14. THE NETHERLANDS

The Netherlands is set to experience its sharpest post-war contraction in 2020, with both domestic demand and trade declining sharply. A rebound is expected next year as economic activity recovers, albeit from a very low level. Notwithstanding the broadening of the work-time reduction scheme, labour market conditions should deteriorate substantially. The authorities have adopted emergency measures to prevent structural damage to the economy, and automatic stabilisers are being allowed to operate in full. Consequently, the general government balance will go into a large deficit.

Sharp contraction in 2020

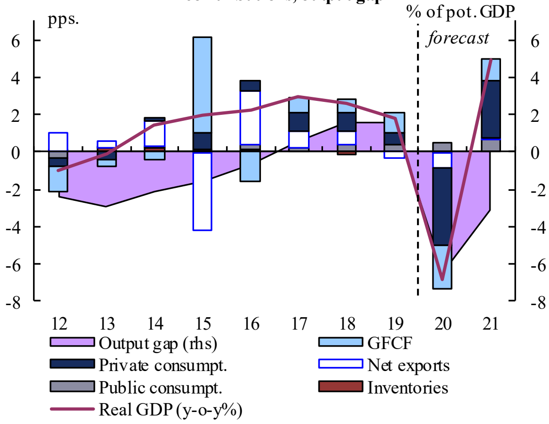
After growth of 1.8% in 2019, the COVID-19 pandemic has put an abrupt end to six consecutive years of economic expansion. In the baseline macroeconomic scenario, the Dutch economy is projected to contract by about 6¾% in 2020, the strongest recorded annual decline in the country's post-war history. All demand components, except public consumption, should contract sharply this year, with a projected trough in economic activity in the second quarter. For 2021, growth is expected to rebound, reflecting a gradual normalisation of economic activity and a recovery of domestic demand and global trade from a depressed level. Activity levels, however, are expected to remain below those of 2019.

Private consumption expenditure is expected to contract this year by around 9½% with household spending constrained by the containment measures. Moreover, adverse unemployment expectations in combination with negative wealth effects are expected to boost precautionary savings, weighing further on household spending. The recovery of private consumption is likely to accelerate only towards the end of the year, as uncertainty fades out and pent-up demand takes over. Investment in equipment is projected to decline sharply this year given weak demand, high uncertainty, low capacity utilisation, as well as restricted access to credit. Construction investment, which was already hampered by low permit issuance and regulatory uncertainty, is set to slow considerably as well.

Global recession weighs on exports

As a highly open economy, the Netherlands is particularly sensitive to the collapse in world trade. However, the negative contribution of exports to growth is projected to be limited by a similarly sharp drop in imports. The latter can be linked to the decline in domestic demand, and the high import content of exports. In line with the projected global recovery, exports should see positive growth again in 2021.

Graph II.14.1: **The Netherlands - Real GDP growth and contributions, output gap**



Labour market to weaken considerably

The unemployment rate is forecast to rise to around 6% this year, after having reached an historic low of 2.9% in the months leading up to the crisis. Mandated business closures and the abrupt decline in economic activity are projected to have an adverse effect on employment in affected sectors. Employment protection measures – in particular the significant expansion of work-time reduction benefits and income support for the self-employed, which have already seen widespread recourse - should help dampen employment losses. Notwithstanding these measures, the deterioration of the labour market is expected to unfold in the coming months as firms in heavily affected sectors inevitably shed labour, especially workers with flexible and temporary contracts. In 2021, the unemployment rate is projected to decline gradually to around 5¼% as economic activity recovers. For 2020, most wage agreements were concluded at a time of positive economic growth assumptions and higher inflation expectations. With these as a basis, nominal compensation of employees per full-time equivalent is expected to see continued growth of

2¼% this year despite the deterioration in sentiment. Together with the substantial decline in production, this entails a sharp increase in unit labour costs. For 2021, labour market slack is set to put downward pressure on wage dynamics.

Subdued inflation dynamics ahead

Consumer prices are set to moderate to 0.8% this year, after having risen by 2.7% in 2019. Around 1.5 pps. of this decline reflects the base effect from the 2019 increase in indirect taxes. A sharp drop in oil prices, as well lower energy-related taxes and dissipating domestic inflationary pressures, put further downward pressure on inflation. As base effects fade away, headline inflation is expected to pick up to 1.3% in 2021.

