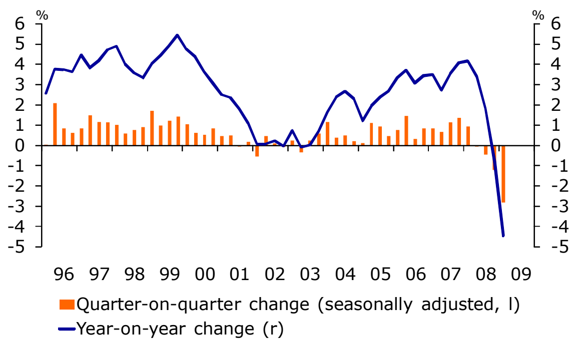
The Netherlands

Recession rages on

Both the speed at which the Dutch economy is deteriorating and the depth of the recession are unprecedented. Businesses in the Netherlands are being confronted with falling domestic and external demand. Dutch households are in turn being hit by a significant drop in wealth and rising unemployment. The Dutch economy is going through a deep downturn this year and is expected to contract by 6% in real terms in 2009. It is forecast to contract further next year and this will drive up the total loss of per capita income in the Netherlands since early 2008 to more than 7%. The only bright spot is that it appears that the worst of the economic contraction has now passed.

Figure 1: Extremely poor performance in first quarter of 2009



Source: CBS, Rabobank

One swallow does not make a summer

The global economy decelerated dramatically in the second half of 2008 and economic activity consequently dropped to a new low point in the first quarter of 2009 in virtually all countries worldwide. The Dutch economy also experienced a sharp decline (figure 1). After a very weak first quarter, we adjusted our outlook for the Dutch economy substantially downward. This was necessary given the fact that the Dutch economy had contracted by 4% in the first quarter alone, surpassing our original forecast for economic contraction for the full year. The volume of the Dutch economy shrank by 2.8% (quarter-on-quarter) with the negative spill-over effect from 2008 accounting for 1.2%. With three quarters remaining in 2009 and few signs of recovery, we believe the Dutch economy could ultimately contract by 6% in 2009 in comparison to 2008.

While hope is slowly but surely being placed in encouraging signs, particularly in the United States, one swallow does not make a summer in the economy. We are convinced that it is still too early to herald the end of the current recession based on the recent positive signals. These signals more likely indicate that the economic freefall that began in the autumn of 2008 has started to slow down. We would only be able to refer to real economic recovery if the positive trend were to continue in the months ahead. This, however, appears unlikely because the current low levels of nearly all the leading indicators suggest continued economic contraction in the months ahead.

The Achilles heel of the Dutch economy has been hit hard

When the Dutch economy is prospering, exports are the key driver of economic growth and account for around a third of all the added value for the economy. But now that global trade has come to a virtual standstill, growth in exports has plunged deeply into the red for five consecutive months since November 2008.

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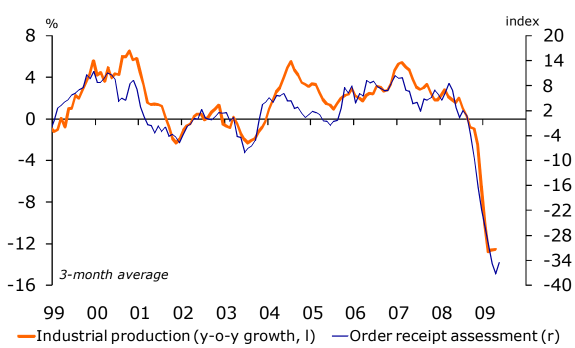
The volume of total goods exports dropped by 14% (year-on-year) in the first three months of 2009. Re-exports, which are largely made up of luxury goods, performed even more poorly because sales of these goods are more susceptible to economic fluctuations. Considering that a large proportion of Dutch exports consists of re-exports, which must first be imported, the volume of import goods also shrank by nearly 13% (year-on-year) in the first quarter of 2009. The decrease in exports coincides with sharply lower production and a historically low capacity utilisation rate in Dutch industry. Industrialists continue to have a negative outlook regarding foreign orders, which plummeted by more than 35% in the first quarter of 2009 compared to 2008 (figure 2). This development does not bode well for the coming quarters.

