Labour costs and prices

3. Labour costs and prices

The marked increase in Belgian employment went hand in hand with an extremely modest advance in labour costs, with the private sector even seeing hourly wage costs contract slightly in 2016. At 1.8 %, however, inflation remained high and was in sharp contrast with only subdued price increases in other euro area countries.

3.1 Wage moderation and tax shift have an effect

A whole range of measures have been taken in the last few years to curb labour cost growth and reduce tax charges on labour, benefiting employers and employees

TABLE 7 PRIVATE SECTOR HOURLY LABOUR COSTS DOWN IN 2016

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

	2011	2012	2013	2014	2015	2016 e
Labour costs in the private sector						
Gross hourly wages	2.6	2.8	2.4	1.0	0.4	1.0
Collectively agreed wages (1)	2.7	3.0	2.0	0.8	0.1	0.6
Real agreed adjustments	0.0	0.2	0.1	0.0	0.0	0.0
Indexation	2.7	2.8	1.9	0.8	0.1	0.6
Wage drift and other factors (2)	–0.1	–0.2	0.4	0.2	0.3	0.4
Employers' social contributions (3)	–0.5	0.1	0.1	0.1	–0.5	–1.3
Social security	0.1	0.0	0.0	0.0	–0.2	–1.1
Other contributions (4)	–0.5	0.1	0.1	0.1	–0.2	–0.3
Hourly labour costs in the private sector	2.1	3.0	2.4	1.1	0.0	–0.4
Hourly labour costs. economic concept (5)	2.1	3.0	2.4	1.0	–0.1	–0.3
p.m. Unit labour costs in the private sector	*2.3*	*3.5*	*2.3*	*–0.2*	*–1.1*	*–0.2*
Unit labour costs. economic concept (5)	*2.3*	*3.5*	*2.3*	*–0.3*	*–1.1*	*–0.1*
Hourly labour costs in the public sector	3.7	3.4	3.1	1.7	1.2	1.7
Of which: indexation	2.7	2.5	2.3	0.0	0.0	1.0
Hourly labour costs in the economy as a whole	2.4	3.1	2.6	1.2	0.2	0.1

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, in 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.

(5) Labour costs based on the economic concept do not match national accounts data, as they also include reductions in social security contributions for the relevant target groups as well as wage subsidies, resulting in a more accurate reflection of the labour costs that companies face.

as well as the self-employed. The government's aim has been to retain cost competitiveness relative to the country's three main trading partners and narrow the gap between gross and net wages for employees, as higher net pay helps support labour supply.

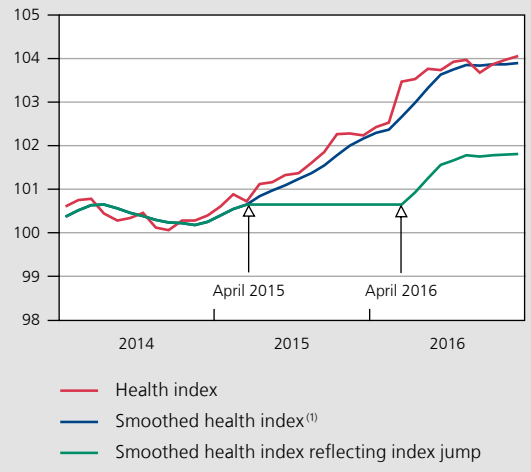
In the private sector, the increase in gross wages per hour worked was held back by the index jump and government-imposed constraints on rises in collectively agreed wages, as the government set the maximum increase at 0.5 % of the gross wage bill (including all charges) and on top of that 0.3 % of the wage bill in net terms. In practice, however, collectively agreed wages barely moved in 2016, suggesting unconventional take-ups of this margin after the previous year's wage freeze. In around one-fifth of joint committees, for instance, luncheon vouchers saw an increase in their nominal values, while employee contributions were kept unchanged, implying higher net wages for the workforce. The wage drift reflects such wage adjustments, and this is also influenced by fundamental changes in the employment composition, such as an ageing labour force, higher average levels of education and the shift to services in the economy.

The index jump came into force in April 2015. In concrete terms, the government's official gauge for index-linking wages, i.e. the average of the health index in the past four months, was blocked until it had grown by 2 %, resulting in a suspension of most automatic indexation mechanisms in the government and private sectors until April 2016. Although reactivated afterwards, index-linking systems differ from one joint committee to the next and the index jump's effects continued to show in the remainder of the year. At 0.6 % in the private sector, the indexation effect in 2016 was well below the increase in the smoothed health index, which stood at 2.1 %.

Employers' social security contributions exerted strong negative pressure on labour cost growth in 2016 of approximately 1.3 percentage points. This is due to the fact that a large number of government measures with an impact on employers' social security contributions came into force under the tax shift and Competitiveness Pact. On 1 April 2016, employers saw their social contributions' basic rate cut to 22.65 % from 24.92 %, while the flat-rate reduction was also lowered, to € 438 from € 462.60. Lastly, the government raised the lower limit for the structural reduction in contributions for low wages and adapted the calculation parameter so as to widen the scope of the measure. The general exemption from paying 1 % of payroll tax for employers in the private sector was converted into lower basic rates for employers' social

