

18. THE NETHERLANDS

Domestic demand dampening recovery

First signs of recovery after deep recession

As one of the most open economies in Europe the Netherlands could not remain untouched by the global financial and economic crisis. Economic activity experienced a severe contraction of 4% in 2009. The economic downturn started in the second half of 2008 and accelerated in the first quarter of 2009. While the second quarter of 2009 still posted a significant negative growth, the economy rebounded in the final two quarters of the year, recording positive growth again. The rebound came in large part from a recovery in world trade, which had a significant upward effect on exports and showed again the particular sensitivity of the Dutch economy to changes in global demand.

Negative confidence and wealth effects triggered a strong decrease in private consumption, with the annual growth rate at $-2\frac{1}{2}\%$ and all four quarters posting negative growth. Wealth effects had an important impact on consumption in the Netherlands, mostly through falling asset prices, which influenced households' wealth both directly via their role as investor and indirectly through the impact on pension fund assets.

The sharp decrease in production caused by weak global demand and tightening credit conditions resulted in a historically low capacity utilisation rate (less than 75%). This, combined with widespread declines in profits and the need to strengthen their balance sheets, meant that businesses sharply cut their investment by over 15%.

In addition to a fiscal stimulus package aimed at limiting the contraction of the real economy, the government helped to stabilise financial markets and provided support for Dutch financial institutions to cope with the crisis. Although part of the government support was repaid towards the end of 2009, Dutch financial institutions remain vulnerable to risks in the financial markets.

Gradual recovery ahead

The rebound in economic growth in the second half of 2009, mainly resulting from the improvement in global demand, explains why the outlook for GDP growth for 2010 and 2011 is positive at $1\frac{1}{4}\%$ and $1\frac{3}{4}\%$ respectively. Since

exports dropped less sharply than world trade in 2009, partly due to the favourable composition of Dutch exports, and given the continuous gain in market share over the past years, the Netherlands is in a good position to profit from the revival of world trade. A projected decrease in unit labour costs in both 2010 and 2011 is foreseen to provide support to competitiveness again, as wage growth is set to decrease in view of the loosening labour market, which is adjusting to lower production levels. In 2010, the rebound in exports is expected to be more pronounced than that of imports, as the latter is linked to the projected continuation of falling domestic demand.

The recovery of asset prices towards the end of 2009 and in the first quarter of 2010, in particular in the stock market, improved the financial wealth of Dutch households and enabled pension funds to improve their asset position to some extent. These encouraging developments in the stock market are expected to have a positive impact on private consumption. However, the financial wealth position of Dutch households is still below its pre-crisis level. Furthermore, consumers' employment expectations have improved over the past few months, although they still point to an overall increase in unemployment.

The improvement is linked to the apparent resilience of the Dutch labour market, and is foreseen to reduce the need for precautionary saving. On the other hand, real disposable income is expected to decrease slightly in both 2010 and 2011, as a result of decreasing wage growth and, in particular in 2010, rising unemployment. Overall, private consumption is foreseen to continue to decrease in 2010 by $\frac{1}{2}\%$ before returning to positive growth of $1\frac{1}{4}\%$ in 2011.

The tightened credit conditions and the reduced profitability, could lead to a prolonged deleveraging of corporate balance sheets, which would adversely affect private investment growth. Ongoing weak domestic demand, combined with the still very low capacity utilisation rate, contribute further to a negative outlook for gross fixed capital formation. Construction is especially projected to impose a drag on investment, given its relatively long planning horizon. All in all, private investment is projected to decrease by 9% in 2010. Led by a recovery in equipment purchases,

investment is foreseen to grow again in 2011, by 3½%.

Inflation is projected to remain relatively subdued in 2010 and 2011 and is projected to reach 1¼% and 1½% respectively. Energy prices are expected to have a depressing effect on inflation in the first half of 2010. This can be ascribed to the decrease in oil prices in 2009, which was passed through into consumer prices with a relatively long lag, as energy prices are only adjusted twice a year. Services are expected to put some upward pressure on inflation, given the significant increase in unit labour cost in 2009. However, this increase may not be fully reflected in prices, given the highly competitive environment.

