

Developments in private consumption over the past three years

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Introduction

Like its partners in the euro area and in most of the advanced countries, the Belgian economy has experienced severe turbulence over the past three years. The financial crisis which spread rapidly following the collapse of the American investment bank, Lehman Brothers, in September 2008, and the ensuing slump in international trade and the widespread recession in global activity up to mid-2009 affected the behaviour of businesses and individuals through various channels. Since then, the situation has improved, notably as a result of accommodating monetary and fiscal policies, but there is still considerable uncertainty in view of the substantial consolidation efforts yet to be undertaken.

It now looks as if Belgium weathered the recession relatively well compared to the euro area as a whole and most of its constituent economies. At the beginning of 2011, it was among the first euro area member countries to see its GDP exceed the level recorded in early 2008, before the recession began.

In that context, it seemed interesting to examine the pattern of household consumption expenditure over the past three years. Traditionally, private consumption is regarded as performing a stabilising role in regard to cyclical fluctuations, but this time the shocks affecting activity and employment, financial assets and uncertainty were so severe that consumption may have suffered. This article therefore aims to shed light on the interactions between the general economic situation and private consumption during the recession and in the recent recovery phase.

To that end, the first part of the article reviews the relative movements in GDP and consumption in Belgium, both from the perspective of the past four decades and during the latest phase of the business cycle. This last point is supplemented by an international comparison. The second part looks at the role of the main determinants of movements in private consumption, particularly in the econometric model of the Belgian economy used by the Bank. The conclusion summarises the main findings and prospects.

1. Consumption and activity

1.1 Historical perspective

To assess developments in private consumption during the recent recession phase, in 2008-2009, and during the ensuing recovery, it is useful to take a longer term perspective in order to analyse the link between this component of demand and GDP.

Analysis of the data for Belgium since 1970, reconstructed by the EC in order to eliminate the effect of breaks in the methodology, shows that the pattern of private consumption has, in general, closely mirrored that of activity over the past four decades. However, it initially grew slightly faster up to the first half of the 1980s, and was subsequently a little less vigorous, particularly between 1995 and 2007.

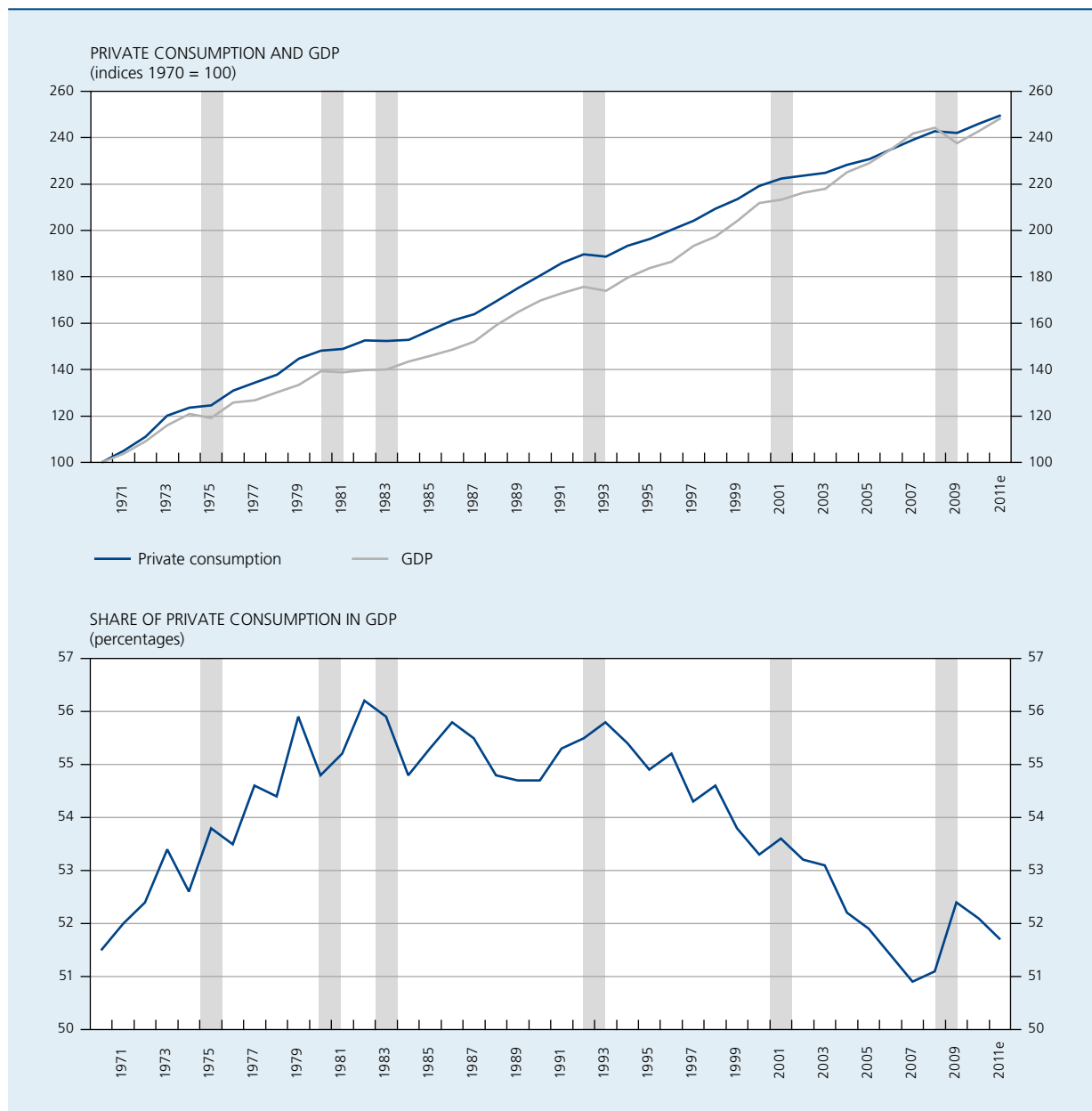
Over the period as a whole – calculated on the basis of chained volume series, expressed at 2000 prices, in order

to eliminate the relative movement in the deflators of these two variables so as to isolate changes in volume – private consumption expenditure thus represented an average of 53.9% of GDP; it is by far the largest component of demand, at least if foreign trade in goods and services is considered in net terms. That figure increased from 51.5% in 1970 to 56.2% in 1982, before dropping back to 52.1% in 2010, close to its level at the start of the period in question. Expressed in nominal terms, the profile

is similar; the proportion averaged 54.3%, with figures of around 53% in both 1970 and 2010.