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

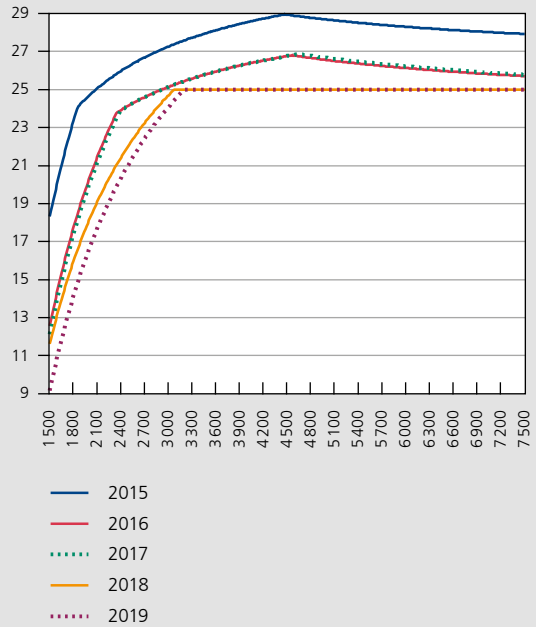
(index, 2013 = 100)



Sources : DGS, NBB.
(1) Four-month moving average of the health index.

CHART 37 TAX SHIFT REDUCES SOCIAL SECURITY CONTRIBUTIONS AT ALL WAGE LEVELS

(actual employers' contributions to social security by wage level, as % of monthly gross wage)



Source : NBB estimate.

contributions from 1 April 2016, and the exemption of businesses from a proportion of payroll tax for night and shift work was raised to 22.8 % from 15.6 % from 1 January 2016, while it changed from 17.8 % to 25 % for continuous work.

The combined measures reduced the actual employer contribution percentage significantly in the year, kicking in at all wage levels but most particularly low wages. In fact, the contribution rate looks set to decline further in 2018 and 2019 on the back of additional measures under the Competitiveness Pact and the tax shift. On 2014 structure-of-earnings data, 3.6 % of employees in Belgium were on gross monthly pay below € 2 000 while 63 % received more than € 2 750.

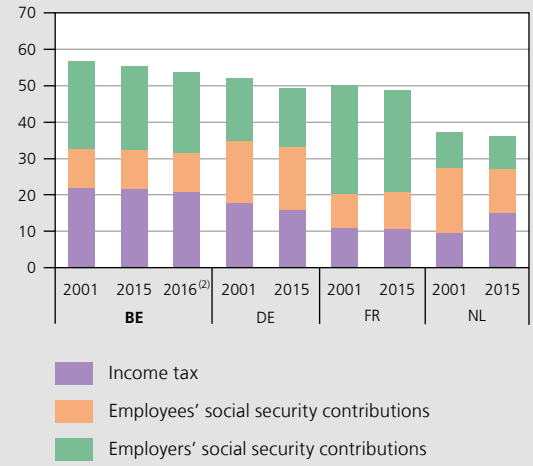
In addition to the tax shift, the sixth State reform also had an impact on labour costs. Competence for targeted reductions in social security contributions was shifted to the Regions as early as 2014 but they did not change their policies in this area until 2016. Flanders brought new employers' contribution reductions into effect from 1 July 2016, focusing particularly on 55-plus employees, under-25s and those with disabilities. The Brussels-Capital Region adapted the targeted reductions for older employees on 1 October and will put the rest of the adjustments in place in 2017, with measures mostly pertaining to the young, long-term job-seekers and the low-skilled. Wallonia plans to move on the reforms in 2017. Here too, reductions will focus on the long-term unemployed, but also on employees aged 55 and over, as well as low-skilled young people.

Factoring in all social security contribution reductions and wage subsidies affecting labour costs (according to the economic concept), hourly wage costs in the private sector should have come down by a total of 0.3 % in 2016, a little more than in 2015. In fact, using the national accounts concept, the drop would have been greater still, in particular because of the April 2016 conversion of the general exemption from paying 1 % of payroll tax into lower basic rates. Previously, this exemption was registered as "other subsidies on production" and not included in the wage bill, whereas it is now. This causes a downward distortion in year-on-year changes in labour costs, although this methodological change does not alter the actual labour costs facing employers. Despite these slight differences in methodologies, both sets of calculations – exceptionally – show the private sector's annual labour costs slightly down.

With labour costs up in the public sector, hourly wage costs across the economy inched up by a slight 0.1 % year on year.

CHART 38 BELGIUM'S TAX WEDGE[1] STILL EXCEEDS THAT OF OTHER EU MEMBER STATES AND ITS NEIGHBOURING COUNTRIES

(levies on income from labour, in % of labour costs for employers)



Source: EC, OECD, NBB.

(1) Businesses with at least ten employees. Tax wedge for a single person without children earning an average wage. This comparison does not take account of wage subsidies.

(2) Preliminary result for Belgium in 2016.

However, lower labour costs for employers did not mean that employees also saw a drop in their net pay. In fact, 2016 net wages rose on the back of a change in the fiscal work bonus, a higher deductible professional expense allowance and tax-free income threshold, as well as tax band reforms. From the 2016 income year (tax year 2017), the lower threshold for the 30 % tax band will gradually be raised, with the band set to disappear entirely from income year 2018. The flat-rate allowance for professional expenses, already put up in 2015, was ratcheted up again at the beginning of 2016, while the fiscal work bonus, a refundable tax credit for low-paid employees, was also raised again after an earlier rise in 2015.

