Economic developments in Belgium

2. Economic developments in Belgium

2.1 Economic recovery remains subdued in Belgium too

In keeping with the ongoing trend noted since the second quarter of 2013, economic expansion in 2015 continued at a moderate pace in Belgium, much as in the rest of the euro area, despite a minor slowdown towards the end of the year. In volume terms, year-on-year GDP grew by 1.4 %, at pretty much the same speed as in 2014 (1.3 %) and slightly below the euro area's 1.6 %.

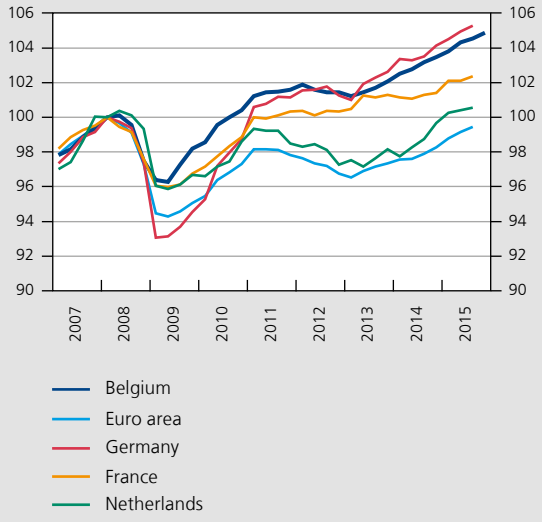
Belgium's economy benefited from the same favourable economic environment enjoyed by its partners in the euro area. First off, monetary policy accommodation made for continued favourable financing conditions for both corporations and private individuals – and the government too, for that matter – as it reduced their financial outgoings. Conditions such as these encourage investment. What is more, companies benefited from improved competitiveness vis-à-vis their rivals outside the euro area because of the weakening of the euro, which was particularly pronounced relative to the US dollar between mid-2014 and early 2015. Lower commodity prices, especially those of crude oil, also helped reduce producer costs and boosted the purchasing power of private individuals.

In addition to these external drivers, Belgian macroeconomic policies were less single-mindedly focused. The fiscal stance, for one, appears to have had a largely neutral effect on economic activity in the past two years. However, wage restraint, which had been ongoing since 2009 and was enhanced by a range of measures in 2015, seems to have supported job creation and so contributed to strengthening the economic fundamentals, even if it did hold back demand and economic activity in the short term. On the whole, and even in the short run, policies supportive of economic potential and the sustainability of public finances should be a force for the good if they give economic agents more confidence in the future.

Economic activity continued to pick up and gradually broadened to include the whole of the Belgian economy. While the cyclical recovery of 2013 initially showed up in higher productivity, employment continued to fall; not until the second quarter of 2014 did the labour market experience net job creation. This improvement

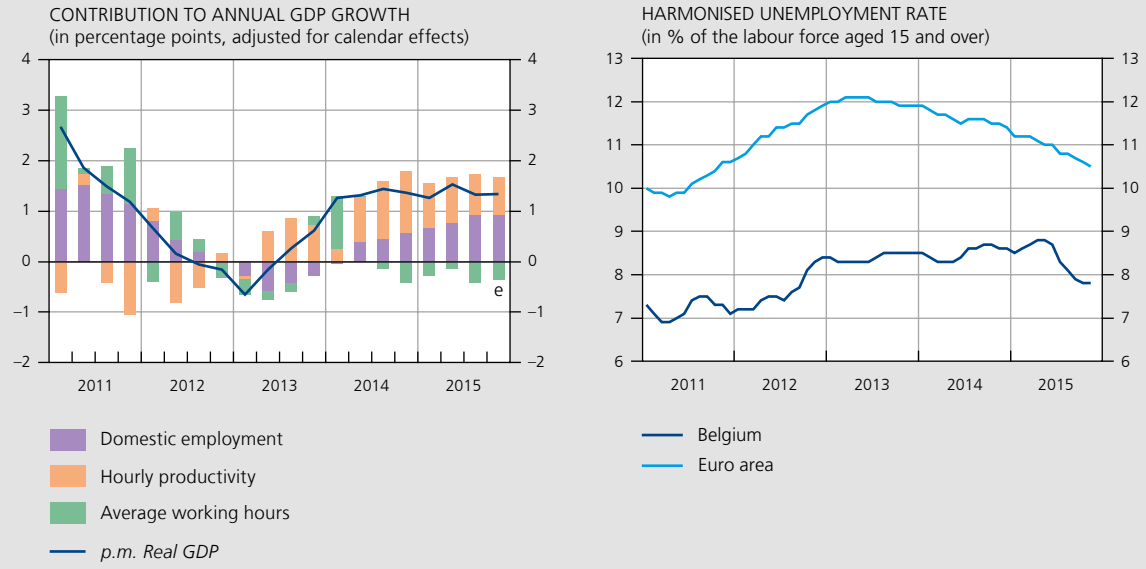
CHART 20 ONGOING BUT MODEST RECOVERY IN BELGIAN ECONOMIC ACTIVITY

(GDP in volume, index 2008Q1 = 100, data adjusted for seasonal and calendar effects)



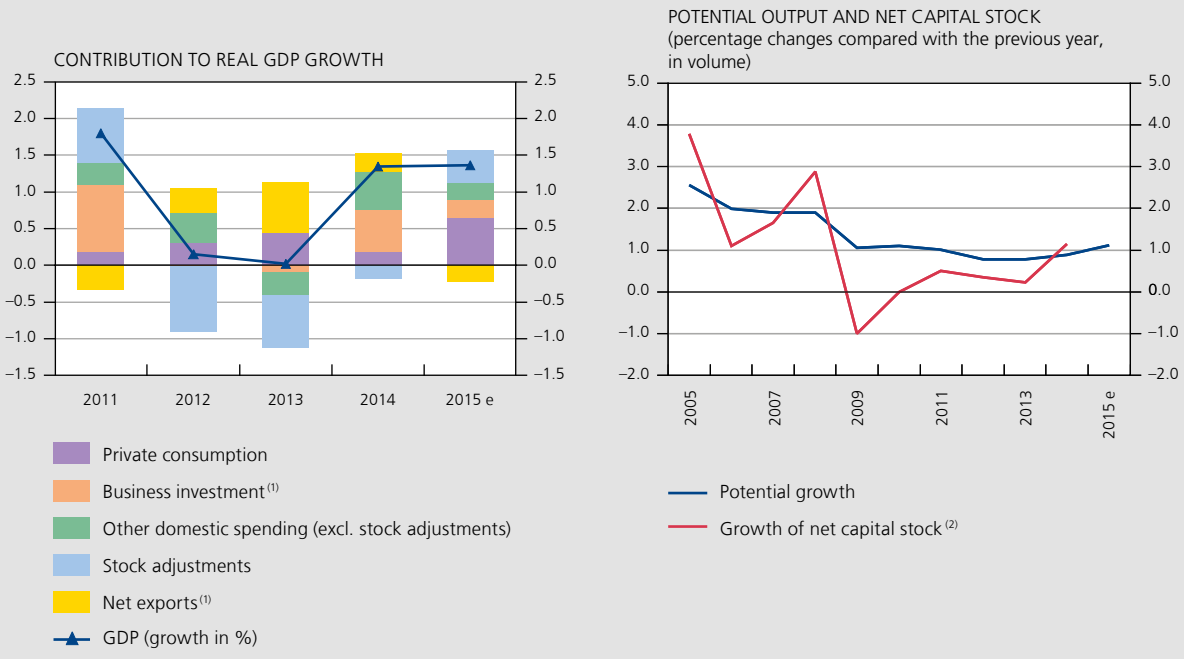
Sources: EC, NAI.

CHART 21 GROWING ECONOMIC ACTIVITY BOOSTS EMPLOYMENT BUT FAILS TO SHOW UP IN UNEMPLOYMENT RATE UNTIL MID-2015



Sources: EC, NAI, NBB.

CHART 22 BROADER-BASED ECONOMIC ACTIVITY, BUT PERSISTENTLY SLOW POTENTIAL GROWTH



Sources: NAI, NBB.
(1) Adjusted for key purchases of capital goods outside Belgium.
(2) Excluding housing and the "public administration and education" branch.

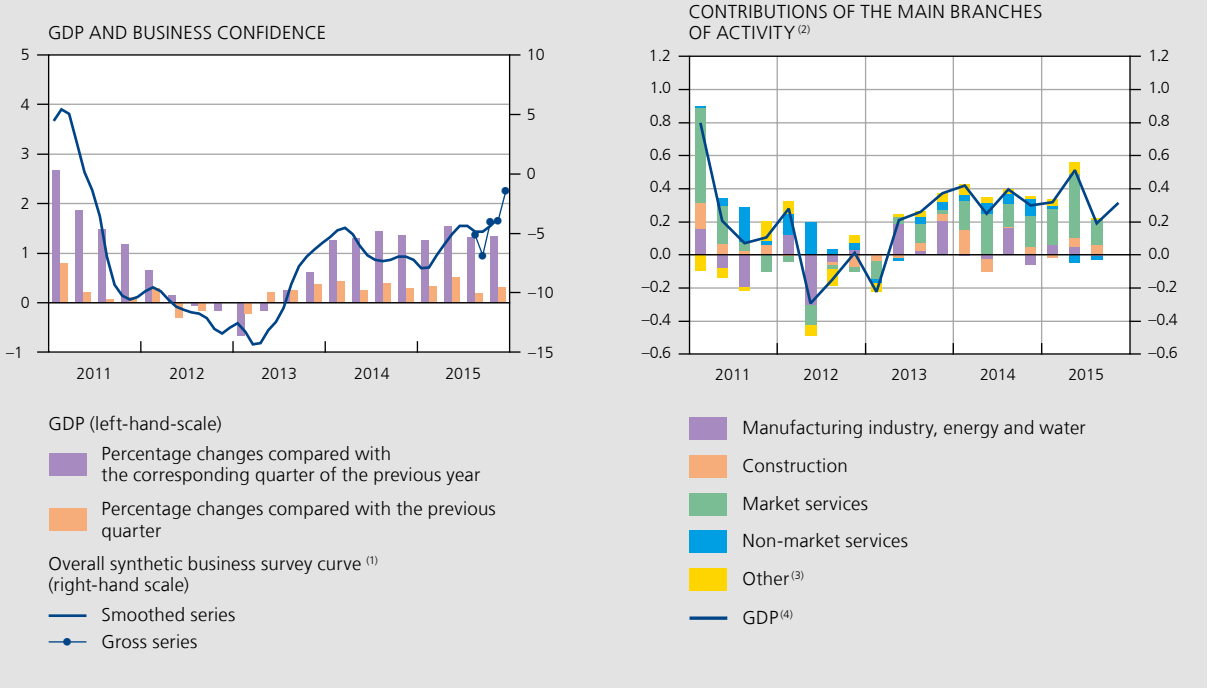
continued throughout 2015 but was fairly modest as the employment rate established on the basis of the labour force survey data did not go up and in fact inched down between 2014 and 2015, from 67.3 % to 67.2 % of the working-age population, while the harmonised unemployment rate rose slightly until May 2015 before moving back down gradually. Meanwhile, the number of corporate bankruptcies has been declining continuously over the past two years.

Domestic demand as a driving force for economic activity has gradually picked up in the past two years. In 2015, private consumption took the lead as purchasing power grew thanks to oil prices plunging to new lows. The recovery may have gained a firmer toehold, but it remained too subdued for Belgian growth dynamics to really lift off. In fact, both potential growth and the pace of the increase in the capital stock still languished below their pre-crisis values. Moreover, developments in the second half of 2015 have once again proved the Belgian economy to be highly sensitive to external vicissitudes.

2.2 Economic activity and job creation up further despite growing uncertainty

Although economic activity remained positive throughout 2015, it slowed in the third quarter. For a few quarters, the external factors mentioned earlier exerted a greater driving force than did the impact of waning global demand on the euro area. However, this changed as the summer progressed. Growth prospects were revised downwards in several emerging countries, particularly in China, while growth in some developed countries faltered a little and, worse, trade growth significantly trailed expectations. As a result, there was a great deal of uncertainty about the direct or indirect impact of foreign demand for goods and services, and increased volatility in the financial markets. Confidence indicators deteriorated considerably, if temporarily: firms grew less sanguine about their future orders, while consumers no longer took such a rosy view of their financial and employment situation, and applied the brakes to their outgoings. At the same time, the positive contribution to purchasing power of the fall in oil prices diminished. Towards the end of

CHART 23 MODERATE GDP GROWTH DUE TO ROBUST FIRST HALF-YEAR



Sources: NAI, NBB.
(1) Balance of replies to the monthly surveys, non calendar adjusted data.
(2) Contributions to the change in GDP compared with the previous quarter, unless otherwise stated; volume data adjusted for seasonal and calendar effects.
(3) Namely "Agriculture, forestry and fishing" and product-related taxes net of subsidies.
(4) Percentage changes compared with the previous quarter.

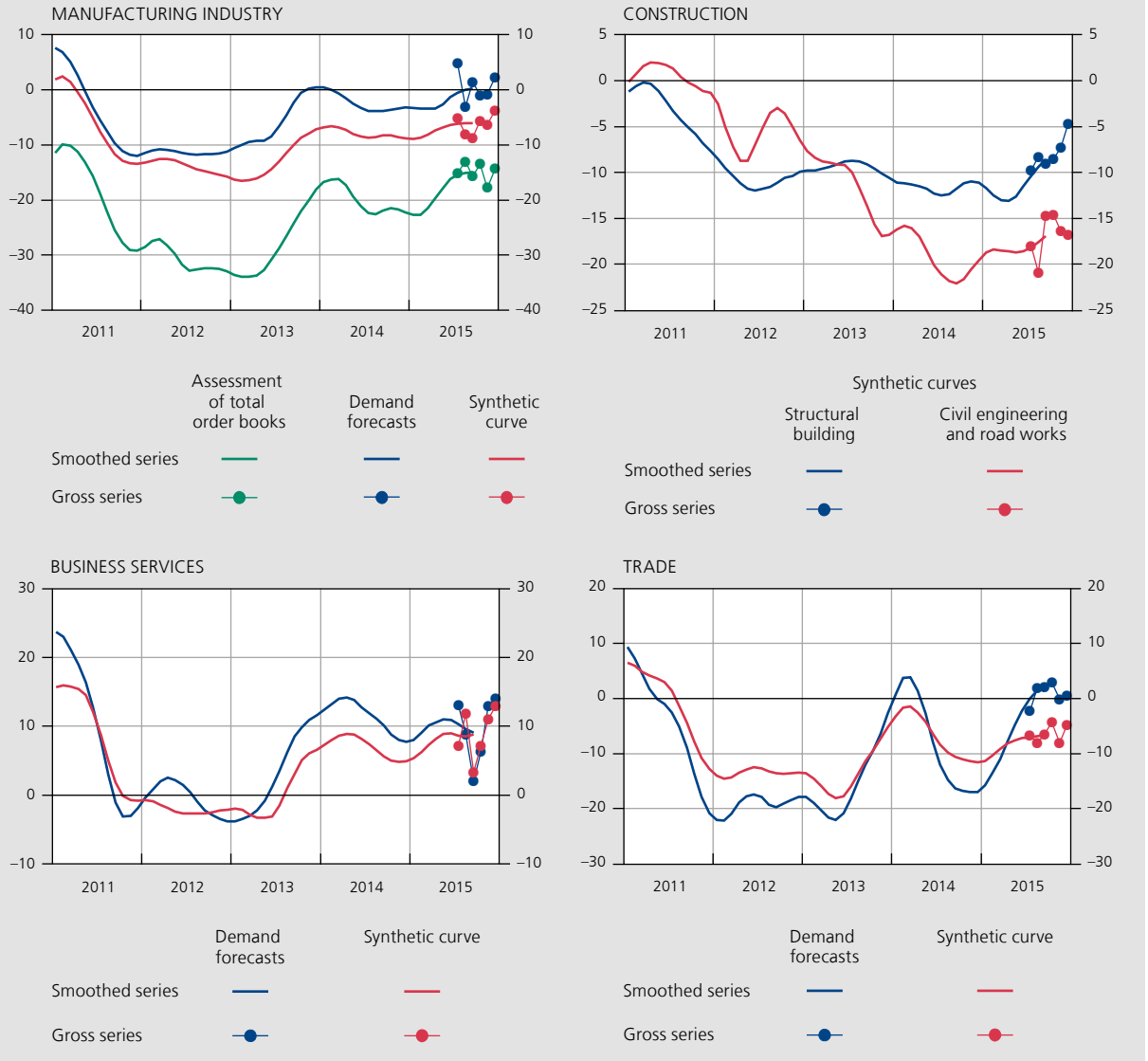
the year, confidence picked up again and the consequences of the terrorist attacks and threats proved altogether muted.

