NBB Business Echo

May 2024

Economic growth is likely to remain stable in the near term while employment growth should recover

- According to Business Echo interviews, economic conditions were still challenging in the second quarter of 2024, but activity growth should remain broadly stable. Expectations for the second half of the year remain somewhat subdued and are affected by considerable uncertainty.
- Investment growth has moderated. This is due more to lower profitability, which is prompting firms to reduce their expenses and enhance operational efficiency, than to tighter external financing conditions. Investments are still primarily focused on the modernisation of production processes or facilities, the seeking of efficiency gains through digitalisation and automation to offset the large rise in wage costs, and the greening of production processes.
- Turning to price developments, respondents pointed to the more moderate increase in wage costs and the decline in many other input costs. Overall, input prices were reported to be decelerating in the second quarter and should stabilise in the third quarter of 2024, which should continue to fuel the disinflation process.
- While job creation has slowed sharply, Business Echo interviews suggest that the labour market has passed the trough. This is in line with the recent uptick in employment expectations recorded by the NBB's monthly business survey. Although labour market tightness has eased somewhat, finding qualified workers continues to pose a challenge across industries, including those offering attractive wages and favourable working conditions. Against this backdrop, labour hoarding remains higher than usual and few companies plan to cut their permanent workforce.
- Manufacturing fundamentals have stabilised but remain weak, albeit with tentative signs of improvement in the near term. In general, conditions are still better in the services industries, but managers' sentiment has softened in a broad range of industries, particularly in consumer-oriented services and some business-related services.
- Regional differences are modest overall, although the interviews confirmed that economic conditions remained more resilient in the Walloon Region. This could be due to upbeat sentiment in the important pharmaceutical industry, as well as a relatively larger share of sales linked to demand from government agencies.

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 44 interviews carried out between 4 April and 8 May 2024. 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.

Economic conditions are stable overall while disinflation is continuing and falls in employment appear unlikely

In general, interviewees for this issue of Business Echo reported that activity growth held broadly stable in the second quarter of 2024. Respondents indicated that while activity had decelerated less than initially feared, the past few quarters were difficult and conditions remain challenging. Expectations for activity growth in the third quarter remain very moderate and affected by uncertainty. Few respondents expected activity to rebound strongly anytime soon.