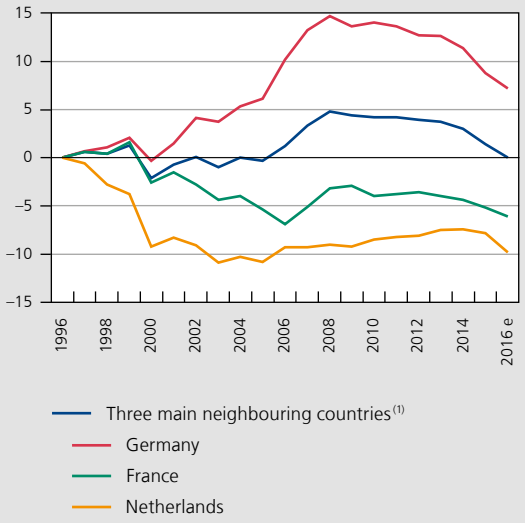
The tax wedge, equal to the difference between labour costs paid by employers and net earnings received by employees, has further narrowed on the back of these measures. That said, it would have remained larger in Belgium than in its neighbouring countries in 2016.

The wage gap accumulated since 1996 was closed in 2016

For Belgium, an open economy whose three largest neighbouring countries also happen to be its three

CHART 39 BELGIUM'S WAGE GAP DISAPPEARED IN 2016

(cumulative differences since 1996 in terms of hourly wage costs in the private sector compared with the three main neighbouring countries, in %)



Sources: CEC, NBB.
(1) Weighted average based on relative size of GDP.

main trading partners, it is important that wage growth should not deviate too much from average wage increases in Germany, France and the Netherlands. According to the Central Economic Council (CEC) Secretariat, hourly wage cost increases in Belgium were generally comparable with average trends in the three neighbouring countries between 1996 and 2005. In subsequent years, a wage gap opened up, peaking at 4.8 % in 2008 and gradually coming down before disappearing completely in 2016: on a range of different CEC estimates, it worked out at between –0.2 % and 0.0 %, mainly thanks to wage moderation measures imposed by the government. Belgium's social partners having been unable to agree on a wage norm to guide developments in collectively agreed wages since 2010, the government stepped in and set a benchmark itself.

This average reference fixed by law masks the fact that the country has built up a labour cost edge on France and the Netherlands over this period, whereas Belgian companies still show a clear wage gap relative to Germany.

To prevent any future labour costs divergences relative to Belgium's three neighbouring countries, the federal government drafted a Law in the autumn of 2016 that proposes a number of amendments to the existing Law on the Promotion of Employment and the Preventive Safeguarding of Competitiveness dating from 1996 (see box 3).

Box 3 – Draft Law to amend the 26 July 1996 Law on the Promotion of Employment and the Preventive Safeguarding of Competitiveness

The Law on the Promotion of Employment and the Preventive Safeguarding of Competitiveness, adopted in 1996, was created by Belgium's federal government to help align labour cost trends with those of the country's three main trading partners, namely Germany, France and the Netherlands. The Law failed to prevent Belgium from seeing a wage gap open up in the 2005-08 period, which it did not manage to close until 2016. In practice, the 1996 Law did not always prove adequate for the task of preventing labour costs from derailing. For that reason, the federal government proposed a series of adjustments in 2016, defined in more detail in draft legislation put to parliament.

The new Law follows the same basic tenets as its 1996 predecessor. As such, the expected average nominal wage increase in the three main neighbouring countries will continue to be a benchmark for the maximum wage increase in Belgium; the social partners will continue to negotiate the wage norm, and automatic indexation mechanisms will stay in place. However, if according to available projections the wage gap threatens to widen to the extent that it can no longer be cleared within the space of two years, the government would be able to take action – after seeking the advice of the social partners – and restrict indexation.

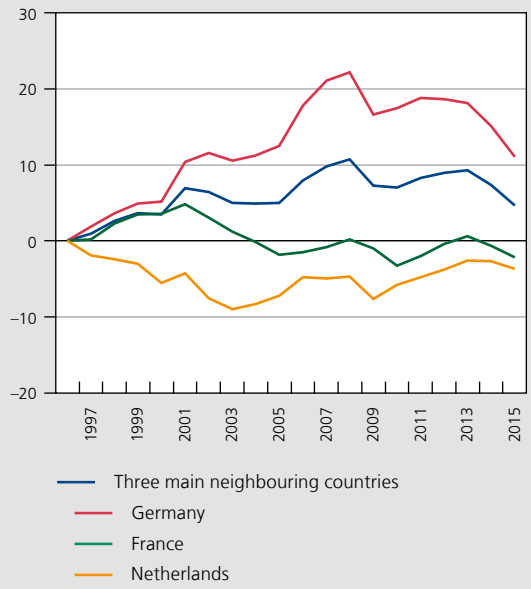
The biggest change involves the methodology used for calculating the two-year maximum margin for real wage cost growth. Henceforth, the Central Economic Council (CEC) is required to allow for an adjustment factor and a safety margin in addition to expected nominal labour cost developments in Belgium's neighbouring countries and projected indexation in Belgium. The adjustment factor should give more room for negotiating wage increases whenever the safety margin – or a proportion thereof – from previous negotiations has proven unnecessary or if a labour cost advantage has been found. If, by contrast, a wage gap is found to exist, the adjustment factor will constrain the available scope for negotiation. The new methodology allows for a safety margin to take account of any forecasting errors in the expected nominal labour costs trends in Belgium's neighbouring countries as well as indexation in the country itself. This safety margin is put at a minimum of 0.5 percentage point. These adjustments will automatically trigger a correction in the maximum margin whenever labour cost developments in Belgium's neighbouring countries are overestimated and/or inflation underestimated. Consequently, Belgium's labour costs should be unable to diverge from its three neighbouring countries for any lengthy time.

