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The Belgian Economy in Corona Times:
The Covid-19 Pandemic is Causing an Unprecedented Economic Rollercoaster

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ABSTRACT

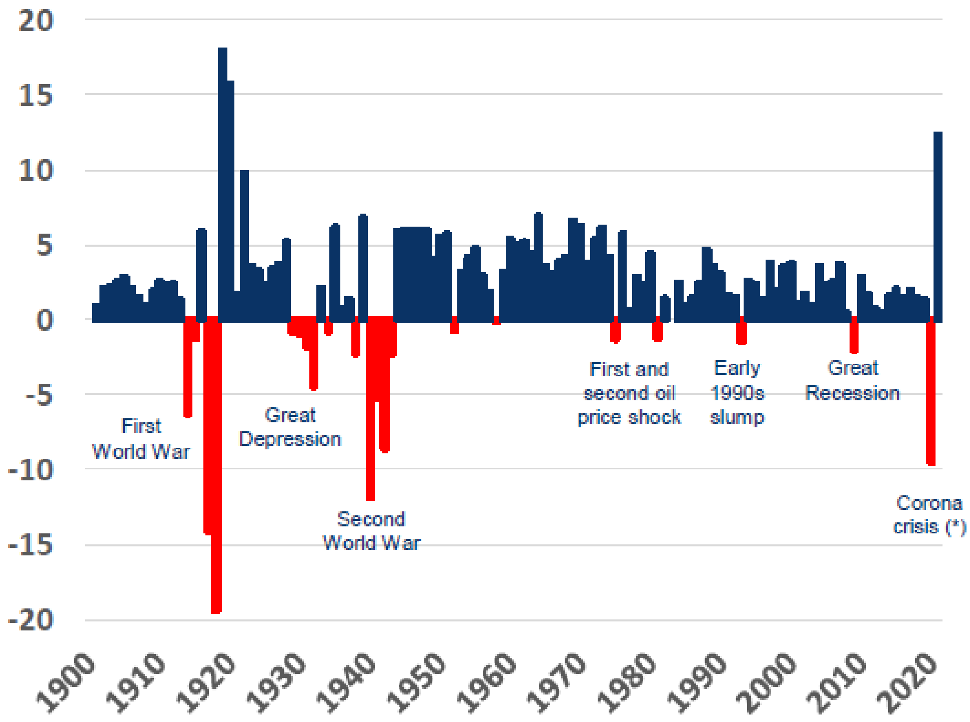
The corona crisis is taking a high human toll, but clearly also has a significant impact on the economy. In this article, we offer an update of KBC's economic outlook for the Belgian economy. We are aware that this numerical estimate, even more than in normal times, is uncertain. Nevertheless, we want to provide new economic insights. They take into account the latest developments in the spread and medical impact of the Covid-19 virus and policy responses to mitigate the impact on public health and the economy. In our analysis we take several possible scenarios for GDP growth into account: a base scenario and an optimistic and pessimistic scenario, which we currently assign a probability of 50%, 15% and 35% respectively. In a box added to the article, we also provide an estimate of the impact of the crisis on Belgium's public finances.

The past few weeks have been challenging for most Belgians, both personally and professionally. The Covid-19 pandemic and related lockdown measures have created such a severe shock that large parts of the Belgian economy had to be shut down. High frequency data, like the weekly survey of nearly 7,000 firms commissioned by the Economic Risk Management Group (ERMG), indeed point to an unprecedented collapse in sales. The retail sector and, in particular, the hotel and catering industry as well as the arts, entertainment and recreation sectors are heavily affected. Within these sectors, a majority of firms are using temporary unemployment for a huge proportion of their employees.

Growth to trough in Q2

Given the scale of disruption to economic activity, we expect a deep recession in the first half of the year. Q2 will undoubtedly be the worst quarter for Belgium's real GDP growth since World War II. More precisely, we expect a double-digit drop of GDP in the second quarter (-21.5% qoq), after already negative growth in the first quarter (-2.4% qoq). In our base scenario, that we currently assign a probability of 50%, we see a gradual removal of the lockdown measures from Q3 on. As a result, activity will pick up again in Q3 (+11.4% qoq) and Q4 (+17.0% qoq). This seems like a significant bounce but under this scenario real GDP at the end of 2020 will still be slightly below the level seen at the end of 2019. For the full year 2020, we expect the Belgian economy to contract by 9.5%, before growing by 12.3% in 2021. If this scenario comes true, the 2020 GDP drop will be by far the deepest one in Belgium's post-war history (figure 1).

