2. Economic developments in Belgium

Belgium's gross domestic product (GDP) increased by 1 % in 2014. However, as the year progressed, the recovery that began in 2013 lost pace amidst the weakening economy in the euro area, major geopolitical uncertainties and doubts about the ability of Europe's economies to develop sustainably. Employment showed a tentative recovery, rising by 15 000 units, but the net creation of jobs failed to prevent a renewed increase in the number of job-seekers. Unemployment reached 8.6 % of the labour force as a result. Against the backdrop of weak demand, inflation continued the decline started in 2011. Falling to a year-on-year average of 0.5 %, inflation even reached a low of –0.4 % in December. Whereas the slowing rate of inflation is due to lower energy prices, underlying inflation appeared to be more robust, at 1.5 %. The marked drop in inflation had a significant impact on hourly wage costs, their growth slowing to 0.7 %. According to the Central Economic Council's technical report, the higher cumulative cost of labour in Belgium relative to its three most important neighbouring countries (since 1996) dropped from 4.2 % in 2013 to 2.9 % in 2014. Growth in economic activity in 2014 may be attributed primarily to a pick-up in domestic demand, excluding stock adjustments. Private consumption rose relatively strongly, in tandem with trends in purchasing power. Business investment continued to grow. The current account on the balance of payments increased on the strength of the effect of higher net exports in volume terms.

2.1 Economic situation

Economic activity somewhat slower since the spring

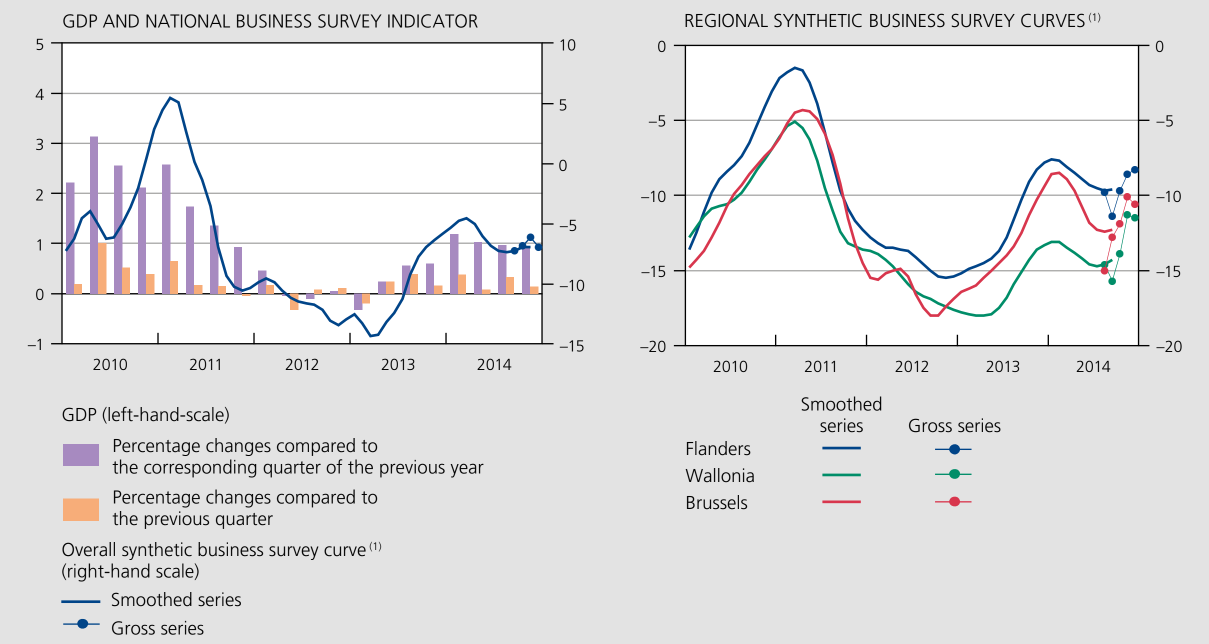
In 2014, economic developments in Belgium were comparable to those in other euro area countries. After two years of virtual stagnation, Belgium's GDP – like that of the euro area – showed clear growth, albeit modest. In volume terms, GDP was up by 1 % on average over the year, compared with very slight increases of 0.1 % and 0.3 % respectively in the previous two years. Growth for the year as a whole may be attributed mainly to increased economic activity at the start of the year, as was the case elsewhere in the euro area. Contrary to expectations, the economic recovery that got underway in the spring of 2013 actually lost pace in the year under review. Quarter-on-quarter growth remained positive, but the rate of growth dropped by almost half, to 0.2 % on average, compared with the first quarter of 2014.

Slackening economic activity during the course of the year gave rise to uncertainty. Business confidence clearly deteriorated in the spring and stabilised at a relatively low level in the summer. Recent months have seen a slight renewed recovery. It is worth noting that the weakening confidence was visible in all three of the country's Regions. The fact that business confidence is lower in Wallonia than in the two other Regions is due mainly to the fact that its economy did not improve as strongly during the short-lived economic upswing of 2013.

The flare-up in uncertainty was a phenomenon shared by Belgium's European partners. It was fuelled by perceptions of increased geopolitical risks, especially in the wake of the heightened conflict in Ukraine in the first half of the year, the subsequent deterioration of relations with Russia and the ever-intensifying clashes in the Middle East. Both in Belgium and in the euro area as a whole, the negative impact on the economy of battered confidence seems to have been stronger than actual trade flows would suggest. These risks may well have stirred up latent doubts about the ability of Europe's economies to show sustainable growth and about the robustness of the global economy against the backdrop of lacklustre international trade.

In Belgium, economic uncertainty does not seem to have had too great an impact on domestic demand, which

CHART 24 GDP IN BELGIUM AND CONFIDENCE INDICATORS



Sources: NAI, NBB.
(1) Balance of replies to the monthly surveys, non calendar adjusted data.

declined markedly less than production. The downturn in production is attributable mainly to the relatively modest growth in exports, which were hard hit by low economic growth, in particular among Belgium's major trading partners. Another factor at play here was the renewed negative effect of stock adjustments. Despite the significant statistical uncertainty of this variable, it seems that in light of the uncertain economic environment, companies did not boost their production volumes as strongly as would otherwise have been possible, considering that domestic demand was still relatively robust.

Decline in market services and industrial sectors

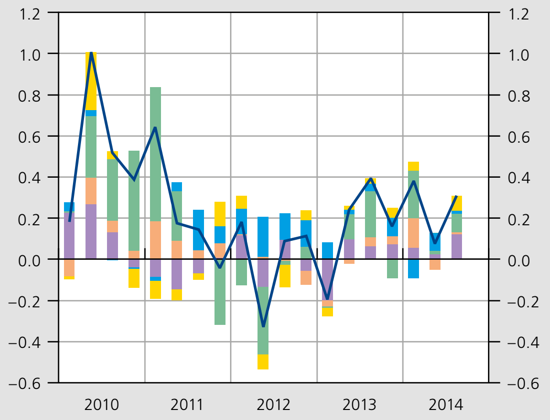
Industry typically responds strongly to changes in actual demand or fluctuations in demand expectations. This sector, which accounts for around 17 % of the Belgian economy's value added, often operates in highly integrated international production chains, making its foreign markets absolutely vital. The manufacturing industry's synthetic business survey indicator may have edged down only slightly and even showed signs of revival by the end of the year, but key sub-indicators, which are more closely correlated with the value added generated by companies in the sector, recorded steeper falls. Demand forecasts, and the assessment of total order books especially, have dipped well below the synthetic indicator, for instance, and industry's value added suffered a temporary dip in growth relative to the increase recorded in the spring of 2013. In the first half of 2014, value added growth in the industry edged down temporarily compared to the increase notched up in the spring of 2013.

The market services sector, which comprises trade, accommodation and food service activities, transport and communication, and financial, real estate and business services, and which accounts for a much bigger proportion of Belgium's total value added – around 52 % – likewise reported a significant economic slowdown from the spring, following a strong first quarter. Trade was hit hardest, but business services also experienced a steep decline in confidence and in demand forecasts.

Economic activity in the construction industry – which has seen its share of total value added gradually edge up in the past few years to reach nearly 6 % in 2014 – was boosted in the first quarter by an exceptionally mild winter. Partly because of this unusually robust first-quarter showing, it subsequently fell, while quarterly value added growth remained weak or negative, as had been the case in the two previous years. Developments in construction are typically

CHART 25 VALUE ADDED OF THE MAIN BRANCHES OF ACTIVITY

(contributions to the change in GDP compared to the previous quarter, unless otherwise stated; volume data adjusted for seasonal and calendar effects)



Source: NAI.
(1) Namely the "Agriculture, forestry and fishing" branch and product-related taxes net of subsidies.
(2) Percentage changes compared to the previous quarter.

dominated by factors specific to the Belgian economy, which nevertheless tend to differ for residential and commercial property and for infrastructure. In that respect, confidence in structural building took a singularly different path from that in civil engineering and road works in 2014. Confidence in the latter sub-sector again deteriorated sharply and continued the trend seen since 2011, in the wake of sharply contracted government investment as part of fiscal consolidation – a factor exacerbated in 2013 and 2014 by the traditional downtrend following local elections. By contrast, confidence in structural building would seem to have stabilised in 2014, in parallel with the tentative recovery in residential housing investment, after a lengthy downward movement (albeit less marked).

Fiscal consolidation at federal and regional levels also restrained value added creation in non-market services in 2014. This sector, which includes education, public administration, health care and social work, typically records strong increases irrespective of economic conditions. This time, however, its growth was weaker than in previous years.

2.2 Labour market

Tentative recovery in employment in 2014

Even though it was fragile, the recovery that started in 2013 had a favourable effect on the labour market. Heightened economic activity first led to improved productivity, as is often the case. Productivity per hour worked increased from the start of the upswing and this improvement was sustained throughout 2014. That said, it was a modest increase given that the level of productivity at the end of 2014 remained below that observed before the crisis, in early 2008. Labour volumes quickly followed suit, rising by 0.4 % on average for the economy as a whole during 2014. This was due mainly to an increase in working hours per person. After this initial increase, however, average working hours edged down. Labour volume growth was therefore reflected in a rise in job numbers of 0.3 %.

The drop in average working hours, particularly pronounced in the second quarter, may be attributed primarily to the construction and manufacturing industries. Additionally, the higher numbers of temp agency workers, who these days are contracted for ever shorter periods, is also resulting in reduced average working hours. To an extent, the fact that employers have increasingly been using temp agency workers since the end of 2013 reflects their reluctance to take on permanent employees in times of economic uncertainty, as well as a need for labour market flexibility.

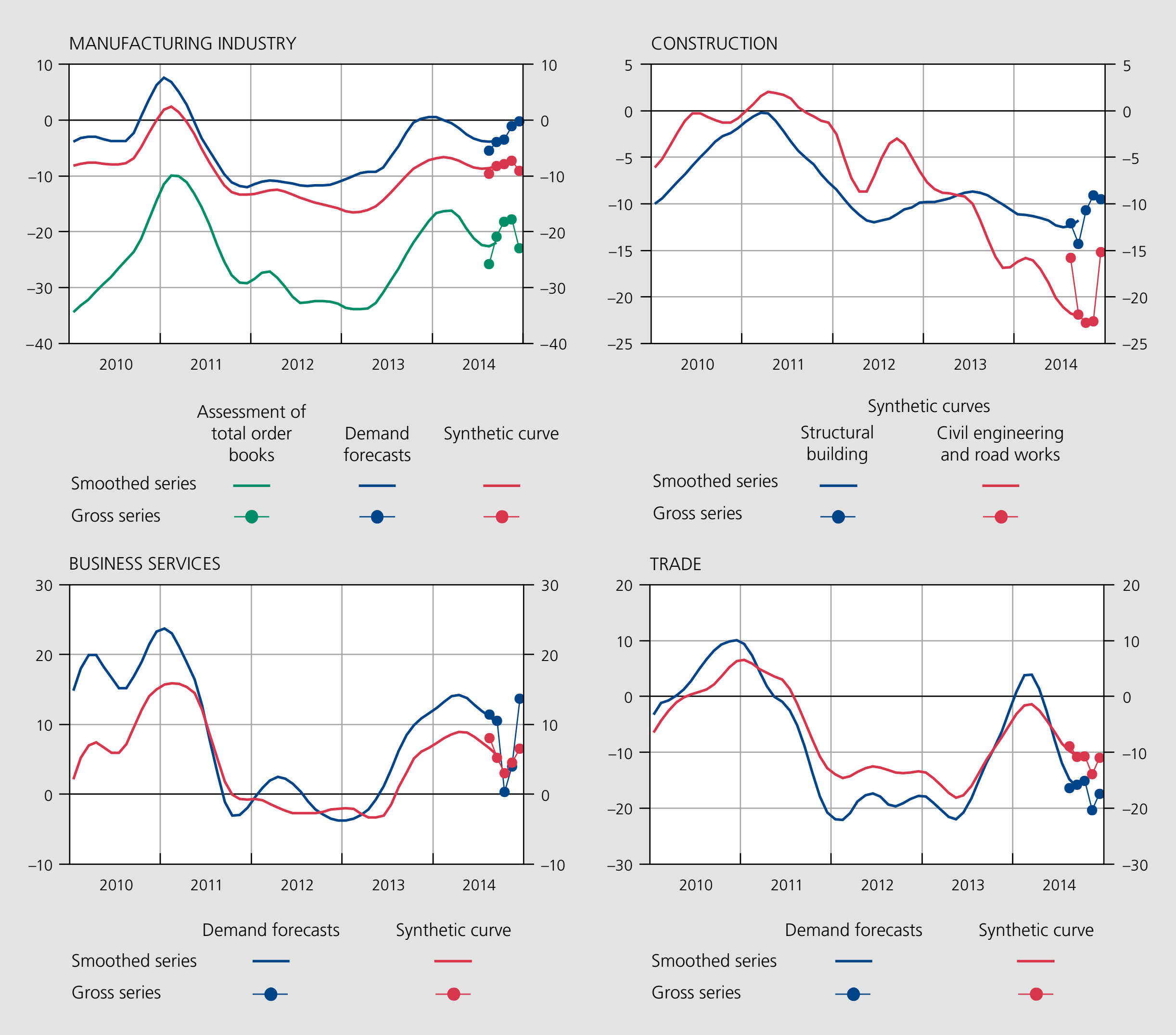
Meanwhile, the number of days of temporary lay-offs came down in 2014 – markedly so at the beginning of the year, continuing a trend that had started to emerge as early as the second half of 2013. Companies had been trimming their workforces in that year in the wake of stagnating economic activity in 2011 and 2012, reducing the number of days of temporary lay-offs. In 2014, employers in branches hit by the embargo on fruit and vegetables exports to Russia compensated for the steep fall in their business by using temporary lay-offs. Companies in the construction sector widely used the same option in the third quarter, citing unfavourable weather conditions in the summer months.

