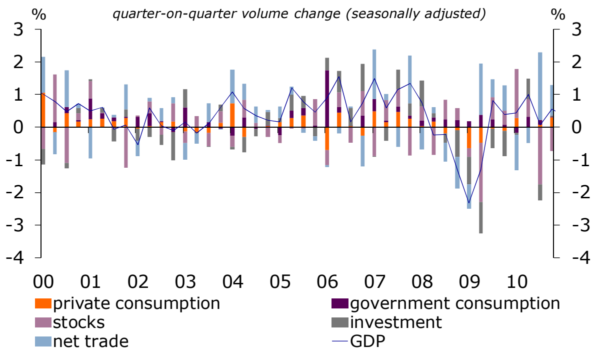
The Netherlands

Who will take over the driver's seat?

After contracting sharply by 3.9% in 2009, the Dutch economy grew in real terms by 1.7% in 2010. While the recovery has so far been driven primarily by exports, the Netherlands will not be able to count on as much growth from abroad in the years ahead. This gives rise to the key question: Who will take over the driver's seat? The Dutch government is going to cut spending, consumers will face tax and premium increases plus higher inflation and manufacturers will for now have little reason to invest on a large scale. Dutch economic growth is forecast to stand at 1½% in 2011 and 2012, which is slightly lower than in 2010.

Figure 1: Economic growth is picking up



Source: Statistics Netherlands

Moving forward step by step

Following a weak third quarter with economic growth of 0.1% quarter-on-quarter, there was a 0.6% rise in economic growth in the fourth quarter of 2010 compared to the previous quarter (figure 1). This brought real GDP growth for the full year 2010 to 1.7%. The gap in production left by the recession has, however, still only been about half filled. Real production is not anticipated to return to the pre-crisis level before the end of next year.

This situation is being caused by a slowdown in the economic recovery, with real economic growth forecast to be at around 1½% (year-on-year) both this year and next. This is due to various factors. For example, the effect of the inventory build-up, which accounted for more than 1% of growth in 2010, will be eliminated. The end of the recovery rally is in sight. Governments worldwide are planning to cut spending, which will cause the growth in world trade and the rise in the Dutch export volume to level off. This means economic growth will be driven less by the external sector in the years ahead and this will heighten the necessity for a recovery in domestic spending. But the Dutch government cannot be expected to spur that recovery. Dutch consumers are also expected to remain cautious. While investment will pick up, growth will not be exuberant.

Box 1: Wealth is more than GDP

The Dutch economy is recovering from the most severe economic crisis since the Great Depression in the 1930s. This recovery is, however, already beginning to lose steam. Should this give cause for concern? We do not think so.

Looking at GDP levels, we see that the size of the Dutch economy has grown continually over the years (figure 2). Measured by per capita purchasing power, Dutch consumers are four times as rich today as they were during the low point of the depression in the 1930s. And during the crisis of 2009, Dutch wealth only dropped back to the 2006 level. This was probably not the year in which many Dutch felt poor.

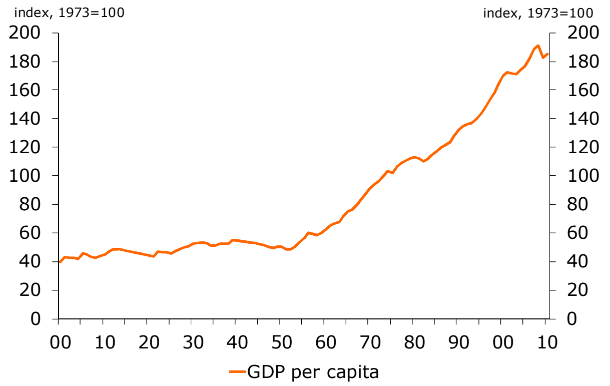
This shows that using GDP as a wealth indicator has its limitations. GDP only measures the economic actions of manufacturers, consumers and the government that are expressed in money. Wealth (or actually prosperity) encompasses much more in a broader sense. This is because people also have other needs besides consumer items that can be paid from income.
Examples of these other needs include a happy and healthy life, sufficient free time, a clean environment, safety and (political) freedom. These needs also gain more importance as people become richer because they will have already more than sufficiently fulfilled the primary needs for which income plays a major role. So sufficient income leads to increased demand for 'luxuries' such as those mentioned above. This means that, while GDP does provide an indicator as to the degree of wealth in a narrow sense, it says much less about the level of prosperity.