When calculating the maximum margin available, the methodology does not factor in wage subsidies, nor tax-shift-derived reductions of social security contributions in excess of those resulting from the Competitiveness Pact. The new set-up will see the CEC not just calculating the hourly wage gap since 1996, but also the historical wage gap, i.e. the wage gap relative to Belgium's three neighbouring countries before the 1996 Law came into force. As long as this historical wage gap is not at nil, a proportion of any reductions in social security contributions will go towards closing the difference.

The amendments to the 1996 Law have major consequences for wage gap calculations and therefore also for the bargaining scope between the social partners. For instance, the rise in hourly wage costs in 2016 is bigger when social security contribution cuts under the tax shift are not factored in. Moreover, the proposed legislation stipulates that the CEC's technical reports should also include calculations of an absolute wage gap, which compares Belgium's wage levels with those in its neighbouring countries, alongside an absolute wage gap factoring in any differences in productivity. In addition, the CEC also has to calculate a wage gap that takes on board all reductions in social security contributions and wage subsidies in Belgium and its neighbouring countries since 1996, and the social partners will be required to factor in these particular wage differentials as well when engaging in collective wage bargaining. All that said, the key reference wage gap will remain the same: the difference in hourly wage cost growth since 1996. Incidentally, the wage norm as agreed by the social partners will be binding in the collective labour agreement of the National Labour Council (NLC), which should give it strong legal force and make any breaches an offence punishable by law.

CHART 40 WAGE GAP FOR UNIT LABOUR COSTS[1] NARROWING SINCE 2014

(cumulative difference since 1996 for the business sector in Belgium[2], in %)



Source: EC.

(1) A positive sign implies that unit labour costs and hourly labour costs are rising faster in Belgium than the average for its three main neighbouring countries.

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

In January 2017, the CEC drew on these new provisions to peg at 1.1 % the maximum available margin for real wage increases in the 2017-18 period. This margin was taken up by the social partners in the draft interprofessional agreement. The draft Law also tasks the CEC with calculating the historical difference for labour costs from a baseline in 1996. These calculations were not yet available when this Report went to press.

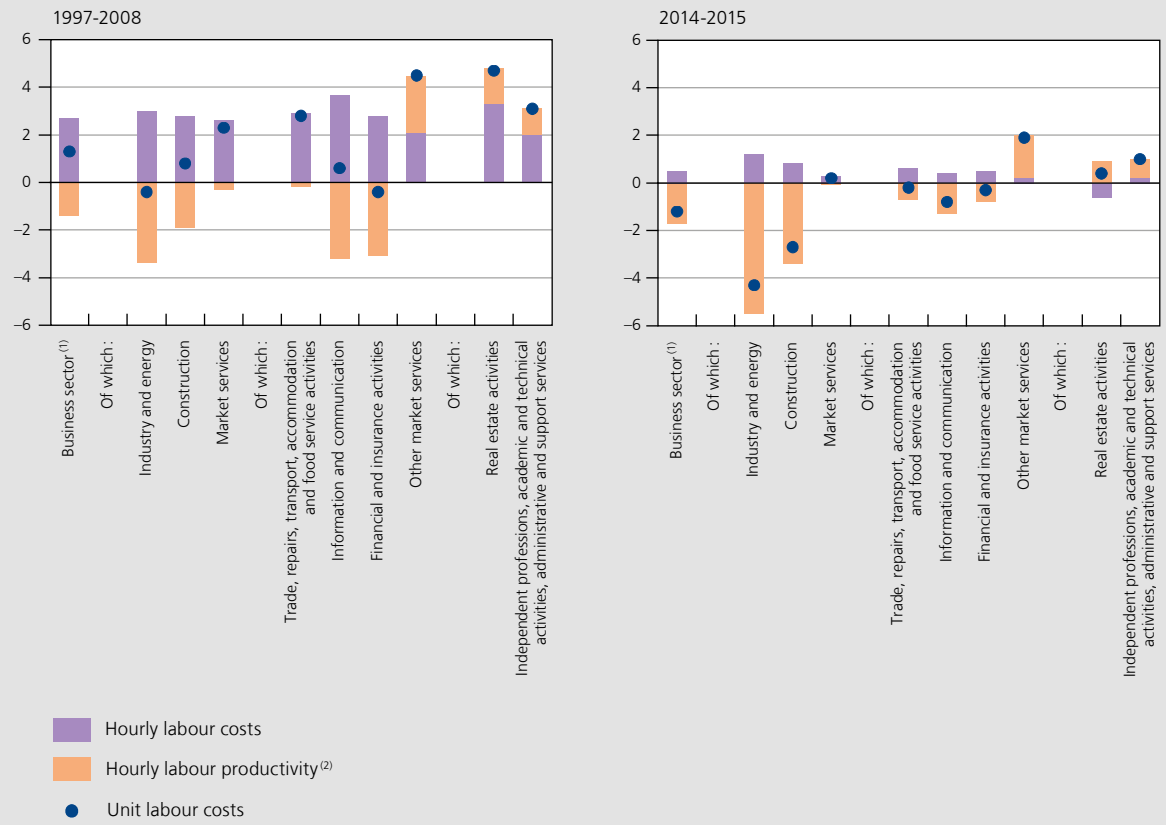
The wage gap, which has up until now served as a reference benchmark in collective bargaining negotiations, does not take account of productivity trends. But this is a key factor in any assessment of labour cost growth. From an economic perspective, after all, a more rapid increase in hourly wage costs may well be justified if it reflects greater productivity gains. Unit labour costs, by contrast, capture both sets of developments, and these fell in Belgium in 2014 and again in 2015, before levelling out in 2016. In fact, for unit labour costs, the gap narrowed further as its neighbouring countries recorded steeper rises than did Belgium. That said, Belgium has not managed to clear the wage gap it has built up since 1996, but it is entirely down to unfavourable developments relative to Germany.

