BELGIUM

BUT WE ONLY JUST GOT STARTED...

A new government has emerged, with the coalition agreement under immediate pressure from protesting unions and criticism on its underlying assumptions. Growth remains positive, albeit below trend as capex spending could take a hit while net exports still weigh on GDP. The housing market slump seems to be gradually dissipating, with prices having marched on regardless. Looking ahead, during the next quarters growth should be affected by higher trade tariffs. From 2026, growth should be supported by trade linkages with Germany, where growth should accelerate.

GDP GROWTH: PROS AND CONS

Having posted positive quarterly growth at the end of last year, the Belgian economy looked set for a slowdown. The outlook for international trade is poor and further deteriorating because of recent events. Pharmaceutical firms in particular look vulnerable to rising tariffs on US exports but so do just-recovering manufacturers. In addition, the effect of tariffs through a slowdown of important neighbouring trade partners like Germany could be sizeable. However, recent events point to a more positive outlook on that front, at least as fiscal spending is set to boost the Germany economy.

That could lessen some of the burden on domestic demand as a growth engine, with private consumption delivering the goods. While the gradually softening labour market did cause a temporary spike in terms of unemployment fears, for the most part, consumer sentiment held up quite well: it is currently slightly higher than its historical average. Momentum on the housing market has yet to return and firm capex spending looks set to decline this year. An uptick in government spending on defence could push growth higher (see below). For the full year, we expect to see growth of 1.2% this year and the next.

INFLATION COOLING OFF SLOWLY

Inflation, measured by the ECB's HICP metric, came in at 4.3% for the full year 2024. Behind this full-year average, a more complicated picture emerges. Government support measures to lower the energy bill for households drove down energy costs throughout 2023. The fading out of these measures mechanically increased last year's energy component of inflation. The resulting base effect is the main reason why Belgium has been the EU country with the highest inflation, behind only Romania. We expect the HICP to gradually reach 2.0% by the end of the year, as core and food inflation continue their normalisation.

Meanwhile, the health index, used to track the cost of living, broke through its latest 2% barrier last month. As a result, automatic wage indexation kicked in. The Belgian Plan Bureau expects another wage indexation later this summer and then no more subsequent ones throughout its 2-year forecasting horizon as price growth slows down.

LABOUR MARKET: SOFT LANDING (IF THAT)

Firm bankruptcy rates are up. They now stand at 4% above pre-covid levels. A historical analysis suggests that the excess could reach double-digit figures in the next couple of quarters. Bankruptcies among constructors, manufacturers and transport firms led to significant job losses last year.

Job creation is clearly slowing down. The Federgon index for temporary employment, a leading indicator, has been steadily trending down since 2021. A soft landing still looks like the most likely scenario, however, as unemployment remains essentially stable at around 5.8%. We are looking at an increase to 6.5% by the end of next year.

