Economic Developments and Outlook

June 2012 / no. 3

De Nederlandsche Bank
Eurosysteem

De Nederlandsche Bank

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In the event of discrepancies between the original Dutch-language version and this translation, the Dutch text shall prevail.

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Summary

The middle of last year saw the onset of a renewed period of economic contraction, just after the damage of the crisis in the previous two years had been largely made good. With gross domestic product (GDP) expected to shrink by 0.6% in 2012, the double dip is set to become reality. The forecast for 2013 calls for moderate growth of 0.6%, while the uncertainties are set to remain as great as ever. This means that economic growth for this year and next will work out lower than forecast six months ago, partly due to disappointing developments in the international economy and the Dutch housing market. The recovery will gather strength in 2014, when the Dutch economy will expand by an estimated 1.2%. Nevertheless, unemployment will rise to 6.4% in 2014, meaning that almost 200,000 more people will be jobless than last year.

The forecast takes account as much as possible of the Budgetary Agreement. The increase in taxes and other levies in 2013 will take a particular toll on households. This will keep inflation at around 2.5% and depress private consumption. The increase in taxes and other levies as well as the public spending cuts the government has announced will ultimately have a limited impact on domestic production as imports of goods and services will also be curtailed. DNB calculations show that the Budgetary Agreement will reduce GDP growth in 2013 and 2014 by, respectively, 0.5 and 0.3 percentage point. Meanwhile, the EMU deficit will decrease to 2.9% of GDP in 2013. Despite reviving economic growth, the budget deficit will again edge higher in 2014 to 3.1% of GDP. This underscores that the need to put the public finances in order will continue to present the government with a substantial challenge beyond 2013.

The moderate growth outlook for the Dutch economy is entirely attributable to the unfavourable development of domestic spending, consisting of private consumption, government expenditure and investments. The contribution to economic growth from foreign sales amounts to about one percentage point per year in the projection period. Exports thus remain an indispensable driver of Dutch economic growth.

Though economic growth will gradually gather momentum during this period, a robust recovery with above-potential growth and a substantially less negative output gap is not in the offing. A higher growth figure that would meet these recovery criteria, say 1.5% in 2013 and 2014, is not inconceivable but will not be easy to achieve. The growth in relevant world trade should show a cumulative increase of about 5 percentage points compared to the baseline forecast. The world trade growth figures required to achieve this are high by historical standards, but not exceptional. Still, an entirely domestic-driven growth impulse cannot be ruled out, but would require a surge in consumer and producer confidence. This provides an extra reason for pursuing further structural reforms that reinforce the longer-term growth potential. Credible reforms not only generate long-term profits, but can also give growth a rapid short-term impulse as households and businesses start spending more in anticipation of better times ahead.

1 The Dutch economy in 2012-2014

Contracting economy and slow recovery

Slow recovery after contraction this year

The outlook for the Dutch economy is hardly auspicious. Gross domestic product (GDP) is expected to contract by 0.6% in 2012, while showing only moderate growth of 0.6% in 2013 (see Chart 1). The recovery will gather pace in 2014, with economic growth of 1.2%, which is close to the potential growth rate. According to these figures, GDP would grow by a mere 2.2% in the 2008-2014 period, the lowest rate in any seven-year period in post-war history.

Fiscal deficit around 3% of GDP

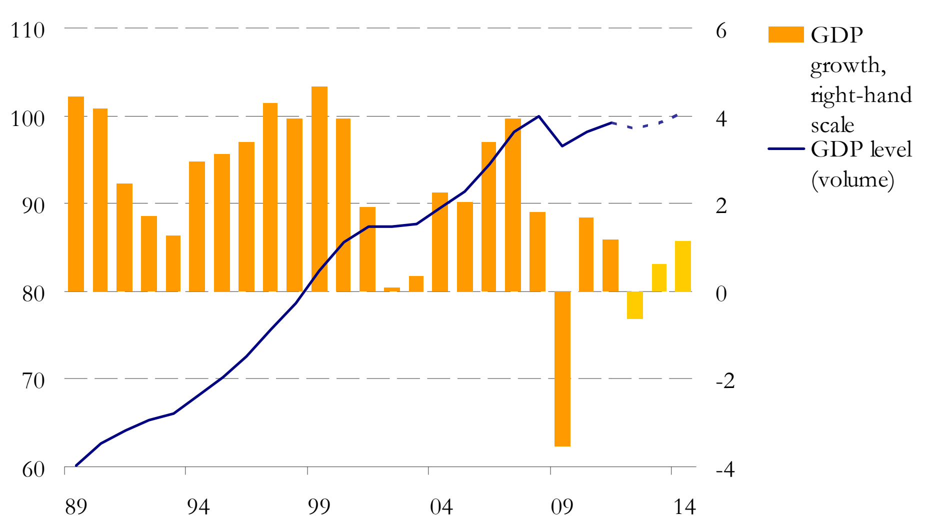
The forecasts take into account the recent Budgetary Agreement for 2013. Next year's increase in taxes and other levies for households will keep inflation at around 2.5% and dampen private consumption. Additional measures will bring the EMU deficit down to 2.9% of GDP in 2013. The deficit will then rise again fractionally to 3.1% of GDP in 2014. That year, higher economic growth will boost government revenues, but this effect will be cancelled out by the reduction in direct taxes announced for that year.