Apart from these results for the period as a whole, a more detailed analysis of the correlation between movements in GDP and private consumption is needed during recession phases. Apart from the recession experienced in late 2008 and early 2009, four episodes of this type can be identified since 1970 according to the usual definition of

CHART 1 LONG-TERM GROWTH OF PRIVATE CONSUMPTION AND GDP⁽¹⁾



Sources: EC, NBB.

(1) Gross data, chained volume series at 2000 prices.

Note: The grey areas correspond to the recession periods identified on the basis of a decline in the level of GDP over two consecutive quarters; in the absence of quarterly data prior to 1980, the 1975 recession was identified on the basis of the fall in the annual average level of GDP compared to the previous year.

a decline in the level of GDP over two consecutive quarters⁽¹⁾: the 1975 recession and those that occurred in the early 1980s⁽²⁾, 1992-1993 and 2001.

These episodes of declining activity varied in scale and duration. However, they all affected the annual average movement in the volume of private consumption, either by causing a marked slowdown in the rate of expansion, as in the 1975 and 2001 recessions, or by triggering a decline in the other episodes. While the scale of the reaction of consumption to cyclical fluctuations in activity varied from one episode to another, the movements in consumption were in all cases smaller than the movements in GDP, so that the ratio between consumption and GDP has tended to increase temporarily during a recession. That was particularly true during the recessions of 1975 and the early 1980s, when this ratio had risen by more than 1 percentage point of GDP. It is true that these cyclical movements are additional to the medium-term tendencies described above, and the change in the ratio is also subject to short-term variability. Nonetheless, each period of a recession in economic activity systematically shows a

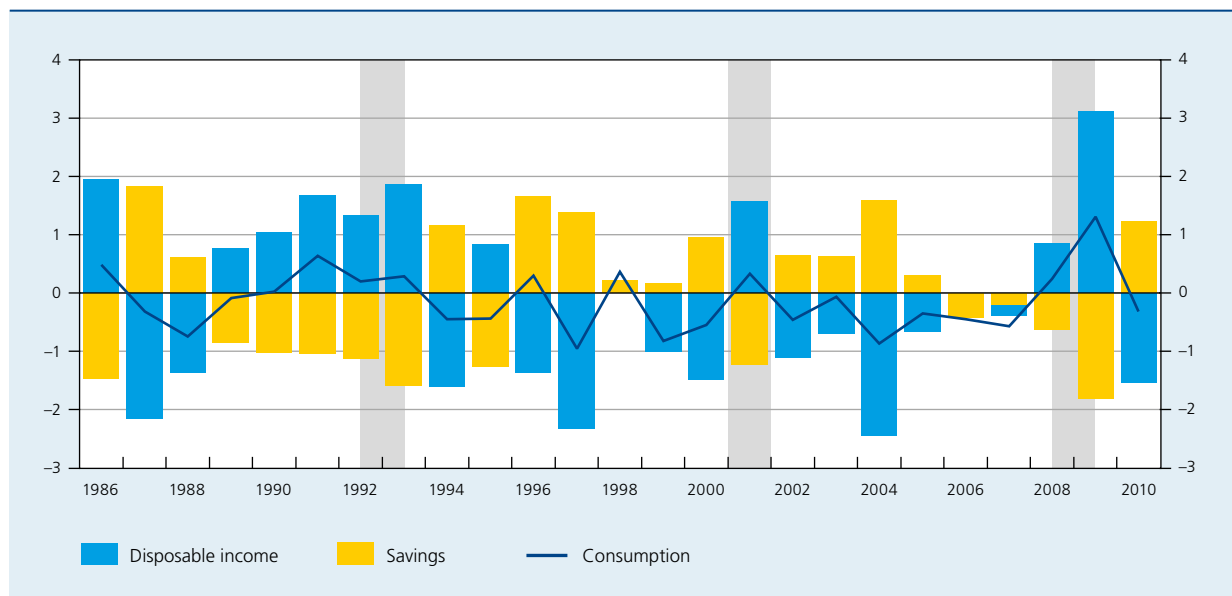
rise in the share of consumption. The reason is that cyclical fluctuations are generally caused by shocks emanating from foreign demand, investment or changes in inventories, whereas private consumption tends to cushion those fluctuations. It is also noticeable that the temporary increases in consumption as a percentage of GDP were accompanied by a rise in wages as a percentage of GDP. As we shall subsequently explain in detail, these movements are interconnected and are due mainly to the short-term resilience of household incomes, particularly labour incomes, in the face of cyclical shocks.

What about the recent recession? In 2009, the volume of private consumption had fallen by 0.2% against the average in 2008, representing a significant decline compared to previous episodes. It was only in 1993 that private consumption had recorded a steeper decline of 0.3%. However, in relation to the extremely sharp contraction in output (-2.7% in volume on average in 2009), the drop in private consumption was particularly modest; that is evident from the steep rise in the ratio of private consumption to GDP, which jumped by 1.3 percentage points from 51.1% in 2008 to 52.4% in 2009.

(1) In the absence of quarterly data prior to 1980, the 1975 recession was identified on the basis of the fall in the annual average level of GDP compared to the previous year.
(2) In the early 1980s, recession phases were specifically recorded in 1980-1981 and 1983; in 1982, though GDP growth was positive, it was extremely weak. By extension, in this article, the whole period is designated as the recession of the early 1980s.

