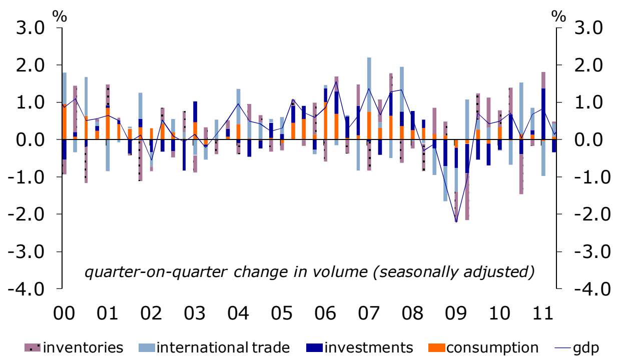
The Netherlands

No surprises

While the economy still appeared to be firing on all cylinders in the first quarter of 2011, by the second quarter the increase in economic activity had stagnated all but completely. The Dutch economy grew by only 0.1% on a quarterly basis, a rate that nevertheless did not come as a surprise. So far, we had mainly been seeing a recovery of exports, but these have now been sluggish for some time. Although investment is slowly beginning to pick up, this trend has been significantly weaker. In order to boost economic recovery, consumer spending must be ramped up; however, consumers appear to be holding back for now. Since we have no reason to expect much expenditure on the government side either, it is not surprising that the economic recovery has lost momentum. We do not anticipate any major changes in the economy over the next few quarters – economic growth is expected to continue at a very moderate pace.

Figure 1: Virtually no economic growth



Source: Statistics Netherlands

Virtual standstill in economic growth

The volume of the Dutch economy increased by only 0.1% (q-o-q) in the past quarter (see Figure 1). It was clear in advance that the growth in economic activity would be significantly lower than the 0.8% attained in the first quarter, when growth was driven by the favourable weather conditions, which caused a substantial increase in building output, in particular. Over the past quarter, private investment reverted to normal levels, resulting in a negative growth contribution compared with the previous quarter. Consumers and the government continued to hold back in terms of expenditure in the second quarter: consumers did not contribute to growth at all, while the government's contribution was modest as well. In fact, it was once again net trade that kept the Dutch economy afloat, although to a lesser extent than in previous quarters.

While the economic outlook for the remainder of the year is less than stellar, we do not anticipate a new recession. And although the Netherlands, with its open economy, has been experiencing the effects of the slowdown in the growth of global trade, manufacturers appear to be making replacement investments, which were postponed due to the 2009 recession. It is likely that the recovery we are seeing in 2011 is more solid than in 2010, when the increase in economic growth was strictly internationally driven. We expect little from either consumers or the government in the immediate future, as the bulk of the government cuts will be made during the period starting in 2012.

The Netherlands

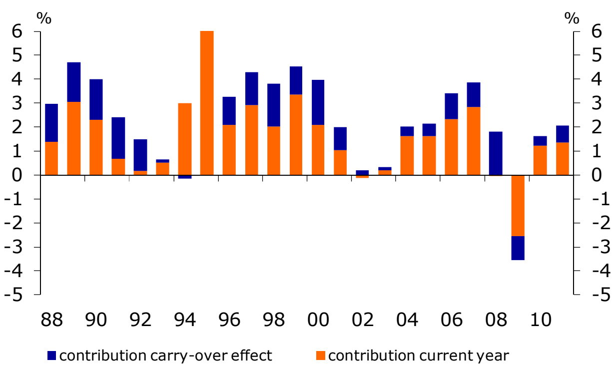
In addition, consumer purchasing power is under pressure and consumers are dealing with a variety of uncertainties. We are therefore expecting very moderate economic growth in the second half of 2011 and in 2012. On the back of the exceptionally strong first quarter and since a large portion of the growth has already been achieved due to the 'spill-over' from 2010, the economy will nevertheless grow by 1¾% this year (see Figure 2). Economic activity is expected to increase by 1% in 2012.

International trade lags behind

Global trade saw a revival in the course of 2009 following a significant decline in global trade volumes in 2008. However, the growth in global trade has levelled off since the end of 2010, and in the past quarter global trade volumes even declined by 0.6% (see Figure 3), due in part to the earthquake and subsequent tsunami in Japan. Although we expect international trade to bounce back somewhat over the next few quarters, the increase will be significantly less substantial than in the past two years. This is because a variety of economic indicators, including the international purchasing managers indexes (PMIs), show a weakening international economy, likely resulting in lower growth in global trade in the immediate future (see also the section titled 'Global Outlook' elsewhere in this Quarterly Report).