We expect the export volume to drop by 11¼% this year. The intense fluctuations in global trade will steer virtually the entire development of Dutch exports this year and next. The slight improvement in the price competition position is insufficient to counteract the negative effect of global trade. The price competition position is improving primarily because the value of the euro is rising less in comparison to other currencies. With the import volume decreasing at a lower rate than the export volume, net exports will contribute negatively to economic growth in 2009 (figure 3). Only once before has there been a sharper decline in the export volume and that was in 1932. The major difference between now and then is that, even though there has been a dramatic drop, the trade volume is currently still forty times greater than it was in the 1930s, primarily on account of globalisation.[1] This clearly shows that the Dutch economy is now more closely interconnected with the global economy. It also explains why the open Dutch economy has been hit relatively hard by the current crisis. But if global trade begins to pick up next year, Dutch exports will also increase in tandem.

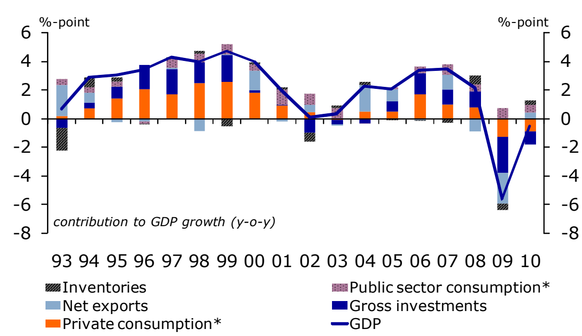
[1] CPB, Centraal Economisch Plan 2009

Figure 2: Sharp drop in industrial production



Source: CBS, Rabobank

Figure 3: Where will growth come from?



Source: CBS, Rabobank

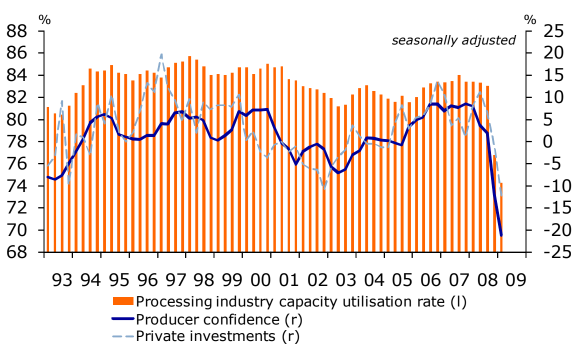
Corporate investment is at a low point

Just as in the past, the fall in foreign demand is the main factor behind the growth slowdown in the Netherlands. It is, however, important to note that the deteriorated domestic dynamics clearly also play a significant role. Amid bleak sales forecasts and a sharp drop in production accompanied by a historically low capacity utilisation rate, there is less need for expansion investments and replacement investments are being postponed (figure 4). There was a 10% drop in investment in the first quarter of 2009 compared to the same period of 2008. While the volume of corporate investment has risen by an average of 5.5% in the past four years, we are now projecting a 15% drop this year.

In the current uncertain climate, the first priority of businesses is to strengthen the balance sheet through profit retention and postponing dividend payments. While businesses are also cutting costs by laying off redundant employees, it takes time for them to align the size of their workforce to the surprisingly rapid drop in production. This will lead to a sharp fall in labour productivity this year. It will also place profitability under pressure, which will cause many businesses to reduce their level of investment.

