# BELGIUM



## DOUBLE SHOCK INDUCES FUTURE-PROOFING INVESTMENTS

**The Belgian economy looks set to grow at its current trend rate for the next few quarters. Despite a challenging international environment, characterised by restrictive monetary tightening combined with economic slowdowns in key trading partners, the economy has held up remarkably well. Consumer spending, supported by wage indexation, and robust investment are leading the charge. Capex expenditures are directed towards automation and climate transition in the wake of energy and labour costs hikes.**

The Belgian economy has managed to experience a soft landing so far. After fears of a recession or at least a slowdown in growth for much of 2023, the Belgian economy now appears to be growing at or close to trend rates. In fact, it is one of the few EU countries to have avoided a single quarter of negative GDP growth since the start of 2022. The main drivers? Private consumption and business investment.

## PRIVATE CONSUMPTION HAS BEEN WELL SUPPORTED

Belgian inflation, as measured by the Harmonised Index of Consumer Prices (HICP), peaked at 13.1% y/y in October 2022. Unique to this economy is its system of purchasing power protection: the health-index, an alternative measure of prices, reached a similar high level at around the same time, leading to automatic wage indexation. The rise in wage costs is weighing on international competitiveness in the short term (more on that below) but it provides a significant support to household disposable income. The National Bank (NBB) also reports that tax cuts had a further positive impact on purchasing power last year, thanks to the "bracket creep" (brackets rise slower than incomes, powered on by inflation). In 2022, more income (already indexed) ended up in higher tax brackets (not yet indexed). In 2023, the reverse happened; brackets rose faster than income so that a smaller share of income was taxed at the highest rates. As a result of all these developments, private consumption quicky picked up speed and has been humming along throughout 2023, growing at an average quarterly rate of 0.3%. In fact, the only component of GDP that has outpaced it in recent quarters is business investment.

## BUSINESS INVESTMENT HAS BEEN EVEN STRONGER

When the ECB began its rate hiking cycle in mid-2022, dark clouds seemed to be gathering over Belgian companies. It looked like a perfect storm with rising financing costs, soaring energy prices, and increased labour costs as a result of the aforementioned wage indexation. Bankruptcy-rates, which at the time were still 20% below pre-covid levels, would surely rise rapidly.

Those fears turned out to be exaggerated. A recent in-house study, based on aggregated inflows and outflows on the bank accounts of corporate clients, underlined the remarkable resilience these firms displayed throughout the shocks, with activity levels across a wide range of sectors barely budging.

Indeed, higher energy costs did not seem to have much of a material impact on companies, as they were able to adapt quickly. Nor did the increase in labour costs. Of course, international competitiveness was on the decline. Compared with neighbouring countries, the cumulative wage gap since 2019 amounted to 4 percentage points in 2023. However, according to the NBB, wages in France, Germany, and the Netherlands will have fully caught up by 2026. Furthermore, an historical analysis of the labour cost shocks in our country suggests that companies usually take the hit in profits rather than reducing activities and employment.

GROWTH & INFLATION

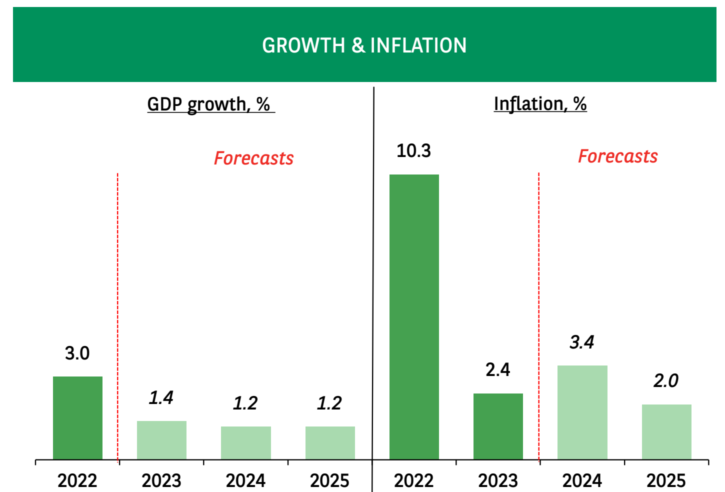


CHART 1

SOURCES: BNP PARIBAS FORTIS

The result? At the end of 2023, bankruptcy rates are still 5% below their pre-covid levels. Certain sectors, such as construction and transportation, overshot their trend rates. For the economy as a whole however, companies have weathered the labour/energy-price shock better than expected. This leaves only the financing shock.

Interestingly, a recent study by the NBB examined the extent to which Belgian companies benefited from three decades of declining interest rates. In addition to lower financing costs, Belgian firms improved their equity positions and cash buffers. Surprisingly, their investment rate did not increase significantly as a result, though remaining higher than the euro area average since around 2010. And this gap was once again evident from the summer of 2022 onwards.

Since then, gross fixed capital formation (GFCF) by Belgian firms grew at an astounding 2.5% per quarter, almost double its trend, seemingly unhindered by rising rates. However, over the same period, household investment (in dwellings) declined by more than 1% per quarter. The higher interest rate environment is proving to be less of a binding constraint on businesses as they source intercompany funding or draw down cash reserves.

So, what is the driving force behind this strong investment activity? Its roots seem to lie in the labour/energy-shock. Companies are investing mainly in digitalisation and automation in response to higher wage costs and labour shortages. They are also investing in the greening of production processes in order to reduce their exposure to energy price volatility and to comply with environmental regulations. With interest rates set to fall in 2024, we can expect this investment boom to continue for a while longer.

**Arne Maes**
arne.maes@bnpparibasfortis.com