1-08](#), January 2008
"Financement public de l'économie belge : mise en perspective générale"
H. Bogaert

[Working Paper 15-07](#), November 2007
"Qualitative Employment Multipliers for Belgium, Results for 2000 and 2002"
B. Van den Cruyce, J. Wera

[Working Paper 14-07](#), October 2007
"Market services labour productivity growth in three small European countries: Austria, Belgium and the Netherlands"
B. Biatour, Ch. Kegels

Research in Progress

[Macroeconomic, budgetary and GHG emissions prospects](#)
Using a consistent modelling approach, medium-term macroeconomic - including labour market - and budgetary prospects, as well as the future evolution of greenhouse gas (GHG) emissions, are investigated. Trends in the forces driving economic growth are analyzed. A consistent regional-national version of the model is being developed in collaboration with experts from the regional governments of Brussels, Flanders and Wallonia.
contact: hermes@plan.be

[The long term budgetary and social challenges of ageing](#)
Different aspects of the long term dynamics of acute health care, long term care and pension expenditure are scrutinized. Furthermore, the social dimension of pension benefits is investigated using micro approaches.
contact: maltese@plan.be

[Demographic projections](#)
New demographic projections for Belgium are prepared in collaboration with Statistics Belgium, a team of scientists, mostly demographers, and representatives of the regional administrations. Results are expected to be published in April-May 2008.
contact: demo@plan.be

[General equilibrium modelling](#)
A general equilibrium model (GEM) for Belgium is under construction. The model will be a long-term model with a particular emphasis on the link between transport and the economy.
contact: transport@plan.be

[Determinants of total factor productivity growth in Belgium](#)
Research is under way to look into two specific determinants of total factor productivity (TFP) growth in Belgium: innovation through R&D and market competition.
contact: productivity@plan.be

[Labour-oriented social accounting matrix applications](#)
The FPB has constructed time series for employment (in number of persons and hours) and wages by industry according to a number of qualitative characteristics (e.g. age, gender and education level). Based on these series, the FPB is carrying out analyses of different types. One example is the linking of these employment data to input-output data to compute qualitative employment multipliers. Another example is the analysis of the gender wage gap.
contact: io@plan.be

Recent history of major economic policy measures

March 2008

After the budgetary negotiations, the federal government announced its objectives for the public finances for 2008. These are based on assumptions of 1.9% economic growth and 2.8% inflation in terms of the “health-index”.

The overall government finances should remain in balance: the deficit of the federal government (-0.6% of GDP) should be compensated for mainly by social security surpluses (0.3% of the GDP) and state government surpluses (communities and regions: 0.2% of GDP). The total state debt-to-GDP ratio should decrease from 85.1% at the end of 2007, to 82.0% at the end of 2008.

Several programmes aimed at supporting employment will be increased: the work bonus - the system of cuts in employees' social-security contributions for low-wage workers - will be strengthened as from October 2008 by raising the maximum reduction from _143 to _175 per month; wage subsidies for the employment of researchers will be increased as from July 2008. While the purchase price of household vouchers for domestic services will be raised from _6.7 to _7 per hour, making government-subsidised domestic services slightly more expensive for consumers, the redemption price of these vouchers will be raised from _20 to _20.22 per hour, allowing employers to pay for wage increases in the sector.

Different categories of social benefits will be increased: minimum pensions in the wage-earners' and self-employed schemes, as well as the means-tested minimum income guarantee for older people and the minimum disability benefit, will be raised by 2% in July 2008. The welfare adjustment of most other pensions, previously decided for 2008, will be made structural. The solidarity contribution for pensions will be reduced. Family allowance supplements will be made structural and progressively increased. Some benefits for handicapped people will be upgraded.

Additional resources will feed into the so-called “fuel oil fund”, set up to help people in need to pay their energy bill, and will support the “social pricing” of gas and electricity.

Reductions in taxation targeted at wage-earners, especially at low-wage earners, have been planned.

Both financing these various initiatives and compensating for the 2007 deficit will mainly rely on various non-tax receipts (from the main power generation corporation, from the FSI/FIF (Fonds voor de Spoorinfrastructuur – Fonds d'Infrastructure Ferroviaire), and from the sale of state-owned buildings), on the abovementioned savings in the state regional and community governments' budgets and the social security budgets (notably by refraining from fully spending the projected 4.5% growth in the health care budget), and on the expected creation of additional jobs stimulated by the different new measures.

February 2008

Together with National Grid of the UK, the transport system operator ELIA has started a feasibility study for an undersea connection with the British electricity network. Furthermore, the federal government has imposed a four-year efficiency programme on ELIA. By 2011, it should have realised EUR 8 million cost savings compared to 2007 expenditure ex.

In electronic communications, the incumbent Belgacom announced its takeover of low-cost provider Scarlet. This take-over is strategic rather than to gain market share, since it allows Belgacom to cover the low-cost segment of the market.

January 2008

The electronic communications market regulator, BIPT, decided that the incumbent Belgacom must open up its VDSL2 network to competitors. At the other edge of the internet spectrum Belgacom stopped offering dial-up internet. This will reduce the remaining number of dial-up connections (for other operators) to about 100,000. In mobile communications, BIPT decided that the incumbent Proximus may increase its termination rates significantly, whereas its competitors should decrease theirs. It was felt in the market that this would reduce fair competition.

December 2007

Transport system operator ELIA and its counterparts from the four neighbouring countries established a joint venture that will optimise cross-border trade in electricity, and thus improve market integration. Furthermore, incumbent Electrabel gave up its blocking minority in ELIA.

October 2007

The European Commission adopted a formal decision that makes the market-opening commitments offered by gas trading company Distrigas legally binding. The commitments imply that Distrigas will reduce the gas volumes tied in long-term contracts, which should encourage competition.

September 2007

Conditional upon shareholders' approval in Spring 2008, Suez and Gaz de France (GdF) will merge to create one of the largest energy groups in the world. The merged company must fulfil the conditions set by the European Commission in November 2006 in order to reduce its dominant position on the Belgian market. Suez will have to sell the gas trading company Distrigas and give up control of the gas transport system operator, Fluxys. GdF will have to sell its share in the Belgian power generation company SPE. Furthermore, the international gas hub at Zeebrugge will be operated independently from Suez, and new network capacity will be developed.

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)