Belgium: Short-term resilience, medium-term challenges

The Belgian economy coped well with the inflation shock in 2022. Even if 2023 looks more difficult, a strong labour market should limit the damage. But in the medium term, the economy will not be able to ignore the challenges of competitiveness and public finances

Belgium's Prime Minister Alexander De Croo attends a panel at the World Economic Forum in Davos, Switzerland, Jan 2023

Source: Shutterstock

Resilience

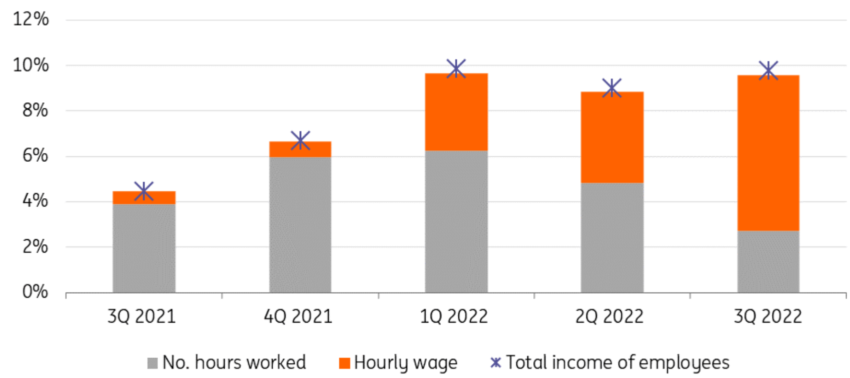
Torn between the post-Covid reopening of the economy and the negative effects of the war in Ukraine, the Belgian economy showed, like other eurozone economies, strong resilience to headwinds. For the year 2022 as a whole, GDP is expected to have grown by 3%, which puts last year's volume of activity around 3.5% above that of 2019, before the succession of negative shocks. It should be noted, however, that on the supply side of the economy, not all sectors have developed so positively: even though the figures for the fourth quarter are not yet available, it is highly likely that activity will have contracted (by around 0.3%) in the manufacturing sector in 2022. Growth is therefore essentially linked to services, and in particular to (retail) trade, which has benefited from the complete end of Covid restrictions.

Household income holds up

It may seem surprising that in the context of the war in Ukraine and the sharp rise in commodity and energy prices, the economy, and household consumption in particular, has shown such resilience. This is most likely linked to two factors: on the one hand, the labour market has put in one of its best performances in recent decades. Indeed, according to the latest available figures, some 100,000 jobs were created in 2022, which is exceptional for the Belgian economy. Even if these are not always fixed-term and full-time contracts, the volume of hours worked has increased (+2.7% year-on-year in the third quarter 2022). This has therefore contributed to an increase in household disposable income. On the other hand, the automatic indexation of income (wages, pensions, social benefits, etc.), itself linked to the evolution of prices, has pushed income upwards, which has enabled households to cope with the energy price shock, especially as many additional measures have been taken to mitigate its effects. These two elements combined have allowed household disposable income to rise by more than 7% in 2022, or by almost €25 billion. Consequently, despite the sharp rise in prices, households have not had to reduce their savings rate (this stood at 13.6% in the third quarter of 2022, whereas it did not exceed 12.0% on average over the three years prior to the start of the Covid), while increasing the total volume of consumption.

Recent growth in compensation of employees (YoY)

This has been driven by an increase in hours worked, but more by the nominal increase in hourly wages in 2022



Source: Statbel, NBB, computation: ING

Slight recession

However, it is undeniable that the pace of growth slowed during the year. As mentioned above, activity even contracted in the manufacturing sector. Household and business confidence have recovered somewhat in recent months, but household confidence remains very low. On the labour market, there has also been some deterioration: although temporary unemployment (which can be used by companies that are suffering too much from the rise in energy prices) has returned to its normal level, there has been a deterioration in activity in the temporary employment sector (it has fallen by more than 11% YoY in November 2022). The number of job seekers is also up by 5% over the same period.

As elsewhere, the slowdown in activity should be less pronounced than we anticipated a few months ago, thanks of course to the fall in energy prices. This is all the more true as the measures taken to combat the rise in energy bills for households will be maintained in the coming months. The manufacturing sector should also benefit from the fall in energy prices and make a positive contribution to growth.

