2010-12-06

PRESS RELEASE

The inflation gap between Belgium and the three main neighbouring countries and likely repercussions on competitiveness

(Article published in the Economic Review, December 2010)

In a monetary union, divergences of inflation rates between the participating countries have direct repercussions on their price and cost competitiveness. Bearing this in mind, this article looks at the implications of inflation differentials within the euro area and shows that participation in the monetary union can only succeed if the Member States pay sufficient attention to changes in their competitive position. That is one of the reasons why the Van Rompuy Task Force put together a new framework for macroeconomic surveillance, which was approved by the European Council at the end of October 2010.

The article then goes onto discuss more specifically the institutional framework for monitoring competitiveness in Belgium and raises the question of whether it is still advisable to focus chiefly on the three main neighbouring countries, as is currently the case, rather than on the euro area as a whole. Since the answer to this question is in the affirmative, the final part analyses the inflation gap with these countries.

Several indicators show that, since the inception of European monetary union, Belgium has managed to maintain its price- and cost-competitiveness in relation to the euro area. Some deterioration in its competitive position vis-à-vis the three neighbouring countries has nevertheless been observed, and more particularly in comparison to Germany. Meanwhile, against a backdrop of a severe recession, a correction of previously accumulated competitive handicaps is underway, and most notably in Ireland, Spain and Portugal. This means that Belgium has less scope for allowing its competitive position to deviate from that of its three neighbours if it is to consolidate its position in relation to the euro area. On the other hand, it is highly unlikely that Germany will continue to boost its competitive edge at the same pace.

The article also confirms the Central Economic Council's findings concerning the competitive disadvantage in terms of hourly labour costs in the private sector that has built up in Belgium since 1996 by comparison to the three main neighbouring countries. The repercussions of this handicap have been further compounded by less favourable productivity trends. The end result is a cumulative positive inflation gap with those countries of around 5 percentage points since 1996, a difference that is in fact primarily attributable to faster growth of unit labour costs, while the contribution of energy price developments has on the whole been neutral over this period. However, in 2008 and again in 2010, energy products clearly contributed positively to the inflation differential, as did foodstuffs, indicating that fluctuations in commodity prices cause more pronounced first-round effects. In this context, the rise in the health index has recently accelerated sharply, to 2.6% in October and 2.5% in November, which enhances the risk of second-round effects. This is a major challenge for safeguarding the country's competitive edge and yet this is absolutely essential.

In this context, particular vigilance is called for on two fronts. On the one hand, attention needs to be paid to the extent of the first-round effects that commodity price changes can have on inflation. The Price Observatory, the Commission for Electricity and Gas Regulation (CREG) and the Competition Council have an important role to play here. As well as food price developments, several recent studies by the Bank suggest that, as far as energy is concerned, attention needs to be focused primarily on natural gas and electricity. For these energy products, raw material price changes feed through to the consumer very quickly through the monthly index-linked pricing formulas used in Belgium – a practice that is not currently used in any of the three neighbouring countries – and, furthermore, it is impossible to tell from publicly available data whether these pricing formulas do actually offer a true reflection of trends in costs. On the other hand, it is important for the social partners to internalise all possible effects of wage indexation and arrive at nominal pay rises that will preserve Belgium's competitive position in accordance with the 1996 Law on the promotion of employment and the preventive safeguarding of competitiveness. In the longer term, a reduction in the energy intensity of Belgium's consumption profile would also help to keep price and cost developments under control.

Communication
National Bank of Belgium Ltd.
boulevard de Berlaimont 14
1000 Brussels
phone + 32 2 221 46 28
www.nbb.be
Company's number:
0203.201.340 – RLP Brussels