# Belgium: Who will pay the inflation bill?

The strong inflation wave is partly being cushioned by the automatic indexation of many incomes, at the price of a deterioration of competitiveness and public finances. It will also not prevent an economic slowdown

Belgian Prime Minister Alexander De Croo

## Satisfactory start to the year...

In the first quarter of this year, the Belgian economy again recorded positive growth of 0.5% compared to the previous quarter. This relatively good performance is due to household consumption (+0.5% quarter-on-quarter) and business investment (+2.7%). But it must be said that the change in inventories also contributed half a point of growth. On the other hand, public spending contracted sharply. On the supply side, most sectors contributed positively to activity, with the notable exception of the manufacturing sector, where activity contracted by 0.7%. The difficulties encountered in supply chains partly explain this disappointing development.

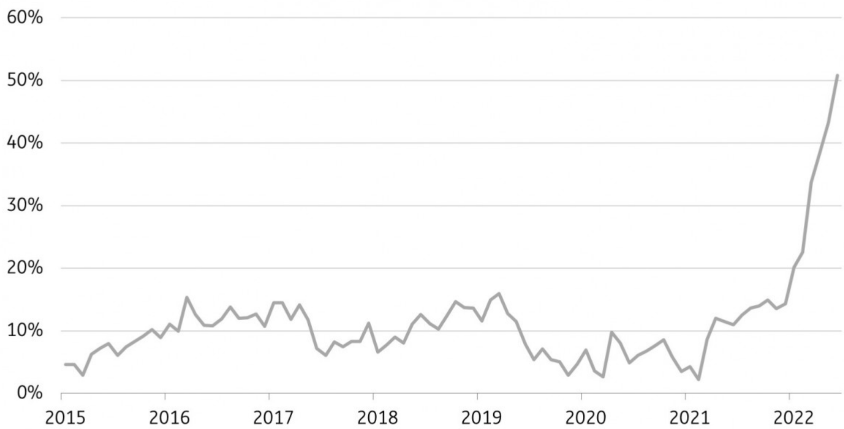
The recovery of 2021, which continued into 2022, still led to the net creation of more than 22,000 jobs in the first quarter, which is still very dynamic. As a result, the unemployment rate remains very low (5.6%).

## … but inflation complicates the situation

That being said, the economic context has become much gloomier in recent months: the supply chain problems are not getting any better due to the strong slowdown in China. And the war in Ukraine has lowered consumer confidence and prolonged and amplified the wave of inflation that began in 2021.

In June, inflation reached 10.5% according to Eurostat's harmonised definition. The contribution of energy prices to inflation remains by far the most important, but it is tending to stabilise. On the other hand, inflation initially driven by energy prices is increasingly spreading throughout the economy, affecting the vast majority of products and services. In June, half of the consumer price index was up by more than 5% over one year (graph 1) and almost 90% of the index is up by more than 2%. It seems, therefore, that increases in commodity prices (including energy), transport costs, and wage costs are now leading to a general rise in prices. Such a development is not likely to disappear quickly. We expect that, under our energy price assumptions, inflation will still be close to 7% at the end of the year, and remain above 2% throughout next year.

## Share of consumer price index that increased more than 5% over the past 12 months




Source: Statbel, ING

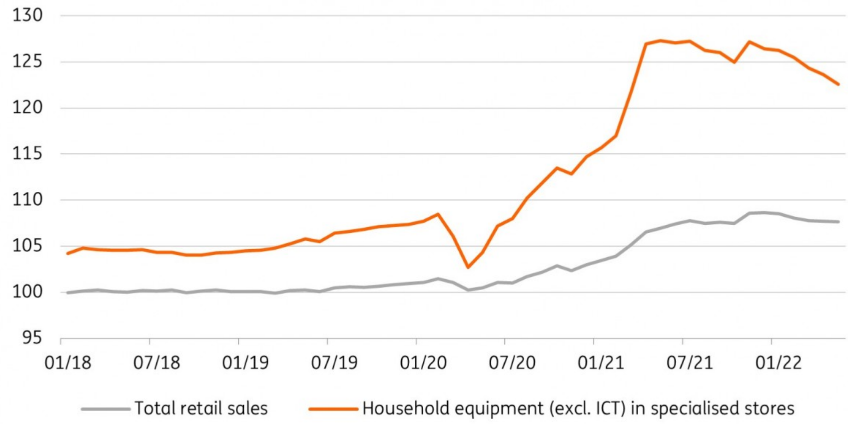
## Indexation protects the consumer, but only partially

Even if it is the direct consequence of external shocks, such a wave of inflation also becomes a shock for the economy. It will therefore not be without consequences. The difficulty lies in knowing who will be the main victim.

