

NBB Business Echo

December 2023

Economic activity may decelerate slightly with some tentative signs of an improvement early next year

- The general indication from the interviews for this issue of the NBB Business Echo is that current economic conditions are challenging, despite remarkably robust GDP growth in the first three quarters of 2023. Uncertainty remains high and the final months of the year could see a slight slowdown in activity although a decline in the fourth quarter still seems very unlikely. Many respondents also pointed to tentative signs of improvement in early 2024.
- Companies reported that rising wage costs were the main source of price pressures in recent quarters. While prices for many inputs have fallen, energy prices remain quite volatile. Structural supply chain issues have largely been resolved. Sales prices have followed a muted trend recently, with often only partial pass-through of higher costs.
- Most companies either retained or grew their permanent workforce in the fourth quarter, with the outlook for the next quarter remaining broadly unchanged. Structural labour market tightness means Belgian firms are hesitant to lay off employees, with labour shortages for certain positions posing challenges to business continuity.
- Despite pressure on margins and a deteriorated external (financing) environment, investment plans remain largely unaffected. Financing conditions have been tightened but are still seen as reasonable compared with the past; access to sufficient internal or intra-group liquidity is often tempering the impact of more constrained credit conditions. Firms are stepping up productivity-enhancing investment in automation and digitalisation in view of higher wage costs and labour shortages, while continuing to invest in new products and the greening of production processes.
- The divergence between activity in the manufacturing and services industries is narrowing. Manufacturing fundamentals remain weak but the near-term outlook is said to be stabilising, with some interviewees noting tentative signs of improvement ahead. This broadly echoes the recent stabilisation in demand expectations in the manufacturing industry recorded by the NBB's monthly business survey. At the same time, conditions in the services industries, which account for the bulk of Belgian economic activity, seem to have deteriorated somewhat, in particular for consumer-oriented services.
- Business confidence has declined less in the Walloon Region than in other regions. Interviewees noted that government demand accounted for a relatively larger share of their sales, helping to stabilise revenue streams, even in challenging business condition. This could in part explain this greater resilience.

The NBB Business Echo is a qualitative, production-side assessment of the current economic situation in Belgium. It is based on a combination of information gathered from, among other sources, targeted interviews with business leaders across Belgian Regions and industries and the NBB's monthly business survey. The latter allows analysis based on a representative sample, while the Business Echo interviews provide additional information on dynamics and context that cannot always be captured by standardised surveys. This issue was based on 40 interviews carried out between 16 October and 15 November 2023. The NBB Business Echo supports our macroeconomic analysis and is an important input for the [Business Cycle Monitor](#), which provides a quantitative estimate of quarterly growth and is typically published shortly afterwards.

Inflation is expected to ease gradually, with businesses continuing to invest despite challenging economic conditions

The general indication from the interviews conducted for this issue of Business Echo is that economic conditions remain challenging, with high levels of uncertainty clouding the short-term outlook. Businesses reported that activity growth had weakened, on average, in the fourth quarter of 2023 but that they expected a levelling off or slight improvement in the first quarter of 2024. Many stressed that the outlook, even for the near term, remained highly uncertain. Their assessment of the current quarter is broadly in line with developments in producer sentiment, as measured by the NBB's monthly business survey. Headline business confidence worsened in the second quarter of 2023, after a tentative recovery in the first quarter and only bottomed out over the summer. The most recent data show some volatility, with a decline in October offset by an improvement in November. It should be stressed that, despite softening business sentiment, the quarterly GDP statistics showed buoyant growth for the first three quarters of 2023.