According to the national accounts approach, movements in the consumption/GDP ratio from one year to the next can be broken down into the change in the proportion of disposable income and the change in the proportion

CHART 2 BREAKDOWN OF THE SHARE OF PRIVATE CONSUMPTION IN GDP
(annual change in percentage points of GDP)⁽¹⁾



Source: NBB.

(1) Gross data. An increase in savings is indicated by a negative bar.

Note: The grey areas correspond to the recession periods identified on the basis of a decline in the level of GDP over two consecutive quarters.

of savings. That breakdown is shown in chart 2 for the period commencing in 1985, the data being available only from that year onwards.

The first term reflects the way in which disposable income moves in relation to activity. In general, disposable income shows a more positive movement during an economic recession period. That is true of the 2008-2009 recession, but also applies to the recessions in 2001 and 1992-1993. *A priori*, that resilience of disposable income may be attributed to a number of factors. First, employment generally takes time to react to fluctuations in activity, and where wages are concerned, real collectively agreed adjustments are negotiated for two-year periods, and that limits the adjustment of labour incomes in the face of unexpected shocks. In addition, social transfer mechanisms also tend to restrain the decline in incomes during periods of weak activity, either as a result of the counter-cyclical character of unemployment benefits or because pensions follow a regular trend regardless of the business cycle. Depending on the case, these general mechanisms may be supplemented by factors specific to each recession, e.g. in the form of discretionary measures concerning taxation or a time lapse between inflation and indexation, since the latter applies to a large proportion of incomes.

The second term in the breakdown of the movement in the consumption/GDP ratio reflects the movement

in household savings: an increase in savings depresses consumption, and is therefore represented by a negative bar in chart 2. In general, this chart shows a rise in the household savings ratio during recessions, which tends to attenuate the effect of the resilience of disposable incomes on consumption during those periods.

More generally, fluctuations in current disposable income, both upwards and downwards, usually cause the savings ratio to move in the same direction (i.e. opposing movements in chart 2), which has the effect of smoothing household consumption over time in the face of the volatility of current incomes. This illustrates the fact that, unless they face budget constraints, households do not determine their level of consumption for a given period solely according to their current income, but also take account of the income that they expect to receive in the future or the value of their assets, the latter constituting a reserve which can be used to maintain a certain level of consumption in retirement. Thus, a change in expectations regarding future income or assets, or even a change in the degree of uncertainty surrounding those expectations, may affect private consumption, even without any change in current income. Conversely, temporary fluctuations in disposable income do not trigger movements in consumption on the same scale. Part 2 returns in more detail to the contribution of these various determinants to the movement in private consumption in Belgium over the past three years.

Box – The concepts of private consumption in the national accounts

The ESA 1995 national accounts methodology distinguishes between two alternative concepts of consumption and income for the sectors:

- The first concept measures **final consumption expenditure**, which covers a sector's expenditure on the acquisition of consumption goods and services, whichever sector benefits;
- The second concept measures **actual final consumption**, which refers to the use of consumption goods and services by a sector, whichever sector finances the acquisition.

The difference between these two concepts lies in the treatment of a number of goods and services which are financed by the government and supplied to households in the form of social transfers in kind. By convention, this "individual consumption expenditure" by the government covers expenditure on education, health care, social security and social work, sport and leisure, and culture. It is included in government consumption expenditure according to the first concept, and in the actual final consumption of households according to the second concept. In this case, a transfer of the same amount is imputed from the general government sector to the household sector for the purpose of calculating the adjusted disposable income.

Whatever the term used, the concept of private consumption in this article, as in the Bank's other economic publications, refers to the final consumption expenditure of households. This is in fact the concept traditionally

used by international institutions, and is the only one for which quarterly data are available. The household sector refers to a combination of two national accounts entities: the household sector (S14) and non-profit institutions serving households (S15).

It is worth noting that private consumption has a more marked cushioning effect on cyclical fluctuations in regard to actual household consumption than for household consumption expenditure, owing to the non-cyclical nature of expenditure on education and health care, in particular.

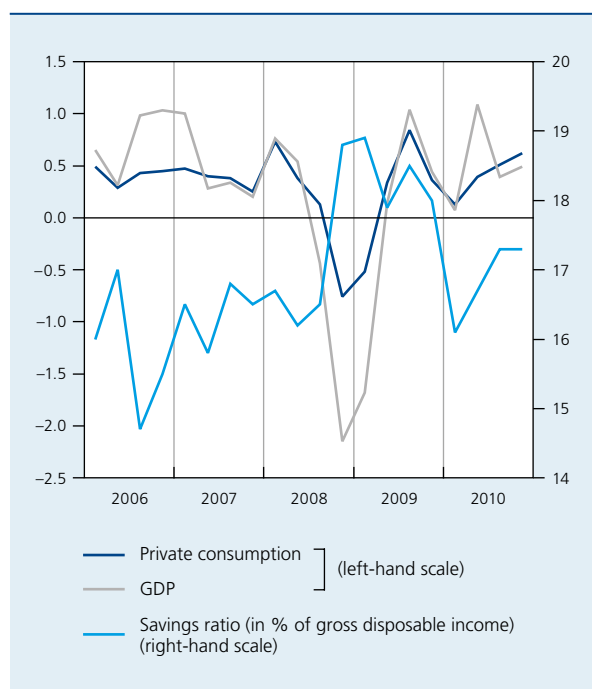
1.2 Developments in private consumption since 2008

The use of quarterly data permits a more detailed analysis of developments in private consumption during the recent recession. To recap, the contraction in activity was initially moderate in the third quarter of 2008, then accelerated very suddenly and sharply in the ensuing two quarters. Altogether, this meant a decline in GDP over three consecutive quarters amounting to 4.3%; this was the most severe recession in over 60 years. From mid-2009 onwards, activity began expanding again by around 0.6%

per quarter or 2.4% year-on-year, outpacing the potential growth of the economy.

