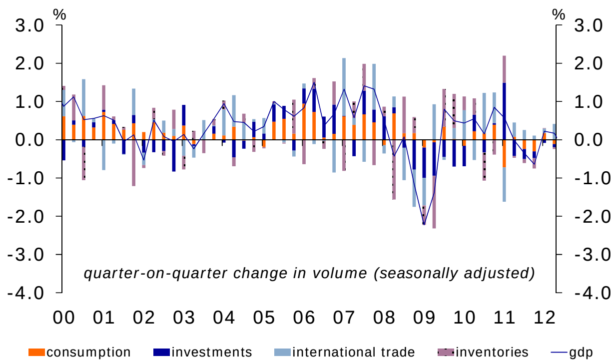
The Netherlands

Towards the elections

The Dutch economy has not yet managed to escape the mire, and faces rising unemployment, shrinking consumption, falling house prices and a lack of business investment. The coming months will be decisive in several respects. Not only is there the continuing uncertainty surrounding the European debt crisis, within the Netherlands the upcoming elections and subsequent coalition negotiations will be the determining factors for policy in the next few years. The economic recovery is expected to be slow in the next quarters, accompanied by the inevitable downside risks in the form of potential new developments in the European debt crisis. Our baseline scenario is that the Dutch economy will contract by ½% in 2012. The economy will return to mild growth in 2013, which is expected to reach ½%.

Figure 1: Low economic growth



Source: Statistics Netherlands

The size of the Dutch economy grew by 0.2% in the second quarter compared to the first quarter of 2012. This is the second consecutive quarter of growth; after a heavy upside revision to the provisional figure, growth in the first quarter also came to 0.2% due to unexpectedly strong growth in government spending.

Despite these two quarters of growth, the outlook is not so rosy. A strong increase in growth in world trade in May (2.5%) was followed by a contraction of 1.4% in June. So there is no strong growth in world trade over several months. Export volume rose 2.1% in the second quarter compared to the previous quarter. Imports also rose, but the 1.8% increase here was less than the growth in exports. Net trade thus made a net positive contribution to economic growth in the second quarter (Figure 1). However, domestic dynamics are still weak as consumers are reluctant to spend and businesses are hesitant to invest . The volume of private consumption was down 0.3% in the second quarter compared to the first three months of 2012. Investment volume fell 0.1% compared to a quarter earlier.

Foreign trade the decisive factor

Traditionally, the Netherlands has long been heavily dependent on the export of goods and services abroad. Since 2010, foreign trade has been the major driving force behind the economic recovery.

The Netherlands

Sales of goods abroad in the first six months of 2012 amounted to more than €215 billion, more than 70% of GDP and almost 6% higher than in the same period in 2011. A major proportion, more than 40% of this figure, concerns re-exports: goods originally imported here that leave the country with (virtually) no processing. These goods are mostly machinery, transport equipment and fabricated goods, such as clothing, furniture and various appliances. Many chemical products and mineral fuels are also imported and re-exported through the Netherlands. Due to the lack of processing involved, the added value of re-exports to the domestic economy is limited. Net trade (exports less imports) accounts for around 10% of GDP.

Approximately three-quarters of Dutch exports go to countries within the EU, and more than half of exports go to other euro countries. Despite the problems with the monetary union, the value of Dutch trade with other euro countries rose by approximately 2.5% in the first half of this year, compared to the same period last year. However, the increase with countries outside the eurozone was much higher, at around 11%. It is mainly the Asian countries that are largely responsible for the increase in world trade since the start of the economic crisis in 2009. Dutch exports to these countries have risen by nearly 30% in this period. In the first three months, trade with Asia thus accounted for roughly 10% of the total value of Dutch exports. Dutch exporters also benefited in the last six months from increasing exports to the United States, where the economic growth figures are relatively high.

The debt crisis in the eurozone has put the single currency under serious pressure: in mid-2012, the euro's exchange rate with our non-euro trading partners (adjusted for the difference in inflation) hit its lowest point since early 2002). The real effective exchange rate fell by around 3% in the first half of this year compared to the first half of 2011 and in June, it was trading at roughly 8% lower than its level in 2008 (Figure 2). The depreciated euro, which makes the prices of Dutch goods and services cheaper in other currencies, has generated strong growth in the volume of our exports of goods and services in the last two quarters. The volume of imports from abroad also increased over the last two quarters, but the increase was smaller than the increase in exports. This was because the price of foreign goods and services in euros has risen, and domestic spending has been under pressure for some considerable time.