Figure 1 - Belgian real GDP growth 1900-2021
annual data, in %



Source: KBC Economics
(*) KBC scenario

The risks to these forecasts are very much to the downside. The main uncertainty is how long the containment measures remain in place. If the virus spread continues until vaccination becomes available, we will likely have on-off lockdowns until then. This more pessimistic scenario, that we assign a probability of 35%, will feature an even deeper contraction of 13.2% in 2020, followed by another contraction of 3.2% in 2021. Although less likely (i.e. a probability of only 15%), there is also still the possibility that the virus spread gets quicker under control. In this case, the quarantine measures could be lifted faster, e.g. in combination with testing. In this more optimistic scenario, the economic damage will be less severe but still substantial, i.e. a contraction of 'only' 5.0% in 2020, followed by 6.0% growth in 2021.

Table 1 - KBC outlook Belgian economy (April 2020)

(in %, annual average for real GDP growth and inflation, end-of-year figures for the unemployment rate)

	Optimistic scenario			Base scenario			Pessimistic scenario		
	2019	2020	2021	2019	2020	2021	2019	2020	2021
Real GDP growth	1,4	-5,0	6,0	1,4	-9,5	12,3	1,4	-13,2	-3,2
Inflation	1,2	0,0	1,8	1,2	-0,7	2,2	1,2	-1,7	-2,2
Unemployment rate	5,3	5,9	5,8	5,3	6,2	5,8	5,3	10,0	12,0

Taking into account the GDP forecasts in our base scenario, we expect the Belgian unemployment rate to increase from 5.3% end 2019 to 6.2% end this year. That is a much smaller rise than would be indicated by the typical relationship between GDP and unemployment. The reason is that the surge in temporary unemployment will surely limit the ultimate increase in the effective unemployment rate. As long as businesses remain intact after the lockdown, workers that became temporarily unemployed should have jobs waiting for them. The biggest risk for the labour market therefore relates to bankruptcies of companies. The success of the massive policy response is therefore crucial. Significant fiscal effort will hopefully counter the economic fallout from Covid-19 but will also worsen Belgium's public finances substantially (see Box below).

We now expect inflation in Belgium to fall sharply and turn negative mainly on the back of extremely low oil prices. The oil price collapse will likely have a somewhat more downward impact on inflation in Belgium compared to the euro area, as Belgian inflation traditionally is quite sensitive to oil price developments. The broad-based slowdown in activity is also likely to exert downward pressure on core inflation. Nevertheless, inflation can be quite volatile in the course of 2020. It can still be relatively high in spring months, as there is indication that consumers were temporarily facing higher prices of food and other products due to a ban on supermarket promotions and discounts. On balance, we see Belgian inflation averaging at -0.7% in 2020. The development of house prices is expected to be negative as well (-3.0% in 2020), due to a decline in real household disposable income and a collapse in general sentiment (for more details, see article "Coronacrisis doet

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Belgische woningmarkt corrigeren maar niet crashen" in this edition of Bank- en Financiewezen).

Box - Brace for a large but temporary bounce in public deficit and debt

The policy response of the Belgian government to Covid-19 to date focused on targeted support measures to households and companies. The key objective is to protect both from the immediate impact of the shock by preserving jobs and incomes (mainly through the system of temporary unemployment), deferring taxes and supporting access to credit. Concerning the latter, Belgian financial institutions have undertaken to grant payment deferrals to those experiencing Covid-19 related repayment problems. To support this, the government will grant the banking sector a guarantee for a maximum of 50 bn EUR to cover any losses on new loans issued by the banks concerned.

