Economic Update Belgium

5 April 2011

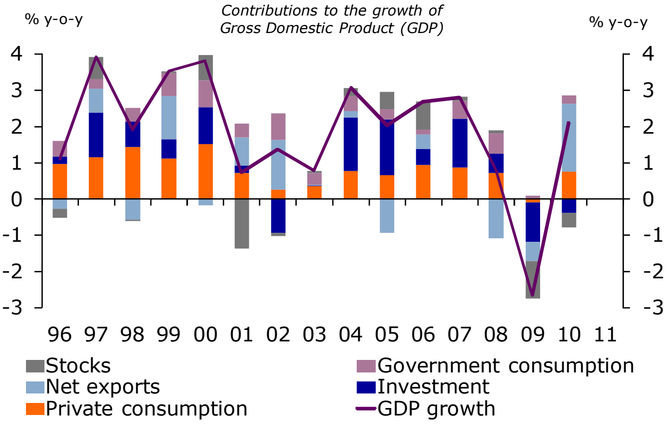
2011: a year of domestic demand dynamics

Year-on-year change (%)	'10	'11	'12
Gross Domestic Product	2.1	1¾	1¾
Private consumption	1.4	1½	1½
Government consumption	1.0	1	¾
Private investment	-1.7	1¾	1¾
Exports	10.2	5¼	6
Imports	7.8	5¾	5¾
Inflation	2.3	3	1¾
Unemployment (%)	8.3	8	7¾
Government balance (% GDP)	-4.6	-3¾	-3
Government debt (% GDP)	97.1	97¾	97¾

Source: Reuters EcoWin, Rabobank

While the Belgian economy benefited from a robust recovery of world trade last year, this year she has to establish growth mainly on her own account. As the export and the government sector step back gradually this year, all eyes are on the Belgian firms and households. Based on high producer confidence and a rising capacity utilisation rate, we expect businesses to increase their investments this year to expand production capacity. Belgian households have a reputation to be robust consumers and they are backed by positive developments in the labour market. Despite a persistent political gridlock, we expect a continuation of the moderate economic recovery in 2011 and 2012.

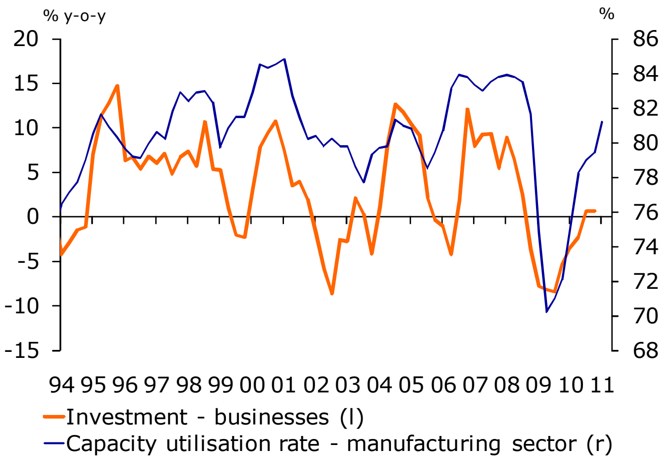
What's going to be the growth engine this year?



Source: Reuters EcoWin

The Belgian economy grew by 0.5% q-o-q in 10Q4, mainly on the back of robust stock formation and moderate investment growth. Over 2010 as a whole, the economy grew by 2.1% y-o-y, with net exports, and to a lesser extent private consumption, acting as main growth drivers. Fixed investment contracted slightly in 2010. Given that the strong rebound of world trade seems to be over now, the export sector will contribute less to growth this year. However, we again expect private consumption to grow strongly. Besides that, we expect private sector investment to partly take over the role as the main growth engine from the export sector.