As a result of the lagging growth in imports, the trade surplus – the difference between exports and imports - increased. In the first quarter of 2012, net goods trade was around 17% higher than in the same period in 2011. In addition, income from work and investments received by Dutch people from abroad was higher than income paid abroad, leading to an increase in the income account (see Figure 3).

As a result of the strong increase in the trade and income account surplus, the first-quarter current account surplus jumped to more than €17 billion (almost 12% of GDP). This is the highest net surplus of income over expenses ever recorded in the current account.

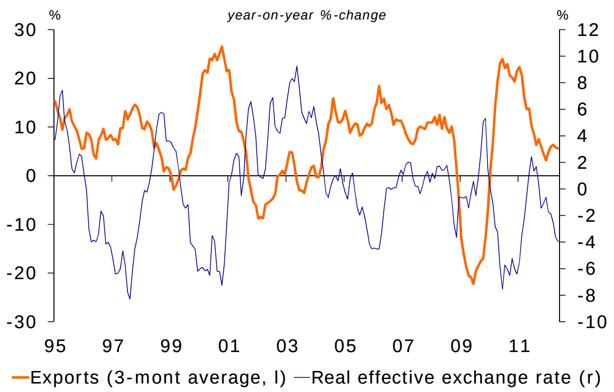
The weak euro and the strong first two quarters are expected to lead to a 4½% increase in export volume in 2012. Export growth will increase another 5% in 2013. Import volume will show a similar development. Import volume is expected to increase 3½% in 2012 compared to a year earlier and achieve 4% growth next year.

Brussels is watching

The European Commission created a new policy instrument called the Excessive Imbalances Procedure last year. The intention is to warn member states when macroeconomic imbalances are in danger of becoming excessive. The Commission can issue an instruction if necessary, and ultimately can impose a penalty if the recommendations are not or not adequately followed.

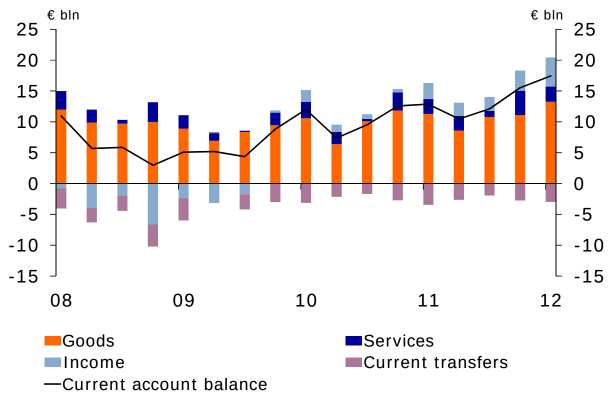
The current account deficit in the balance of payments is one of the ten indicators monitored by the Commission to identify signs of excessive imbalances. The indicative upper limit for the current account surplus is set at a 3-year average of 6% of GDP. If the current account surplus is higher than this signalling value, alarm bells will start to ring in Brussels. In the period from 2009 to 2011 the current account surplus in the Netherlands has been 6.5%, and our forecast is that it will rise further. Another indicator monitored by the Commission is the share of a country's exports in total global exports.

Figure 2: Exchange rate gives a helping hand



Source: Reuters EcoWin, BIS

Figure 3: Current account surplus increases



Source: DNB

The Netherlands

A contraction of more than 6% over a 5-year period is reason to investigate a country more closely. The Dutch economy's share in global exports decreased by 5.4% between 2005 and 2010, implying that it is close to the indicative value.