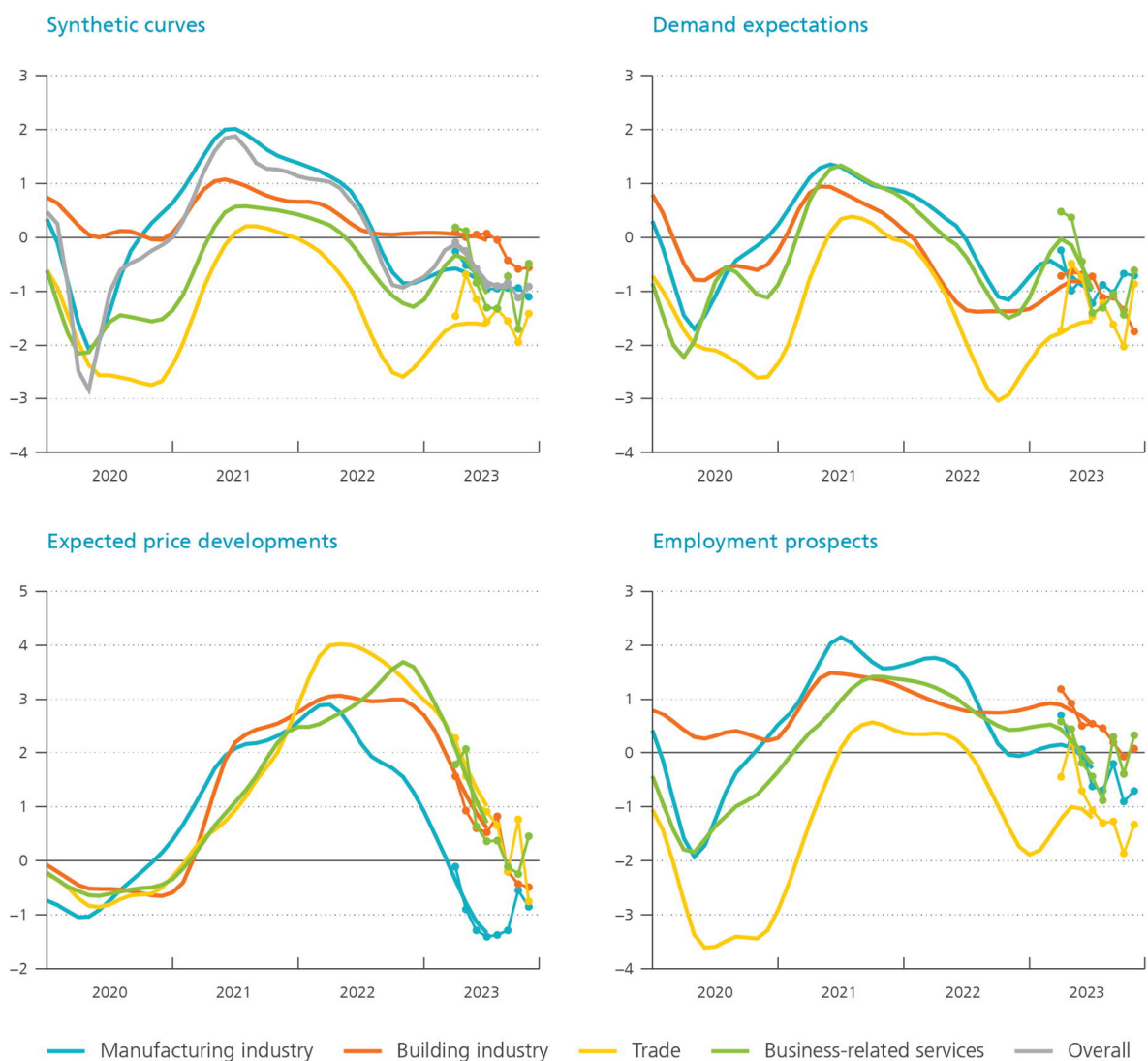
Inflationary pressures are expected to continue easing gradually. Respondents frequently referred to rising wage costs as the main driver of price pressures over the past year. Many other input costs have since fallen, although energy prices remain quite volatile. The spike in the price of oil and its derivatives in early autumn tempered the ongoing decline in input prices for many (energy-intensive) businesses. Structural supply chain issues have been resolved, according to most interviewees, although a small number of businesses pointed to certain persistent issues with deliveries. Most firms have had to make operational adjustments to accommodate a “new normal” marked by interruptions or even stoppages in deliveries of certain specific (niche) inputs with low margins for their suppliers. Overall, the expectations are that trends in input prices will continue to stabilise into the first quarter of 2024, and wage cost pressures will continue to ease, although the speed with which they should return to normal may differ based on sector-specific indexation mechanisms. The recent trend in sales prices has been muted, with often only a partial pass-through of higher costs. Most firms expect sales prices to remain broadly stable in the near future, with many business leaders indicating that profit margins are currently serving as a temporary buffer. This could lend some credence to the expectation that inflation will continue to decline. For the most part, respondents indicated that raising sales prices has become much more challenging compared with last year given weaker economic conditions. However, the responses were quite heterogeneous: firms in the services industries, where demand has remained robust, often have stronger pricing power, while sales prices are expected to (continue to) decrease in some hard-hit industries, such as construction. Signs of further disinflation can also be seen in the NBB's monthly business survey: higher oil prices have, to some extent, pushed up price expectations in the manufacturing industry and business-related services, but expected price developments are still clearly muted in other industries, especially when compared with the recent past (see the bottom-left chart in Figure 1).

