Economic Developments and Outlook

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Contents

Economic growth

Inflation

Labour market and wages

Households and housing market

Exports and businesses

Public finances

An alternative scenario

Summary and policy recommendations

Outlook for the Dutch economy

The Dutch economy is returning to a slower pace of growth. Gross domestic product (GDP) is expected to grow by 0.8% in 2023, after the solid 4.5% growth in 2022. Higher energy prices and their pass-through to almost all other prices are putting a drag on household purchasing power and spending. Central banks worldwide have also been forced to tighten their policies further. Higher interest rates are cooling the housing market and weighing on investment. The cooling of the international economy is also reducing Dutch exports. After running above capacity for several years, the economy is consequently developing in a more balanced way, with growth projected at 1.3% in 2024 and 1.1% in 2025.

The unemployment rate is projected to rise slightly, reaching the still very low level of 3.8% in 2025. Projected wage growth is set to peak at 5.7% in 2023 but to remain high thereafter. At 5.4% in 2024 and 3.7% in 2025, projected wage growth is sharply higher than the 1.9% average over the past decade. Higher wage costs are impacting the prices of Dutch exports, which are projected to become less competitive and lag behind the growth in global trade.

Inflation is set to fall from 4.2% in 2023 to 3.7% in 2024 and 2.5% in 2025. Price rises are proving more persistent than previously expected. Core inflation is expected to rise to 6.8% in 2023, exceeding HICP inflation. The cooling of the economy will contribute to downward pressure on core inflation in the years ahead. There is nevertheless a risk that core inflation will prove more persistent than currently projected. We have therefore produced an alternative scenario simulating the economic effects of a longer period of high core inflation.

Policy recommendations related to the projections

1. **The fight against inflation requires action by central banks, governments and social partners**
   The Dutch economy will cool in 2023 and growth will remain moderate in the years ahead. The labour market will remain favourable, with unemployment between 3.6% and 3.8%. Inflation is a major concern. It will remain high and is projected to fall only slowly. The projected cooling of GDP growth will help to bring inflation back down to the 2% target. Behind this macroeconomic reality, households and businesses are worried about their financial position, but if they try to mutually pass on the full loss of purchasing power due to higher energy prices, a longer period of persistent high inflation will result. To the extent that this applies to the Netherlands and the euro area more broadly, monetary policy will have to cool the economy more substantially to bring inflation back to target. That will cause collateral damage in terms of income and employment. Inflation is nevertheless contained most effectively when central banks, governments, employers and employees help each other to do so.[1] If inflation is relatively high only in the Netherlands, it will be even more difficult to bring down. After all, the ECB focuses on the euro area as a whole and cannot tailor its interest rate policy specifically to the Netherlands. Lower inflation then has to be achieved mainly through the efforts of the government and social partners. If they do not take action in this scenario, the euro's real exchange rate in the Netherlands will appreciate at the expense of Dutch competitiveness.

2. **Keep profit and wage growth under control**
   Last year, we became collectively poorer due to the high cost of energy we import from abroad.[2] The economy is now adapting. Employees and employers play an important role in allocating the

1 Inflatiebestrijding zaak van lange adem (Fighting inflation is a long-term affair - in Dutch only) (dnb.nl)
2 Netherlands suffered income loss in 2022 from higher energy prices (dnb.nl).

loss of purchasing power through wage negotiations. The outcome of these negotiations depends on sector- and company-specific factors, with labour market tightness also playing a role. To prevent the economic adjustment from triggering leapfrogging wage claims that stoke inflation, it is imperative that businesses and workers keep wage and profit growth under control.[3]

3. **Government must return to fiscal discipline**
The budget deficit is widening and remains only just below 3% of GDP in the 2024 and 2025 projections. The structural budget deficit, which takes into account the state of the business cycle, is logically even slightly above this level. By pursuing this expansionary fiscal policy, the government is contributing to the overheating of the economy.[4] At the same time, the denominator effect means that high inflation pushes the debt-to-GDP ratio lower, keeping government debt fairly stable at around 50% of GDP in the projection. However, if the budget deficit stays at its current level for longer, the debt-to-GDP ratio could eventually rise well above the European ceiling of 60%. From the perspective of both balanced macroeconomic developments in the short term and sound public finances in the longer term, it is therefore important to return to fiscal discipline.[5] Specifically, any new purchasing power measures and new policies should be covered in the decision-making for the next budget. Due to the labour market tightness, increasing the burden on labour is a less appropriate solution than, for example, phasing out negatively viewed tax arrangements, which would have the additional advantage of simplifying the tax system.

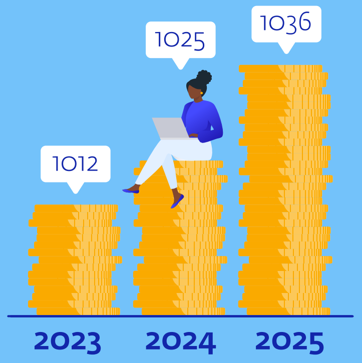
3 For an explanation see Hoe kijken wij naar winsten en lonen? (How do we view profits and wages? - in Dutch only) (dnb.nl).
The relationship between wages and prices is described in more detail in Wage-price dynamics: a negative spiral? (dnb.nl)
4 For the connection between fiscal and monetary policy, see Inflation reduced faster if central bank and governments apply brakes simultaneously (dnb.nl).
5 An explanation of the impact of support measures on inflation can be found in Box 2 of the December 2022 EOV.