Against this backdrop, domestic employment increased by an average 15 000 people in the year under review, after having recorded a fall of 12 000 people in 2013, that is to say an even stronger decline than during the great recession.

Providing jobs for the majority of all workers, employers in branches of activity sensitive to the business

CHART 26 BUSINESS SURVEY INDICATORS FOR THE MAIN BRANCHES OF ACTIVITY

(balance of replies, seasonally adjusted data)



Source: NBB.

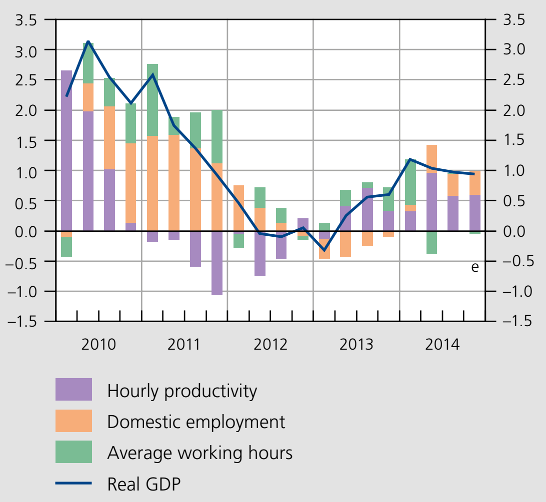
cycle – primarily industry, construction and the market services sector – did not contribute to these higher numbers, cutting 1 800 jobs. In 2013, these industries saw over 23 000 jobs lost. Trends nevertheless diverge within this group. So, companies in industry, construction and financial services reduced their workforces by 12 900, 6 400 and 1 200 in the first three quarters of 2014, with industry thus confirming a strong downward trend and financial services continuing the decline that had started in 2002. Conversely, workforce numbers in market-services companies, comprising temporary work and a significant proportion of service voucher jobs, were up by 17 100. Of these new jobs, nearly 4 000 are estimated to come under the service voucher scheme. However, the scheme's growth looks to be decelerating due to a gradual saturation of demand and the higher hourly cost to its users, as well as the recruitment problems facing providers of these services (see Box 5).

In 2014, the highly subsidised activities that make up "other services" (primarily health care and social services) further contributed to rising employment by adding 9 600 jobs.

By contrast, in the "public administration and education" branch, job numbers stagnated, as budgetary measures resulted in a proportion of employees not being replaced upon retirement.

CHART 27 EMPLOYMENT, WORKING TIME AND PRODUCTIVITY

(contribution to annual growth of GDP, percentage points, data adjusted for calendar effects)

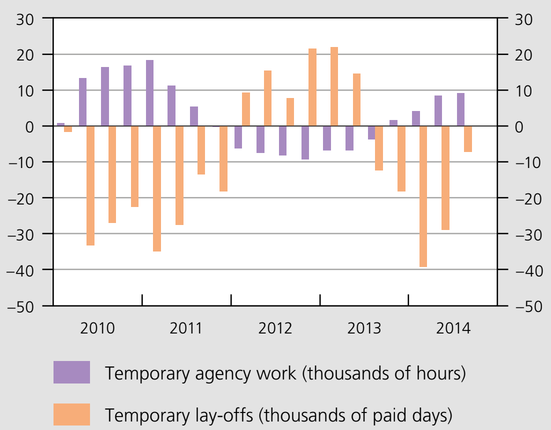


Sources: NAI, NBB.

Lastly, self-employment grew faster than average at around 1 %, corresponding to 7 300 extra people. This is in keeping with the consistent increase in self-employment as a share of employment since 2008.

CHART 28 TEMPORARY AGENCY WORK AND TEMPORARY LAY-OFFS

(changes compared to the corresponding quarter of the previous year)



Sources: Federgon, NEO.

Job creation failed to prevent unemployment from inching up

2014 witnessed a continuation of the gradual slowdown in growth of the working age population seen since 2007, with an increase of 10 500 people as compared with record growth of 70 200 in 2007. The labour force grew by 28 900 people in the year under review, at a faster pace than in the two previous years. But the modest upturn in employment was not enough to absorb the growth of the labour force, and joblessness rose further. A total of 14 000 extra job-seekers were recorded, an increase that was well below the 2013 surge. On annual average, though, the 600 000 jobless mark was nearly breached in 2014.

This upsurge was visible in the harmonised unemployment rate, which, at 8.6 %, has reached its highest level since 1999. Based on the labour force survey and the definitions of the International Labour Office, this indicator expresses the relationship between the number of job-seekers – i.e. unemployed people available for work and actively looking for jobs, regardless of whether they are registered as benefit claimants with the National Employment Office (NEO) – and the labour force. In November 2014, the Belgian unemployment rate was 3 percentage points below the figure for the euro area. However, the euro area rate – though diverging strongly between countries – has been on a downward trajectory since the start of 2013, whereas Belgium's unemployment levels have remained virtually static.

The rise in administrative unemployment varies across the country's three Regions. If year-on-year changes are taken into account – in order to iron out seasonal effects –, the number of job-seekers grew strongest in Flanders in 2014, in both absolute and relative terms. Wallonia, by contrast, has been seeing a gradual reduction in the number of unemployed job-seekers since the middle of 2014. In December 2014, Flanders recorded nearly 252 000 job-seekers, Wallonia 230 000 and Brussels 108 000.

Youth unemployment declined in the year, after shooting up in 2012 and 2013. As in the past, the young were quicker to benefit from recovering growth, while they had been hit first by the crisis because of their lack of experience. That said, there were still 111 000 unemployed job-seekers under the age of 25 by December 2014, accounting for nearly one-fifth of the total.

In contrast, the over-50s age group among unemployed job-seekers continued to swell, if slightly more moderately than before, continuing the trend started in the early 2000s. To a degree, the rise reflects successive

TABLE 4 LABOUR SUPPLY AND DEMAND

(calendar adjusted data ; annual averages, unless otherwise stated)

	2010	2011	2012	2013	2014 e
			(percentage change)		
Labour volume in hours	1.0	2.2	0.4	–0.1	0.4
Domestic employment in number of people	0.7	1.4	0.3	–0.3	0.3
			(change in thousands of persons)		
Population of working age	55.3	45.3	21.9	12.0	10.5
Labour force	44.7	42.9	27.9	11.5	28.9
National employment	31.0	62.8	13.5	–13.0	14.9
Frontier workers	0.8	–0.3	0.3	–0.7	–0.1
Domestic employment	30.2	63.0	13.2	–12.4	15.0
Employees	23.9	53.3	4.3	–19.1	7.8
Cyclical sectors	2.5	31.8	–7.5	–23.4	–1.8
Agriculture	0.2	0.6	0.1	1.4	0.3 (2)
Manufacturing	–18.9	–1.3	–6.3	–12.4	–12.9 (2)
Construction	1.0	4.0	–0.5	–5.5	–6.4 (2)
Market services	20.3	28.5	–0.9	–6.9	15.9 (2)
Public administration and education	7.5	3.8	–1.6	2.2	0.0
Other services	13.9	17.8	13.4	2.1	9.6
p.m. Service vouchers	*15.2*	*11.5*	*8.1*	*8.5*	*5.2*
Self-employed	6.3	9.7	8.8	6.7	7.3
Unemployed job-seekers	13.7	–19.8	14.5	24.6	14.0
p.m. Harmonised unemployment rate (1)	*8.4*	*7.2*	*7.6*	*8.5*	*8.6*

Sources : DGS, NAI, NEO, NBB.
(1) In % of the labour force between 15 and 64 years.
(2) Average of the first three quarters, according to the NAI.

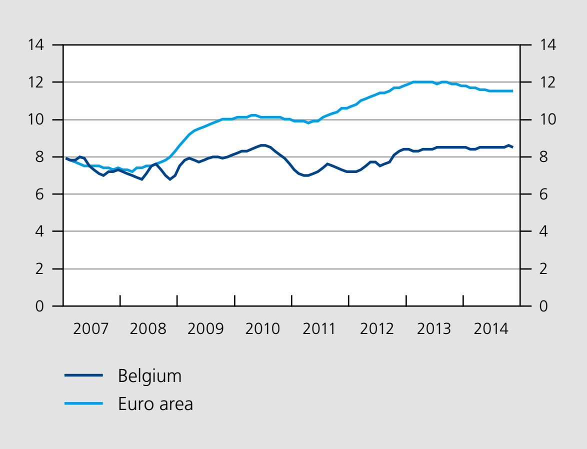
tightening of the criteria granting older unemployed people exemptions from looking for work. The minimum exemption age has gone up from 50 in 2002 to 60 in 2013. From 1 January 2015, all unemployed people, irrespective of age, will be subject to the same rules governing availability and active job-searching. Exemptions will continue to apply to people who were registered as unemployed and had turned 60 before the end of 2014. In December 2014, Belgium recorded 145 000 unemployed job-seekers aged 50 and over, 60 000 of them in Flanders, 62 000 in Wallonia and 23 000 in Brussels.

The number of unemployed workers receiving an employer top-up has edged down slightly since 2010. This trend continued into 2014, with the overall number standing at 100 000 in November, compared with 118 000 in early 2010. Under the October 2014 coalition agreement, the eligible age for the scheme will go up to 62 from 60 with effect from 1 January 2015, and for restructuring companies from 55 to 60 years of age from 2017. The social partners have agreed a government-approved option to deviate from these new rules until the end of 2017, provided they do so in a collective labour agreement (CLA) before 30 June 2015. By the same token, companies can also agree to postpone the increase from 55 to 60 of the eligible age for taking end-of-career time credit.