Slow recovery...

Barring a sharp rise in energy prices similar to that seen in the summer of 2022, a slow recovery of the Belgian economy is likely to take shape in the course of the year. However, this will initially be hampered by more restrictive financing conditions for the economy, due to the rapid and significant increases in European Central Bank interest rates. This could weigh on construction activity in particular. Indeed, there is already a clear cooling of the housing market, with mortgage lending down by almost 25%. In addition, job creation is likely to slow down significantly this year, which will limit the growth of real household income, and therefore consumption.

... and inflation down, but still high

In 2022, inflation reached almost 10%. This is quite exceptional. Of course, the direct impact of rising energy prices is largely responsible for this figure. But we should not forget that in December last year, more than 70% of the prices of goods and services included in the consumer price index had risen by at least 5% over the previous 12 months. The indirect effects of rising energy, commodity and labour costs have thus played an important role in the inflation dynamics.

Thanks to the recent fall in energy prices, inflation has started to decline. It should continue to fall in the coming months, although this will probably be hampered by the desire of many companies to try to pass on the recent increases in labour costs to their sales prices. Indeed, around 500,000 workers will see their wages indexed by over 11% from this month. This is good for household income but represents a significant cost for the companies concerned.

Competitiveness and public finances, problems for tomorrow

In the end, therefore, despite the multiple shocks impacting the Belgian economy, it should get through the turbulent period without too much damage. This is at least the case at first sight. However, the shocks and the measures taken to deal with them will leave their mark. In other words, the legacy of multiple crises over recent years will continue to be felt.

On the one hand, it is known that the automatic indexation of wages is largely responsible for the increase in households' disposable income, and thus their ability to cope with the increase in energy bills. But it is also an equivalent cost for companies. Therefore, if wage growth (and therefore labour costs) does not reach an equivalent level in Belgium's trading partners, Belgium will lose competitiveness. As the inflation wave is huge, the wage cost differentials could be substantial. This may ultimately affect the economic recovery, in terms of jobs or income, if no measures were to be taken to correct the excessive wage handicap.

On the other hand, it should be noted that the state has borne the brunt of past shocks. For example, between March 2020 and the end of 2022, more than €6 billion of additional temporary unemployment benefits were paid to counter the loss of activity linked to the shocks (mainly the Covid crisis). To this must be added aid to businesses, aid to households for energy bills (tax cuts, lump sum cheques, etc.), as well as indexation of civil servants' salaries and social benefits. In the end, the budget deficit has struggled to fall since 2020, and should still approach 5% of GDP in 2022 and 2023. It should also be added that the level of interest rates on the markets is now higher than the average financing rate of the existing debt, and the replacement of maturing debt will tend to increase the latter.

No major corrective measures are currently being put in place, while the prospect of federal and regional elections in 2024 will make it increasingly difficult for the parties in the broad governing coalition to reach agreement. For the same reasons, the much-needed structural measures to reform the labour market and the pension system are also in jeopardy.

The health of public finances is likely to be a drag on the economy sooner or later. Corrective measures will inevitably include tax increases or spending cuts. The question is when the pressure will be felt to take these corrective measures. This may come from the new European fiscal rules under discussion, or from a loss of creditor confidence in the financial markets. The former may still take some time to be decided, while the latter is unpredictable.

The Belgian economy in a nutshell (% YoY)

	2021	2022F	2023F	2024F
GDP	6.1	3.0	0.2	1.0
Private consumption	5.5	3.9	0.5	1.1
Investment	4.9	-1.4	-0.8	1.4
Government consumption	4.8	-0.4	1.6	1.8
Net trade contribution	0.7	0.4	-0.2	-0.2
Headline CPI	2.4	9.6	5.8	2.1
Unemployment rate (%))	6.3	5.5	5.8	6.0
Budget balance as % of GDP	-5.6	-5.5	-5.1	-5.3
Government debt as % of GDP	109.2	103.8	104.6	106.9

Source: Thomson Reuters, all forecasts ING estimates

Author

Philippe Ledent
Senior Economist, Belgium, Luxembourg
philippe.ledent@ing.com