A large part of the measures are not traditional stimulus but rather enhanced automatic stabilisers. The huge size of these stabilisers means the budgetary costs of the current crisis will ramp up much faster than in 'normal' recessions. The extent to which automatic stabilisers play a role can in practice be estimated by the change in the cyclical component of the budget balance. Based on KBC's GDP growth forecast in the base scenario and using the European Commission's method of cyclical adjustment, we expect the cyclical component of Belgium's budget to deteriorate to -6.2% of GDP in 2020, from +0.2% in 2019. However, the bulk of the cyclical impact is likely to prove temporary. As the economy recovers, the cyclical component will improve again to an estimated -0.3% of GDP in 2021.

Besides the cyclical component, the actual budget balance is also determined by temporary one-off measures and by the structural component. In the past few weeks, the government also took several Covid-19 related one-off measures, in particular focused on the immediate pandemic control and increased health-care expenditures. The cost of these measures are estimated at 0.5 to 1% of GDP. Unlike the cyclical component and one-off measures, the structural balance is not directly impacted by Covid-19. According to a report published by the Belgian Monitoring Committee on March 13, the structural deficit was at -11.2 bn EUR in 2019 (i.e. -2.4% in GDP). The Committee expects the structural deficit to worsen to -14.1 bn EUR in 2020. Expressed as a percentage of GDP, the structural deficit will be impacted by the crisis due to a (temporary) decline in the nominal GDP (the denominator of the deficit figure). Based on KBC's GDP growth and inflation forecast, we estimate the structural deficit to worsen to -3.3% of GDP in 2020. The Monitoring Committee does not project 2021 figures. Therefore, we rely on the European Commission's scenario for Belgium's structural deficit in 2021, i.e. a further worsening by 5.2 bn EUR (under a no policy change assumption).

Under the above assumptions, we estimate that Belgium's fiscal deficit will soar to -10.1% of GDP this year, from -2.0% in 2019. The 2020 public sector debt is set to climb to 118.8% of GDP, from 99.0% in 2019 (figures B1 and B2). 11.7 percentage points of the increase in the debt ratio in 2020 is due to a snowball effect and 8.0 percentage points due to the primary deficit. Risks to this scenario are firmly to the downside: e.g. there are no expected costs of the huge loan guarantees offered by the Belgian government factored in. On the positive side, public finances should improve again as the economy recovers. Therefore, a sharp drop is expected in 2021, both in the deficit and debt. Based on our base scenario for growth in 2021, we estimate the deficit and debt ratio to fall back to -4.2% respectively 109.0% of GDP that year.

Figure B1 - Government balance Belgium 1900-2021

% of GDP

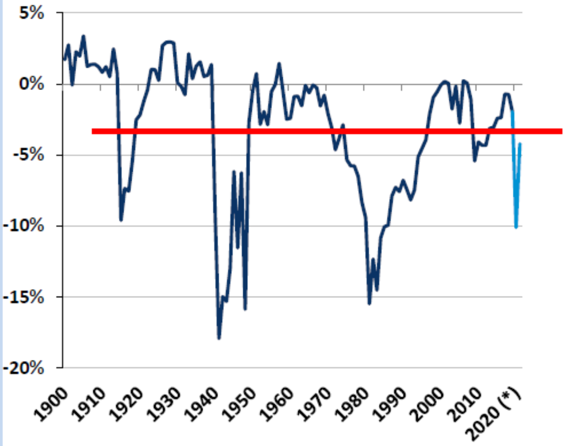
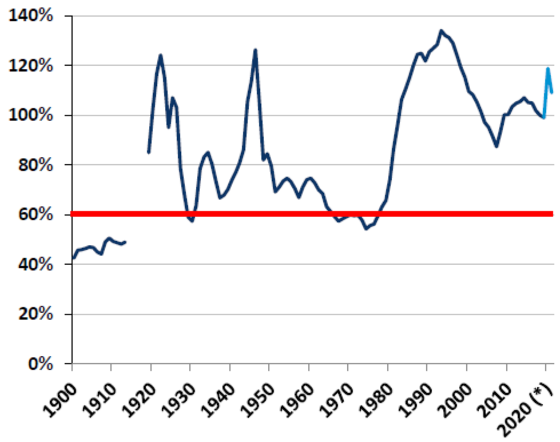


Figure B2 - Gross public debt Belgium 1900-2021

% of GDP



Source: KBC Economics

(*) 2020-2021: KBC scenario