2015-09-22

PRESS RELEASE

Corporate profit margins: recent developments in a context of low inflation
(Article for the September 2015 Economic Review)

Firms which are sufficiently profitable stand up better to fluctuating economic conditions and are more inclined to invest. However, since the 2008-2009 crisis the profit margins of Belgian firms have exhibited a marked decline which has been widespread, affecting almost all branches of activity. The decline has been slightly greater in industry than in market services, particularly if account is taken of the expenditure necessary in the future to replace and modernise production facilities, which are tending to depreciate ever more rapidly. The profitability of large firms has been eroded more significantly than that of SMEs, but it had improved more strongly before the crisis. The movement in the profit margin of firms in Belgium has been no different from that evident in neighbouring countries.

It is mainly cyclical factors that explain the fall in profit margins since the crisis, whereas those margins had risen considerably during the pre-crisis period. In industry the adverse trend in relative prices is putting structural pressure on profit margins in a context of ever fiercer global competition in manufactured goods. However, the steady rise in labour productivity in volume, clearly outpacing real wage growth makes it possible to maintain a reasonable margin. Firms in market services, which are less exposed to international competition, are suffering from very inadequate productivity growth, while until recently their labour costs were still rising quite steeply. For firms active in this branch, it is essentially their ability to charge high selling prices that enables them to preserve a comfortable profit margin. Ultimately, other factors such as the development of e-commerce, may also influence profit margins in the service sector.

There appears to be a close correlation between the movement in margins and the trend in economic activity, as firms tend to increase their margins when economic activity is buoyant and reduce them when activity loses momentum.

The link between margins and the relatively stable price situation in Belgium seems more tenuous, though price movements do comprise some highly cyclical components. However, when economic activity weakens, unit margins are probably used as a buffer to offset, in the short term, unit labour cost increases resulting from declining productivity. The margins thus absorb shocks when the economy is doing less well, thereby moderating the general movement in prices. One explanation for this could be the existence of price rigidities, especially in the services. When economic activity picks up, the opposite happens and operating margins rapidly increase. The decline in inflation in recent times occurred despite the slight upward pressure on prices exerted by increasing margins.

The role of corporate profit margins as a buffer absorbing unit labour cost shocks is not specific to Belgium but has been likewise apparent in neighbouring countries in the recent period. Conversely, southern European countries have recorded steady margin growth even during the crisis; in these countries, the adjustment to the low price environment has occured mainly through wages.

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