All that said, 2015 got off to an auspicious start: supported by pick-ups in the manufacturing industry and market services sector, GDP was up 0.5 % in the second quarter, its most robust quarterly growth in four years. In the Bank's surveys around that time, businesses in these sectors were reporting an upswing in the economic cycle.

In the third quarter, however, momentum faltered temporarily. Industrial production chains being strongly interlinked globally, the slowing pace of growth in the emerging countries rapidly affected industry, leading to a reversal of the trend in the synthetic curve for manufacturing in the July-September period. A less upbeat outlook was attributable to the order book position – and particularly its foreign component – which suddenly got more negative scores, on top of a notable increase in inventories, which pointed to an imbalance between supply and demand. The reversal in confidence in the market services sector was chiefly reflected in the outlook for economic activity and demand in business services, which typically enjoy close ties with

CHART 24 TEMPORARY UNCERTAINTIES IN SOME SECTORS

(economic indicators, balance of replies, seasonally adjusted data)



Source: NBB.

the manufacturing industry. Company managers in the trade sector, by contrast, benefited from continued domestic consumption growth and stayed fairly optimistic.

Economic activity in the construction industry is largely determined by domestic factors. In 2015, value added did not move ahead as smartly as it had the previous year: the winter months were less mild and held back growth somewhat in the first quarter. Synthetic business survey indicators show confidence in new constructions of buildings to have improved throughout 2015, albeit more in the residential than in the commercial market. Infrastructure was mired in malaise a lot longer and confidence only perked up towards the end of the year, possibly as a result of the recent recovery in public investment.

Value added in non-market services, which include public administration, education, health care and social work, was virtually stable in 2015, after recording a minor upturn in 2014. Taking the longer view, value added creation is currently rather low in the sector and reflects fiscal consolidation efforts.

Tentative economic activity no curb on labour market recovery

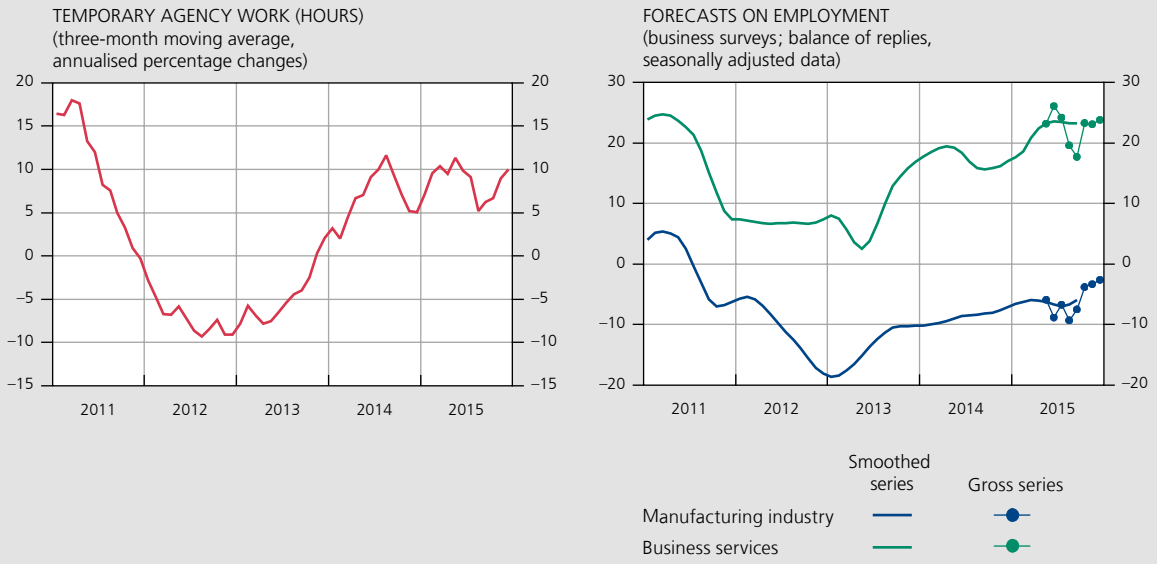
As it was only very short-lived, the deterioration in the economic climate during the course of the year barely had any impact on employment in 2015. Admittedly, during the summer, business leaders in industry and services were slightly more cautious about hiring prospects and there was a brief slowdown in the use of temporary workers, which closely reflects fluctuations in the business cycle. But other than that, labour demand was primarily bolstered by the gradual strengthening of economic activity and years of moderate developments in labour costs.

Companies reported an increase in the number of unfilled vacancies. Employer surveys by FPS Economy, SMEs, Self-employed and Energy recorded nearly 93 000 vacancies on average in the first three quarters of 2015, taking the vacancy rate – the number of vacancies as a ratio of total available jobs, filled or unfilled – to 2.5 % compared with 2.3 % in the same period of 2014. Cyclical sectors recorded a rise, whereas the "public administration and education" branch fell.

To fill these vacancies, employers typically turn to temporary employment agencies – marrying their need for extra workers with a reluctance to hire permanent workers in an uncertain economic climate – and to the regional employment services.

Vacancies reported to the public employment services rose in Flanders and Brussels between 2014 and 2015, whereas they came down further in Wallonia.

CHART 25 BRIEF SLOWDOWN IN TEMPORARY AGENCY ACTIVITY AND HIRING PROSPECTS IN INDUSTRY AND SERVICES



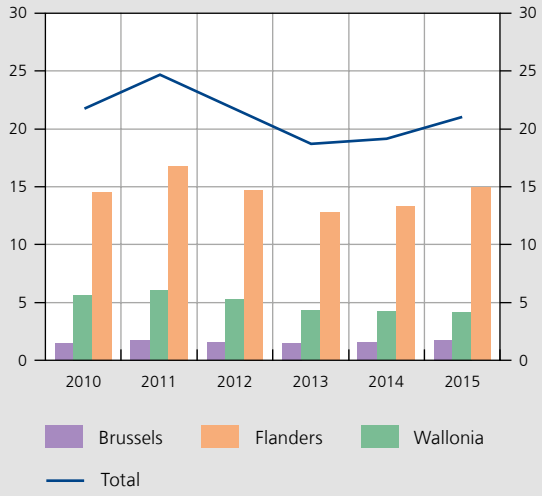
Sources: Federgon, NBB.

Some of these vacancies remain unfilled; at the end of each month, there were around 35 000 job openings across the country. Frictional unemployment accounts for a proportion of this, i.e. the time needed to optimally align labour supply and demand. Another part of the remaining unemployment figure is attributable to – often overlapping – structural factors, such as a mismatch in skills or work experience, mobility aspects or employment conditions, causing so-called critical occupations in all three Regions. In Flanders, commercial and technical positions as well as cleaning jobs are the hardest to fill, in Wallonia technical, commercial and management positions, while Brussels is particularly short of teachers and technical, back-office and commercial staff.

Total employment added 37 500 people in 2015, notably more than the figure for 2014. Salaried employment contributed most, compared with only a minor recovery in 2014. Contrary to recent trends, business-cycle-sensitive branches supported the upturn this time, with market services being one of the key driving forces. Job creation in the market services sector is clearly less based on new service voucher jobs than it has been in

CHART 26 RISING NUMBER OF VACANCIES IN BRUSSELS AND FLANDERS

(vacancies reported by the public employment services[1], in thousands, monthly averages)



Sources: Actiris, Forem, VDAB.
(1) Normal economic cycle excluding temporary workers.

TABLE 2 DOMESTIC EMPLOYMENT AND ITS COMPONENTS

(calendar adjusted data; change in thousands of persons in comparison to previous year, unless otherwise stated)

	2011	2012	2013	2014	2015 e
Labour force	41.2	31.1	6.1	29.0	18.0
National employment	61.1	16.6	–18.5	14.9	37.2
p.m. Employment rate[1][2]	*67.3*	*67.2*	*67.2*	*67.3*	*67.2*
Frontier workers	–0.2	0.5	–0.8	–0.7	–0.3
Domestic employment	61.3	16.1	–17.7	15.6	37.5
Self-employed	8.0	7.8	5.9	7.1	9.9
Employees	53.3	8.3	–23.6	8.6	27.6
Branches sensitive to business cycle	31.9	–7.8	–25.1	–3.8	16.2
Of which:					
Industry	3.0	–7.4	–12.4	–11.6	–8.4[4]
Market services	25.5	–0.8	–7.9	13.3	24.6[4]
Public administration and education	5.0	1.7	2.7	5.1	–2.6
Other services	16.4	14.5	–1.3	7.3	14.0
p.m. Service vouchers	*11.5*	*8.1*	*8.5*	*5.1*	*3.7*
Unemployment	–19.8	14.5	24.6	14.0	–19.2
p.m. Unemployment rate[1][3]	*7.2*	*7.6*	*8.5*	*8.6*	*8.4*

Sources: EC, NAI, NEO, NBB.
(1) Data from labour force surveys.
(2) As a percentage of working-age population (20-64).
(3) As a percentage of labour force (15-64).
(4) Average of first three quarters.

the past, as a result of saturated demand, the increase in the hourly wage cost and hiring issues. Government austerity measures have served to reduce the number of workers in public administration and education in 2015. Employment numbers were also boosted by higher numbers of self-employed workers: 10 000.

Domestic employment solely comprises Belgian or non-Belgian employees in the service of a Belgian employer or registered as self-employed. Foreign service providers and posted workers are excluded even if they work in Belgium and add to value creation. Based on documents drawn up by their countries of origin, the European Commission notes that Belgium is among the key European destinations for workers on secondment: the data suggest that 134 000 – i.e. 3 % of the country's total workforce – worked in Belgium in 2013, compared with 374 000 in Germany (less than 1 %) and 182 000 in France (not even 0.7 %). These posted workers are mostly active in construction.

Box 4 – Seconded workers in construction

Posted workers are contracted to work in Belgium while they are typically employed in other countries. Their contractual relationships with their non-Belgian employers remain in place and they are governed by the social security system of their country of origin. Under European law, employers are required to respect social legislation in force in the host country, e.g. governing working hours, wage conditions and more specifically local minimum wages, etc.

According to NSSO figures based on Limosa returns[1], there were 216 000 workers posted to Belgium in the year 2014 as a whole, compared with 90 000 in 2007. These workers do not show up in Belgium's employment statistics, but in those of their employers' countries of origin. Nearly 60 % of them work in construction. Note that they are not necessarily on annual contracts: the returns record the number of people on secondment contracts, not the length of their service.

EMPLOYMENT AND SECONDMENTS IN CONSTRUCTION

(annual changes in thousands of people)

Sources: NAI, NSSO.

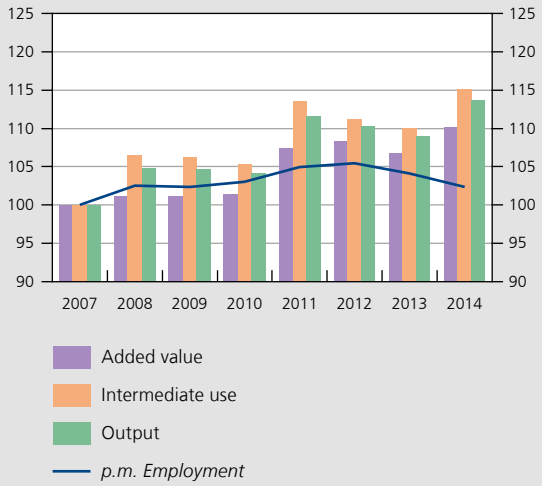
Construction workers on secondment are typically nationals from neighbouring countries, Portugal, Poland and other East European countries. Measured by the foreign company's location, the Netherlands tops the league table,

(1) Compulsory return prior to employment of seconded workers in Belgium.

reflecting the flexibility of Dutch laws on temporary employment agencies, which has led to the establishment of a large number of companies offering such services.

ECONOMIC ACTIVITY AND CONSTRUCTION EMPLOYMENT IN BELGIUM

(index 2007 = 100; by volume for economic activity indicators, by people for employment)



Source: NAI.

Secondments in the construction industry have boosted sector output, and Belgium's national accounts put its rise between 2007 and 2014 at 14 % in volume terms. Construction companies' intermediate use, which includes wages for secondment work, increased a little faster, while the value added generated by the sector advanced 10 %.

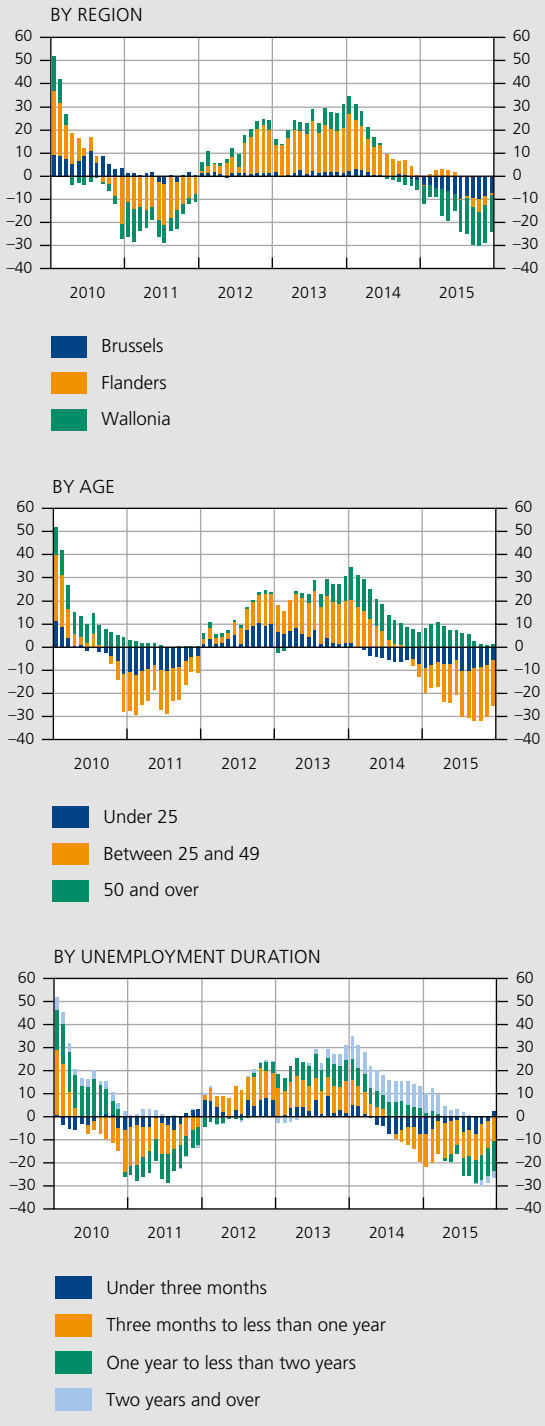
Employment in Belgium did not benefit from it. Between 2012 and 2014, in particular, the period in which the number of seconded workers grew most strongly, the number of construction employees fell by 11 300. Even disregarding seconded workers, the sector also saw a shift from salaried employees to self-employment, which added 4 400 people.

