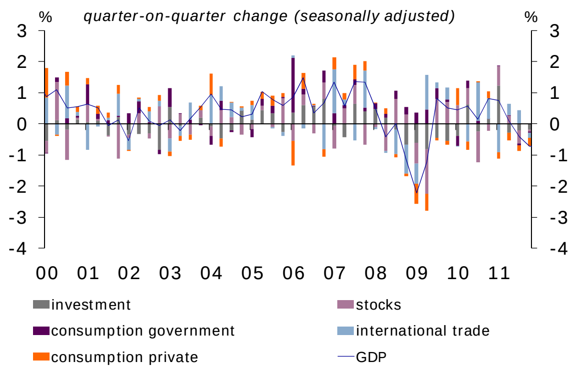
Netherlands

Always look on the bright side

Everybody saw it coming and now it is here: the Dutch economy is back in recession. After a quarter-on-quarter contraction in the third quarter of 2011, the size of the Dutch economy shrank by 0.7% in the last quarter of 2011. But this is still no reason to give up. The Dutch economy is expected to pick up again in the course of 2012, even though the quarter-on-quarter growth figures will likely be meagre. We forecast average contraction in real terms of ¾% for 2012 as a whole compared to 2011. Gross Domestic Product (GDP) is expected to increase by 1% in volume in 2013.

Figure 1: Netherlands in recession



Source: Statistics Netherlands, Rabobank

Netherlands in recession

Even though the Dutch economy had not yet recovered fully from the dip in 2009, the economy is once again in a new recession. While a decrease in the volume of the economy in the fourth quarter of 2011 was to be expected, the degree of contraction ended up being more negative than anticipated (figure 1). It already became obvious in 2011 that net foreign trade would no longer be able to drive the economy on its own due to stagnating growth in world trade. Consumers, producers and the government did not, however, contribute to growth. In the second half of 2011, Dutch consumers were faced with a further stagnating housing market, mounting uncertainty regarding future pension payments and rising unemployment. Autumn 2011 was also marked by European and Dutch political developments: the European debt crisis continued and, due to worse-than-expected growth resulting in part from the European debt crisis, the Dutch government must introduce additional austerity measures on top of the planned € 18 billion in spending cuts in order to fulfil both its and the European budget rules. All these factors impacted sentiment among consumers and caused them to curb their spending. Without the revival of ‘animal spirits’ of consumers, the companies focused on the domestic market also have few impulses to invest. The export-focused business community also has little reason to invest in new production capacity in view of stagnating growth in the volume of world trade.

The current recession does not, however, give reason to despair. Sentiment has turned a good deal more positive on the financial markets in any case. This is above all thanks to the European Central Bank (ECB) that introduced a new long term refinancing operation (LTRO) for the banking industry in December. This move reduced fears that less strong, but still solvent banks would face liquidity problems.

Banks also used part of the liquidity on the money market to buy government bonds from the periphery countries. The second longer term refinancing operation (LTRO) in late February buoyed confidence further. The markets welcomed a higher voluntary haircut on privately held Greek debt. The ensuing easing on the financial markets led to rebounding stock markets. The financial markets consequently appear to be giving policymakers the time to work on a solution for the European debt crisis. Clarity is the magic word for 2012. Clarity regarding a range of current issues on the European and Dutch front could make consumers prepared to start spending the euros they have. But they have not got a lot of room for manoeuvre. Consumers' individual savings rate (available income[1] minus consumer spending as a percentage of available income) is on average only marginally positive in the Netherlands. Recovering consumption can nonetheless improve the future prospects of businesses, which will in turn give them an incentive to invest. Dutch government spending cannot be expected to provide any boost whatsoever in the years ahead.

According to our estimates, the Dutch economy continues to show some volume contraction in the first half of 2012, but to a much lesser degree than in the fourth quarter of 2011. Economic growth will also then pick up slightly in the subsequent period. The average size of the Dutch economy is expected to shrink for the full year 2012 by ¾% in real terms compared to 2011. This sharp decline is due primarily to the negative spill-over effect[2] (at -0.7) from 2011. The spill-over effect will conversely be positive in 2013 and net trade will once again boost the Dutch economy. We nonetheless foresee only a modest real year-on-year growth of 1% in 2013.