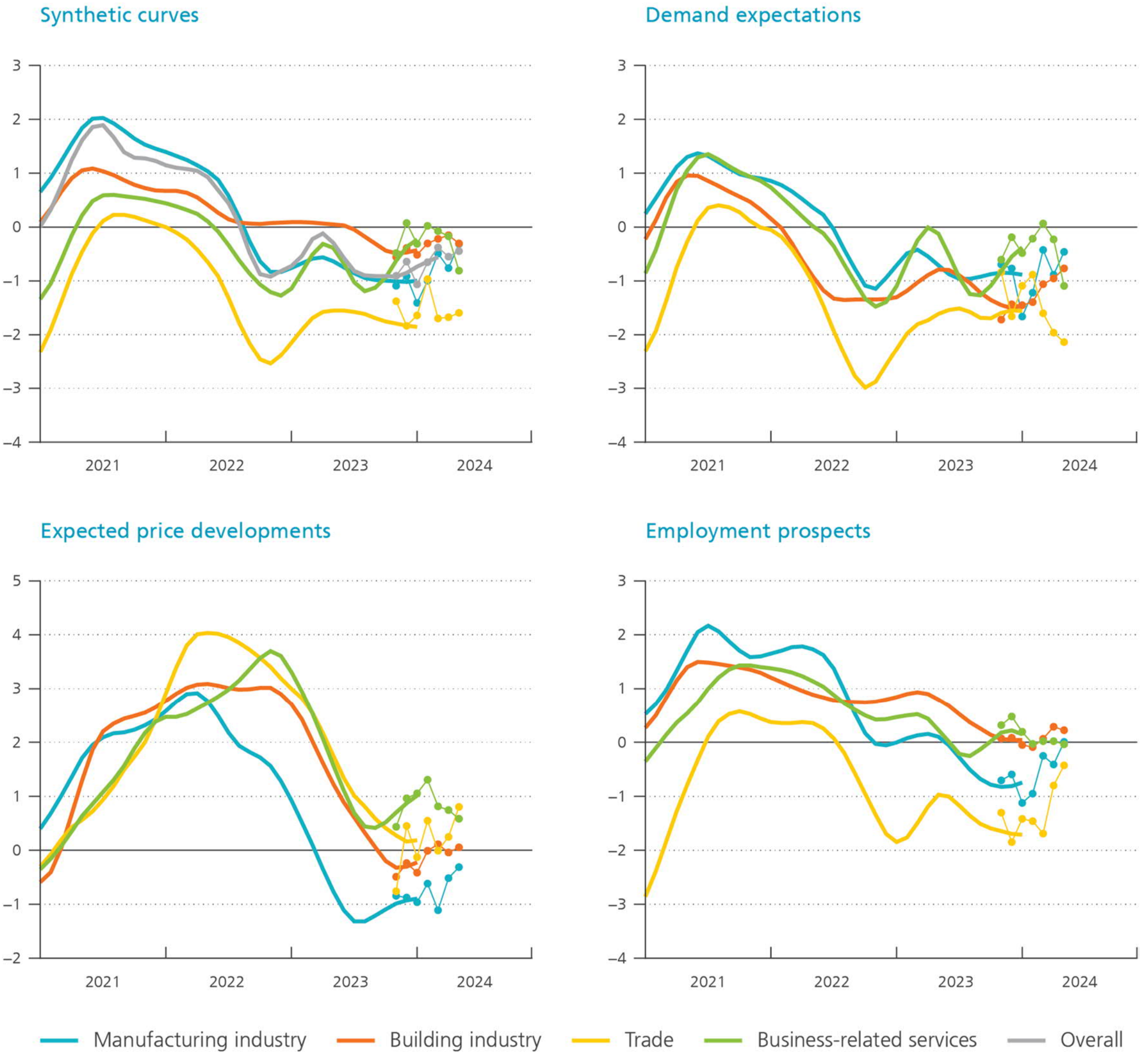
This assessment is slightly more pessimistic than, but not at odds with, developments in producer sentiment, as measured by the NBB's monthly business survey. Compared with the previous quarter, headline business confidence improved slightly in the first quarter of 2024 and results for the second quarter up to May show confidence edging up further. Zooming out somewhat, business sentiment bottomed out in the second half of 2023 and has been trending upwards slowly since then. At the same time, quarterly GDP statistics have been remarkably stable: in the previous quarter growth came in again at 0.3%, on par with the pace observed throughout 2023.

Cost pressures have receded and sales prices should continue to decelerate. With regard to domestic cost pressures, nearly all respondents pointed to the more moderate increase in wage costs and the decline in many other input costs. Commodity prices were down overall and energy bills have fallen considerably for most firms. Oil prices remain quite high, but this was not reported as problematic. Nearly all firms indicated that they had no significant problems with supply chains, although some issues remain for niche goods and activities. The rerouting of shipping lanes after the attacks in the Red Sea was said to be of limited importance; the extension of delivery times was thought to be temporary and limited to an initial adjustment phase. Many firms stressed that the series of shocks over the past years has led to operational adjustments and a diversification of their suppliers, rendering production processes less vulnerable. Overall, input price growth was reported to be decelerating and should stabilise in the third quarter of 2024, with sales price growth following suit. Customers are aware of this and are exerting pressure on sales prices. Elevated levels of pricing power are now limited to a few industries, such as ICT services. Against this backdrop, Business Echo interviewees reported increasing pressure on profit margins, which have indeed fallen substantially according to national accounts data. Many firms are now cutting back on spending and trying to increase efficiency with a view to raising profitability in the coming quarters. The NBB's monthly business survey confirms the overall message that expected price increases across all industries have declined substantially from the peaks reached in 2022 and remain subdued (see the bottom-left chart in Figure 1).