In this context, households curbed their consumption expenditure from the final quarter of 2008 and the first quarter of 2009, cutting it in real terms by 0.8% and 0.5% respectively, making a cumulative reduction of 1.3%. The fall in consumption was even more marked in nominal terms, since consumer prices dropped sharply during the same period. Consumption growth became positive again in the second quarter of 2009, and has continued to expand slightly more slowly than GDP since then.

CHART 3 RECENT TREND IN PRIVATE CONSUMPTION AND HOUSEHOLD SAVINGS
(percentage changes compared to the previous quarter, unless otherwise stated)⁽¹⁾



Source: NAI.

(1) Data adjusted for seasonal and calendar effects.

The decline in consumption in late 2008 and early 2009 was due largely to the increase in the savings ratio, from around 16% of disposable income during the previous three years to almost 19% at the height of the recession, whereas at that time real disposable incomes were still rising. Conversely, the return to positive growth in the volume of consumption in the second half of 2009 and in 2010 was accompanied by the gradual decline in the savings ratio, whereas in contrast the purchasing power of households had almost ceased rising.

As explained by the 2010 Annual Report, the fact that the movement in real disposable income was at odds with the trend in economic activity in 2009 and 2010 is due largely to various temporary factors. First, owing to the time lapse between movements in inflation and indexation, the strong rise in inflation in the previous year continued to boost the indexation of wages and social benefits in 2009, at a time when inflation was actually falling. The opposite effect was seen in 2010, depressing the real growth of disposable income in that year. Apart from the indexation effect, wages also maintained their rapid rise in 2009 as a result of an inertia effect. Finally, the tax burden was eased temporarily during that same year by measures such as the extension of the temporary reduction in personal income tax granted by the Flemish Region and the accelerated personal income tax assessments. In

2010, these tax cuts were largely abolished and there was no further acceleration in the assessments; the result was downward pressure on household incomes. These factors contributed to the volatile movement in disposable incomes in 2009 and 2010. Where consumption is concerned, they were largely smoothed out by opposing movements in the savings ratio, and in any case they do not explain the relative resilience of private consumption over the past three years.

The decline in consumption in 2009 was not uniform across the various component items. It was mainly spending on clothing and on hotels and restaurants that fell significantly in real terms, i.e. disregarding price changes. Expenditure on leisure and furniture was also down against 2008, though to a lesser extent, in the latter case mirroring lower investment in housing.

Conversely, the consumption of goods and services relating to communications continued to rise, in line with the growing importance of services concerning mobile telephony and other electronic data exchange facilities in

household budgets. Similarly, certain items which cannot be cut, such as household expenditure on food, recorded an increase in 2009.

1.3 International comparison

On the basis of international comparison, the decline in consumption expenditure in Belgium of around 0.3 % in volume was very modest in 2009, and the 1.6 % revival in 2010 was relatively strong. Taking an average for the euro area, private consumption fell by about 1.1 % in the first year, and picked up by only 0.8 %.

This relatively favourable performance is in line with that seen at the level of economic activity and employment. In fact, the scale of the decline in GDP was also smaller in Belgium than in the euro area, whereas the Belgian recovery was slightly stronger. In addition, the fall in employment was limited and short-lived.

Moreover, there are wide variations between euro area countries. In common with Germany, Austria, France and – to a lesser extent – Finland, Belgium belongs to a first group of countries where the decline in consumption was small in 2009 – in France and Austria consumption actually expanded –, and where the recovery was already solid by 2010. In the absence of major macroeconomic imbalances in recent years, the cumulative movement in the savings ratio was generally modest over the years 2009 and 2010 as a whole.