Movements in hourly wage costs nevertheless remain a key indicator, as businesses may try to offset hourly wage costs that get out of hand through investment that raises capital intensity and consequently reduces the number of workers needed in the production process. Of course, such measures could sharply reduce unit labour costs, but at the same time would have an adverse effect on employment.

If trends in labour costs per hour worked and per unit produced in the Belgian business sector during the recent period of strong wage moderation are compared with the same figures for the 1997-2008 period – the first set of wage moderation measures were taken in 2009 and immediately cut social security contributions significantly, possibly causing comparative distortions from that year – it can be seen how effective wage moderation policies have been for labour cost growth across all sectors. Between 1997 and 2008, both hourly wage costs and unit labour costs recorded average annual increases across all sectors well in excess of the average growth for 2014 and 2015. For the Belgian business sector as a whole, unit labour costs added an average 1.3 % per annum in the 1997-2008 period while they contracted by an annual 1.2 % on average in 2014 and 2015. This contraction is due to declining unit labour costs in manufacturing industry and construction, as well as to the marked slowdown of these costs in market services, thanks to virtually unchanged hourly wage costs.

CHART 41 LABOUR COSTS FELL IN MOST BRANCHES ACROSS BUSINESS

(compound annual growth rate, in %)



Sources : EC, NAI, NBB.

(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) A positive sign implies that labour productivity in Belgium is falling.

3.2 Persistently high inflation in Belgium

Services inflation remained high in Belgium, in contrast with elsewhere in euro area

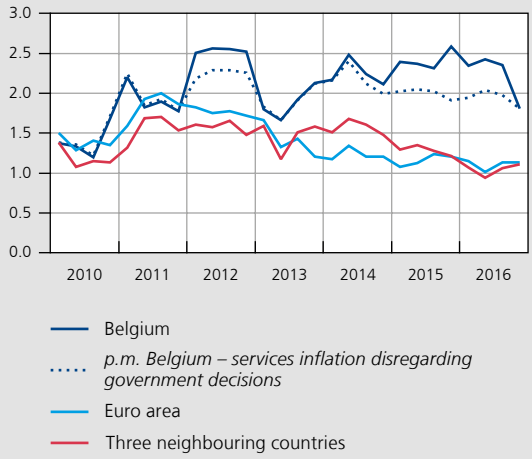
For many companies, the cost of labour accounts for a significant proportion of total production costs and can make a key difference in pricing. The wage moderation policies of the recent past should therefore curb price trends in Belgium, in particular services prices, as labour costs typically take up a greater proportion of production costs for services than for other components of the price index. Contrary to assumptions, however, prices have continued to stage uninterrupted high growth in Belgium's services sector.

In 2016, services inflation worked out at 2.2 % and contributed 0.9 percentage point to headline inflation, which stood at 1.8 %. The two previous years had seen services prices move ahead at almost the same pace, by 2.4 % in 2015 and 2.2 % in 2014. By contrast, Belgium's neighbouring countries have been reporting systematically lower services prices and even a further slowdown : 1.6 % and 1.3 % in 2014 and 2015 respectively, and then down to 1 % in 2016. Average services inflation for the euro area was the same : around 1 % in 2016. Against this background, a task force of FPB, FPS Economy and NBB experts was established in mid-2016 to investigate the underlying causes of the country's high services inflation. It will report its findings to the Minister of the Economy in 2017.

Services sector companies find their costs not driven just by labour, but also – as in other sectors – by intermediate consumption goods, whether imported or not. Examples include fuels, a key input in transport services, and food in accommodation and food service activities. Companies' profit margins are also a major

CHART 42 SERVICES INFLATION REMAINS HIGH IN BELGIUM, WHILE SLOWING IN ITS THREE NEIGHBOURING COUNTRIES AND THE EURO AREA

(annual changes, in %)



