June 2017
Number 13

Economic Developments and Outlook

DeNederlandscheBank
EUROSYSTEEM

Economic Developments and Outlook

June 2017, number 13

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Closing date: 8 June 2017

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Summary

2017 is the fifth consecutive year of accelerating economic growth. Growth is expected to peak at 2.5% this year, reflecting the pick-up in world trade and the recovery of corporate investment. The next two years are also likely to show robust growth, at 2.1% and 1.9%, respectively. Economic growth is broadly based and will be supported by all expenditure categories, mostly by domestic spending, particularly in 2018 and 2019.

Sustained income improvement should boost household consumption by 1.5% to 2% per annum over the projection horizon. This improvement is fuelled above all by higher compensation levels for employees and self-employed persons, as well as by fast-growing employment. Corporate investment is showing robust growth, driven by beneficial financial conditions and rapidly increasing capacity utilisation. The housing market remains bullish, and price increases are flattening somewhat. Likewise, housing investment is returning to calmer waters, following the exceptionally steep growth rates recorded in recent years.

Negotiated wages are strengthening moderately, at a rate of 1.8% in 2017, and are set to climb gradually to 2.2% in 2019. The limited wage growth is related to the current labour market slack. Although unemployment is set to fall from 6.0% in 2016 to 4.4% in 2019, a sizeable unused labour force will remain for some time to come, including part-time workers seeking to work more hours. The pick-up in productivity growth will limit the increase in unit labour costs, thereby relieving price pressures. Inflation is expected to reach 1.1% in both 2017 and 2018, followed by 1.4% in 2019.

An alternative scenario shows the potential effects that intensifying protectionism will have on the Dutch economy, starting with higher US import tariffs and export subsidies. If other countries refrain from taking countermeasures, the Dutch economy will suffer to a limited extent only. If countermeasures are taken, however, global economic consequences will be far more damaging, including for the US economy. The downward effect on economic growth in the Netherlands will be -0.5 percentage points in 2018 and -0.2 percentage points in 2019, compared with the baseline projections.

1 The Dutch economy in 2017-19

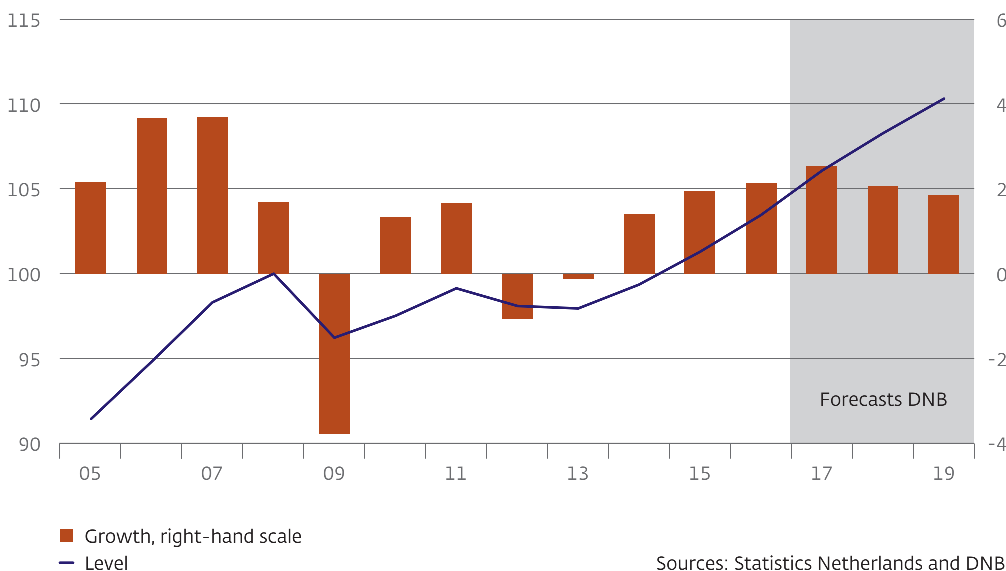
Economic growth will peak in 2017 ...

2017 is the fifth consecutive year in which growth in gross domestic product (GDP) is up from the year before. Economic growth in the Netherlands is expected to peak at 2.5% in 2017, a growth rate not seen since 2007. The next two years will also see persistent solid growth, at 2.1% and 1.9%, respectively (Chart 1). The strong economic performance projected for 2017 will be driven by factors such as an upswing in world trade, as well as a recovery in corporate investment following a one-off setback in 2016. From 2018 onwards, growth in world trade will be less pronounced, and the Dutch housing market is set to return to calmer waters following three years of extraordinarily sharp growth.

GDP growth exceeds potential growth across the entire projection horizon, thereby closing the output gap, narrowing it from -3% on average in the 2013-16 period to 0% in 2019. The bright economic outlook is also reflected in the rapid improvement of the Dutch labour market. The number of jobs grew by 1.7% (year-on-year) in the first quarter of 2017, which is the fastest increase witnessed in nine years. Our projections assume a reduction in unemployment from 6.0% on average in 2016 to 5.0% in 2017, and a subsequent further gradual decrease to 4.4% in 2019.

Chart 1 Gross domestic product

Volume; 2008 = 100 and year-on-year percentage changes



Sources: Statistics Netherlands and DNB.

... following the favourable quarterly figures recorded in 2016

The first three quarters of 2016, in particular, showed stable and buoyant GDP growth. With quarter-on-quarter growth figures consistently close to 0.8%, growth was predominantly driven by domestic spending. Growth edged down to 0.6% in the final quarter of 2016, due mostly to non-recurrent contraction in corporate investment. The first quarter of 2017 saw a further slide in quarterly growth, to 0.4%, with private consumption this time disappointing, showing a 0.1% decline. The mild winter depressed energy spending, which was also reflected in a sharp contraction in output in the mining and quarrying sector (19% quarter-on-quarter). When adjusted for this, the growth rate picked up to reach 0.8%. The outlook for spending remains bright for the quarters ahead. The GDP growth rate is set to return to a level of around 0.5% quarter-on-quarter.

The international economic assumptions underlying our projections

World economic growth is picking up on the back of robust growth in the developed economies and the easing of the deep recessions in the commodity exporting economies.[1] The ECB projects average world growth (excluding the euro area) of 3.7% for 2017-19. Growth in the United States has increased since 2016, fuelled by diminishing labour market slack, higher house and equity prices and the expected increase in government expenditure. China will continue on its gradual adjustment towards a slower and more sustainable growth path. Growth in the euro area economy is expected to outstrip potential growth in the years ahead, supported by the accommodative monetary policy, restoration of household and corporate balance sheets and sustained labour market recovery. The ECB estimates euro area GDP growth of 1.9% in 2017, 1.8% in 2018 and 1.7% in 2019. The upturn in the world economy will also accelerate growth in world trade relevant to the Netherlands, from 2.9% in 2016 to 4.6% in 2017, before edging down to just under 4% per annum.

These expectations for the world economy are surrounded by a fair amount of uncertainty. For example, US Congress may not approve the expected fiscal stimulus, or at a later stage. Besides, the further unwinding of financial imbalances in China may be disorderly. In addition, the financial conditions for the emerging economies may worsen sooner than expected as US monetary policies are tapered further. In the more distant future, spreading protectionist policies pose an important risk (see also section 3, Intensifying protectionism: an alternative scenario).

1 The assumptions underlying the development of relevant world trade, exchange rates, international commodity prices, and interest rates are based on information available on 17 May 2017.

Over the past six months, oil prices have dropped on balance as investors are less confident about the effectiveness of the production restriction agreed between the OPEC and various other oil-producing countries. Non-OPEC members proved unwilling to fully comply with the restriction and US corporations increased their output of shale oil production as oil prices went up. Oil prices in our projection horizon are based on the average futures prices for the two weeks preceding the cut-off date, i.e. approximately USD 51.50 for the entire projection horizon.