Under EU law, foreign employers are required to comply with the rules on working hours and minimum wages of the host country, but audits by FPS Employment Labour and Social Dialogue find that they do not necessarily do so. In the real world, discouraging audits are very difficult to carry out, enabling foreign companies to offer a service at lower prices than their domestic counterparts thanks to less strict employment conditions and lower wages. European rules are being circumvented at the expense of Belgian employment, which is marked by high wages and heavy direct tax charges on labour.

On the whole, the minimum employment conditions as enshrined European law are not enough to prevent social dumping. More specifically, conventional wages would be more relevant as a criterion than minimum wages. The Commission's proposed Labour Mobility Package to better coordinate social security systems is intended to encourage worker mobility and to help national authorities combat abuse and fraud, but it will take a while before this initiative takes on a more concrete shape. And so to address the shortcomings of the current system, Belgium and a number of other Member States are calling for a review of the conditions that apply to secondments.

CHART 27 FASTER DROP IN NUMBER OF UNEMPLOYED JOB-SEEKERS

(changes in thousands of people compared with the same month of the previous year)



Source: NEO.

While the labour force swelled by around 18 000 people, job creation actually helped to push down unemployment in 2015 by 19 000. This fall in the number of unemployed job-seekers came on top of a cumulative increase of 53 000 people between 2012 and 2014. However, in 2015, unemployed job-seekers still averaged an annualised 579 000, compared with 500 000 in pre-crisis 2008.

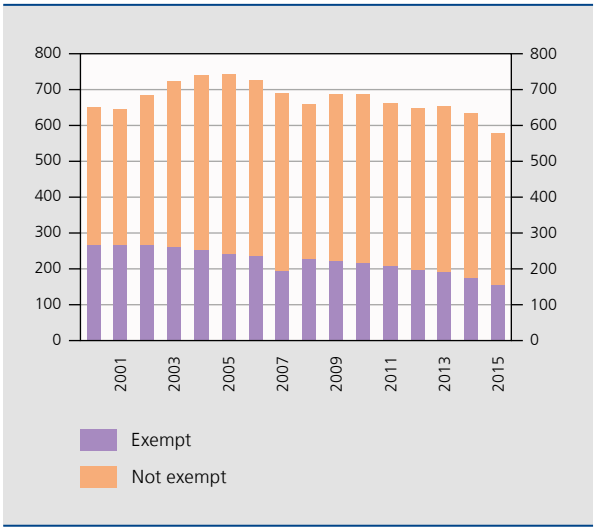
Unemployment has not been coming down at the same speed in all three Belgian Regions. Flanders responded more slowly and did not see unemployment begin to shrink until July 2015, while Wallonia and Brussels recorded falls from July and November 2014 respectively. A note of caution is in order: the unemployment rate in the Flemish Region averaged 5.1 % in the first three quarters of 2015, well below those for Wallonia and Brussels, where 12 % and 17.6 % of the labour force between 15 and 64 years of age are out of work, respectively.

Lower numbers of unemployed job-seekers – a trend that got under way in 2014 – first emerged in the contraction of the pool of those unemployed for less than a year. Short-term unemployment, which typically affects youngsters and the 25 to 49 age bracket the most, has traditionally been more sensitive to cyclical effects and, more specifically, to any upturn in economic activity. Conversely, the number of unemployed people who have been looking for jobs for two years or longer has persistently grown since mid-2013. These situation is primarily due to the job-seekers of 50 and above, notably numerous in this group and difficult to reintegrate on the labour market.

From 2015, though, the rise in long-term unemployment gradually slowed, albeit partly because of an outflow of people claiming insertion allowances who did not bother to re-register as job-seekers when their benefits ceased. In practice, insertion allowance entitlements have been capped at three years since 1 January 2012, with the initial effect of these measures beginning to percolate through in January of the year under review. In fact, in September 2015, the number of long-term unemployed even shrank compared with the previous year. Despite this positive trend, unemployment exceeding one year averaged 51 % in total in the third quarter of 2015 – a worrying phenomenon more prevalent in Belgium than in the EU at large, where it averages 48.2 %. After all, in terms of knowledge, skills and attitudes, the long-term unemployed are the least connected to the labour market and the hardest to re-employ even when economic activity picks up. This is a phenomenon that, if it

CHART 28 ACTIVATING JOB-SEEKERS: CONSTANT REDUCTION IN BENEFIT CLAIMANTS EXEMPT FROM LOOKING FOR WORK

(in thousands of people)



Source: NEO.

persists, causes steeper structural unemployment and erodes the economy's growth potential.

Broken down by age bracket, unemployment shows up major differences between the different age groups. In 2012 and 2013, the crisis had made youth unemployment much more severe, with lacklustre demand reducing the job prospects of young people and forcing them to compete with more experienced job-seekers. As is often the case, in 2014, young people were the first to benefit from the cyclical upturn, and the number of unemployed job-seekers under 25 fell off from the end of the first quarter, a trend that continued throughout 2014 and into 2015. The 25-49 age bracket also started to shrink at the end of 2014, while the number of over- 50s among the unemployed swelled further. That said, a more specific age demarcation within the latter group reveals diverging trends: whereas the 55-60-year-olds accounted for the bulk of the increase in 2014, their share shrank markedly in 2015, when the over-60s were hit hardest. Unlike these two older sub-groups, the 50-55 age bracket has been enjoying a decline in unemployment since mid-2014. The upward trend in the over-50s age group is not a recent phenomenon and has been evident since the early 2000s. The rise reflects successive 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, and then to 65 in 2015. All these people are now registered as job-seekers.

Trends in the number of unemployed entitled to benefits based on their status as job-seekers or not do tend to reflect the impact of different measures taken since the 2000s to reduce exemptions from looking for work. The proportion of non-job-seeking unemployed entitled to benefits had fallen to 27 % by 2015, compared with over 40 % in 2000. In January 2015, the government scrapped age-based exemptions altogether and decided that all jobless, including those with an employer top-up and irrespective of their age, should be available for work and actively look for employment. Still, some exemptions, transition measures and adjusted availability were introduced. Beside age reasons, people may be granted an exemption for social and family reasons, albeit that the government has now imposed stricter conditions on access to this system. This set of new measures should accelerate the downward trend in the number of non-job-seeking unemployed entitled to benefits, and re-include them in the supply of labour. In fact, this could contribute to welcome changes in labour market attitudes, as both employees and employers may stop seeing the age of 50 as an "inactivity threshold".

2.3 Subdued inflation only partially reflects moderation in labour costs

Inflation edged up in 2015 but remained low

In 2015, inflation measured by the year-on-year change in the harmonised index of consumer prices (HICP) stayed low at 0.6 %. This was mainly due to crude oil prices, which in fact pushed inflation numbers into negative territory between December 2014 and March 2015.

The downtrend in inflation recorded since mid-2011 nevertheless came to an end, after falling for three years in a row, from 3.4 % in 2011 to 0.5 % in 2014. The situation in Belgium differs from that in the euro area and in its three neighbouring countries, which continued to see average year-on-year inflation decline in 2015. In the final quarter of 2015, Belgium notched up price rises of 1.3 %, compared with 0.2 % in its neighbouring countries and the euro area.

The widening of the inflation gap between Belgium and the three main neighbouring countries in 2015 was caused by multiple factors. For one thing, services inflation, despite lower labour cost growth, is persistently high in Belgium and contrasts with the situation in its three main neighbouring countries. Furthermore,

TABLE 3 HARMONISED INDEX OF CONSUMER PRICES

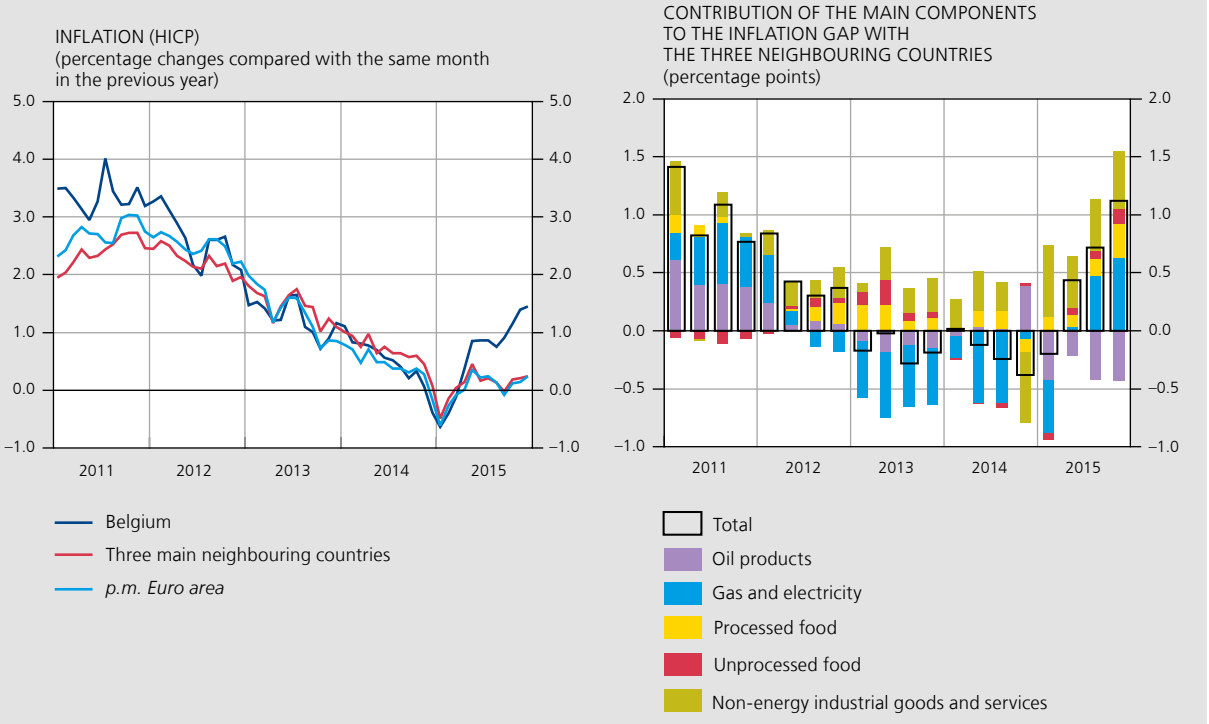
(percentage changes compared with the previous year)

	2011	2012	2013	2014	2015
HICP	3.4	2.6	1.2	0.5	0.6
Energy	17.0	6.0	–4.6	–6.0	–8.0
Unprocessed food	0.2	3.4	4.4	–1.3	2.1
Processed food	3.1	3.1	3.2	2.1	1.6
Underlying inflation	1.5	1.9	1.5	1.5	1.6
Services	1.9	2.5	1.9	2.2	2.4
Non energy industrial goods	1.0	0.9	1.0	0.3	0.5
Health index	3.1	2.7	1.2	0.4	1.0

Source: DGS.

a number of measures introduced by the federal and regional governments are conspiring to push up inflation. Electricity distribution rates have been raised, for instance, while some of the measures taken to finance the tax shift had already exerted a major influence on prices of energy products – chiefly electricity – and alcohol. Regulated prices likewise affected inflation, in particular services prices.

CHART 29 GREATER INFLATION GAP BETWEEN BELGIUM AND ITS NEIGHBOURING COUNTRIES



Sources: EC, DGS.

TABLE 4 CONTRIBUTIONS TO INFLATION FROM PRICE CHANGES FOR LARGELY REGULATED GOODS AND SERVICES
(percentage points)

	2013	2014	2015	*p.m. HICP weight in 2015 (in %)* *2015*
Contribution to total HICP inflation	0.3	0.1	0.5	
Contributions to price changes among the main components:				
Energy	0.6	–2.0	1.2	*11.0*
Excise duties on motor fuels	0.1	0.1	0.1	
VAT on electricity	0.0	–2.4	0.3	
p.m. Annualised impact as of September			*3.1*	
Electricity distribution rates[1]	0.5	0.3	0.9	
Services	0.3	0.5	0.6	*40.8*
Domestic services (including service vouchers)	0.1	0.2	0.2	
Education	0.0	0.0	0.1	
p.m. Annualised impact as of October			*0.4*	
Medical services	0.1	0.1	0.2	
Waste collection	0.0	0.1	0.0	
Sewage	0.0	0.1	0.1	
Processed food	1.0	1.2	0.9	*13.1*
Excise duties on tobacco	0.7	1.1	0.8	
Excise duties on alcohol	0.2	0.1	0.1	
p.m. Annualised impact as of November			*0.6*	

Sources: EC, NBB.
(1) Including a "Prosumer" rate introduced in Flanders in August 2015.

Energy prices stayed below those in 2014, but inched back up during the year

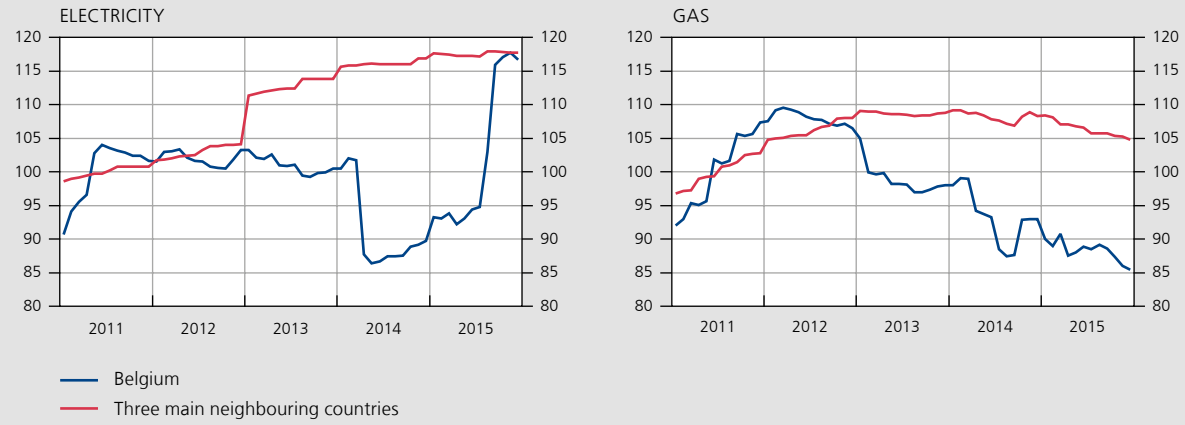
After recording declines of 6 % in 2014, energy prices fell by 8 % in 2015, due to a confluence of factors that brought both upward and downward pressures. The slowdown since 2014 is attributable to sharply lower global oil prices and the downstream drop in prices for refined products. Throughout 2015, Brent crude prices were much lower than in 2014, a year that had already seen sharp falls. In euro terms, Brent slumped by 36 % in 2015, compared with 10 % in 2014.

Higher consumer prices for electricity have wiped out part of the effect on total inflation of oil-derived products. In the first quarter of 2015 energy prices were also pushed down by the previous government's decision to cut the VAT rate on electricity from 21 % to 6 % from April 2014 – a decision that was reversed in September 2015 to help fund the tax shift, taking overall inflation in 2015 up by 0.1 percentage points. Next, distribution rates went up in the country's three Regions: Belgium's utility companies have been subject to corporation tax since mid-2015 and have passed on the extra charges to consumers. In Flanders, August saw the introduction of a so-called "Prosumer rate", imposing a charge for the use of the power grid on consumers generating a proportion of their own (green) electricity. The distribution rate rise caused by both factors combined added an estimated 0.1 percentage point to total inflation in 2015.