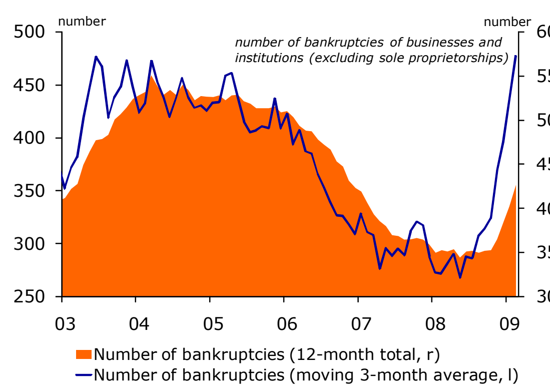
Waning profitability also negatively affects the financing terms and conditions agreed with banks and other financiers. Many businesses have raised their leverage during recent favourable years and are currently facing financial difficulties because their debt burden is now more difficult and expensive to finance. Combined with extremely sharp falls in revenue, this makes bankruptcy unavoidable for many businesses. The number of bankruptcies has nearly doubled in the Netherlands within a period of just one year (figure 5).

Figure 4: Capacity utilisation rate, corporate investment and producer confidence



Source: CBS, Rabobank

Figure 5: Explosive rise in number of bankruptcies



Source: CBS, Rabobank

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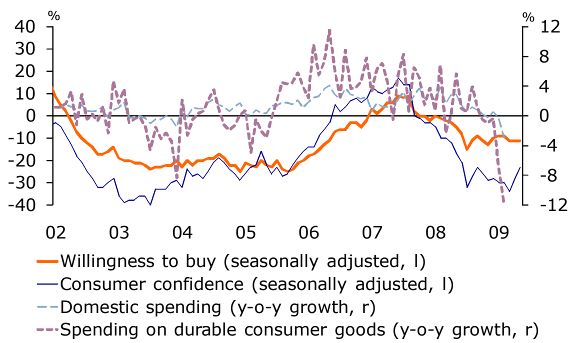
Dutch consumers count their blessings

Consumer confidence rose slightly for the second month in a row in May. Consumers were especially less gloomy about the economic outlook for the coming twelve months. Positive reports in the media regarding so-called green shoots and the recovery on stock exchanges make consumers feel more positive, even though the pessimists still form the vast majority. The less negative sentiment is not yet, however, being transformed into actions. Consumers' willingness to buy remained at the same low level and consumer spending even fell sharply in the first quarter of 2009 (figure 6). While the drop in consumer spending was the steepest in relation to spending on durable consumer goods, Dutch households also spent less on food, drink and tobacco. The latter is striking because this category is usually not sensitive to economic cycles. Unemployment was also not higher in the first quarter of 2009 than in the same period of last year. Consumer spending is consequently set to fall further in the coming quarters as unemployment increases (refer to box 1).

Figure 6: Consumer confidence and consumer spending



Source: CBS

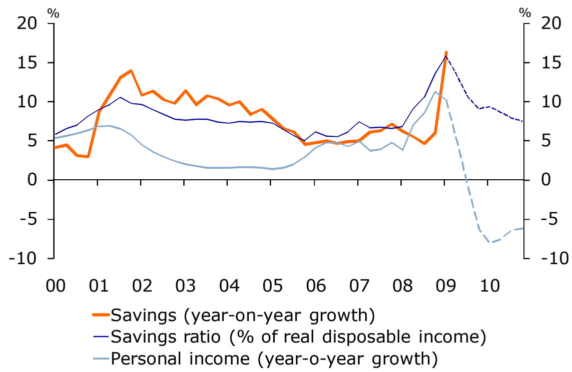
A bright spot is the development of Dutch consumer prices, which are expected to fall from 2.3% in 2008 to an average of 1% in 2009. The rate of monetary depreciation decreased by only 0.2 percentage point in May to 1.6% in comparison to the previous month. Inflation in the Netherlands is consequently much higher than in the eurozone, which amounted to 0% in May. The sizeable difference is due to the fact that in the Netherlands the decrease in the price of oil was integrated in energy prices later than in the rest of the eurozone. This is because rates for most gas and electricity contracts are only adjusted in January and July in the Netherlands. The hardest blow will consequently not come until July when the sharp fall in the oil price will finally be calculated into energy bills. At that time inflation will nosedive by more than 1.5 percentage points and end at close to 0%. The decrease in energy prices and the economic cooldown make it impossible to rule out the possibility of a slight decrease in average price levels in the second half of 2009 and the first half of 2010.