Growth to remain elevated throughout the projection horizon

Table 1 lists the key data in the forecast for the Dutch economy for 2016-19. Broadly speaking, recovery in growth will continue at the same rate of just over 2% which was set in 2015. Following the 2.1% figure seen in 2016, economic growth will peak at 2.5% in 2017, after which it will reach 2.1% in 2018 and 1.9% in 2019. The 2017 growth peak is related to the vigorous GDP growth in the final quarters of 2016, which spilled over to a relatively large extent into growth figures for 2017. In addition, the contraction in corporate investment in the fourth quarter of 2016 was followed by a sharp upward correction in the first quarter of 2017. From 2018 onwards, domestic spending is projected to grow at a slightly slower pace. For private consumption, this will be due to higher inflation and the slowdown in the rise of house prices, which will dampen increase in value of household wealth. Housing investment will gradually return to calmer waters, following the exceptionally steep growth rates recorded in recent years. Construction businesses will be approaching their capacity limits, and pent-up demand for new construction projects and renovation should be less exuberant. At 5.5% on average in 2018 and 2019, housing investment is still projected to be above the long-term average of around 1%. Corporate investment will rebound sharply in 2017 (4.5%), following the disappointing 1.2% growth in 2016. In the next few years, businesses will continue to expand investment, with growth figures expected to be well above the 3.5% annual long-term average.

Economic recovery in the Netherlands was supported mainly by domestic spending in recent years, which will continue to provide support over the entire projection horizon, but in 2017 exports will also make a relatively large contribution, at 1.1 percentage points (Chart 2). In the other projection years, exports will on balance contribute around 0.7 percentage points per annum to GDP growth, just below the 1 percentage point contribution seen on average over the past two decades. Private consumption has substantially contributed to GDP growth since 2016, fluctuating around 0.5 percentage points in the 2016-19 period, something not previously seen this century, with the exception of 2007. Other major domestic contributions to growth include investment, with non-housing investment gradually replacing housing investment.

Table 1 Key data in forecast for the Dutch economy

Percentage changes, unless stated otherwise

	2016*	2017	2018	2019
Volume of expenditure and output				
Gross domestic product	2.1	2.5	2.1	1.9
Private consumption	1.7	1.5	2.0	1.6
Public expenditure	0.8	1.0	1.3	1.4
Business investment	1.2	4.5	4.8	3.8
Housing investment	19.0	13.1	6.4	4.7
Exports of goods and services	3.3	4.4	4.4	4.2
of which domestically produced	1.4	3.3	3.6	3.8
of which re-exports	5.5	5.6	5.2	4.6
Imports of goods and services	3.6	4.5	5.3	4.8
of which domestically used	1.8	3.6	5.4	4.9
Wages and prices				
Negotiated wages, private sector	1.6	1.8	2.1	2.2
Compensation per employee, private sector	1.1	2.6	2.4	2.5
Unit labour costs	0.6	1.8	1.3	1.3
Prices of domestically produced exports	-1.9	3.2	1.5	1.3
Harmonised consumer price index	0.1	1.1	1.1	1.4
House prices, existing own homes	5.1	6.6	5.7	4.1
Labour market				
Employment (persons, growth)	1.1	2.0	1.2	0.9
Labour supply (persons, growth)	0.2	0.9	0.8	0.7
Unemployment (persons x 1.000)	538.8	443.9	413.7	398.4
Unemployment (% of labour force)	6.0	5.0	4.6	4.4
Public sector and financial				
EMU balance (% of GDP)	0.4	0.7	1.0	1.1
EMU debt (% of GDP)	62.3	58.6	54.9	51.3
Current account (% of GDP)	7.9	9.2	9.1	9.3
Mortgage loans (based on end-of-period)	2.1	4.0	3.9	4.3
Bank lending to NFC (based on end-of-period)**	-2.2	-2.0	0.2	2.6
International assumptions				
Volume of relevant world trade	2.9	4.6	3.9	3.8
Volume of GDP US	1.6	2.2	2.5	2.3
euro area	1.7	1.9	1.8	1.7
emerging markets	3.9	4.2	4.6	4.7
Short-term interest rate in the euro area (%)	-0.3	-0.3	-0.2	0.0
Long-term interest rate in the Netherlands (%)	0.3	0.6	0.8	1.1
Euro exchange rate (USD)	1.11	1.08	1.09	1.09
Competitor prices	-2.9	3.7	2.0	2.1
Oil price (UK Brent in USD per barrel)	45.1	51.7	51.4	51.5
Commodity prices excluding energy (USD)	-3.9	6.4	2.0	4.5

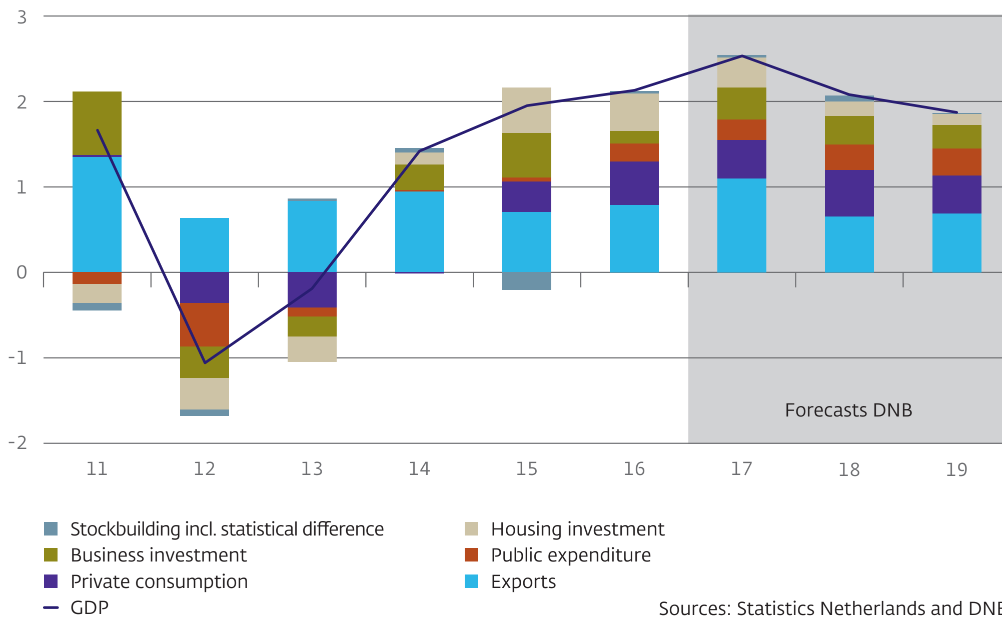
Sources: DNB and ECB.

* Annual figures have been calculated based on seasonally adjusted quarterly figures and may therefore deviate marginally from the most recent National Accounts.

** Excluding cash pooling, adjusted for securitisations and breaks.

Chart 2 Sources of GDP growth

Percentage changes and contributions in percentage points



Stockbuilding incl. statistical difference
Business investment
Private consumption
GDP
Housing investment
Public expenditure
Exports

Sources: Statistics Netherlands and DNB.

Note: Net contributions to GDP growth. The final and cumulative intermediary imports have been deducted from the related expenditure categories.