Companies overwhelmingly reported no scaling back of their investment plans despite margin pressures and tighter external financing conditions, with the latter still considered reasonable compared with the past. Only a few respondents perceived current credit conditions as restrictive. As noted in the June 2023 issue of Business Echo, some firms noticed banks adopting a more conservative approach to lending; however, banking industry representatives report that, to date, their credit standards have not been changed, with the exception of those applicable to real estate developers. The impact of tighter external financing conditions has been tempered by the possibility for many companies – particularly larger ones, which account for the bulk of investment – to access sufficient internal or intra-group liquidity. Macroeconomic statistics indicate that many firms currently have large cash balances (see e.g. [Piette and Tielens, 2023](#)). With regard to the type of investments being made, most firms are adopting a prudent approach to the expansion of production capacity in Belgium due in part to the fact that they consider the country's growth potential to be limited. Some reported that the conditions and opportunities for expansion through acquisitions have improved owing to lower valuations and recent deterioration of the business climate. Nevertheless, it is notable that nearly all firms are targeting productivity-enhancing investments in digitalisation and automation, often driven by (intra-group) competitiveness issues due to recent large nominal wage increases and a structurally tight labour market. Investment in new products and the greening of production processes continue as firms face increasingly strict regulatory requirements both directly and indirectly via pressure from within their business ecosystems. Most respondents noted that the costs

involved in the green transition were being passed through to sales prices quite easily, with (business) clients often willing to pay a premium to comply with their own regulatory obligations. Firms with international branches or those that are part of multinational groups indicated that the recent increase in operating costs and fall in margins have also led to a diversion of investment away from Belgium. The companies reporting the most substantial scaling back of their investment (plans) were those most dependent on external financing.

Figure 1

Business sentiment and relevant sub-indicators by industry
(normalised series)



Source: NBB monthly business survey.

As regards employment, current conditions and the short-term outlook remain robust, although labour market tightness is still a concern notwithstanding a slight softening recently. Overall, most businesses retained or even grew the size of their workforce, despite high levels of uncertainty and cost pressures. Nearly all reported that ensuring business continuity with an ageing workforce was challenging and that they have been struggling to fill vacancies for specific positions. However, labour shortages now appear largely limited to particular roles. Hiring for certain - often low-skilled - positions has become easier, while recruiting people with specific skillsets remains a structural challenge, even in industries with attractive wages and working conditions. Some managers expressed surprise at finding themselves in the paradoxical situation of having to make

extensive use of the furlough scheme despite labour shortages. Most companies are looking for ways to increase productivity, such as the aforementioned investment in digitalisation and automation, while others have turned to outsourcing or the creation of their own international low-cost hub to reduce costs. Firms that have decreased their workforce are often active in industries characterised by a high degree of (international) competition and are struggling with decreasing margins. However, only a minority of those respondents have reduced their permanent workforce, with most preferring cuts to the number of flexible contracts. This overall picture appears in line with the continued gradual softening of employment prospects reported by the NBB's monthly business survey (see the bottom-right chart in Figure 1).

Sentiment weakened but remains positive in the services industries while manufacturing confidence is still downbeat

As was reported in the previous issue of Business Echo, economic conditions in the services industries remain better than in the manufacturing industry. The improvement in business sentiment as measured by the NBB's November business survey was entirely due to services, as confidence again dipped slightly in the manufacturing industry (see the top-left chart in Figure 1). For its part, sentiment in the building industry held virtually stable. Current quarterly statistics reflect this divergence: services activity continued to expand in the third quarter, while value added fell further in the manufacturing industry.