Investment growth is reported to have moderated and is still focused on productivity gains. Respondents indicate that while external financing conditions are somewhat tighter, they do not pose a significant barrier to investment. The consensus is that financing remains accessible, with no widespread reluctance from banks to provide funding. Banking industry representatives continued to report that credit conditions have not been tightened but remained particularly cautious regarding commercial real estate. However, many firms indicated that their investments are traditionally financed through (intra-group) cash flows and that recent margin pressures have led to a re-assessment of investment plans. Current investments are primarily focused on the modernisation of production processes or facilities, the seeking of efficiency gains through digitalisation and automation to offset the large rise in wage costs, and the greening of production processes. The latter is often driven by regulatory requirements, for example in the context of the renewal of operating permits. At the same time, few firms reported planned expansionary investments in Belgium. Current production capacity is seen as sufficient to meet demand, for the most part, and structural factors were cited as reasons to prioritise other locations to expand capacity. Such factors include "a heavy and unpredictable regulatory process", "limited availability of suitable locations", "labour shortages and high wages", "market saturation", and "high energy costs".

Figure 1

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



Source: NBB monthly business survey.

Current conditions and the short-term outlook for employment remain quite robust, although labour market tightness was reported to have eased in most industries, particularly for positions requiring more generic skillsets. The strong increase in wage costs and continued uncertainty about the economic outlook led to a slight deceleration in labour demand. Many companies reported greater use of the temporary unemployment scheme, the discontinuation of flexible contracts, and scaling back on consultancy contracts in order to reduce costs. At the current juncture, however, only a minority plan to cut their permanent workforce. Firms prefer to avoid high severance costs and re-hiring challenges if and when activity picks up again. Finding qualified workers often remained challenging, for both blue-and white-collar positions, even in industries with attractive wages and working conditions. Some managers reported that positions and roles were currently not being filled or were being combined in order to reduce payroll costs but admitted that such measures are not sustainable in the longer run. Recent statistics confirm that job creation decelerated sharply in 2023. The key information gleaned from Business Echo interviews is that this is not likely to morph into a significant decline in employment. This finding is confirmed by the results of the NBB's monthly business survey. In the most recent months, employment prospects edged up again in most industries, in particular manufacturing and trade (see the bottom-right chart in Figure 1), which could be an early indication that the labour market has passed the trough.

Manufacturing confidence has bottomed out but remains downbeat while sentiment is softening in the services industries

In the manufacturing industry, sentiment has bottomed out but remains downbeat, even though many interviewees noted tentative signs of improvement ahead. Overall, fundamentals for the manufacturing industry remain weak and firms are struggling to return to pre-pandemic production levels. The competitive position of these often export-oriented businesses is reported to have deteriorated structurally: managers indicate that the wage-cost gap between Belgium and neighbouring countries has widened significantly and that energy prices, although lower, remain above their pre-crisis levels and far above prices for energy in North America or Asia. Production costs for certain goods continue to exceed global market prices, which is leading to a restructuring of activities. As in the previous issue of Business Echo, managers in the manufacturing industry also pointed to increasingly cost-conscious behaviour on the part of Belgian consumers, which has led to a decline in upstream production volumes and some downtrading. Conditions remained gloomy in the building materials industry due to the prolonged slump in the construction industry: construction firms reported a pessimistic outlook and were battening down for a protracted period of weak demand. In contrast, companies in the important pharmaceutical industry and specialised firms producing niche goods reported buoyant conditions and growth opportunities. Moreover, the situation in the manufacturing industry does not appear to be worsening further: input costs are down and the near-term outlook for demand appears to be stabilising. The recent uptick in German economic activity was cited as a reliable leading indicator for the economic performance of this sector. All in all, interviewee responses in the manufacturing and construction industries seem to match the trends revealed by the NBB's monthly business survey, where the synthetic indicators appear to have bottomed out, while demand expectations rose more clearly compared to the average of recent months (see the top-left and top-right charts in Figure 1).

