

Need to boost competitiveness

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Executive summary

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- After a weak economic performance in 2013 (+0.2%), we expect GDP growth to pick up to +1.2% in 2014, driven by a rebound in investment and consumption.
- The recent deterioration in terms of trade is largely explained by the loss of competitiveness of the country. Labor costs in Belgium are among the highest of the Eurozone, due to automatic wage indexation and elevated taxes as a share of wages.
- Business insolvencies continued to increase in 2013 (+11%), for the 7th consecutive year, and are likely to continue to do so in 2014 (+3%) before stabilizing in 2015.
- The government managed to reduce its fiscal deficit but public debt remains very high and political uncertainties represent another downside risk.

Positive (but moderate) economic growth

In 2013, economic activity expanded by only 0.2%, dragged down by a fall in investment and negative contribution of inventories while private consumption remained resilient. Net trade boosted economic activity though exports started to fall in Q4. In Q1 2014, GDP growth has slightly accelerated to +0.4% q/q driven by strong domestic demand (especially a +1.6% rebound in investment). Unfavorable terms of trade cut GDP growth by 0.2pp as exports dropped by -1.5%, underlying the loss of competitiveness of the country.

In the first months of Q2, advanced indicators suggested economic activity will remain flat, as business confidence deteriorated in most sectors (industry, retail and construction), with the only exception being services. Additionally, consumer confidence slightly improved, albeit only in May. All in all, we expect economic activity to expand by +1.2% in 2014, on the back of a rebound in investment (after two years of deterioration) and strong private consumption while terms of trade should be less favorable than during the previous years (see Chart 1). In 2015, domestic demand should remain fair and international trade should improve, driving GDP growth up to +1.4%.

Table 1: Key economic forecasts

Belgium	Weights	2012	2013	2014	2015
GDP	100%	-0.1	0.2	1.2	1.4
Consumer Spending	53%	-0.3	0.8	1.3	1.2
Public Spending	27%	1.8	0.3	0.4	0.3
Investment	19%	-2.4	-1.1	2.8	2.1
Construction	6%	-3.2	-2.6	0.8	0.9
Equipment	13%	-2.1	-0.5	3.6	2.6
Stocks	*	-0.5	-0.6	-0.3	0.2
Exports	87%	1.8	1.9	1.3	3.3
Imports	85%	1.3	1.4	1.1	3.2
Net exports	*	0.5	0.5	0.2	0.1
Current account	**	-7	-6	-7	-10
<i>Current account (% of GDP)</i>		-1.9	-1.6	-1.8	-2.5
Employment		0.7	0.5	0.1	0.9
Unemployment rate		7.6	8.4	8.4	8.3
Wages		2.8	1.9	1.4	1.6
Inflation		2.6	1.1	0.7	0.9
General government balance (% of GDP)		-4.1	-2.6	-2.7	-2.5
Public debt (% of GDP)		101.1	101.5	103.7	104.1
Nominal GDP	**	376	383	390	399

Change over the period, unless otherwise indicated:

* contribution to GDP growth

** EUR bn

Sources: National Statistics, Euler Hermes

Deteriorating competitiveness weighs on export performance

Though Belgium usually benefits from its role as a regional trade hub for the European market, terms of trade deteriorated in the past two quarters, as exports fell by -0.2% in Q4 2013 and by -1.5% in Q1 2014. Moreover, after a slight improvement in the beginning of the year, export-order book level worsened in the following months, going from -13 in January to -18 in May. The loss of competitiveness (high labor costs) of the country largely explains this downside trend. Indeed, Belgian hourly wages are the highest in the Eurozone (see Chart 2) due to automatic wage indexation (Belgium is the only Eurozone member to retain this system) and taxes as a share of wages are among the highest in the region. The N-VA party (conservative), which won the legislative elections in May, has declared itself in favor of market labor reforms (especially ending the indexation system) but the likely difficulty in forming a coalition and the unpopularity of such reforms may be important obstacles.

Improving public finances but downside risks remains

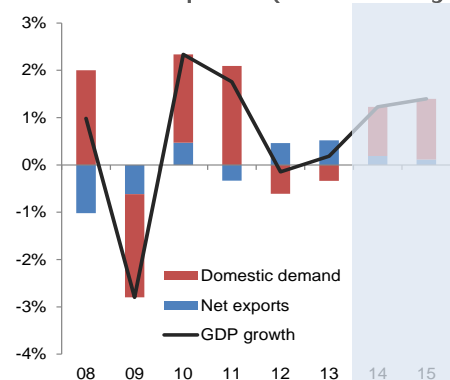
In 2013, the country managed to significantly lower its fiscal deficit, from -4.1% of GDP in 2012 to -2.6%. In 2014 and 2015, public authorities should be able to contain government balance deficit around this level, thus respecting the Maastricht threshold (of -3%). However, public debt remains very elevated (101.5% of GDP in 2013) and is expected to increase further in the medium-term (to 103.7% in 2014 and to 104.1% in 2015). In this context, political uncertainty represents an important downside risk on public finance - especially on the debt burden - since forming a coalition is likely to take time. Indeed, the last political crisis (after the 2010 elections, Belgium had no government for 541 days) severely impacted interest rates on Belgian government bonds (see Chart 3).