Even though the size of the Dutch economy has shrunk as a result of the economic crisis, this has not on average made Dutch citizens feel less healthy or happy (figure 3). This shows that while wealth may, narrowly speaking, only be growing step by step, the Netherlands still has a relatively good level of prosperity.

Will trade remain the driving force?
Dutch export volume rose in step with the strong recovery in world trade. Dutch export and import volume surged by 10.9% and 10.6% respectively in 2010 in comparison to the year before. Growth in world trade did, however, level off in 2010 and this was reflected in the development of the Dutch export volume. While Dutch exports were still up by 4.1% (quarter-on-quarter) in the first quarter of 2010, growth in exports fell to 2.1% in the fourth quarter of 2010 (quarter-on-quarter; figure 4).

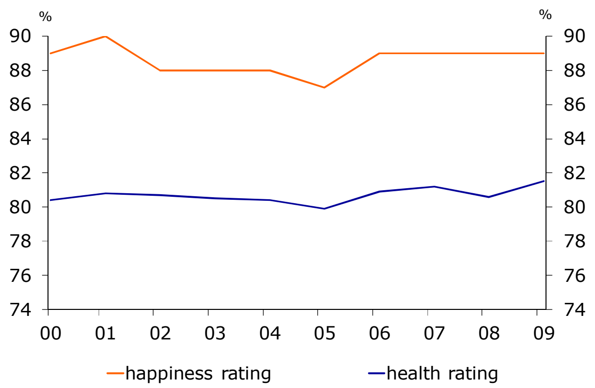
This trend is expected to continue this year and next. The Dutch export volume is forecast to rise by only 6¼% in 2011, with growth of just 4½% being projected for 2012. This decrease in export volume growth will also cause growth in imports to fall to 4¾% in 2011 and 3¾% in 2012. So while foreign trade will consequently continue to contribute positively to the economic recovery, the size of its contribution will decrease.

Figure 2: Growth in perspective



Source: Statistics Netherlands

Figure 3: People are not unhappier



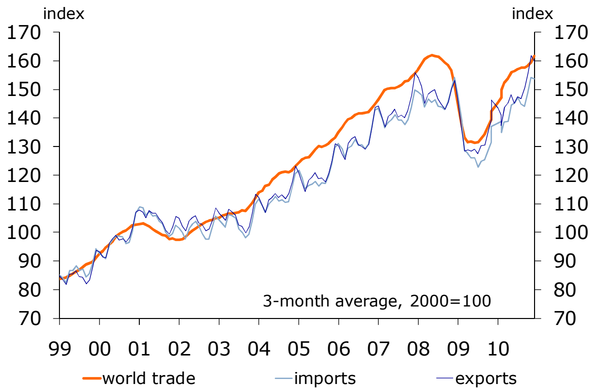
Source: Statistics Netherlands

The Netherlands

Box 2: Is the grass greener in Germany?
The German economy made a strong recovery from the Great Recession of 2009. GDP volume grew by 3.5% in 2010 compared to 2009, while growth in the Netherlands was 'only' half that amount. At an estimated growth rate of 2½% for 2011 compared to 2010, German economic growth is also set to be markedly higher than in the Netherlands this year. While Germany seems to be outperforming the Netherlands in the field of economic growth, is the grass really greener on the other side of the border?

