The Netherlands

Lows followed by flats

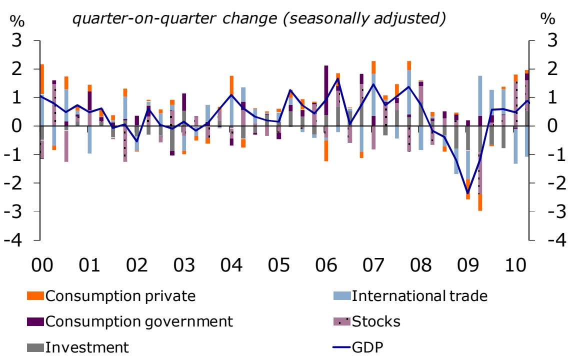
The Dutch economy is clambering back up, but the recovery is not yet robust. Strengthening world trade is currently driving economic growth, with the domestic sector not contributing significantly at present. Investments, though rising again in the past few months, are still down from last year. Nor do consumers really appear to be buying into the recovery yet. The magic word for them to do so is greater clarity, for instance about the effects of the government's austerity measures. Clarification can boost confidence and cause consumers to resume spending. A recovery of the employment market would also contribute to this.

Dutch economy clambering back up

Economic activity continued to grow in the second quarter of 2010 (figure 1). The volume of the Dutch economy grew by 0.9% (quarter on quarter) and in addition first-quarter growth was adjusted upwards to 0.5% (quarter on quarter, from 0.2%). The Netherlands benefited from the growing world trade that is driven by temporary factors, including governments' stimulation measures, positive effects on demand from the inventory cycle and monetary impulses. Domestic activity also contributed modestly in the second quarter. Private investments increased and consumers spent more than in the first quarter, albeit only slightly.

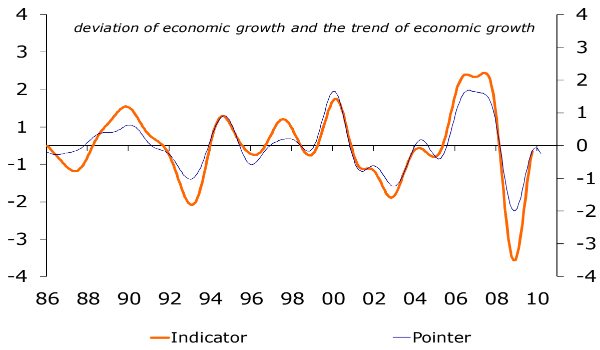
In the second half of 2010 and in 2011 the temporary impulses currently driving the economic momentum will gradually subside and growth in world trade is expected to level off. Domestic producers do have incentives to start planning investments, in view of the increasing capacity utilisation, improved order books and the low levels of long-term interest rates. But if domestic demand does not increase, such plans may not progress very far. Consumers have the option of upping their spending, but it remains to be seen whether they will actually put their euros to work in the coming period, given the government's imminent austerity measures.

Figure 1: Economic recovery



Source: Statistics Netherlands, Rabobank

Figure 2: Rabobank economic growth indicator: Economy cooling down

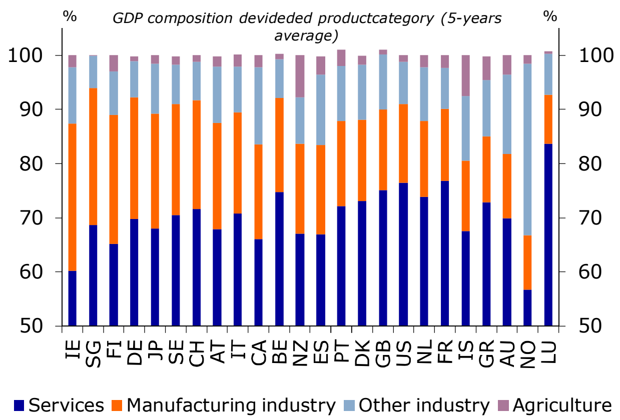


Source: Statistics Netherlands, Rabobank

We therefore expect more moderate economic growth for the next few quarters. The volume growth of the Dutch economy is expected to reach 1¾% in 2010 (year on year) and 1½% (year on year) in 2011. This view is confirmed by the Rabobank economic growth indicator (figure 2). This indicator confirms the strong recovery recorded in the first six months. On the basis of leading indicators including lending, consumer confidence, long-term interest rates, industrial orders and the German IFO index, the pointer shows where the economy is headed in the next few months. The pointer indicates an economic cooling-down towards the end of 2010.