Net trade no longer carries the economy

The Netherlands has been one of the world's top-ten largest exporters for years. The workings of the Dutch economy are consequently strongly dependent upon international trade. The interconnectedness has also increased through time, which has made the Netherlands more and more vulnerable to loss of international demand. The share of re-exports[3] within total exports has become increasingly larger. Re-exports accounted for approximately 50% of all exports of goods in 2011 (figure 2). This is a high percentage from an international perspective, which can partially be explained by the Netherlands' geographical location bordering the sea, the good infrastructural connections to the European hinterland and the high purchasing power of its neighbouring countries. The value added of re-exports after deduction of purchases from abroad is

[1] The income that is left over after payment of taxes for income and capital and social and pension premiums.
[2] The contraction at the end of 2011 has a negative effect on growth this year.
[3] Goods produced elsewhere that are first imported into the Netherlands and then exported abroad without virtually any processing.

consequently limited (7.4 cent per euro re-exports in 2009). Exports of goods and services produced in the Netherlands contributes considerably more to the Dutch economy (respectively 58.5 cent per euro exports of goods and 75.5 cent per euro exports of services 2009, Kuypers et al, 2012)[5]. Exports of Dutch products have, however, lagged behind the growth in the (relevant) world trade for years (figure 3). This implies the Netherlands is losing market share in the markets in which it is active. But this development is not surprising given that the fast-growing emerging countries are becoming increasingly important players on the world market. The Netherlands does not currently notice the effects of this to an overly great extent because most sales markets are fortunately still growing in size. The Netherlands' price competitiveness , measured on the basis of the nominal and real effective exchange rate, has improved in recent years.
The world trade volume barely increased in the fourth quarter of 2011, nor did it in the rest of 2011. This was attributable to the situation on the financial markets, government spending cuts and the high oil price in the highly developed economies. The emerging markets reached the limits of their production capacity and faced monetary contraction. The limited growth in the volume of world trade meant that import and export volumes in the Netherlands also scarcely changed by only 0.2% and -0.1% respectively. The contribution of net trade to growth was also negative (-0.2%-point). Growth in world trade will presumably remain limited in 2012 because the above factors will continue to leave their mark. According to our estimates, the import and export volume will increase by 1% and 1¾% respectively.

[5] Kuypers, F., A. Lejour, O. Lemmers and P. Ramaekers (2012). Characteristics of re-export companies. Netherlands Bureau for Economic Policy Analysis/Statistics Netherlands, The Hague/Heerlen.

Figure 2: Share of re-exports of goods has increased

Source: Statistics Netherlands

Figure 3: Growth in exports is lagging behind growth in world trade volume

Source: Statistics Netherlands, Netherlands Bureau for Economic Policy Analysis

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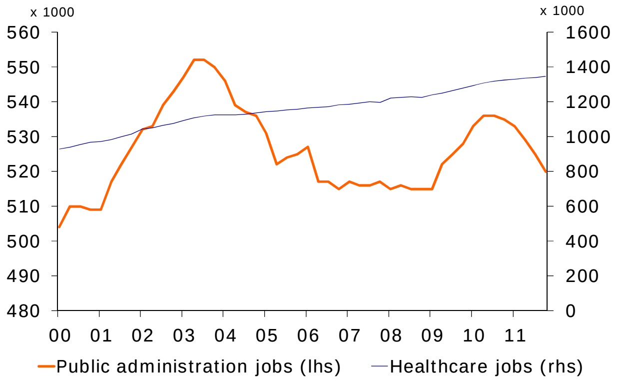
Worldwide economic growth is expected to pick up in 2013 and this will spur a further increase in the volume of world trade. The Netherlands is primarily reliant on increasing growth in Germany, Belgium, France, the United Kingdom and Italy because they are its key trading partners both in terms of re-exports and exports of Dutch products. This will cause the import and export volume to rise by 4¼% and 5% respectively.