Box 1: Dutch consumers are minding the pennies

In the first three months of 2009, the balance on Dutch savings accounts surged by approximately 15% in comparison to the previous year (figure 7). The savings ratio (savings as a percentage of real disposable income) has also risen substantially since the second half of 2008. While the savings ratio is currently also increasing in other countries, the long-term trend is downward.

The latter is primarily due to the ageing population. Only part of the current increase can be attributed to an increase in personal income. The savings ratio rose markedly in the first quarter of this year, while growth in income actually slowed down. Owing to uncertainty regarding their financial future, consumers are spending less and saving a larger part of their income. This higher level of savings has also been partly born of necessity. The Dutch savings ratio is partially comprised of pension provisions, which are so-called 'forced savings'. Pension funds have suffered considerable capital losses and pension contributions are inevitably set to rise as a result. Substitution behaviour is probably also playing a role in this development. The sharp drop in share prices following the outbreak of the financial crisis has scared off many investors. We saw a similar development during the dot-com bubble burst in 2001 when savings also rose steeply.

Figure 7: Savings behaviour of Dutch households



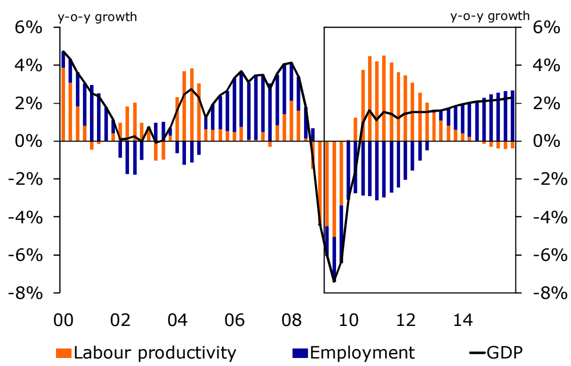
Source: CBS, Rabobank

Following the recent sharp rise, we expect that the savings ratio will return fairly rapidly to the long-term average of approximately 11%. While this will be accompanied by a decrease in the savings ratio in 2010, it does not mean that consumer spending will increase proportionally. This is because unemployment is going to rise in 2010 and the Dutch government budget deficit will unavoidably be translated into spending cuts and tax increases. This is sometimes referred to as Ricardian equivalence. This principle treats government debt as a postponed taxation. Government debt must be repaid at some point and, based on the principle of Ricardian equivalence, consumers already factor the additional taxes that will be levied in the future into their current spending decisions.

Labour market: Eastern European workers first to be affected

The forecast rise in unemployment began to materialise in the period February-April. Unemployment in the Netherlands rose by 18,000 people during this period (seasonally adjusted) in comparison to the previous three-month period. A total of 338,000 people were jobless in this period, representing 4.4% of the working population in the Netherlands. While the rise in unemployment had been moderate up to this point, this increase marks a strong upsurge. Despite the poor economic conditions, employment does, however, still remain higher than a year earlier. This could be related to so-called labour hoarding whereby companies retain their employees for as long as possible due to the costs connected with hiring and training new employees should the economy pick up again. This behaviour on the part of businesses is extremely understandable in light of the tight labour market in both the short and long term due to the ageing population. This strategy of hoarding has, however, become untenable as a rapid recovery appears increasingly unlikely. Business profitability has come under pressure due to the limited decrease in employment during a sharp economic downturn in the first quarter of this year. This in turn led to a steep drop in labour productivity in the first months of 2009 (figure 8). While numerous job cuts have been announced and lay-off procedures have been initiated, it will take several months for these measures to produce effects and for the people in question to show up as unemployed in the statistics.