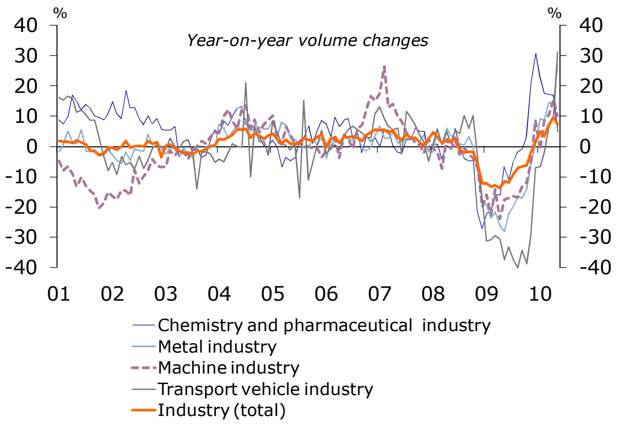
The Netherlands lagging behind internationally?
The Dutch economy is slower to recover than the German economy. This suggests that the Netherlands might be lagging behind internationally. It is not, however. The difference is due to the fact that in Germany more of the added value is earned in the manufacturing industry (figure 3). In the Netherlands, around three quarters of the added value (Gross Domestic Product or GDP) consists in services. The manufacturing industry (where materials are processed into new products) accounts for 'only' around 14% of GDP in the Netherlands. By contrast, in Germany almost a quarter of added value is generated in the manufacturing industry. Manufacturing was one of the first industries to benefit from the global recovery, above all the chemical industry. The machine-building, metal and transport vehicle industries likewise showed a robust recovery in the past few months (figure 4). As the Netherlands' manufacturing industry is smaller than that of Germany, so the recovery of the Dutch economy as a whole is less vigorous.

Figure 3: Structure of the Dutch economy



Source: EcoWin, World Bank

Figure 4: Substantial recovery of Dutch manufacturing industry



Source: Statistics Netherlands

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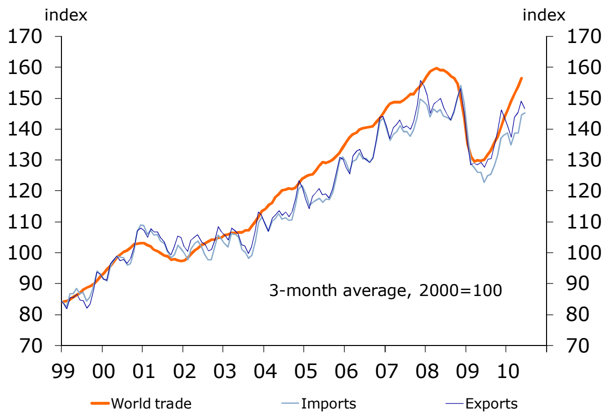
World trade growing more moderately

The economic growth of the past few months is to a large extent attributable to an increase in the volume of world trade, which is usually the case in the early stages of an economic recovery. Both export and import volumes grew in the second quarter of 2010, by 1.8% and 3.3% respectively compared to the first quarter (figure 5). World trade is expected to continue its growth during the remainder of this year and next year, albeit more slowly.

Figure 5: World trade continues to grow



Source: Statistics Netherlands

Dutch exporters are benefiting mainly from economic growth in their main export markets (Germany and the rest of the eurozone). In addition, the depreciation of the euro at the start of this year improved the competitive position in terms of pricing for Dutch exporters who export goods to countries outside the eurozone. World trade is expected to level off in the second half of 2010 and 2011 due to the elimination of temporary factors. We furthermore expect a further appreciation of the euro, which will adversely affect the competitive position of Dutch exporters in the world market. In view of these developments, we expect full-year export volume growth for 2010 and 2011 of 9½% and 4¾% respectively.