In keeping with the steady increase in the share of older unemployed workers, there has been an uninterrupted rise in long-term unemployment since mid-2013, as measured by the number of unemployed job-seekers looking for work for two years or longer. Unlike other categories of unemployed people, this group did not see the upward trend decelerate but rather pick up in the year under review. By December 2014, the long-term unemployed accounted for over one in three job-seekers

CHART 29 HARMONISED UNEMPLOYMENT RATE IN BELGIUM AND THE EURO AREA

(seasonally adjusted monthly data, in % of the labour force, aged 15 and over)

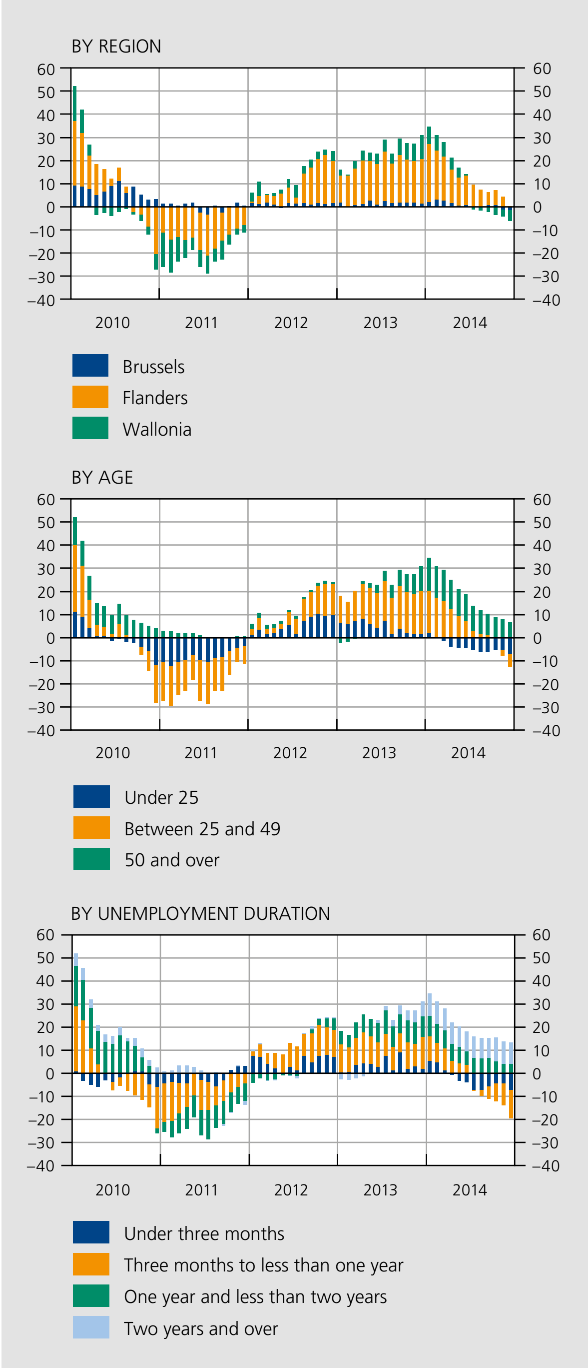


Source: EC.

and totalled 211 000. In terms of knowledge, skills and attitudes, these people are the furthest removed from the labour market and the hardest to re-employ, even when economic activity revives. Slower unemployment growth in the year under review is primarily attributable to a fall in very short-term unemployment (under three months) and short-term unemployment (between three months and less than a year). If these trends continue, structural unemployment might rise and depress the economy's growth and employment potential.

CHART 30 UNEMPLOYED JOB-SEEKERS IN BELGIUM

(changes in thousands of people compared to the corresponding month of the previous year)



Source: NEO.

Box 5 – The development of the service voucher scheme

The service voucher scheme, which was introduced by the Law of 20 July 2001 and came into effect on 1 January 2004, aims to promote neighbourhood services and jobs, these being primarily held by low-skilled workers, and to regularise some of the work done in the shadow economy. Under the scheme, private individuals buy home help services from authorised companies and pay with special vouchers that they buy from the voucher issuer. Authorised companies return to the issuer all vouchers paid to these employees for the hours worked, for which they are reimbursed. The amount reimbursed equals the nominal value of the service vouchers, plus an addition from the government to defray the cost to the employer of one hour of work as well as structural costs, such as administrative expenses and supervision of the employees.

Service vouchers were initially priced at € 6.20, an amount that has been incrementally raised since 2004 to reach € 9 in 2014 for the first 400 vouchers purchased and € 10 for any subsequent purchases. Voucher users enjoy tax breaks, calculated at a tax rate of 30 % (so they end up paying only € 6.30 for a € 9 service voucher). Since 1 January 2014, the tax deduction on service vouchers has been capped at € 1 400 per person a year. Authorised companies receive a total of € 22.04 per voucher, implying that the government pays € 13.04 (or € 12.04 as the case may be) towards every voucher used. In its 2013 annual review, Idea Consult put the total gross costs of the scheme in 2012 at € 1.8 billion (0.5 % of GDP). Factoring in the direct payback effects – the unemployment benefits that do not need to be paid, social security contributions and income taxes levied on employee wages – in addition to the indirect first-order effects such as tax receipts from supervisory staff, takes around 45 % off the cost.

NUMBER OF EMPLOYEES IN THE SCHEME AND SERVICE VOUCHER PRICES

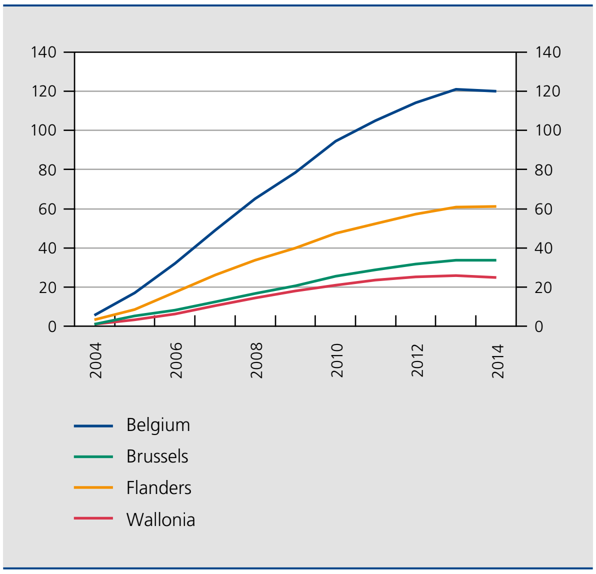
	Number of employees (annual averages, in thousands)	Price of a service voucher (on 1 January, unless otherwise stated, in €)
2004	3	6.2 – 6.7 (1)
2005	12	6.7
2006	24	6.7
2007	37	6.7
2008	56	6.7 – 7.0 (2)
2009	74	7.5
2010	90	7.5
2011	101	7.5
2012	109	7.5
2013	118	8.5
2014 e	123	9.0

Sources: NSSO, NEO, NBB.
(1) Raised in November 2004.
(2) Raised in May 2008.

The number of workers paid under the scheme has steadily risen from an average of 3 000 in 2004 to 118 000 in 2013 according to the latest data provided by the National Social Security Office (NSSO) and to 123 000 in 2014 under the NBB's forecasts, continuing the slowdown in jobs growth that started in 2010. In the early days, a large proportion of jobs thus created replaced work in the informal economy or were a conversion of services previously provided by local employment agencies, and the net effect on employment was less than it is today. Idea Consult reports that a majority of these workers are women (97 %), one-fifth are under 30 years of age and another one-fifth 50 or over. The workforce breaks down into 56 % low-skilled – a primary school certificate or lower secondary school at most – and 40 % medium-skilled. Lastly, nearly three in four workers are Belgian nationals, with 20 % nationals of another EU27 country and 8 % from outside the EU27.

The total volume of hours worked under the scheme, as measured by the number of reimbursed vouchers according to NEO statistics, has exploded since its implementation, from 6 to 121 million for Belgium as a whole in 2013, with Flanders accounting for the bulk (61 million hours). However, the rise in the volume of work has been slowing down for years, because of gradual demand saturation and the increase in the price users pay per hour. In 2014, for the first time, the number of reimbursed service vouchers even declined slightly.

NUMBER OF REIMBURSED SERVICE VOUCHERS
(in millions of units)



Source: NEO.

Following the sixth State reform, the Regions were put in charge of the service voucher scheme. They have the power to authorise the service voucher companies located in their territories, decide what activities they will allow under the scheme and set the price of the service vouchers, including the tax deduction percentage. To ensure continuity of the scheme, the NEO will run it until the Regions are operationally able to take over.

2.3 Inflation and labour costs

Consumer price trends

Inflation even slower in 2014…

During the year under review, inflation measured by the year-on-year change in the harmonised index of consumer prices (HICP) declined for the third year running, averaging 0.5 % in 2014, compared with 1.2 % in 2013 and even dipping to –0.4 % in December. Having begun in the closing months of 2011 and due mainly to the fall in energy prices, the downward trend was accelerated by moderating food prices. Underlying inflation, by contrast, went up a little on the back of higher services prices.

The fall in total inflation in Belgium is largely in line with European trends, and in the past two years it has closely mirrored those in the euro area or the average of the three main neighbouring countries, which serves as a benchmark for calculating the wage norm. However, this comparable overall figure is the result of a much sharper fall in consumer energy prices in Belgium, whereas the modest 0.1 percentage point increase in underlying inflation contrasts with an equally large fall on average in the three neighbouring countries.

…despite persistent underlying inflation trends…

While underlying inflation, as measured by the HICP excluding food and energy, has steadily moved down in the three main neighbouring countries since the last quarter of 2013, Belgium saw it accelerate in the first six months of 2014, in line with a trend that had started in the third quarter of the previous year. Underlying inflation did come down in the second half of the year, but remained quite a bit higher than the average for the neighbouring countries. Taken over the full year, these percentages worked out at 1.5 % in Belgium, compared with 1 % in the neighbouring countries. In 2013, they stood at 1.4 % and 1.1 % respectively.

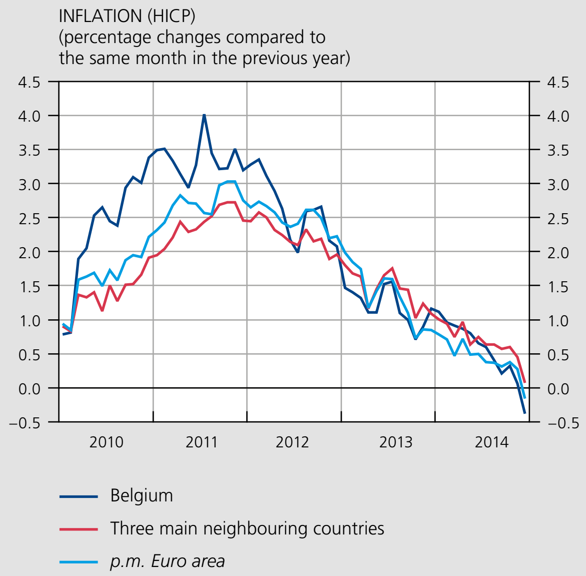
The (albeit very slight) revival of the underlying inflationary tendency in Belgium reflected rising services prices, which added 2.3 % in 2014, compared with 1.9 % in 2013. Non-energy industrial goods, by contrast, saw underlying inflation edge down to 0.5 % from 0.8 %.

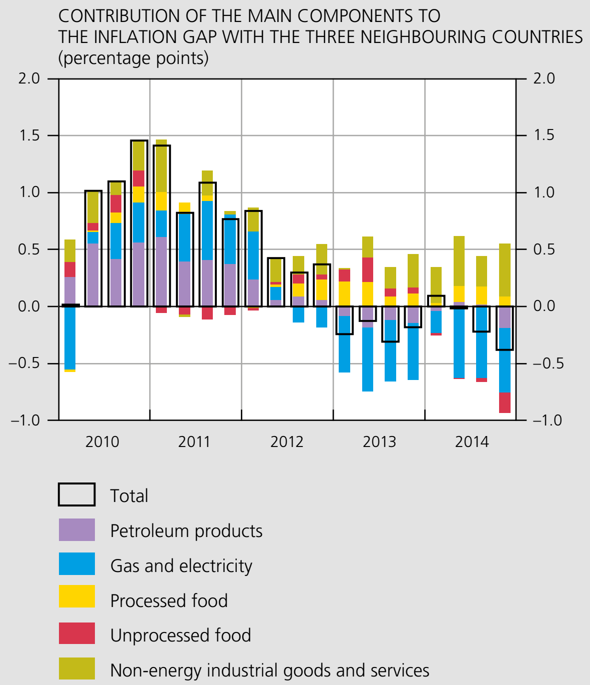
TABLE 5 HARMONISED INDEX OF CONSUMER PRICES AND LABOUR COSTS
(percentage changes compared to the previous year)

	2010	2011	2012	2013	2014	*p.m. Three main neighbouring countries* [1] *2014*
HICP	2.3	3.4	2.6	1.2	0.5	*0.7*
Energy	10.0	17.0	6.0	–4.6	–6.0	*–1.6*
Unprocessed food [2]	3.5	0.2	3.4	4.4	–1.3	*–0.9*
Processed food	1.0	3.1	3.1	3.2	2.2	*1.6*
Underlying inflation [3]	1.1	1.5	1.9	1.4	1.5	*1.0*
Non-energy industrial goods	0.8	1.0	0.9	0.8	0.5	*0.1*
Services	1.4	1.9	2.5	1.9	2.3	*1.6*
p.m. Health index [4]	*1.7*	*3.1*	*2.7*	*1.2*	*0.4*	–
p.m. National index	*2.2*	*3.5*	*2.8*	*1.1*	*0.3*	–
Labour costs in the private sector						
Per unit of output	–0.6	2.5	4.0	2.2	0.0 e	*1.4* [5]
Per hour worked	0.8	2.3	3.2	2.4	0.7 e	*1.9* [6]

Sources: EC, OECD, CEC, DGS, NAI, NBB.
(1) As in the other tables and charts in this section: HICP, weighted average based on private consumption; labour costs, weighted average based on GDP.
(2) Fruit, vegetables, meat and fish.
(3) Measured by the HICP, excluding food and energy.
(4) National consumer price index excluding products deemed harmful to health, i.e. tobacco, alcoholic beverages, petrol and diesel.
(5) Average of the first three quarters; business sector (NACE sectors B to N); source: EC.
(6) Annualised CEC estimate.