The private sector still struggling

In 2013, corporate insolvencies increased for the 7th consecutive year (+11%) and they are expected to continue to increase in 2014 (+3%, see Chart 4), while insolvencies in Western Europe as a whole should fall by -12%. Construction and services remain the two most impacted sectors: in 2013 they accounted for respectively 17% and 76% of total bankruptcies.

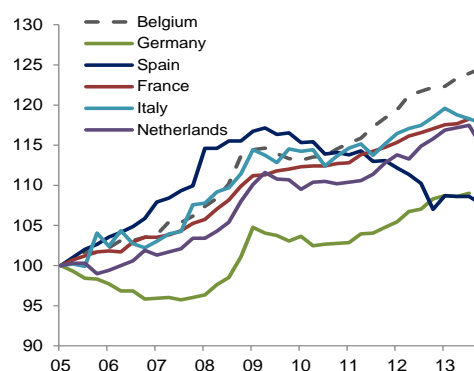
We expect business insolvencies to stabilize only in 2015, and they will stand at a high record level (more than 12,000 bankruptcies). Furthermore, operating profits of corporations have been on a downward trend since Q2 2013, driving down their margins, which were already eroded by the loss of competitiveness (wages have increased faster than productivity).

Chart 1: GDP and components (contribution to growth)



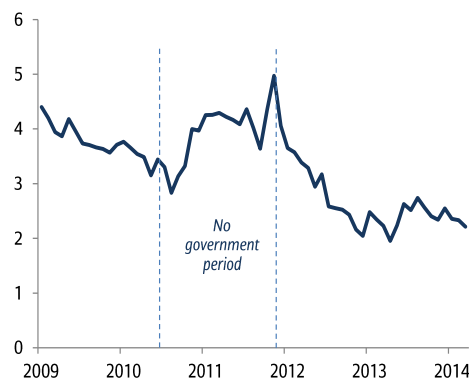
Sources: IHS Global Insight, Euler Hermes

Chart 2: Nominal unit labor costs (2005=100)



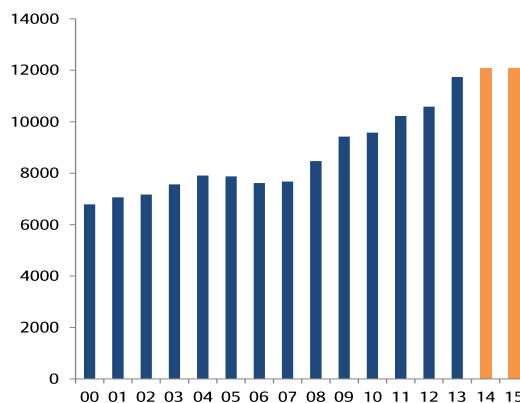
Sources: Eurostat, Euler Hermes

Chart 3: Interest on Belgian government bonds (%)



Sources: Bloomberg, Euler Hermes

Chart 4: Corporate insolvencies



Sources: INF/SPF, Euler Hermes

General Information

GDP	USD483.709bn (World ranking 25, World Bank 2012)
Population	11.14 million (World ranking 77, World Bank 2012)
Form of state	Federal Parliamentary Democracy under a Constitutional Monarchy
Head of government	Elio Di Rupo
Next elections	2019, legislative

Strengths

- Role as a regional trade hub in the Eurozone
- Presence of many European institutions
- Fairly resilient economic activity since the crisis
- Better investment conditions compared to other Eurozone members (improvement in credit conditions, net FDI inflows)
- Low indebtedness of the private sector

Weaknesses

- Political instability
- High tax rate for firms
- High labour costs due to wage indexation on inflation
- Dependence on the Eurozone cycle
- High public debt

Trade structure

By destination/origin

Exports		Rank		Imports
Germany	16%	1	17%	Netherlands
France	16%	2	16%	Germany
Netherlands	12%	3	11%	France
United Kingdom	8%	4	7%	United Kingdom
Italy	5%	5	6%	United States

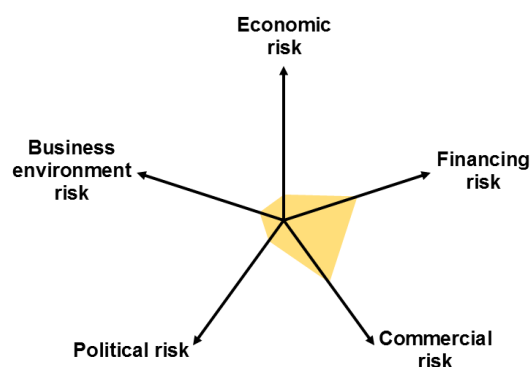
By product

Exports		Rank		Imports
Pharmaceuticals	9%	1	8%	Pharmaceuticals
Refined Petroleum Products	8%	2	7%	Basic Organic Chemicals
Plastic Articles	8%	3	6%	Refined Petroleum Products
Basic Organic Chemicals	6%	4	6%	Cars And Cycles
Cars And Cycles	6%	5	5%	N.E.S. Products

Source: Chelem

Risk Dimensions

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Source: Euler Hermes

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