On average, business sentiment softened in the services industries. In line with reports from consumer goods manufacturers, consumer-facing (B2C) services firms attested to difficult conditions as much of the boost to purchasing power from wage indexation ran its course, leading to shifts in consumption patterns and intensifying competition among retailers. Managers indicated that sales price pressures and higher wage costs were weighing on profitability, prompting productivity-enhancing investments. This aligns with the stagnation of the synthetic indicator and the recent drop in demand expectations for trade observed in the NBB's monthly business survey (see the top-left and top-right charts in Figure 1). Compared with the previous issue of Business Echo, the most marked deterioration in the assessment of activity this quarter was observed in specific business-to-business (B2B) services segments, particularly those facing (much) lower demand due to cost-cutting across the wider economy, such as temporary agencies and consulting firms. Some activities are facing increasing competition due to the ever-improving services offered by digitalisation and automation. Logistics companies reported low demand and a decline in sales prices, largely due to overcapacity and intense competition. On the other hand, while interviewees from real estate firms remained very cautious, they were somewhat more confident and noted that they had observed a tentative recovery in transaction volumes. Optimism was prevalent among business leaders active in ICT services, many of whom reported being fully booked and planning expansion. The dispersion of assessments revealed by interviews with respondents active in B2B services helps nuance the recent downturn in the synthetic indicator for business-related services in the NBB's monthly business survey (see the top-left chart in Figure 1) while the synthetic indicator for trade seems to reflect the downbeat sentiment expressed in the interviews. Regarding the short-term outlook, demand expectations for business-related services deteriorated abruptly in May (see the top-right chart in Figure 1), bringing the indicator more in line with the views expressed by most business-related services interviewees. The downward trend in demand expectations in trade, on the other hand, again by and large corresponds with the feedback received from interviewees in that industry.

On the nominal side, input prices have largely normalised while supply chains have stabilised. There were some exceptions, such as the recent unprecedented surge in cacao prices. While challenging for some specific firms, these issues are deemed largely transitory. As expected, profits are currently under significant pressure. Managers, in particular those in highly competitive industries, report that still-weak demand and overcapacity are weighing on sales price developments. The NBB's monthly business survey seems to confirm the overall message that price increases are muted. Price expectations in the manufacturing industry remain at a very low level and have been trending up very gradually since the unexpected increase in oil prices in the second half of 2023. In the construction industry, price expectations appear to be bottoming out, while they are holding steady in trade. The results for business-related services showed some up- and downswings recently, which may tie in with the reports of contrasting developments in that industry (see the bottom-left chart in Figure 1).

In terms of employment trends, workforce downsizing was mentioned somewhat more often than six months ago. This was in particular the case for labour-intensive, low-margin firms struggling with inflated wage bills. On the other hand, demand for labour was reported to remain particularly high in ICT services and for similar profiles in other industries investing in ICT-related projects.

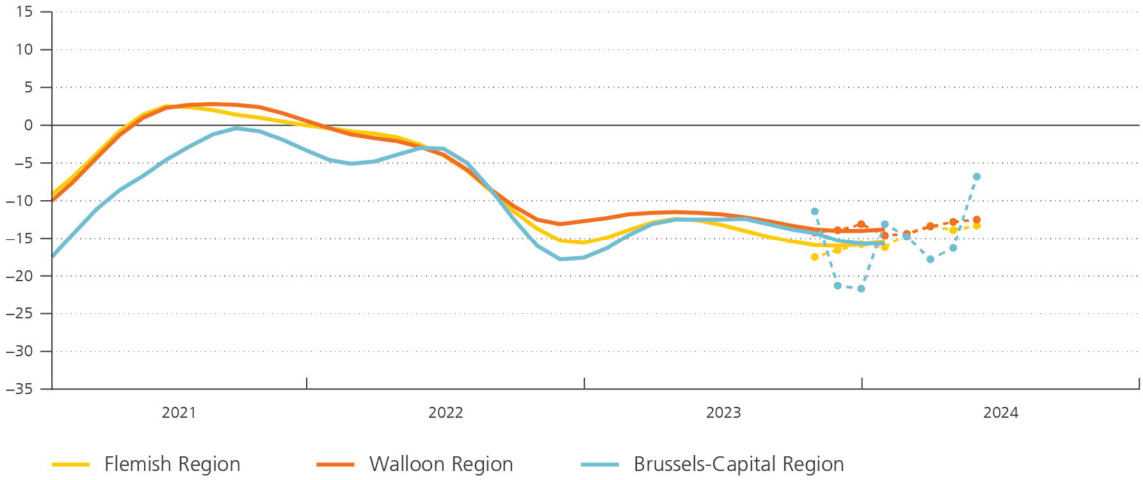
Investments aimed at productivity gains are still surging, driven by higher wage costs. While this was a common issue for most firms, the need to achieve productivity gains is particularly urgent in both highly competitive, capital-intensive industries and some low-margin, labour-intensive services industries. Manufacturing investments tend to focus on modernising production facilities and enhancing efficiency, while working towards climate neutrality. In the services industries, most companies reported investing in ICT, warehousing and logistics to cut costs. While business expansion plans are still relatively common in some services sectors, they are rarer in manufacturing, where local expansion often results from an intra-group reshuffling of activities due to the closure of production sites abroad. Moreover, manufacturing firms are more likely to mention high wages, regulatory uncertainty, administrative burdens and the low growth potential in Europe as detrimental to investment in Belgium or Europe.

