

18. THE NETHERLANDS

Recovery from recession to be led by external demand

Strong downturn in 2008 leading to a strong policy response

As one of the most open economies in Europe the Netherlands could not remain untouched by the effects of the global economic and financial crisis. As a result, the high economic growth recorded in the Netherlands in 2006 and 2007 came to a sudden end in the second quarter of 2008. Thereafter, the economic downturn accelerated further, with a contraction of 1.1% quarter-on-quarter in the fourth quarter, as exports were particularly severely hit by the abrupt fall in world trade. A sizable effort from the government to stabilise financial markets helped financial institutions to cope with the crisis, although Dutch financial institutions remain vulnerable. Despite the sharp downturn, neither public finances nor the labour market reacted immediately, with the government budget still posting a surplus in 2008 (0.7% of GDP) and unemployment even falling to 2.8% during 2008.

In response to the economic crisis, the Dutch government adopted a total of three recovery packages, containing stimulus measures which were broadly in line with the EERP. The first two packages, which were adopted at the end of 2008 and the beginning of 2009 amounted to ½% of GDP in both 2009 and 2010. The third package adopted in March 2009 in view of a further economic deterioration, was roughly twice the size of the two previous packages taken together, providing a total stimulus of around 2%. The stimulus measures were aimed at the areas most affected by the crisis, focusing on household purchasing power, private (and public) investment and employment protection.

Economy hit by weak external and domestic demand

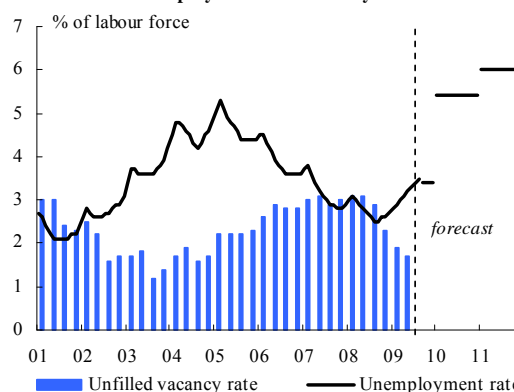
GDP growth is projected to only just escape negative territory at the end of 2009, after six consecutive quarters of negative growth. The moderate recovery is expected to come from a rebound in external demand and should lead to zero growth in the fourth quarter. Overall in 2009, GDP should fall by 4½%, which is the sharpest contraction ever registered. In 2010, domestic demand is foreseen to show a protracted decrease, mostly due to lingering wealth effects, but its

negative contribution to GDP growth will most likely be more than offset by a positive one from net exports so that GDP growth comes out at 0.3%. A recovery in domestic demand, notably in private consumption, should then lead to a further recovery of economic growth - to 1.6% - in 2011.

Exports, which account for almost 80% of GDP, are expected to fall sharply in 2009, which will undoubtedly have a considerable negative impact on GDP growth. In line with the recovery in world trade, exports should post positive growth again in 2010 and 2011. In combination with the projected slower recovery of domestic demand, which leads to slower import growth, the contribution of net exports in 2010 and 2011 should be positive overall.

The global economic and financial crisis provoked a sharp decrease in asset prices. The resulting negative wealth effects led to a strong contraction in private consumption expenditure in the first half of 2009, despite a rise in real disposable income resulting from pre-crisis wage negotiations.

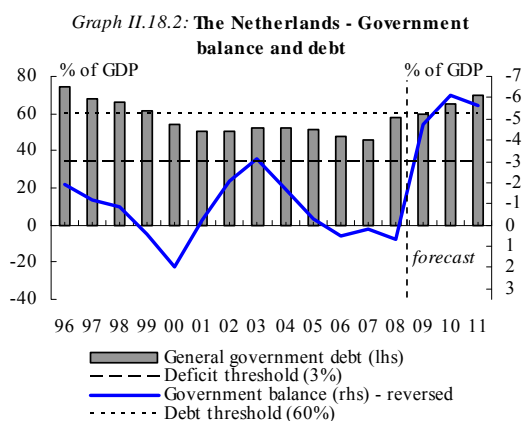
Graph II.18.1: The Netherlands - Unemployment and vacancy rates