CHART 31 INFLATION IN BELGIUM AND IN THE THREE MAIN NEIGHBOURING COUNTRIES





Sources: EC, NBB.

This latter downward movement mirrors the prevailing gloomy economic climate in Belgium and Europe, as industrial goods prices are more sensitive to international trends than services prices. These prices are a slightly watered-down reflection of lower import prices – regardless of whether imports are used immediately or serve as input for goods intended for consumption – and unit labour costs.

Slowing unit labour costs benefit service providers even more than manufacturers of goods. However, whether any cost gains are passed on to consumer prices depends on companies' approach to margins. Wage moderation can help rebuild margins, particularly if these have recently narrowed, as had been the case between 2011 and 2013. With non-energy industrial goods subject to more international competition, opportunities for bolstering margins are fewer than for services. It would seem that the latter sector is the main contributor to the rigidity of the underlying trend, coupled with wage cost trends that are more pronounced than in the three main neighbouring countries.

Services whose prices have contributed to higher underlying inflation include volatile categories such as tourist trips and hotels and restaurants, with the latter accounting for a larger weighting in Belgium's HICP than the average for neighbouring countries. In 2014, numerous councils also raised the rates of some price-regulated services, such as waste collection and waste water treatment. Meanwhile, the HICP category related to residential maintenance reflected the increased prices for service vouchers from January 2014. And then there are a lot of services whose prices are routinely linked to the general consumer price index, the health index or other benchmarks, and which reduces the transmission of price dynamics onto underlying inflation.

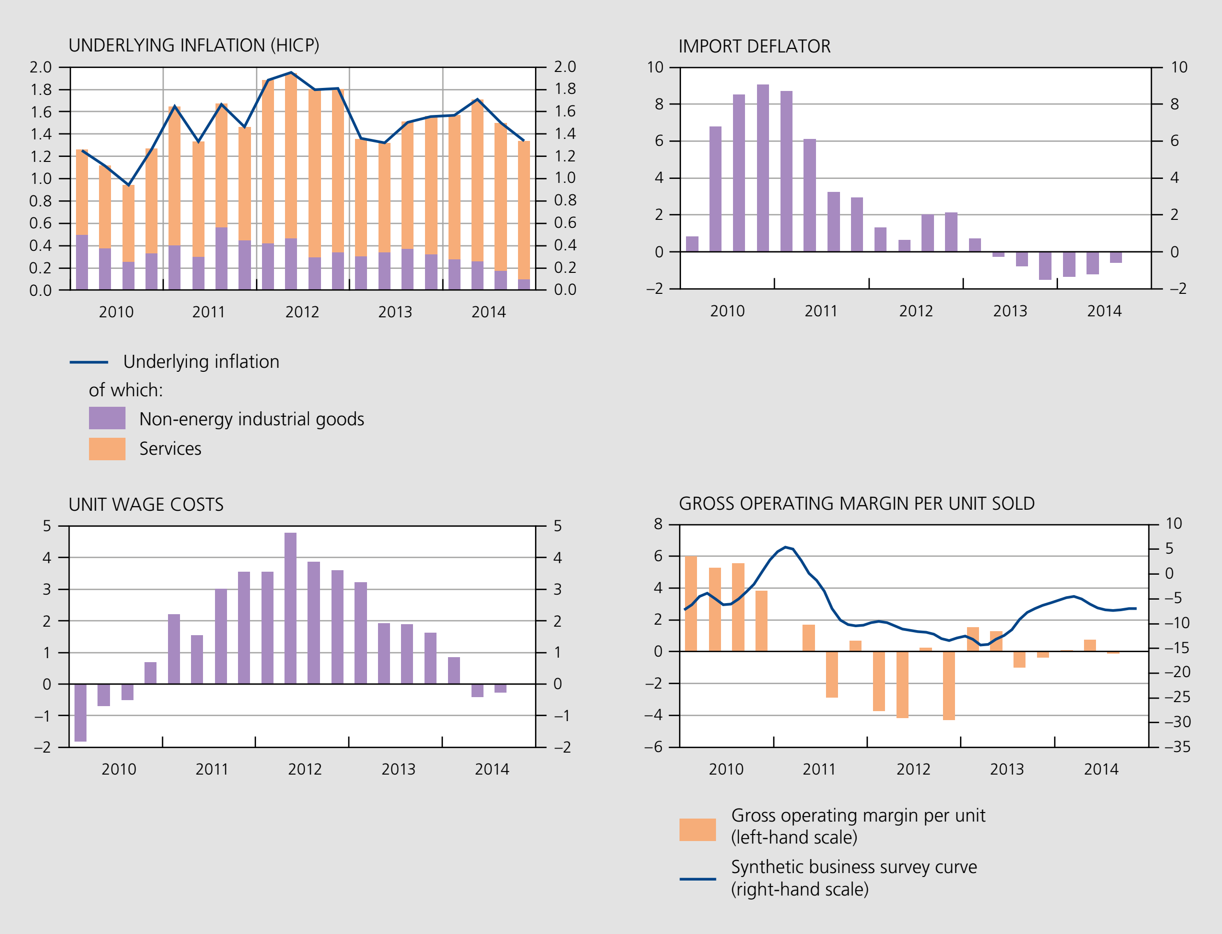
Lastly, underlying inflation was also influenced by a number of methodological changes, particularly relating to the registration of rent payments. These adjustments aim to provide a better view of implicit price increases when new leases are signed, in addition to rent being linked to the health index as is the case with existing contracts.

… related to food prices

Unprocessed food claims but a modest weighting in the HICP basket, and yet the 0.7 percentage point drop

CHART 32 UNDERLYING INFLATION AND COSTS

(percentage changes compared to the previous year)



Sources: EC, NBB.

in inflation in 2014 is mostly down to this category. Prices here fell by 1.3 % on average, compared with a hefty 4.4 % increase in 2013. Two factors came into play: supply conditions were not as dreadful in 2014 as they had been in 2013, as fruit and vegetable harvests benefited from favourable weather conditions. Secondly, a proportion of food exports intended for Russia ended up on the Belgian market because of the Russian embargo on food imports, pushing down prices.

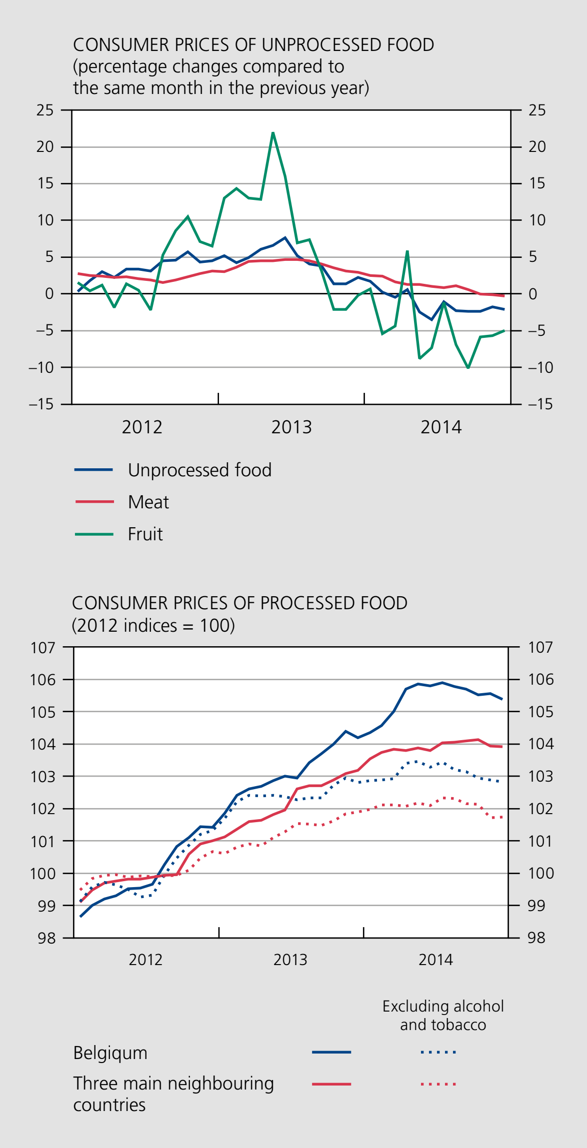
Price rises for processed food also slowed in 2014, to 2.2 % from an average 3.2 % in 2013 or, excluding alcohol and tobacco, whose prices are heavily influenced by changes in excise duty, from 2.4 % to 0.7 %. However, the pricing of processed food in Belgium continues to be asymmetrical. After the renewed upswing in international food commodity prices in 2012, Belgium had recorded steeper food price increases than neighbouring countries, adversely affecting the inflation gap in 2013. Yet the reverse did not happen when food commodity prices started to come down in the course of 2013. Ignoring alcohol and tobacco, this led to an unfavourable effect of 1.1 percentage points in 2013, while the same gap worked out at barely 0.1 percentage points in Belgium's favour in 2014, despite lower commodity prices and the impact of base effects.

Energy prices still on a downward path …

Energy retail prices slid by a further 6 % in 2014, following a significant 4.6 % fall in 2013. In Belgium, this downward trend had been fuelled both by price swings in oil-derived products – as also seen in the neighbouring countries – and a reduction in retail prices for gas and electricity, which was more specific to Belgium.

In 2014, prices per barrel of Brent continued their downward trajectory for the second year running, falling by an

CHART 33 CONSUMER PRICES OF FOOD



Source: EC.

average 9 % (annualised) in the wake of lower US dollar prices. On average, the euro exchange rate against the dollar stayed close to its 2013 level. Prices for oil-derived energy products such as heating oil and motor fuels declined by 7.1 % and 3.7 % respectively. Consumer prices for all these products displayed similar trends in the main neighbouring countries.

However, other retail energy resources contributed greatly to narrowing the inflation gap with neighbouring countries. Retail gas prices reflected the sharp falls in market prices for gas, which since 2013 have served as the benchmark for the quarterly index-linking of variable-price contracts offered by gas suppliers. As a result, gas prices have fallen by an average 5.6 % per year, compared with barely 0.4 % in the three neighbouring countries. In its December 2013 Pact for Competitiveness and Employment, the government had moved to cut the VAT rate on household electricity to 6 % from 21 %, effective from April 2014. This measure, whose direct impact on electricity prices works out at –12.4 %, has vastly accelerated the rate reductions linked to lower prices on the international electricity markets. Retail electricity prices nosedived by an average 9.6 % in 2014, but would have gone down by a mere 1.5 % had the old VAT rate stayed in place. In the neighbouring countries, electricity prices have gone up by 2.9 % on average – admittedly less than in 2013. Rate rises in Germany were primarily to blame, as a higher tax was levied to finance subsidies for energy generation from renewable sources.

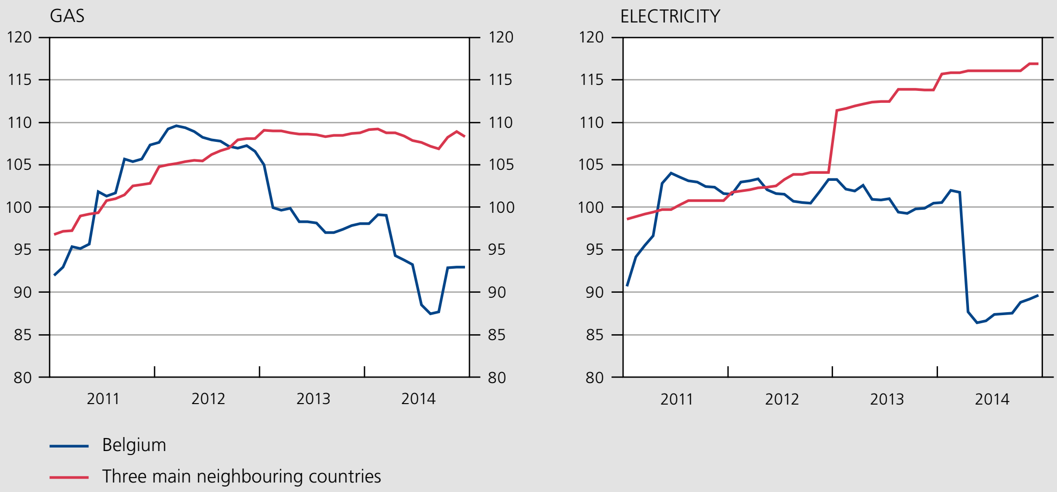
… and having a moderating effect on the health index

Although the health index basket excludes motor fuels – as it does alcohol and tobacco – in order to limit the effects of excise duties and, above all, oil shocks, it does include other energy products. As a result, the index, which is used for the automatic indexation of not just wages and social benefits and contributions but also of the prices of a number of services, remains highly sensitive to fluctuations in energy prices – all the more visible in the year under review, when gas, electricity and heating oil recorded massive price falls. On average, then, the health index barely rose, by 0.4 % on average in 2014. This compares with 1.2 % in 2013, which had already seen significant declines on the two previous years.