Full capacity utilisation approaching

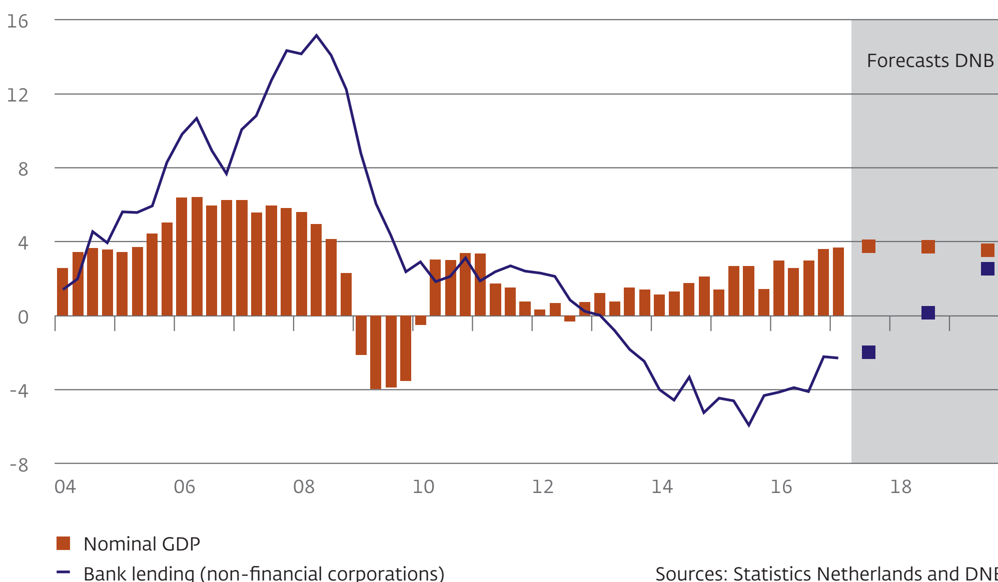
The potential rate of economic growth in the Netherlands, i.e. GDP growth adjusted for business cycle effects, stands at around 1.2% annually during the 2017-19 projection horizon. This means the output gap will be able to narrow gradually from its widest position of -3.2% in 2015. With economic growth exceeding potential growth, the available production capacity will be increasingly utilised, allowing the output gap to close in 2019. This means the economy will reach its potential output level by the end of the projection horizon. This will reduce slack in labour and product markets, which in the projections will have an upward effect on wages and prices.

Bank lending lags behind recovery in investment

Thus far, the recovery of economic growth since the 2012 recession has not been reflected in a rise in corporate lending (Chart 3). In fact, a prolonged period of contraction in lending started in 2013, bottoming out at -5.3% in 2014. Lending in 2016 still contracted by 2.2%, whereas corporate investment had been rebounding since 2014. A lagged correlation between bank lending and GDP and investment is not unusual, with lags between the lending and investment cycles averaging between three and five quarters. What is more, given the depth and duration of the most recent recessions, it is not surprising that the rebound in lending is currently taking longer to materialise. Economic research suggests that episodes of "creditless recovery" occur regularly in both emerging and developed economies. Creditless recovery is more likely if recovery follows a period of exuberant credit growth and deep recession, particularly if the latter coincides with a banking crisis. That said, the contraction in lending is more sustained in the Netherlands than in other European countries. Moreover, SME lending was relatively low, particularly for smaller loans, i.e. under EUR 250,000. Our projections assume that 2017 will be the fifth and final consecutive year of negative credit growth. We expect credit growth to be slightly positive in 2018, at 0.2%, followed by 2.6% growth in 2019.

Chart 3 Bank lending and GDP

Year-on-year percentage changes



Sources: Statistics Netherlands and DNB.

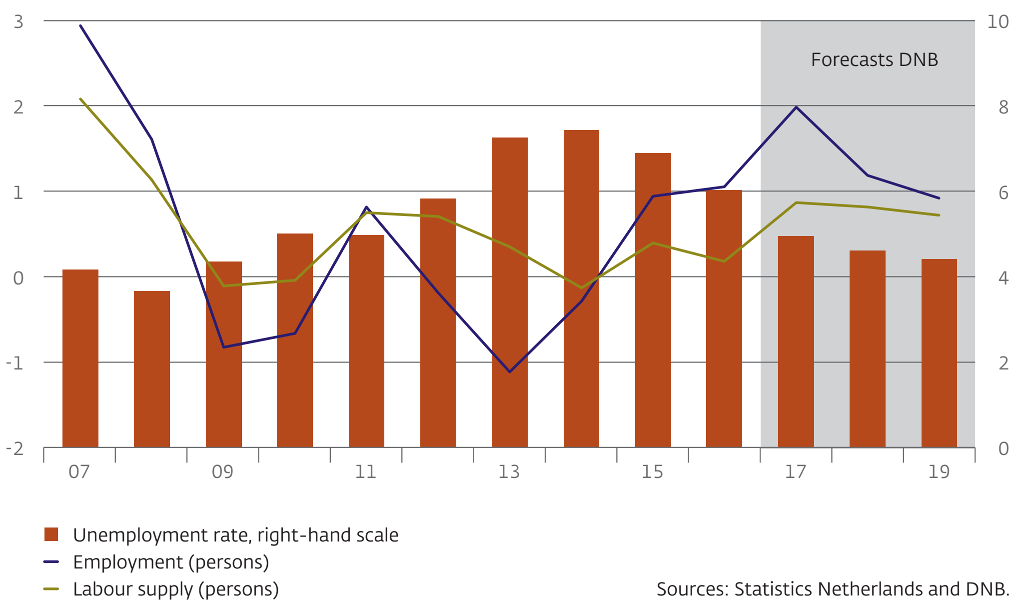
Dutch businesses have more options for financing their investment than bank lending alone. Other forms of external financing, such as corporate bonds, have grown rapidly since 2016. In the current period of economic recovery, however, businesses can primarily draw on strongly improved profits to make investments, an option generally preferred in the corporate sector over raising external financing. Not only large corporations express this preference: Roughly half of all SMEs surveyed in 2016 said they had not applied for bank loans because their own resources sufficed. Of the SMEs which has submitted loan applications, 21% were rejected in the first quarter of 2017, up from the 13% reported a year earlier, but significantly down from the peak seen in 2014, when 39% of all SME loan applications were rejected (ECB, SAFE survey).

Vigorous growth in employment

The robust economic expansion is accompanied by growing demand for labour, causing slack in the labour market to diminish. Total employment expressed in the number of employed persons is projected to go up by 2% in 2017, with 1.2% growth expected in 2018 (Chart 4). Rising real labour costs will put a slight drag on employment growth in businesses. In addition, certain sectors will experience some labour market tightness, so that vacancies cannot be immediately filled. In the first quarter of 2017, the total number of vacancies went up by 13,000 to over

Chart 4 Labour market supply and demand

Year-on-year percentage changes and percentage of labour force



Sources: Statistics Netherlands and DNB.

180,000, which is the sharpest quarter-on-quarter increase seen in over a decade. The number of vacancies in early 2017 was still below the end-2007 peak of nearly 250,000. There are large differences between industry sectors, however, with relatively many vacancies in information and communications services and catering, and fewer in other business services.

Unemployment is set to drop to 4.4% of the labour force by 2019, representing 398,000 people. The unemployment rate should fall at a slower pace during the projection years than in 2016, despite the vigorous employment growth seen in 2017. This is because growth in labour supply will accelerate to 0.8% per annum on average, from a mere 0.2% in 2016. Persons previously not active in the labour market will be attracted by the more favourable prospects of finding a job. In the first quarter of 2017, there were 2.7 unemployed people on average to each vacancy, which is substantially below the figure at year-end 2013 (7), but not as low as in 2008 (1.3).

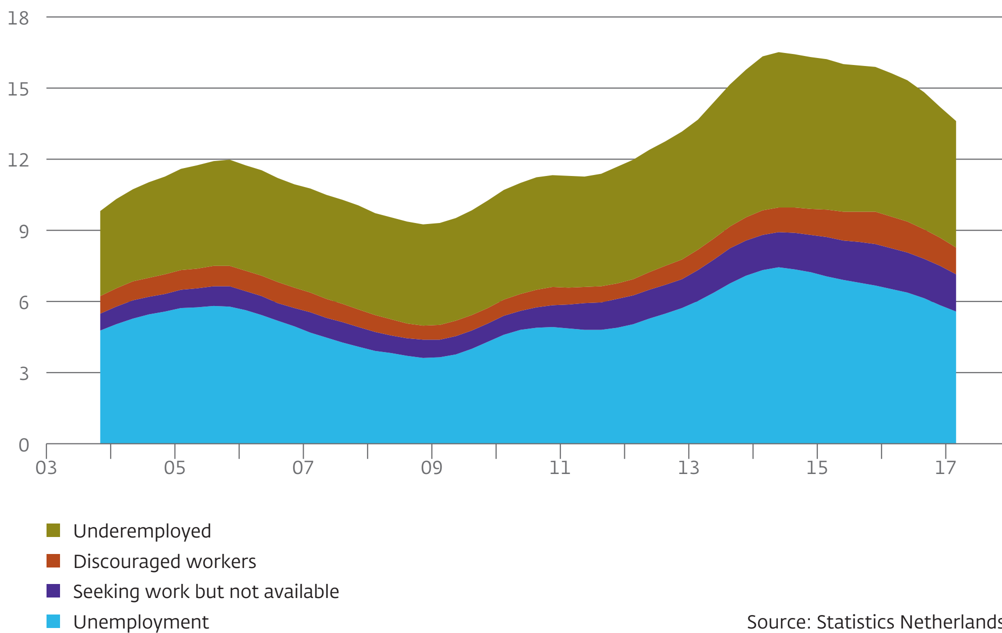
Labour market slack not caused by unemployment alone