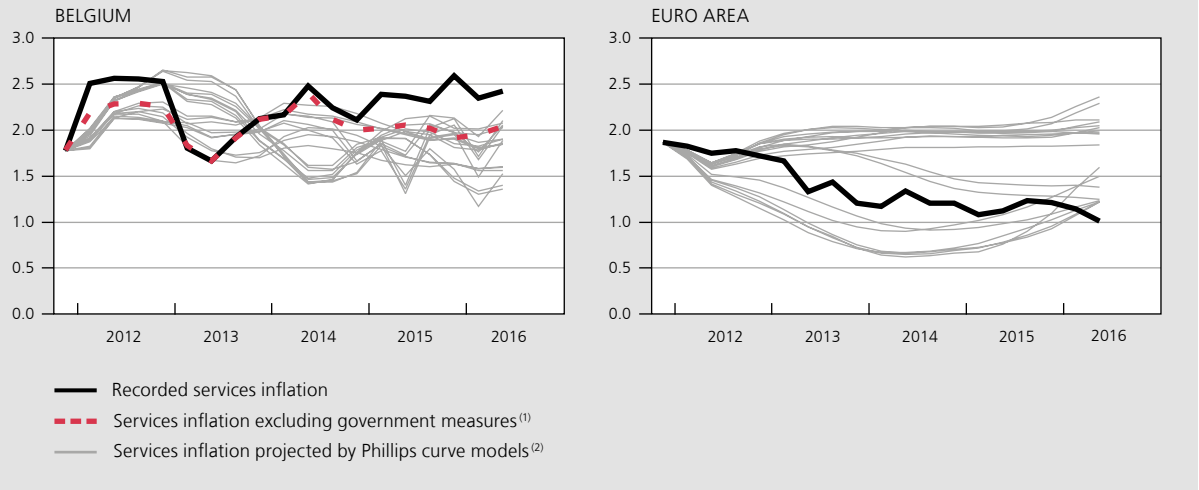
Sources: EC, NBB.

factor influencing sales prices. They will notably depend on how intense the competition is: the fiercer the competition, the lower the sales price must be, reducing profit margins for business. The state of the economy also has a part to play: inflation typically rises when the economy is at the top of its cycle, boosted by greater demand for consumer goods as well as strong upward pressure on wages. Lastly, government decisions also have a major impact on the pricing of certain services.

Belgium's high services inflation suggests that a detailed review of price trends for this particular category is in order. Phillips curves capture the correlation between macroeconomic variables and price increases. Our analysis estimated services inflation, each time using a model of three macroeconomic variables. Its conditional forecasts for services inflation from 2012 – i.e. the year in which Belgium's services inflation started to deviate from that of its neighbouring countries and the euro area – suggest that recorded services inflation in Belgium has been significantly higher than predicted on the basis of macroeconomic conditions since the end of 2014. It would appear that determinants that used to predict a large proportion of services inflation in the past no longer apply. The same conclusion emerges for

CHART 43 UNLIKE THE EURO AREA, SERVICES INFLATION IN BELGIUM EXCEEDS PROJECTIONS BASED ON MACROECONOMIC VARIABLES

(annual changes, in %)



Sources: ECB, NBB.

(1) Projection of services inflation trend, not including the following government measures: the increase in sewage charges in January 2012, January 2014 and January 2015; the increase in waste collection charges in May 2014 and May 2015; the VAT rise for cable TV subscriptions in January 2012; the imposition of VAT on notaries' fees from January 2012; higher rates for medical services resulting from a harmonisation of patient fees paid to medical specialists in January 2015; and steeper tuition fees for higher education in Flanders in October 2015.

(2) Services inflation calculated using Phillips curve models on a range of specifications and incorporating the following variables: unit labour costs – which, in addition to wage costs per hour, also take into account productivity – in the services sectors; real GDP; import prices for competitors from outside the euro area; past services inflation; consumer confidence; oil prices; unemployment rate; and investment volume. The data relates to the period from the first quarter of 1998 to the second quarter of 2016. Conditional forecasts of services inflation start from the first quarter of 2012.

a conditional forecast beginning in 2009, at the start of the period of wage moderation. Factors other than the economic environment must have pushed services inflation to exceptional highs in recent years.

The services inflation gap that has opened up since 2012 between Belgium and its neighbouring countries and with the euro area is not merely attributable to Belgian price increases simply being "too big". A similar analysis for the euro area suggests that actual services inflation works out well below predictions based on macroeconomic models. That said, forecast spreads for the euro area are rather wide, making for less reliable outcomes.

Belgium's higher services inflation is due, among other factors, to the indexation of a range of services prices. Drawing on the consumer price index or other price indicators, these prices are adjusted once or several times a year, frequently at fixed intervals – e.g. rent, public transport rates and fire insurance premiums. This type of indexation based on recent price trends typically creates inflation persistence. These mechanisms should have caused services inflation to fall in the wake of lower inflation in 2014 and 2015. However, the decline was only very small.

Meanwhile, a few key telecommunications operators raised their rates in February 2015 and at the beginning of 2016, pushing up 2016 inflation in this category to 4.2 % on average. As this category claims 6.5 % of services, it contributed 0.3 of a percentage point to services inflation. It had helped slow it down in the past, albeit to a lesser extent than in Belgium's three neighbouring countries: between 2012 and 2016, telecoms shaved an average 0.04 percentage points off the rate of increase in services prices in Belgium, compared with 0.19 percentage points for its neighbouring countries.

Government measures also had a significant impact on services inflation. In 2016, higher tuition fees in Flanders (0.6 % of the household consumer basket) added a significant 0.4 of a percentage point to services inflation up to and including September. Increased excise duties on alcohol and the introduction of the so-called "soda tax" on soft drinks containing sugar – measures taken as part of the tax shift – pushed up prices in cafés and restaurants even further, to 3.2 % from 2.7 % in 2015. The legal obligation to keep a registered till from January 2016 may well have had something to do with price rises in the hospitality industry, but it is difficult to factor out this measure from all other price changes. Restaurants and cafés, which account for 6.4 % of the consumption basket, were the biggest contributors to services inflation in 2016, as in previous years. Their contribution worked out at around half a percentage point, compared with 0.4 percentage point in 2015.

In recent years, a range of government measures had already bumped up services inflation: in 2012, the government raised indirect taxes on certain services, increased sewage charges in 2014 and 2015 and put up charges for medical services in 2015.