Regional differences in sentiment are small and are broadly in line with the results of the NBB's monthly business survey

According to the regional breakdown of the NBB's monthly business survey results (see Figure 2), differences in sentiment between regions remain limited (in particular taking into account the typically greater volatility in the Brussels-Capital Region). The uptick in national business sentiment seen in May was modest but broad-based. Confidence edged up marginally in the Flemish and Walloon Regions. In the Brussels-Capital Region, business sentiment increased markedly in May but the results for this region tend to be volatile.

Figure 2

Business sentiment by region



Source: NBB monthly business survey.

Interviews conducted for this issue of Business Echo broadly confirmed these regional divergences even if they were slightly more outspoken. Companies based in the Flemish Region were somewhat more downbeat on average, which can however be partly traced back to the relatively larger share of manufacturing activities in that region. Companies based in the Walloon Region were again somewhat less downbeat on average, which could be tied to both the stabilising impact of the large, business cycle-insensitive pharmaceutical industry and the relatively larger share of sales linked to government demand, in particular when government investment is at high levels.

Recent reports from regional employer federations in the Flemish and Walloon Regions point to a broadly pessimistic outlook for economic conditions. In March, Voka, the largest network of businesses in Flanders, surveyed 1,600 firms and found that only one in ten viewed the current economic situation positively, with most expecting a worsening in the next 12 months. Additionally, only one in four industrial firms considered Belgium to be an attractive location for new investment, echoing the concerns raised by Business Echo interviewees active in the Flemish Region. In Wallonia, the April survey by AKT for Wallonia (formerly UWE) of 260 CEOs revealed cautious optimism about current activity but a remarkably pessimistic outlook for the future.

Overall, activity growth is likely to remain roughly constant in the second quarter

Looking at the economy as a whole, the qualitative results derived from interviews with business leaders seem to point to roughly stable economic growth in the current quarter and in the near term. Sentiment remains downbeat but is bottoming out in the manufacturing industry while confidence in the services industry remains more resilient but is clearly softening. Household consumption demand may have peaked, and investment growth has moderated against the backdrop of efforts to cut costs.

Turning to the outlook for the second half of the year, respondents pointed to some tentative signs of improvement in demand but acknowledged that uncertainty remains high going forward. Business Echo interviews broadly confirm the tentative recovery in demand expectations in the manufacturing industry since the drop in January revealed by the NBB's business survey. Demand expectations in business-related services have taken a downward turn which reflects the cautious tone of Business Echo interviewees in that industry. The same holds true for the construction industry. The outlook in trade, according to both the NBB's monthly business survey and Business Echo interviewees, is somewhat downbeat, which could be due to the loss of some traction in final consumer demand. All in all, activity growth should remain roughly unchanged in the second half of 2024 as well.

The disinflation process should continue. Business Echo respondents clearly confirmed that wage cost pressures have now moderated. In addition, the impact of geopolitical conditions on supply chains is muted for the time being, and nearly all input costs are down. Against this backdrop, goods and services inflation should continue to fall.

The most important finding from the Business Echo interviews pertains to the labour market: it appears unlikely that the current slowdown in job creation will get worse. While employment growth declined sharply in recent quarters, only a minority of respondents are considering cutting their permanent workforce. Labour hoarding is higher than usual in a labour market that remains quite tight; more moderate labour costs, coupled with somewhat improved demand conditions in manufacturing in particular, should lead to a gradual recovery of labour demand. This is corroborated by the recent uptick in employment expectations in the NBB's monthly business survey.

These factors will be taken into account in the upcoming Business Cycle Monitor (BCM), which will be published on 5 June 2024. 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 second quarter of 2024.