So far, the Dutch labour market is not characterised by overall tightness. Growing demand for labour can also be met from other categories of people than the registered unemployed alone. The size of those categories may be related to the subdued wage increases seen in the Netherlands to date. In addition to registered unemployed, there are persons seeking work while not being immediately available, such as students, and those no longer seeking a job while being immediately available, commonly referred to as discouraged workers. Besides, there is also a category of part-time workers seeking to work more hours. Chart 5 shows that labour market slack is decreasing, but at a lower pace than unemployment. This may dampen the correlation usually seen between unemployment and the growth rate of negotiated wages. An indication for this is the relationship between growth in negotiated wages and an alternative indicator for labour market slack, based on a questionnaire by the European Commission to survey whether businesses have difficulty in recruiting staff. In the Netherlands, this indicator has improved less markedly than unemployment since 2014, and it can be better related statistically to wage growth in the post-crisis period.[2]

2 See the DNBulletin “Unemployment rate overestimates labour market tightness” of 9 June 2017.

Chart 5 Labour market slack

Percentage of labour force



Source: Statistics Netherlands.

Note: Based on four-quarter averages. Labour force extended with number of discouraged workers and number of persons seeking work but not available.

Wage costs for businesses are going up

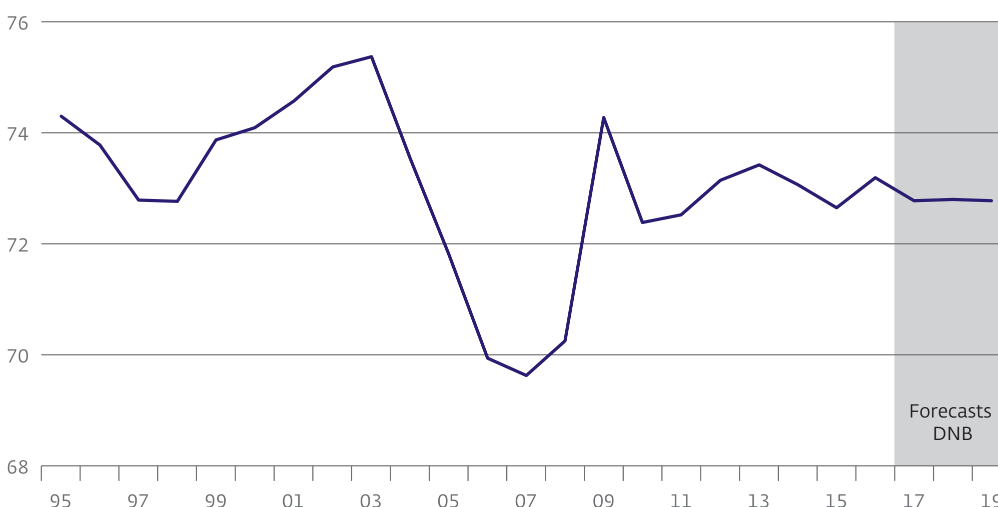
In 2016, corporate sector negotiated wages rose 1.6%, the largest increase seen since the credit crisis. For several years already, the recovery in the labour market and the growth in productivity have seen negotiated wages grow faster than during the recession. At the exceptionally low inflation rate of 0.1%, 2016 was one of the three years with the strongest real growth in negotiated wages in the past 40 years. Our projections assume a further rise in negotiated wages to 1.8% in 2017 and further increases to just over 2% in subsequent years.

Strengthening business sector negotiated wages will also push up the wage and salary bill, which also comprises wage drift and employers' social insurance contributions. The latter in particular (notably pension contributions) will push up the compensation per employee in 2017 by 2.6%, against 1.1% in 2016. In spite of this, the labour income share (LIS) of businesses should remain virtually stable throughout the projection horizon (Chart 6).[3] Although

3 Chart 6 presents the alternative LIS for the business sector, for which the mixed income of self-employed persons is used to approximate their labour income. Statistics Netherlands (CBS) will also switch to this revised definition of the LIS for the next national accounts.

Chart 6 Labour income share for business sector

Percentages; alternative definition



Sources: Statistics Netherlands and DNB.

the compensation per employee is expected to go up in real terms, this will be offset by growth in labour productivity. In the business sector, the growth in added value per labour year will gradually accelerate, from 0.6% in 2016 to 1.4% by 2019, which roughly equals the long-term average. This means, given the productivity growth, that a stronger increase in real compensation is needed to achieve a higher LIS. In view of the historical figures, the domestically-oriented sectors in particular should have scope for increases.

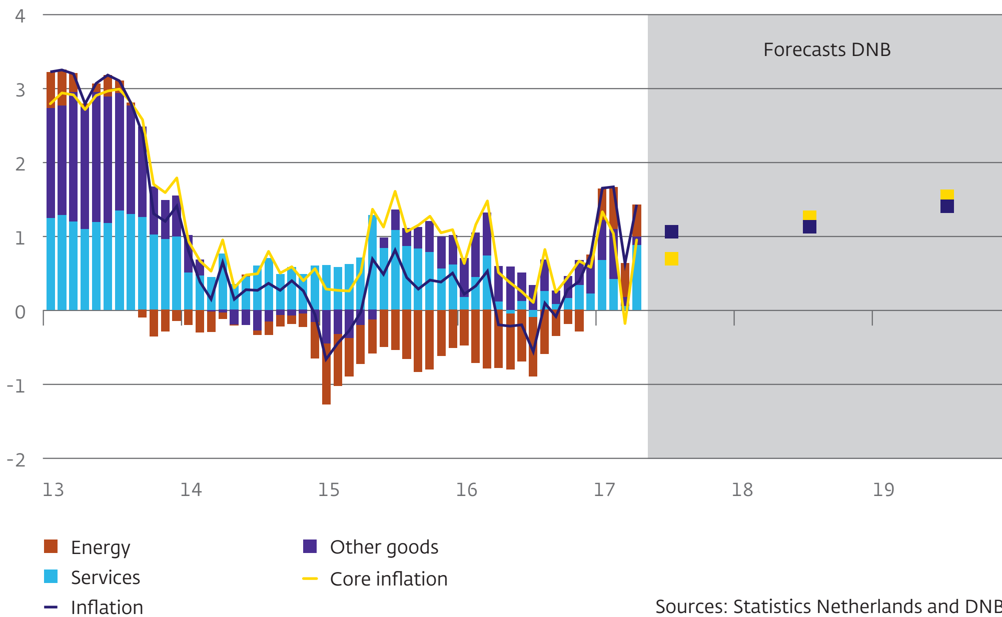
Inflation to remain well below 2%

HICP inflation averaged 1.3% in the first four months of 2017, sharply up from 2016, when inflation averaged just 0.1%. Much of the increase can be attributed to higher oil prices, which boosted the positive contribution of energy to inflation. In the first four months of 2017, that contribution averaged 0.5 percentage points, against -0.5% percentage points in 2016. We expect inflation to land at 1.1% for 2017, after which it should stabilise in 2018 and climb to 1.4% in 2019 (Chart 7). Core inflation, which excludes food and energy, has risen only modestly thus far, having reached 0.8% in the first few months of 2017, against 0.6% in 2016. This is substantially below the 1.7% long-term average between 1988 and 2016. Core inflation will go up more markedly, from 0.7% in 2017 to 1.2% in 2018, reaching 1.5% in 2019.