As part of the tax shift, in November 2015, the government introduced a ratchet system for diesel and a reverse ratchet system for petrol – linked to diesel prices – with the aim of pushing up diesel prices relative to petrol prices over time. Under this mechanism, any falls in daily maximum prices that are fixed in the "programme contract" for diesel are not fully passed on to consumers but are partly offset by higher excise duties. Once diesel prices have hit an excise duty ceiling, an offsetting cut in excise duties on petrol kicks in, with the mechanism ending as soon as government-targeted amounts have been reached, i.e. € 2 for 50 litres of diesel and € –1.3 for petrol by the end of

CHART 30 DIVERGING ELECTRICITY AND GAS PRICES

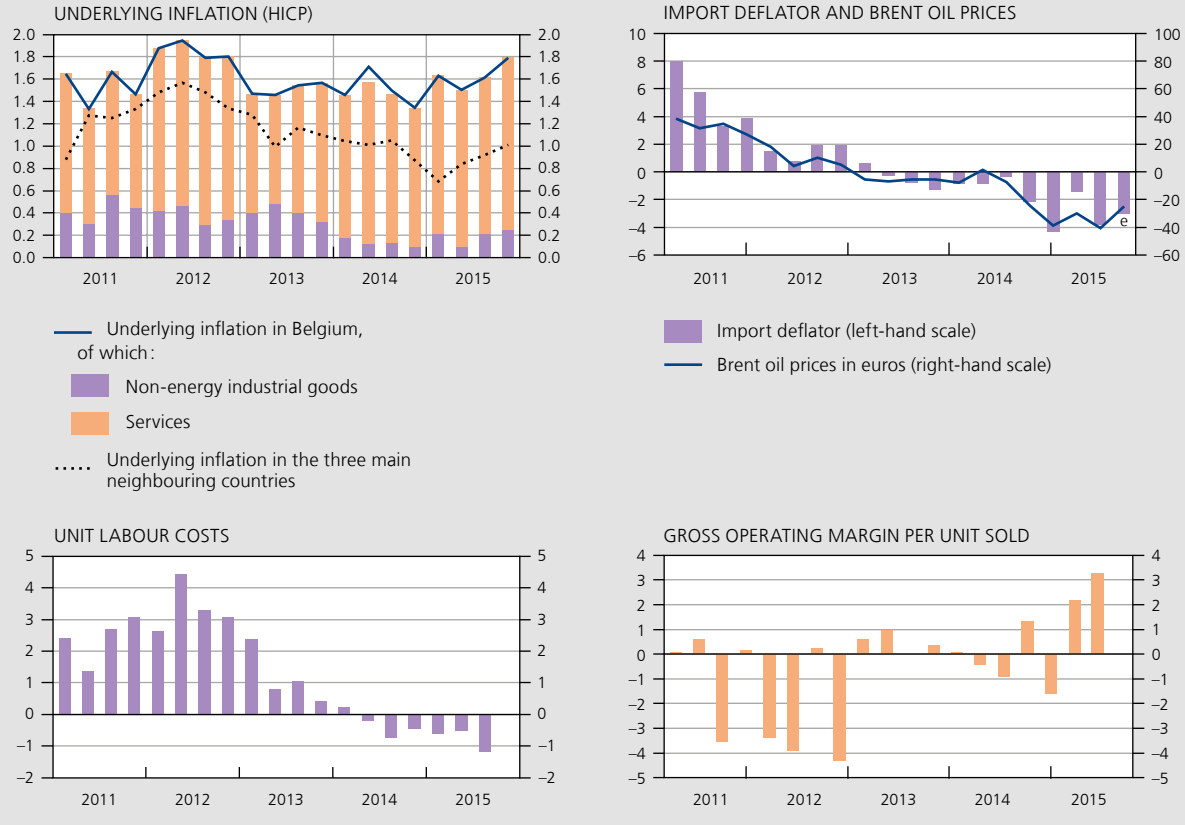
(index 2011 = 100)



Source: EC.

CHART 31 IMPORT PRICES AND PROFIT MARGINS OFFSET MODERATING INFLUENCE OF WAGE GROWTH ON UNDERLYING INFLATION

(percentage changes compared with the previous year)



Sources: EC, NBB.

2016. In 2015, the measure had no significant effect on total inflation.

Gas prices came down slightly in 2015, reflecting Zeebrugge Hub prices and a reduction in distribution network rates.

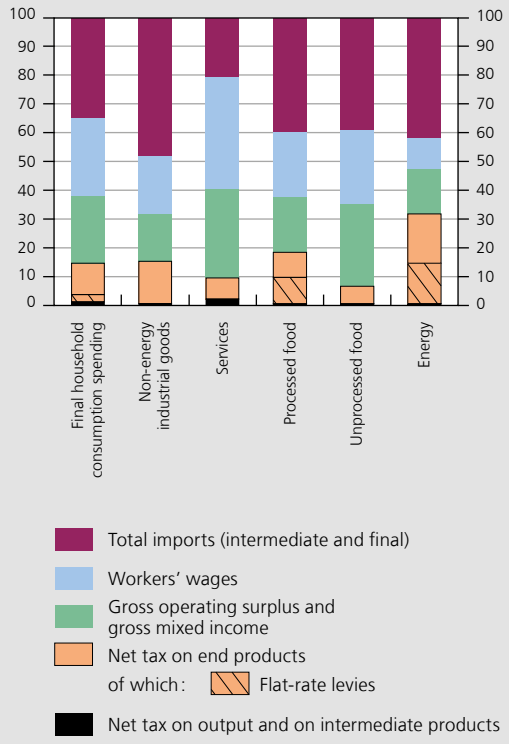
Underlying inflation persistently high due to services prices

Underlying inflation, as measured by the HICP excluding food and energy, averaged 1.6 % in 2015, a minor pick-up relative to 2014's 1.5 %. It has proven to be more persistent in Belgium than in other countries: in Belgium's neighbouring countries, underlying inflation dropped for the third year running, to an average of 0.9 % in 2015, compared with 1 % in 2014 and 1.1 % in 2013. And in the broader euro area as well, it failed to move beyond 0.8 % in 2015.

Services prices are the primary reason for underlying inflation's persistence, growing by 2.4 % in 2015 compared with 2.2 % in 2014 while neighbouring countries posted a mere 1.2 % in 2015 and 1.6 % in 2014. Pricing of services is influenced chiefly by domestic factors such as unit labour costs and corporations' gross operating surpluses. Labour costs account for 27 % of the total household final consumption expenditure but take up over 40 % of total costs in the services sector. In fact, prices for services might have been expected to come down as unit labour costs have grown more slowly in the past couple of years. Although labour costs typically show up in consumer prices gradually, their absence in the pricing figures suggests other factors pulling in the opposite direction.

CHART 32 WORKERS' PAY ACCOUNTS FOR SIGNIFICANTLY HIGHER PROPORTION OF COSTS IN SERVICES COMPARED WITH OTHER SECTORS

(breakdown of cumulative costs of household spending (1), in %, in 2010)



Sources: NAI, NBB.
(1) At purchase prices.

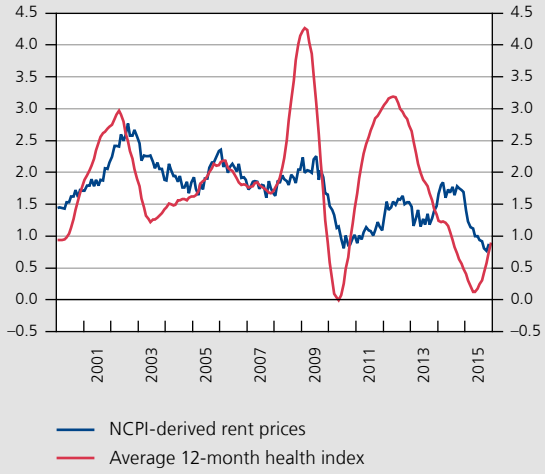
First of all, unit labour costs have been advancing more strongly in services than in the manufacturing industry or even the broader economy. Trends in services prices are also related to firms' profit margins to the extent that they are able to widen these margins, or preserve them in times of low economic activity. In that respect, the OECD's Product Market Regulation (PMR) indicators suggest that some of Belgium's services sectors are more strictly regulated than those in other countries and that, theoretically at least, there is less competition. A survey commissioned by the Eurosystem's Wage Dynamics Network (WDN) indicates companies generally reporting intensified competition in the 2010-2013 period compared with 2008, but less so in business services and financial services. This is not new: as early as 2005, the Eurosystem Inflation Persistence Network reported that euro area prices in services are typically more rigid than in other sectors.

Insufficient competition may explain why communication as a services category made a less negative contribution to inflation in 2015. Normally, this category – which accounts for 8.4 % of the services consumption basket – is best known for falling prices on the back of major quality improvements of the kinds of products that are taken into account in compiling the consumer price index. Yet in 2015, this category scarcely declined at all, mainly because of price rises for packages announced by a major telecoms company at the start of the year.

Pricing of a large proportion of services in Belgium, particularly if regulated, is index-linked – albeit with some time lag – to a range of indicators such as the national consumer price index or the health index, e.g. prices of rent, education, public transport, etc. Theoretically, these types of services might be expected to contribute less to inflation in view of the overall slowdown in inflation in the past few years, but other factors have been known to upset this relationship. Rent prices, for instance, would have gone up less in 2015 if they had been subject to index-linking only. In the event, supply

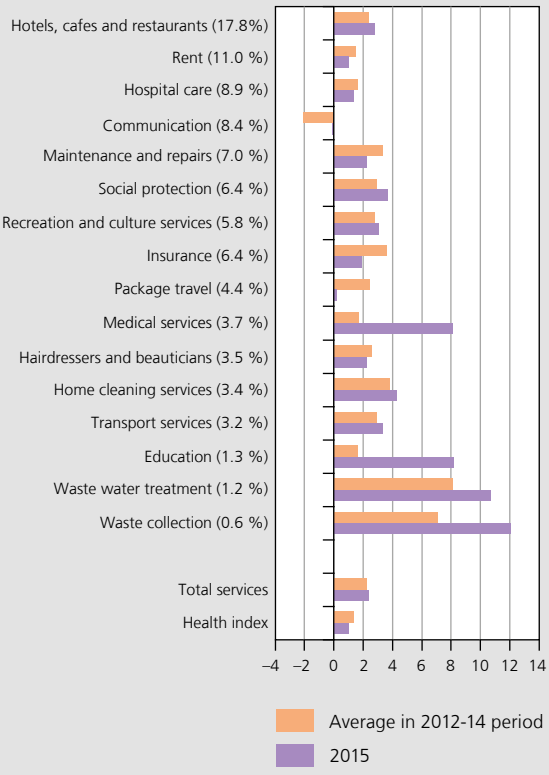
CHART 33 RENT PRICES DO NOT ALWAYS REFLECT INDEXATION MECHANISM

(change in percentages compared with the previous year)



Sources: DGS, NBB.

CHART 34 AVERAGE INFLATION IN THE 2012-14 PERIOD AND IN 2015 ADDS UP TO OVER 2% FOR A WIDE RANGE OF SERVICES COMPONENTS (1)



Source: EC.

(1) In brackets: category weight in the HICP services component.

and demand factors in the property market also came into play.

Services prices are also influenced by administrative decisions, some of which result from fiscal consolidation. The education category, for instance, saw its index surge by 29 % in October even though a negative figure would have been more likely based on typical index-linking. Indeed, the Flemish authorities raised higher education tuition fees sharply and thereby significantly accelerated inflation in this particular category, the effect of which is estimated at +0.4 percentage point on an annual basis in the overall services index. Another example of the influence of regulated prices is the 6 % increase in medical costs in January 2015, which resulted from a harmonisation of patient fees paid to consultants.

Prior to 2015, other regulated services have also become much more expensive, e.g. service vouchers, with prices having gone up from € 8.5 to € 9 in 2014, and the waste collection (with prices rising by 1.4 % in 2013, 18.5 % in 2014 and 12.1 % in 2015) and waste water treatment (from 3.4 % in 2013 to 9.4 % in 2014 and 10.7 % in 2015) categories. The hotels, cafés and restaurants category was a major contributor to the inflation gap between Belgium and its three main neighbouring countries in the 2008-14 period, as revealed in the 2014 annual report of the Price Observatory (NAI).

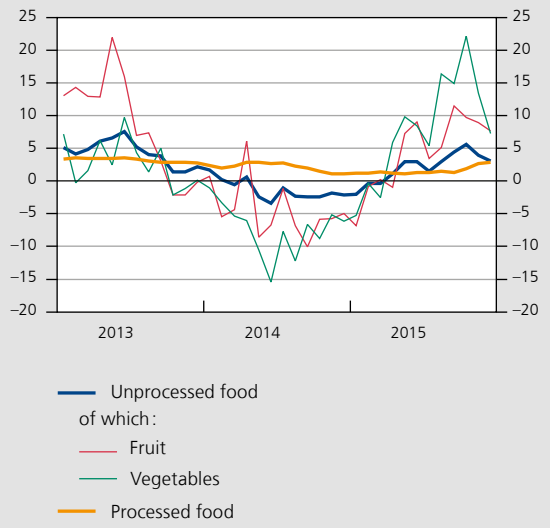
The inflation rate for non-energy industrial goods amounted to 0.5 % in 2015, against 0.3 % in 2014. With industrial goods prices more reliant on global developments than those for services, their still minor price rises would seem to reflect the gloomy economic climate. That said, industrial goods prices picked up slightly in the final months of 2015, mainly because of the influence of euro depreciation on the import deflator – which itself primarily reflects plunging crude oil prices.

Food prices go up

Unprocessed food prices rose by 2.1 % in 2015, compared with a fall of –1.3 % in 2014. Higher prices were chiefly recorded in the vegetables category and to a lesser degree also for fruit. In 2014, good harvests and the Russian trade embargo had caused a collapse in prices, as both had swollen fruit and vegetables supplies. Slightly less favourable weather conditions in 2015 and new markets in Europe and Canada combined to push up the year-on-year inflation figures. Also, drought and poor harvests in the second and third quarters of the year made potatoes a lot more expensive.

CHART 35 FOOD PRICES RISE AND FEEL THE TAX PINCH

(percentage changes compared with the previous year)



Source: EC.

Processed food price increases slowed from 2.1 % in 2014 to 1.6 % in 2015 or – ignoring alcohol and tobacco, whose prices are heavily influenced by excise duty changes – from 0.6 % in 2014 to 0.4 % in 2015. In this segment, lower food price inflation compared with 2014 was mainly down to falling global dairy prices. Later in the year, milk prices were raised by 14 eurocents a litre for a period of nine months, starting in October 2015, a measure taken to pay for a common fund for troubled milk producers facing sales prices that no longer cover their costs. An upside push came from the November rise in alcohol prices as part of the tax shift.

Wage restraint and index jump continue to push down labour cost growth

The growth of labour costs had already clearly slowed down in 2014 but continued to slacken in 2015. Hourly wage costs barely edged ahead by 0.5 % across the Belgian economy, down from 0.9 % in 2014. Main explanations for this slowdown include the freeze, for the third year running, of real collectively agreed wage adjustments in the private sector; a very slight increase in the health index at

TABLE 5 LABOUR COSTS

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

	2011	2012	2013	2014	2015 e
Labour costs in the private sector	2.1	3.1	2.5	0.7	0.4
Gross hourly wages	2.6	3.0	2.3	0.8	0.5
Collectively agreed wages (1)	2.7	3.0	2.0	0.8	0.1
Real agreed adjustments	0.0	0.2	0.1	0.0	0.0
Indexations	2.7	2.8	1.9	0.8	0.1
Wage drift and other factors (2)	–0.1	0.0	0.3	0.0	0.4
Employers' social contributions (3)	–0.5	0.1	0.2	–0.1	–0.2
Social security	0.1	0.0	0.1	–0.2	–0.2
Other contributions (4)	–0.5	0.1	0.1	0.1	0.0
p.m. Unit labour costs in the private sector	*2.3*	*3.5*	*2.1*	*–0.2*	*–0.5*
Hourly labour costs in the public sector	3.7	3.2	3.2	1.5	0.9
of which: indexations	2.7	2.5	2.3	0.0	0.0
Hourly labour costs in the economy as a whole	2.4	3.2	2.7	0.9	0.5

Sources: FPS ELSD, 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.