Uncertainties remain large

World trade growth picks up

Great uncertainties currently surround the international economic outlook, with the European debt crisis by far the most important factor. In giving the banking sector a net liquidity injection of about EUR 500 billion, the ECB has averted a phase of acute stress in the financial sector, but this does not resolve the structural problems. The forecast assumes that the European debt crisis will ultimately be resolved without extreme shocks. It also assumes, by extension, that the relevant

Chart 1 Dutch GDP growth
2008 = 100 and percentage changes



Source: CBS and DNB.

world trade for the Netherlands, which contracted in the last quarter of 2011, will accelerate in the course of 2012 and grow by about 5% to 6% per year in the coming years. The favourable growth prospects for Germany are crucial in this respect.

Dutch economy in slow recovery from crisis

Double dip

After the low point of the crisis in 2009, GDP initially recovered to such an extent that around 80% of the loss in output had been recouped by 2011. However, the

Table 1 Key data in forecast for the Dutch economy

Percentage changes, unless otherwise stated

	2011	2012	2013	2014
Volume of expenditure and output				
Gross domestic product	1.2	-0.6	0.6	1.2
Private consumption	-1.1	-1.0	-0.7	-0.1
Public expenditure	-0.1	-0.8	-1.1	0.0
Corporate investment	8.6	0.1	0.9	2.2
Housing investment	6.3	-5.9	-1.9	0.1
Exports	3.8	4.8	4.5	5.4
of which domestically produced	2.5	2.5	3.9	3.8
of which re-exports	5.3	7.6	5.2	7.2
Imports	3.5	4.0	3.5	4.9
Wages and prices				
Contractual wage per private sector employee	1.4	1.7	2.0	1.9
Compensation per private sector employee	2.0	2.8	2.4	2.2
Harmonised consumer price index	2.5	2.6	2.5	1.5
Labour market				
Employment (persons, growth)	0.3	-0.4	-0.5	0.1
Labour supply (persons, growth)	0.3	0.6	0.3	0.4
Unemployment (persons x 1,000)	387	471	542	570
Unemployment (level, %)	4.4	5.4	6.1	6.4
Public sector				
EMU balance (EDP; level, % of GDP)	-4.7	-4.1	-2.9	-3.1
EMU debt (level, at year-end, % of GDP)	65.2	69.1	70.5	71.8
Other				
Current account (level, % of GDP)	7.5	9.7	11.2	10.8
International assumptions				
Volume of relevant world trade	5.2	2.4	5.4	6.0
Volume of GDP US	1.7	2.2	2.2	2.8
Euro area	1.5	-0.5 - 0.3	0.0 - 2.0	
Emerging markets	5.8	5.0	5.6	5.9
Short-term interest rate in the euro area (level, %)	1.4	0.8	0.7	0.9
Long-term interest rate in the Netherlands (level, %)	3.0	2.3	2.6	3.0
Euro exchange rate (level, USD)	1.39	1.30	1.30	1.30
Oil price (level, UK Brent in USD per barrel)	111.6	114.6	107.9	102.0
Commodity prices excluding energy, in USD	17.9	-8.0	1.6	5.1

Source: DNB and ECB.

second half of last year brought the onset of a new period of contraction related to the escalating debt crisis, the higher oil price and the monetary tightening in emerging economies. As a result, the 'double dip' is set to become reality, with GDP contracting 0.6% in 2012.

Economic outlook revised downwards

Table 1 presents the outlook for the 2012-2014 period.[1] Both in 2012 and in 2013, GDP growth is about 0.7% lower than forecast six months ago. The deteriorated international outlook results in lower growth figures for the export sector. Meanwhile, the persistent malaise in the Dutch housing market is making household spending even tighter than before and is putting the brakes on housing investments. In addition, the government's announced increases in taxes and other levies as well constraints on public expenditure are affecting domestic spending. The ultimate effect on domestic production is limited because imports of goods and services will also be dampened (see Box 1). DNB calculations indicate that the Budgetary Agreement will curb GDP growth in 2013 and 2014 by 0.5 and 0.3 percentage point, respectively. Note, incidentally, that part of the proposed policy, namely the public spending cuts (EUR 0.875 billion), has not yet been sufficiently detailed to be included in the analysis.

Box 1 Uncertainty about the budgetary multiplier and the 'Zijlstra' effect

The budgetary multiplier indicates the degree to which policy-driven changes in government revenues and expenditure influence economic growth. This multiplier is determined by many factors, such as the openness of the economy, the interest rate policy and the economic situation. The budgetary multiplier cannot be observed directly, as changes in economic growth can have many causes. An increase in economic growth may result from higher government spending, but also from higher foreign demand for Dutch products or a fall in oil prices. An economic model is necessary to make a more accurate distinction between these diverse factors. DNB uses the DELFI macro-economic model for this purpose.

A model is always an imperfect description of reality. This means that the size of the budgetary multiplier as derived from a model is uncertain and depends on the assumptions made in the model. The modelling of the import of goods and services is particularly crucial for an open economy like the Netherlands. That said, the reaction of the imports to changes in domestic demand strongly determines the size of the budgetary multiplier. After all, the latter concerns the consequences for domestic production. According to DELFI, the growth in imports of goods and services ultimately falls into step with domestic spending. When domestic spending accelerates, imports will initially grow at a slightly faster pace, as it takes time to adjust production capacity to changes in demand. In addition, the economic situation also plays a role. This is sometimes referred to as the 'Zijlstra' effect. During an economic downturn, imports will decline in relative terms due to the availability of sufficient domestic production capacity to meet demand. Conversely, when tensions in the economy rise, a larger proportion of the demand will be met by imports.

Table 2 illustrates how the government's decision to cut public spending or raise taxes and other levies will affect GDP. This policy has a dampening effect on spending, both in the public sector and among consumers and businesses.