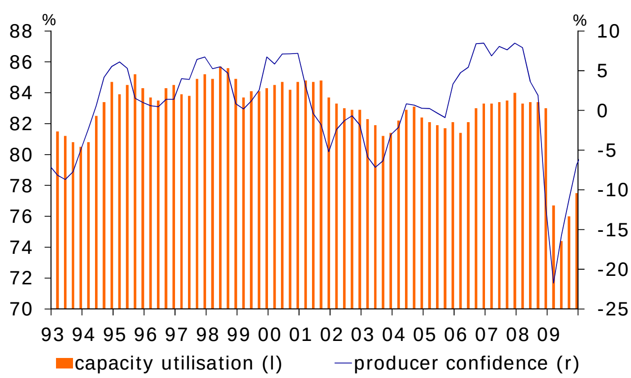
Another cause for concern in the Netherlands is the need to pay down debt. Both the government and the private sector have debt levels that are higher than the respective upper limits of 60% and 160% set by the European Commission. The paying down of debt, possibly in combination with reducing the current account surplus, could significantly restrain growth in the coming years, certainly in view of the fact that growth since 2009 has mostly been generated by foreign trade.

Producers are looking for customers

The lack of domestic demand and the uncertainties at home and abroad are not helping producers. Business confidence in the Dutch industry has almost continuously declined since the beginning of the year. The figure for producer confidence in August was -4.6. This represented a slight improvement since July, when the figure hit its lowest level since the beginning of 2010. A majority of producers expect production to fall in the coming months, and capacity utilisation of 78.8% is still well below the long-term average of 83% (Figure 4). Demand growth is very limited, both at home and abroad.

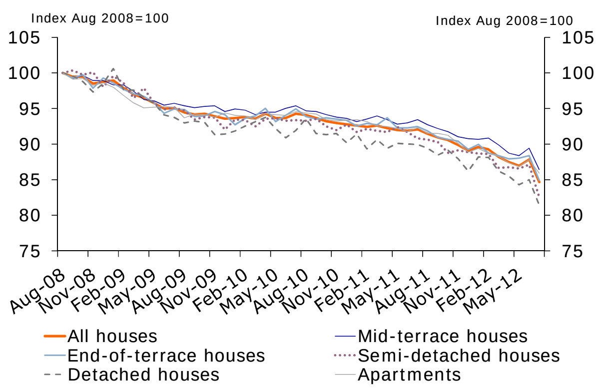
These developments mean that businesses are taking a very cautious to invest. The volume of investment is currently still more than 18% below its pre-crisis level. We do not expect total private sector investment to pick up any time soon; in 2012 there will be a contraction of 2¼% on average compared to 2011.

Figure 4: Low capacity utilisation



Source: Statistics Netherlands

Figure 5: House prices under pressure



Source: Statistics Netherlands

Investment volume will probably pick up slightly in 2013, but the estimated increase of 1% hardly represents a catching-up of growth.

Consumers refuse to play

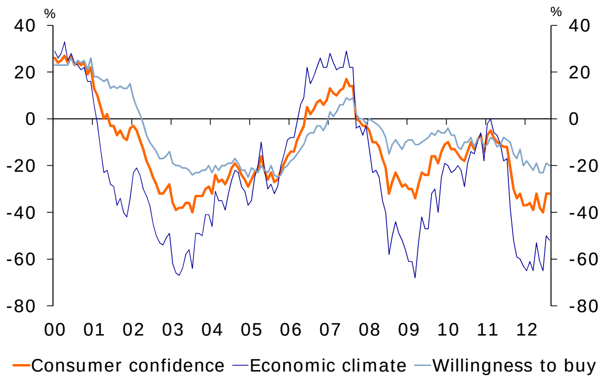
There was no change to the downward trend in private consumption in the second quarter. In volume terms, consumption is currently more than 4% below its pre-crisis level. Consumers moreover have little cause for optimism in the near future. Purchasing power has been under pressure for some time because wage growth cannot keep up with increasing prices. Consumers are also facing equity losses because house prices continue to fall, and are now some 15% lower than at the start of the crisis (see Figure 5). House prices are expected to decline further next year. Furthermore, there are uncertainties regarding pensions (see below), the debt crisis and government policy.

While consumer confidence is past its lowest point, at least for the time being, the August figure of -32 was still extremely low (Figure 6). Consumers are mainly pessimistic regarding the economic climate. A large majority thinks that the economic climate will deteriorate in the coming 12 months. As a result, consumers are unlikely to resume spending in the near future. Private consumption is expected to fall by 1% in 2012 and will remain at the same level next year.