Encouraging signals from businesses



Source: Reuters EcoWin

The level of business investments has decreased by more than 11% since the inception of the crisis, but it is growing again, albeit modestly, since 10Q2. Also for this year we expect private sector investment to grow by 1¾% y-o-y. First of all, this expectation is based on the current level of producer confidence. The NBB index is rising for months now and is clearly above its long term average. Producers in the manufacturing industry are mainly optimistic about their (foreign) orders. What's more, the capacity utilisation rate has increased last year and is currently around its long term average. This stimulates producers to make investments in order to expand their production capacity.

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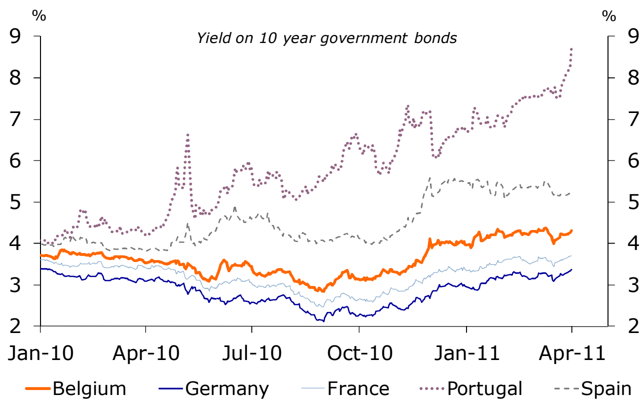
Political formation remains very tough



Source: Reuters EcoWin

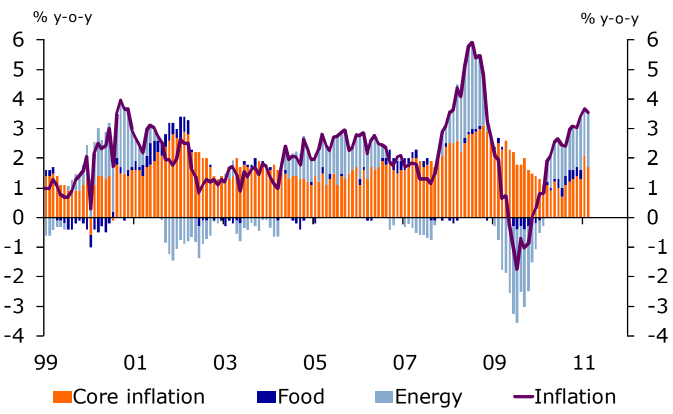
Almost ten months after the elections in June 2010, the Flemish (N-VA) and Flanders (PS) parties cannot come to an agreement about a new coalition. The new negotiator, Wouter Beke, has not been able to achieve any concrete results so far. The turmoil around Belgian government bonds is surely less dramatic than the beleaguered periphery countries, but the interest rate (currently around 4.3% on 10-year bonds) keeps the pressure on the negotiations very high. We are of the thought that the Belgian government is solvent, but because foreign investors hold 65% of Belgium's public debt, the interest rates charged remain highly sensitive to market sentiment.

Labour market shows signs of improvement...

Source: Reuters EcoWin

The positive sentiment in the labour market in recent months turns out to be justified. With further job growth in 10Q4 (+11,000) total employment is already above it pre-crisis level. With an initially constant labour force, the unemployment rate rose to 8.5% during the peak of the crisis. Subsequently, the pickup in job growth pushed down the jobless rate in recent months (7.6% in February). Amid relatively high wage growth prior to the crisis, the competitiveness of Belgian firms came under pressure. In the current wage negotiations round, the government has proposed a modest real wage growth (0.3%). However, employers fear persistently elevated labour costs amid accelerating inflation.

... but higher inflation impairs competitiveness



Source: Reuters EcoWin

Belgian inflation (+3.5% y-o-y in February) towers above the European average (2.4%). Due to a relatively high weight of the energy component in Belgium's consumer price basket, the current oil prices result in higher inflation. Also core inflation (1.7% y-o-y) is above the European average, which is an indication of strong domestic demand dynamics. The proposed wage growth by the government on top of the inflation indexation protects consumers for the coming two years against a steep fall in purchasing power. That said, higher inflation will not lead to the desired reduction of labour costs. This means Belgian firms will lose competitiveness in the international marketplace.

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