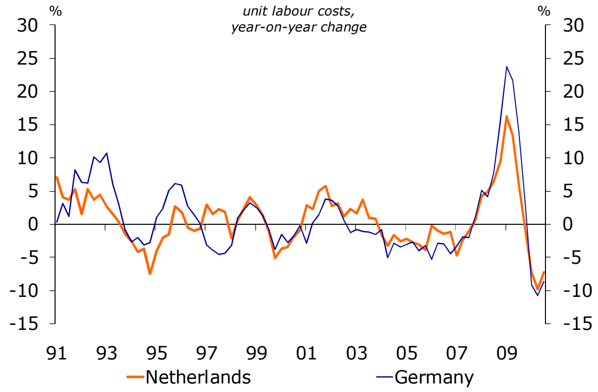
The German economy received a boost in 2010 from the strong pick-up in global demand and the related rise in the export volume. Even though the Dutch economy also benefited from this development, it did so to a lesser degree. The Netherlands is primarily reliant on trade with other European countries considering that some three-quarters of the country's exports go to EU countries, compared to approximately 60% of German export products. This is while countries outside the EU, particularly in Asia, have specifically been the ones that posted strong growth in recent quarters. Asian countries account for around 15% of German exports, nearly twice as much as in the Netherlands (8%). The Netherlands does, however, profit indirectly from Germany's trade success in Asia thanks to the fact that Germany is its most important trading partner, with around a quarter of Dutch exports going to the country.

Figure 4: World trade is levelling off



Source: Statistics Netherlands, CPB

Figure 5: Germany takes on the competition



Source: OECD

The Netherlands

The composition of total exports also differs between the two countries. Industrial products represent the lion's share of German exports, with capital goods accounting for nearly half of all exports. In contrast, agricultural products and energy account for only a limited part of Germany's total exports. The exact opposite is true in the case of Dutch exports. Industry in general and the automotive, machinery and metal industries in particular have profited substantially from the increased demand ensuing from strengthening world trade. Other sectors have benefited comparatively less from this development.

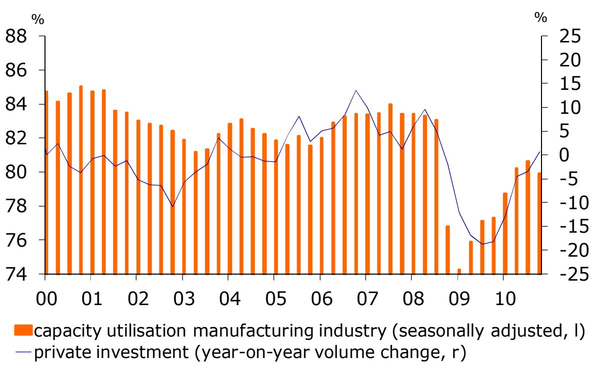
German wage development and labour productivity performance also contrasted favourably to that of the Netherlands in the years prior the crisis. Germany's performance in these areas led to a steep fall in the relative unit labour costs (figure 5). A decrease in relative unit labour costs strengthens international (price) competitiveness. Unit labour costs did, however, climb faster in Germany than in the Netherlands during the crisis.

The strong recovery of the German economy in recent quarters is consequently attributable primarily to the relatively large share of trade with Asia and the mix of products the country exports. So if the grass looks greener in Germany, it's because it is a different kind of grass.

Green lights for a recovery in investment, but still barely any movement

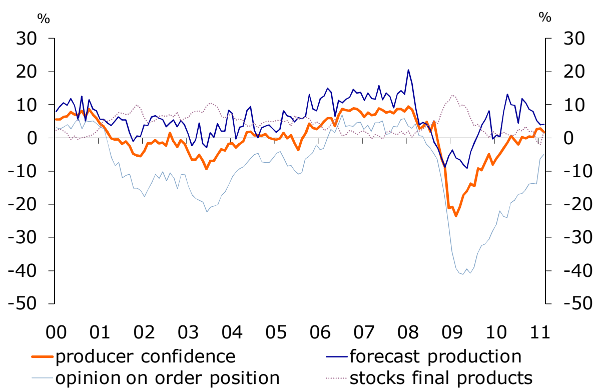
While the investment volume has decreased by more than 20% since mid-2008, there are now a growing number of green lights for an investment recovery. There has been a 6.3% rise in the volume of industrial production and improvement in the capacity utilisation rate of the production facilities due to the upswing in world trade (figure 6). There was also a profit recovery and more positive sentiment among industrial firms (figure 7). It consequently briefly seemed that investment would pick up as well in 2010, but the upswing turned out to be short-lived. We do, however, expect that Dutch companies will invest more in 2011 and 2012, with estimated growth in investment of 2¾% in both years. But this level of growth remains far from exuberant, particularly given the large drop that occurred during the crisis.