The interviews revealed that sentiment remains downcast in the manufacturing industry, but the outlook was said to be stabilising, with some interviewees noting tentative signs of improvement ahead. Fundamentals for the manufacturing industry remain weak, with softening demand leading to pockets of overcapacity and reports of high inventory levels. Prices for natural gas have remained clearly above pre-crisis levels, while the recent surge in oil prices was an unwelcome surprise for many. Representatives from several energy-intensive companies stated that, as things stood, certain activities were simply no longer viable in Europe, with production costs of certain goods exceeding global market prices. Moreover, manufacturers of consumer goods reported challenging conditions for non-food retailers, with Belgian consumers becoming more cost conscious and a larger share of the household budget being spent on services rather than (durable) goods. That being said, the near-term outlook appears to be stabilising, with most respondents not expecting a further worsening of economic conditions. One notable exception is building materials, whose manufacturers reported a marked slowdown in demand and a rapidly worsening outlook for 2024. Some interviewees described the current climate as the worst in decades, with the tightening of monetary policy leading to a rapid fall in new real estate projects. All in all, interviews with respondents in the manufacturing and construction industries seemed to confirm the trends revealed by the NBB's monthly business survey synthetic indicators (see the top-left chart in Figure 1). Demand expectations continued to plunge in the construction industry, while they rebounded in the manufacturing industry according to the NBB's October business survey and were only slightly down in November (see the top-right chart in Figure 1). Some managers at (energy-intensive) manufacturing companies noted that several countries had set up some form of energy price subsidy mechanism for businesses, thereby distorting the European internal market. This was said to be leading to a diversion of investment. In addition, stricter environmental requirements, in combination with lengthy and uncertain regulatory processes, were cited as a further impediment to growth and investment. Finally, multiple respondents pointed to increasingly strained relations with the Belgian tax authorities, resulting in reputational concerns among local divisions of multinational groups.

Turning to the nominal side, prices of many intermediate goods are down, with the notable exception of energy, as supply chains have stabilised. Some respondents noted that they had postponed the pass-through of these lower costs to their sales prices in recent quarters, in an effort to temporarily claw back some of the losses in profit margins. However, overall, the downturn in demand, higher energy prices and the continued increase in labour costs have led to a downgrading of profit margin expectations among most interviewees, in particular those active in highly competitive environments.

As regards the services industries, sentiment remains resilient but the overall picture that emerged from this round of Business Echo interviews is clearly a less positive one. While some consumer-facing (B2C) firms acknowledged that wage indexation had shored up demand, shifting consumption patterns and, more importantly, higher (wage and other) costs and elevated levels of uncertainty are weighing on business sentiment and leading to increased cautiousness. These findings are slightly more pessimistic than the synthetic indicators for trade and business-related services in the NBB's monthly business survey, which had been quite volatile until recently but whose gradual downward trend now appears to have halted. The most-pronounced negative sentiment was expressed by real estate-related businesses and retail firms. The decline in demand in these industries has been confirmed by logistics companies involved in their supply chains. Warning signals of falling demand and rising inventory levels in non-food retail had already been flagged in the June issue of Business Echo. Fast-growing business-to-business (B2B) services, on the other hand, were again the most openly positive, which corresponds with the continued push towards digitalisation and automation in the broader economy. The assessment of Business Echo interviewees of the near-term outlook mirrors the findings of the NBB's monthly business survey: demand expectations for services improved markedly according to the November survey (see the top-right chart in Figure 1) and most interviewees in the broader services industries are cautiously optimistic that the worst economic conditions for their businesses have passed this quarter and, on average, expect activity to increase slightly in the next.

Wage indexation remains the main preoccupation in labour-intensive industries (even more so in services). While in June quite a few companies reported being able to raise their sales prices to pass through higher costs (or in anticipation of higher costs), this is now said to have become difficult. Margins are being hard hit and nearly everyone is looking for cost-cutting measures and productivity gains. Explicit workforce adjustments were mentioned but are rarely used, partly due to a persistently tight labour market (along with re-hiring challenges) and high severance costs. Firms that form part of a multinational group or that are exposed to (international) competition were more likely to point out the negative impact of wage indexation on their business, whereas B2C firms describe indexation as both a blessing and a curse.