1 The assumptions for the development of world trade, exchange rates, international commodity prices and interest rates were determined jointly by experts from the ECB and the national central banks of the euro area. The assumptions are based on information available through 15 May 2012.

The ultimate effect on growth depends on how imports respond to the lower expenditures. In DELFI, the lower expenditure is absorbed to a relatively strong degree by lower imports, because econometric analyses confirm the Zijlstra effect for the Netherlands. This limits the dampening effect on economic growth. However, growth falls more sharply in a model that excludes the Zijlstra effect. This is because in this case, imports respond less quickly to lower spending so a larger part of the lower domestic demand impacts domestic production. In other words, consolidation puts the brakes on economic growth, but the effect is less pronounced if the economic impact on imports is also taken into account.

Table 2 Effects of spending cuts and increases in taxes and other levies (1% of GDP) on GDP volume

Cumulative deviations from baseline scenario

	Year 1	Year 2	Year 4
DELFI			
Reduction in government expenditure [1]	-0.7	-0.7	-0.8
Increase in wage and income tax	-0.1	-0.3	-0.6
Increase in standard VAT- rate	-0.2	-0.3	-0.5
DELFI without Zijlstra effect			
Reduction in government expenditure [1]	-0.8	-1.1	-1.2
Increase in wage and income tax	-0.1	-0.5	-1.0
Increase in standard VAT-rate	-0.3	-0.6	-1.0

1 excluding wages and salaries

Source: DNB.

Negative output gap

GDP will not return to the 2008 level until 2014. And it will take a lot longer for the Dutch economy to start performing to capacity again. This is because the output gap – the difference between actual and potential output – will still be negative (-2.6%) in 2014. The output gap will only close after a protracted period in which actual economic growth remains substantially above potential growth, which is estimated at 1.2% per year for the 2013-2017 period (see Box 3 in chapter 3).

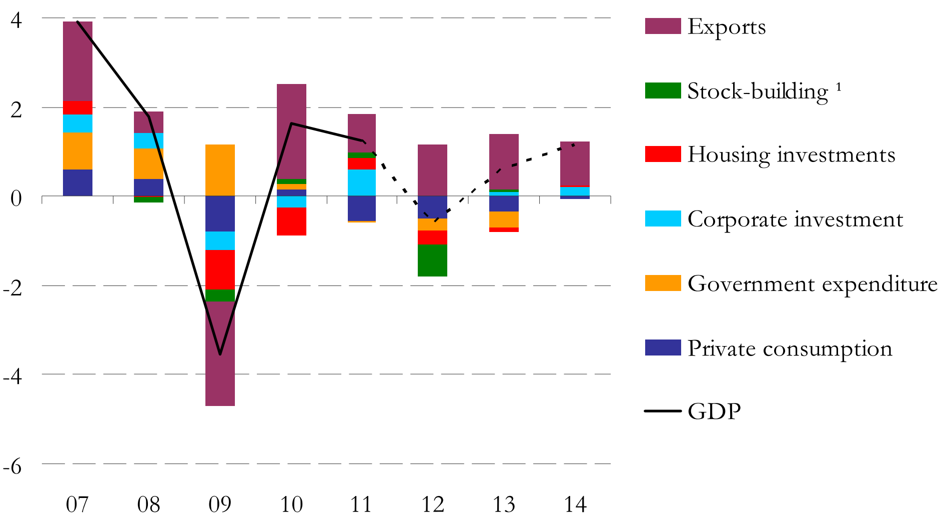
Domestic spending contributes negatively to economic growth

The low economic growth in the 2012-2014 period is entirely attributable to domestic spending. This is evident from the net contributions of expenditures to economic growth, while an adjustment for the required imports has been made for each category of expenditure (see Chart 2).

Negative growth contributions from consumption

Private consumption makes a negative contribution to economic growth over the entire projection period. This has been the case since 2009, when the rise in house prices came to an end. One striking factor is the negative growth contribution of public expenditure both this year and next, partly due to measures from the Budgetary Agreement. In 2014, joint domestic expenditures are once again expected to make a slight positive growth contribution, almost entirely thanks to increased corporate investment activity.

Chart 2 Sources of Dutch GDP growth
Percentage changes and percentage points



Explanation: Net contributions to GDP growth, where the final and cumulative intermediary imports have been deducted from the relevant expenditure categories.
1 Including statistical difference. Source: CBS and DNB.

Exports support economic growth

In 2013 and 2014, the Dutch economy will benefit from international economic development via the export sector. Domestically produced exports will grow by almost 4% per year. The fact that exports can rapidly fall into step with the international recovery is partly attributable to the moderate development of unit wage costs in the past and the previously implemented structural reforms, including measures to make the labour market more flexible. As a result, the Netherlands is sufficiently competitive and the business climate is attractive.

2 The domestic economy

Consumption under pressure from lower disposable income and assets

Lower consumption due to...

In the past three years, private consumption contracted by 3% in real terms and consumption growth remains negative in the forecast until the end of 2014. At the same time, consumers are spending more than the disposable income they are receiving. This is evident from the negative non-compulsory savings ratio, which will in fact fall to a record low of almost -3% in 2013 (see Chart 3).

...decline in real disposable income...

The decline in private consumption over such a prolonged period is primarily due to the disappointing growth in income. Adjusted for inflation, disposable income was lower in 2011 than ten years ago. In 2012 and 2013, real disposable income will drop further, falling almost 4% in total (see Chart 4). This means that household disposable incomes will not have advanced between 2000 and 2013. Thanks to the lower inflation and the announced decrease in taxes and other levies, real disposable income will rise slightly in 2014, and the fall in consumption volume will virtually come to a halt.