Figure 6: Virtually no increase in investment



Source: Statistics Netherlands

Figure 7: Manufacturers in a more optimistic mood



Source: Statistics Netherlands

The Netherlands

While the transport and wholesale sectors also benefited in 2010 from the increase in world trade, other sectors including the retail and catering sectors still encountered difficulties. This was because these sectors are much more dependent upon domestic spending and consumers were not yet really spending freely in 2010 (please refer to the following section). A slight recovery in revenue did, however, begin in the course of 2010 and this upward line will assumedly continue this year. The crisis in the construction sector was still clearly tangible last year and conditions are not expected to improve this year. We do not foresee a strong recovery in residential construction, nor do we expect investment in industrial and commercial buildings to pick up.

Figure 8: Uncertainty arouses urge to save

Source: CPB, Rabobank

Focus on consumers

Even though all eyes are focused on consumers, it appears that they will once again keep a tight grip on the purse strings in 2011 and 2012. Inflation is forecast to go up a bit in 2011 (refer to the following section) and as a result money devaluation will quickly overtake growth in wages and real wages will remain virtually unchanged this year. Healthcare premiums are forecast to rise sharply in 2011 and 2012[1] and real disposable income will come under further pressure due to the Dutch government's planned spending cuts, particularly after 2011. The uncertainty surrounding aspects such as pensions and the housing market are also arousing an urge to save. Since 2009, the savings ratio, i.e. the proportion of disposable income that is not spent, is once again rising after a downward trend that lasted for years (figure 8). The volume of consumer spending is forecast to rise by ¾% compared to 2010. This increase is partially due to a favourable spill-over effect connected with a relatively high level of growth of consumer spending in the fourth quarter of 2010 on account of increased natural gas consumption owing to the cold winter weather.

Consumer spending is not expected to increase by more than ½% in 2012 compared to 2011. The Netherlands has a history of lagging behind a number of other countries in terms of increases in consumer spending. The rate of real growth in consumer spending in France has, for example, been much higher than in the Netherlands for the past ten years (figure 9). While the Germans gained the same reputation as the frugal Dutch in recent years, it now seems that nothing stands in the way for German consumers to spend freely. The German economy is, after all, the fastest-growing of all the EU countries and German consumers have saved considerable amounts of money and have spent very little extra money over the past few years.

[1] *Zorgpremie stijgt volgend jaar weer met zes tientjes* (Healthcare premiums to rise by EUR 60 again next year), *Het Financieele Dagblad*, 24 February 2011

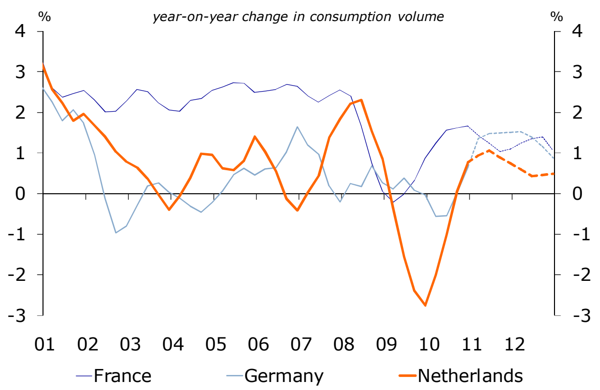
The Netherlands

Labour market: tight, tighter, tightest

There are, however, still reasons for Dutch consumers to be optimistic. Unemployment has been falling since March 2010 and is among the lowest in the EU (figure 10). The seasonally adjusted unemployment rate was 5.1% in February 2011, compared to 5.8% in February 2010. Employment is, however, only expected to recover on a limited scale due to government spending cuts and the levelling off of economic growth. A further fall in unemployment will also be unlikely if people out of work who were too discouraged to look for employment due to the recession, and were consequently not officially included in the unemployment rate, get up the courage to start looking for work again. Unemployment is hence expected to hover at around 5% in 2011 and 2012.