Figure 4: Number of government jobs decreases



Source: Statistics Netherlands

No more sacred cows

The Dutch government's restrictive budget policy also contributed to the contraction in the fourth quarter of 2011. The Dutch government consumed 0.1% less in real terms than in the third quarter. It has implemented a range of spending cuts, including reducing the number of civil servants (figure 4).

The budget deficit is expected to amount to 4½% of GDP in 2012, while government debt will rise to 69½% of GDP. Due to disappointing economic growth data, the Dutch government will be unable to escape introducing additional austerity measures in 2013 according to its own budget rules. Providing the policy remains unchanged, the budget deficit is expected to equal 4½% of GDP, while a deficit of 1.8% was forecasted at the beginning of this government's term. The Dutch government will have to introduce more than 9 billion euros in additional spending cuts because the current figure deviates more than 1%-point downward and the budget deficit must be reduced to at least 3% according to European budget rules. It will in practice have to implement further spending cuts because so-called earn-out effects will have to be taken into account. This relates to the fact that the spending cuts will place pressure on growth, which will in turn cause government finances to deteriorate further. In our view the Dutch government should take a reserved approach to piling up spending cuts and/or tax and premium increases as this would have a procyclical effect on the economy and would not ultimately help government finances. It would be better to implement credible structural reforms that would also produce sufficient proceeds for the treasury after the current period of government (please also refer to the Government finances: Reforms or spending cuts theme elsewhere in this publication).

Wanted: Companies that invest

The Dutch are known as a thrifty nation. The Netherlands has had a surplus on the current account for time immemorial (figure 5). This implies that in the Netherlands more money is earned than is spent (a national savings surplus).

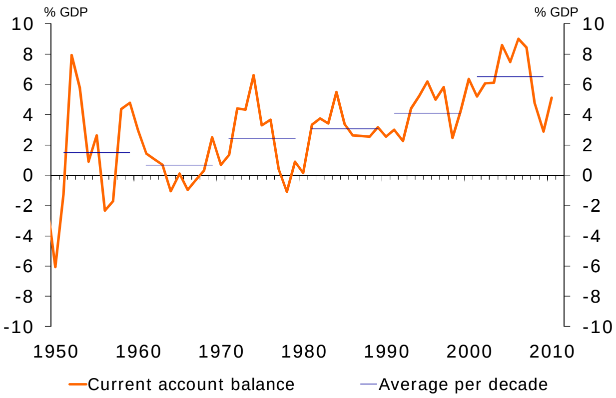
The savings surplus has, however, no longer on balance been hoarded by households since the start of this century, but is now due solely to the savings penchant of non-financial companies (figure 6). Research conducted by Schotten and Leering (2012)[6] reveals that companies use these savings surpluses primarily for foreign direct investment (FDI) and increasing liquidity. So while companies have the scope to invest, these investments barely get off the ground in the Netherlands. The figures from the fourth quarter of 2011 paint the same picture: the private investment volume fell by 1.3% and this resulted in a negative contribution to growth of 0.2%-point.

The Netherlands needs companies that want to invest domestically, but it remains to be seen whether they can be found at this time. The capacity utilisation rate still remains below the long-term average due to limited growth in domestic and foreign demand for Dutch products. The underutilisation of available production capacity and a decrease in order receipts translate into a limited necessity to invest. Business investment will pick up in the second half of 2012 in line with the forecasted international economic recovery and the accompanying recovery in demand. This will, however, not be enough to bring about an increase in the investment volume on an annual basis: we foresee contraction of 2¼% for 2012. We are more optimistic for 2013 due to the global economic recovery and expect growth to amount to 2% in that year.