Negative wealth effects seem to have a larger impact on consumption in the Netherlands than in other European countries. Household wealth is influenced by falling asset prices, both directly via households' role as investors, and indirectly through the impact on pension fund assets. The wealth losses suffered by households are foreseen to have a prolonged upward effect on their saving rate which is expected to increase by about 5 pp. in 2009 to 18%. In combination with precautionary saving, in view of adverse unemployment expectations this should lead to a further

contraction of private consumption in 2010. As the labour market adjusts to lower production levels, unemployment is expected to roughly double over the forecast period, to around 6%. Until now, the increase in unemployment has been dampened by flexible working hour arrangements, the part-time working scheme introduced by the government and labour hoarding, as companies are reluctant to let qualified personnel go. With unemployment growth expected to start decreasing from 2011 onwards, the savings rate is expected to start to (slowly) adjust downwards.

A sharp decrease in production caused by global weak demand and tightening credit conditions, resulted in a historically low capacity utilisation rate. This, combined with widespread declines in profits and the need to strengthen their balance sheets, means that businesses are expected to sharply cut their investment by almost 15% in 2009. The strongest decline will most likely be recorded by cyclically-sensitive investment. Construction should show a prolonged contraction, which could last well into 2010, because of its relatively long planning period, resulting in a negative private investment growth close to 8% in 2010. With replacement investment picking up again, gross fixed capital formation is foreseen to recover moderately in 2011, showing a growth of ½%.



Since consumer gas prices are only adjusted twice a year, energy prices tend to have long adjustment lags in the Netherlands. This led to part of the sharp increase in energy prices in 2008 only being passed through to consumer prices in the first half of 2009. This limits the expected decrease in inflation in 2009, which is now projected to come out at around 1% in 2009, from just over 2% in 2008. For 2010 and 2011, inflation is forecast to remain relatively stable as it will remain difficult

for producers to strongly increase prices to restore profit margins.

This scenario is subject to both positive and negative risks. On the positive side, a more dynamic recovery in world trade would lead to a stronger contribution of exports to growth. Negative risks are mainly related to ongoing uncertainties in the financial sector. The risk to the stability of the financial sector has not yet fully disappeared, due to its relatively large exposure to troubled markets. This may also lead to a structural lower supply of credit, which could hamper a sustained economic recovery.

Sustained recovery linked to competitiveness

Although the significantly positive trade balance in 2008 pointed to a relatively favourable competitive stance, a closer look reveals that Dutch price and cost competitiveness have been deteriorating since 2000 as unit labour costs have increased more sharply than in neighbouring countries. The dynamic development of unit labour costs is mainly due to a relatively strong increase in compensation of employees and to a much lesser extent to productivity developments. Despite a policy of wage moderation in 2004 and 2005, employees have profited from a generally tight labour market over the past years, which put upward pressure on wages. For the coming years, the government has announced a renewed policy of wage moderation. Combined with the expected loosening of the labour market, this could exert downward pressure on wage increases, thereby improving competitiveness. This would in turn increase the probability for the Netherlands to benefit fully from the expected recovery in external demand in 2010 and 2011.

In the short run, labour supply is negatively affected by discouraged workers. Some rigidity in the labour market, as reflected for example by difficulties in work-to-work transitions, may lead to some hysteresis in the aftermath of the crisis. This could also hamper labour productivity and could eventually limit the possibilities for future real wage growth without damaging competitiveness. In the long run, the labour market is expected to tighten again, as a result of ageing. This will lead to a structural decrease in the labour force and thus in labour supply, which could have an adverse effect on future wage growth and competitiveness.

Rapid deterioration of public finances

In 2009, the budget is foreseen to show the sharpest drop ever recorded in the Netherlands. The surplus of 0.7% of GDP posted in 2008 has turned into a deficit of 4.7% of GDP in 2009. Despite the relatively good starting position, the recovery measures taken by the government in response to the economic crisis, the full working of the automatic stabilisers and decreasing gas revenues have eroded the budgetary position very quickly. In 2010, the deficit will most likely widen further to over 6% of GDP, as unemployment benefits and interest expenditure in particular will show further increases.

The recovery packages, amounting to about 1% of GDP in 2009, are planned to be continued in 2010. Depending on growth dynamics, they will be (partially) reversed in 2011. Furthermore, government plans indicate the start of consolidation in 2011. This would lead to an improvement of the budget to around 5½% of GDP in 2011.

