The Netherlands

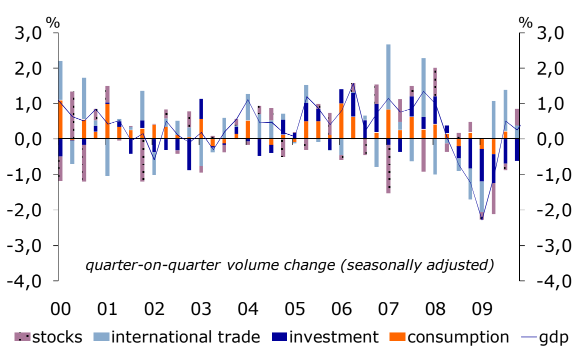
Stumbling along

During the past year the economy was in a deep slump. And although the end of the recession was officially heralded in the third quarter of 2009, the recovery is not yet very convincing. For 2010 the expected real growth of the Dutch economy of 1¾% on average will be below the trend of before the crisis. While the acute crisis may be behind us, its ramifications will remain palpable for some time to come. Both consumers and companies are still buckling under the burden of enormous production loss, the incomplete recovery of financial markets, rising unemployment and the government's budget deficit. Yet, for many people the crisis will have felt less painful than the numbers might suggest. This is chiefly due to the relatively limited rise in unemployment. But many self-employed individuals felt the pinch all the more.

Return to growth

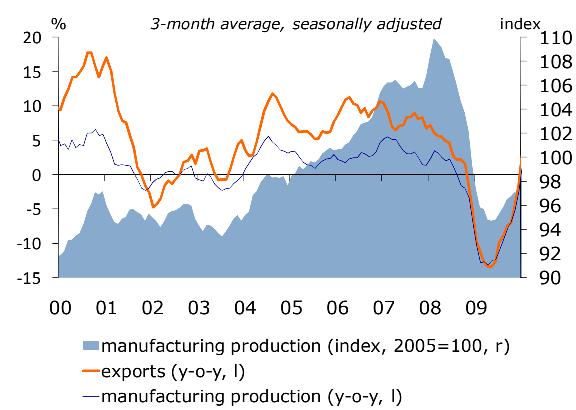
After four quarters of economic contraction, the volume of the Dutch economy grew in the third quarter of last year by 0.5% compared to the previous quarter. In the fourth quarter growth was 0.3% (figure 1). Dutch economic growth reached its peak in the second quarter of 2008. After that it went rapidly downhill, with the sharpest decline occurring in the first quarter of last year. Real economic growth, when compared to the high levels of a year earlier was particularly low in the first two quarters of 2009, registering -4.5% and -5.5% respectively. During the coming quarters the opposite will be the case. The lowest point of this cycle was reached in the second quarter of 2009. Compared to that trough, year-on-year economic growth will show a rise in the second quarter of this year –and probably also in the first quarter– provided that quarter-on-quarter growth continues.

Figure 1: Modest economic recovery



Source: Statistics Netherlands

Figure 2: Production loss not yet restored



Source: Statistics Netherlands

The Netherlands

Growth driven by international demand
The recovery in growth can chiefly be attributed to demand from abroad. Thanks to the sizeable economic stimulus packages from governments worldwide, global demand has picked up in recent months. Companies have also started rebuilding inventories, which they had reduced drastically during the crisis, and this has also boosted global demand.

Our open Dutch economy has benefited from the recovery in world trade, as can be seen in the improvement in export volume. In December 2009 exports were over 2% higher than in December 2008 (Figure 2), when the sharpest drop took place. Of course this is partly due to so-called base effects. In the previous eleven months of 2009, exports had declined by an average of over 9% year-on-year. Furthermore, looking at the short-term development, the recovery appears to be losing momentum. In the period from October to December 2009, the volume of exports rose by 6.7% compared to the previous three-month period. A month earlier, there had been a rise of 12.6%. Imports are showing a similar trend. In December 2009, imports had declined by almost 1% compared to the same month a year earlier. But this drop was significantly smaller than the minus 5.5% of a month earlier.

The recovery is expected to continue further in 2010 – if at a slower pace - with Dutch exporters profiting from the rebound in world trade. And the recent recovery of the dollar against the euro has led to an improvement in competitiveness as regards prices, with Dutch products now (relatively) cheaper abroad. Imports, on the other hand, will not benefit much from a domestic recovery in demand. This is because Dutch companies and consumers are still fairly cautious in their spending. On balance, net international trade will make a positive contribution to economic growth in 2010.