Extraordinary budget measures to support the economy

The general government budget surplus, which stood at 1.7% of GDP in 2019, is projected to evaporate this year as emergency measures are implemented and automatic stabilisers function fully. The general government balance is forecast to reach a deficit of about 6¼% of GDP in 2020 and around 3½% in 2021. Revenues are expected to decrease sharply this year due to the projected drop in consumption, production and profitability.

Higher spending on social security and healthcare will lead to a strong increase in expenditure. Furthermore, the government has adopted a significant package of emergency measures with an estimated budgetary impact of more than 2½% of GDP to help avoid structural damage to the economy. The measures focus on employment protection, household purchasing power and loan guarantees to support the flow of credit to the private sector and prevent temporary liquidity problems from morphing into insolvency issues.

In 2021, based on a no-policy-change assumption and assuming that the measures adopted to fight the pandemic only have a temporary effect in 2020, revenues are expected to increase again, leading to a gradual improvement in the deficit. Government debt is forecast to rise to around 62% of GDP and to decline again in 2021 to 58%. The large amount of loan guarantees present a significant downside risk to the budget balance.

Table II.14.1:

Main features of country forecast - NETHERLANDS

	2018		Annual percentage change						
	bn EUR Curr. prices	% GDP	00-15	2016	2017	2018	2019	2020	2021
GDP	774.0	100.0	1.3	2.2	2.9	2.6	1.8	-6.8	5.0
Private Consumption	341.5	44.1	0.6	1.1	2.1	2.3	1.4	-9.5	7.2
Public Consumption	187.6	24.2	2.2	1.3	0.9	1.6	1.6	2.1	2.6
Gross fixed capital formation	157.5	20.3	1.4	-7.3	4.2	3.2	5.3	-11.2	5.9
of which: equipment	44.4	5.7	0.8	4.8	3.2	1.5	8.1	-15.1	9.1
Exports (goods and services)	652.7	84.3	4.2	1.7	6.5	3.7	2.4	-10.6	7.0
Imports (goods and services)	567.6	73.3	4.2	-2.0	6.2	3.3	3.1	-11.2	8.0
GNI (GDP deflator)	781.7	101.0	1.3	0.6	5.2	2.8	1.2	-7.6	4.9
Contribution to GDP growth: Domestic demand			1.1	-0.8	2.0	2.1	2.1	-6.0	4.9
Inventories			0.0	0.1	0.0	-0.2	0.0	-0.1	0.0
Net exports			0.3	2.9	0.9	0.7	-0.3	-0.7	0.0
Employment			0.4	2.1	2.2	2.6	1.8	-2.4	1.4
Unemployment rate (a)			4.8	6.0	4.9	3.8	3.4	5.9	5.3
Compensation of employees / f.t.e.			2.7	1.2	1.0	1.7	2.9	2.2	1.5
Unit labour costs whole economy			1.7	1.1	0.3	1.8	3.0	7.0	-2.0
Real unit labour cost			-0.1	0.6	-1.0	-0.4	-0.1	5.9	-3.4
Saving rate of households (b)			12.3	16.6	15.3	15.1	15.1	20.9	18.1
GDP deflator			1.8	0.5	1.3	2.2	3.0	1.1	1.5
Harmonised index of consumer prices			2.0	0.1	1.3	1.6	2.7	0.8	1.3
Terms of trade goods			0.2	1.0	-0.3	-0.3	0.9	-0.1	0.0
Trade balance (goods) (c)			8.2	9.3	9.7	9.6	8.5	8.2	7.7
Current-account balance (c)			6.7	8.1	10.8	11.2	10.2	9.0	8.4
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			6.5	7.9	10.8	11.1	10.2	9.0	8.4
General government balance (c)			-2.0	0.0	1.3	1.4	1.7	-6.3	-3.5
Cyclically-adjusted budget balance (d)			-1.6	0.5	0.9	0.4	0.8	-2.4	-1.6
Structural budget balance (d)			-	0.2	0.5	0.4	0.6	-2.4	-1.6
General government gross debt (c)			55.5	61.9	56.9	52.4	48.6	62.1	57.6

(a) as % of total labour force. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.