As it is derived from the national consumer price index (NCPI), the health index was also influenced by the methodological changes that came into effect in January 2014 as part of the complete overhaul of the NCPI. In addition to an extensive review of the basket of products and their weights to better reflect today's consumer patterns, NCPI now also factors in consumer tendencies to switch to cheaper product ranges, yet the basket of products is unchanged throughout the year. Methods for recording rent and telecom services rates were likewise adjusted. These reforms did not fail to affect the health index, particularly in the twelve months after their implementation, but their precise impact cannot be estimated on the basis of current data releases. The methodological changes are described in greater detail in an article published in the NBB's June 2014 Economic Review [1].

(1) Langohr J. (2014), "The new national consumer price index", NBB, *Economic Review*, June, pp. 45-60.

CHART 34 GAS AND ELECTRICITY CONSUMER PRICES
(2011 indices = 100)



Source: EC.

Labour costs

Nominal growth of labour costs slows

The marked decline in inflation, and more specifically the health index, had a major impact on labour costs in 2014. Hourly labour costs in the private sector recorded a much slower increase in growth to an average 0.7 % in the business sector as a whole, compared with 2.4 % in 2013 and 3.2 % in 2012. Public sector pay was much the same. With no indexation in 2014 as the key index has not been exceeded since the end of 2012, hourly labour costs rose by a mere 0.8 % in 2014, whereas they had gone up 3.1 % in 2013.

Much as in the public sector, private sector labour cost increases primarily reflect automatic indexation, which worked out at 0.7 % in 2014, below the levels of the three previous years. Given the time lags relating to the indexation mechanisms applied by the relevant joint committee, the significantly lower increase in the health index since the end of 2013 proved the key determinant for average wage indexation. And the index's more rapid slowdown since the second quarter of 2014 has yet to be fully reflected in wages.

The real agreed adjustments in the private sector are governed by a Royal Decree freezing real wage increases for 2013-2014. As had already been the case for the previous two-year period, the government pushed through the draft interprofessional agreement that some unions had refused to approve. While a margin of 0.3 % had been available in 2012 for agreed adjustments in excess of indexation, that margin was set at 0 % for 2013 and 2014, the aim being to narrow the wage gap with the three main neighbouring countries.

The "wage drift and other factors" item covers increases and bonuses granted by companies in excess of the interprofessional and sectoral collective bargaining agreements (including pay-scale increases), the effects resulting from changes in the employment structure, and measurement errors. On balance, these factors were neutral in 2014.

Employers' contributions had a similarly neutral effect on labour costs. With previously agreed measures to reduce labour costs coming into force or being expanded, the scale of cuts in social security contributions increased by nearly € 200 million to € 5.7 billion, or 3.7 % of the total private sector wage bill. Overall, these measures had a slight downward effect on labour cost trends.

With measures to reduce payroll tax not significantly different in 2014, these did not substantially affect changes in total labour costs. Accounting for € 2.7 billion or 1.8 % of the total private sector wage bill, they comprise a general reduction together with subsidies designed to

TABLE 6 LABOUR COSTS

(calendar adjusted data ; percentage changes compared to the previous year, unless otherwise stated)

	2010	2011	2012	2013	2014 e
Labour costs in the private sector					
Gross hourly wages	0.8	2.6	3.2	2.5	0.8
Collectively agreed wages [1]	0.7	2.7	3.0	2.0	0.7
Real agreed adjustments	0.1	0.0	0.2	0.1	0.0
Indexations	0.6	2.7	2.8	1.9	0.7
Wage drift and other factors [2]	0.0	–0.1	0.1	0.5	0.1
Employers' social contributions [3]	0.0	–0.3	0.1	–0.1	–0.1
Social security	0.0	0.1	–0.1	–0.1	0.0
Other contributions [4]	0.0	–0.4	0.1	0.0	–0.1
Hourly labour costs in the private sector	0.8	2.3	3.2	2.4	0.7
p.m. Unit labour costs in the private sector	*–0.6*	*2.5*	*4.0*	*2.2*	*0.0*
Hourly labour costs in the public sector	1.7	3.8	3.9	3.1	0.8
of which : indexations	0.5	2.7	2.5	2.3	0.0
Hourly labour costs in the economy as a whole	1.0	2.6	3.4	2.5	0.7

Sources : General notes on the budget ; FPS Employment, Labour and Social Dialogue, NAI, NSSO, NBB.

(1) Wage increases fixed by joint committees.
(2) Increases and bonuses granted by companies over and above those under interprofessional and sectoral collective agreements ; wage drift resulting from changes in the structure of employment, and errors and omissions ; contribution to the change in labour costs, percentage points.
(3) Contribution to the change in labour costs resulting from changes in the implicit social security contribution rates, percentage points.
(4) Actual social contributions not paid to the government, including premiums for group insurance, pension funds or occupational pension institutions, and imputed contributions, including redundancy pay.

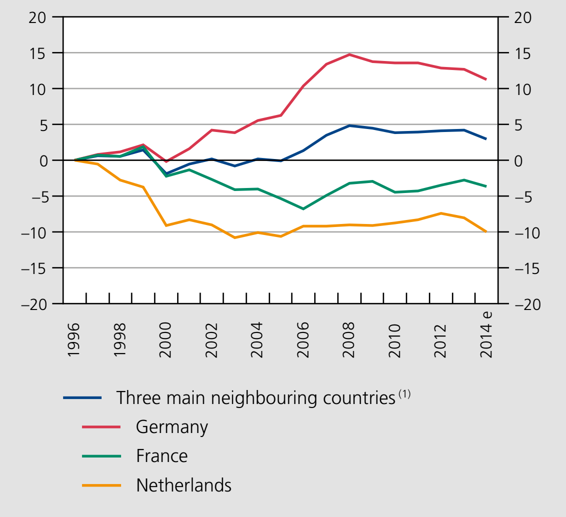
support R&D activities and certain specific forms of employment, such as shift work, night work and overtime. According to the national accounts methodology, these reductions are recorded as subsidies and are not deducted directly from labour costs.

Wage gap narrows on favourable productivity and, to a lesser degree, hourly labour cost trends

According to the technical report released by the Central Economic Council (CEC) secretariat, the wage gap with Germany, France and the Netherlands – Belgium's three main neighbouring countries and its key trading partners – narrowed to 2.9 % after having risen by 4.2 % between 1996 and 2013. This wage gap, called the "wage handicap" in Belgium, is mostly down to the cumulative difference of over 10 % compared with wages in Germany, as trends in labour costs were much less significant in Belgium than in France or the Netherlands. None of these figures – either in Belgium or in its three neighbours – allow for the effect of wage subsidies that the Belgian government will review in consultation with the social partners.

CHART 35 BELGIUM'S WAGE HANDICAP IN TERMS OF HOURLY LABOUR COSTS IN THE PRIVATE SECTOR, ACCORDING TO THE CEC

(cumulative percentage differences vis-à-vis the three main neighbouring countries, since 1996)

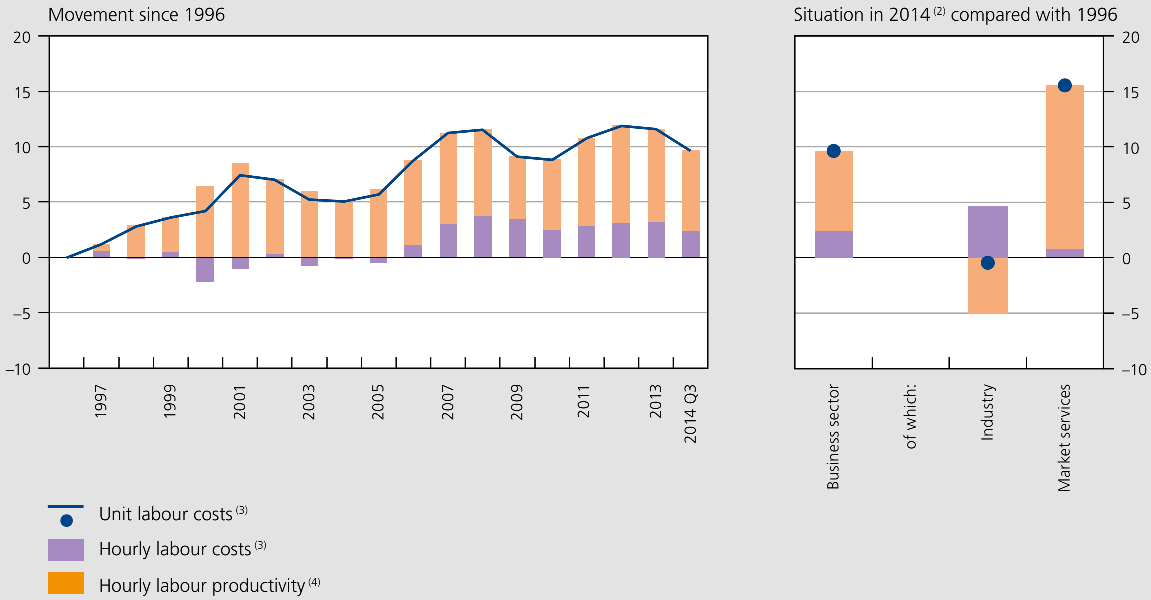


Source : CEC.
(1) Weighted average based on relative size of GDP.

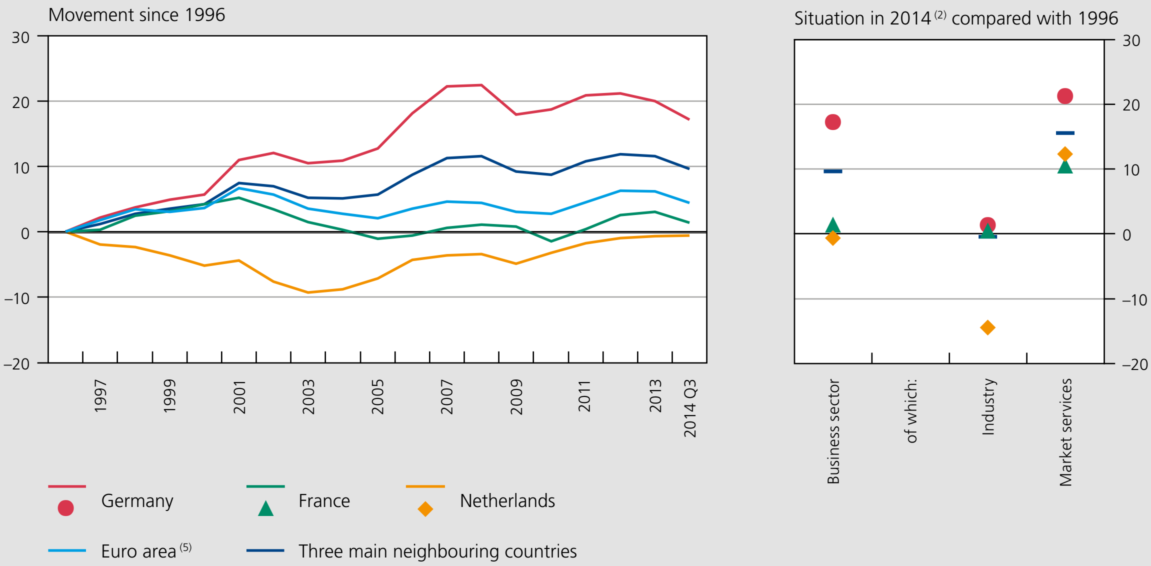
CHART 36 UNIT LABOUR COSTS IN THE BUSINESS SECTOR IN BELGIUM

(percentage differences, cumulative since 1996)

COMPARED WITH THE AVERAGE OF THE THREE MAIN NEIGHBOURING COUNTRIES



COMPARED WITH THE THREE MAIN NEIGHBOURING COUNTRIES



Source: EC
(1) The business sector comprises NACE categories B to N and so includes industry, construction and market services, serving as a proxy for the private sector.
(2) Average of the first three quarters.
(3) A positive sign implies that unit labour costs and hourly labour costs are rising faster in Belgium than the average for the three main neighbouring countries.
(4) A positive sign implies that labour productivity is rising more slowly in Belgium than the average for the three main neighbouring countries.
(5) Figures for the 1996-1999 period were retropolated on the basis of the national accounts (ESA 95).

In 2014, growth in nominal wages slowed more rapidly in Belgium than in the neighbouring countries, while the country's productivity trends have been rather more favourable since 2012. The analysis of unit labour costs in the business sector, which takes account of these two factors, confirms this improvement relative to the three main neighbouring countries. In fact, the differential has narrowed from 11.6 % in 2013 to 9.6 % in the first three quarters of 2014. Over the full 18-year review period since 1996, however, the cumulative difference remains significant.