Unemployment to rise further

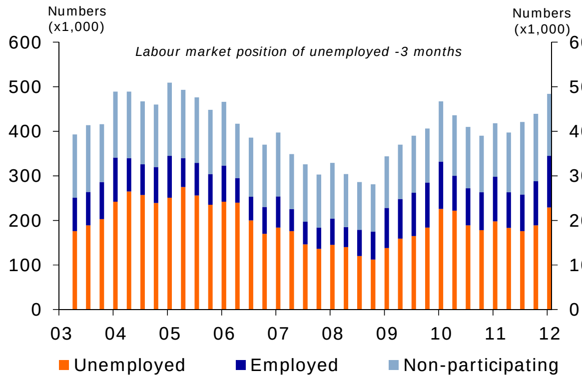
Unemployment has been rising gradually since the summer of 2011. The figure in July stood at 6.5% of the working population, an increase of 0.2% with respect to the previous month. There were thus 510,000 people who want to work for more than 12 hours a week without a job. This is an increase of 15,000 since May. The number of employed persons fell by 11,000, while the number of people looking for work (labour supply) rose by 3,000. This represents the fifth consecutive monthly decline in employment.

Figure 6: Consumers still pessimistic



Source: Statistics Netherlands

Figure 7: Unemployment duration increases



Source: Statistics Netherlands

The increase in the labour supply may be attributable to the fact that many students graduate or are approaching graduation during the summer and they have joined the ranks of those looking for work. The rise in the labour supply combined with a fall in employment explains the sharp increase in unemployment.

Since employment has been in a downward trend for months, it is getting more difficult for those unemployed to find a job. The effect of this is that it becomes more difficult for them to escape the situation of being unemployed, and on average they remain unemployed for longer. This trend is visible in the figures on the dynamics of the labour market. Almost half of the people unemployed in the first quarter of 2012 were also unemployed three months earlier (Figure 7). Their number has been increasing in recent quarters, and at 229,000 is now approximately at the previous high seen in early 2010. The number of people who had a job three months earlier and were unemployed on the reference date also rose in the first quarter. This is in line with the downward trend in employment which is causing an increase of the inflow in unemployment.

In the coming period, we expect businesses to continue to look for ways to cut costs driven by low capacity utilisation and declining profits. Among other things, this will also affect employee turnover. One of the straws in the wind is that expectations for the temporary staffing sector in the Netherlands are very modest. Employment is also under pressure in the public administration and government sector, where 27,000 jobs have been lost since 2010. The outgoing Rutte Cabinet among other things committed to €6.1 billion of cuts in the civil service in the coalition agreement of 2010, only a part of which have currently been implemented. So government jobs will also have to go in the near future. Unemployment is therefore likely to continue to rise for the rest of this year, reaching an average of 6½% for 2012 as a whole. A further rise to 7% is forecast for 2013.

Low discount rates are hampering pension funds

Many pension funds will be forced to curtail pensions at the beginning of next year due to low funding ratios (the ratio between assets and liabilities). Recently, four of the five largest pension funds in the Netherlands have already announced curtailments. The funds submitted recovery plans in 2008 whereby they committed to return their funding ratio to the required level within a 5-year period. But many of them will most probably not succeed as a result of low interest rates. The degree of pension cuts announced vary widely. Members of the civil service fund ABP are expecting a curtailment of 0.5% in 2013, probably followed by a much more significant curtailment in 2014. The curtailments announced by the metal industry funds PME and PMT for 2013 will be in the order of 6% to 7%.

Lower pensions reduce the disposable income of retirees and has a negative effect on consumption. Members of funds that are in poor shape could face significant cuts in their nominal pensions. In the case of sizeable curtailments, the pension regulator DNB (Dutch Central Bank) is allowing funds to spread the reduction by applying an initial curtailment of 7%, even though a higher cut is called for. The remaining pension cut will be postponed until the end of 2013. The uncertainty regarding the possibility of a second curtailment is expected to make pensioners more cautious as regards their spending.