Economic growth is falling; inflation is persistent

Gross domestic product

Overheated economy will cool down in 2023, with growth of 0.8%

Growth will remain subdued in 2024 and 2025, which also helps to bring inflation down



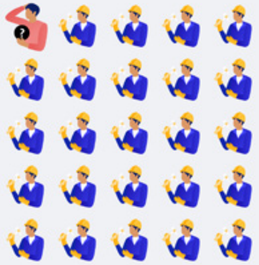
GDP in billions of euros at 2023 prices

Labour market

Employment continues to grow, but at a **slower rate**.

This leads to a **small increase** in unemployment to just under 4% up to 2025. The labour market remains tight.

Strong wage growth of 5.7% this year and 5.4% next year. In 2025, wage growth will decline to 3.7%



Inflation

Inflation will fall sharply, from 11.6% in 2022 to 4.2% in 2023. We foresee a further decline in 2024 and 2025

Fall in inflation mainly due to **lower energy prices**

Risk that **core inflation** is more stubborn than we currently estimate and remains high for longer

Public finances

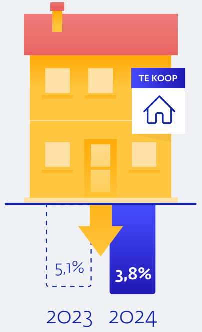
Budget deficit will rise to 2.7% in 2024 and 2025 and is high given the overheated economy

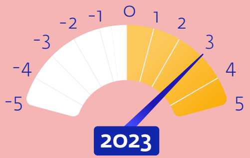
Public debt remains around 50% of GDP

House prices

House prices fall by 5.1% in 2023 and by 3.8% in 2024

After 2023, **housing investments will fall** due to increased interest rates and construction costs, and falling house prices





Businesses

Investment **will grow** by 3% in 2023

We foresee **further growth** for 2024 (1.4%) and 2025 (1.7%)

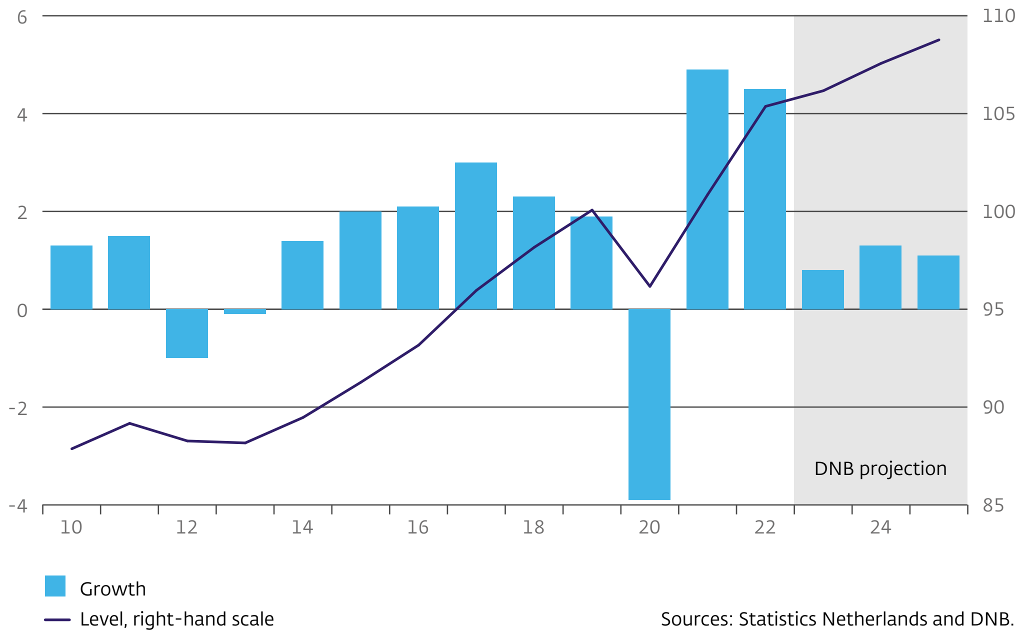
Economy returns to slower pace of growth

In economic terms, 2023 is significantly different from 2022. Gross domestic product (GDP) is set to remain relatively stable this year with expected growth of 0.8%, following the solid growth of 4.5% in 2022. Whereas the economy was still benefiting from the post-pandemic recovery in 2022, this year the economic impact of Russia's invasion of Ukraine is more evident. Higher energy prices and their pass-through to prices of almost all other goods and services are putting a drag on household purchasing power and spending. Widening inflation also meant central banks worldwide had to continue tightening their monetary policy, driving interest rates higher for households and businesses. As a result, the Dutch housing market is cooling and business investment is under pressure. The cooling of the international economy is also reducing Dutch exports. As the economy has been producing above capacity for several years, the less exuberant spending growth means the economy is becoming slightly more balanced.