This observation is also confirmed when subsidies to help ease the cost of labour are factored in – subsidies that are not deducted from labour costs in the national accounts – such as targeted cuts in employers' contributions and reductions in payroll tax. As envisaged in the October 2014 coalition agreement, preserving cost competitiveness will require additional measures both to ensure a structural reduction of labour costs and to enhance the wage-setting mechanism, in order to strengthen the link with productivity trends.

The widening of the wage handicap at the level of the business sector since 1996 is down primarily to the market services sector, and more particularly to "trade, transport and hotels and restaurants" and "information and communication". It was largely caused by less favourable productivity trends, but hourly wages were also a contributing factor. In industry, by contrast, the productivity difference is in Belgium's favour and largely offsets the hourly labour cost-related cumulative gap, especially so in relation to Germany. For several reasons, this analysis should be interpreted with caution, as this sector is the most exposed to international competition and companies will only survive if they manage to offset cost disadvantages with greater productivity improvements. Such international competition is not limited to the three main neighbouring countries, but also includes the other countries in the euro area, including those in the periphery, some of which have greatly improved their relative labour cost positions. What is more, the services sector's lack of cost competitiveness might also weigh down on industry indirectly, as it limits synergy perspectives that enable an effective set-up of production in cross-border value chains – companies using such services as input could suffer from higher costs. But even ignoring competition effects, high labour costs directly depress job creation opportunities.

2.4 Demand and income

Growth still solidly supported by domestic demand, excluding change in inventories

In 2014, economic activity primarily expanded on the back of higher domestic demand, excluding changes in inventories; the most striking feature perhaps being the investment revival. In 2013, investment had still contracted significantly on average in volume terms, but the recovery got underway as the year progressed and pushed up gross fixed capital formation. This trend continued into 2014 and was accompanied by higher investment in residential property construction. The government then moved to scale back its investment even further, and fiscal consolidation caused public consumption to grow more slowly than it had in the previous year.

Net exports of goods and services still made a sizeable contribution to year-on-year GDP growth, even though this was solely down to a positive spillover effect from their dynamic trend at the end of 2013. In 2014, exports clearly lost momentum, with key markets weakening while imports continued to grow more strongly. The significantly negative contribution to growth by changes in inventories also tied in with the situation at the end of 2013. The absence of a reversal in 2014 suggests that companies continued to exercise caution in raising production and instead ran down their inventories in the face of a persistently challenging economy and despite rising investment.

Private consumption and household income are growing

Economic activity may have slowed in 2014 but private consumption grew steadily, if moderately. Average consumption growth in the year worked out at 1 %, quite a bit more than in 2013. Once again, consumption trends proved less volatile than GDP, and by the end of 2014 it was already 6 % higher than before the crisis – compared with a GDP increase of only 2 % – despite a brief period of negative growth during the great recession.

Households' greater willingness to consume matches the increase in their purchasing power and is also reflected in improved retail sales, which had slumped in 2013. A slight drop in joblessness fears may have something to do with this: after peaking at the beginning of 2013, this sub-indicator in the Bank's consumer survey plunged – reflecting a more positive assessment – before stabilising at around its average showing since 1998 during the larger part of 2014; to move back to just below the average since November. By then, the general synthetic consumer confidence indicator had slid down further. Statistical analyses suggest that the sub-indicator is better correlated with household consumption than the general indicator. What is more, a tentative recovery throughout the year may be gleaned from indicators in the survey measuring people's intentions to purchase consumer durables. That said, this trend is not apparent in new car registrations, which are still well below the average in recent years. More specific factors might explain these lower levels, such as early 2012 changes in the tax treatment of passenger cars – e.g. the discontinuation of subsidies

TABLE 7 GDP AND MAIN EXPENDITURE CATEGORIES

(calendar adjusted volume data; percentage changes compared to the previous year, unless otherwise stated)

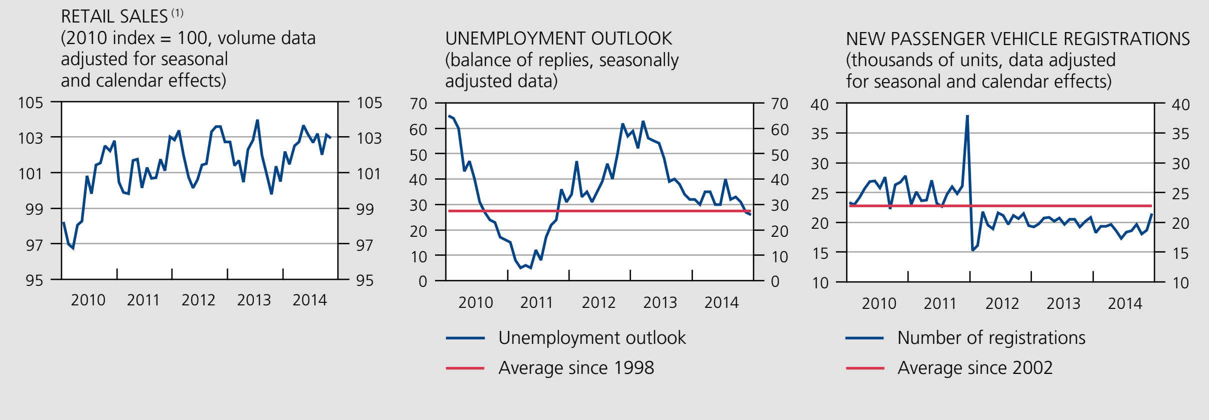
	2010	2011	2012	2013	2014 e
Private consumption	2.8	0.6	0.8	0.3	1.0
General government consumption	1.2	0.8	1.4	1.1	0.5
Gross fixed capital formation	–0.1	4.0	0.0	–2.2	4.7
Housing	3.3	1.4	–0.5	–3.5	0.9
Enterprises	–1.9	5.2	–0.3	–1.2	6.6
General government	3.6	2.5	3.4	–5.4	0.7
p.m. Final domestic expenditure (1)	*1.7*	*1.4*	*0.8*	*–0.1*	*1.7*
Change in inventories (2)	0.3	0.8	–0.8	–0.7	–1.0
Net exports of goods and services (2)	0.5	–0.5	0.1	1.0	0.4
Exports of goods and services	10.0	6.6	1.9	2.9	4.0
Imports of goods and services	9.6	7.4	1.8	1.7	3.6
GDP	2.5	1.6	0.1	0.3	1.0
p.m. Final demand	*5.4*	*4.1*	*0.9*	*0.9*	*2.2*

Sources: NAI, NBB.
(1) Excluding the change in inventories; contributions to the change in GDP compared to the previous year, percentage points.
(2) Contributions to the change in GDP compared to the previous year, percentage points.

previously granted on the purchase of environmentally friendly cars – or a change in car trade-in habits, as reflected in the steady increase in the average age of the fleet, to a little over eight years in 2013 (last available figures).

Household purchasing power is a key determinant of private consumption trends, and real gross disposable income rose by 1.3 % in 2014 – the first increase since 2009. Its slump in previous years primarily reflected shrinking capital income: in 2013, this was still more than 15 % below 2008 levels in nominal terms. Steep interest rate falls are to blame, coupled with the fact that the level of profit paid out by companies was heavily eroded by the financial crisis and the need to rebuild

CHART 37 PRIVATE CONSUMPTION INDICATORS



Sources: EC, FEBIAC, NBB.
(1) Excluding motor vehicles.

TABLE 8 DETERMINANTS OF HOUSEHOLD GROSS DISPOSABLE INCOME, AT CURRENT PRICES

(percentage changes compared to the previous year, unless otherwise stated)

	2010	2011	2012	2013	2014 e	*p.m. In € billion* *2014 e*
Gross primary income	2.2	3.1	2.1	1.6	1.6	*289.9*
Compensation of employees	2.0	4.4	3.4	2.1	1.1	*209.7*
Volume of labour of employees	0.9	1.9	0.1	–0.5	0.3	
Labour costs per hour worked	1.0	2.6	3.4	2.5	0.7	
Gross operating surplus and gross mixed income	2.9	1.5	1.6	2.7	2.4	
Capital income (1)	2.2	–2.6	–5.6	–3.7	4.4	*29.5*
Interest (net)	–8.3	–5.7	2.4	–15.8	–7.0	*4.4*
Dividends received	5.1	–6.3	–11.4	0.7	17.2	*15.1*
Net current transfers (1)	6.6	6.7	2.2	4.1	–0.3	*–52.2*
Current transfers received	1.7	3.3	4.7	3.7	2.0	*91.8*
Current transfers paid	3.4	4.6	3.8	3.9	1.2	*144.0*
Gross disposable income	1.3	2.3	2.1	1.0	2.1	*237.7*
p.m. In real terms (2)	*–0.4*	*–0.8*	*–0.1*	*–0.2*	*1.3*	
Savings ratio (3)	16.1	14.7	13.9	13.5	13.8	

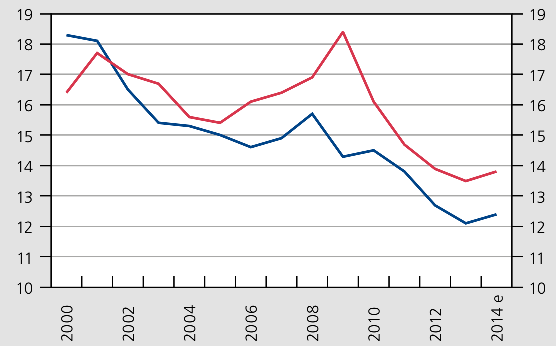
Sources: NAI, NBB.
(1) These are net amounts, i.e. the difference between income or transfers received from other sectors and those paid to other sectors.
(2) Data deflated by the household final consumption expenditure deflator.
(3) In % of disposable income in the broad sense, i.e. including changes in households' entitlements to additional pensions accruing in the context of an occupational activity.

their balance sheets. In 2014, these weaker capital income figures reversed into an increase on the back of dividends received.

Consumption profiles are more strongly influenced by labour income, however, as people put much less of their earnings towards savings. In the year under review, the wage bill rose slightly in real terms, i.e. adjusted for the private consumption deflator, as a result of as yet moderate growth in the number of employees. Since 2008, it has gone up by over 4 % in real terms, while real GDP has grown nearly 3 %. The gap widened sharply at the time of the crisis, particularly in 2009, when economic activity slumped. Lastly, other primary income, such as the earnings of self-employed people, moved ahead more rapidly, one reason being that self-employment has again risen faster than employee numbers. In terms of transfers to other sectors, with those to the government accounting for the biggest proportion by far, social benefits have grown much more than tax receipts on income or capital, so that net current transfers by private individuals have inched down.

CHART 38 SAVINGS RATIO AND CAPITAL INCOME

(in % of gross disposable income (1))



Sources: NAI, NBB.
(1) In % of disposable income in the broad sense, i.e. including changes in households' entitlements to additional pensions accruing in the context of an occupational activity.

Given that not all income immediately readjusts, rapidly falling inflation is generally also supportive of purchasing power. This includes income earned by self-employed people.

In 2014, the savings ratio edged up to 13.8 % of disposable income, in sharp contrast to the relentless falls of the past years following 2009's peak of 18.4 %. In that year, consumption contracted temporarily as uncertainty flared up, while incomes were still growing around 2 % in real terms. Over the following years, individuals did not adjust their consumption levels to negative growth in disposable income ; instead, the savings ratio plumbed historic lows of 13.5 %.