After the sharp increase in the debt level in 2008, because of government operations to stabilise the financial markets (amounting to approximately 15% of GDP), debt is set to increase further over the forecast period, mainly as a result of the

deficits exceeding nominal GDP growth. In 2009 it would come very close to 60.0% of GDP and should further increase to 70% of GDP in 2011, reaching a level not recorded since 1996.

In March 2009, the government updated the budgetary framework by removing the cyclically sensitive unemployment benefits from the expenditure ceilings. This measure prevented pro-cyclical budget cuts as a result of increasing unemployment. It also resulted in a strengthening of the automatic stabilisers, which at the same time negatively affected the general government balance. In principle this is a temporary measure, although there is not yet a clear indication of how it will eventually be reintegrated under the expenditure ceiling.

Measures were also announced to improve the long-term sustainability of public finances. Most importantly, the government decided to increase the pensionable age from 65 to 67 in two steps (to 66 in 2020 and 67 in 2025).

Table II.18.1:

Main features of country forecast - THE NETHERLANDS

	2008			Annual percentage change						
	bn Euro	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	-4.5	0.3	1.6
Private consumption	272.5	45.7	2.3	2.3	-0.3	1.7	1.3	-2.7	-0.6	0.6
Public consumption	151.8	25.5	2.1	2.1	9.5	3.7	2.0	2.4	0.7	0.4
Gross fixed capital formation	121.7	20.4	2.6	2.6	7.5	4.8	4.9	-11.7	-6.0	0.4
of which : equipment	40.4	6.8	3.9	3.9	11.4	7.8	4.0	-14.8	-6.1	3.1
Exports (goods and services)	457.4	76.8	6.2	6.2	7.3	6.7	2.7	-10.8	1.9	4.1
Imports (goods and services)	407.6	68.4	6.0	6.0	8.8	5.1	3.7	-10.6	0.5	2.9
GNI (GDP deflator)	580.2	97.4	2.6	2.6	5.7	2.4	-2.1	-4.6	0.0	1.4
Contribution to GDP growth :										
Domestic demand			2.2	2.2	3.5	2.7	2.1	-3.0	-1.2	0.4
Stockbuilding			0.0	0.0	0.2	-0.6	0.3	-0.5	0.4	0.0
Foreign balance			0.4	0.4	-0.3	1.5	-0.4	-1.0	1.0	1.1
Employment			1.0	1.0	1.6	2.3	1.2	-0.1	-2.1	-0.9
Unemployment rate (a)			4.5	4.5	3.9	3.2	2.8	3.4	5.4	6.0
Compensation of employees/f.t.e.			3.6	3.6	2.4	3.4	3.8	2.6	2.5	1.7
Unit labour costs whole economy			2.0	2.0	0.7	2.1	2.9	7.4	0.1	-0.8
Real unit labour costs			-0.4	-0.4	-1.1	0.5	0.2	6.2	-0.8	-2.2
Savings rate of households (b)			-	-	-	13.8	13.1	18.1	18.4	17.9
GDP deflator			2.4	2.4	1.8	1.6	2.7	1.0	1.0	1.4
Harmonised index of consumer prices			2.2	2.2	1.7	1.6	2.2	1.1	0.9	1.2
Terms of trade of goods			0.5	0.5	-0.3	-0.3	-0.1	0.3	-0.5	0.1
Trade balance (c)			5.7	5.7	7.7	8.0	7.4	6.0	6.2	6.8
Current account balance (c)			5.4	5.4	9.0	8.5	4.2	3.1	3.1	3.9
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			5.1	5.1	8.7	8.1	3.9	2.7	2.7	3.6
General government balance (c)			-1.7	-1.7	0.5	0.2	0.7	-4.7	-6.1	-5.6
Cyclically-adjusted budget balance (c)			-1.5	-1.5	0.1	-1.3	-1.0	-3.2	-4.4	-4.3
Structural budget balance (c)			-	-	0.1	-1.3	-1.0	-3.6	-4.4	-4.3
General government gross debt (c)			63.4	63.4	47.4	45.5	58.2	59.8	65.6	69.7

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