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PRESS RELEASE

Inflation in services: the Belgian exception

(Article for the June Economic Review)

The article sets out the main results of the report on inflation in services commissioned by the Minister of the Economy from a working group formed by the FPS Economy (Price Observatory and Directorate General Statistics - Statistics Belgium), the National Bank and the Federal Planning Bureau, under the aegis of the National Accounts Institute.

Since mid-2015, a positive inflation gap has appeared between Belgium and its three main neighbouring countries. In contrast to previous episodes when energy was the primary cause, the size of the gap was due mainly to services prices. Since 2009, the services category has systematically contributed to the inflation gap, thus determining the subsequent choice of the analysis period: up to 2016, the average annual growth of services prices came to 2.2% in Belgium, compared to 1.4% in the neighbouring countries.

A detailed breakdown of services reveals that, each year, the “restaurants and cafés” component has made a big contribution to the inflation gap in services between Belgium and the neighbouring countries. The “telecommunications” component also made a clearly positive contribution in 2011, 2012 and 2016. In certain years, some other services have also influenced the gap considerably, on account of specific government measures; instances include medical services (e.g. harmonisation of user charges in 2015) and education (increase in higher education enrolment fees in the Flemish Community, the impact of which was mainly apparent in 2016).

The movement in services prices can be linked to the trend in the economy by means of Phillips curves. This type of analysis of the macroeconomic variables shows a disconnect between those variables and services inflation since 2014. That is borne out by the apparent absence of any impact on prices of the wage moderation imposed in recent years. Moreover, the study shows that much of the inflation in services originates from government measures concerning prices. First, some prices may be directly set or influenced by the government, be it at federal, regional, community or local level. Since 2012, inflation in regulated services in Belgium has accelerated, whereas it has slowed down in the main neighbouring countries. On average, it represented more than half of the inflation gap in services between 2012 and 2016. Next, adjustments to the prices of certain public services are linked to a price index via a formal indexation mechanism defined notably in the service providers’ management contracts. These mechanisms contribute to the persistence of services inflation. However, this form of regulation has made only a limited contribution to service inflation in Belgium. In fact, it has been factors other than actual indexation that have caused the acceleration of inflation in certain services categorised as indexed.

Macroeconomic determinants cannot account entirely for the movement in unregulated service prices either. That raises the question of the competitive environment in which the service providers operate. In that regard, there are several indicators for assessing the market operating conditions. For instance, the OECD indicators reveal an unfavourable position in telecommunications services in Belgium. Analysis of the annual accounts of firms in the “information and communication” sector reveals relatively high – and in Belgium, fairly stable – profitability, whereas net margins in the hotels and catering sector are very low (in Belgium and in neighbouring countries). However, high profitability cannot be automatically attributed to a lack of competition. Another source, the horizontal screening conducted annually by the Price Observatory on the basis of eight market operation indicators also identifies the activities presenting a higher risk of market dysfunction. A number of network service sectors such as telecommunications are found there.

For the purpose of the working group’s assignment, the FPS Economy conducted a detailed analysis of the two branches which are most “problematic” from the point of view of the movement in services prices: restaurants and cafés, and telecommunications.

The steeper price increase in restaurants and cafés in Belgium compared to the three main neighbouring countries between 2009 and 2016 is attributable partly to the adverse movement in the prices of their two main cost items, namely the purchase cost of food and beverages, and wage costs. It is also assumed that the mandatory introduction of certified electronic cash registers in 2016 is having an impact on consumer prices, to make up for the lost margins. However, a more favourable trend is expected in cafés, with the end of the binding brewery contracts.

On average over the period 2009-2016, the decline in telecommunications prices was significantly smaller in Belgium than in the neighbouring countries. Most of the inflation gap recorded in 2016 is attributable to the rise in telecom pack prices. While the divergences here cannot be explained by the movement in supply costs for the branch, other factors are suggested, such as the cost of investment by operators in Belgium, and weak competition on certain market segments. However, the opening up of the cable operators' network and the Easy Switch rules intended to assist consumers in choosing the best offer should help to stimulate competition and – after a time – should influence prices.

Regular monitoring of services inflation, finding the right balance in market regulation – so as to ensure that the benefits exceed the costs of regulation– and increasing the visibility of pricing mechanisms are among the measures that might be recommended here.