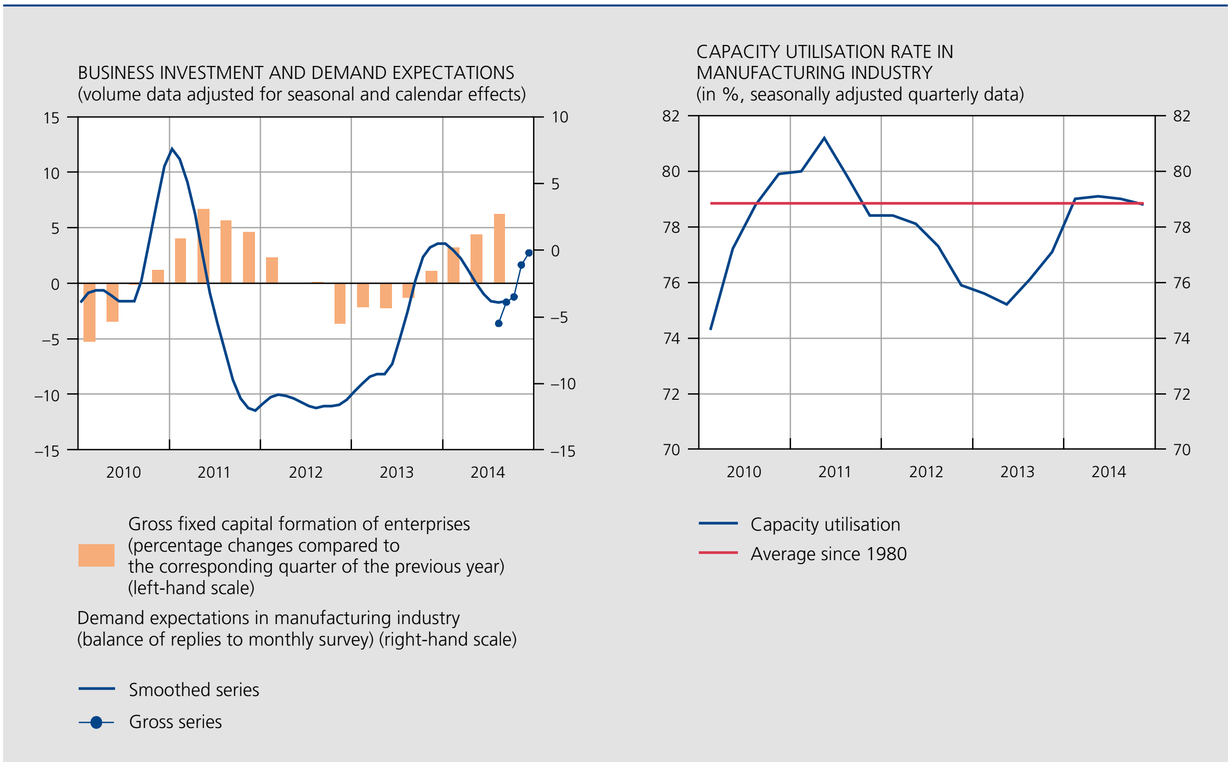
As Box 5 of the NBB's 2013 Annual Report noted, the savings ratio is largely determined by the breakdown of income and, more specifically, by the share of income from capital, as households typically save a larger proportion of property income than they do from their labour income. The past years' crumbling income from capital thus squeezed the savings ratio.

After coming down further in 2012 and 2013, much as it had done throughout the great recession, investment in housing inched back up in 2014, although volumes still languished around 10 % below those recorded before the recession.

In addition to higher disposable incomes, this tentative revival also draws on less fear among people of losing their job and its related income, while exceptionally low mortgage rates were an influence as well. Other factors were the changes in the law and tax rules related to the tax treatment of mortgage loans, which resulted from the federal government transferring authority to the Regions under the sixth State reform. When the Flemish Region announced it would sharply cut tax relief on mortgage loans – the housing bonus – from January 2015, households were quick to decide to buy homes in order to take advantage of the still existing, more favourable tax scheme. With housing construction and renovation looking at longer lead times for logistical reasons, anticipation primarily drives the secondary market. And indeed, housing investment was further bolstered by the significant increase in the number of secondary market transactions in the second half of 2014, as registration fees are stated in the national accounts on the dates of these transactions.

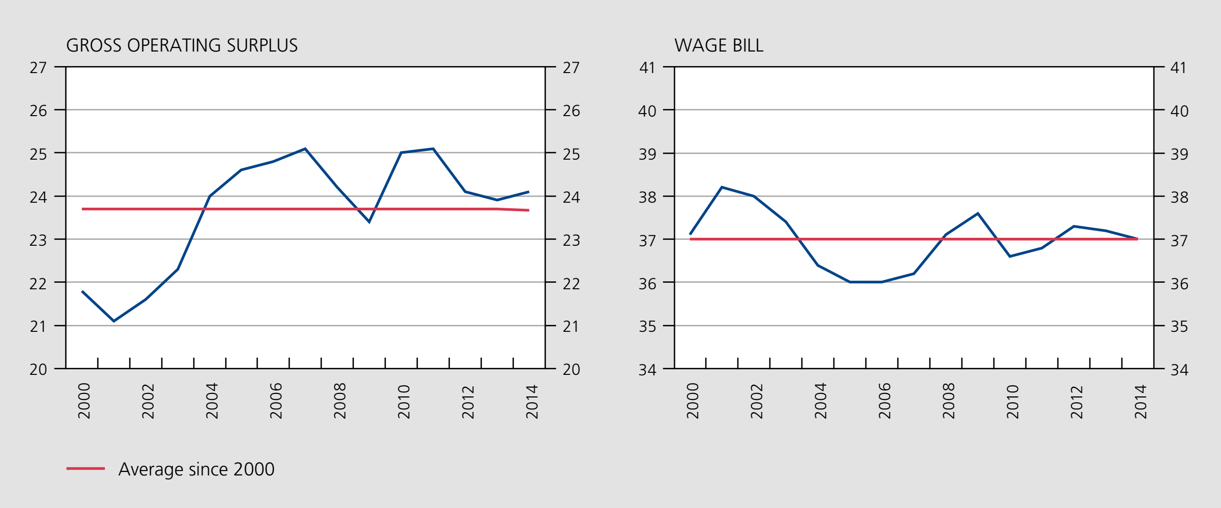
Business investment picked up strongly at the beginning of 2014 and gathered momentum from one quarter to the next, taking average growth to 6.6 % (annualised).

CHART 39 BUSINESS INVESTMENT



Sources : NAI, NBB.

CHART 40 **GROSS OPERATING SURPLUS AND WAGE BILL OF COMPANIES**
(in % of GDP)



Sources: NAI, NBB.

The extent to which this growth boosted economic activity has to be qualified, however, as it partly reflected specific transactions such as a big licence contract for one company and major purchases of ships abroad – which caused an equivalent increase in imports. But even ignoring this exceptional factor, business investment recovered in the year under review, on the back of improved demand forecasts. After a strong rebound in 2013, capacity utilisation in manufacturing hovered around its average showing since 1980 throughout the year. Together, these two factors could support both expansion and replacement investment. The slowdown that emerged as

TABLE 9 **DETERMINANTS OF THE GROSS OPERATING SURPLUS OF COMPANIES [1], AT CURRENT PRICES**
(percentage changes compared to the previous year, unless otherwise stated)

	2010	2011	2012	2013	2014 e
Gross operating margin per unit of sales [2]	5.2	–0.1	–3.0	0.3	–0.2
Unit selling price	4.1	3.5	1.8	0.5	–0.2
On the domestic market [1]	3.6	2.9	2.3	1.5	0.6
Exports	4.6	4.1	1.3	–0.4	–0.9
Costs per unit of sales [1]	3.9	4.2	2.7	0.5	–0.2
Imported goods and services	6.3	5.1	1.5	–0.5	–1.0
Costs of domestic origin per unit of output [2] [3]	–0.6	0.7	4.1	1.7	0.4
of which:					
Unit labour costs [4]	–1.2	1.8	3.6	1.9	0.2
Unit net indirect taxes	0.8	–1.0	7.2	0.1	0.9
Final sales at constant prices	6.1	4.5	0.9	0.9	2.3
Gross operating surplus of companies	11.6	4.4	–2.1	1.2	2.0

Sources: NAI, NBB.
(1) Private and public companies.
(2) Including the change in inventories.
(3) In addition to wages, this item comprises indirect taxes minus subsidies, and gross mixed income of self-employed people.
(4) Unit labour costs are expressed in units of value added of the business sector and are not calendar adjusted.

the year progressed appears to have had only a limited influence, either because of the time-lag between designing and implementing investment projects or because companies did not consider it a structural threat to the recovery.

Companies were able to defray their investment expenses from a solid level of own resources, coupled with favourable external financing conditions.

Funds generated through company activity rose by 2 % in 2014 and were slightly ahead of GDP growth in nominal terms, with companies' gross operating surplus accounting for a slightly higher proportion of GDP. This figure stood at 24.1 %, barely higher than the average since 2000. Conversely, wages accounted for a slightly lower share of GDP in 2014 and likewise remained a touch above the average of the past 15 years. The fact that operating surplus and wages both ended up above their average shares had more to do with tax on production less subsidies going down. Overall, as in 2013, movements in the share in income of the various factors of production – whether upward or downward – were very small in 2014, i.e. almost 0.1 % of GDP. This suggests that tighter wage restraint and falling inflation – both consumer prices and the GDP deflator – were on a similar trajectory.

The increase in gross operating surplus was primarily due to 2.3 % higher final sales volumes, including the change in inventories. This percentage does not however reflect real sales developments, as sales demand was partly met by a contraction of inventories rather than by an increase in production.

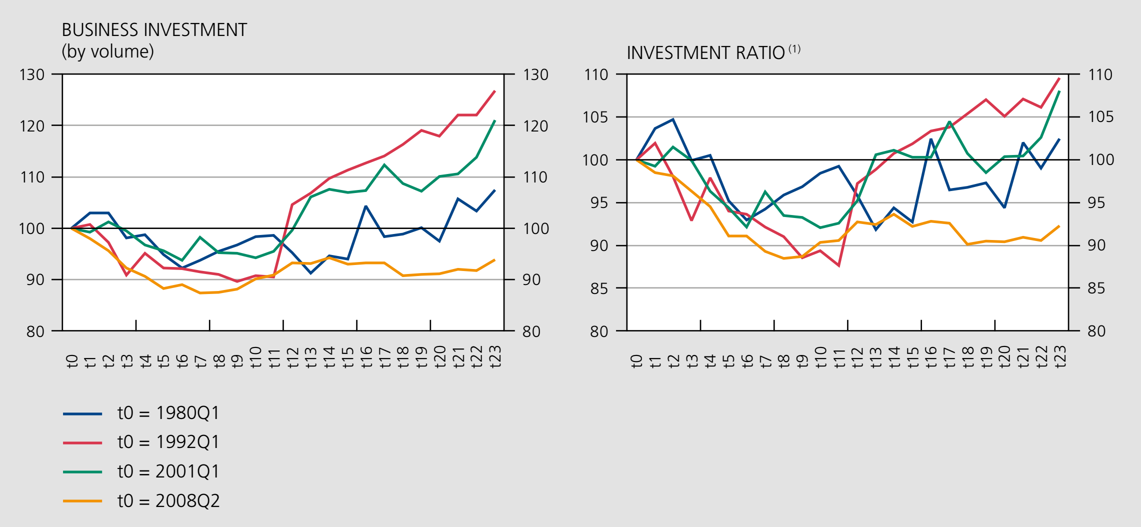
Gross operating margin per unit of sales contracted in 2014, albeit in a very minimal way. Selling prices fell, but this was exclusively down to lower export prices due to international competition in combination with lower input

Box 6 – Business investment slowly recovers

Much like the euro area at large, Belgium has seen business investment struggle to recover from the depths plumbed during the great recession. Six years after the recession took hold, investment volumes were still

BUSINESS INVESTMENT IN BELGIUM

(data adjusted for seasonal and calendar effects; indices, pre-recession high = 100)



Sources: NAI, NBB.
(1) Investment as a ratio of GDP (by volume).
ti: Quarters since the start of the relevant recession period.

around 6 % below the all-time high of the second quarter of 2008. Compared with the previous recessions of 1980, 1992 and 2001, business investment fell very hard and very fast at the nadir of the economic and financial crisis. And the decline has proved very stubborn indeed : in each of the three previous recessions, business investment exceeded pre-crisis levels within six years.

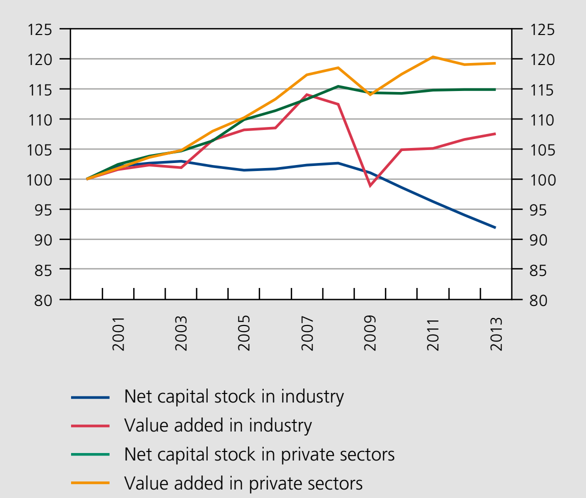
Of course, the slower revival of business investment after the latest recession period is partly down to the lacklustre recovery in economic activity. Granted, GDP has been back at pre-crisis levels since 2011 but it has hardly moved since, whereas economic activity bounced back much more strongly after earlier recessions. The tentative feel of the recovery has made investors wary of new investment projects, particularly in view of uncertain return prospects.

Today's recovery is clearly also weaker than previous post-recession recoveries when looking at the investment ratio, i.e. business investment as a ratio of real GDP. Macroeconomic uncertainty was not the only determinant of this ratio : financial conditions during the period also had a part to play. Lenders sharply tightened conditions for investment project funding during the financial crisis, while relatively high gearing levels in those turbulent days may also have squeezed investment plans. And it is always possible that companies considered it was not necessary to increase capacity to meet future demand, as growth prospects for the longer term were being revised downwards.