The slower pace of recovery in evidence at the end of last year is representative of the expected modest development of international trade in 2010. Historically, an average growth rate of 5% for exports of goods and services and of 3.5% for imports can hardly be called vigorous. Accordingly, the slower pace of growth in world trade growth will result in a slightly lower growth of Dutch exports in 2011.

Production loss far from fully restored
The base effect is also visible in the output levels of Dutch industry. In December 2009, production volume was almost 1% higher than a year earlier, compared to an average drop of almost 10% in the eleven preceding months. As in the case of exports, the recovery appears to be losing momentum. In the last quarter of 2009, the volume of industrial production actually showed a slight decline on a quarter-on-quarter basis, while a quarter earlier production had risen by over 2%.

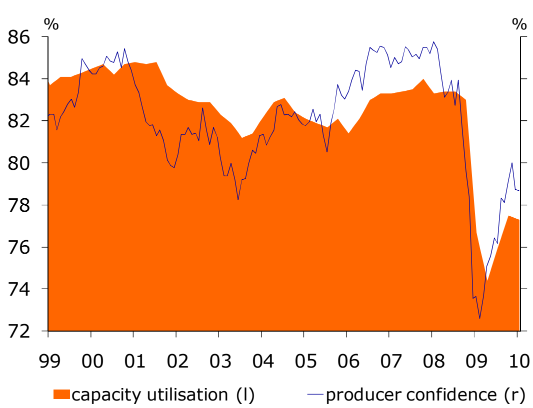
The Netherlands

Output levels still have a long way to go to recover from the blow of the economic downturn. The volume of production registered in December 2009 was over 12% below the peak of early 2008 (Figure 2). Much of production capacity remains underutilized. In January only about 77% of available capacity was in use (Figure 3).

These data notwithstanding, sentiment among producers has improved considerably in recent months. In January 2010 producer confidence had risen to -6.9 compared to a low of -23.5 in February 2009 (Figure 3), although this figure remains negative. The slight deterioration in December 2009 and January 2010 furthermore underlines how fragile the budding recovery is. This uncertainty, combined with low production and possible rationing of credit by suppliers of capital will ensure that the volume of corporate investment will also remain under pressure in 2010. Investment can be expected to decline by an average of 5% this year, but to recover somewhat by the end of the year. For 2011 we expect to see investment volume increase by 2¾%. In view of the cumulative decline in investment – totalling almost 22% since the second quarter of 2008 – this is a very meagre recovery.

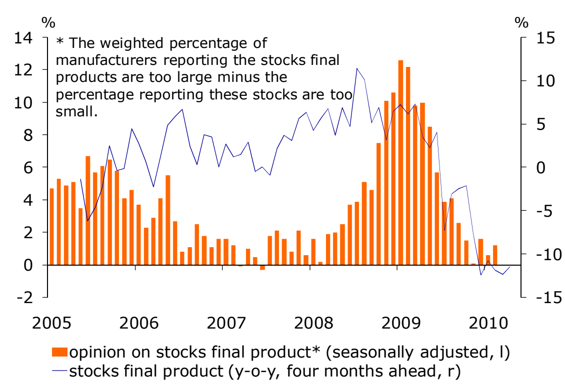
Box 1: An end to destocking?
As was the case in many other countries, Dutch industry sharply reduced inventories in 2009. By December 2009 inventories of finished products were down by over 11% compared to December 2008 (Figure 4). Together with a decline in end-user demand, this led to a contraction of industrial production by an average of almost 9% in 2009. In the second half of last year, the pace of destocking slowed globally, leading to rebound in demand in the production chain. In the last quarter of the year, the volume of end-product inventories declined by an average of 2.3% compared to the previous quarter.

Figure 3: Producers less gloomy



Source: Statistics Netherlands

Figure 4: An end to inventory reduction?