...and lower home equity

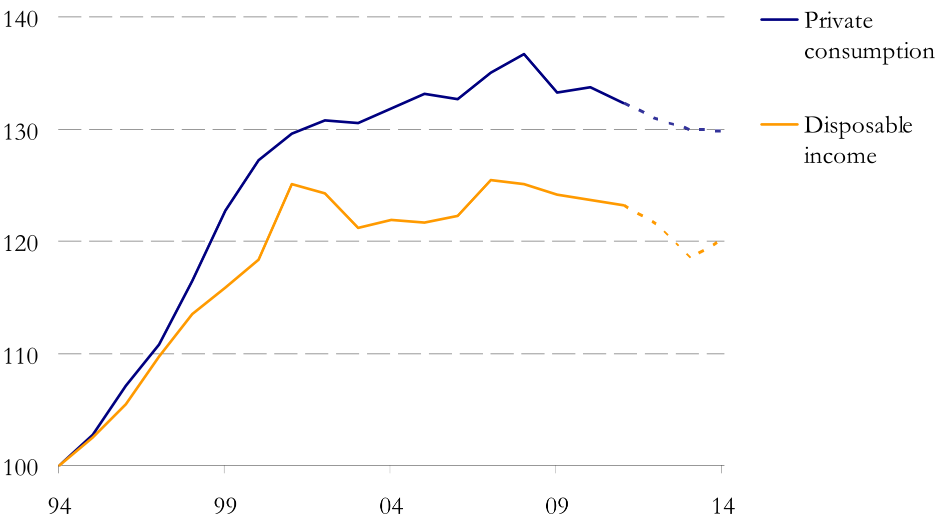
Apart from the income situation, the housing market is also important for consumption growth. Now that house prices have been in decline since 2008, home equity (the difference between home value and mortgage debt) is also being eroded. In the three-year forecast period, this will depress consumption growth by about 0.9 percentage point per year. A stronger-than-anticipated decline in house prices could cause consumption to contract even more sharply in 2014 than currently forecast. See Box 2 for an analysis of the reasons why private consumption is failing to recover.

Chart 3 Individual savings

Percentages of disposable income including adjustment for net equity in pension funds reserves

Source: CBS and DNB.

Chart 4 Consumption volume and real disposable income
Index 1994 = 100



Source: CBS and DNB.

Box 2 Consumption failing to recover

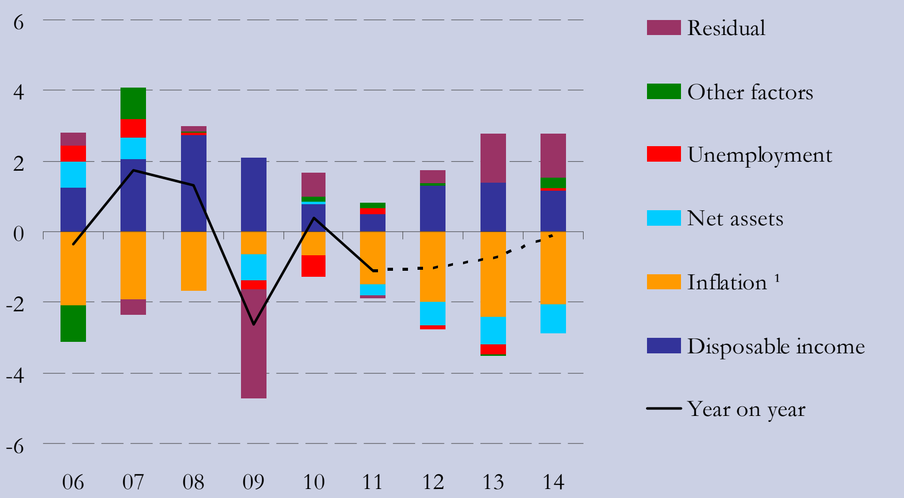
Ever since the crisis started, private consumption has been disappointing in the Netherlands. Compared to the last peak, in mid-2008, the decline in real terms now exceeds 4%. The current forecast anticipates a further decrease of about 2%. This means that a recovery in consumer spending, which was expected until very recently, will fail to materialise. The developments in 2011 were particularly disappointing. The forecasts that DNB prepared between December 2009 and December 2010 assumed consumption growth of over 1%. However, Statistics Netherlands (CBS) has now published all the figures for that year, leaving a net consumption contraction of 1.1%.

DNB's macro-economic model DELFI explains the development of private consumption, based on the following financial-economic variables: disposable income, inflation, household assets, unemployment and long-term interest rates. Household assets are broken down into net home equity (home value less mortgage debt) and net financial assets (liquid savings less other debts). The model comparison is obviously not perfect. There is always a difference between actual and projected consumption growth. This is known as the 'residual'. Looking back, the residual is a measure of the changes in consumer behaviour that were not included in the model. Looking forward, the residual is an indicator of the need for an adjustment to the consumption growth implied by the model comparison. Particularly if the projection of consumer behaviour was not very accurate in past years, there is every reason to assume that consumer behaviour will also deviate from the model comparison in the future. In recent times, for instance, Dutch consumers have been rather pessimistic. This depresses their spending. However, if their mood brightens in the future, this could give a positive impulse. The model indirectly incorporates the fluctuations in consumer sentiment – or consumer confidence – through changes in home equity and unemployment. Consumer confidence may sometimes also be driven by other factors, such as uncertainty about the financial situation in the Netherlands or Europe. This can be expressed in due course in a changing residual.

Chart 5 shows how changes in the explanatory variables and the residual contribute to consumption growth. Inflation and disposable income are usually the key determinants of consumption. In 2009, when consumption fell sharply, there was also a strong negative contribution from the residual. In other words, the model was unable to fully 'explain' the decline.