The languishing recovery of business investment also affects capital stock in the Belgian economy. Ignoring government and housing construction sectors, capital stock volumes grew by an average 1.9 % per year between 1995 and 2008. In the post-great-recession recovery, capital stock has virtually stagnated, as the level of investment barely offsets impairments of existing assets. The sharp contraction in manufacturing is one reason for the shortfall, as traditional industry with its extensive, capital-intensive machinery is losing ground. This is only partly offset by the increasing

NET CAPITAL STOCK [1] AND VALUE ADDED

(volume data adjusted for seasonal and calendar effects, indices 2000 = 100)



Sources : NAI, NBB.
(1) Excluding housing.

proportion of the cumulative net value of R&D investment. There are a few exceptions: in the pharmaceuticals industry, for one, innovation has been a key driver of capital stock, even during the crisis.

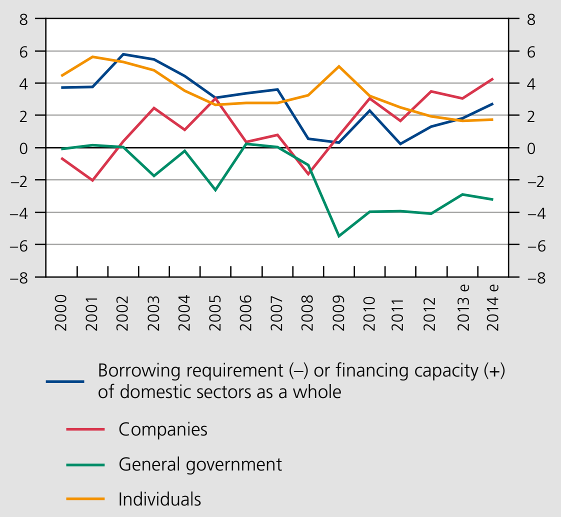
Both in manufacturing and – to a lesser degree – in market activities at large, value added has been growing a bit faster than capital stock since the great recession, also in the longer term. The shift identified earlier (from investment to other sectors and other types of assets) would appear to have had a modestly upward effect on the average productivity of capital assets.

prices, for commodities among other things. Prices of imported goods and services and, more broadly, costs per unit of sales fell even more sharply than company selling prices, lower oil prices compared with 2013 being a major factor. Domestic costs, by contrast, were up, but only moderately so. Unit labour costs recorded their lowest growth rate of the past four years, reflecting the combined influence of moderate wage growth and productivity gains.

In addition to extremely low real returns on the financial markets, which have significantly lowered break-even point for investment projects, business investment also benefited from the increase in the gross operating surplus and the relatively high level of cash held by non-financial corporations, some 29.1 % of GDP. And even ignoring lower interest rates, survey responses about lending suggest that banks also eased other credit conditions a little in the course of 2014.

CHART 41 FINANCING BALANCE OF DOMESTIC SECTORS AS A WHOLE

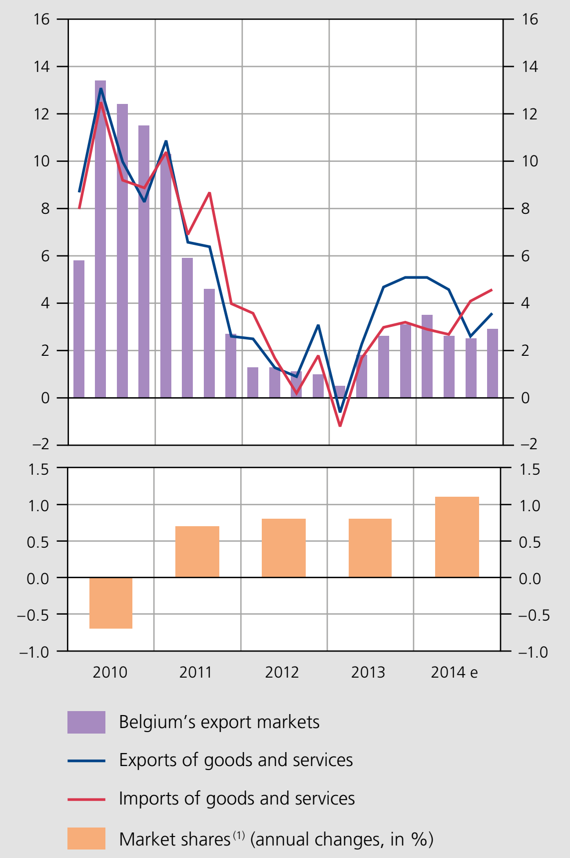
(in % of GDP)



Sources: NAI, NBB.

CHART 42 EXPORTS AND IMPORTS OF GOODS AND SERVICES, BY VOLUME

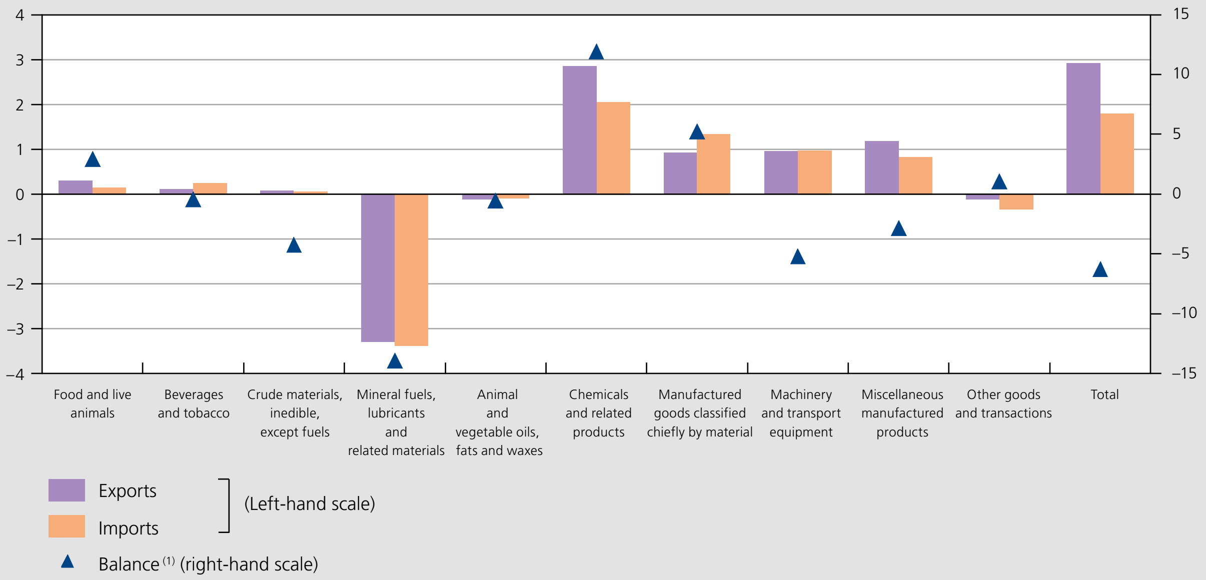
(data adjusted for seasonal and calendar effects; percentage changes compared to the corresponding quarter of the previous year, unless otherwise stated)



Sources: ECB, NAI, NBB.

CHART 43 EXPORTS AND IMPORTS OF GOODS IN VALUE BY PRODUCT CATEGORY

(national concept, in € billion, change in the first nine months of 2014 compared to the corresponding period of 2013, unless otherwise stated)



Source: NAI.
(1) Balance in € billion for the first three quarters of 2014.

TABLE 10 BALANCE OF PAYMENTS AND NET LENDING TO THE REST OF THE WORLD

(balances; in € billion, unless otherwise stated)

	2010	2011	2012	2013	2014 e
1. Current account					
Goods and services	4.3	–2.9	–3.3	–0.6	0.0
Goods	–3.8	–10.1	–10.6	–7.7	n.
Services	8.1	7.3	7.2	7.1	n.
Primary income	6.6	3.9	6.6	9.1	11.3
Earned income	4.9	5.0	5.1	5.4	5.4
Investment income	2.3	–0.5	2.1	4.3	6.5
Other primary income	–0.6	–0.7	–0.6	–0.6	–0.6
Secondary income	–5.4	–6.0	–6.7	–7.9	–7.8
General government	–4.1	–4.1	–3.8	–4.8	–4.7
Other sectors	–1.3	–1.9	–2.9	–3.1	–3.1
Total	5.5	–5.0	–3.4	0.6	3.6
p.m. Idem, in % of GDP	*1.5*	*–1.3*	*–0.9*	*0.1*	*0.9*
2. Capital account	–0.9	–0.4	2.3	–0.1	–0.4
3. Net lending to the rest of the world (1 + 2)	4.6	–5.4	–1.1	0.4	3.2
p.m. Idem, in % of GDP	*1.3*	*–1.4*	*–0.3*	*0.1*	*0.8*

Sources: NAI, NBB.

Improved current account balance

Taken as a whole, the country's economic sectors recorded a financing capacity ratio of 2.7 % of GDP in 2014, compared with an estimated ratio of 1.8 % in 2013 (1). Households' net financing capacity, traditionally positive, remained stable in 2014 at 1.8 % of GDP, as individuals' gross savings increase was offset by higher capital spending, including investment in housing. As chapter 4 explained, the government's borrowing requirement rose slightly and the improved financing balance was the outcome of an increase in companies' financing capacity to nearly 4.3 % of GDP, thanks to higher gross savings derived from a slight increase in their gross operating surplus coupled with reduced inventories. All this adds up to a consistent financing capacity on the part of companies since 2009.

The increase in the economic sectors' overall financing capacity is also reflected in a higher current account surplus, which partly derives from an improved goods and services balance. Indeed, as explained earlier, annualised imports lagged behind exports in real terms, resulting in higher net exports in volume terms. Also, the terms of trade stabilised, as the improvement recorded during the last couple of months of 2014 on the back of tumbling oil prices had offset the deterioration observed at the beginning of the year.

As in the three previous years, the increase in exports was again supported by higher market share (in volume terms) in 2014. According to available estimates when this Report went to press, exports from Belgium grew faster than import demand from the main trading partners, weighted by its export structure. Belgium would appear to have won market share in markets both within and outside the euro area in the past year.

According to balance of payments data, the latest improvement in the balance of international goods and services reflected a lower goods transaction deficit coupled with an unchanged services surplus. The consolidation in services was the result of positive developments in goods for processing, construction and financial services.

As far as goods trade is concerned, foreign trade statistics for the first three quarters of 2014 reveal improved net figures for chemicals and related products on the back of a significant increase in exports. This product category alone accounted for 25 % of total Belgian exports in the nine months, and its growth mainly reflects net exports of medicinal and pharmaceutical products. Lower exports in terms of value of mineral fuels, lubricants and related materials were offset by a comparable contraction in imports. In the end, trends in this product category had only a limited net effect on the total value of goods imports and exports – which stayed negative for the first three quarters of the year under review.

Retaliatory sanctions imposed by Russia, and more specifically the import ban on most foods from Europe, have only had a slight immediate effect on the Belgian economy. Trade flows covered by the Russian embargo account for less than 0.1 % of GDP. However, individual companies and sectors have been harder hit, for example in fruit and vegetables, dairy and meat products.

Russia is in fact only Belgium's 15th largest trading partner for goods exports, accounting for € 3.3 billion or 1.4 % of total Belgian exports in 2013. As far as services are concerned, balance of payments statistics suggest that flows to and from Russia were even less significant, representing around 1 % of the total in 2012. That said, this analysis of direct trade may mask indirect economic relations, as a country can use value added created by a country that does not rank among its direct suppliers, for example if a third country acts as a broker. So Russia might well be more important to Belgium than would appear on the basis of direct export and import data.

In addition to the € 0.6 billion increase in the goods and services balance, the primary income surplus also rose in 2014, to € 11.3 billion from € 9.1 billion. This improvement can mostly be traced back to higher income from investment on the back of higher dividends received, coupled with a fall in dividends paid. Earned income, another key component of primary income, recorded a surplus of € 5.4 billion, comparable with 2013.

The secondary income deficit is reported to have narrowed a little in 2014. These transactions include Belgian contributions to the budgets of EU institutions linked to the VAT base and gross national income (GNI), international collaboration and transfers between resident and non-resident private individuals. The improvement in this item reflects the fact that, in 2014, the Belgian government paid significantly less to European institutions on balance than it had in 2013, in keeping with a lower rate of call of the GNI resource.

All in all, the balance of payments suggests that the current account continued its favourable course in 2014, with its surplus rising to € 3.6 billion in the year under review from € 0.6 billion in 2013. This is 0.9 % of GDP.

(1) To better interpret economic developments, this analysis has adjusted the NAI's national accounts data for 2013 and 2014. The adjustment mimics the effect of the new methodology for calculating income from investment in the balance of payments, which now reflects a macroeconomic approach. It applies to the accounts for corporations and for the rest of the world.