The growth projection for 2023 is largely due to disappointing GDP growth in the first quarter (-0.7% compared to the last quarter of 2022). The slump is expected to be short-lived, with the economy possibly regaining some momentum in 2023. Households are receiving substantial financial support from the government, including through the energy price cap. The labour market also remains very favourable and wage growth in new collective labour agreements is accelerating sharply. Hardly any further interest rate hikes are expected after 2023, while global trade should gradually increase. This will support GDP in the years ahead, with growth projected at 1.3% in 2024 and 1.1% in 2025 (Figure 1). A full overview of projections for the 2022-2025 period can be found in the Key Data Table. The international assumptions used for the projections appear in Box 1.[6]

Figure 1 Gross domestic product

Figure 1 Gross domestic product



Sources: Statistics Netherlands and DNB.

6 We carry out our projections in part using the DELFI macroeconomic model. These projections are based on information available on 23 May 2023. The assumptions for relevant world trade, exchange rates, international commodity prices and interest rates were adopted by ECB and euro area NCB experts as part of the Eurosystem projections. These international assumptions feed into our own projections for the Dutch economy. More background can be found at www.dnb.nl/the-state-of-the-dutch-economy.

The economy remains strained, with high inflation and low unemployment. With projected growth rates slightly below the trend growth rate, the output gap, i.e. the difference between actual and potential GDP, narrows slowly from 1.7% in 2023 to 1.4% in 2024 and 1.0% in 2025. This suggests that the economy will continue to run above capacity in the coming years, and this will be reflected in inflation falling only slowly amid a persistently tight labour market. HICP inflation is projected to fall gradually from 4.2% in 2023 to 3.7% in 2024 and 2.5% in 2025. Despite lower energy prices and easing supply chain bottlenecks, price rises have so far been more persistent than previously expected. This is evident from core inflation, which excludes energy and food prices. Core inflation is expected to rise to 6.8% in 2023, exceeding HICP inflation. This is mainly due to upward pressure from wages, which will continue into 2024 due to labour market tightness. In the years ahead, however, the cooling of the economy will contribute to downward pressure on core inflation (see Section 2).
Unemployment has been very low for several years. Although it remains low in the projections, employment growth weakens as the economy cools. In 2023, the number of jobs will grow by 1.8%, after which growth falls back to almost zero in 2025. Labour market tightness continues to add to upward pressure on wages, especially in 2023 and 2024, resulting in a slight increase in the labour income share (see Section 3).

Box 1 International assumptions

These projections are part of the projections by the European Central Bank (ECB) for the euro area. All central banks use the same international assumptions for their national projections. The ECB expects global GDP growth (excluding the euro area) of 3.1% in 2023, down 0.2 percentage points on 2022. Partly due to the tightening interest rate policies adopted by most central banks and tight labour markets around the world, there is little international capacity for more economic activity. The ECB also projects global GDP growth (excluding the euro area) of 3.1% in 2024, while expecting slightly stronger GDP growth of 3.3% in 2025.

The projections are based on a continuation of the war in Ukraine, but they assume that the high prices and volatility in the energy market are behind us. This is mainly because Europe has become less dependent on Russia for its energy supply. Gas prices have fallen sharply compared to last year: in 2022, the natural gas price was USD 123.1 per MWh, whereas a price of USD 42.4 is assumed for 2023. The gas price assumption is based on market expectations and is one of the principal uncertainties in our projections. The ECB projects an oil price of USD 78.1 per barrel in 2023, substantially less than the USD 99.1 per barrel in 2022, mainly due to lower global economic activity. The monetary policy aimed at curbing inflation and returning it to 2% over the medium term will (of course) continue. The short- and long-term interest rates used in the projections are between 0.4 and 0.5 percentage points higher in 2023, 2024 and 2025 than in the December projections. As usual, these assumptions are also based on market expectations.

Energy prices weigh on inflation; core inflation remains high

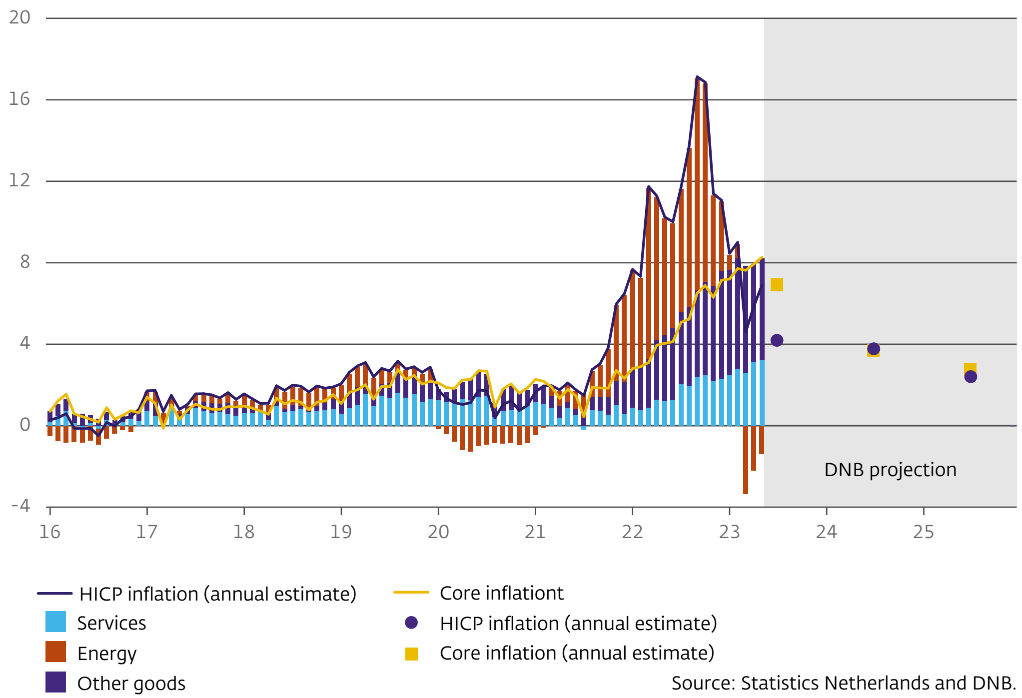
In 2023, inflation is set to fall to 4.2% on average over the year, from 11.6% in 2022. In subsequent years, HICP inflation declines further to 3.7% in 2024 and 2.5% in 2025 (Figure 2). The decline is largely due to energy prices, which are expected to be over 25% lower in 2023 than in 2022. The energy price cap set by the government for 2023 was therefore particularly helpful in the early part of the year. Later this year, market prices for gas and electricity are expected to fall further, translating into markedly lower energy prices for consumers in the projections. The energy component will reduce inflation by about 2.5 percentage points in 2023. This becomes especially noticeable in the second half of the year, as that is when the difference with the previous, extremely high energy prices will be the greatest.[7]

