Nothing comes for free in Belgium

Solid household consumption is keeping the Belgian economy afloat, but a loss of competitiveness accompanied by worsening public finances and political hurdles will likely weigh on future growth

Solid consumer spending

The sharp rise in energy prices through to autumn 2022 and fall in prices thereafter raised fears of a V-shaped recession, particularly for household consumption. This, however, was not the case in Belgium. On the contrary, household consumption remained very solid throughout the period, even when energy bills hit consumer budgets the hardest. Household consumption has actually remained the main driver of economic growth over the last four quarters, as shown in the first chart below. There are several reasons for this:

1 Labour market strength

First, the labour market remains very solid. Despite slowing economic growth in the last quarter of 2022, 75,000 jobs were created in 2022 and 11,500 in the first quarter of this year alone. Job creation has therefore become a key driver in supporting both household income and consumption.

Automatic wage indexation

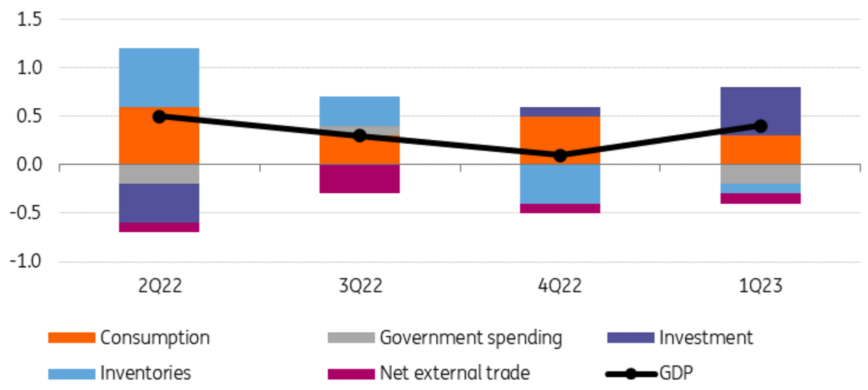
Second, automatic wage indexation has remained in place and has resulted in a nominal increase in wages of at least 10%. It should be noted that, depending on the sector, the indexation mechanism comes into play at different times. A large number of workers, for example, saw their nominal wages increase by more than 11% at the start of 2023. It should also be noted that indexation applies to pensions and all social benefits too.

3 Government support measures

Third, significant additional measures have been taken by the authorities to soften the impact of rising energy prices on household bills – including the first few months of 2023, when gas and electricity prices were falling sharply.

Consumption remains the main support for GDP growth

Quarterly GDP growth decomposition, demand side



Source: NBB, calculation: ING

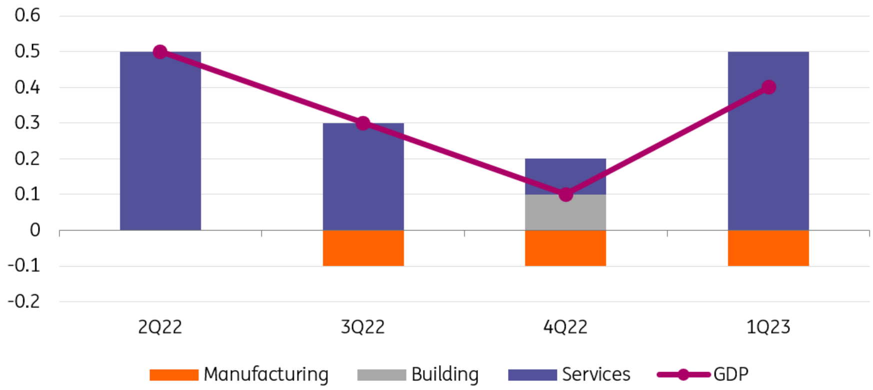
Firing on all cylinders? Not quite

In addition to household consumption, investment has remained volatile and has been impacted by a few large transactions in the shipbuilding industry. This largely explains the solid growth seen in the first quarter of this year. However, the contribution of net foreign trade to growth remains negative. This can be explained by imports holding up well on the back of solid domestic demand while the export sector is dealing with weak foreign demand and is also reflected on the supply side by the prolonged contraction in manufacturing activity (as detailed in the graph below). In short, the Belgian economy is not currently performing at its peak level. On the demand side, domestic demand alone is fuelling growth. On the supply side, only the services sector is still showing signs of growth as industry remains in recession.

We should also point out that the ECB's restrictive monetary policy is weighing on household investment in housing, which fell by no less than 4.2% year-on-year in the first quarter of 2023. Nevertheless, activity in the construction sector continues to grow (+2.2% in the first quarter of this year), thanks to other developments in conversion, non-residential buildings and infrastructure.

Manufacturing sector in recession

Quarterly GDP growth decomposition, supply side



Source: NBB, calculation: ING

Threat to competitiveness

The fact that the Belgian economy has a less volatile cycle than the eurozone average is nothing new. As we are currently seeing, growth is more resilient in periods of economic weakness. Unfortunately, this is also accompanied by a lack of vigour throughout periods of recovery. In addition to factors currently impacting the eurozone economy as a whole (weakness in global industry, restrictive monetary policy), two key concerns are mounting in Belgium's case. These concerns are nothing more than the other side of the coin of the elements currently underpinning the solidity of the Belgian economy, but they could have a negative and lasting impact on growth.