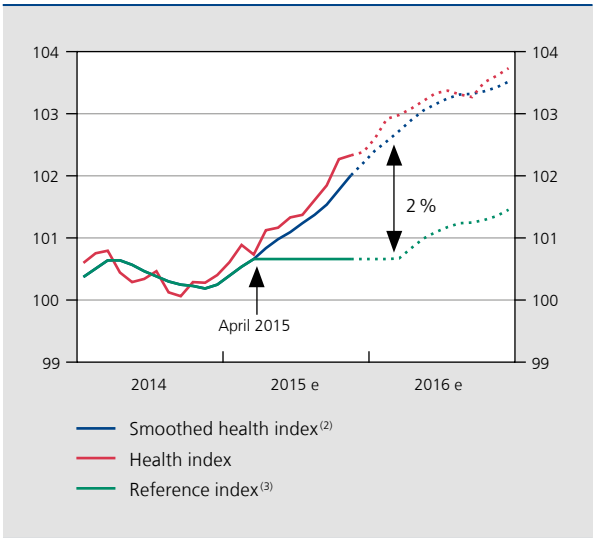
(4) Actual social contributions not paid to the government, including premiums for group insurance, pension funds or occupational pension institutions, and imputed contributions, including redundancy pay.

the start of the year; and the index jump implemented by the government from 1 April 2015. This latter measure effectively boils down to a freeze on automatic wage indexation in both the private and government sectors.

The increase in hourly labour costs in the private sector slowed down to 0.4 % in 2015, compared with 0.7 % in 2014 – far below the average 2.5 % increase of the past decade. Low inflation and the index jump were major factors behind this deceleration: whereas indexation still added 0.8 % to labour cost growth in 2014, this percentage fell to 0.1 % in 2015. In concrete terms, the official indexation parameter, i.e. the smoothed health index calculated as the average of the health index in the past four months, was blocked from 1 April 2015 until it will have grown by 2 %, implying that most automatic indexation mechanisms are temporarily shelved. The fact that indexation still contributed 0.1 % in 2015 was attributable to the fact that the private sector has a wide range of indexation mechanisms in place, depending in particular on joint committee agreements. Some of these had been activated before the index jump was put in place, others after the temporary freeze of the indexation mechanisms – e.g. periodic indexation mechanisms (annual, quarterly or other), which saw indexation occur on the usual dates but based on a reference index that no longer reflected price swings after the freeze. Even without the index jump, indexation would have added only 0.5 % to wage rises in 2015, because of subdued inflation and the time lags between price trends and indexation. The index jump will have the largest impact on labour costs in 2016.

CHART 36 IMPACT OF THE TEMPORARY SUSPENSION OF INDEXATION MECHANISMS ON THE REFERENCE INDEX FOR WAGES

(index(1), 2013 = 100)



Sources: DGS, NBB.

(1) Based on the NBB's 2015 autumn projections.

(2) Four-month average of the health index.

(3) Smoothed health index, taking into account the temporary freeze of the indexation mechanisms.

Real negotiated wage growth had already been frozen in 2013 and 2014, in accordance with the draft interprofessional agreement imposed by the government as some unions withheld their approval, as they had done in the 2011-12 period. This procedure was replicated for the 2015-16 period in the absence of a generally accepted collective agreement. With a view to further reducing the wage gap with Belgium's three main neighbouring countries, no real pay rises in excess of inflation were allowed. For 2016, the law makes provision for the possibility of granting new real negotiated wage increases provided they remain within the total margin of 0.5 % of the gross wage bill, corresponding to the total employer labour cost including all charges, plus 0.3 % of the wage bill in net terms, at no extra cost for the employer.

The effect of the wage drift – which comprises, without distinction, pay scale increases agreed by employers and the effects of changes in the employment structure – climbed to 0.4 % in 2015, compared with 0 % in 2014. In addition to long-term trends such as lengthening careers, this modest increase may be explained by the upturn in economic activity for a second consecutive year and the emergence of tensions in some sectors of the labour market. In part, this upward effect was offset by the slight fall in employers' contributions, which partly reflected a lower rate of employer contributions to the fund for business closures and reductions in social security contributions for the fourth and fifth worker employed by SMEs or the self-employed.

In October 2015, as part of the tax shift (see section 5.2 as well), action was taken to enhance the competitiveness of Belgian corporations and cut their labour costs. Some cost reductions had already featured in the May 2014 Competitiveness and Employment Pact. The measures with regard to labour costs are not expected to have any real effect until 2016 as they are to be put in place only gradually from the beginning of the year. Employers' contributions to social security, which had been between 19 % and 29 % in 2015, including the structural cost reductions, are expected to range from 15 % to 25 % by 2018, depending on employees' pay levels. However, measures to fund the tax shift are likely to put upward pressure on inflation and, via the indexation mechanisms,

on labour costs, partly offsetting the initial drop in labour costs under the tax shift.

Public sector wages showed a similar trend to those in the private sector: they grew by 0.9 % in 2015, compared with the 1.5 % figure for 2014, which itself had been half of 2013's growth rate. The public sector did not enjoy any indexations in 2014, as the threshold index had not been reached since the end of 2012; 2015 saw the introduction of the index jump and with it the further delay of indexation until 2016. No real adjustments were agreed either. The fact that wages budged at all in 2015 in part reflected changes in the employment structure of civil servants: employees staying in service for longer as a result of the reforms to early retirement plans continue to enjoy seniority-related wage increases, while newly hired employees are typically better educated than those they replace, which puts them in a higher salary scale.

Wage gap continued to narrow, primarily due to trends in hourly labour costs

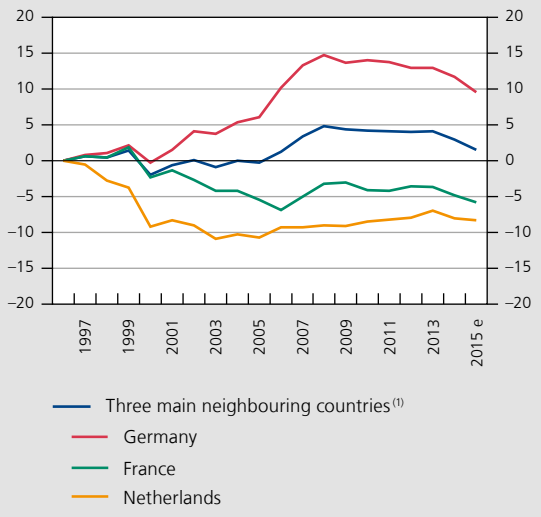
According to the Central Economic Council (CEC) secretariat, the cumulative wage gap since 1996 with Belgium's three main neighbouring countries in terms of hourly labour costs narrowed from 4.1 % in 2013 to 2.9 % in 2014 and then to 1.5 % in 2015. As in previous years, this wage gap is mostly down to the cumulative difference of around 10 % compared with wages in Germany, whereas labour costs have risen more strongly in France and the Netherlands than in Belgium since 1996. The CEC expects the gap to close in 2016, partly on the back of the tax shift. One measure to reduce taxes on labour specifies that the budget derived from employers' exemption from paying 1 % of payroll tax will be earmarked to cut employers' social security contributions. These funds are not in any way to be used to increase wage margins in any future pay negotiations, as this is a measure that is already in place, but recognised in the national accounts as a business subsidy and therefore not deducted from labour costs. The shift of this budget merely has an accounting effect, rather than any real effect on labour costs, and should not therefore have any impact on wage negotiations between the social partners. The government agreement envisages an overhaul of the 1996 Law on the Promotion of Employment and the Preventive Safeguarding of Competitiveness which underpins wage bargaining. To date, no concrete steps have been taken.

In addition to hourly wages in Belgium's business sector rising at a slower pace than in its three main neighbouring countries, productivity also worked out a little better in 2015 and, consequently, unit labour costs were down for the second year running, in fact even more so than in 2014. As a result, the cumulative wage gap since 1996 for unit labour costs in the business sector came down from 9.7 % in 2013 to 5.3 % in the first three quarters of 2015. However, despite notable progress in the past couple of years, the difference relative to Germany as recorded since 1996 remains significant.

This gap with Germany is primarily traceable to unit labour cost trends in the market services sector. Although hourly labour costs in the Belgian industry rose faster than the average in the three neighbouring countries, this was more than offset by productivity developments. Meanwhile, the reverse happened in the market services sector: hourly labour costs recorded a slight difference in Belgium's favour, while productivity growth was so poor relative to its neighbouring countries that Belgium ended up with a considerable wage gap. Labour cost trends in the market services sector, like margins, also have an impact in industry though, particulary via outsourcing. When we compare the cumulative difference in unit labour costs with the figures for each of the three neighbouring countries separately, the same pattern emerges: a gap vis-à-vis Germany, more specifically in the market services

CHART 37 BELGIUM'S WAGE GAP NARROWED FURTHER

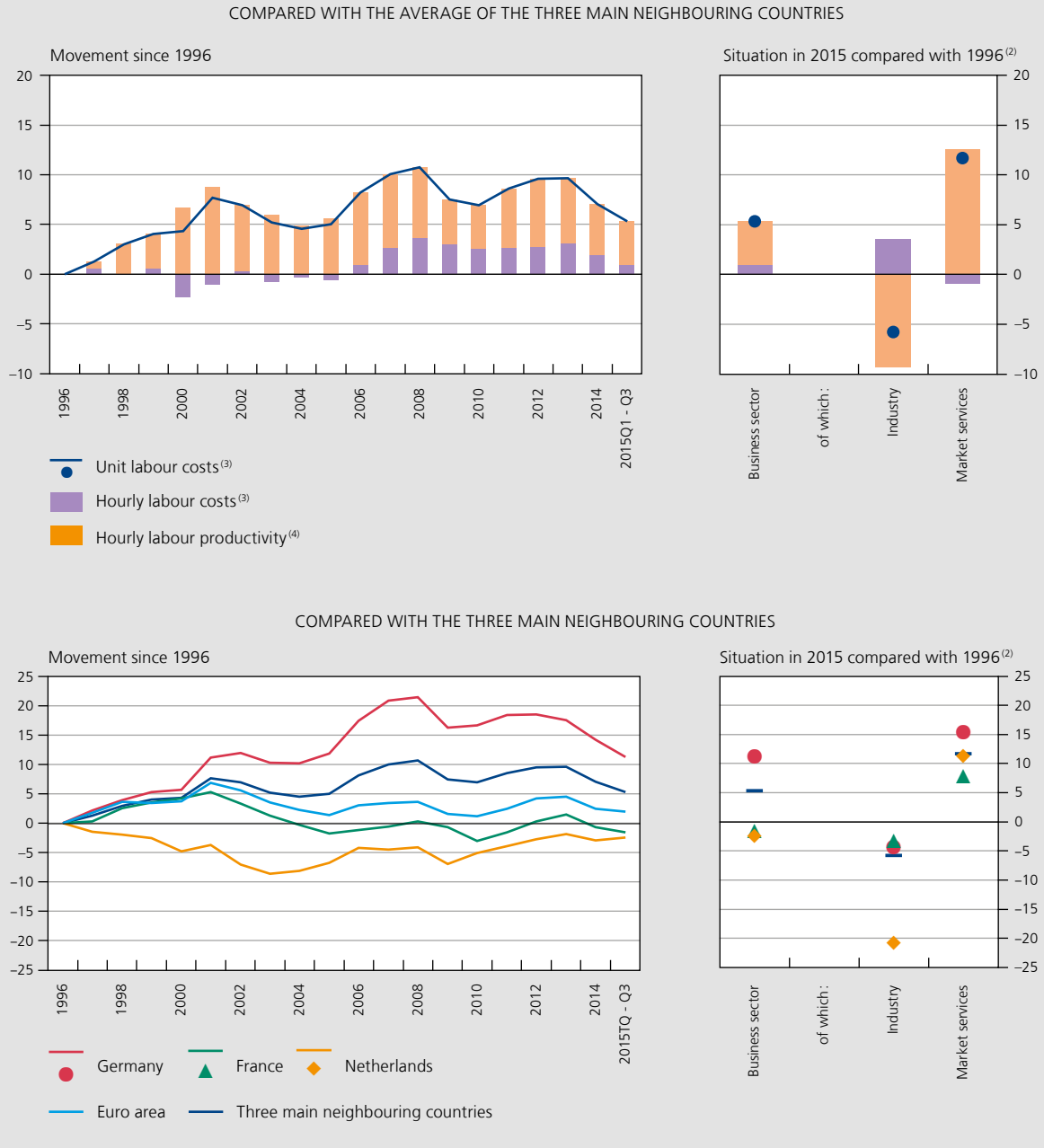
(percentage differences in hourly labour costs in the private sector compared with the three main neighbouring countries, cumulative since 1996)



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

CHART 38 WAGE GAP IN TERMS OF UNIT LABOUR COSTS NARROWED FURTHER IN 2015, BUT REMAINS SIGNIFICANT COMPARED WITH GERMANY

(business sector[1] in Belgium, percentage differences, cumulative since 1996)



Sources: EC, NAI.

(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.

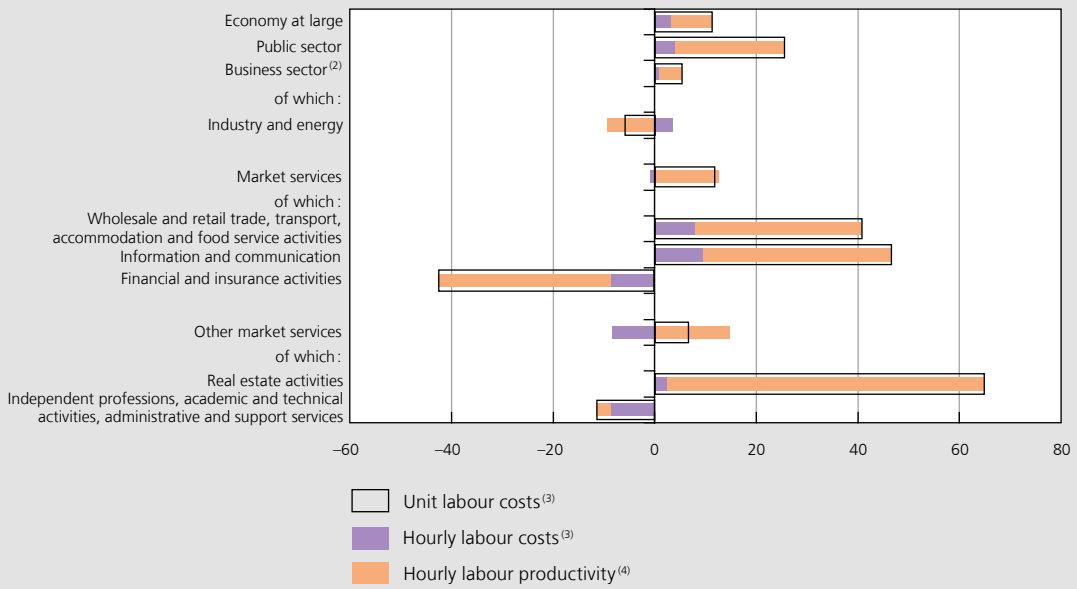
(4) A positive sign implies that labour productivity is rising more slowly in Belgium than the average for the three main neighbouring countries.

sector. Compared with the Netherlands, Belgium recorded a lower increase in cumulative labour costs in industry, but labour costs in the market services sector have gone up so much more that the gains in the manufacturing sector were virtually wiped out.