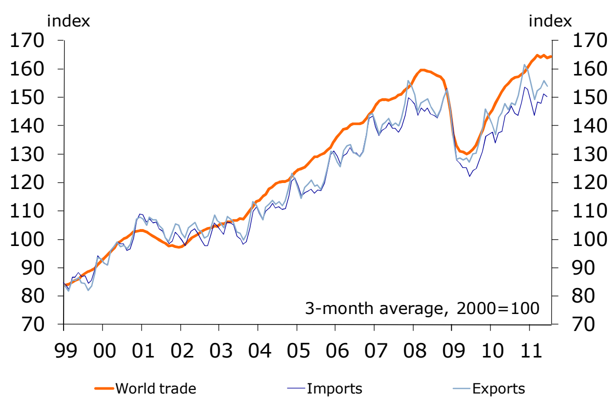
Growth of Dutch imports has been levelling off as well. Over the past quarter, import volumes increased by only 1.6% compared with the previous quarter, while they still rose by an average of 2½% per quarter in 2010. This downward trend is expected to persist in the immediate future, causing import volumes to increase at a substantially lower pace (6½% in 2011 and 3% in 2012) than in 2010. Dutch exports depend strongly on imports from abroad. Approximately 40% of exports consists of re-exports, i.e. goods that were imported into the Netherlands and have left the country in an unaltered or virtually unaltered state. Re-exports increased by 15.8% (y-o-y) in 2010, due in part to

Figure 2: Spill-over effect of growth



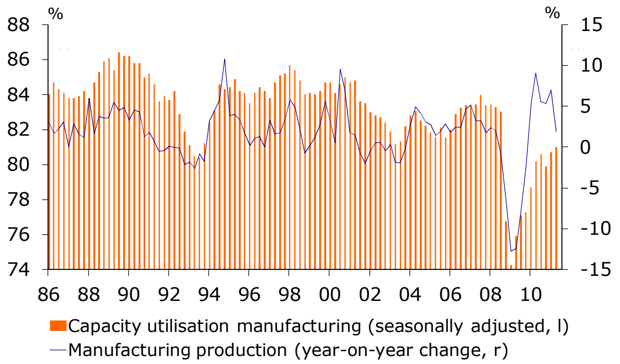
Source: Statistics Netherlands, Rabobank

Figure 3: Growth of global trade levels off



Source: Statistics Netherlands, CPB Netherlands Bureau for Economic Policy Analysis economic performance in the surrounding countries. Re-export levels were back to above pre-crisis levels by early 2011, but since then growth in this area has slowed down significantly, as has been the case with export volumes. While these increased by an average of 2.6% per quarter in 2010, by the second quarter of 2011 export growth was down to just 1.9%. This downward growth trend is expected to continue, with export growth expected to reach 6¼% in 2011. We are expecting an increase of 4¼% for 2012.

Figure 4: Capacity utilisation rate remains low



Source: Statistics Netherlands

Production hampered by lack of demand

In June 2011, production was up 2.4% from the previous year, and while production volumes have been improving since early 2009, they are still some 3% below pre-crisis levels. It is expected to take some time before production is back at this level, as one in five businesses in the industrial sector have reported a lack of demand. By way of comparison: before the crisis, only one in 20 manufacturers reported being faced with this problem. Given the slump in demand in the industrial sector, it is therefore no surprise that a significantly larger number of manufacturers feel they are overstocked and are dissatisfied with their order position. Due to the slowdown in economic recovery, the sales outlook is not expected to change in the immediate future. Manufacturers have been considerably less affected by barriers to production such as a shortage of labour or a lack of production capacity. Approximately 65% of businesses do not perceive any production obstacles, which is not surprising given that there is no shortage in the labour market (yet) and that companies are producing below their long-term average (see Figure 4).

In the past quarter, private investment volumes declined by 3% (q-o-q), whereas in the first quarter private investment was up 7.9%. The downturn did not come as a surprise, as the investment rush at the start of the year was driven in part by the mild winter weather. The investment machine, which had just started to gain momentum, prevented a more substantial downturn. Many businesses decided to postpone replacement investments during the crisis; however, manufacturers cannot push back such investments indefinitely. Expansion investments, nonetheless, do not appear to be in the pipeline for the immediate future, on account of the moderate growth expectations, sales issues and capacity utilisation rate. For 2011, we expect investment volumes to increase by 7%, while investment growth is expected to reach 2¾% in 2012.