A large portion of Dutch exports is traditionally imported first and then, after only minimal processing, sold on abroad. Dutch importers are consequently currently profiting mainly from increased re-exports. Due to the flatter growth of export volumes in the second half of this year and next year, we also expect slower growth of import volumes. In addition, the inventories of Dutch companies have now been adequately restocked, and as a result this impulse for imports is also eliminated. Full-year import volume growth is expected to reach 10% in 2010 and 3¾% in 2011.

Production on the way back

In the second quarter of 2010, the production volume of industry rose by 8.6% compared to a year ago, accelerating from growth of 5.3% (figure 6) in the first quarter compared to the same period of last year. Production in June, however, (101.5; seasonally adjusted) was still slightly down on the level of before September 2008 (104.3), just before industry experienced an enormous downturn. Industry is also benefiting, in particular, from the global economic recovery. In line with this development, producers are progressively less negative about their order position. In the next few quarters production growth is likely to moderate, due to slowing world trade.

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The growing production volume has a beneficial effect on industrial capacity utilisation, which in July was at 80.2% (not seasonally adjusted) (figure 6). The combination of growing capacity utilisation, an improved order position and the low level of the long-term interest rates provides businesses in industry with an incentive to start planning investments. The cautiously improving private investments are not clearly visible yet in 2010 on a full-year basis. Owing to the low starting level in 2009 the volume of private investment is still expected to be 5% lower in 2010 than last year. Growth of 2¾% on a full-year basis is expected to be achieved in 2011.

Austerity measures ahead

The Dutch government has to implement a number of necessary austerity measures in the next few years to reduce the government deficit. These measures will not be painless and there is a chance that they will nip the economic recovery in the bud. But if the cabinet manages to take credible measures that do not unnecessarily harm the Netherlands' competitive position versus other countries nor consumer confidence, these austerity measures can in the long term put the economy on a stronger footing. Social security and public administration appear to be the main targets for savings thus far. We therefore expect the austerity measures to have a negative effect on private consumption because (1) disposable incomes will fall, particularly those of benefit payment recipients and civil servants and (2) consumers will probably start saving more to be able to themselves stop the gaps arising in the social security net and afford the additional healthcare spending.

Coalition government negotiations exceedingly difficult

The outcome of the Dutch coalition negotiations is highly uncertain. The free-market liberal VVD and the Christian Democratic CDA appeared to be set to form a cabinet with parliamentary support from the Freedom Party PVV. However, rifts within the CDA over working with the PVV may cause negotiations to founder. The next question would be which parties should then try to put together a cabinet. Based on the austerity plans of the various parties, no single combination is self-evident. While all parties see the need for cuts, opinions differ on their extent and the policy areas in which they are to be made (figure 7). Due to the fragmentation of the political landscape and the pronounced differences on the required cutbacks, the formation of a cabinet is a protracted process. But it is not the first time in Dutch history for it to take this long. Bearing in mind the record set by negotiations lasting 209 days in the early 1980s, the current period of 85 days and counting is still comparatively short.

One of its consequences is, however, the protracted uncertainty among consumers about the government's imminent plans for cuts. Cutbacks have been in the air since the publication of the reports containing proposals for cuts by the twenty government working groups in April, but consumers still do not know in which policy areas they will actually be made. They have no way of knowing what their housekeeping finances will look like in the future and therefore prefer to put their cash aside rather than spend it.