Upward price pressures caused by labour costs should remain limited throughout the projection horizon. Especially in the services sector, unit labour costs are an important determinant of price movements. In the business sector, the increase in unit labour costs will accelerate from 0.5% in 2016 to 1.7% in 2017, driven mainly by a one-off hike in pension contributions in 2017. Later on in the projection period, the increase should flatten to around 1.0% in both 2018 and 2019.

Chart 7 HICP inflation

Year-on-year percentage changes and contributions in percentage points



Energy
Other goods
Services
Core inflation
Inflation

Sources: Statistics Netherlands and DNB.

Note: Core inflation = total excluding food and energy.

2 A closer look at spending and public finances

Dutch export growth outpaces world trade

The slowdown in world trade witnessed in 2016 did not affect Dutch exports. Whereas the growth in world trade relevant to the Netherlands softened by almost one percentage point to 2.9%, Dutch exports grew 3.3% (Table 2). Global trade growth is expected to increase strongly, reaching 4.6% in 2017, and continue at a slightly lower pace, of 3.9% in 2018 and 3.8% in 2019. In the projection years, Dutch exports should also grow at a faster rate than relevant world trade, causing the market share of Dutch exports to expand further, most notably in 2018 and 2019.

Re-exports are expected to make the largest contribution to the growth in exports. The counterpart of re-exports, domestically produced goods and services, in 2016 lagged significantly behind world trade growth, and will catch up only slowly over the projection horizon. Energy exports are a significant factor and will recede by more than 2% in 2017, mainly due to mild weather conditions in Europe in the first quarter. A large part of energy exports are natural gas, so this also affects domestically produced exports.

Corrected for energy exports, however, growth in domestically produced exports will outstrip the increase in relevant world trade by around 0.3% in each of the projection years. An important factor is that export prices will continue to rise more gradually than competitor prices from 2017 onwards. As a result, the Netherlands' price-competitive position should make a positive contribution to growth in domestically produced exports excluding energy throughout the projection horizon (Chart 8).

Table 2 Dutch exports and competitiveness

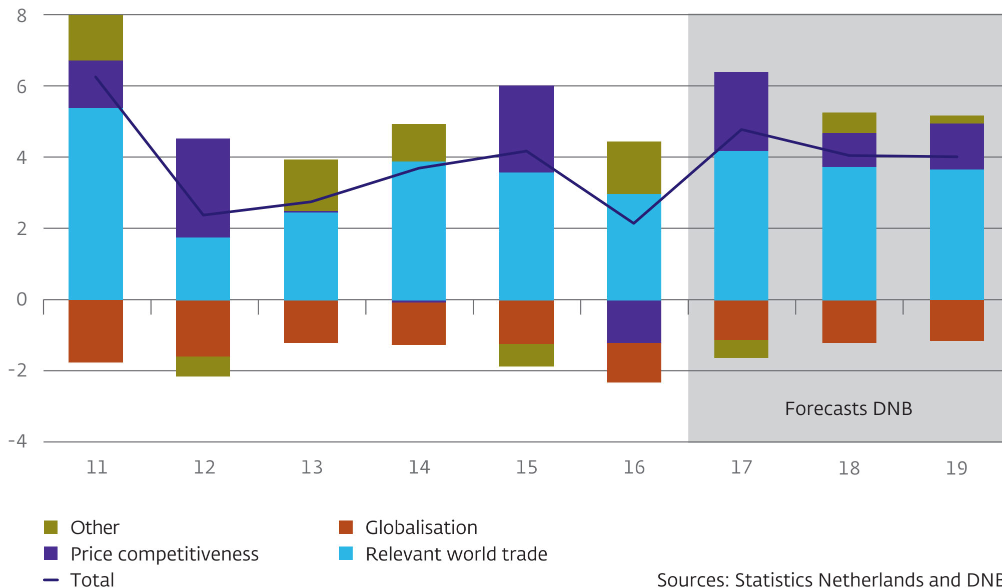
Percentage changes, unless stated otherwise

	2016	2017	2018	2019
Volume				
Relevant world trade	2.9	4.6	3.9	3.8
Exports of goods and services	3.3	4.4	4.4	4.2
domestically produced	1.4	3.3	3.6	3.8
re-exports	5.5	5.6	5.2	4.6
Exports of goods and services excl. energy	3.4	5.2	4.6	4.4
domestically produced	2.2	4.9	4.2	4.1
re-exports	4.9	5.6	5.2	4.6
Price				
Competitor prices (1)	-2.9	3.7	2.0	2.1
Exports of goods and services	-2.6	3.7	0.7	0.6
domestically produced, excl. energy (2)	-0.6	1.0	1.7	1.3
Price competitiveness (1-2)	-2.3	2.6	0.3	0.8

Sources: DNB and ECB.

Chart 8 Sources of export growth

Year-on-year percentage changes and percentage points



Sources: Statistics Netherlands and DNB.

Note: Estimated contributions to growth in domestically produced exports, excluding energy.

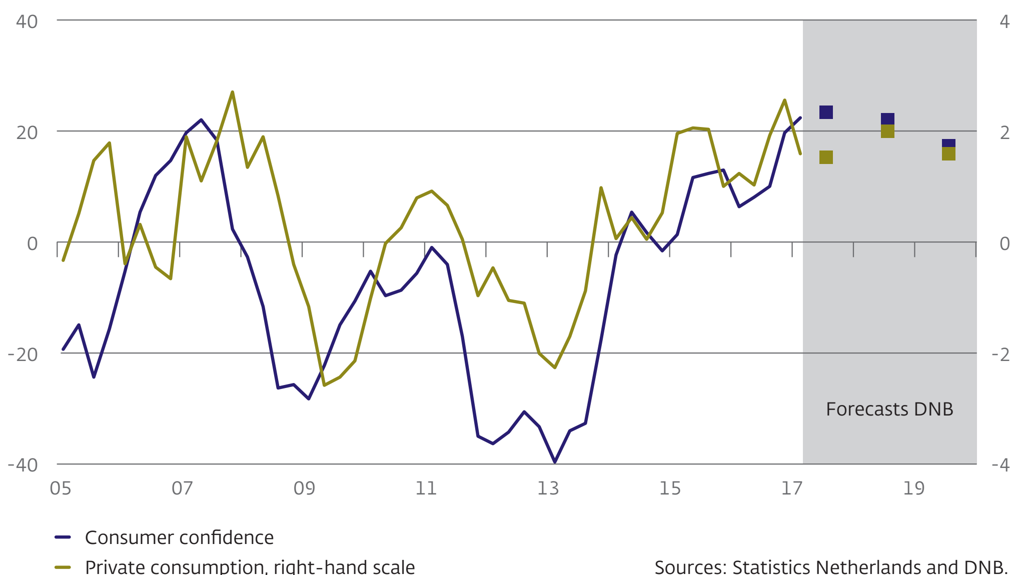
Temporary dip in private consumption growth

Since 2015, private consumption has seen a return to its growth rate of shortly before the credit crisis. The projections show a slight growth dip to 1.5% in 2017, however, as the mild winter sharply depressed energy spending at the beginning of the year. Consumption in the first quarter was 0.1% lower than in the final quarter of 2016. In the projections, household spending will continue its solid growth, averaging 0.5% quarter-on-quarter throughout 2017 and 2018, resulting in 2.0% growth in 2018. Consumption growth will subsequently flatten somewhat to reach 1.6% in 2019, which is just above the 1.5% long-term average.

The improvement in consumption growth that set in in 2013 is closely related to the increase in consumer confidence (Chart 9). In the first quarter of 2017, confidence was on average above the most recent peak registered shortly below the credit crisis, close to the record level reached around the turn of the century. Furthermore, household disposable income has gone up, as has the value of home ownership. The latter factor will contribute between 0.75 and 1 percentage point to consumer growth in 2017-19, its impact gradually decreasing. In addition, rising inflation will act as a brake on private consumption growth.

Chart 9 Consumer confidence and private consumption

Balance of positive and negative answers and year-on-year percentage volume changes; seasonally adjusted



Sources: Statistics Netherlands and DNB.