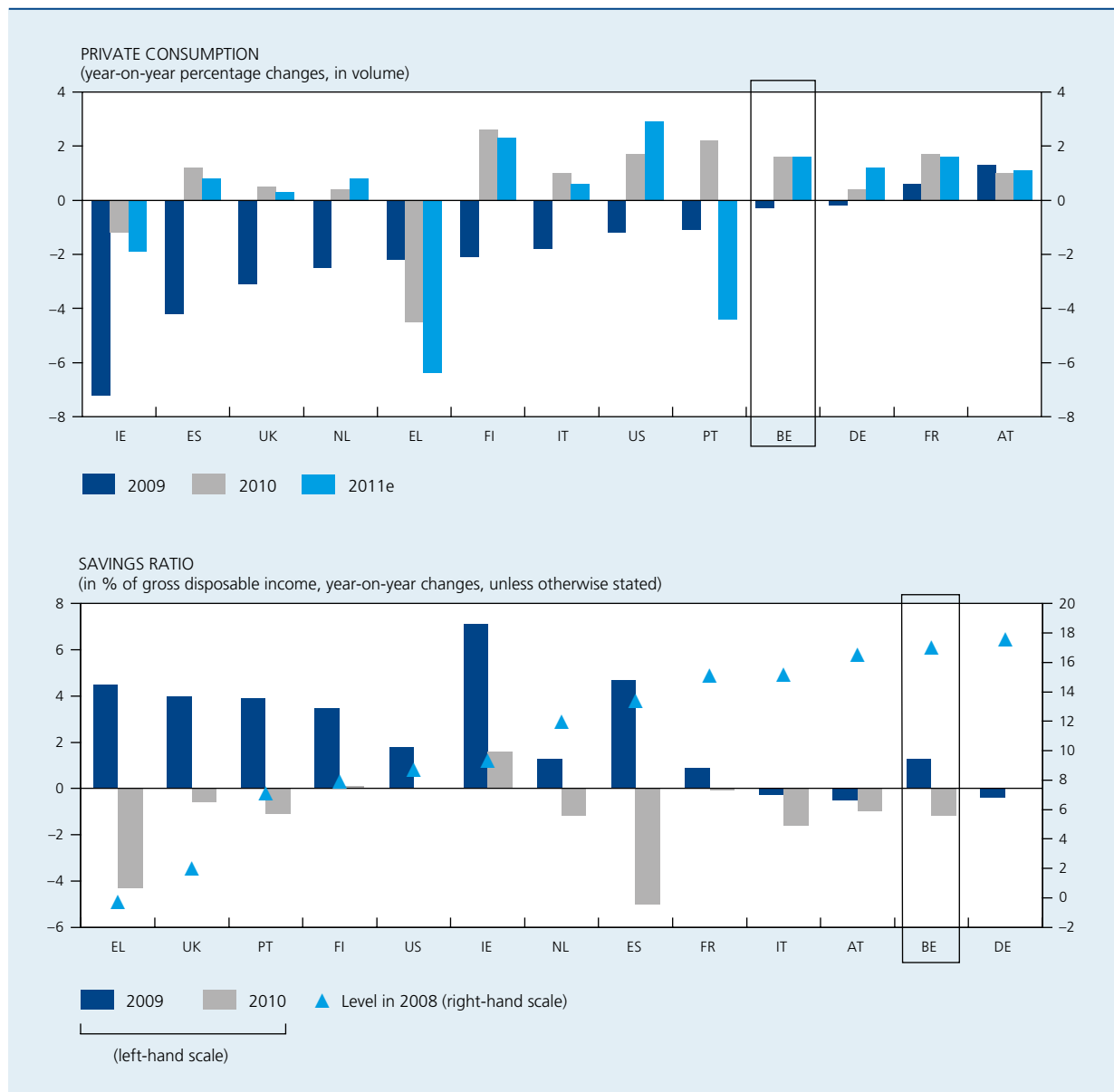
In contrast, the countries which faced serious structural imbalances, and which are still making significant restructuring efforts, saw a sharp fall in private consumption, which slumped in Ireland (–7.2 %) and Spain (–4.2 %), and was down by over 2 % in Greece. Whatever the nature of the structural problems facing these countries, private consumption there reinforced the recessive effects of the financial crisis and the temporary paralysis of international trade, instead of acting as a buffer. According to the EC's spring forecasts, the situation regarding consumption is set to deteriorate further in Greece, Ireland and Portugal in 2011.

TABLE 1 BREAKDOWN OF PRIVATE CONSUMPTION BY TYPE OF GOODS AND SERVICES

	Weight in total consumption (2008)	Average annual growth ⁽¹⁾ : 2002-2007	Annual growth ⁽¹⁾ : 2009
Housing, water, electricity, gas and other fuels	23.6	0.5	0.5
Food and non-alcoholic beverages	13.0	0.1	2.5
Miscellaneous goods and services	12.9	0.8	2.0
Transport	12.0	1.0	-0.9
Leisure and culture	9.5	4.9	-2.2
Restaurants, cafés and hotels	5.8	0.9	-6.3
Furniture, household equipment and cleaning materials	5.7	1.5	-2.6
Health expenditure	5.3	2.2	1.9
Clothing and footwear	4.8	3.0	-8.6
Alcoholic beverages and tobacco	3.5	-0.6	1.9
Communication	2.3	3.0	4.0
Education	0.5	0.2	0.3
Total	100.0	1.3	-0.3

Source: NAI.
(1) In real terms.

CHART 4 INTERNATIONAL COMPARISON OF TRENDS IN HOUSEHOLD CONSUMPTION AND SAVINGS RATIO



Source: EC.

2. Explanation of recent movements in consumption

2.1 Determinants of consumption in the Bank's econometric model

By the way in which it represents the Belgian economy, the Bank's econometric model reveals the role of the various determinants in the declining consumption phase, in late 2008 and early 2009, and subsequently in the recovery. To explain this variable, the model bases household

behaviour on the "life-cycle" approach, whereby consumers try to maximise the benefits which they obtain from their consumption not only during the current period but also during future periods up to the end of their life, taking account of the resources which will be available to them in different periods (see Jeanfils and Burggraeve, 2005). Those resources consist of labour incomes in the broad sense – i.e. including replacement incomes –, plus assets and the income which they generate. It is the accumulation of assets via savings that determines the intertemporal character of consumers' decisions. This process of maximisation is subject to various uncertainties,

e.g. concerning the lifespan, and future income flows from labour or assets. That uncertainty may be taken into account by the discount rate which is used to discount future income. Finally, apart from these long-term determinants, there are also short-term factors determining the dynamics of consumption, such as the movement in current disposable income or the economic situation, particularly regarding employment.

In this chapter, we analyse the extent to which the events observed during the financial crisis and the economic recession affected these variables and therefore influenced consumption.

2.2 Recent developments in the main determinants

FINANCIAL WEALTH

Since the first phase of the crisis was essentially financial, households initially felt its impact in the erosion of their financial wealth, following the collapse of share prices more or less worldwide. Stock markets had already begun to fall by July 2007: in the space of six months, the Belgian reference index for listed companies⁽¹⁾ lost 11 % of its value. In 2008, the stock market fall accelerated sharply throughout the world as well as in Belgium, and the Belgian reference index plummeted by 41 %, dropping alarmingly in October 2008 at a time of extreme concern about the impact of the crisis on the Belgian economy, notably via its repercussions on the financial sector.

The impact of the stock market crash on the financial assets of households⁽²⁾ was considerable, even though listed shares made up only about 8 % of those assets before the crisis, since the valuation of a large part of their assets – in this case unlisted shares – is also based on stock market valuations. Overall, from the end of June 2007 to 31 December 2008, Belgian households thus suffered a cumulative loss of around 90 billion on their financial assets, representing a fall of around 13 % against their initial value. Historically speaking, it is not so much the scale of the financial losses that is remarkable, but the speed with which they occurred, namely in the space of six quarters. For comparison, when the dotcom bubble burst in the early 2000s, household assets were cut by 116 billion, a 17 % fall, but the decline was spread over ten quarters, from the third quarter of 2000 to the first quarter of 2003.