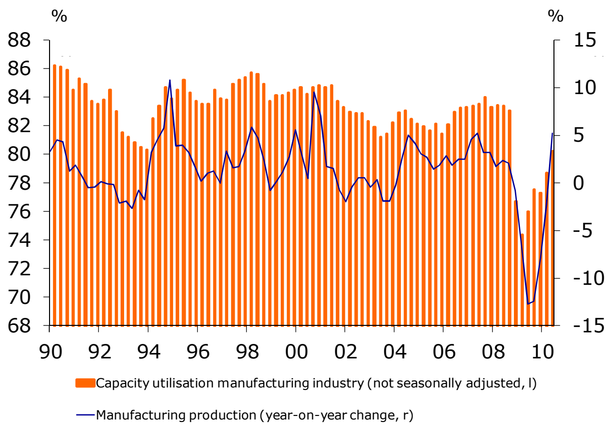
It is important for a lasting economic recovery that consumers start spending again. The government can contribute to this by swiftly clarifying what austerity measures lie ahead. This requires a new cabinet to be formed soon.

Consumers not really buying in yet

Dutch households spent 1.3% more in terms of volume on goods and services in June than a year ago, continuing the growth seen in the past few months. Consumers can start spending still more in the next few months, but it remains to be seen whether they really will. The imminent cutbacks will hit consumers' pockets and increase their propensity to save.

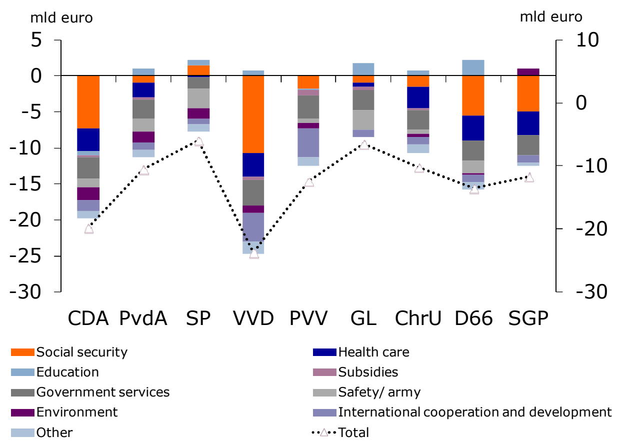
To speed up the economic recovery, the outgoing Minister of Finance decided to release, with effect from 15 September 2010, the employee savings balances accrued in the years 2006 to the end of 2009. Up to 2010, people in the Netherlands had built up some € 4.2 billion in blocked employee savings balances. Releasing them is seen by politics as a boost for consumer spending.

Figure 6: Production and capacity utilisation increasing



Source: Statistics Netherlands

Figure 7: Cuts according to election manifestos



Source: Netherlands Bureau for Economic Policy Analysis

Whether consumers will actually spend the savings released very much remains to be seen, as this depends partly on the cutbacks the government will make, developments in consumer confidence and the employment market situation. Also, employees might set aside the released savings to take early retirement. In view of the increased contributions to lifestyle savings schemes employees may not be inclined to work longer. Due to the existing uncertainties, private spending is expected to rise only to a limited extent during the remainder of this year and next year. Greater clarity may be the magic word for consumers to put their euros to work. Clarification can make a positive contribution to the fragile consumer confidence and therefore consumers' propensity to buy (figure 8). For both 2010 and 2011, we foresee an average increase in real consumer spending by only ½%.

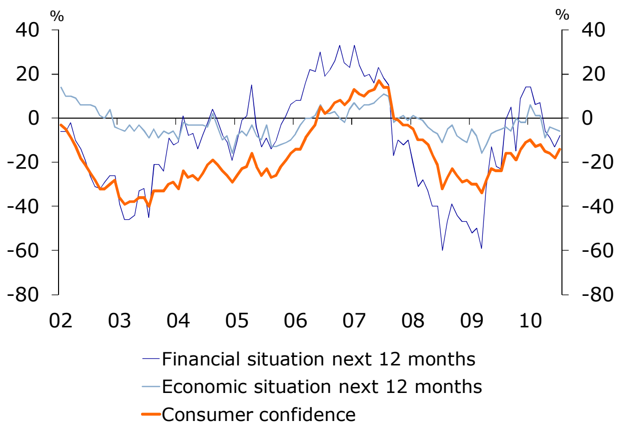
The miracle of falling unemployment may not last long

The employment market staged a limited recovery (figure 9) in the second quarter. A total of 17,000 jobs were added (year on year) and the seasonally adjusted unemployment rate fell to 5.5% in July (from a peak of 5.8% in February 2010). At the same time, the employment market was more vigorous in the second quarter; compared with the first quarter of 2010, 7,000 more vacancies arose in the second quarter and 10,000 more vacancies were filled.