Probing deeper into the market services sector, a whole range of sub-sectors turn out to have built clear wage gaps relative to the average for the three neighbouring countries, particularly trade, transport, accommodation and food service activities, information

CHART 39 WAGE GAP IN TERMS OF UNIT LABOUR COSTS LARGELY ATTRIBUTABLE TO MARKET SERVICES SECTOR

(2015 (1), percentage differences relative to the three neighbouring countries, cumulative since 1996)



Sources : EC, NAI.

(1) Average of the first three quarters.

(2) The business sector comprises NACE categories B to N and thus includes industry, construction and market services, serving as a proxy for the private sector. The public sector coincides with NACE categories O to Q.

(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.

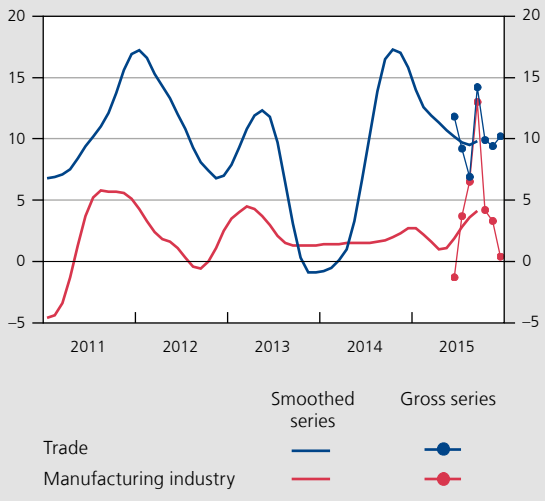
and communication and real estate activities. The gap was mostly attributable to less favourable productivity trends, but the evolution of hourly wages also contributed. Faster wage increases recorded in Belgium in a number of services sub-sectors may partly explain why Belgian prices firmed so much more than those in the neighbouring countries. In financial and insurance activities, by contrast, cumulative labour costs since 1996 have gone up much less strongly in Belgium than in its three neighbouring countries, reflecting more favourable trends in terms of both productivity and hourly labour costs.

2.4 Economic activity growth increasingly driven by consumption

In 2015, economic activity was driven by more robust household spending and the change in inventories – the latter having returned to positive territory after years of negative contributions to growth. That said, this variable is volatile and is frequently revised. Due caution should be observed when interpreting the outcomes.

CHART 40 SPIKE IN INVENTORIES TEMPORARY, ACCORDING TO BUSINESS LEADERS

(balance of replies, seasonally adjusted data)



Source : NBB.

TABLE 6 GDP AND MAIN EXPENDITURE CATEGORIES

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

	2011	2012	2013	2014	2015 e
Private consumption	0.3	0.6	0.9	0.4	1.2
General government consumption	1.3	1.5	–0.1	0.6	0.5
Gross fixed capital formation	4.2	0.2	–1.7	7.0	1.9
Housing	–2.5	–0.1	–4.1	5.7	–0.1
Enterprises	6.5	0.0	–0.5	8.0	2.0
General government	5.9	2.1	–3.7	4.0	5.4
p.m. Final domestic expenditure(1)	*1.4*	*0.7*	*0.0*	*1.9*	*1.2*
Change in inventories(2)	0.7	–0.9	–0.7	–0.2	0.5
Net exports of goods and services(2)	–0.3	0.3	0.7	–0.4	–0.3
Exports of goods and services	6.7	1.8	1.6	5.4	3.5
Imports of goods and services	7.3	1.4	0.8	5.9	3.8
GDP	1.8	0.2	0.0	1.3	1.4
p.m. Final demand	*4.2*	*0.7*	*0.4*	*3.4*	*2.5*

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

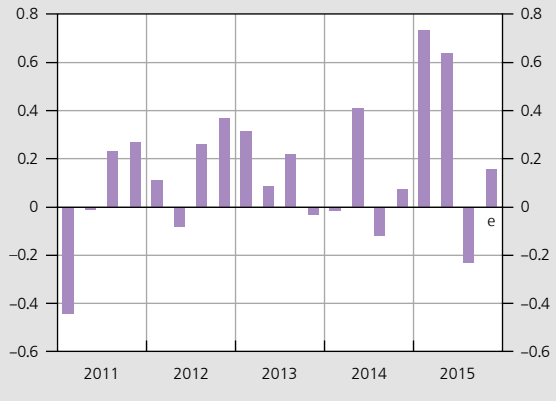
The replies to the Bank's monthly business survey of the manufacturing industry and trade suggest that inventories in the first months of the year were considered to be becoming more 'normal' gradually, reflecting the economic recovery. By the second half of 2015, firms soon began to feel that inventory levels were running too high, particularly in industry, as the outlook for foreign demand turned less certain.

Government consumption expenditure added only 0.5 % in volume terms in 2015. Although similar to the pace of growth in the previous year, this remains historically low compared with an average rise of around 1.5 % since 2000. Government austerity measures have, after all, curbed current expenditure. Public investment, on the other hand, has gone up sharply, as this Report's chapter on public finances will show.

Companies saw their gross fixed capital formation rise further in 2015, albeit a lot more slowly than in 2014. Net exports of goods and services, by contrast, continued to shrink slightly in 2015, as imports were up a little more than exports, despite the country's wage moderation policies aimed at boosting corporate competitiveness. This contraction was down to a few major – though one-off – purchases abroad, the most important of which was a patent in the pharmaceuticals industry. Although causing major spikes in total investment and services imports, these transactions hardly affect economic activity in the short term, even if they do serve to increase the economy's intangible assets.

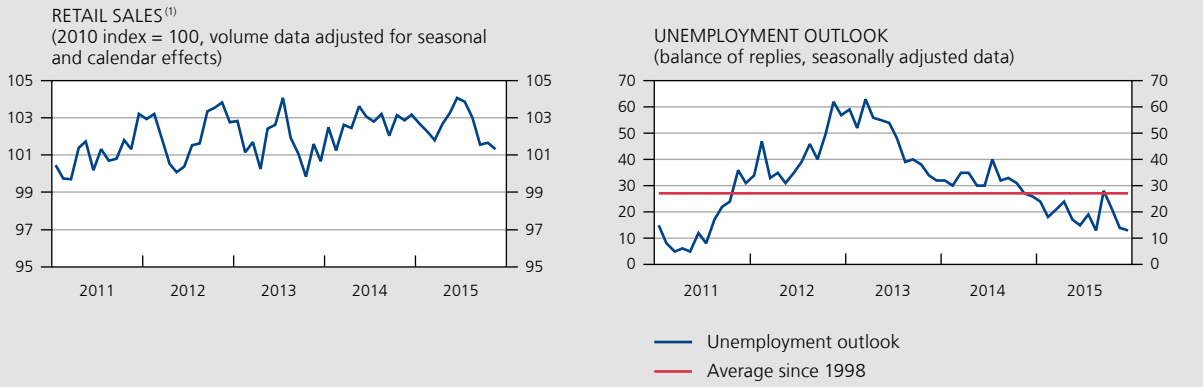
CHART 41 DYNAMIC CONSUMPTION GROWTH IN FIRST HALF-YEAR

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



Sources: NAI, NBB.

CHART 42 PRIVATE CONSUMPTION INCREASES ON THE BACK OF SHARPLY IMPROVED CONFIDENCE



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

Household consumption up faster than incomes

Staging the fastest increase since 2010 at 1.2 %, private consumption was a key driver of higher economic activity in 2015 and recorded very robust growth indeed at the start of the year.

The rapid decline in commodity prices from the second half of 2014 boosted household purchasing power and was one of the drivers of consumption. At the same time, the labour market perked up while the fear of redundancy waned towards the end of 2014, even taking this sub-indicator of consumer confidence below its normal levels by 2015. As corroborated by its firm correlation with actual consumption, households' more positive take on labour market conditions was the motor behind their willingness to spend.

The favourable climate also showed up in the synthetic consumer confidence indicator, which improved right through to June 2015, when confidence reached its highest levels since mid-2011. Around the same period, the indicator capturing consumers' inclination to buy durable goods also peaked and June retail transaction volumes also reached a new high.

However, the confidence boost of the first half was cut short as the third quarter progressed, with private individuals becoming increasingly worried about the impact of current geopolitical events on the local economic situation, and taking a notably more pessimistic line on the consequences for job security. At the same time, the stimulus of lower oil prices in terms of purchasing power declined and quarterly consumption growth slowed from 0.6 % in the second quarter to –0.2 % in the third. And although the turmoil abated after the summer and confidence perked back up, households kept a tighter rein on their purse-strings throughout the second half.

All that said, and bucking the second-half slowdown, total private consumption rose virtually in line with gross disposable income, which added 1.8 % in nominal terms and 1.2 % in real terms.

Looking at private individuals' primary income, the sum total of the gross operating surplus and gross mixed income staged the strongest growth in 2015 – 3.2 % in nominal terms, its highest pace since the great recession. Both types of income grew at similar rates, with the first comprising both actual collected rental income and imputed rental income from owner-occupied housing. The second type of income is earned by the self-employed and benefited from improved general economic conditions, with the steady increase in the number of self-employed people also weighing in.

Compensation of employees advanced by 1 % in 2015, lagging behind the two previous years despite a more rapid increase in the number of hours worked on the back of the rebounding business cycle. As noted, the upturn was held back by measures to keep labour costs in check, such as the index jump – against a background of low inflation too – and frozen real agreed adjustments.

Lastly, households saw their capital income shrink again in 2015, as they had in the four previous years. In the wake

TABLE 7 DETERMINANTS OF HOUSEHOLD GROSS DISPOSABLE INCOME, AT CURRENT PRICES

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

	2011	2012	2013	2014	2015 e	*p.m. In € billion* *2015 e*
Gross primary income	2.8	2.5	1.2	1.0	1.2	*291.2*
Compensation of employees	4.5	3.4	2.0	1.2	1.0	*212.4*
Volume of labour of employees	2.1	0.3	–0.8	0.3	0.4	
Labour costs per hour worked	2.4	3.2	2.7	0.9	0.5	
Gross operating surplus and gross mixed income	2.0	1.3	0.9	2.1	3.2	
Capital income[1]	–6.1	–1.2	–3.2	–2.6	–1.2	*28.4*
Interest (net)	–4.3	0.6	–14.4	–39.2	–21.0	*2.5*
Dividends received	–15.4	–1.8	0.0	11.9	0.7	*14.6*
Net current transfers	6.4	2.4	4.5	0.6	–1.5	*–53.7*
Current transfers received	2.8	5.5	3.9	0.8	1.0	*91.1*
Current transfers paid	4.1	4.3	4.2	0.7	0.1	*144.7*
Gross disposable income	2.0	2.6	0.5	1.1	1.8	*237.5*
p.m. In real terms[2]	*–1.0*	*0.6*	*–0.6*	*0.5*	*1.2*	
Savings ratio[3]	13.6	13.5	12.3	12.6	12.5	

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' supplementary pension entitlements accruing in the context of an occupational activity.

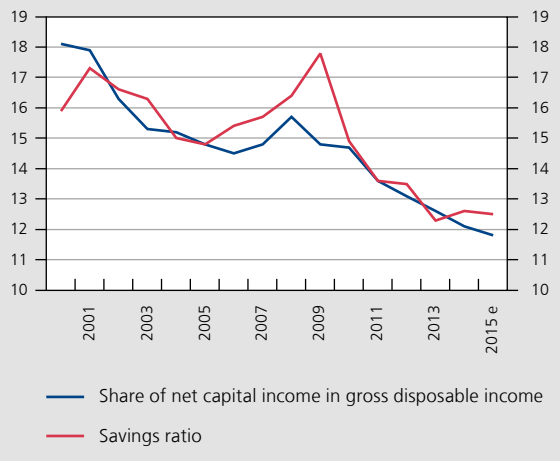
of the great recession, the low interest-rate climate and reduced corporate dividend payments have squeezed capital income and, more generally, household disposable incomes. In 2015, net interest income contracted further, but this was partially offset by a tentative upturn in dividends received.

In addition to higher labour income, private individuals saw their disposable incomes boosted by reduced net transfers to other sectors, which fell for the first time since 2009. As in the previous year, transfers received – mainly social benefits – again rose modestly in 2015 in the wake of limited indexation among other factors. Modest though this was, it exceeded the slim rise in paid transfers, depressed as they were by reduced taxes on income and wealth. The net contraction compared with 2014 was due not only to a higher deductible professional expense allowance, but also to a 2015 decline in amounts paid on liquidation surpluses and tax regularisation compared with the previous year.

Simultaneously to the minor recovery of disposable income in 2015, the proportion saved also edged down

CHART 43 CONTINUOUS EROSION OF 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' supplementary pension entitlements accruing in the context of an occupational activity.

further to 12.5 %, taking the savings ratio to within an inch of 2013 all-time lows and way below the levels of around 16 % seen before the onset of the great recession. This persistently low savings ratio – by Belgian standards at least – may be explained by households' propensity to save capital income sooner than labour income, with a drop in the share of the former type of income spelling a lower average savings ratio. Additionally, private individuals may not have tailored their consumer spending patterns to slower income growth and have therefore been limiting their savings accruals to keep raising their consumption expenditure.

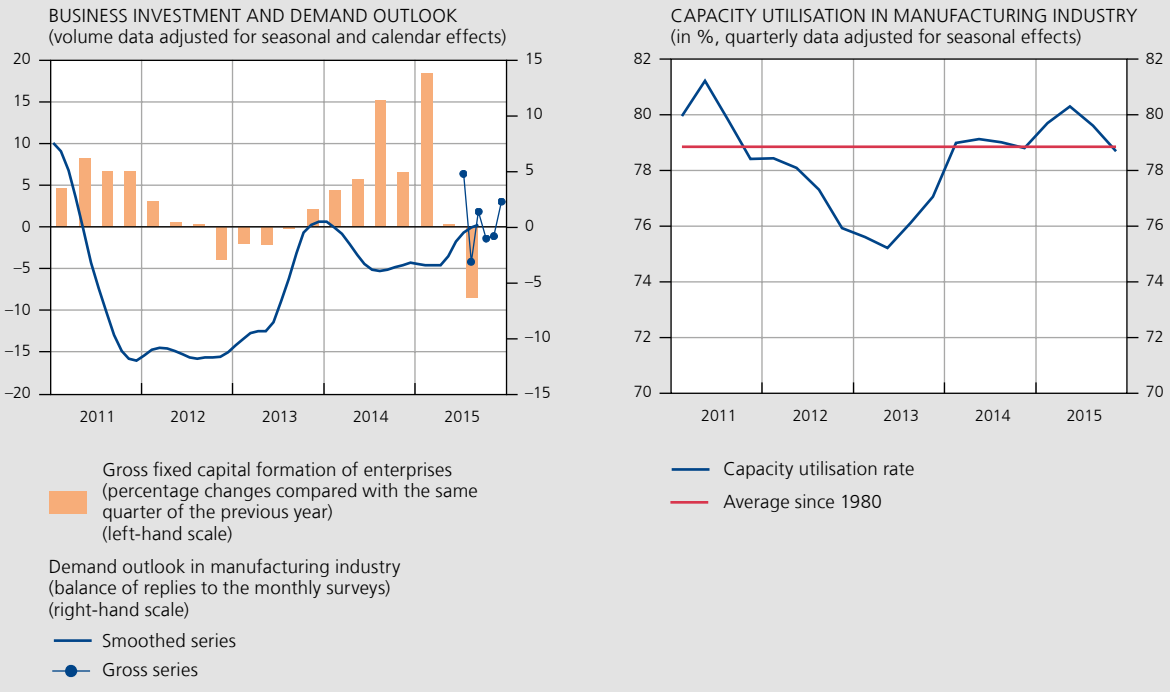
Investment in housing came down by 0.1 % in 2015 even though mortgage rates kept falling and people's fears of losing their jobs diminished on average. This decline stands in contrast to 2014, when households had been very active in the property markets. This rather more subdued picture reflects the changes announced in 2014 concerning the tax treatment of mortgage loans in Flanders, which would appear to have prompted the Region's residents to put in place their investment plans before the year was out. The contraction in the first half of 2015 reflects this backdating shift, specifically in terms of payment of registration fees (stamp duty).