Source: Statistics Netherlands

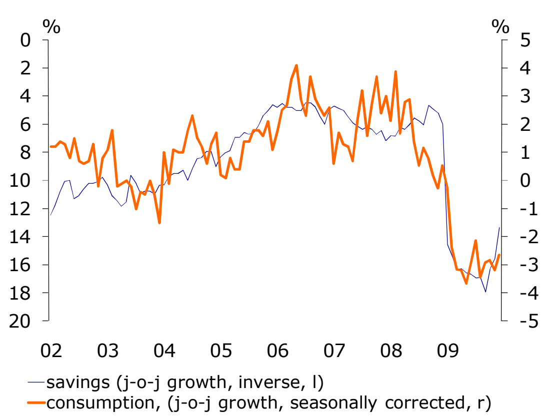
This compares to a quarter-on-quarter decline of over 9% a quarter earlier. In the last three months of 2009, inventories and international trade were the only spending categories that made a positive contribution to growth (Figure 1).

Inventories have indeed reached a low ebb. During the past five months, the percentage of entrepreneurs indicating that they found stocks of finished products too high was only marginally greater than the percentage that indicated inventories were too low (Figure 4). Until then, the first group had been in a clear majority. An end to destocking may give a boost to industrial production.

Economic thermometer reflects better than expected jobs situation
For the time being, producers cannot depend on consumers to drive the recovery forward. In December the volume of consumer spending was a further 2.6% down on a year earlier (Figure 5). In 2009 consumers spent on average 2.7% less than in 2008. Of course base effects also play a part here. But because the sharpest decline in consumer spending did not occur until February the base effect will be mainly palpable from then on.

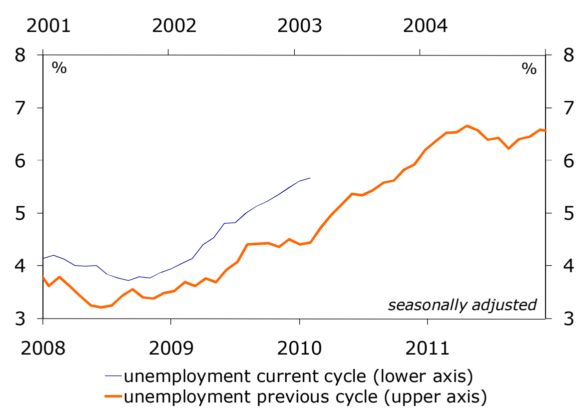
During the months ahead, the data on the development of consumption volume will paint a more positive picture. At the same time, the expectations for 2010 are not over-optimistic. For most people, purchasing power is declining, unemployment is rising further and large wealth gains that could be used for consumer spending – such as stock market gains – are unlikely to materialise this year. With zero growth in consumer spending expected for 2010 and a paltry ½% in 2011, a consumer-driven recovery would appear to be far off as yet (box 2).
Unemployment in the Netherlands has now been rising for 14 months in succession, reaching 5.6% in January. In 2009 a total of 109,000 people joined

Figure 5: Consumers still cautious



Source: Statistics Netherlands

Figure 6: Rise in unemployment relatively limited



Source: Statistics Netherlands

the jobless ranks. In the first half of 2009 the pace of rising unemployment was about the same as in 2002, although the current economic downturn is much more acute (Figure 6). There are several reasons for this. At the start of this economic crisis, the labour market was tight; there is now a higher proportion of self-employed workers without staff (Zelfstandigen Zonder Personeel - ZZP); some Eastern European workers are returning to their own country; and the introduction of the legislation on part-time unemployment benefits has dampened the unemployment numbers statistically.[1] The effect of this latter measure is only temporary in nature, and the absorptive power of the 'flexible layer' of workers with a flexible contract and ZZP workers is declining. Consequently, unemployment will rise further in 2010 to an average of 6¼%. And it will remain above 6% in 2011 as well. The same factors that initially inhibited a rise in unemployment will have the effect of curbing its decline during economic recovery.

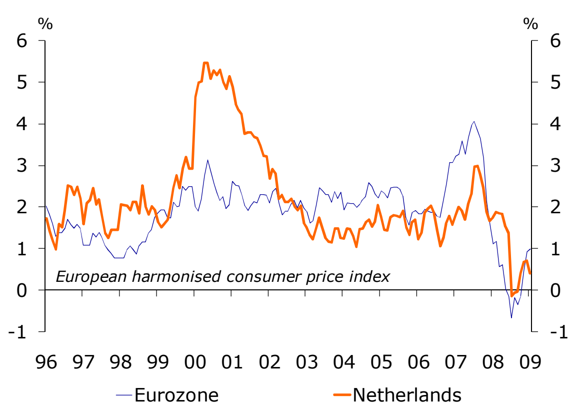
Inflation

After five months of rising inflation, the average rate at which prices were rising declined again in January, registering 0.8%. This decline in the rate of inflation can be chiefly attributed to a drop in energy prices in January, falling by over 17% compared to a year earlier. However, thanks to the recent rise in oil prices and the decline in the euro-dollar exchange rate, energy and fuel prices will go up again in the months ahead. Imported goods and services will likewise become more expensive on account of the weakening of the currency.