Hidden jobless found

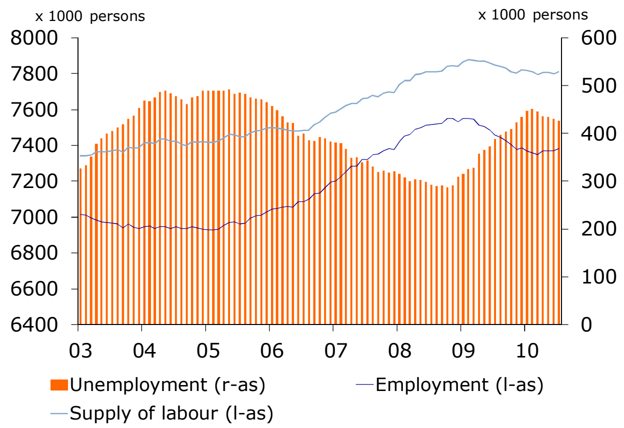
The current unemployment figures are not in line with expectations of a year ago, when the recession had broken out in full force. Far fewer people lost their jobs than we had expected on the basis of the slowdown in production. This was partly fuelled by the spending incentives governments injected into the economies. In addition, employers appear to have kept on the surplus personnel capacity, as labour productivity declined by 2.3% in 2009 (year on year) (figure 10).

Figure 8: Consumers less pessimistic



Source: Statistics Netherlands

Figure 9: Unemployment number falling



Source: Statistics Netherlands

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Employers may be reluctant to dismiss people, given the tightness in the employment market seen before the crisis and expected in the future again. In addition, employers may be planning ahead for the fact that the baby boomers are set to leave the employment market. It is often cheaper for employers to retain these employees a little longer than to initiate proceedings for dismissals at the present time.

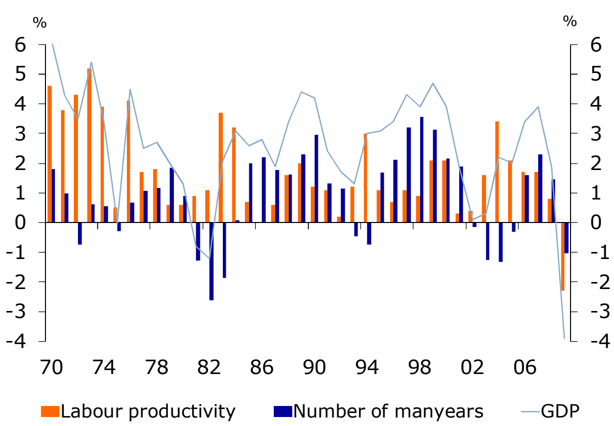
The unemployment figures also present a slightly distorted view, as hidden jobless numbers are not included. An example of a group of unemployed people that is not included in the statistics are part-time unemployed persons. There is also hidden unemployment among self-employed persons without personnel and other self-employed people. This group has less work than before the crisis, but deals with managing on a lower income itself (figure 11). They still work for more than twelve hours a week and are not immediately available for a job in paid employment. Which means that, statistically, they are not unemployed. This group will only count as jobless if they work fewer than twelve hours a week and are actively seeking a job in paid employment.

During the rest of this year and in the next year, we expect unemployment to fluctuate around the present level. The employment market appears to lack a clear direction. On the one hand employment in central government organisations, local government and late-cyclical sectors is falling. This is compensated, however, by sectors in which employment is on the rise again, including industry and the transport sector. The unemployment rate in 2010 and 2011 is expected to average 5½%.