In the coming years, this negative growth contribution from the residual in 2009 is expected to be gradually eliminated, largely in the forecast years 2013 and 2014. However, the total consumption growth forecast remains weak due to low income growth, relatively high inflation and a further fall in home equity.

Chart 5 Sources of consumption growth
Percentage changes and percentage points



1 Private consumption deflator.
Source: DNB.

Consumption through public sector rising quickly

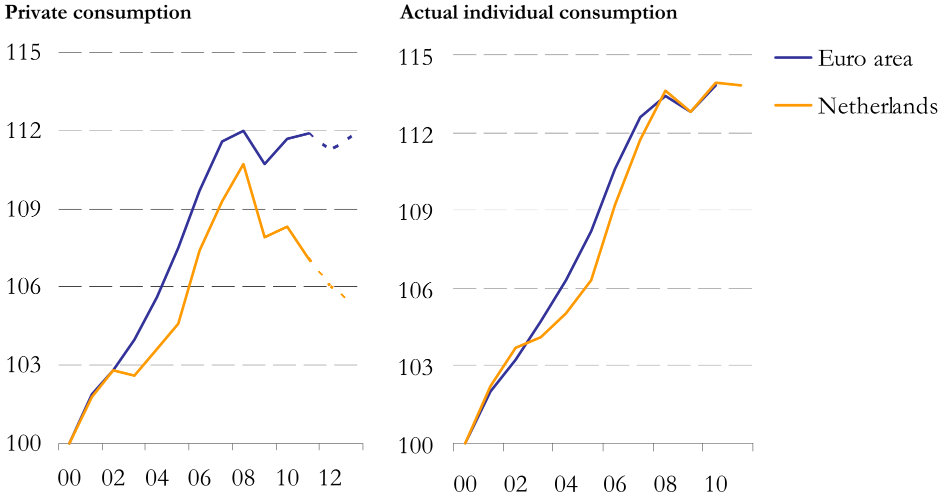
The development of household consumption is disappointing, also by international standards. However, this must be qualified as a large proportion of Dutch consumption is related to the public sector, particularly healthcare. Chart 6 illustrates this. Between 2000 and 2011, average consumption rose much faster in the euro area than in the Netherlands. But this difference disappears entirely in the 'actual individual consumption', which also includes household consumption related to the public sector, such as healthcare and education. Between 2000 and 2011, these expenditure categories rose by 40% in the Netherlands, which is considerably higher than the euro area average increase of 22%.

Depressed housing market

Falling house prices

In April, the number of houses sold fell on a twelve-month basis to 114,500, while the average number of days that a house is on the market has risen sharply (see Chart 7). Compared with the peak in August 2008, house prices have now fallen by 12.5%. The permanent reduction of property transfer tax to 2% is expected to have a favourable effect on the housing market. In addition, in order to be eligible for mortgage interest relief from 2013 new mortgages must have a repayment method that is at least annuity-based. Another change taking effect next year is the reduction in the maximum LTV ratio for new loans by 1% per year, ultimately reaching 100%. The implementation of the latter two measures will be phased to avoid an immediate impact on the entire housing market. Together with the expected slow growth in

Chart 6 Development of Dutch consumption in international perspective
2000 = 100



Explanation: The forecasts for other countries come from the European Commission, Spring Forecast. Dutch private consumption for 2006 has been corrected for the changes in the healthcare system.
Source: Eurostat, OECD, European Commission, CBS and DNB.

mortgage lending, rising mortgage interest rates and higher unemployment, this means that house prices will continue to fall until 2014, albeit at an increasingly gradual rate.

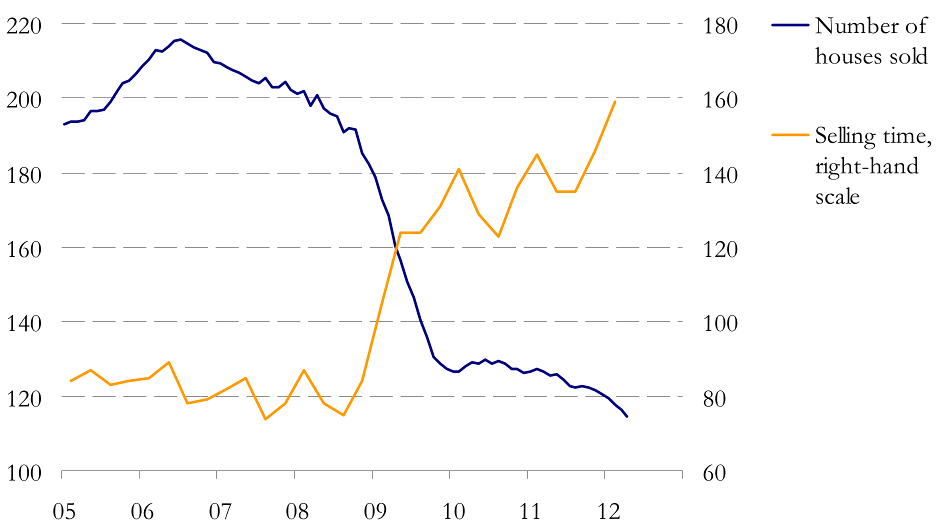
Low growth of corporate investment

Corporate investment remains sluggish

Last year, corporate investment grew 8.6%, marking a partial recovery from the substantial decline of a total of 14% in the two preceding years.