At the same time, the upward inflationary pressure is being counteracted by the excess capacity in the economy. Core inflation (which does not include food and

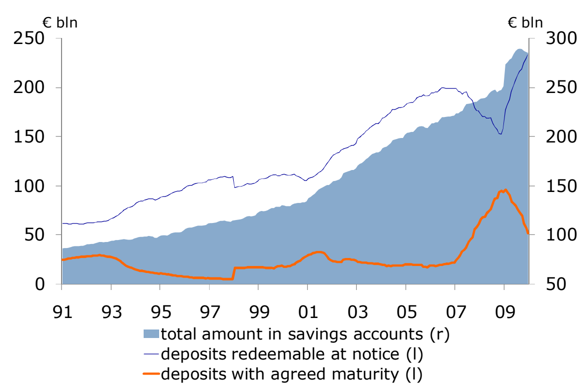
[1] For a comprehensive analysis of the differences between the situation on the labour market now and in the 1980s, see the article 'Het angstbeeld van de jaren tachtig', [The spectre of the 1980s] in the Rabobank publication 'Outlook on 2010'.

Figure 7: Inflation higher than EU average



Source: Statistics Netherlands

Figure 8: Decline in savings with banks



Source: Statistics Netherlands

energy prices) declined in the second half of 2009, amounting to 1% in January 2010. Declining investment in 2010 combined with consumer restraint will continue to put downward pressure on prices both this year and next, resulting in an expected inflation rate of only about 1% through 2011.

According to the harmonised EU calculation method, inflation in the Netherlands was below the eurozone average in December for the first time. In January the Dutch harmonised consumer price index was, at 0.4%, as much as half a percentage point below the eurozone average. For 2009 as a whole, inflation in the Netherlands was, by contrast, quite a bit higher than the eurozone average (Figure 7). This difference can be chiefly attributed to the delayed effect of oil price changes in Dutch energy prices.

Box 2: Consumers saving less with banks

In the last three months of 2009 the savings deposits of Dutch households declined by a total of some € 4.2 billion. It is unusual for more money to be withdrawn than deposited over a period of several months. The last time this occurred was in the autumn of 2005. The reasons for the decline in savings deposits cited by the central bank (DNB) are the lower deposit interest rate, higher yields on other markets and the deterioration of the jobs market. At the end of last year, there was a total of some € 285 bn in savings deposits in the Netherlands, which is 13% more than a year earlier. Since January 2009 Dutch households pushed up their bank savings sharply (Figure 8). Yet the decline in deposits is not reflected in additional consumer spending during the months of November and December 2009 (Figure 5).

Despite rising unemployment, consumer confidence improved considerably during the course of 2009. Although the still negative number reflects a largely pessimistic view of developments in the Dutch economy, the relative improvement of consumer sentiment in recent months may perhaps be a sign of less uncertainty. It was this uncertainty that induced households to increase their savings rate dramatically last year.

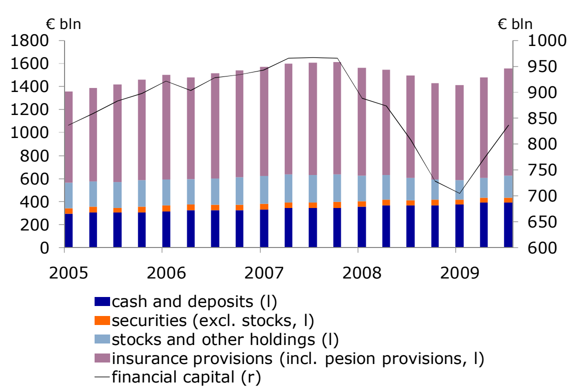
Consumer uncertainty is fed by a deteriorating labour market situation and by wealth losses. In 2008 the financial assets of households declined by about a quarter compared to the level of a year earlier (Figure 9). The drop in house prices in 2009 led to a decline in homeowner equity. A part of the losses incurred on the stock market was restored during the course of 2009. In the second and third quarters of 2009 financial assets rose by 9.4% and 8.4% respectively compared to the previous quarter.