Inflation remains moderate

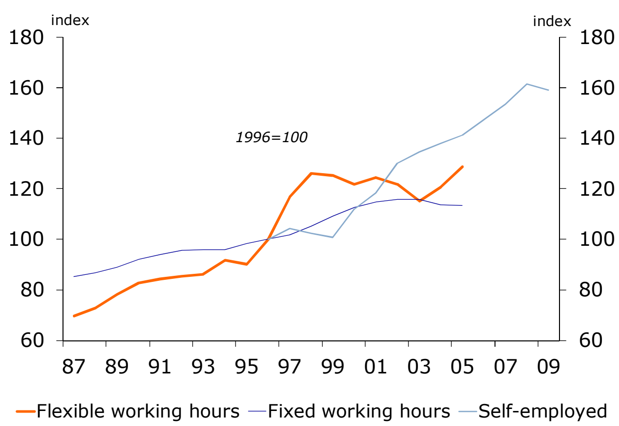
Energy and gas prices fell sharply in July 2009, which helped to constrain inflation in the past year. In the past half-year, inflation accordingly fluctuated at around 1%. That effect has now subsided (figure 12). In the second half of

Figure 10: Labour productivity down



Source: Statistics Netherlands

Figure 11: Flexible buffer thinning



Source: Statistics Netherlands

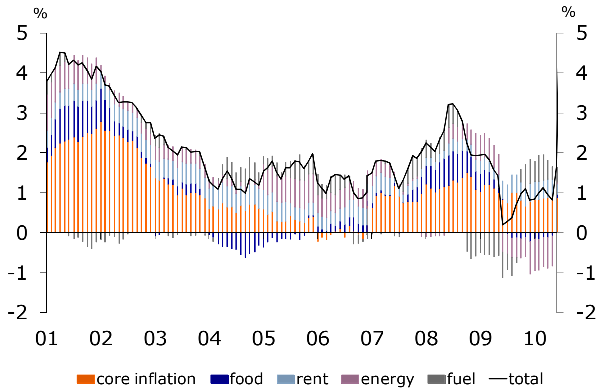
2010, energy and gas prices will exert upward pressure on prices. In addition, rising food prices, for instance for grain, barley and wheat, will tend to boost inflation. On the other hand producer prices, conversely, will tend to constrain it, as diminishing world trade will reduce the demand for commodities, which will result in falling commodity prices. Import prices will also fall, as the euro appreciates again to some extent. Core inflation will remain relatively modest as well due to the moderate wage cost growth. Overall, inflation is expected to reach 1¼% in 2010 and 1% in 2011.

Conclusion

Lows are followed by flats. The Netherlands has already recouped a substantial portion of the damage caused by last year's recession in the past few quarters. Both production and trade have surged, with trade in fact almost back at pre-crisis levels. The recovery will continue at a more moderate pace in the second half of 2010 and in 2011. The government, which so far has footed most of the bill for the recession, will have to put matters in order. The next few years are therefore set to bring substantial cuts to nurse public finances back to health. These austerity measures will affect consumers. The disposable incomes of benefit payment recipients and civil servants are likely to fall and the propensity to save might rise.

A lasting economic recovery, however, requires consumers, and in their wake producers, to take over from the government. Although the improved outlook for the employment market benefits consumer confidence, due to the cuts the question is whether consumers will really put their euros to work in the second half of 2010 and in 2011. Another question is to what extent producers will actually start investing.

Figure 12: Inflation rising



Source: Statistics Netherlands

Table 1: Key data

Year on year % change	*2009*	*2010*	*2011*
Gross domestic product	-3,9	1¾	1½
Private consumption	-2,5	½	½
Government expenditures	3,7	½	¾
Private investment	-16,5	-5	2¾
Exports of goods and services	-7,9	9½	4¾
Imports of goods and services	-8,5	10	3¾
Consumer price index	1,2	1¼	1
Unemployment (% labour force)	4,9	5½	5½
Government budget (% GDP)	-5,4	-6	-4½
Government debt (% GDP)	60,8	66	69

Source: Statistics Netherlands, Rabobank

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