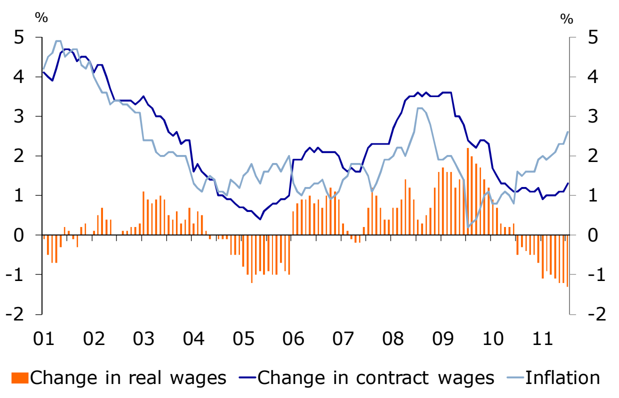
Consumer spending still down

Private consumption volumes declined for the second consecutive quarter, with consumers spending 0.1% less in the second quarter than in the first quarter. One possible reason for the low consumption levels is the decline in real wages. Since July 2010, inflation levels have risen faster than wages under the Collective Labour Agreement (CAO; see Figure 5), and in addition employees have less to spend due to the ever-increasing health insurance premiums. This is compounded by the slump in the housing market and the lack of capital gains in the stock market. Consumers have been pessimistic ever since the start of the Great Recession, but when concerns about the US budget and the European debt crisis reached a climax in recent weeks, consumer confidence plummeted to the July 2009 level in early August. In particular, consumers were much more negative about the economic climate, although, since they are not yet personally affected by the impact of the debt crisis, consumers' willingness to buy has remained virtually unchanged.

Consumer confidence in sync with AEX

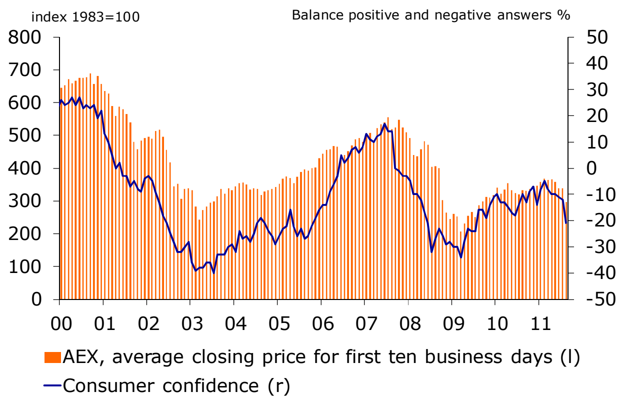
Since the late 1990s, changes in consumer confidence have moved in sync with fluctuations in the AEX index (see Figure 6). The strong correlation between both these indexes is related in part to consumers' increased involvement in the stock market. In addition to private share ownership having increased, on balance, since the end of the last century, share prices are also important to many consumers in an indirect way. Specifically, pension funds began increasing investment in equity in the late 1990s. After interest rates, fluctuations in share prices are the main reason for fluctuations in the funding ratios of pension funds. In order to at least keep funding ratios level when stock markets are in decline, pension premiums must increase or pension payments will no longer be indexed. Share prices, in particular, are currently down, as investors are afraid the

Figure 5: Decline in real wages for consumers



Source: Statistics Netherlands

Figure 6: Consumer confidence and AEX



Source: Statistics Netherlands, EcoWin

economy will slip into a new recession. Fortunately, to date this anxiety has been limited mainly to the financial markets. However, the first signs of these problems in the financial markets spilling over into the real economy are already visible due to the lower consumer confidence and capital effects. As this causes consumers to spend less, it is important that government leaders manage to placate investors in the near future, for example by offering solutions to the European debt crisis (see elsewhere in this report) in order to prevent further economic damage.

Due to consumers' pessimism, consumption levels are also expected to remain virtually stagnant for the remainder of this year, and we also do not expect consumers to kick-start the Dutch economy in 2012 with their spending patterns. Minister of Social Affairs and Employment Henk Kamp has already announced that Dutch people will really start feeling the cuts in their wallets next year. Purchasing power will be further eroded, including through a reduction in the rental allowance, higher health insurance premiums, lower government income support and an increase of the personal contribution to childcare. Although there has been talk of restoring purchasing power, we do not expect consumers to be fully compensated, or that their capital will increase. We also do not anticipate consumption volumes to increase in 2011 and 2012.