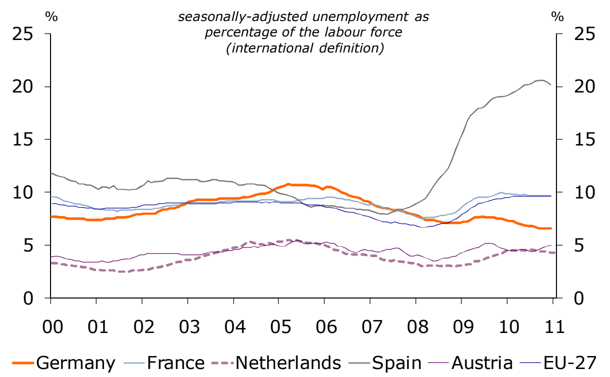
Dutch unemployment is relatively low, partially due to the fact that many companies had difficultly recruiting good employees before the crisis owing to the tight labour market. With this still fresh in their minds, companies were more reluctant to lay off professionals that they had only recently been able to recruit with great effort. The need for good employees will grow further in the years to come as the labour supply decreases due to an ageing population. Many companies will consequently face an outflow of older employees. This year will mark the turning point. The first baby boomers will reach the pensionable age of 65 in 2011 and many more will follow in the years to come. The pensionable age will only start being gradually raised in 2020. This means the chief solution to the ageing population issue will not be put into effect for a number of years. Many companies will therefore be faced with increasing shortages in the labour market and the challenge of keeping older employees active and productive for longer.

Figure 9: Dutch are frugal



Source: Reuters EcoWin, Rabobank

Figure 10: Lowest unemployment in EU



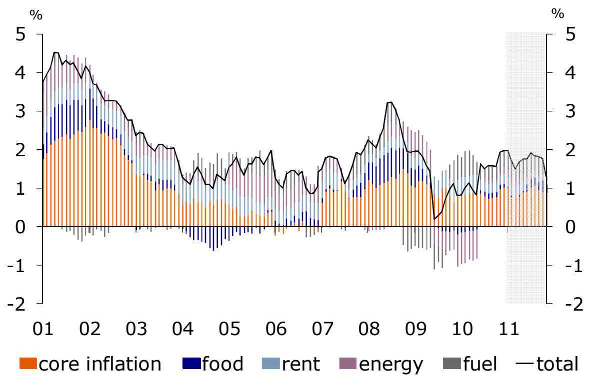
Source: Statistics Netherlands

The Netherlands

Fuelling inflation

Inflation climbed to the highest level in two years in January 2011, with prices an average of 2% higher than a year earlier (figure 11). Inflation totalled 1.3% for the full year 2010, compared to 1.2% in 2009. The money devaluation has increased particularly since the second half of 2010 due to higher energy and fuel prices. The contribution of energy and fuel prices to inflation is expected to remain high in 2011 owing to the delayed effect that higher oil prices have on Dutch energy prices. While the upward pressure on food prices is currently limited, this situation will most likely change in the year ahead. Food prices have been rising rapidly on the world market for the past several months and it usually takes a while before these price increases are reflected in Dutch retail store prices. The domestic pressure on Dutch price levels, i.e. the core inflation, is expected to remain limited. After all, businesses currently have restricted scope for asking higher prices considering the relatively slow economic recovery. There is, however, a danger that incidental wage increases will rise in the upcoming period due to the already tight labour market in certain segments. All things considered, we expect inflation to total 1¾% in 2011 and 2012.