Food inflation is also set to remain high for the time being. For vulnerable households, the price cap and lower market prices for energy are a welcome respite from the loss of purchasing power they have recently suffered. However, soaring food prices have also hit these households hard in recent months. Food inflation in 2023 averaged 14.5% up to the end of April and, with a weight of 18% in the consumption basket, contributed an average of 2.7 percentage points to HICP inflation. High food inflation is partly explained by a delayed pass-through of high energy prices into food production costs. For 2023 as a whole, we expect food inflation at 10.8%. Food inflation is expected to fall sharply to 3.2% in 2024.

Core inflation, i.e. HICP without the contribution from energy and food, will average 6.8% in 2023, compared to 4.8% in 2022. In the first months of 2023, core inflation was well above 7%, and it is not expected to fall markedly until after the summer. The main reason is that the economy is operating

Figure 2 HICP inflation and core inflation

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



Source: Statistics Netherlands and DNB.

Note: Core inflation excludes food and energy.

7 Published energy inflation may turn out higher in the second half of 2023 as Statistics Netherlands is due to switch to a new measurement method for consumer gas and electricity prices in June. This is expected to have little impact on HICP inflation.

well above capacity. The contribution to core inflation from price rises in the service sector is also notable. In this sector, labour market tightness and hence rising wage costs are being clearly felt.

Projected core inflation will average 3.6% in 2024 and 2.8% in 2025. Core inflation is expected to ease slowly due to a combination of factors. Import prices, including declining international energy and commodity prices, are less strongly reflected in the prices of other goods and services. The economy is also cooling. Over time, this will contribute to declining core inflation through lower growth in wage costs. While unit labour costs will continue to rise in the coming years as wages adjust to the higher price level, the pace of growth is set to fall from 7.2% in 2023 to 4.6% in 2024 and 3.3% in 2025. Nevertheless, amid the current labour market tightness and uncertain geopolitical conditions, there is a risk that core inflation may prove more persistent than currently projected. We have therefore produced an alternative scenario simulating the economic effects of core inflation remaining high for longer (see Section 7).

More on inflation can be found at https://www.dnb.nl/en/the-euro-and-europe/inflation/

Labour market tightness contributes to higher wage growth

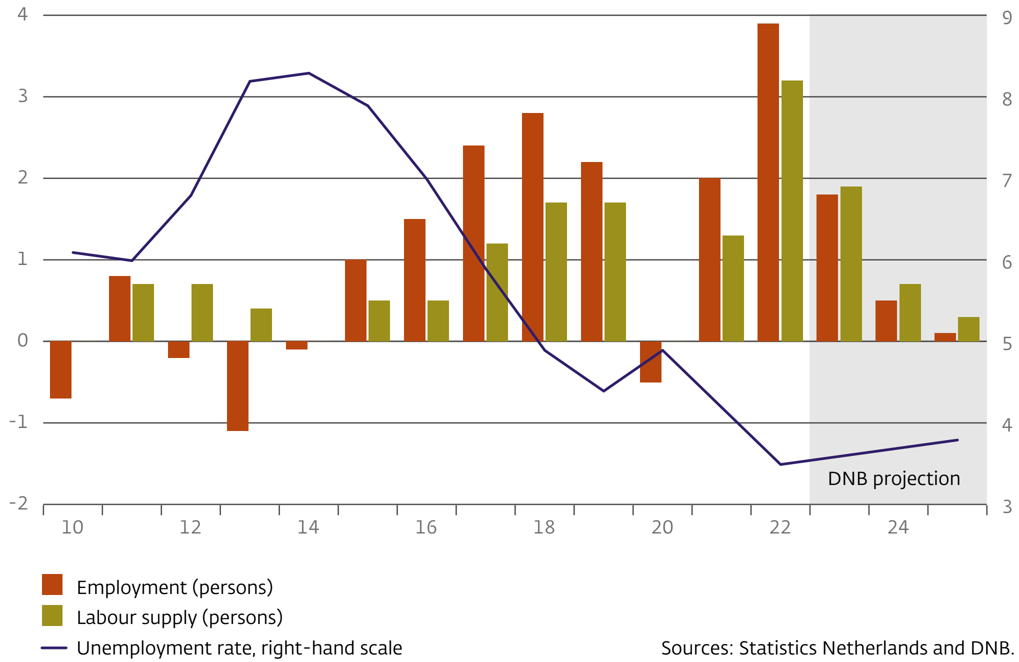
Employment growth is levelling off. Employment growth was robust in 2021 and 2022 but is expected to fall to 1.8% in 2023 (Figure 3). It will almost come to a halt in 2024 (0.5%) and 2025 (0.1%). This slowdown is associated with the cooling of the economy. Continued high wage growth will also weigh on demand for labour. Employment growth in 2023 is higher than in the previous projections, mainly due to the carry-over of stronger-than-expected growth in the second half of 2022. In the first quarter of 2023, the number of employed persons grew by a further 0.5% compared to the previous quarter, whereas GDP contracted.