However, the pace of the recovery will be significantly lower in the coming years: 0.1% in 2012, 0.9% in 2013 and 2.2% in 2014. The industrial capacity utilisation rate

Chart 7 Number of houses sold and selling time
Twelve-month sum in thousands and number of days



Source: CBS, Kadaster and NVM.

of 79% (start of this year) is still significantly lower than the long-term average of 83.7. Another consideration is that the sales outlook for businesses is far from rosy, while the uncertainties – surrounding the outcome of the European debt crisis, for instance – remain as great as ever. Added to this, the tighter lending conditions that banks have applied since 2008 also make it less attractive for small and mid-sized businesses to finance their investments with borrowed capital. Since last year, banks are increasingly reporting that this policy is related to their balance sheets and the perceived collateral value risks. Still, the forecast does not see the tighter lending conditions as an impediment for investments as the demand for credit has simultaneously diminished sharply and companies are generally in a reasonably healthy financial condition.

Rising unemployment

Deteriorating labour market

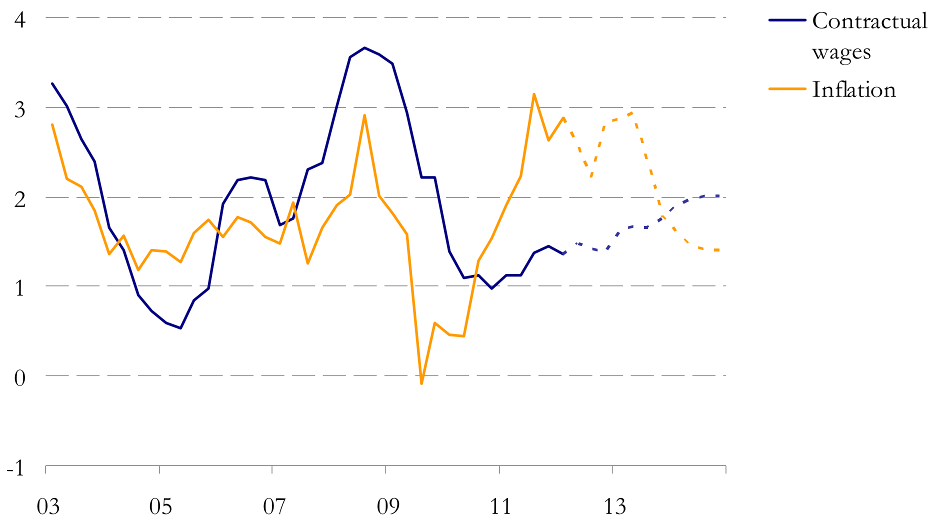
The unemployment rate is expected to rise sharply, from 4.4% in 2011 to 6.4% in 2014 (ILO definition). Demand for labour will contract both this year and next due to the unfavourable development of production. In 2012, this will be compounded by a strong increase in the labour supply. A relatively large number of young people are due to complete their extended or additional training, while the number of women who have indicated that they are seeking work has increased. In 2014, employment will rise slightly in the corporate sector, but not sufficiently to compensate the contraction in the public sector.

No fall in inflation until after 2013

Inflation remains high

Inflation was fairly high last year (2.5%), and will remain so both this year (2.6%) and next (2.5%). The forecast assumes that the VAT rate will be raised from 19% to 21% on 1 October 2012. As consumers are still watchful of their spending, companies will not immediately be able to pass on the full rise in their selling prices. The Budgetary Agreement will add 0.7 percentage point to inflation in 2013, mainly due to the higher VAT rate. Though a portion of the indirect tax increase will be passed on in 2014, inflation will fall that year to 1.5%, partly as a result of the lower expected prices of oil and other commodities (see Chart 8). Despite accelerating inflation, contractual

Chart 8 Contractual wage growth versus inflation
Percentage changes relative to previous comparable periods and percentage points



Explanation: HICP Inflation.
Source: CBS and DNB.

wages will continue to develop moderately in 2013. Over the past 18 months, contractual wage growth was below the inflation rate, due in part to the increased unemployment, which makes it more difficult to press through higher wage demands. The forecast foresees a slight rise in real wages with effect from 2014; lower inflation in that year will not be immediately reflected in contractual wages.

3 The international environment as growth engine

World trade growth picking up, mainly outside Europe

Favourable outlook for world trade...

Last year, with growth of over 5%, world trade relevant to the Netherlands regained its pre-crisis level (see Chart 9). However, in 2012 growth will be significantly lower at 2.4%, before accelerating to an expected 5.4% next year and even 6.0% in 2014. These figures are above the long-term average of 5.2%.

...partly due to emerging economies

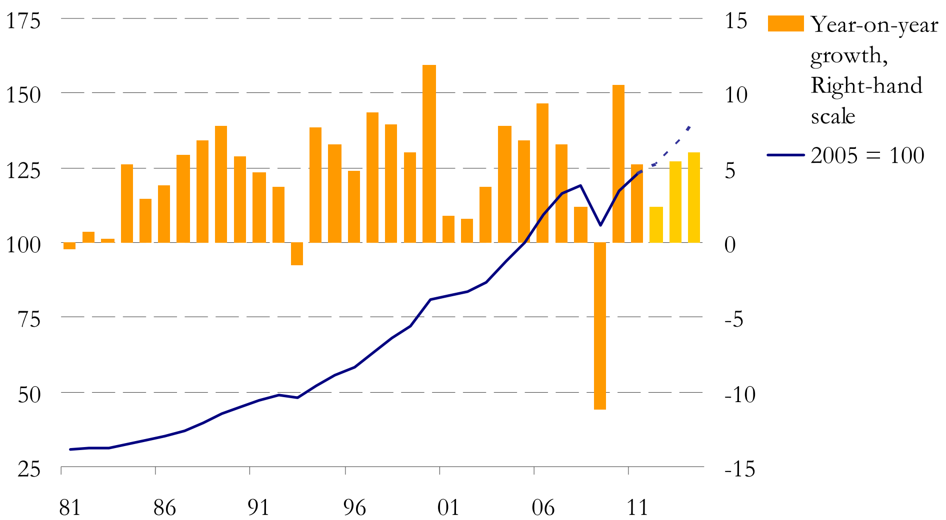
One important driver of world trade consists of the emerging economies, which look set to continue expanding by almost 6% per year in the coming years. The GDP of the emerging economies is expected to outpace that of the developed economies in 2014. In the coming years, the emerging economies can also benefit from their relatively low national debt (see Chart 10) as their governments face less need to consolidate.