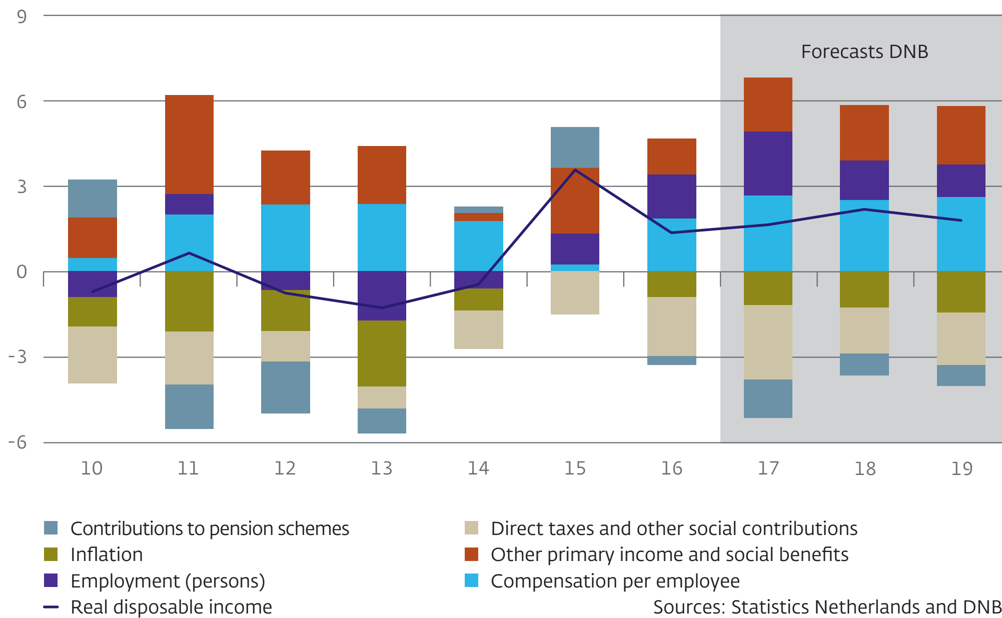
Income growth persists

Household income is the key determinant of private consumption. Following the strong impetus that lower pension contributions provided in 2015, real disposable income climbed 1.3% in 2016. Projected increases are 1.6% for 2017, 2.2% for 2018 and 1.8% for 2019. As a result, by 2019 real disposable income will have risen nearly 8% above the 2007 pre-crisis level.

Chart 10 shows the developments underlying income growth. Since 2015, employment has again given an upward stimulus to household incomes, and the contribution of wage growth is also increasing significantly. Other primary income likewise continues to contribute, as the number of self-employed persons and their earned income continue to keep rising. Other income also benefits from the widening discrepancy between interest income and interest expenses. Low interest rates have pushed down households' interest income, but the stronger drop in interest expenses more than offsets this. Gross income is depressed not only by inflation, but also by taxes and pension contributions. Neither index-linking for pension benefits, nor nominal benefit curtailments are assumed in the projections.

Chart 10 Real disposable household income

Year-on-year percentage changes and contributions in percentage points



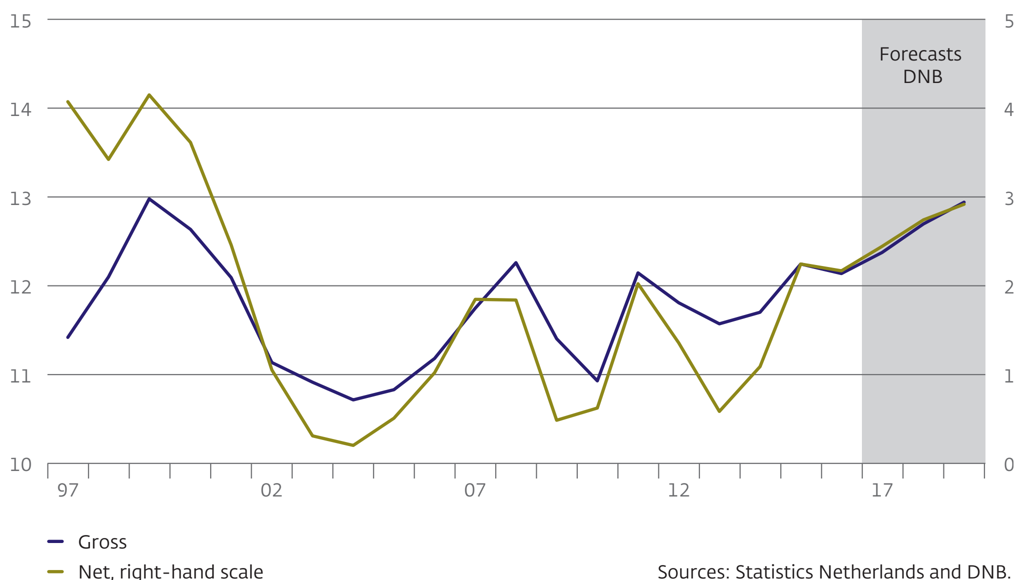
Sources: Statistics Netherlands and DNB.

Solid growth in corporate investment

The level of business investment has been volatile quarter-on-quarter for some time now. This can be explained by tax regime changes, notably for company cars, and large fluctuations in aircraft investments. These one-off events are also reflected in recent annual figures, which show strong growth (6.7%) in 2015 and sharply lower growth (1.2%) in 2016. By contrast, the first quarter of 2017 showed robust growth, at 7.1% quarter-on-quarter. The underlying conditions for corporate investment are favourable. The economic environment has improved substantially since the double dip recession. In the first quarter of 2017, all sectors reported higher profitability compared with the preceding year. The share of businesses that reported constraints in their business operations fell to 6.7% in the second quarter of 2017; it stood at 13.5% four years ago. Moreover, capital costs are much lower than before, with interest rates on new bank loans having almost halved for all maturities since 2011. Furthermore, the number of bankruptcies has dropped sharply, to the lowest level since 2000, and producer confidence (PMI) recently returned to levels close to those seen before the 2008 crisis. Businesses are mainly upbeat about their order books.

Chart 11 Investment ratio for business sector

Percentage of GDP; volume



Sources: Statistics Netherlands and DNB.

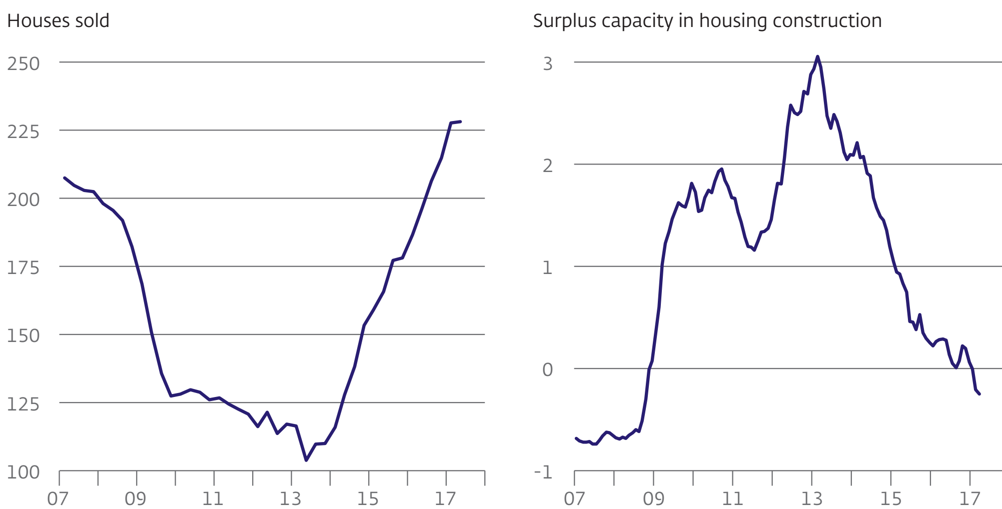
Our projections show that investment growth should pick up speed, growing above average, in line with the solid GDP growth. Corporate investment will increase by 4.5% in 2017, 4.8% in 2018 and 3.8% in 2019. Based on these projections, the investment ratio - the ratio of real corporate investment to real GDP will edge up from 12.1% in 2016 to 12.9% in 2013 (Chart 11). With the exception of 1999, this level of investment has not been witnessed since 1977. An increasing proportion of the corporate investment ratio comprises net investments which businesses make to enlarge their production capacity. The real net corporate investment ratio is expected to increase further until 2019, which is understandable, given the substantial improvement in capacity utilisation rates. These rose in April 2017 to reach 82.5%, which is the highest level seen since the sudden turnaround that occurred nine years ago, when the credit crisis broke out.