Unemployment rises slightly, but the labour market remains tight. Strong employment growth in recent years has been supported by robust labour supply growth. More than three-quarters of the Dutch population aged between 15 and 75 are now in paid employment or looking for work, which is a record. In our projections, labour supply growth slows, but as it remains slightly higher than employment growth, the unemployment rate rises from an average of 3.6% in 2023 to 3.8% in 2025. The labour market thus remains tight.

Projected wage growth peaks in 2023 but remains high thereafter. Growth in negotiated wages (in the corporate sector) rises from an average of 3.0% in 2022 to 5.7% this year (Figure 4). Due to the tight labour market and only slowly declining inflation, wage growth is also set to remain historically high in the years ahead. At 5.4% in 2024 and 3.7% in 2025, negotiated wage growth is sharply higher than the 1.9% average over the past decade. Moreover, the current wage projection is higher than the December projection, which is consistent with recent wage growth data (5.8%, Statistics Netherlands, May 2023) and with the trend in new negotiated wage settlements (8.2%, AWVN, May 2023). Nevertheless, average wage growth in our projections does not reach the pace of the latest collective labour agreements. Most collective labour agreements have a term of one or two years, so future

Figure 3 Labour market

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



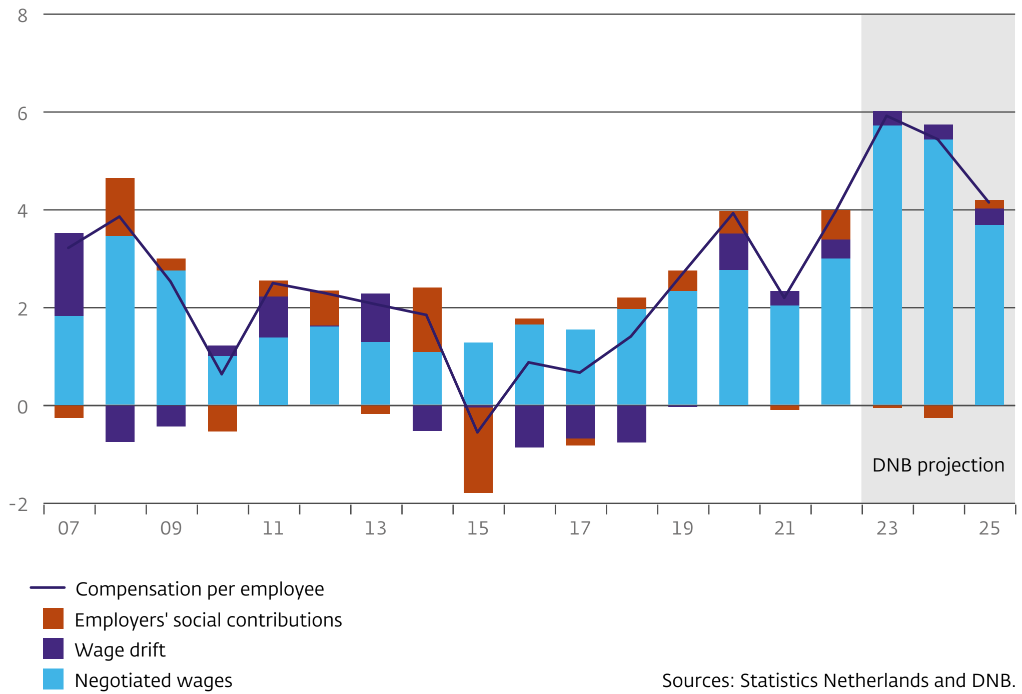
Sources: Statistics Netherlands and DNB.

wage growth is always a mix of wage settlements in newer collective agreements and existing collective agreements.

The labour income share (LIS) returns to pre-pandemic levels in our projections. This ratio measures the distribution of domestic income between workers (wages) and capital providers (profit). In our projections, the LIS increases slightly in 2024 and 2025, to just above the level recorded shortly before the pandemic.[8] This implies that projected average wage growth in the years ahead will outpace growth in labour productivity plus GDP price growth. In the light of persistent labour market tightness, it is not surprising that the share of workers in national income is set to rise again slightly. This will not be sufficient to recoup all of the real wage losses of 2022 and 2023. Compared to 2021, nominal wage growth (compensation per employee) in 2025 lags 2.2 percentage points behind HICP inflation on a cumulative basis. Box 2 shows an alternative scenario in which wage growth accelerates faster next year than in the projections, to such an extent that the real wage bill reaches the 2025 level.