Figure 8: Labour productivity and employment



Source: CBS, Rabobank

It furthermore appears that the 'flexible shell' comprised primarily of Eastern European workers absorbed the first blows of decreasing employment. Unemployment amongst this group of non-registered workers does not show up in the statistics. The free movement of workers agreement went into effect on 1 May 2007 for workers from the new Eastern European member states that joined the European Union in 2004. Only Romanians and Bulgarians are still required to have a work permit in order to work in the Netherlands. Since the introduction of the free movement of workers, the number of Eastern European workers in the Netherlands has increased sharply (figure 9). Primarily workers from Poland found employment in the Netherlands. The rise in their number came, however, to an end in the last quarter of 2008. In February of this year, there were approximately 84,000 Polish workers in the Netherlands. This number represents a decrease of more than 23,000 compared to the high point in September 2008, but still exceeds the 2007 peak.

Government: Doing nothing is the best option

The Dutch government's bail-out operations in the financial sector cost it approximately €37 billion last year. This caused government debt to surge in 2008 to nearly 60% of GDP at the end of the year, which is only just within the European norm. The support measures for the financial sector do not affect the government budget balance because rising debt is accompanied by an increase in assets such as shares and outstanding loans. The increased debt will, however, lead to a rise in interest charges. Rising unemployment, falling company profits and economic stimulus packages will drive up the budget deficit further in 2009 and 2010. While the crisis is not the only cause of the Netherlands' high government deficit[2], the elimination of income is currently the primary reason for the skyrocketing deficit. This places the Dutch government in a very difficult situation. Another crisis package on top of the €3 billion from the previous one is out of the question. While strict accountants would like to see spending cuts, this is also not the right way to tackle the current problems. The best solution for the Dutch government for now is to do nothing, which will mean that government spending will be the only spending category to still positively contribute to growth.

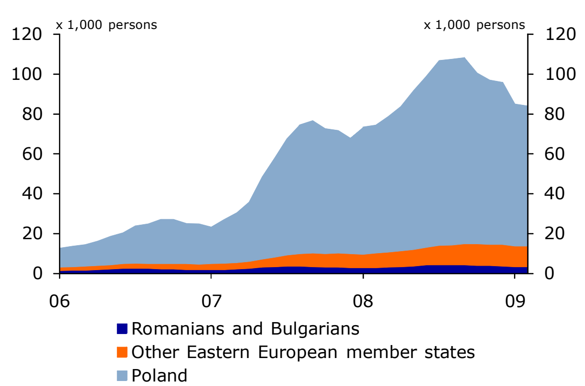
Conclusion

'When other countries sneeze, the Netherlands catches cold.' This expression underscores the open nature of the Dutch economy. It has suffered seriously this year from the global fall in demand, which is also strongly impacting production and investment. Dutch consumers have also caught the cold virus and 2009 will be a year of letting the virus run its course. The encouraging signs we referred to at the beginning of the report are only a plaster on the wound.

While the worst now appears to have passed following an extremely poor first quarter, economic recovery will only barely get off the ground in 2009. It will be possible to gain control over the main source of infection when global trade picks up again in 2010, but consumers will continue to suffer the symptoms of the lingering illness. Rising unemployment will be primarily to blame for consumer spending once again negatively contributing to economic growth in 2010. With budget deficits of 4% in 2009 and 6% in 2010, the government coffers are clearly already empty. This means the Dutch government can now do very little except let the patient gradually recover.

[2] Refer to the Rabobank Theme Report 2009/09 for a detailed explanation of the budget policy in recent years and the emergency measures that have been taken.

Figure 9: Workers from Eastern European EU countries



Source: CBS

Table 1: Key data for the Netherlands

annual averages, y-o-y changes in %	'08	'09	'10
Gross domestic product	2,1	-6	-½
Private consumption	1,6	-2¾	-2
Public sector expenditure	2	3	3
Private investments	6,2	-15	-6¼
Export of goods and services	2,6	-11¼	2¼
Import of goods and services	4,1	-9¼	2
Consumer price index	2,3	1	½
Unemployment (% of labour force)	3,9	5½	8
Government balance (% GDP)	0,6	-4	-6
Current account balance (% GDP)	6,7	5	6½

Source: CBS, Rabobank

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