GROWTH AND INFLATION

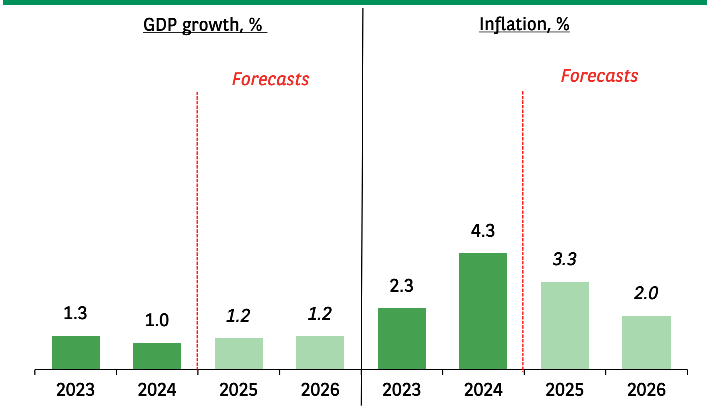

CHART 1 SOURCE: BNP PARIBAS FORTIS

LABOUR MARKET OF BELGIUM: SOFT LANDING

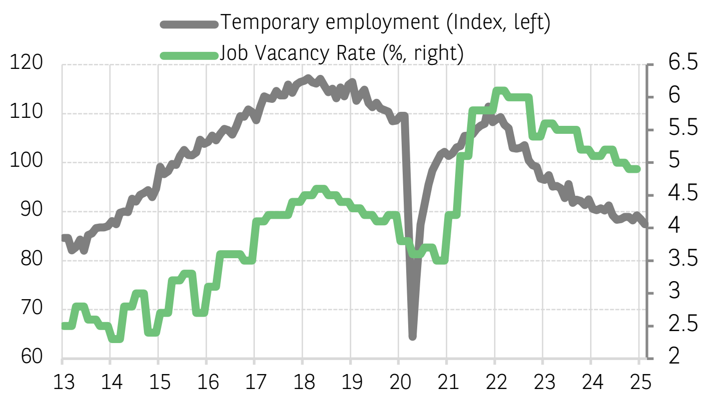

CHART 2 SOURCE: EUROSTAT, BNP PARIBAS FORTIS

PUBLIC FINANCE FAIRY-TALES

The European Commission is breathing heavily down Belgium's neck about the spiralling budget deficit and public debt ratio forecasted to rise to 140% over the next ten years under current (2024) policy settings. The five-party coalition emerged with a reasonable-looking plan to bring the deficit back from its current 4.5% to 3% over the next couple of years.

Some kinks remain to be ironed out however, as Bart De Wever hopes to exclude the obligatory pick-up in military spending (currently 1.3%) from consideration in the structural deficit measure on which the EC likes to focus its analysis.

The assumption of 500,000 extra jobs out of a current total of slightly more than 5 million people at work seems highly unlikely over the next four years. Especially as the Michel I government, with its "Jobs! Jobs! Jobs!" tagline, only managed to crank out some 250,000 new positions.

In 2023, a new government bond, targeted at Belgian retail investors, raked in north of EUR 20 billion. Spiced up by tax breaks, this bond helped the debt agency complete its financing goals for the year in advance. Subsequent issues targeted at a wider audience lacked tax advantage and were much less popular.

The average maturity of government debt remains above 10 years, but the average yield on outstanding loans rose from the 2021 low point of 1.43% to 1.98% at the end of last year. Compared to 2024, long-term funding is issued this year at a comparable cost, but at a lower average maturity (it might turn out to be 12 years – compared to almost 15 years in 2024).

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Military expenditures

Defence spending picking up

With just 1.3% of GDP spent on defence last year, Belgium comes in last in NATO's ranking, together with Spain and Luxembourg. 0.15% of the total amount spent constitutes support to the ongoing war in Ukraine, with this outlay entirely financed by exceptional corporate tax receipts from returns on frozen Russian assets held in Belgium according to the National Bank. The government now aims to increase military spending to 2% of GDP already by summer, while new defence minister Theo Francken is floating the target of 3.5% further down the line.

Spending categories

Labour costs account for close to half of what the country spends on defence. Military personnel has declined by more than 25% over the last 10 years, whereas the neighbouring countries kept their dedicated labour force stable, or even on an increasing path in the case of Germany.

That could all be about to change, however. Since the start of the year, the defence department has reported a record uptick in new applicants, with résumés arriving at HQ at about double the pace of last year. This is one area where the increased appetite for defence spending is at odds with much-needed structural reforms, as the IMF recommends in its article IV review to gradually raise the retirement age for specific civil servant groups, including certain military personnel. This could hinder the effort to increase the Defence payroll, losing out to better-paying private firms.

At barely 15%, the share of total defence outlay on Equipment puts Belgium once again dead last of all NATO countries. Neighbours France, Germany and The Netherlands spend about double that. Expect this number to shoot up however, as talks of using a now abandoned car production site in Vorst for increased military production are ongoing.

Financing

The question of how to pay for this uptick remains a thorny issue, given the weak ties that bind this coalition. It emerged that there is limited appetite to increase the already heavy reform package to offset the fiscal impulse. The uptick in defence spending as of Q3 will therefore most likely be debt-financed, at least for this year.

In terms of what comes next, various scenarios have been debated, with none proving particularly convincing so far. In the wake of 2023's successful retail bond issue, dedicated military bonds look like a tempting option, however practical constraints remain. Theo Francken is also interested in setting up a military investment fund to support the sector on a more structural basis. Lastly, talk of selling some of the government's holdings in telecom and/or financing seem preliminary but will almost surely return to the fore as the pressure to balance the budget piles up in the coming months.

As a result, additional military spending this year would likely constitute EUR 2 bn or about 0.3% of GDP, as a purely debt-financed fiscal impulse, unless the EC agrees to De Wever's request. Typically, more than half of all EU military equipment is procured in the US, but recent events will undoubtedly encourage a search for EU-based alternatives. As the labour market cools off gradually, the risk of crowding out seems rather low. We thus expect to see increased defence spending at home and abroad (especially by key trade partner Germany) to boost short-term GDP growth by 0.2% this year and 0.4% next year.

A new world, with new needs, is emerging fast, while this government struggles with the inheritance of the old one.