Firstly, economic developments in recent quarters have led to a loss of competitiveness for the Belgian economy. The automatic indexation of wages has meant that they have risen faster in Belgium than in neighbouring countries. Negotiated nominal wage increases this year could narrow the gap between these countries and Belgium, but they will not fully compensate for it.

While the strength of the labour market is a good thing for the economy and the improved financial health of households, it is also currently translating into a decline in productivity. On the one hand, there are negative productivity gains within certain sectors. This is particularly evident within the manufacturing sector, where employment grew by 0.8% between March 2022 and March this year, while the sector's value added fell by 2.4%.

On the other hand, we're seeing a composition effect on productivity. A large number of jobs are being created in low-productivity sectors (leisure, healthcare, public sector), while fewer jobs are being created in high-productivity sectors – some of which are even losing jobs (the financial sector, for example). Since productivity is an essential factor in the competitiveness of an economy, recent trends are jeopardising the Belgian export sector's ability to maintain its market share.

Ambitions scaled back

With just one year to go before the elections, coming up with clear and effective measures will likely prove a challenge

Secondly, while growth in activity is fuelling tax receipts, Belgian public finances continue to create problems. The measures taken to support households and businesses in recent years have weighed heavily on public finances and so far have not been offset. Given the deterioration in public finances, the government will have to take the first steps towards fiscal consolidation in order to comply with the requirements of the European Commission. However, with just one year to go before the elections and given that the coalition in place brings together parties that are opposed in socio-economic terms, coming up with clear and effective measures will likely prove a challenge.

Even so, we believe that consolidation will have to take place sooner or later. Most of the effort will probably be made after the elections and will follow the formation of a new majority, which is likely to weigh on the dynamics of the economy over the next few years.

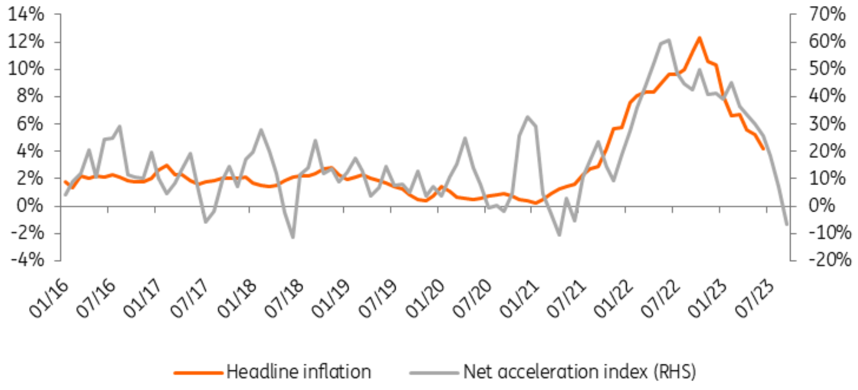
On top of this, the federal government had originally planned to carry out two major structural reforms (pensions and fiscal). Pension reform was agreed at the beginning of July, but political hurdles have greatly reduced the initial ambitions included in the final agreement. In a nutshell, there will be an incentive to keep employees at work longer, and at the same time, the highest additional pension schemes will be required to contribute more to the legal pension system. This should satisfy the European Commission, which requested certain measures before releasing funds from the Recovery and Resilience Facility (RRF).

This agreement is certainly not the major structural reform that was announced. Moreover, it's becoming increasingly clear that the tax reform will not be achieved. Instead, it will be left to the next legislature, which once again limits the ability of the current majority to put public finances back on a sustainable track.

Further decline in inflation story

Inflation peaked at 12.3% in October 2022, and fell back to 4.2% in June, thanks mainly to lower energy prices (gas bills down by almost 64% YoY, and electricity bills down by more than 29%). We're now also seeing signs of easing in other areas – and particularly for food products. Overall, our leading inflation indicator (Net Acceleration Inflation Index – see chart below) tends to show that inflation should continue to fall over the coming months. This indicator uses all the categories of goods and services that are included in the consumer price index in order to determine whether upward pressure on inflation is broad-based or not. In June, the proportion of the consumer price index in a deceleration phase now far exceeds the proportion in an acceleration phase, which is a strong sign that the bulk of the inflation wave is behind us.

Leading indicator shows further decline in inflation



Source: Statbel, computation: ING

The Belgian economy in a nutshell

Note: the net acceleration index is calculated as the share of the CPI with lower inflation in t compared to t-1 minus the share with higher inflation. The shares are calculated on the basis of the weights of each item in the index. The net acceleration indicator is then taken as a three-month moving average.

	2021	2022	2023F	2024F	2025F
GDP	6.3	3.2	1.0	0.7	1.4
Private consumption	5.5	4.1	2.1	0.7	1.2
Investment	5.1	-0.8	0.7	0.5	1.6
Government consumption	5	3.1	-0.5	1.0	1.6
Net trade contribution	0.7	0.4	-0.7	-0.2	0.0
Headline CPI	2.4	9.6	4.6	2.2	2.1
Unemployment rate (%)	6.3	5.6	5.9	5.8	5.7
Budget balance as % of GDP	-5.6	-3.9	-4.3	-4.9	-5
Government debt as % of GDP	109.2	103.2	102.6	104.8	107.5

Source: Refinitiv Datastream, National Bank of Belgium. All forecasts ING estimates

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