The recovery in investment is slow in comparison to previous periods of investment recovery. This is caused by the expected disappointing

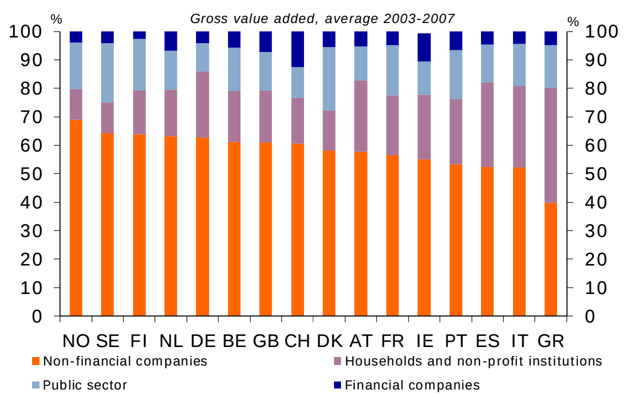
[6] Schotten, G. and R. Leering (2012). The puzzle of the Dutch savings surplus. www.mejudice.nl, February 2012.

Figure 5: Current account surplus



Source: Statistics Netherlands

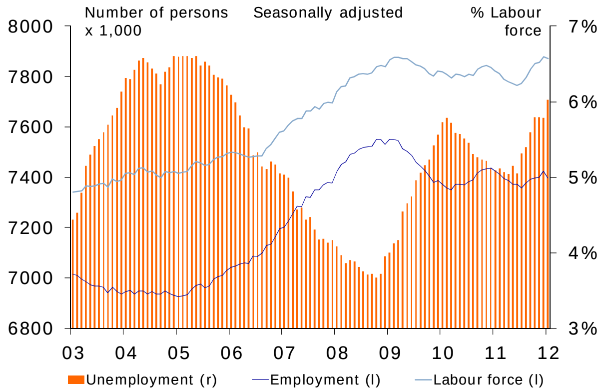
Figure 6: Savings drive non-financial companies



Source: Statistics Netherlands

development of demand, which means companies expect little in the way of new capital goods purchases. If the returns these companies can realise through the investment goods are lower than the costs attached to the investment, there will be little reason to invest. There have also been few groundbreaking technological improvements in recent years and there may consequently be a low incentive to invest in capital goods.

Figure 7: Rising unemployment



Source: Statistics Netherlands

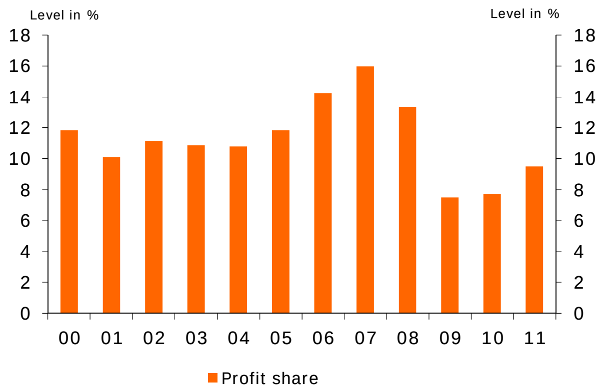
Labour market

In keeping with their sombre outlook, Dutch companies are aiming for a more efficient deployment of personnel. This is reflected in a number of factors, including the decreased number of vacancies and the sharply lower employment forecast survey results. In January 2012, there were 474,000 jobless persons in the Netherlands who wanted to work more than twelve hours a week, 18,000 more than in December 2011. The labour supply fell by 7,000 persons in January, while employment decreased by 26,000 persons. The fact that the decrease in employment was much greater than the decrease in the labour supply caused the seasonally adjusted unemployment rate to rise to 6.0 (figure 7). This suggests that a change has taken place in the labour market situation. While unemployment has been climbing since July 2011, this was until December due to the fact that the number of persons looking for work rose more quickly than the number of jobs. Employment will, however, come under pressure in the remainder of 2012, which will make it more difficult for unemployed persons to find a job. In January no less than three-quarters of the Dutch population expected unemployment to rise further in the coming year.

The relationship between developments in production and employment is dependent upon the economic state of affairs. In the period preceding the Great Recession there was a tight labour market and this is why companies were prepared to keep employees in service during the crisis. While this resulted in a considerable drop in labour productivity, companies had sufficient reserves to absorb this. The current recession may have a greater negative impact on employment. While businesses in the non-financial sector still have financial scope with respect to solvency, profitability has deteriorated.

