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PRESS RELEASE

Developments in private consumption over the past three years
(Article for the September 2011 Economic Review)

Belgium weathered the 2008-2009 recession relatively well compared to the euro area as a whole and most of its constituent economies. Against that backdrop, this article looks at the interactions between the general economic situation and household consumption expenditure during the recession and the recent recovery phase. Private consumption is actually supposed to play a stabilising role in regard to cyclical fluctuations, but this time the shocks affecting activity and employment, financial assets and confidence were so severe that household spending may have suffered.

The pattern of private consumption has, in general, closely mirrored that of economic activity. Thus, the share of private consumption expenditure in a country's GDP remains relatively stable. In times of recession, private consumption expenditure tends to decline to a lesser degree than general economic activity. First, disposable income shows some resilience during recessions, mainly because of the time lag for employment to react to fluctuations in economic activity, and because of social transfer mechanisms. In addition, fluctuations in current disposable income, both upwards and downwards, usually cause the savings ratio to move in the same direction, which has the effect of smoothing household consumption over time. Unless they face budget constraints, households do not determine their level of consumption solely according to their current income, but also take account of future income or the value of their assets.

During the recent crisis, households curbed their consumption expenditure from the final quarter of 2008 and the first quarter of 2009, cutting it by a cumulative 1.3%. It was mainly spending on clothing and on hotels and restaurants that fell significantly. The decline in consumption was due largely to the increase in the savings ratio, from around 16% of disposable income during the previous three years to almost 19% by early 2009. At that time, real disposable income was still rising, thanks to a still sustained increase in wages, as well as measures which temporarily reduced private income tax. These effects played in opposite directions in 2010, but the sluggish evolution of purchasing power that resulted was offset by a drop in the savings ratio, thereby allowing a moderate recovery in consumption. Both consumption and employment have held up well over the last three years.

The Bank's econometric model reveals the avenues through which the crisis had a negative impact on household consumption. In the first phase of the recession, the collapse of share prices more or less worldwide considerably eroded the value of financial assets. Despite the theoretically limited significance of financial wealth in determining household consumption in Belgium (the so-called wealth effect), the intensity of the shock was so great that the impact on consumption expenditure was unusual. The rapidly mounting uncertainty and the deterioration in the general macroeconomic environment and the outlook also undermined consumer confidence, prompting a drop in consumption expenditure and an increase in savings. These braking effects gradually faded over the course of 2009 and 2010.

All in all, the fall in private consumption expenditure in Belgium turned out to be limited in the recent crisis, especially considering the then plummeting economic activity and in comparison with other countries. If consumption is to continue to play a stabilising role in the face of fluctuations in economic activity, it is crucial to maintain an economic context free of serious imbalances - whether in terms of the actual financial situation of the various sectors or in terms of overall competitiveness of the economy - in which agents can form their expectations without excessive uncertainty. In particular, though it was smaller than in most other European countries, the large increase in the public debt between 2007 and 2010 must rapidly give way to consolidation to restore the debt to a path which is sustainable in the long term. Otherwise, there is a risk that consumers, aware of the intertemporal budget constraint that governments must also respect - will rapidly step up their savings ratio, in anticipation of the future effort that will be needed in terms of higher taxes or cuts in government transfers.

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