Household assets – in the form of financial or real estate assets – constitute a reserve which can be used to maintain a certain level of consumption following retirement,

i.e. when disposable income declines, but which can also be consumed at any other time. The assets which constitute wealth generate income, but may be resold or used to augment borrowing capacity, by serving as collateral. If wealth depreciates sharply while disposable income remains unchanged, and if that depreciation is considered permanent, households can logically be expected to reduce their (current and future) consumption expenditure in order to rebuild their assets.

However, in Belgium, this effect – called the wealth effect, a generic term designating the link between assets and consumption, and in particular the impact on consumption of (large) fluctuations in the prices of the assets which make up the wealth – is considered to be limited (Eugène *et al.*, 2003). In particular, the wealth effect in Belgium is thought to be weaker than the average for the euro area, where it is moreover considered to be smaller than in the United States⁽³⁾.

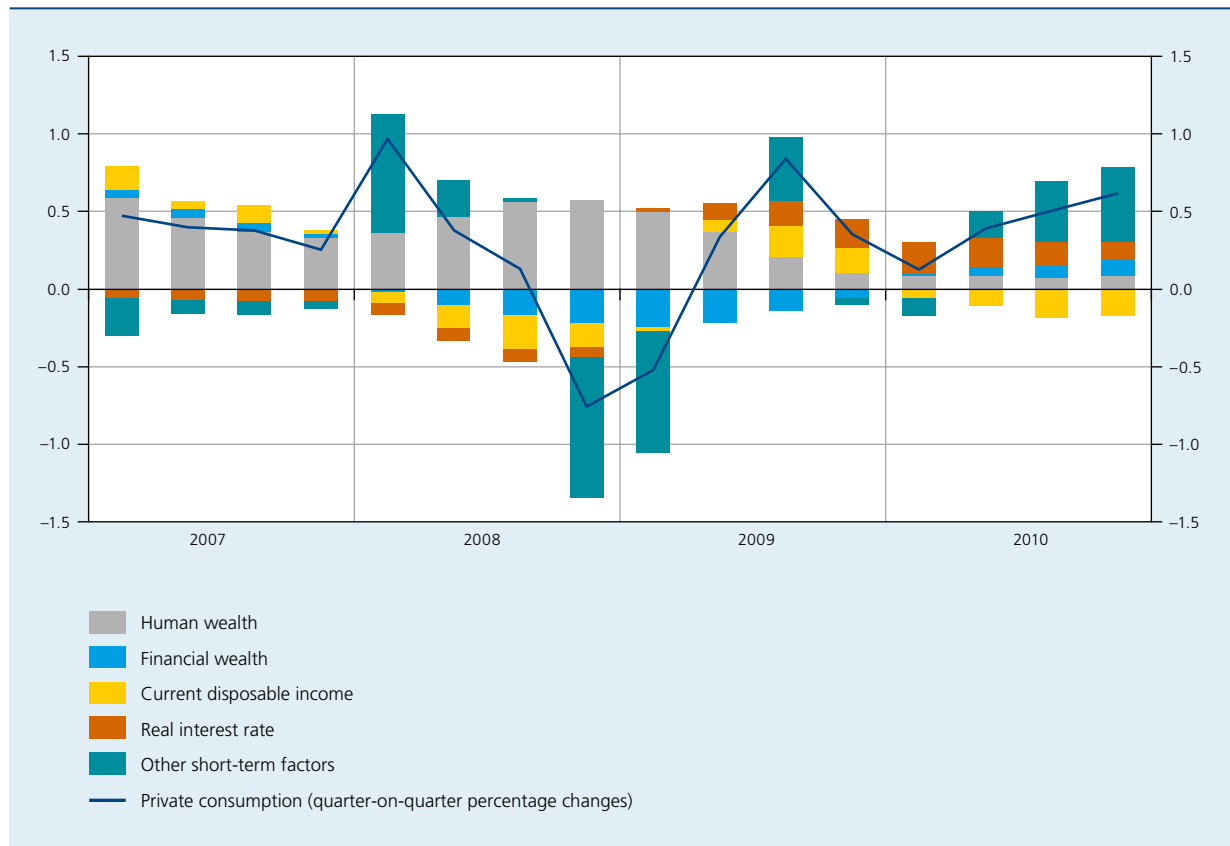
The scale of the wealth effect in an economy depends on two elements: the size of household assets in relation to consumption, on the one hand, and the marginal propensity to consume those assets, on the other hand. In regard to the first element, international comparisons show that households' assets are substantial in Belgium, and that this is due to the size of their financial assets, which should augment the wealth effect. Conversely, the marginal propensity to consume those assets seems to be lower than elsewhere, owing to the concentration of the assets in a small segment of the population, and their composition, namely the small proportion of listed shares.

The marginal propensity to consume real estate assets is regarded as virtually zero in Belgium. Given the high transaction costs, real estate is viewed to a greater extent than elsewhere as an asset providing housing services rather than as an investment. The absence in Belgium

(1) Index covering all listed companies excluding financial corporations. The global index which also covers financial corporations showed an even sharper fall.

(2) The financial assets in question here are net assets, i.e. the value of the financial assets less the value of the financial liabilities (consisting mainly of mortgage loans): if households manage to reduce their liabilities in parallel with the decline in their assets, that curbs the erosion of their wealth. That did not happen in the recent crisis, as lending to households remained relatively sustained throughout the period.