Possible additional sources for faster growth recovery

Conditions for higher growth...

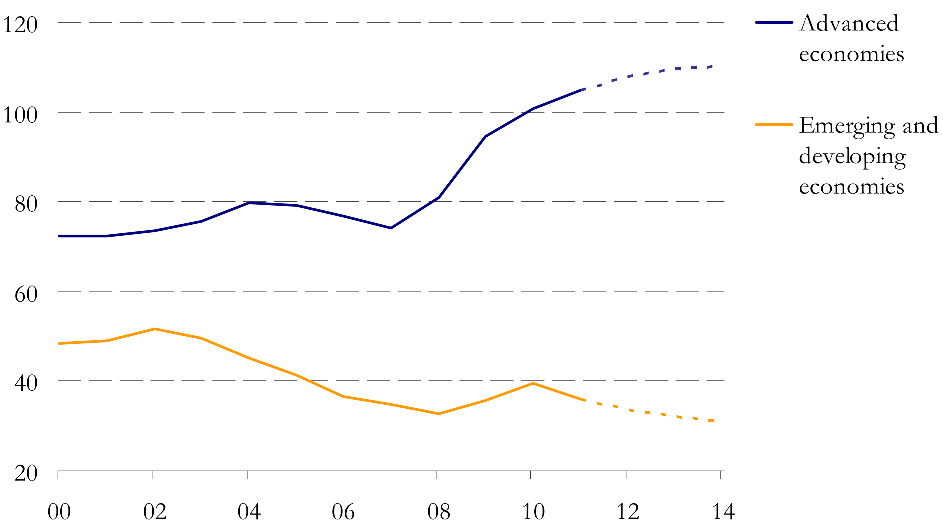
Despite accelerating world trade, a substantial economic recovery will fail to materialise in the Netherlands. The output gap will remain negative in the 2012-2014 period, varying between -2.5%and -2.8%. This raises the question of what is necessary to achieve higher-than-forecast GDP growth of, say, 1.5%. This growth rate level is higher than the forecast potential growth, which would enable that the output gap to close more quickly. Box 3 looks in more detail at the potential growth for the coming years.

Chart 9 Relevant world trade



Source: ECB.

Chart 10 Gross government debt
Percentage of GDP



Source: IMF.

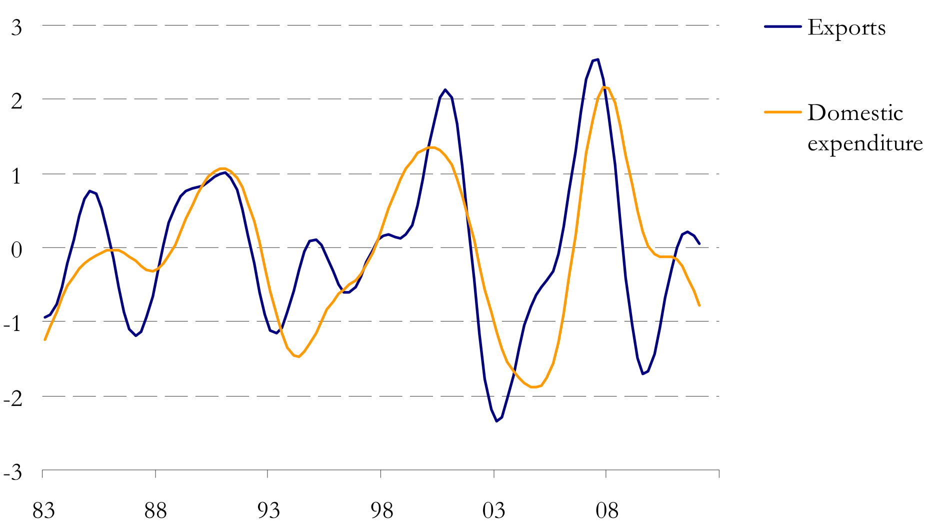
A faster recovery than currently projected could come from both international and domestic sources. Chart 11 shows the cyclical movement of exports and domestic spending. In almost all cases, exports pick up first, followed by domestic spending. This, however, does not apply to the recent export recovery.

Additional required world trade growth not impossible

... robust world trade growth...

One potential source of rising demand for Dutch products is a revival in German and US consumer confidence. Unemployment in the US and Germany is already showing a downward trend. In addition, German households have relatively low debts, while US households have already paid off part of their debts. In our line of argument, it is assumed that stronger consumer confidence would translate into

Chart 11 Cyclical movement in exports and domestic expenditure
Standardised deviation from the trend



Explanation: The trend was determined with the aid of the Christiano Fitzgerald (CF) filter.
Source: CBS and DNB.

Box 3 Lower potential growth due to more limited labour supply

Potential growth is economic growth adjusted for temporary cyclical influences. The level of potential growth in the medium term partly determines the budgetary scope in the coming government period. It breaks down into the increase in potential employment and the increase in structural labour productivity, which depends on investments and technological progress. Table 3 shows the potential growth for the years 1998-2017, which was calculated using DNB's macro-economic model DELFI.