This scenario is subject to both positive and negative risks. On the positive side, a further recovery of asset prices could have a positive impact on private consumption, while this could also fuel investment. On the other hand, risks to the stability of the financial sector have not yet fully disappeared. This may lead to a structural decrease in the supply of credit, which could hamper a sustained economic recovery.

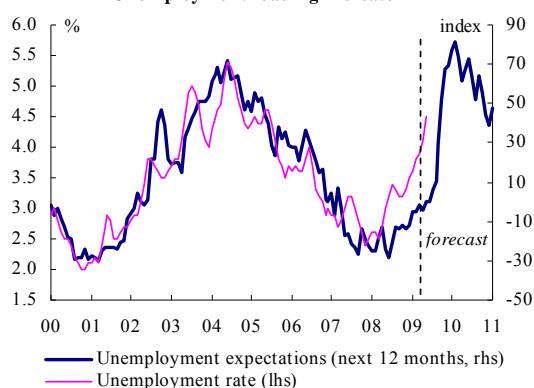
Labour market remaining rather resilient

The Dutch labour market seems to be rather resilient. Despite the severe economic crisis, the unemployment rate increased by only 0.6 pp. to 3.4% in 2009 and remained one of the lowest in the EU. One of the main elements explaining the relatively limited increase in unemployment is labour hoarding. At the dawn of the crisis, the labour market was extremely tight, with an unfilled vacancy rate roughly equalling the unemployment rate. This situation proved to be very difficult for employers to attract and retain qualified personnel. When demand decreased, employers were (initially) reluctant to let personnel go.

The flexible working arrangements, together with the part-time working scheme introduced by the government, also played an important role in dampening the rise in unemployment. The high share of self-employed in the labour force was an additional mitigating factor, as they were able to easily adjust their hours worked. Finally, there was also an effect coming from a decrease in labour supply, mainly resulting from discouraged workers, but also from students who chose to continue studying, and elderly workers who decided to retire earlier. Some of these mitigating

factors are likely to disappear gradually in 2010. Most importantly, the corporate sector will find it difficult to sustain labour hoarding, given the sharp rise in unit labour costs in 2009, the associated drop in productivity and the limited recovery of demand. As a result, the unemployment rate is expected to increase to 5% in 2010 and to increase slightly further to 5¼% in 2011.

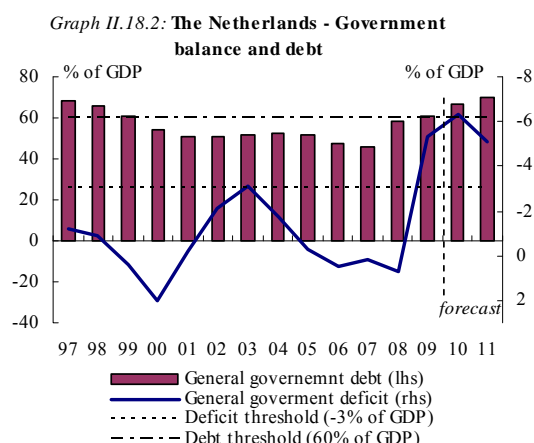
Graph II.18.1: The Netherlands -
Unemployment leading indicator



The sharp decrease in economic activity and the contraction in employment are forecast to negatively impact labour supply, also in view of some existing rigidities in the labour market. This could eventually have a negative impact on potential output and is gaining greater significance in view of the approaching effects of population ageing. As ageing will lead to a structural decrease in labour supply, the labour market is expected to tighten again in the medium to long run.

Deterioration of public finances to be halted in 2011

In 2009, the Dutch budget deteriorated sharply from a small surplus in 2008 to a general government deficit of 5.3% of GDP, thus triggering the excessive deficit procedure. Automatic stabilisers have operated fully and were even strengthened by the removal of cyclically sensitive social benefits from under the expenditure ceiling. Furthermore, the Netherlands has implemented a set of measures in response to the crisis covering financial market support, fiscal stimulus, and structural measures. This package amounted to 1% of GDP in 2009 and will be continued in 2010.



Despite the expected rebound in real GDP growth in 2010, the public finances are expected to deteriorate further. Most importantly, besides the continuation of the 1% of GDP stimulus package, this is the result of various lagged effects, in particular the projected further increase in unemployment.