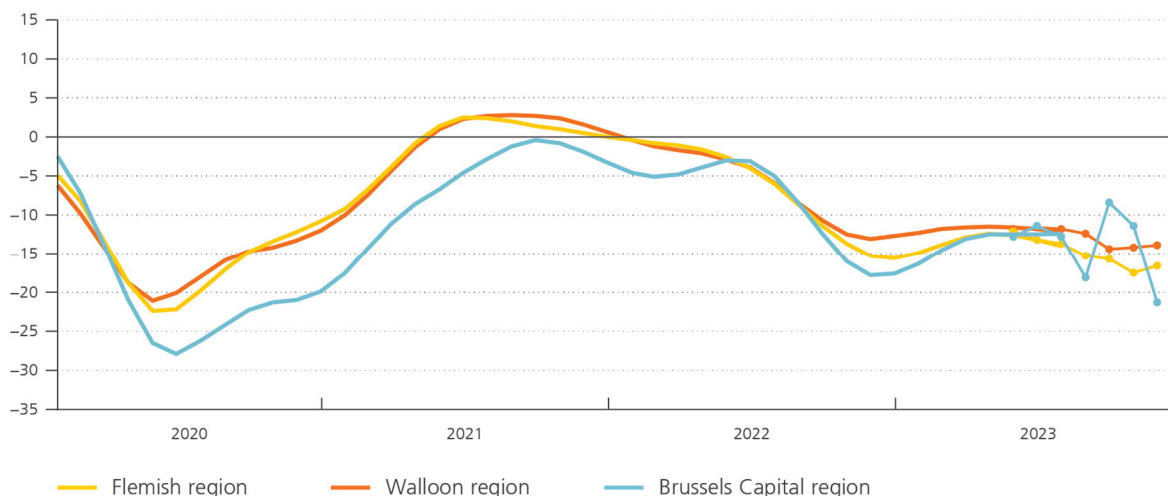
Rising wage costs are prompting the launch of projects aimed at productivity gains, while higher interest rates are mostly weighing on new investment projects in capital-intensive industries. Many companies, in both the manufacturing industry and services, indicated that rising wage costs were in fact driving new investment projects, with some reporting outsourcing to regions with lower wages, which is obviously easier for companies with a presence abroad. However, in the manufacturing industry, lengthy and uncertain regulatory and administrative processes, a tight labour market in certain regions, and high energy costs were all singled out as significant impediments to investment. The bulk of negative sentiment in the services sector was expressed by real estate developers, which remain highly exposed to the cost of external financing. The viability of new projects depends on credit conditions, and banks confirmed that they are becoming more selective when it comes to such projects. These firms often expressed pessimism about the near-term outlook. The residential real estate market is reported to have slowed abruptly but to be holding up better than elsewhere in Europe due to wage indexation.

Regional differences in sentiment are roughly in line with the trends revealed by the NBB's monthly business survey

According to the November NBB business survey, business sentiment in the Walloon Region is holding up slightly better than in other Regions (see Figure 2). Both the Flemish and Walloon Regions saw a modest uptick in business confidence, which however plunged in the Brussels-Capital Region (although results for the latter are typically more volatile).

Figure 2

Business sentiment by Region



Source: NBB monthly business survey.

Interviews conducted for this issue of Business Echo told a similar story. Indeed, companies based in the Walloon Region were somewhat less downbeat, seemingly due to the fact that a larger share of their sales is linked to government demand compared with companies in other Regions. This was particularly true for those involved in public investment projects, which provided them with a steady revenue stream when private sector demand was flagging. Certain respondents indicated that they are actively seeking greater access to government clients as a coping strategy.

While recent reports of regional employer federations are scarce, the latest round of Business Echo interviews seems to confirm the findings of a recent analysis by Voka (the largest Flemish network of enterprises) regarding a slightly more marked weakening in sentiment in the Flemish Region. Voka's findings paint a quite pessimistic picture, particularly concerning the manufacturing and construction industries, and point to order levels that are 60% lower than usual among firms surveyed, with four out of 10 expecting a further worsening in the final quarter of 2023. Increasing wage costs have eroded firm competitiveness and structural reforms are necessary, according to Voka.

Overall, activity may decelerate somewhat but continue to expand in the fourth quarter and could accelerate again early next year

Looking at the economy as a whole, the qualitative results derived from interviews with business leaders broadly confirm the findings of the NBB's monthly business survey and certain other high-frequency data. Sentiment is downbeat in the manufacturing industry but confidence in the services industry, which accounts for the bulk of Belgian economic activity, remains more resilient. While consumption demand may be softening, respondents stressed that investment growth remains robust, with some pointing to more stable and ample government demand (mostly in the context of investment projects).

All in all, activity could decelerate in the fourth quarter of 2023 but should continue to expand. Despite weaker sentiment, Belgian GDP growth remained remarkably robust in the first three quarters of 2023 and a decline in activity in the fourth quarter still seems highly unlikely. Employment is expected to at least remain stable.

Turning to the outlook for next year, respondents pointed to some tentative signs of improvement in demand but confirmed that uncertainty remains high going forward. The NBB's November business survey found demand expectations in the manufacturing industry to be stable, and this was confirmed by Business Echo interviews. Demand expectations in both trade and business-related services have noticeably recovered, according to both the November business survey and Business Echo interviewees, with most expecting activity to remain stable or increase slightly. All in all, economic activity could accelerate slightly early next year, with the short-term outlook remaining brighter for services than for manufacturing.

These factors will be taken into account in the upcoming Business Cycle Monitor (BCM), which will be published on 11 December 2023. As usual the BCM will examine current economic conditions through the lens of the main demand components and include a quantitative nowcast for quarterly growth in the fourth quarter of 2023.