If all these measures are factored out, price trends in the services sectors are a much closer match to the estimated Phillips curves, but still higher than might be expected on the majority of the relevant factors. It would appear that services inflation in Belgium, excluding the impact of government decisions, is constantly at around 2 %, independently of the macroeconomic context. To an extent, this might be explained by the fact that services companies face less foreign and domestic competition than businesses in other sectors.

The report to be submitted by the task force to the Minister of the Economy should provide a more in-depth

TABLE 8 ESTIMATED IMPACT OF SOME GOVERNMENT MEASURES ON HEADLINE INFLATION

(in percentage points)

	2014	2015	2016
Tax shift-impacted categories[1]	–0.1	0.1	0.4
Food	0.1	0.1	0.2
Tobacco	0.1	0.1	0.1
Soft drinks	0.0	0.0	0.0
Alcoholic drinks	0.0	0.0	0.1
Energy	–0.3	0.0	0.3
VAT on electricity	–0.3	0.0	0.2
Motor fuels	0.0	0.0	0.1
Inflation impact of other government measures[2]	0.1	0.3	0.5
Electricity	0.0	0.1	0.4
Higher education tuition fees in Flanders	0.0	0.0	0.1
Harmonisation of patient fees paid to specialists	0.0	0.1	0.0
Higher charges for waste collection and waste water treatment	0.0	0.1	0.0
Total	**0.1**	**0.4**	**1.0**

Sources: EC. NBB.

(1) The tax shift was announced at the end of 2015 and concerned all categories listed. Some of these had faced earlier measures. which are also included in this table.

(2) Non-exhaustive list of measures. The table only includes measures with headline inflation impacts of at least 0.1 percentage point.

analysis of the causes that underpin higher services inflation in Belgium. It will discuss the telecoms industry as well as restaurants and cafés in greater detail, as these have contributed most to the inflation gap relative to Belgium's neighbouring countries.

Other inflation components also affected by measures

The government has taken a series of measures to cushion the adverse effects of the tax shift on its budget and these have fed into inflation since the end of 2015. First, in November 2015, excise duties on alcohol were raised significantly and from that same month the government gradually increased excise duties on diesel using the ratchet system while at the same time cutting back excise duties on petrol, albeit to a lesser extent. In January 2016, it raised excise duties on tobacco and introduced a "soda tax". Excise amounts are set to go up even further in the years ahead and these measures are likely to have an inflation impact at least until 2019. Lastly, VAT on electricity was put back up to 21 % in September 2015 after having been cut to 6 % in April 2014.

Yet other measures triggered a surge in energy prices – more specifically of electricity – as Belgium's utility companies became subject to corporation tax in mid-2015 and passed most of the extra charges onto consumers. In Flanders, meanwhile, a so-called "prosumer rate" was put into place, imposing a charge for the use of the power grid on consumers generating a proportion of their own (green) energy. And then, in March 2016, Flanders massively stoked up the energy levy from around € 3 to € 100 per annum per average household. The Flemish Region also got rid of the free basic electricity package, which showed up in the index from May 2016 onwards. These measures, coupled with the VAT rise under the tax shift, pushed electricity prices up by an average 28 % in 2016.

In November 2015, a new European emissions standard for vehicles came into force (switchover from Euro 5 to Euro 6). The technical changes required to meet the new standard were also passed on in the prices that end users pay for their new cars. What is more, Flanders raised the vehicle registration and licensing tax from January 2016, adding 0.1 of a percentage point to price increases for non-energy industrial goods.

Lastly, partners in the Belgian agri-food chain platform agreed to support the country's dairy farmers: between September 2015 and the end of May 2016, the distribution sector put 14 eurocents per litre of milk sold into a special fund. This was passed through to the consumer price of milk in full and thus went straight to the inflation figures. It was not until a few months after the agreement had ended that milk prices came back down.

And so, Belgium's inflation gap with its three neighbouring countries has widened again

Headline inflation in Belgium worked out at 1.8 % in 2016, up from 0.6 % a year earlier. Its acceleration was

TABLE 9 HARMONISED INDEX OF CONSUMER PRICES

(percentage changes compared with previous year)

	2013	2014	2015	2016	Three neighbouring countries 2016
HICP	1.2	0.5	0.6	1.8	0.3
Energy	–4.6	–6.0	–8.0	–0.6	–4.4
Food	3.6	0.8	1.8	3.1	0.9
Underlying inflation(1)	1.5	1.5	1.6	1.8	0.9
Services	1.9	2.2	2.4	2.2	1.0
Non energy industrial goods	1.0	0.3	0.5	1.0	0.6
p.m. Health index(2)	*1.2*	*0.4*	*1.0*	*2.1*	–

Source: DGS, EC.

(1) Total harmonised index of consumer prices, excluding the volatile food and energy components.

(2) National consumer price index, excluding products considered to damage health, i.e. tobacco, alcohol and motor fuels.

largely down to a less rapid fall in energy prices because of the measures we have reviewed – and the higher electricity price they resulted in – as well as to higher oil prices (Brent) making inflation from oil-derived products less negative than in 2015. Under the tax shift measures and the milk agreement, food also helped to speed up inflation, and product prices recorded average upticks of 3.1 %, from 1.8 % in 2015. A wider use of scanner data for price index calculations since January 2016, and principally for food products, also seems to have had the effect of pushing up food prices.