A pension agreement is in place – but for how long?[1]
After more than one year of negotiations, employers and unions reached an agreement in June regarding the future of the pension system. The agreement offers improvements in a number of areas. For one, the amount of the supplementary pensions will depend explicitly on the investment results achieved by pension funds. In exchange for providing 'hard' guarantees, pension funds no longer need to maintain additional buffers for their high-risk investment portfolios. The pension agreement is based on the assumption that, due to the release of these buffers, pension funds will soon revert to indexation again. And therein lies the rub, because due to the payment of pension buffers to older generations, young people are left with the risk of empty coffers by the time they themselves are ready to retire. Furthermore, it is uncertain whether the pension agreement will stand now that the two largest Dutch unions (FNV bondgenoten and AbvaKabo) have turned against the agreement within the FNV federation of trade unions. Even a concession by Minister Kamp that should make it easier for people performing physically demanding work to retire at the age of 65 was to no avail. It is now up to construction union FNV Bouw to ensure majority support for the agreement within the federation council. If this fails to materialise, Minister Kamp may push through his own pension plans. The uncertainty regarding

[1] See also: Smid, T. *Pensioenachtbaan* (Pension Rollercoaster), Special Report 2011/11, Rabobank Nederland.

the future of old-age pension provision and the amount of future pensions encourages consumers to save, whereas in fact they should be spending in order to boost the economy.

Government to present bill for Great Recession

On Budget Day (the third Tuesday in September), the Dutch government will be disclosing the budget for 2012. This will most certainly be affected by global economic trends. Government spending is likely to be higher, whereas government revenues are lower than expected. Nevertheless, the current economic situation is no reason for the government to implement additional austerity measures for the time being. The coalition agreement states that the government will be increasing cuts significantly in 2012 compared to 2011. Whereas expenditure had to be reduced by 'only' EUR 2.9 billion this year, a EUR 3.6 billion austerity package is scheduled for next year, resulting in a substantial decline in purchasing power. Although several parties, including the FNV, have already called on the government to curtail its cost-cutting, the cuts are necessary in order to reorganise public finance. So far, it is the government that has paid the bill of the Great Recession, while consumers who have not lost their jobs have barely been affected financially at all. However, this is set to change over the next several years, when consumers will be presented with the bill. At -3½% of GDP, the EMU balance is expected to remain just above the European deficit ceiling of 3% in 2011. We will likely dip below this number in 2012, at which point the actual budget deficit will be equivalent to 2½% of GDP.

No real changes

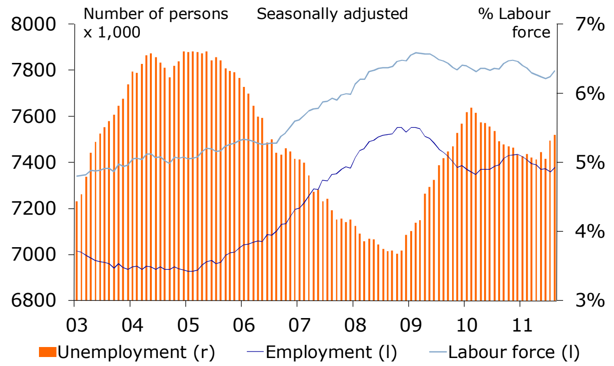
French President Nicolas Sarkozy and German Chancellor Angela Merkel recently presented a plan to control the European debt crisis. The plan advocates a central economic policy within the eurozone and the introduction of a debt ceiling. However, it does not provide a solution to the problems faced by EU government leaders. The introduction of a European economic government will not help solve the current problems as long as individual countries retain full control over their economic policies. In the present plan, such a government will have more of a symbolic value than actual power, and will be unable to make any important decisions. Further political integration is essential in order to truly tackle the problems at hand; however, as it stands countries seem unwilling to give up their autonomy. While the introduction of a deficit ceiling, where eurozone countries set down a maximum amount of their government deficit in their constitution, is an interesting idea in itself, the introduction of such a ceiling will result in a number of practical problems. For one, constitutional amendments would be required in the seventeen eurozone countries that generally take many years to implement, and second, the plan requires that countries conduct a well-balanced budget policy.

It remains to be seen how such a policy would manifest itself in reality. A ban on deficits is not realistic, as this is not prudent from an economic perspective. When the economy is in a recession, it is important that governments have the scope to pursue a countercyclical budget policy, where their expenditure increases while their revenues, including tax revenues, decline. This policy proved its worth in the Netherlands during the Great Recession. In order to ensure that the country can pursue such a policy in times of crisis without a budget deficit occurring, the Netherlands should aim for an annual surplus of approximately 2%. This means that the Dutch government must cut back significantly more than the EUR 18 billion currently scheduled. This would further hamper economic growth in the Netherlands, which is weak enough to begin with.