Figure 11: Rising inflation



Source: Statistics Netherlands

The government money faucet will be gradually turned off

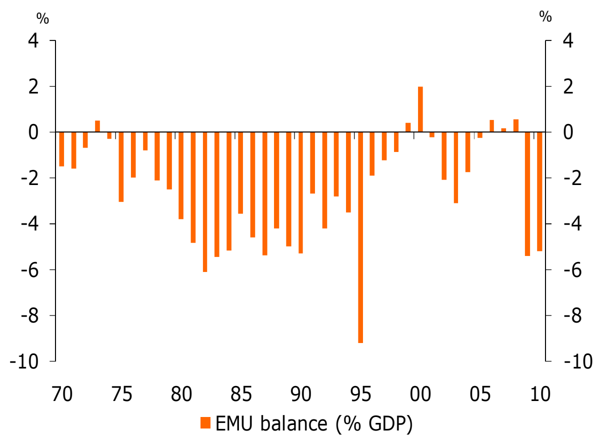
Government spending will not carry the economy in the years ahead. The stimulus policy implemented by the government during the crisis has caused Dutch government finances to deteriorate drastically. The Dutch government now has to get its finances back in order and presented the necessary plans for spending cuts in its coalition agreement. Consolidation remains necessary despite the financial windfalls of the past year that will likely mean the budget deficit will ultimately be lower than originally forecast (5.2% instead of 5.8%, figure 12). The Dutch government will hopefully not fall into the trap of reducing spending cuts if there are better-than-expected budget balances. The Dutch government's plans will not, on balance, meaningfully lower spending in 2011, but will result in significant reductions in 2012. Government income will conversely rise in the years ahead due to a strengthening economy and the accompanying higher tax revenues. These developments will lead to a substantial improvement in government finances. The budget deficit is expected to fall to -3½% and -2¼% in 2011 and 2012 respectively. The structural government balance, i.e. the balance adjusted for economic developments, will decrease sharply as the former government's stimulus package expires.

It must, however, be noted in this regard that the present government's effectiveness could be restricted if it fails to gain a majority in the Upper Chamber of Dutch Parliament. The coalition partners most likely did not win enough votes in the Provincial States Elections held in early March to secure a majority in the Upper Chamber. There will not be certainty as to whether the coalition partners will or will not gain the 38-seat majority until the members of the Provincial States vote on 23 May. The absence of a majority would call into question the implementability of the government's policy. This is because the Upper Chamber is able to delay or block bills. The government would then consequently have to find a majority in the Upper Chamber for each of its proposals.

In conclusion

It remains to be seen who will take over the driver's seat from international trade now that the first round of the recovery is nearing completion. Right now it looks like there will not be another driver waiting when it comes time to pass the wheel. The Dutch government is going to consolidate. Dutch consumers are wary of spending money in the face of far-reaching uncertainties regarding tax and premium increases, inflation, pensions and the housing market. And businesses lack the necessity to invest on a large scale. International trade will therefore continue to be the main engine behind the economic recovery in 2011, but it will be running in a lower gear. The outlook for a slower economic recovery is, however, still better than the most probable alternative: a bumpy recovery with new setbacks. The euro crisis has not yet been resolved and unrest in North Africa and the Middle East is creating large-scale uncertainty worldwide. With international trade as the key driving force, the recovery of the Dutch economy is extra vulnerable to the associated risks. This is why the motto for 2011 is: Better half an egg than an empty shell.

Figure 12: Windfall for treasury



Source: CPB, Ministry of Finance

Table 1: Key figures Netherlands

	2010	2011	2012
Year-on-year % change			
Gross domestic product	1.7	1½	1½
Private consumption	0.4	¾	½
Government expenditures	1.0	0	-½
Private investment	-4.9	2¾	2¾
Exports of goods and services	10.9	6¼	4½
Imports of goods and services	10.6	4¾	3¾
Consumer price index	1.3	1¾	1¾
Unemployment (% labour force)	5.4	5	5
Government budget (% GDP)	-5.2*	-3½	-2¼
Government debt (% GDP)	64*	66	66½
Current account balance (% GDP)	5.5	6½	7

* Preliminary data

Source: Statistics Netherlands, Rabobank

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