In 2011, the deficit is expected to decrease by 1¼% of GDP to 5% of GDP. Apart from the positive contribution from cyclical conditions, the improvement mainly results from the withdrawal of stimulus measures and the additionally planned consolidation package amounting to ¼% of GDP.

The government gross debt ratio, which breached the 60% Treaty reference value in 2009 on the back of significant financial support measures in 2008, is expected to increase substantially over the forecast period as a result of deficits in excess of nominal GDP growth. It is projected to come out at almost 70% of GDP in 2011, a level not recorded since 1996.

The main challenges for public finances are the correction of the excessive deficit by 2013 and the improvement of the long-term sustainability of public finances. Budgetary consolidation accompanied by structural reforms would address these challenges.

To this end the Dutch authorities carried out a fundamental budget review, which identified structural reforms and savings options in a wide range of policy areas totalling 20% of government expenditure. An increase in the pension age by 2 years (from 65 to 67), as proposed by the previous government, would also be a first step in improving the long-term sustainability of public finances, should it be adopted.

Table II.18.1:

Main features of country forecast - THE NETHERLANDS

	2008			Annual percentage change						
	bn EUR	Curr. prices	% GDP	92-05	2006	2007	2008	2009	2010	2011
GDP	595.9	100.0	2.6	2.6	3.4	3.6	2.0	-4.0	1.3	1.8
Private consumption	272.5	45.7	2.3	2.3	-0.3	1.7	1.3	-2.5	-0.4	1.3
Public consumption	151.8	25.5	2.1	2.1	9.5	3.7	2.0	3.2	2.0	0.2
Gross fixed capital formation	121.7	20.4	2.6	2.6	7.5	4.8	4.9	-13.0	-9.7	3.6
of which : equipment	40.4	6.8	3.6	3.6	12.0	7.8	3.9	-20.8	-10.4	6.9
Exports (goods and services)	457.4	76.8	6.2	6.2	7.3	6.7	2.7	-8.2	5.9	5.2
Imports (goods and services)	407.6	68.4	6.0	6.0	8.8	5.1	3.7	-8.7	3.1	5.1
GNI (GDP deflator)	580.2	97.4	2.6	2.6	5.7	2.4	-2.1	-3.7	2.2	1.8
Contribution to GDP growth :										
Domestic demand			2.2	2.2	3.5	2.7	2.1	-3.0	-1.5	1.3
Inventories			0.0	0.0	0.2	-0.6	0.3	-0.7	0.6	0.0
Net exports			0.4	0.4	-0.3	1.5	-0.4	-0.3	2.2	0.6
Employment			1.0	1.0	1.6	2.3	1.2	-0.9	-1.6	-0.2
Unemployment rate (a)			4.5	4.5	3.9	3.2	2.8	3.4	4.9	5.2
Compensation of employees/f.t.e.			3.6	3.6	2.4	3.4	3.8	2.3	1.8	1.7
Unit labour costs whole economy			2.0	2.0	0.7	2.1	2.9	5.6	-1.1	-0.3
Real unit labour costs			-0.4	-0.4	-1.1	0.5	0.2	5.9	-2.1	-1.9
Savings rate of households (b)			-	-	-	13.8	13.1	15.6	15.4	13.7
GDP deflator			2.4	2.4	1.8	1.6	2.7	-0.3	1.0	1.6
Harmonised index of consumer prices			2.2	2.2	1.7	1.6	2.2	1.0	1.3	1.5
Terms of trade of goods			0.5	0.5	-0.3	-0.3	-0.1	-1.0	-1.1	0.1
Trade balance (c)			5.7	5.7	7.7	8.0	7.4	6.6	8.3	8.5
Current account balance (c)			5.4	5.4	9.0	8.5	4.2	3.9	5.9	6.4
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			5.1	5.1	8.7	8.1	3.9	3.6	5.6	6.0
General government balance (c)			-1.7	-1.7	0.5	0.2	0.7	-5.3	-6.3	-5.1
Cyclically-adjusted budget balance (c)			-1.5	-1.5	0.3	-1.0	-0.5	-3.6	-4.9	-4.0
Structural budget balance (c)			-	-	0.3	-1.0	-0.5	-3.6	-4.9	-4.0
General government gross debt (c)			63.4	63.4	47.4	45.5	58.2	60.9	66.3	69.6

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.