The profit share of production in the Netherlands stood at 13.4 in 2008, but dropped to 9.4 in 2011 (figure 8). The Dutch labour market is also considerably less tight at the moment. The number of businesses in January that expected to reduce their workforce in the coming three months exceeds the number that expected to increase their workforce. Employment in the market sector is shrinking because production is not expected to pick up. Planned reductions in the numbers of government workers will lead to a decrease in employment in public administration and education as well, although there is still expected to be an increase in healthcare. The labour supply is anticipated to remain approximately on the same level. On the one hand, some employees are discouraged and others are leaving the labour market due to ageing. On the other hand, the labour force participation rate is increasing, albeit to a lesser degree than in the past. This will cause unemployment to rise further to 6½% this year. This situation is not forecast to change in 2013 because employment will pick up again due to the economic recovery.

Figure 8: Profit share has fallen



Source: Netherlands Bureau for Economic Policy Analysis

Wanted: Spend-happy consumers

Dutch households consumed 0.6% less in the fourth quarter compared to the third quarter of 2011. This is not surprising considering the extremely low level of consumer confidence. On the one hand this low consumer confidence is related to economic developments. In recent months consumer purchasing power has dropped further , capital (share prices and house prices) came under pressure and unemployment increased. On the other hand weak consumer confidence is also caused by consumers' emotions. The bad news stacked up in recent months, making consumers fearful and uncertain. This caused them to postpone purchases, even though as we said before spend-happy consumers are needed more now than ever (Van de Belt, 2012)[8]. Many of the aforementioned factors will continue to play a role in 2012. Real available income is expected to develop negatively owing to disappointing growth in wages and employment and (additional) tax and premium increases. There is also still not a recovery in the housing market: house prices are forecast to fall by an average of 5% (although 2.5% of this is due to the spill-over effect from 2011).

[8] Van de Belt, R. (2012). Consumers let themselves be talked into the doldrums. Special Report 2012/02, Rabobank Nederland.

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Rising unemployment may also make consumers fearful to spend. They prefer to save a precautionary amount that they can use to absorb a potential loss of income in the future. Total consumption volume is expected to decrease by 1¼% in 2012. Purchasing power will remain under pressure in 2013 due to supplementary tax and premium increases. What's more, 103 pension funds are under threat of having to reduce pension payments. Consumption is forecast to decrease as a result by ½%. In order to revive consumption, it is important for consumers to both overcome their insecurity and have enough money to spend. Forced wage restraint is consequently a poor and unnecessary idea in this light. It not only further weakens domestic spending, it is also unnecessary in order to maintain businesses' profitability.

Table 1: Netherlands key figures

	2011	*2012*	*2013*
Year-on-year change in %			
Gross Domestic Product	1.2	-¾	1
Private consumption	-0.9	-1¼	-½
Government expenditures	0.4	-1	-1¼
Private investment	5.8	-2¼	2
Exports of goods and services	3.7	1¾	5
Imports of goods and services	3.5	1	4¼
Consumer price index	2.4	2¼	2
Unemployment (% labour force)	5.4	6½	6½
Government budget (% GDP)	-5	-4½	-4½
Government debt (% GDP)	65.4	69½	73
Current account balance (% GDP)	6¾	7¼	7

Source: Statistics Netherlands, Rabobank

Inflation

Inflation stood at 2.5% in January. The contributions of food, energy and fuel prices will decrease in the course of the year. The oil price is also forecast to decrease slightly and we expect the euro to appreciate against the dollar, which will make the oil price lower in euros. The limited growth in wages means labour costs contribute only negligibly to higher inflation. The same thing applies on the demand side. Domestic demand is weak and as a result the production capacity is not fully utilised. This makes businesses more likely to initiate price competition rather than to introduce price increases. The average price level is forecast to rise by 2¼% in 2012. Inflation will fall to 2% in 2013 because the contributions of food, energy and fuel prices to money devaluation will decrease further.

Conclusion

The Dutch economy is once again in a recession. The export engine is sputtering and domestic spending is lagging. But giving up is not an option. There is fortunately hope on the horizon. The rise in unemployment remains within the limits, the economy is forecast to pick up again in the second half of this year and the Netherlands is expected to attain modest economic growth in 2013.

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