(3) Numerous studies have tried to quantify the importance of the wealth effect in various countries – generally comparing the situation in the United States to that in European countries – and, depending on the type of assets, generally making a distinction between financial wealth and real estate wealth. In a recent study, the OECD presented new empirical findings concerning the importance of wealth effects in the United States, Japan and the euro area, on the basis of observations covering the 2008-2009 crisis (see Kerdrain, 2011). These showed that the marginal propensity to consume (MPC) financial assets is similar overall in the three regions (US, EA, JP), and comes to around \$ 5 to 6 per additional \$ 100 of financial wealth. Conversely, the marginal propensity to consume real estate wealth is higher in the United States – \$ 5 to 6 – than in the euro area and Japan – \$ 1 to 1.5 per additional \$ 100. Overall, taking account of the respective proportions of financial and real estate wealth in the total assets of each region, the total wealth effect (expressed in MPC) is around \$ 5 in the United States and \$ 3 to 4 in the euro area and Japan per \$ 100 of additional wealth. In broad terms, this study confirms previous research findings whereby the wealth effect is greater in the Anglo-Saxon countries, notably because real estate wealth is easier to mobilise for the purpose of consumption, as a result of explicit arrangements of home equity withdrawal.

CHART 5 DETERMINANTS OF PRIVATE CONSUMPTION IN BELGIUM(contributions to the quarter-on-quarter percentage change, unless otherwise stated)⁽¹⁾

Source: NBB.

(1) Contributions calculated by the Bank's econometric model for the June 2011 macroeconomic forecasts.

– as in most euro area countries – of explicit arrangements for the release of capital via home mortgages (mortgage equity withdrawal), probably the main channel for transmitting the effect of real estate wealth on to consumption, also greatly inhibits the existence of any housing wealth effect.

These findings are fully reflected in the Bank's econometric model. Financial wealth has only a fairly marginal influence on the level of household consumption, which is determined to a much greater extent by human wealth, i.e. the discounted value of labour incomes. The long-term elasticity of consumption to human wealth is 0.95, against 0.05 for financial wealth. On the other hand, the assets taken into consideration in the context of a potential wealth effect are solely the net financial assets, because if real estate assets are taken into account, that does not yield plausible significant coefficients.

Despite the theoretically limited significance of financial wealth in determining household consumption in

Belgium, the intensity of the shock to the financial assets of households during the recent crisis was so great that the impact on consumption expenditure was unusual. The contribution of financial wealth to consumption thus became negative in the first quarter of 2008, and deteriorated very rapidly and significantly up to the first quarter of 2009. It was not until the first quarter of 2010 that financial wealth again made a positive contribution to household consumption. The efforts which households made to save, from the end of 2008, and the simultaneous fairly strong stock market recovery in fact meant that household financial assets were gradually rebuilt. In the third quarter of 2010, they had regained their pre-crisis level at a net value of €716 billion.

UNCERTAINTY AND OTHER SHORT-TERM FACTORS

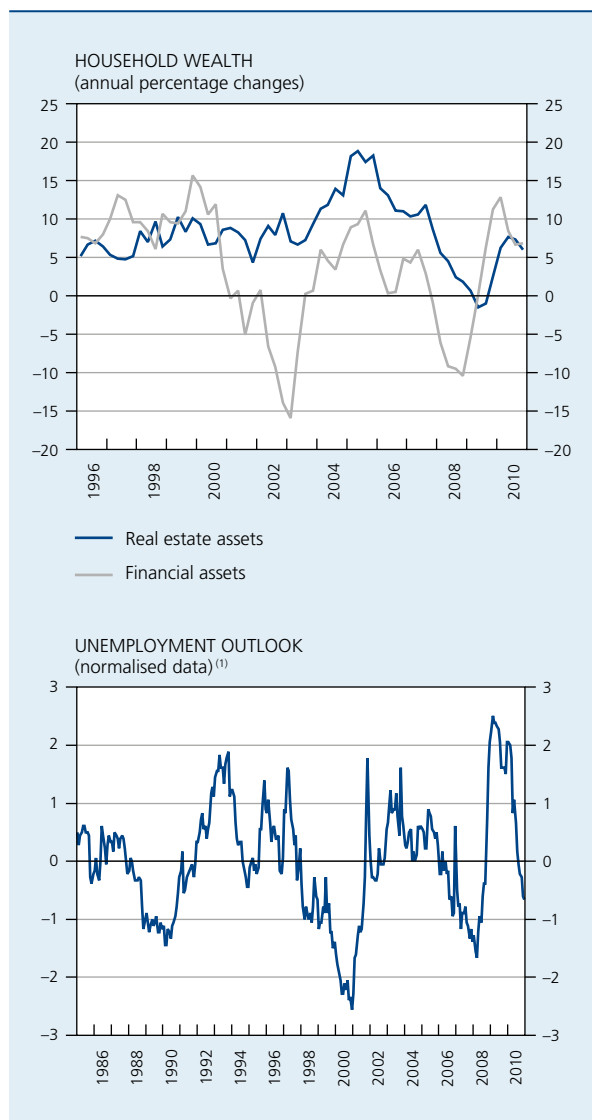
The negative effect of financial wealth was greatly exacerbated by the rapidly mounting uncertainty – covered by the variable "other short-term factors" in chart 5 – in late 2008 and early 2009, as the crisis was reaching its height.

The sudden deterioration in the general macroeconomic environment and the outlook undermined consumer confidence, prompting sharp cuts in consumption expenditure and increases in savings. The consumer confidence indicator, and more particularly the component which measures households' expectations regarding unemployment over the next twelve months, showed a very sharp fall during this period, reaching a record level of pessimism in February 2009.

Another element of uncertainty concerns developments on the real estate markets, even though – as already mentioned – housing wealth does not play a fundamental

role in determining consumption in Belgium. Compared to other recession episodes, and particularly the 2001 recession, the 2008-2009 crisis has a strong housing component since it was triggered by the problems on the subprime segment in the United States and was accompanied by a severe housing crisis and the collapse of prices in numerous countries. It is true that, in retrospect, the real estate market in Belgium withstood the crisis very well, as the housing price correction in particular was very small. But in the highly uncertain environment prevailing at the end of 2008 and in early 2009, Belgian households may have feared that what was happening elsewhere might spread to their own market, with a subsequent erosion of their housing wealth.

