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PRESS RELEASE

Price-setting behaviour in Belgium: what can be learned from an ad hoc survey?
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In February 2004, the Bank carried out an ad hoc survey gauging the price-setting behaviour of around 2,000 Belgian companies in industry, construction, trade and business services. Combined, the sectors covered by the survey account for 60 p.c. of GDP. The survey is the Belgian component of an initiative covering the entire euro area in the context of the "Eurosystem Inflation Persistence Network" (IPN), a research network of the 12 national central banks within the euro area, the ECB and the academic world. This research network examines the degree, causes and consequences of inflation persistence.

In order to gain an accurate insight into price-setting behaviour, the IPN felt it useful to conduct an ad hoc survey in all countries within the euro area. The comparative advantage of such surveys lies in the fact that they can gauge the underlying motives for the observed price-setting behaviour which are more difficult to discover based on quantitative databases of consumer and producer prices. Nine national central banks carried out a similar survey and the overall results for the euro area will be published in the course of 2005. In this article, we expound the main results of the Belgian survey.

The survey focuses on the following questions: what environment do the companies operate in? Which factors lead to price adjustments? When are the prices adjusted and are they flexible or rigid? Why are the prices rigid? The main results are summarised below.

Market structure and the level of competition are crucial environmental factors in price-setting behaviour. A certain amount of market power is essential in order to make a company's pricing policy meaningful. In the absence of any market power (in the case of perfect competition), prices are dictated by the market rather than being decided upon by companies and they will always be equal to the marginal costs. In other words: there is no mark-up. Nor is there any scope for price rigidities in that environment, precisely because a mark-up is essential to leave the firm some margin for not adjusting prices when costs change. The survey results show that the environment Belgian companies operate in clearly differs from a 'perfect competition' situation. Various indicators reflect that the companies have some market power which is greater on the Belgian market than abroad. Furthermore, most of the companies in industry adjust their prices as a function of the market (pricing-to-market).

However, this does not mean that customer relations and the behaviour of competitors do not play a role in the price-setting behaviour of Belgian companies. After all, competitors' prices emerge from the survey both as an important contributory factor for setting one's own price and as a reason for adjusting prices, which is more likely to occur in the case of a price decrease than in the case of a price rise. All things considered, the competitor's price is considered to be slightly more significant in industry. According to the results of the survey, industrial companies tend to operate in a more competitive market than the other sectors. Costs also play an important role in price-setting behaviour, slightly more when they increase than decrease, while demand fluctuations seem to prompt companies mainly to cut their prices.

When it comes to the frequency and timing of price adjustments, the survey results show up a relatively high level of price rigidity. The average time lapse between two consecutive price reviews is ten months and thirteen months between two consecutive price changes. The highest level of price rigidity was recorded for business services and the lowest level for the construction sector. In normal circumstances, the lion's share of companies adopt time-dependent price-reviewing. This means that they review their prices at a moment which is fixed in advance, for example, at the beginning of every year. However, if sufficiently significant economic shocks take place, the process becomes state-dependent for most companies. The prices are consequently allowed to react immediately to sufficiently large shocks, namely when the deviation between the price charged and the new optimal level has grown sufficiently big to compensate for the costs of adjusting the price.

This survey is perhaps the only source of information allowing us to examine why prices are rigid. According to the survey results, prices are rigid mainly due to the existence of implicit and explicit contracts with customers and only to a small extent due to menu costs or costs related to collecting the relevant information for price-setting. Implicit and explicit contracts tend to be a source of rigidity mostly in sectors where companies maintain a long-term relationship with their customers. Price rigidity also stems from the fact that the business cycle gives companies limited incentive to adapt their real or relative prices. Possible reasons are a flat cyclical marginal costs curve, or because the mark-up desired by companies shows countercyclical movements. One example of the latter is when companies are reluctant to reduce their prices in a recession in order to keep their cash-flow on a sufficiently high level.

Another finding was that only one third of companies had based their latest price reviews on a complete set of data also including expectations for the future. The remaining companies either used a more limited set of data containing only information with regard to the current environment or they applied a rule of thumb (for example, indexing their price based on the consumer price index). Price-setting behaviour is most forward-looking in industry, whereas the business services more commonly use rules of thumb. The considerable amount of non-forward-looking price-setting may constitute a further source of inertia in the inflation process.

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