The increase in bank savings deposits in 2009 occurred entirely in savings accounts without an agreed maturity. Deposits with an agreed maturity actually declined during the same period (Figure 8). A rise in non-high yield short-term savings accounts is typical of a period of considerable uncertainty. The recovery in confidence among consumers, combined with the record level of on-demand savings deposits may lead to additional spending in the coming months.

Government collapse creates opportunities, but also risks
Stumbling along. That is also true for the fourth Balkenende coalition that fell in late February over the issue of Dutch troops in Afghanistan's Uruzgan province. How soon a new cabinet can pick itself up remains to be seen from the elections and the government that is subsequently formed. There are dangers attached to a government collapse during a crisis, but equally, there are opportunities. The general election to be held on 9 June will compel the parties to clearly state their position on the policy proposals and measures that are aimed at restoring equilibrium to the government budget. Clarity on these issues is an important pre-condition for a restoration of confidence.

At the same time, cutbacks are not a popular election topic. The formation of a new cabinet means that political compromises may have to be made. And creating a new cabinet may, depending on the election result, prove to be a difficult and time-consuming process. In the meantime, the Netherlands is being run by a transitional government (or a rump cabinet, operating on sufferance) that has a merely gatekeeping function and does not take any key or controversial decisions. We will have to wait and see what this means for the introduction of the Crisis and Recovery Act, which still has to come before the Senate. Or the raising of the pensionable age, which until recently appeared to be a political fait accompli. Likewise, the (imminent) retrenchment proposals of the administrative work groups commissioned by the cabinet are likely to be shelved for the time being.

Figure 9: Large wealth losses



Source: Statistics Netherlands

Table 1: Key data

Year on year % change	2009	2010	2011
Gross domestic product	-4	1¾	1¾
Private consumption	-2,4	0	½
Government expenditures	3	¼	½
Private investment	-14,5	-5	2¾
Exports of goods and services	-8,4	5	4½
Imports of goods and services	-8,9	3½	3¼
Consumer price index	1,2	1	1
Unemployment (% labour force)	4,9	6¼	6¼
Government budget (% GDP)	-5,3	-6¼	-4¾
Current account (% GDP)	62	67	68
Saldo lopende rekening (% BBP)	6,8	7¾	7¾

Source: Statistics Netherlands, Rabobank

The Netherlands

In the meantime, in the absence of counteractive measures, the budgetary deficit will rise to some 6¼% of GDP this year. Likewise, the government debt, which is running at over 68% of GDP in 2010, is well above the EU limit defined in the Stability and Growth Pact.

To conclude
A robust recovery, which was cautiously hoped for late last year has not materialised at the start of this year. Although the economy has returned to growth, recent figures show a mainly stabilising trend. This is still good news in the wake of the dramatic figures of 2009. Equally, the fact that unemployment has not risen explosively to the extent feared should be a cause for optimism to many – particularly those who have a job.

It must be borne in mind that the recovery is virtually entirely driven by increased demand on global markets. And that increase is chiefly due to sizeable government stimulus packages, as well as the accommodating policy of central banks and the temporary boost to demand arising from a slowing of the pace of inventory reduction. In 2010 these factors will weaken. The domestic growth engine, consisting of demand from Dutch consumers and businesses for internally produced goods and services, is not yet up to the task of taking over the growth baton in 2010. This means that the recovery, which began so promisingly, will lose momentum during the course of the year.

After 2010 the consequences of the financial and economic crisis will continue to be felt in the Netherlands. The government has a large budget deficit on its hands, which needs to be addressed in the years ahead and turned into a surplus. This is necessary because of the additional budgetary pressure caused by population ageing and rising health care and pension costs, while at the same time the workforce that bears these costs is dwindling. The new cabinet will face a challenge in the order of many billions of euros. The required measures to achieve the necessary changes will be sometimes drastic and painful. They will be a heavy drag on economic growth during the coming years. Consequently, for economic recovery during the years ahead, it will be a case of stumbling along.

Anke Struijs
A.C.A.Struijs@rn.rabobank.nl