Increased unemployment

In July, the seasonally adjusted unemployment rate increased to 5.3%, compared to 5.0% the previous month. However, this does not necessarily mean that the labour market will be downhill from now: fluctuations in unemployment rates can be substantial. In July, this may have been a result of the poor weather conditions. Although a large number of jobs are traditionally created in the hospitality industry during the summer months, demand for labour may have been lower this year due to the weather conditions. Figures are adjusted for the usual fluctuations in seasonal patterns, but not for one-time effects. The unemployment rate is expected to hover around 5% this year and will likely rise to 5¼% of the working population in 2012. The marginally higher unemployment rate is the result of the expected slight increase in the labour supply due to the fact that a portion of job seekers discouraged by the Great Recession are returning to the labour market. In a parallel trend, the number of government jobs has been declining as a result of the austerity measures. Many temporary contracts are currently not being renewed and new openings are no longer being filled, although people are not yet forced to look for new jobs. However, this is likely to change in the near future. At the same time, employment in the private sector has barely increased. During the crisis, companies kept a large number of employees on staff, since because of the shortage in the labour market prior to the crisis it could prove to be difficult to find a sufficient number of new employees if the economy improved. This has created considerable reserve capacity in recent years, which is used before any new staff is recruited.

Figure 7: Unemployment on the rise



Source: Statistics Netherlands

The Netherlands

Rents and energy rates drive inflation

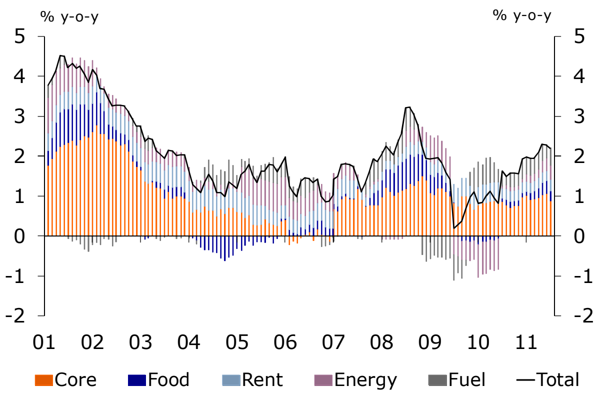
In July the inflation rate was 2.6% – the highest level since December 2008. Rents contributed significantly to this rate. The maximum statutory rent increase, which was implemented on 1 July, amounted to 1.3% for the majority of rented homes, making it equal to average inflation for 2010. Inflation was further spurred by an increase in the energy rates, which are adjusted biannually. The peak will likely be reached in the second half of this year. Average inflation for 2011 is expected to reach 2¼%. Due to the cooling of the economy, the lower oil and food prices, and monetary measures, we expect average inflation to drop to 2% in 2012.

Conclusion

We anticipate moderate economic growth in the immediate future. Although we could potentially see one or two quarters of slightly negative growth, we are not sliding towards a new abyss. As long as no downside risks actually occur[2], we are not likely to head into a new recession. A moderate economic growth forecast is no reason to despair, and the Netherlands remains one of the wealthiest countries in the world. Besides our relatively high incomes, there are many other areas in which we can consider ourselves lucky: we live in freedom, have high levels of education, and are relatively healthy, as well as having ample time for relaxation.

[2] See also: Stegeman, H.W. *Negen scenario's voor het niet uitkomen van onze voorspelling* (Nine scenarios in case our forecasts prove incorrect) Theme Report 2011/23, Rabobank Nederland

Figure 8: Inflation



Source: Statistics Netherlands

Table 1: Key figures

	2010	2011	2012
Year-on-year change in %			
Gross Domestic Product	1,8	1¾	1
Private consumption	0,4	0	0
Government expenditures	1,5	½	-¾
Private investment	-4,7	7	2¾
Exports of goods and services	10,9	6¼	4¼
Imports of goods and services	10,5	6½	3
Consumer price index	1,3	2¼	2
Unemployment (% labour force)	5,5	5	5¼
Government budget (% GDP)	-5,4	-3½	-2½
Government debt (% GDP)	62,8	64	64¾
Current account balance (% GDP)	5,5	6½	7

Source: Rabobank

Ruth van de Belt
R.Belt@rn.rabobank.nl

Theo Smid
T.H.Smid@rn.rabobank.nl