Dutch housing market remains bullish

The sentiment in the Dutch housing market has improved substantially since 2013 after the sharp decline witnessed during the credit crisis. Sales, prices and confidence indicators have risen for the past four years. Home buyers are benefiting from low interest rates and improved income positions. Up to the first quarter of 2017, house prices had risen by over 14% from the low point of 2013. The number of house transactions, which also reached a low in 2013, has recovered at a fast pace since, to reach a level above the pre-crisis peak (Chart 12, left-hand

Chart 12 Housing market: transactions and surplus capacity

Four-quarter sum in thousands and normalised percentage, three-month average



Note: Houses sold in Q2 2017 represents twelve-month sum through April 2017. Surplus capacity concerns subquestion ("insufficient demand") in confidence survey in construction sector. Normalised over historical length of series.

Sources: European Commission and Statistics Netherlands.

scale). Similarly, more mortgage loans are being extended than before the crisis. New home owners on average have a less heavy mortgage burden than before, the ratio of total mortgage debt to household income having fallen to 210% in 2016, from 228% in 2009. We project a slight rise to 216% in 2019. Our projections assume further recovery in house prices, with increases peaking at 6.6% in 2017 and more moderate growth of 5.7% in 2018 and 4.1% in 2019. The record price level registered just before the crisis should be matched over the course of 2019.

The persistent price increase is related not only to the demand factors referred to, such as mortgage interest rates and income positions, but also to shortages seen at the supply side of the market. While new housing projects increase rapidly, the growth in the supply of houses fails to keep pace with demand. Although expansion of housing production has been planned in many regions, capacity constraints seem evident. Surveys show that the prolonged period of spare capacity in the construction sector appears to have ended in late 2016 (Chart 12, right-hand scale). On balance, more than 27% of the construction firms indicate that their order positions are large or too large, against a mere 5% three years ago.

Budget surplus set to go up

Following the budget surplus of 0.4% of GDP achieved in 2016 on the back of substantially higher than expected income tax revenues, the surplus will grow further to 0.7% of GDP in 2017 and 1.1% of GDP in 2019. This means the Dutch government budgetary position will remain in positive territory for four consecutive years for the first time in over 60 years, subject, of course, to any new measures the next government may take. Economic growth will contribute to improve government finances throughout the projection horizon. In addition, the introduction of the measure relating to self-administered pensions will push up tax revenues from 2017 onwards. At EUR 2.1 billion, the biggest upward effect of this measure will be in 2017. Public spending as a percentage of GDP is expected to fall over the 2017-19 period, driven by low unemployment and the effects of cost-saving measures already in place. The structural balance will be above the European agreed medium-term objective of -0.5% of GDP in all projection years.

Public debt in 2017 will decline, to land at 58.6% of GDP, falling below the European debt ceiling of 60% of GDP. This figure should stand at 51.3% of GDP by 2019. The strong decrease is caused by the budget surplus, the sale of more stakes in ABN AMRO and ASR, and GDP growth.

These projections, as with every projection of government finances, are surrounded by uncertainties, and they were cut off before the Spring Memorandum was issued, which provides insight in developments of public finances in the current year.[4] Similarly, there is still no new coalition agreement, due to which the projections do not incorporate the effects of any new policies.

Table 3 Public sector key data

Percentage of GDP

	2016	2017	2018	2019
Public expenditures	43.6	43.2	42.7	42.5
Taxes and social security contributions	39.2	39.0	39.0	39.0
Other income	4.9	4.8	4.7	4.7
Primary balance	1.5	1.6	1.9	2.1
EMU balance	0.4	0.7	1.0	1.1
Structural balance (EC method)	0.9	0.5	0.7	0.7
EMU debt	62.3	58.6	54.9	51.3

Source: DNB.

4 The balance for 2017 estimated in the Spring Memorandum is below that presented in the present projections, because the latter assume higher economic growth in 2017. In addition, the government has decided to use revenue windfalls for additional spending on healthcare and increasing civil servants' salaries, as well for absorbing higher than expected expenditure, including by the Ministry of Education, Culture and Science

3 Intensifying protectionism: an alternative scenario

Although global trade is gaining momentum, there is a risk of international trade policies being made more restrictive, putting a brake on the growth in world trade and global economic growth. Intensifying trade protectionism could affect the open Dutch economy disproportionately.

The United States administration has announced that it would use its trade policies to project the domestic corporate sector and promote exports of US products and services. It cannot be excluded that trade partners of the United States respond by taking countermeasures. This section analyses and illustrates the impact which increased protectionist tendencies in international trade could have on the US and Dutch economies, starting with higher US import tariffs and export subsidies. The first variant of this scenario assumes that stricter US trade policies are not met with countermeasures. In the second variant, retaliation is assumed, with countermeasures taken globally, aimed at hindering exports of US goods and services. The consequences of these measures for government finances are also taken into account.[5] While only 4.4% of Dutch goods and services exports were directly destined for the United States in 2015, the Dutch economy could suffer considerably as a result of US protectionist policies through indirect adverse trade effects on other countries.

Variant 1: US protectionism without countermeasures

This variant assumes that the United States implements a 15% import tariff for all imports of foreign goods and services (Table 4). To supplement this, it grants price-reducing export subsidies of 10% to support US exports. Both instruments have been referred to in the context of the Trump administration's planned tax reforms. The US corporate tax system does not currently differentiate between origins or destinations of goods and services. The use of import levies and export subsidies could change this. If the tax rate was lowered from 35% to 20%, as favoured by the Trump administration, this would effectively imply import levies and export subsidies of 25%.[6] As the introduction of such high rates is uncertain, this alternative scenario assumes lower rates.[7] The assumption is that they take effect on 1 October 2017.

5 We have assumed that any net revenues of import tariffs and export subsidies are gradually fed back into the economy, both in the United States and in other countries, through what is known as a "fiscal solvency rule". We have also assumed that economic agents model their forecasts rationally (forward-looking forecasts). Both variants were simulated using the global NiGEM model and DNB's macroeconomic DELFI model. Due to the complexity of the scenario, the results should first and foremost be considered as an illustration of the impact that will occur.

6 Under this modified regime, costs of imported goods and services would not be eligible for tax relief, and profits from exports would be tax-exempt.

7 See an analysis prepared by UBS (Are US tax and trade policies a zero-sum game?, Global Economic Comment, 13 February 2017), simulating a scenario with import levies and export subsidies of 10%.

Table 4 Assumptions in protectionism scenario without countermeasures

Percentage deviations from baseline scenario, unless stated otherwise

	2017	2018	2019
For the United States:			
Import tariff	7.5	15	15
Export subsidy	5	10	10
Gross domestic product	0.1	0.1	0.5
Private consumption	-0.3	-1.7	-1.3
Business investment	0.1	-0.5	0.3
Exports of goods and services	1.6	5.9	7.7
Imports of goods and services	-0.4	-3.4	-2.4
Real disposable household income	-1.1	-2.4	-0.6
Private consumption deflator	1.1	3.2	1.8
Unemployment (% of labour force)	0.4	0.5	-0.1
Long-term interest rate (level)	0.1	0.1	0.1
Short-term interest rate (level)	1.0	1.2	0.0
For the Netherlands:			
Volume of relevant world trade	-0.1	-0.2	0.5
Euro exchange rate (USD)	-1.3	-1.3	-0.6
Competitor prices	-0.6	-2.3	-2.2
Equity prices	0.2	0.4	0.3

Source: DNB.

Notes: Results for the United States and assumptions for the Netherlands are based on NiGEM. GDP and expenditure components are in real terms. Responses in terms of oil and other commodity prices were disregarded.