Business investment creeps up; own resources rise steeply

Enterprises account for around two-thirds of the economy's total annual gross fixed capital formation. This particular component of demand is quite volatile as it is prone to occasional exceptionally large individual items that can have a major impact on quarterly figures. A case in point is evident for the first quarter of 2015, when a large amount was paid to acquire a foreign patent. In accordance with ESA 2010 methodology on national accounts in force since 2014, the capitalisation of research and development is recognised as an investment, while the purchase of a patent abroad also constitutes an import transaction. Adjusted for this, business investment would have gone up by an annualised 1.6 %, instead of the 1.9 % actually recognised. This is significantly below the 3.9 % upturn in 2014, ignoring comparable transactions.

It may well be that investment growth is somewhat dampened by structural effects related to changes in the type of assets into which investment is channelled. A possible explanation is that the manufacturing industry with its extensive plant and equipment is losing ground and accounts for a smaller proportion of gross investment, with

CHART 44 BUSINESS INVESTMENT EDGES UP



Sources: NAI, NBB.

TABLE 8 DETERMINANTS OF THE GROSS OPERATING SURPLUS OF COMPANIES[1], AT CURRENT PRICES

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

	2011	2012	2013	2014	2015 e
Gross operating margin per unit of sales[2]	–0.8	–2.4	0.6	0.0	1.7
Unit selling price	3.5	1.7	0.4	–0.3	–1.1
On the domestic market	3.0	2.2	1.3	0.5	0.0
Exports	3.9	1.3	–0.4	–1.0	–2.1
Unit sales costs	4.3	2.5	0.4	–0.4	–1.6
Imported goods and services	5.1	1.5	–0.4	–1.0	–3.1
Costs of domestic origin per unit of output[3]	1.0	3.8	1.4	–0.4	0.2
of which :					
Unit labour costs[4]	1.9	3.3	1.8	–0.4	–0.5
Unit net indirect taxes	–1.2	7.2	–0.2	0.4	1.9
Final sales at constant prices[2]	4.6	0.7	0.3	3.7	2.7
Gross operating surplus of companies	3.8	–1.7	0.9	3.7	4.5

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.

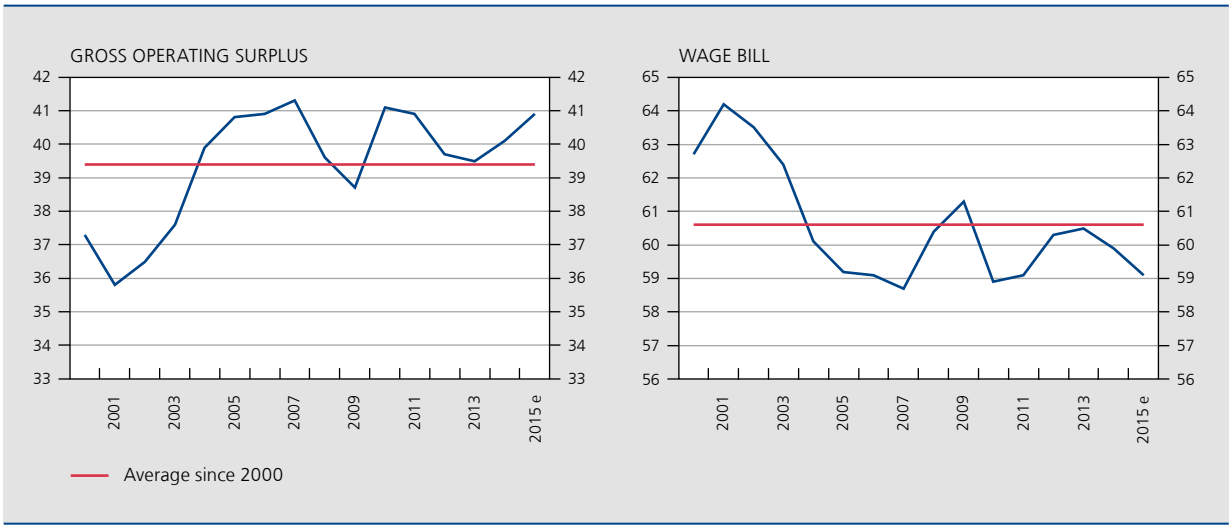
(4) Unit labour costs are expressed in units of value added of the business sector and are not calendar adjusted.

less sizeable investment in, say, research and development mopping up some of the slack.

Business investment in 2015 slumped, despite supportive factors such as a capacity utilisation rate in the manufacturing industry that had been – as early as the end of 2013 – at or over its average as recorded since 1980, and despite the demand outlook for this sector looking brighter. What is more, companies were able to tap funding for their investment plans at very

CHART 45 GROSS OPERATING SURPLUS KEEPS GROWING, WHILE COMPENSATION DIPS BELOW AVERAGE

(in % of the value added of companies)



Sources : NAI, NBB.

favourable conditions indeed, while their internal resources had also grown steadily. The gross operating surplus of companies, i.e. revenues from their activities, shot up by 4.5 % in nominal terms in 2015, once again pushing the operating surplus as a share of value added slightly ahead of the average since 1995. Conversely, the corresponding share of worker compensation declined for the second consecutive year.

Both the 1.7 % advance in the gross operating margin per unit of sales and the 2.7 % volume increase in final sales contributed to a higher gross operating surplus in 2015. Margin improvement reflected sharply lower unit sales costs, while imported goods and services were a lot cheaper in 2015 than in previous years, most of these items of course reflecting lower prices of oil and other commodities. By contrast, costs of a domestic origin inched up despite curbs on labour costs, as unit net indirect taxes rose. Lower costs were not fully passed on to prices and ended up adding 1.7 % to the gross operating margin per unit of sales – a marked change on the weaker margin performance of the previous four years. Final sales fell below the previous year's figures, reflecting less dynamic exports among other factors.

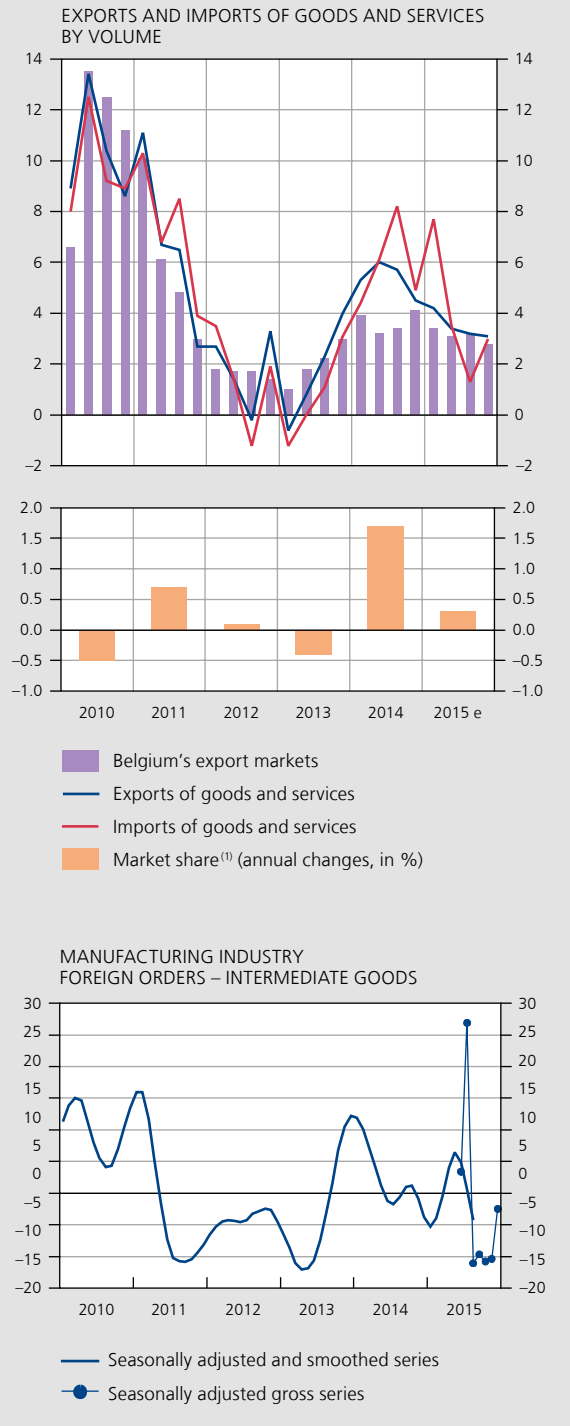
Foreign demand slowing

In 2015, exports of goods and services in volume terms recorded growth lagging the previous year's: 3.5 % compared with 5.4 %. In part, this was down to declining foreign demand – which, incidentally, accelerated as the year progressed.

Despite the fall in the value of the euro vis-à-vis the US dollar from the autumn of 2014 and the first effects of recent labour cost restraints on improved cost competitiveness, it would appear that exports in 2015 were not supported nearly so much as before by new gains of market share in volume terms, as they had been in 2014, even if these were exceptionally large at 1.7 %. According to projections available by the cut-off date of this Report (particularly the statistics for the first three quarters), Belgium's exports only rose slightly faster than the import demand from its main trading partners, weighted by the structure of the exports. However, this new market share gain (around 0.3 %) is close to the average recorded over the post-crisis period.

CHART 46 LESS ROBUST GROWTH OF GOODS AND SERVICES EXPORTS

(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.

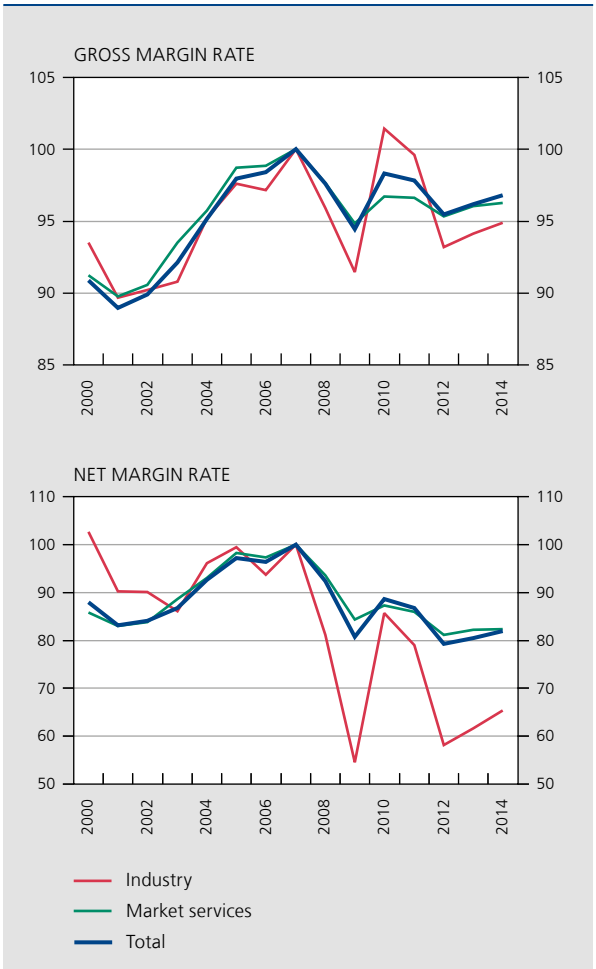
(1) Based on the most recent projections for import demand from trading partners, dating from mid-November 2015.

Box 5 – Trends in corporate operating margins

Corporations' profitability is an essential prerequisite for growth in both investment spending and employment. One way to gauge profitability is to look at the margin rate, defined as the ratio of the operating surplus to the value added. This indicator measures the percentage of the value added available to the company after payment of wages and taxes on production and imports, plus any subsidies. This macroeconomic concept differs sharply from the taxable profits of a company, as it does not include any net payments for debt funding, for instance, in order to neutralise any distortion to results arising from the financial structure. In corporate accounting it would more or less equal EBITDA-to-sales, less current purchases of goods and services.

This margin may be analysed at sector level based on NAI data releases between 1995 and 2014. For all private, non-financial corporations together, the gross margin rate amounted to 44 % in the final year of that period (2014). This is below the 46 % reached before the onset of the great recession, but still ahead of levels recorded at the end of the 1990s and in the early 2000s. In fact, after the boom in the run-up to the crisis we would now seem to be looking at levels normalising.

MARGIN RATE IN INDUSTRY AND THE MARKET SERVICES SECTOR
(index 2007 = 100)



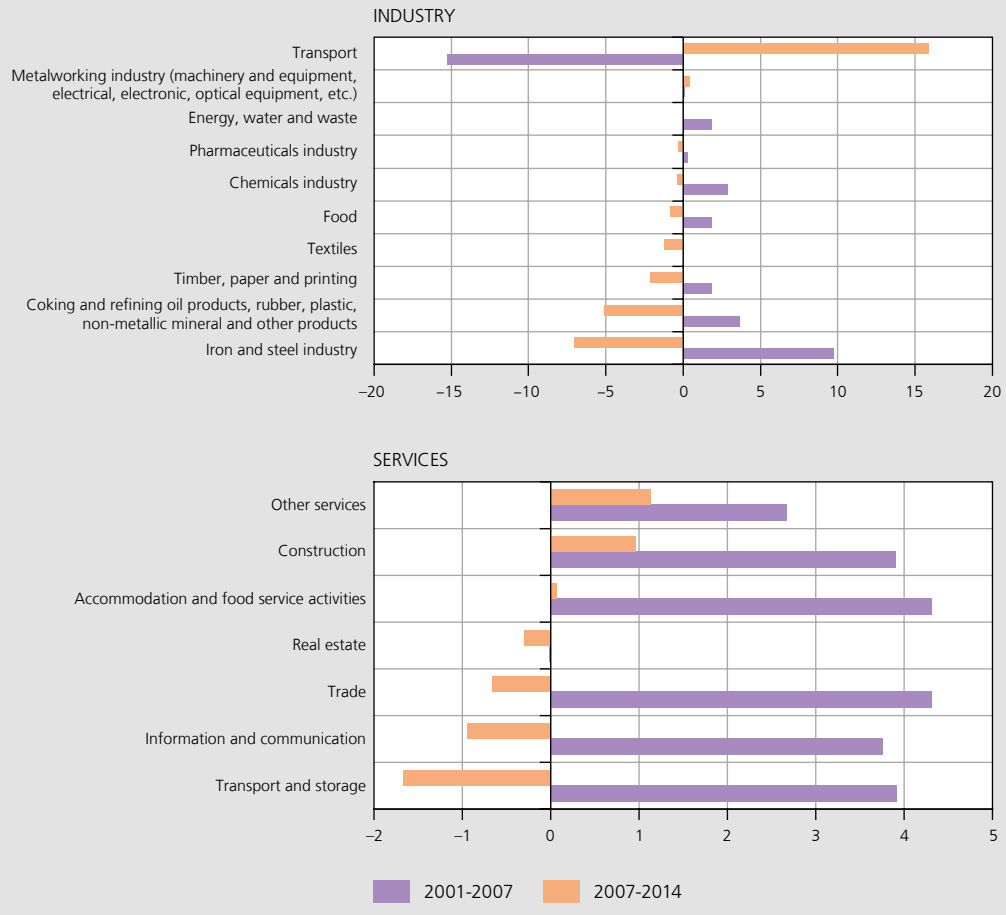
Source : NAI.