CHART 6 DETERMINANTS OF CONSUMPTION AND SAVINGS



Source: NBB.

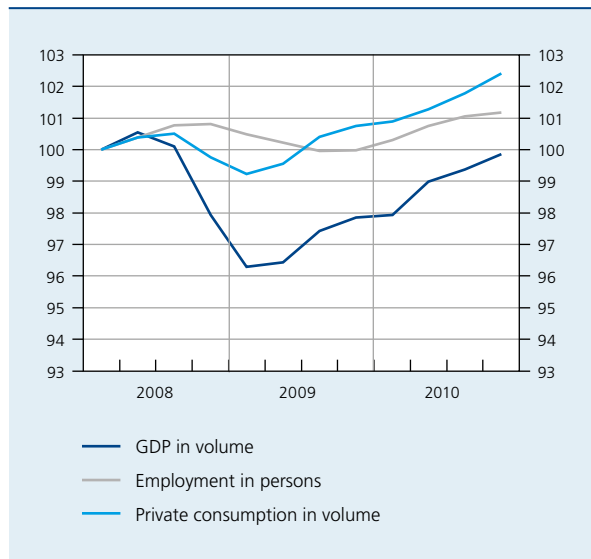
(1) Balance of replies to the monthly consumer survey; original series less the average over the period from 1985 to 2010 divided by its standard deviation.

This braking effect due to uncertainty gradually weakened in the second half of 2009 and in 2010, as is evident from the almost continuous improvement in household expectations regarding the unemployment outlook. In August 2010, expectations had reverted to their long-term level, indicating that households took a more or less neutral view of their future labour incomes. Consequently, the contribution to consumption growth of short-term factors due to uncertainty became more decidedly positive again from the second quarter of 2010.

HUMAN WEALTH

While the uncertainty over future income flows diminished, those income flows became smaller from the second half of 2009 and throughout 2010, as the contraction in economic activity affected employment and wages. True, in relation to the fairly dramatic expectations of households on the subject, the worst did not materialise on the employment front. As explained in detail by the article published in the June Economic Review on the reaction of the Belgian labour market to the recent crisis (see De Mulder and Druant, 2011), the decline in economic activity had a greater impact on the number of hours worked per employee than on the number of persons employed. The usual practice of labour hoarding, whereby staff are not made redundant in the expectation of a rapid revival in activity and in the light of existing shortages of skilled staff, was in fact reinforced by the system of temporary lay-offs and a series of special anti-crisis measures.

The resilience of employment therefore helped to support private consumption at the height of the recession. Nonetheless, the gradual adjustment of employment and wages and the persistent effect of the crisis on the potential growth of the economy, implying weaker income growth in the future, subsequently meant that the contribution of human wealth to consumption declined throughout 2009 and remained low in 2010.

CHART 7 RECENT DEVELOPMENTS IN PRIVATE
CONSUMPTION AND EMPLOYMENT(indices 2008 Q1=100, data adjusted for seasonal and
calendar effects)

Source : NAI

CURRENT DISPOSABLE INCOME

Although the life-cycle theory states that discounted future income is the main determinant of the consumption profile, the influence of current income must not be neglected. In particular, the existence of liquidity constraints may give current income a much bigger role in consumption than that attributed to it by the life-cycle theory. Moreover, individuals' expectations regarding their future income are not unrelated to their current income. But the movement in current disposable income may also be directly contrary to short-term uncertainty over future income. That was precisely the case during the recent crisis: current disposable income had a negative influence on consumption in 2008 and a positive influence in 2009, for reasons explained in detail in section 1.2.

REAL INTEREST RATE

The real interest rate expresses intertemporal substitution in consumption, or the decision to consume today rather than tomorrow. Having been slightly negative up to mid-2008, its influence on consumption turned around from the first quarter of 2009 and gradually strengthened up to mid-2010. The sharp cut in interest rates from the autumn of 2008 and their maintenance at a low level in fact encouraged current consumption rather than postponement.

Conclusion

Viewed overall, private consumption accounts for half of the growth of activity in Belgium. Despite exceptionally severe shocks, it cushioned the decline in activity during the 2008-2009 economic recession in conjunction with the resilience of employment during that period. The operation of the automatic stabilisers inherent in the social security system played a key role here.

Private consumption therefore provides a stable basis enabling the economy to pursue a growth path which is sustainable in the long term. However, these specific features are not inherent in this demand component; they are seen only in an economic context free of serious imbalances, in which the agents can form their expectations without having to take account of avoidable uncertainty. The example of certain euro area countries shows that where structural imbalances develop – be it in public finances or firms' competitiveness – and need to be corrected, the impact on private consumption is liable to be serious and lasting, which in turn weakens the potential for activity, income generation and job creation.

Therefore, in order to maintain the positive interaction between the supply capacity of the economy and domestic sources of demand, taking account of the structural challenges posed by population ageing and globalisation, it is vital to preserve or even reinforce the conditions for balanced development. Those conditions concern numerous variables, notably the financial situation of households and non-financial corporations, but also that of the financial sector and the government or, in general, the competitiveness of the economy.

In particular, the large increase in the public debt between 2007 and 2010, though it was smaller than in most other European countries, must rapidly give way to consolidation to restore the debt to a path which is sustainable in the long term. That increase was due to support measures for the financial sector, the endogenous effects of the economic recession on public finances and, to a lesser extent, to other anti-crisis measures. Without consolidation, it is likely that consumers – aware of the intertemporal budget constraint that governments must also respect – will rapidly step up their savings ratio in accordance with the principle of "Ricardian equivalence", in anticipation of the future effort that will be needed in terms of increased taxes or cuts in government transfers.

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