Belgium differs from most other countries in that an automatic indexation system exists for most incomes: wages in the private and public sectors, pensions, and all social benefits. Thus, according to the National Bank, households' real disposable income is expected to increase slightly in Belgium this year, whereas in the eurozone it is expected to contract by almost 1%. However, the indexation system does not perfectly protect households from all price increases. On the one hand, some prices (transport fuel, alcohol and tobacco) are excluded from the index used to calculate the indexation. On the other hand, some incomes are indexed with a delay (sometimes almost a year) on the evolution of prices. Purchasing power can therefore be affected, at least temporarily.

It is therefore not surprising that, despite the automatic indexation of incomes and the measures taken by governments to counter the rise in energy prices, retail sales are stagnating in real terms, and some of their components are even declining (graph 2). For the second half of the year, we expect continued high energy prices and the uncertain geopolitical context to dampen consumer spending further, especially on durable goods.

## Retail sales (in real terms) seem to be affected by the higher energy bill (2015 = 100)




## Competitiveness problem

So far, business sentiment has been more resilient to the shocks of this year. This is probably because many companies still believe that they will be able to pass on higher production costs (including labour costs) to their selling prices. However, the slowdown in demand that we expect may change their minds. Moreover, companies will increasingly face the problem of competitiveness. Indeed, the automatic indexation of wages should cause an increase in hourly wage costs of 5.5% this year and more than 6% in 2023, compared to +3% (2022) and +4% (2023) on average in the three neighbouring countries (France, Germany and the Netherlands). This very sharp rise means that companies are in fact bearing a large part of the inflation wave. The resulting loss of competitiveness is likely to weigh on economic activity and employment.

## Public finances are a problem

Governments have already taken action to address the sharp rise in energy prices, notably by lowering VAT on electricity and gas. Many households also benefit from a preferential rate on their energy bill. A €225 voucher has also been given to households heating with fuel. A new package of measures could be introduced in the next few months, as the federal government has commissioned a group of experts to make proposals on the subject.

That said, all these measures have a cost that comes on top of public finances that have already been severely eroded in recent years. If we add to this the fact that the political parties forming the federal government majority are struggling to agree on important structural reforms (pensions, tax reform), a clear improvement in the public deficit seems difficult to imagine in the near future.

Faced with the very high inflation wave that the Belgian economy is experiencing, households are probably less exposed than in other countries to the deterioration in purchasing power. Through automatic wage indexation, companies partly compensate for the rise in prices for employees, but at the cost of a deterioration in their competitiveness. Public finances are also taking their share of the burden, through the indexation of pensions and social benefits, but also through the measures taken to counter the rise in energy prices. This is good for households, but it should not be forgotten that, in the end, companies and public finances also have an impact on the financial health of households, via employment or future tax increases.

## The Belgian economy in a nutshell

| (% YoY) | 2020 | 2021 | 2022F | 2023F | 2024F |
|---|---|---|---|---|---|
| **Demand and output** | | | | | |
| GDP | -5.7 | 6.2 | 2.2 | 0.5 | 1.5 |
| Private consumption | -8.2 | 6.4 | 3.4 | 0.4 | 1.7 |
| Investment | -6.1 | 7.8 | 0.2 | 1.7 | 1.5 |
| Government spending | -0.4 | 4.4 | 1.7 | 2.0 | 1.8 |
| Net trade contribution (% points of contribution to GDP) | 0.4 | 0.6 | -0.2 | -0.1 | -0.6 |
| **Labour market** | | | | | |
| Employment net variation | 0.0 | 1.7 | 1.5 | 0.3 | 1.3 |
| Unemployment rate (%, Eurostat) | 5.8 | 6.3 | 5.5 | 5.4 | 5.4 |
| **Government finances** | | | | | |
| Budget balance as a % of GDP | -9.0 | -5.5 | -5.2 | -4.9 | -4.7 |
| Government debt as a % of GDP | 112.8 | 108.2 | 106.0 | 105.9 | 106.8 |
| **Prices** | | | | | |
| Inflation | 0.7 | 2.4 | 8.4 | 4.1 | 2.1 |

Source: Refinitiv Datastream, ING computation

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