Figure 4 Compensation per employee (private sector)

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



Sources: Statistics Netherlands and DNB.

8 This assumes a broad definition of the LIS that is appropriate for the macroeconomic model. For a clearer assessment of wage trends, it is necessary to examine the LIS at sector level.

Box 2 Variant with stronger wage growth in the Netherlands

This projection variant assumes that wages rise sufficiently to recoup all of the real wage loss suffered since 2021. The assumed wage boost takes the average real wage in 2025 to the average 2021 level. Since this variant involves a wage boost in the domestic market, we assume that there is no response from the ECB.

The rise in wages means higher disposable incomes for households, which gradually feed through into private consumption. At the same time, production costs rise, reducing businesses' demand for labour and, after a while, also reducing corporate investment. Businesses will also try to pass on the higher production costs to consumers by raising their prices. Higher prices in turn drive up wages, creating persistent wage-price dynamics. Since they have to price to market, exporters can only raise their prices partially to mitigate the loss of market share. This weighs on exports.

In 2023 and 2024, the economic effects on GDP are minimal (Table 1). Thereafter, economic growth falls by 0.2 percentage points in 2025, as the negative effects of declining exports and corporate investment outweigh the positive expenditure effects. Nominal wages rise substantially, taking wage growth in 2024 (measured in terms of compensation per employee) to just under 7.5%, about 2 percentage points higher than in the baseline. Delayed pass-through effects cause core inflation to rise significantly in 2025, by about one percentage point. The unemployment rate eventually rises and is 0.5 percentage points higher in 2025.

Table 1 Results for Dutch wage increase scenario

Percentage changes, unless stated otherwise

	2023	Difference vs projection	2024	Difference vs projection	2025	Difference vs projection
Gross domestic product	0.8	(0.0)	1.3	(0.0)	0.9	(-0.2)
Private consumption	1.7	(0.1)	1.4	(0.5)	1.3	(0.4)
Business investment	3.0	(0.0)	1.3	(-0.1)	0.4	(-1.3)
Exports of goods and services	0.9	(0.0)	2.4	(-0.1)	2.4	(-0.3)
Compensation per employee	6.5	(0.7)	7.4	(1.9)	4.8	(0.6)
Harmonised consumer price index	4.2	(0.0)	4.1	(0.4)	3.1	(0.6)
HICP excl. energy and food	6.8	(0.0)	4.2	(0.6)	3.6	(0.8)
Unemployment (% of labour force)	3.6	(0.0)	3.9	(0.2)	4.3	(0.5)

Source: DNB.

Household consumption growth slows as housing market cools

Private consumption grew very strongly, by 6.5%, in 2022. This growth was driven almost entirely by services consumption, which had been under pressure from pandemic containment measures in the previous two years. Due to the recovery, services consumption grew by 13.1% in 2022. By contrast, consumption of non-durable goods such as food and beverages, energy and fuels contracted. Higher food and energy prices were a contributory factor. Growth in consumption of durable goods was positive in 2022, but its contribution to overall consumption growth was small.

Private consumption growth is expected to fall sharply in 2023, to 1.6%. This growth is almost entirely due to carry-over from growth in 2022, largely driven by strong growth in the fourth quarter. Consumption growth in the first quarter of 2023 was zero (q-o-q). In the rest of the year, private consumption growth is set to remain relatively low (on a quarterly basis). This is mainly due to low consumer confidence and high inflation. The cooling housing market also has a negative effect on household spending, in contrast to the positive effect in recent years. On the other hand, accelerating wage growth has a positive effect on consumption.

Looking further ahead, private consumption growth continues to slow, to an expected 0.9% in both 2024 and 2025. The fact that growth in full-year 2024 is lower than in 2023 is due to the carry-over effect from 2022. On a quarterly basis, private consumption actually grows more strongly in 2024 than in 2023, partly due to the expected improvement in consumer confidence, although the difference is small. Households' real disposable income is set to grow by 1.1% in 2024 and to contract by 0.2% in 2025 (Figure 5). Factors contributing to the contraction in 2025 compared to 2024 are the slightly weaker growth in negotiated wages and the rise in employee contributions and payroll taxes. At the same time, consumers put some of their free savings into consumption. As a result, the individual savings rate is expected to fall to 6.2% of disposable income in 2025, from 7.8% in 2022.

The housing market cools further, with lower prices and fewer transactions. Nominal house prices are now down substantially from the peak in July 2022; in April 2023 the difference was over 6%. The number of housing transactions has also decreased: 15% lower in 2022 than in 2021. This applied particularly to newbuild transactions. Falling house prices may pose a risk for households who have been pushing the borrowing limits in recent years. The cooling is not expected to create any financial stability risks, however.[9]

House prices are expected to fall further in the years ahead, by 5.1% in 2023 and 3.8% in 2024 (compared to the previous year). For 2023, this represents a downward adjustment to the December projection, which also carries over to 2024. The total expected price fall from the peak in the summer of 2022 is around 10%. This is due to higher mortgage rates, which mean homebuyers can borrow less.[10] The uncertainty surrounding the projected housing market figures is high, and confidence in the housing market is hard to predict. After 2024, the projected recovery in household incomes starts to translate into higher house prices. The projections assume a slight price recovery averaging 0.2% in 2025.