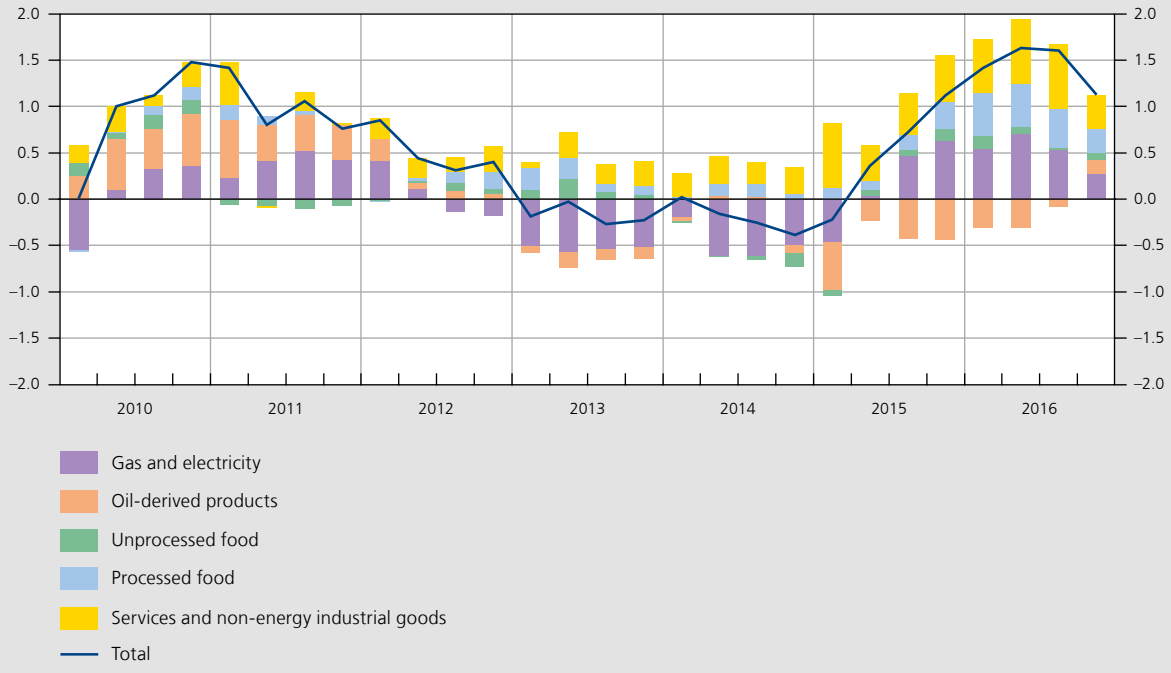
Underlying inflation – i.e. headline inflation excluding the volatile components food and energy – worked out at 1.8 % in 2016, no longer exceeding headline inflation for the first time since 2012. As noted, services prices continued to rise fast. Inflation for non-energy industrial goods, which accounts for a smaller weight in underlying inflation, stood at 1 %, compared with 0.5 % in 2015, and largely tied in with the measures making vehicle purchases more expensive (Euro 6 standard and vehicle registration and licensing).

The range of developments and measures as described here also explain the significant 1.4 percentage point inflation gap that existed between Belgium and the three neighbouring countries in 2016. The key differences were attributable to electricity, processed food and services, three categories whose prices were heavily influenced by government measures. Prices of oil-derived products, by contrast, served to narrow the inflation gap with Belgium's three neighbouring countries, as changes in Brent oil traditionally translate more strongly into consumer prices than in other countries. In Belgium, commodities account for a much larger proportion of the price that final consumers pay, in part because of very low excise duties on heating oil. As a result, Brent price ups and downs have a much bigger impact on inflation. Recent years' historically low Brent prices, which reached their nadir at the beginning of 2016, mitigated the impact of the stark increases in electricity prices.

By the end of the year, the inflation gap had narrowed, as several key measures – such as the electricity VAT hike and higher tuition fees in Flanders – were no longer reflected in total price trends. However, the increase in Brent prices kept Belgium's inflation figure high. In its neighbouring countries, more expensive oil pushed up inflation to 0.8 % in the final quarter of 2016 from 0.1 % in the first. A similar trend was reported for the euro area at large.

CHART 44 ELECTRICITY, PROCESSED FOOD AND SERVICES CONTRIBUTED TO THE INFLATION GAP BETWEEN BELGIUM AND ITS THREE NEIGHBOURING COUNTRIES

(in percentage points)



Source: EC.

The health index, i.e. the national consumer price index excluding alcohol, tobacco and motor fuels, rose by 2.1 % in 2016, as against 1 % in the previous year. This indicator is used for calculating wage indexation.

One-off factors exerting a temporary and direct influence on certain components of inflation combined with more structural factors have kept inflation high. It should be noted, however, that non-recurring factors may have what are called second-round effects : services whose price trends are somehow linked to a price indicator may push up inflation further. And automatic indexation mechanisms imply that higher prices may drive wage increases, which in turn can push prices up even further. And so, an initial, temporary and direct impact can turn structural after all. Such wage-price spirals are less likely in Belgium's three main neighbouring countries, as these do not apply automatic indexation. Consequently, government measures that serve to raise prices may end up eroding the country's competitiveness. By introducing an automatic adjustment in the event of unexpected derailments, the amended 1996 Law on the Promotion of Employment and the Preventive Safeguarding of Competitiveness might help to prevent this from happening.