The expectation for the years 2013-2017 is moderate potential growth averaging 1.2% per year. This is considerably lower than the actual growth percentages observed for the periods 1998-2002 and 2003-2007. The first reason is the much smaller growth contribution from potential employment; both the labour force and the labour participation rate are showing limited growth. In addition, the structural labour productivity is developing less favourably. Since the start of the financial crisis, growth in structural labour productivity has noticeably decelerated. This may have to do with the reallocation of labour between economic sectors and a mismatch between supply and demand in the labour market. Full-time male workers from sectors that are currently undergoing radical restructuring, such as financial services, construction and industry, cannot simply switch to other sectors such as health care where, due to the nature of the work, part-time female workers are largely employed. The forecast assumes that the period of reallocation will continue for some time yet. Therefore, a recovery of the growth in structural labour productivity to the pre-crisis level is not yet anticipated.

The output gap is the difference between actual output and potential output, and is a measure of the current economic situation. Normally, economic highs and lows alternate with fairly regular frequency; in DELFI the average duration of a period with a negative (positive) output gap is 4 (3) years. The output gap has now been negative since 2009 and is expected to remain negative in the forecast years; actual growth in these years will be below or close to potential growth. The potential growth forecast in the table implies that even average actual growth of 1.5% per year in the years 2013-2017 will not be sufficient to close the output gap by 2017. This exceptionally long economic stagnation is consistent with OECD research, which shows that after a financial and banking crisis, the output gap remains negative for twice to three times longer than in a normal recession.

Table 3 Potential growth, 1998-2017

Percentage changes per year

	1998-2002	2003-2007	2008-2012	2013-2017
Potential growth (added value, basic prices)	3.1	2.0	1.3	1.2
of which growth in potential employment (man years)	1.6	0.2	0.2	0.2
of which structural growth in labour supply (persons)	1.5	0.7	0.6	0.4
contribution of change in equilibrium unemployment	0.4	-0.2	-0.2	-0.1
contribution of growth in part-time work	-0.3	-0.3	-0.2	-0.2
growth in structural labour productivity	1.5	1.9	1.0	1.0

Source: DNB.

Table 4 Consequences of internationally-driven recovery
Percentage changes, unless otherwise stated

	2012	2013	2014
Relevant world trade	3.2	8.7	6.9
Gross domestic product	-0.5	1.5	1.5
Private consumption	-1.0	-0.5	0.4
Corporate investment	0.2	2.8	4.2
Exports	5.5	7.8	6.3
HICP	2.6	2.6	2.0
Unemployment (level, %)	5.4	5.9	5.7
EMU balance (EDP; level, % of GDP)	-4.1	-2.6	-2.3

Source: DNB and ECB

plausible additional growth of private consumption in the US and Germany. It is also assumed that the increased optimism would make investors more readily inclined to start up projects. With the aid of the NiGEM world trade model, the assumption that oil prices and competitor prices will rise on the back of heightened worldwide activity is also included.

Under these international conditions, the relevant world trade for the Netherlands could accelerate to such an extent that GDP growth works out at the desired 1.5% in 2013 and 2014 (see Table 4). In this case, the cumulative increase in the relevant world trade between 2012 and 2014 would be about 5% stronger than assumed in the forecast. Particularly in 2013, the relevant world trade for the Netherlands would have to grow much more rapidly than forecast (8.7% instead of 5.4%), whereas in 2014 the growth rate only needs to be one percentage point higher than currently forecast. Though such growth figures are high by historical standards, they are not exceptional.

Domestically-driven growth demands strong confidence boost

... or substantial domestic confidence recovery

An unexpectedly powerful domestic recovery could conceivably also serve to generate higher growth (of 1.5%). In this case, consumer spending and corporate expenditures need to regain momentum, mainly driven by an extra confidence boost. The results in Table 5 show that growth in consumption and investments must be substantially higher than the forecast to reach the required growth level of 1.5% in 2013 and 2014. The confidence boost would have to lift consumer growth more than 2 percentage points above the forecast in 2013, while corporate investments would need to exceed the forecast by as much as 6.8% that year. As the GDP growth forecast for 2014 is already 1.2%, the required extra increase in consumption and investments is relatively limited in that year. In this analysis, the extra consumption growth is mainly propelled by reviving consumer confidence and not by higher income. To finance this growth, households would have to dip further into their savings than anticipated in the forecast.

Structural reforms are important

The above analysis shows that it will be no easy task to raise Dutch economic growth to a higher level in the short term. World trade growth is already fairly strong in the baseline forecast and would need to be historically high in order to achieve GDP growth of 1.5%. A domestically-driven recovery is not impossible, but requires a substantial improvement in consumer and producer confidence. This could conceivably be spurred by structural reforms that reinforce the long-term growth

Table 5 Consequences of domestically-driven recovery
Percentage changes, unless otherwise stated

	2012	2013	2014
Relevant world trade	2.4	5.4	6.0
Gross domestic product	-0.4	1.5	1.5
Private consumption	-0.4	1.4	0.7
Corporate investment	1.8	7.7	3.7
Exports	4.8	4.5	5.4
HICP	2.6	2.5	1.6
Unemployment (level, %)	5.3	5.9	5.9
EMU balance (EDP; level, % of GDP)	-4.0	-2.4	-2.1

Source: DNB and ECB.

potential. Credible reforms not only generate long-term profits, but can also give economic growth a rapid short-term impulse as households and businesses start spending more in anticipation of better times ahead.