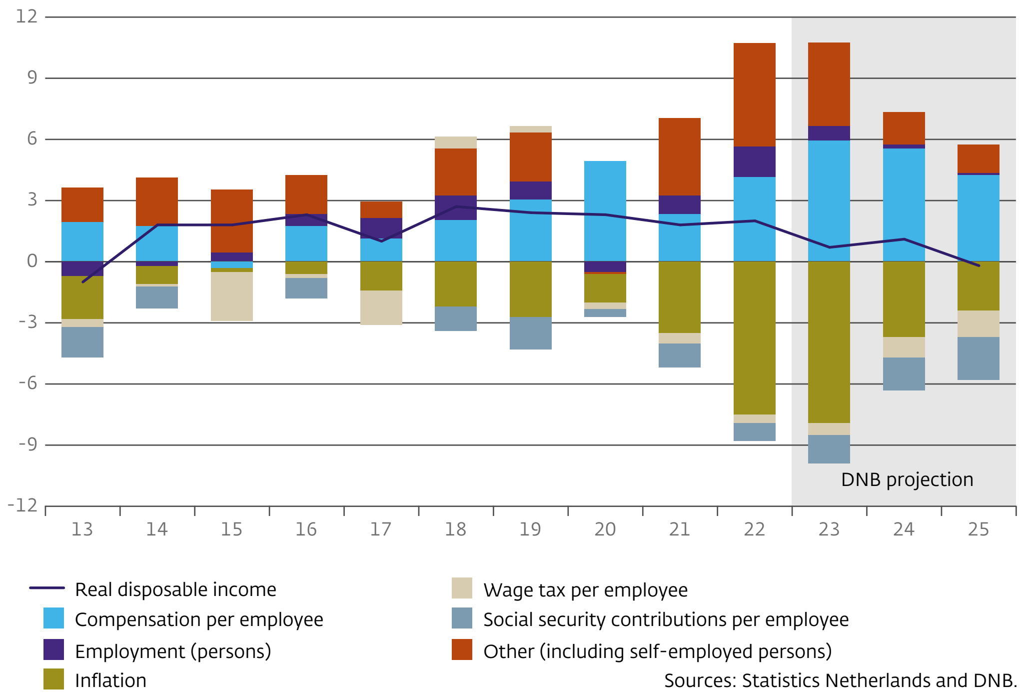
9 Financial Stability Report, Spring 2023
10 Will Dutch first-time buyers be able to afford a home again? (dnb.nl)

Residential investment grows slightly in 2023, but declines sharply in 2024. It is expected to rise by 0.7% in 2023, before falling by 4.7% in 2024. Lower house prices, lower transaction numbers and a decrease in the number of building permits have a delayed impact on these investment figures. Residential investment is expected to grow slightly in 2025, by 0.6%. The Dutch Economic Institute for Construction and Housing (EIB) assumes falls of 3.5% and 5.5% in new construction output in 2023 and 2024, respectively. The decline in construction output is mainly associated with higher interest rates, falling house prices and rising construction costs. The scrapping of the construction exemption for nitrogen emissions is also a factor but is mainly expected to have a delaying effect. On the other hand, investment in the sustainability of the built environment has a positive effect. This was also evident in the first quarter of 2023, when housing investment grew by as much as 3.7% (q-o-q) due to strong growth in installation engineering.

More on the housing market can be found at https://www.dnb.nl/en/current-economic-issues/housing-market/

Figure 5 Real disposable household income

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



Sources: Statistics Netherlands and DNB.

Note: Here inflation refers to the private consumption deflator.

Exports and businesses

The outlook for international economic activity has weakened considerably since the December 2022 projections. High inflation and central bank interest rate hikes are leading to less growth in expenditure and international trade worldwide. The implications for our projections can be seen first and foremost in the volume of world trade relevant to the Netherlands. This continued to grow by 7.8% in 2022, but the projected growth in 2023 is only 0.6%. In 2024 and 2025, expected world trade growth picks up somewhat, to 3.2% and 3.0% respectively. A key factor behind this is the reopening of China, where stronger growth is expected in the near term after a long period of strict lockdowns. Globally, a positive impact is also expected from falling inflation (including in energy prices) and decreasing economic uncertainty.

After strong growth of 4.8% in 2022, domestically produced exports are set to fall by 1.7% in 2023 (excluding energy). The projection for domestically produced exports in 2023 has been revised sharply downwards from the December projections. These decreases occurred largely in the second half of 2022 and the first quarter of 2023, and collectively had a strong negative carry-over effect into the 2023 annual figure. At the end of 2022, exports were under pressure due to disappointing global trade data, partly due to the resurgence of the pandemic in China. The disappointing exports may also be linked to the high energy prices at the time, which made the production of energy-intensive exports such as metals and chemicals less profitable. Despite the disappointing first quarter, re-exports (excluding energy) are expected to grow by 2.1% in 2023, following 5.6% growth in 2022.