However, the picture is influenced by depreciation and amortisation, which are typically less dependent on the business cycle and which therefore tend to eat into margins more when production slows or declines. In addition, a steady increase in capital depreciation has been making itself felt since the mid-1990s, particularly related to the share of IT assets – which depreciate relatively quickly – in the total. Expressing the margin rate in net terms, i.e. after depreciation (or EBIT), the great recession does turn out to have been a turning point. The net margin rate declined from its peak of around 30 % in 2007 to a mere 25 % in 2014, and no recovery has materialised on this gauge.

When margin rates are broken down using the net approach, industrial services are found to have been much harder hit than were market services. In 2014, the net margin rate languished more than 30 % below 2007 levels in industry, compared with around 20 % in market services. Gross margin rates show only minor differences in trends, barring a difference in cyclical sensitivity.

GROSS MARGIN RATE BEFORE AND AFTER THE FINANCIAL CRISIS, BY SECTOR

(average annual growth in the period under review, percentage changes)



Source: NAI.

Broken down by different industrial branches, gross margins paint a widely divergent picture even within industry itself, with more innovative branches typically generating more robust or even improving rates. Also, margin developments in the more traditional industrial branches prove the most sensitive to the vagaries of the economic cycle, strong demand for industrial products from the emerging countries having been a major upward driver of results in these branches before the crisis.

Branches in market services and construction were affected by the crisis in varying degrees, and there would not appear to be any clear correlations between trends before or after. Margin rates fell hardest in information and communication and transport and storage. The latter branch is closely linked to industry and suffered the brunt of collapsing global trade in the aftermath of the recession. Trade has also found it tough to sustain margins since the crisis, while construction and other services – which include specialist services and rapidly growing research and development activities – recorded a further improvement in profitability in the same period.

Apart from cyclical factors, structural factors weigh in on margin rates, and relative price effects emerge due to industry's far greater exposure to global competition than market services: revenues depend on sales prices for goods, while some costs, e.g. wage costs, are index-linked in Belgium. Particularly fierce competition in industry in effect means that companies in this sector have less pricing power than their counterparts in services. That said, productivity gains are much more substantial in industry, with unit labour costs only slightly up and margin rates more or less sustained. Unit labour costs are rising much faster in services considering their lower productivity gains compared with industry, but sales prices also advanced much more briskly.

RELATIVE PRICES BY SECTOR

(Value-added price deflator, average annual growth in the period, in %)

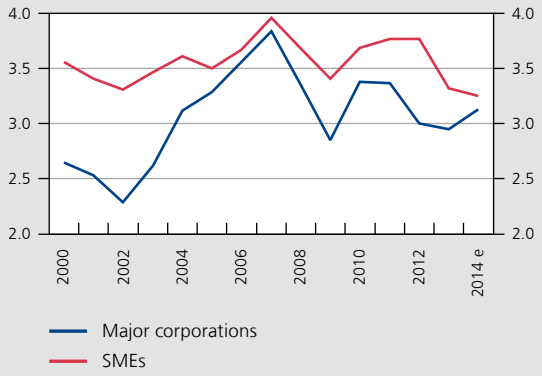
	1995-2014	1995-2001	2001-2007	2007-2014
Total	1.5	1.5	2.0	1.0
Market services	2.2	2.8	2.5	1.4
Industry	–0.2	–1.2	0.9	–0.4

Source: NAI.

Drawing on corporate profit and loss accounts, a similar analysis may be applied from the perspective of company size. The net sales margin, i.e. net operating result as a percentage of turnover, reveals strong correlations between developments before and after the start of the crisis. Pre-tax profitability of larger corporations had improved much more markedly than that of SMEs in the years before the crisis, but plunged just as fast after peaking in 2007. In fact, SMEs prove somewhat more profitable on average. A number of factors might explain the different developments and profitability levels: large corporations, regardless of their sector, tend to be more exposed to the global economy, while SMEs are typically better represented at the rather more profitable services end of the spectrum. Statistical effects may also come into play: bankrupt companies are factored out of the population, leaving only companies with higher average profitability. With bankruptcies affecting the SME population more, plotted series may well overestimate their profitability levels.

PROFITABILITY OF MAJOR CORPORATIONS AND SMES

(Net sales margin [1])

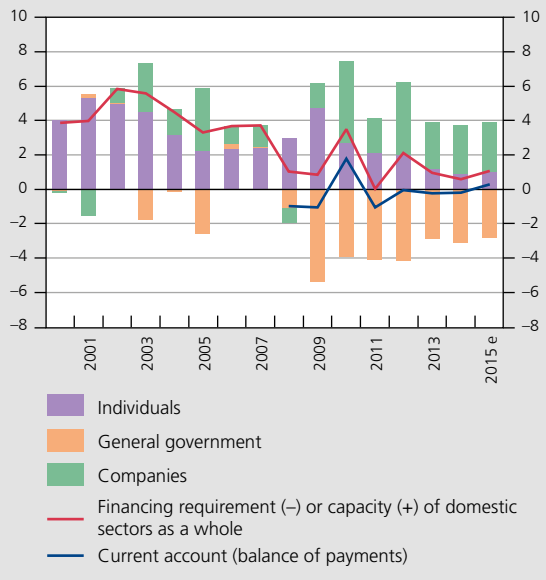


Source : NBB (Central Balance Sheet Office).

(1) Defined as the net operating result as a percentage of turnover.

CHART 47 CORPORATE FINANCING CAPACITY INCREASES

(in % of GDP)



Sources : NAI, NBB.

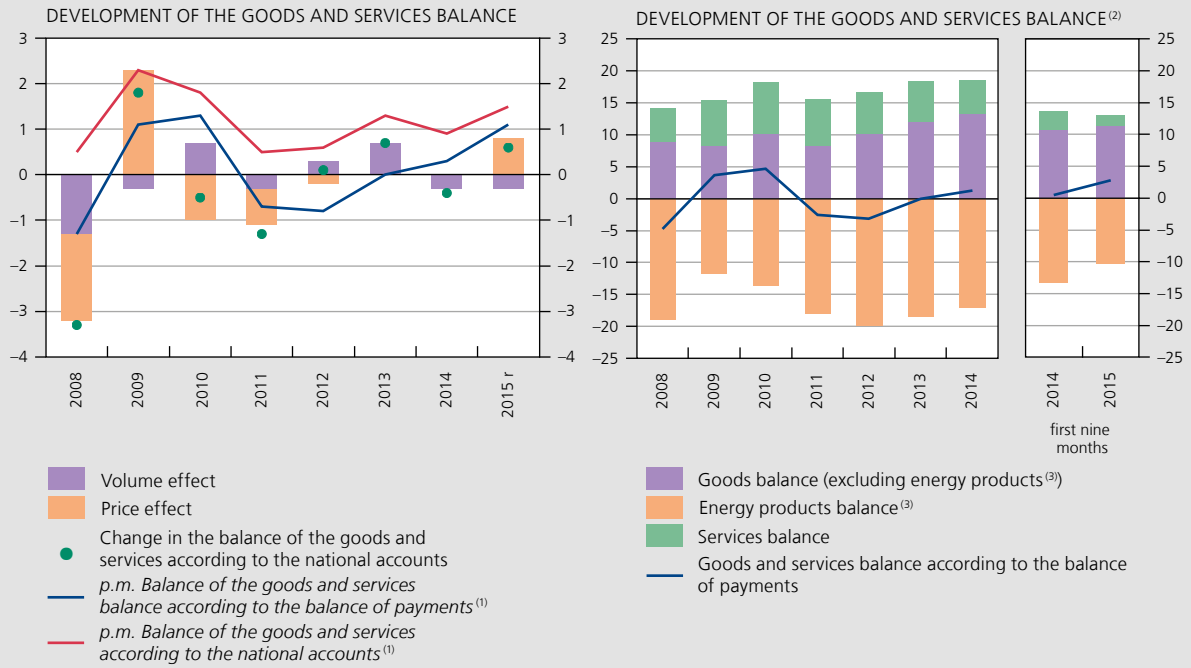
2.5 Improved current account balance

In 2015, given the trend in all income and expenditure across the different sectors, the amount of savings in the Belgian economy has once again outstripped investment. The country's financing capacity, as estimated on the basis of the national accounts, grew from 0.6 % in 2014 to 1.1 % in 2015, particularly on the back of firms seeing their revenues increase while their gross investment in fixed assets lagged behind. As a result, since 2010, companies have recorded, year after year, financial surpluses ranging between 2 % and 5 % of GDP (2.9 % in 2015). In addition, the public sector borrowing requirement came down slightly while household financing capacity increased somewhat to 1 % of GDP.

The economy's improved financing capacity also shows up in similar developments of the current account balance with the rest of the world as recorded in the balance of payments. These statistics show the external balance to have turned positive again in 2015 and to have amounted to 0.3 % of GDP, compared with negative figures since 2011. The breakdown by types of transaction underlines the importance of goods and services in achieving this surplus, although this was partly offset by a deteriorating balance of primary income – which mostly covers income from labour and investment with the rest of the world – and,

CHART 48 IMPROVED GOODS AND SERVICES BALANCE THANKS TO POSITIVE TERMS OF TRADE

(percentage points of GDP, unless otherwise stated)



Sources: NAI, NBB.

(1) In % of GDP.

(2) According to balance of payments statistics, in € billion.

(3) According to foreign trade statistics – mineral fuels, lubricants and related materials (SITC-3).

to a lesser extent, by the worsening of the secondary income balance.

Like other net importers of oil products, Belgium has benefited from steeply lower oil prices, which, because of their greater weighting in the basket of imported goods, have had a bigger impact on import prices than on export prices. Annualised import prices declined by around 3.1 %, compared with a fall of some 2.1 % in exports. This improvement in the terms of trade has reduced the net energy bill from an average of nearly € 17.5 billion per year between 2010 and 2013 to € 17.1 billion in 2014 and around €10 billion for the first nine months of 2015.

This favourable price effect has more than made up for the negative contribution of net foreign trade in real terms, as export volumes rose less rapidly than import volumes. As noted, the purchase of a foreign patent significantly pushed up imports in 2015 and volume effect would have been virtually neutral without this exceptional transaction.

This smaller energy deficit combined with higher imports related to this specific investment explain why the goods trade is responsible for the improved trade balance in 2015, even though the services surplus has fallen.

While the overall balance of goods and services recorded favourable figures, the primary income surplus continued its downward trend first seen in 2012. Although minor in 2015, this deterioration can primarily be traced back to falling investment income balance – mostly portfolio investment in 2015 – whereas the balance of labour income remained relatively stable.

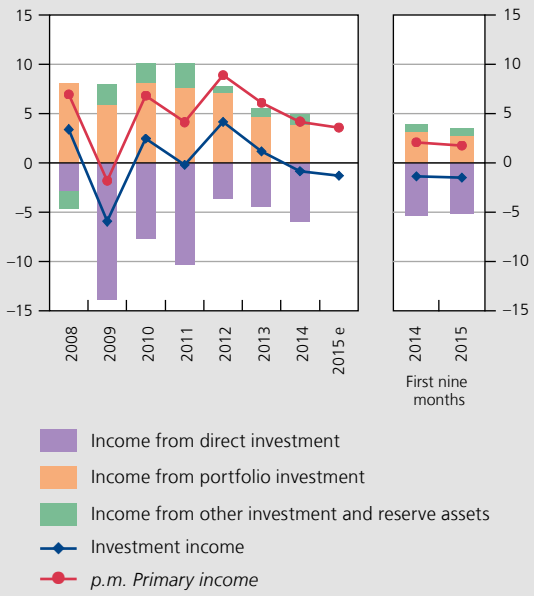
This downward trend in net investment income at work since 2012 is due, to a lesser extent, to the slight decline of the net international investment position vis-à-vis the rest of the world recorded up to 2014. However, this has to be viewed more specifically in the context of the general decline in returns on investment products which exert a negative effect on the income of a net creditor country such as Belgium, whose net international investment position remains exceedingly positive at over 50 % of GDP.

Moreover, the trend in net investment income would also appear to have been influenced by structure effects in the composition of external assets and liabilities.

In this way, the "other investment" category, which includes deposits and loans from various sectors including banking, trade credit, etc., would appear to account for a bigger chunk of Belgium's global investment position, while this investment category records the lowest implied returns. Despite the depreciation of the euro, implicit yields of some categories of financial products seem to have fallen further on the external assets side than on the liabilities side. This is particularly the case for portfolio investments, where implied returns on assets worsened, while those on liabilities remained stable. A similar picture emerges, although to a lesser degree, for direct investment. Despite a limited net position, total direct investment by respectively Belgian residents abroad and foreign residents in Belgium is actually quite high – over twice the size of GDP. The fact that implied returns on these different categories of assets are declining more strongly than those on liabilities might be attributable to a different breakdown, particularly in terms of maturity. Tax considerations may also explain why income flows from direct investment in Belgium

CHART 49 FALL IN NET PRIMARY INCOME

(balances according to the balance of payments; in € billion, unless otherwise stated)



Source: NBB.

TABLE 9 BALANCE OF PAYMENTS AND NET LENDING TO THE REST OF THE WORLD

(balances; in € billion, unless otherwise stated)

	2011	2012	2013	2014	2015 e
1. Current account					
Goods and services	–2.5	–3.1	0.0	1.3	4.5
Goods	–9.7	–9.6	–6.4	–3.9	n.
Services	7.3	6.5	6.4	5.2	n.
Primary income	4.1	8.9	6.1	4.2	3.6
Compensation of employees	5.1	5.4	5.5	5.7	5.8
Investment income	–0.2	4.2	1.1	–0.8	–1.3
Other primary income	–0.7	–0.6	–0.6	–0.7	–0.8
Secondary income	–5.7	–6.0	–6.9	–6.4	–6.9
General government	–3.8	–3.1	–3.8	–3.5	–3.9
Other sectors	–2.0	–3.0	–3.1	–2.8	–3.0
Total	–4.1	–0.2	–0.9	–0.9	1.1
p.m. Idem, in % of GDP	*–1.1*	*–0.1*	*–0.2*	*–0.2*	*0.3*
2. Capital account	–0.4	2.3	–0.4	–1.0	–0.1
3. Net lending to the rest of the world (1 + 2)	–4.5	2.1	–1.3	–1.9	1.0
p.m. Idem, in % of GDP	*–1.2*	*0.5*	*–0.3*	*–0.5*	*0.3*

Sources: NAI, NBB.

CHART 50 DECLINING RETURNS ON ASSETS AND LIABILITIES[1] DESPITE BELGIUM'S CONTINUED VERY POSITIVE NET INTERNATIONAL INVESTMENT POSITION

(in %, unless otherwise stated)

Source: NBB.

(1) Implied returns calculated on the flow data of the balance of payments in year t and of Belgium's average external position in year t-1.

are somewhat at variance with market conditions. Regardless of the country's extremely positive net international investment position, this general slow-down in implied returns, together with changing assets and liabilities composition, helps explain weak net income as well as its downward trend recorded since 2012. The investment income deficit is projected to have widened a little further in 2015.

The secondary income deficit deepened as a result of a higher amount paid by Belgium to European institutions under the fourth own resource, which is linked to gross national income. Balance improvement in 2014 reflected an adjustment of Belgium's national contributions to the EU budget following gross national income revisions for various Member States of the EU. This happened to be favourable for Belgium.