Inflation subsides a little

The average price level in July was up 2.3% compared to the same month in 2011. Inflation was moreover 0.2 percentage point higher than in June. The rise was mainly due to higher rents and changes to the tax allowances for the purchase of new passenger vehicles (road tax or BPM). The BPM tax rules for CO_2 limits applying to passenger vehicles and motorcycles have been tightened as of 1 July 2012, increasing the tax on higher-emission vehicles. Inflation over 2012 as a whole is expected to be 2½%. We expect inflation to fall slightly over the rest of year, due to a lower contribution from energy and fuel (Figure 8). The VAT increase that will take effect in October will on the other hand push up average prices. The increase, from 19% to 21%, is expected to add ¾%-points to prices. The remainder of the increase will be at the expense of companies' profit margins.

Besides the increase in VAT, the duties on beer, wine and tobacco are also going up. This will lead to an additional price increase of around 0.1%-point. This rise is limited because these products collectively account for only 3% of total consumer spending. The upward pressure from higher VAT and duties on inflation will disappear in the second half of 2013. Fuel will also make a negative contribution to inflation next year. The forecast is that the average price level in 2013 will increase by 2%.

Elections cause uncertainty

On the day of the Queen's Speech, we will know the exact nature and scope of the restructuring measures discussed in the Spring Agreement. The five political parties that signed up to this agreement last May can in any case feel supported by favourable calculations by the Netherlands Bureau for Economic Policy Analysis, which predict a 2.7% budget deficit (EMU balance) in 2013. The approximately €12 billion in restructuring measures in the agreement will, according to estimates, be enough to meet the European budgetary rules. These state that the budget deficit in 2013 may not exceed 3%. Whether the deficit will actually remain within the European parameters is not certain, of course. There is a chance that various measures, including the commuting tax, will be scrapped or amended after the elections to be held on 12 September.

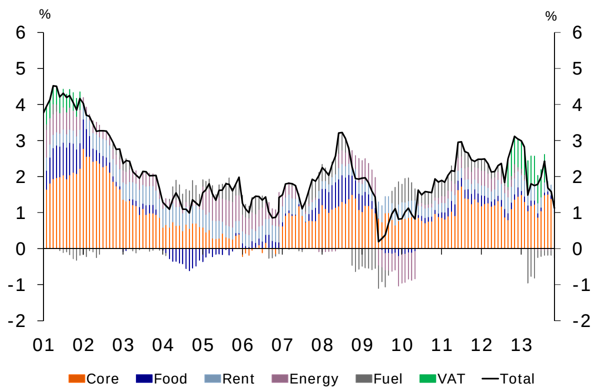
In addition, the potential for deterioration of the European debt crisis poses a serious risk to the Treasury.

The current economic circumstances demand a clear response from the government. Only when we have more certainty regarding what will happen to the housing market, health care and pensions will consumers be ready to resume spending. However, it does not look as though the period of uncertainty will come to an end just yet. The fragmented political landscape and the differences between the parties suggest that the coalition negotiations could be lengthy. The opinion polls indicate that forming a coalition with a majority after the elections will be no easy task for the party charged with forming a new government.

Conclusion

Despite two decent quarters, the Dutch economy is still plagued by weak domestic dynamics. Consumers and businesses are unremittingly pessimistic, and will not put the economy on the road to stronger growth any time soon. Furthermore, the cuts in government spending that are still to come will not be helpful to the economy in its current condition. The weaker euro will give some help in the form of an increase in net trade, but growth will only be slight because foreign demand will only pick up to a limited extent. The Netherlands faces an uncertain period over the coming months, which will be dominated by the elections and the euro crisis. We expect that it will be long after the elections on 12 September before we get the clarity regarding the course the government intends to take in the coming years that is so urgently needed.

Figure 8: Inflation subsides



Source: Statistics Netherlands

Table 1: Netherlands key figures

	2011	2012	2013
Year-on-year change in %			
Gross Domestic Product	1.1	-½	½
Private consumption	-1.0	-1	0
Government expenditures	0.1	-¼	-1
Private investment	8.9	-2¼	1
Exports of goods and services	3.9	4½	5
Imports of goods and services	3.6	3½	4
Consumer price index	2.4	2½	2
Unemployment (% labour force)	5.4	6½	7
Government budget (% GDP)	-5.0	-3.6	-2.7
Government debt (% GDP)	65.4	71.6	72.9
Current account balance (% GDP)	6¾	7¼	7

Source: Statistics Netherlands, Rabobank

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

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