A unilateral lowering of US export prices will improve the US price-competitive position in the world market, thereby providing a strong boost to US exports. At the same time, US imports will fall, as foreign products become more expensive due to the import tariff imposed. More expensive imports will drive up inflation in the United States. The Fed will respond by raising interest rates, causing the US dollar to appreciate promptly. The effect of the interest rate hike on inflation will only become visible in the longer run. Lower real disposable income will weigh on private consumption. Investment in the United States will benefit from increased exports, but will be depressed by lower consumption and higher interest rates. Near-term beneficial effects on exports will be almost fully offset by adverse effects on domestic spending, and the US GDP volume will remain virtually unchanged. After a while, prices and interest rates will decline and the US economy will rebound somewhat, driven in part by the beneficial impact of the export subsidy.[8] In 2019, US real GDP will be 0.5% above the projected figure, with unemployment marginally lower.

8 The US economy would be severely hit if no export subsidies were granted. In spite of the budgetary costs involved, export subsidies provide a sustained boost to exports, dampening the adverse economic impact of import levies on both the US economy and global trade.

Reduced US imports will have a substantial impact on such countries as Mexico and Canada, over 70% of whose exports are destined for the US. Likewise, the United States is an important export destination for China, Japan and the United Kingdom.[9] For the Netherlands, the impact on relevant world trade will be relatively minor, not only because Dutch products are sold in the US market to a limited extent only, but also because of economic growth in the US in 2019 and appreciation of the US dollar. The cheaper euro will partly compensate for the effect of the import tariff imposed by the United States.

If no countermeasures are taken, any damage to the Dutch economy caused by US protectionism will be rather limited (Table 5). The worsened price-competitive position will initially depress exports, but in 2019 exports will rebound, fuelled by a pick-up in world trade. Inflation will be somewhat pushed down by lower import prices, thereby keeping purchasing power intact and, hence, private consumption. On balance, economic growth will in 2017 and 2018 end up slightly lower than in the projections and be fractionally higher in 2019.

Table 5 Impact on the Dutch economy of US protectionism without countermeasures

Percentage changes. unless stated otherwise

	2017	Deviation from projection	2018	Deviation from projection	2019	Deviation from projection
Gross domestic product	2.4	(-0.1)	1.9	(-0.2)	2.0	(0.1)
Private consumption	1.5	(0.0)	2.0	(0.0)	1.5	(-0.1)
Business investment	4.6	(0.1)	4.3	(-0.5)	3.1	(-0.7)
Exports of goods and services	4.1	(-0.3)	3.9	(-0.5)	4.7	(0.5)
Imports of goods and services	4.3	(-0.2)	4.9	(-0.4)	5.1	(0.3)
Negotiated wages, private sector	1.8	(0.0)	2.0	(-0.1)	1.9	(-0.3)
Harmonised consumer price index	1.1	(0.0)	0.9	(-0.2)	1.0	(-0.4)
Unemployment (% of labour force)	5.0	(0.0)	4.7	(0.1)	4.7	(0.3)
EMU balance (% of GDP)	0.7	(0.0)	0.9	(-0.1)	0.9	(-0.2)

Source: DNB.

9 Shares of exports to the United States in 2015 were as follows: China 18%, Japan 20% and United Kingdom 15% (IMF database).

Variant 2: US protectionism with countermeasures

This variant assumes that the rest of the world responds by imposing 15% import tariffs on US products, assuming a three-month delay. This variant has significantly larger adverse consequences than that without countermeasures. The US price-competitive edge in the world market will now be short lived. Higher import prices will send US inflation higher and erode purchasing power. The Fed will act more decisively to keep spiralling inflation in check, causing the US dollar to appreciate by over 3% in the third quarter of 2017. With US products becoming more expensive in the world market, US exports will drop substantially. Lower purchasing power will depress consumer spending in the United States. Similarly, corporate investment in the United States will be significantly revised downwards due to the strong decline in economic activity. Ultimately, US real GDP will be 1.7% lower than projected in 2018 and 2.2% lower than projected in 2019 (Table 6).

Table 6 Assumptions in protectionism scenario with countermeasures

Percentage deviations from baseline scenario, unless stated otherwise

	2017	2018	2019
For the United States:			
Import tariff	7.5	15	15
Export subsidy	5	10	10
Gross domestic product	-0.1	-1.7	-2.2
Private consumption	-0.4	-2.1	-2.6
Business investment	-0.8	-7.0	-6.3
Exports of goods and services	0.9	-2.3	-4.5
Imports of goods and services	-0.9	-7.5	-7.9
Real disposable household income	-1.1	-3.0	-2.7
Private consumption deflator	1.1	4.5	5.0
Unemployment (% of labour force)	0.3	0.4	0.4
Long-term interest rate (level)	0.4	0.6	0.5
Short-term interest rate (level)	1.2	2.2	1.1
For the rest of the world			
Import tariff on imports from United States	3.75	15	15
Netherlands:			
Volume of relevant world trade	-0.4	-2.6	-3.1
Euro exchange rate (USD)	-1.7	-1.8	-0.5
Competitor prices	-0.1	2.0	3.4
Equity prices	-2.3	-4.2	-3.7

Source: DNB.

Notes: Results for the United States and assumptions for the Netherlands are based on NiGEM. GDP and expenditure components are in real terms. Responses in terms of oil and other commodity prices were disregarded.

The sharply lower US expenditure will have immediate negative effects on other countries' import and export volumes. At the same time, imports of more expensive goods and services will push up inflation in many countries. Higher prices, lower private consumption and sluggish corporate investment will weigh down economic growth. The volume of world trade relevant to the Netherlands will suffer a major blow and end 3.1% lower in 2019 (Table 6), sending export volumes of Dutch goods and services lower. Sluggish demand, mounting capital costs and lower equity prices will depress corporate investment. Economic growth in the Netherlands will suffer drops of 0.5 percentage points in 2018 and 0.2 percentage points in 2019, causing unemployment to end 0.4 percentage points above the projections in 2019 (Table 7). Inflation will rise 0.3% percentage points to 1.7% in 2019 due to higher import prices. Lower real disposable incomes and higher unemployment will depress consumer spending. The EMU balance will remain intact, as lower tax revenues and higher expenditure due to worsened economic conditions will be offset by higher revenues from import levies.

Table 7 Impact on the Dutch economy of US protectionism with countermeasures

Percentage changes, unless stated otherwise

	2017	Deviation from projection	2018	Deviation from projection	2019	Deviation from projection
Gross domestic product	2.4	(-0.1)	1.6	(-0.5)	1.7	(-0.2)
Private consumption	1.5	(0.0)	1.6	(-0.4)	0.8	(-0.8)
Business investment	4.5	(0.0)	3.9	(-0.9)	2.6	(-1.2)
Exports of goods and services	4.0	(-0.4)	2.6	(-1.8)	3.8	(-0.4)
Imports of goods and services	4.2	(-0.3)	3.5	(-1.8)	3.9	(-0.9)
Negotiated wages, private sector	1.8	(0.0)	2.1	(0.0)	2.1	(-0.1)
Harmonised consumer price index	1.1	(0.0)	1.2	(0.1)	1.7	(0.3)
Unemployment (% of labour force)	5.0	(0.0)	4.7	(0.1)	4.8	(0.4)
EMU balance (% of GDP)	0.8	(0.1)	1.3	(0.3)	1.2	(0.1)

Source: DNB.

However, under this alternative scenario, protectionism could result in allocative inefficiencies in the longer run. Higher trade costs, pushed up by levies and subsidies, will ease pressures from foreign competition and allow domestic profit margins to grow. This will enable less productive businesses to survive, resulting in higher costs and prices, less innovation and lower average productivity. Furthermore, higher trade tariffs distort international production chains, for instance due to inefficient cross-border labour distribution and a lower level of knowledge sharing between countries.[10] These effects of restrictive trade policies are more microeconomic in nature and will play a role in the more distant future, which is why they are not reflected here.

10 See, among others, Caliendo and Parra (Estimates of the trade and welfare effects of NAFTA, Review of Economic Studies, 82, 2015) for an empirical analysis in which dynamic joining and leaving, productivity differences and sectoral dependencies are determinants for the prosperity effects of trade measures.

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