From 2023, price competitiveness deteriorates due to rising wage costs and the appreciation of the euro. Compared to the December projections, the euro exchange rate has appreciated sharply, especially against the dollar. This has made Dutch products more expensive for countries outside the euro area. Dutch products are also becoming more expensive due to rising wage costs. This deteriorating price competitiveness means domestically produced exports grow only moderately after 2023, by a projected 2% on average in 2024 and 2025. Over the projection horizon as a whole, the growth of domestically produced exports lags behind the growth of relevant world trade, so exporters' market share of these goods and services declines somewhat (Table 2).

Corporate investment (excluding residential property) grows by 3% in 2023 before slowing to 1.4% in 2024. The projected increase this year is much higher than in the December 2022 projections (0.8% contraction). This difference is mainly due to a carry-over effect, as corporate investment grew more strongly than expected in the fourth quarter of 2022 and the growth fed through into the 2023 annual figure. In 2024, corporate investment growth is projected to fall back to 1.4% in tandem with slowing economic growth. Investment growth barely recovers in 2025 (1.7%), mainly due to the dampening effect of higher capital and wage costs. Despite the projected slowdown, businesses in a recent Statistics Netherlands survey (only available in Dutch) said they were positive about corporate investment in 2023. There are nevertheless differences between sectors. The chemical and steel industries expect strong growth, whereas the paper and clothing industries expect to invest less.

Projected bank lending to businesses contracts slightly in 2023. Rising interest rates and lower economic growth are leading to less demand for credit. This is also borne out by the Bank Lending Survey. In the fourth quarter of 2022 and in the first quarter of 2023, the majority of Dutch banks reported falling demand for credit and they expect the same for the second quarter. Credit conditions for businesses have tightened in the past two years, whereas the second quarter of 2023 is expected to see them ease overall. In the 2024 projections, bank lending stabilises before rising slightly by 0.9% in 2025.

Table 2 Dutch exports and competitiveness

Percentage changes

	2021	2022	2023	2024	2025
Volume					
Relevant world trade (1)	9.9	7.8	0.6	3.2	3.0
Exports of goods and services (2)	5.2	4.7	0.9	2.5	2.7
domestically produced	1.5	4.4	-0.1	1.5	1.8
re-exports	10.6	5.1	2.0	3.8	3.9
Trade performance (2-1)	-4.2	-2.8	0.2	-0.7	-0.3
Exports of goods and services excl. energy	5.6	5.1	-0.1	2.8	2.9
domestically produced (3)	1.2	4.8	-1.7	2.0	2.1
re-exports	11.9	5.6	2.1	3.8	3.9
Market performance (3-1)	-7.9	-2.7	-2.3	-1.2	-0.9
Price					
Competitor price (4)	8.2	16.7	-0.8	2.5	2.3
Exports of goods and services	8.3	17.2	0.5	1.5	1.7
domestically produced excl. energy (5)	6.1	10.3	3.4	3.1	2.4
Price competitiveness (4-5)	1.9	5.8	-4.1	-0.6	-0.1

Sources: DNB and ECB.

Government deficit approaches 3% of GDP

After a balanced budget in 2022, a deficit of 2.2% is projected in 2023. This deterioration in the budget balance is partly caused by the government's purchasing power measures. These include the energy price cap, the temporary increase of allowances and the 10% rise in the minimum wage. Due to declining energy prices, the cost of the price cap (around €5 billion) is lower than previously expected, but the benefit is offset by lower gas revenues for the government. Besides these temporary effects, the gradual implementation of spending increases under the government's coalition agreement also weighs on public finances, such as additional resources for education, defence and climate.

The budget deficit increases slightly in 2024 and 2025 but remains just below the European deficit ceiling at 2.7% (Table 3)**.** In August, the government will decide on purchasing power measures for the coming year. Our projections assume that the energy price cap and other temporary purchasing power measures will not be extended. Despite the winding down of these measures, the deficit is set to rise slightly in the years ahead, due to both government policies and macroeconomic developments. The projections take into account the measures in the Spring Memorandum, which included additional resources for addressing the problems associated with gas extraction in the Province of Groningen and higher expenditure on refugees from Ukraine. We have also assumed that the government's decisions on additional climate measures, which are not yet reflected in the Spring Memorandum, will accelerate spending from the Climate Fund. Furthermore, higher interest rates will gradually impact interest charges on government debt. Finally, the cooling of the economy is also weighing on tax revenues.

Table 3 Public sector key data

Percentage of GDP

	2021	2022	2023	2024	2025
Public expenditure	46.8	44.5	45.4	45.4	45.8
Taxes and social security contributions	40.0	39.4	39.2	39.0	39.6
Other income	4.4	5.1	4.0	3.6	3.5
Primary balance	-1.8	0.6	-1.6	-1.9	-1.8
EMU balance	-2.4	0.0	-2.2	-2.7	-2.7
EMU debt (year-end)	52.5	51.0	49.3	48.9	49.7

Source: DNB.

The beneficial impact of the denominator effect diminishes, causing the debt-to-GDP ratio to stop falling. The debt-to-GDP ratio was 51% in 2022. In 2023, debt is expected to fall to around 49%, despite the deterioration in the budget balance. This fall is due to the denominator effect, which means that debt as a share of GDP falls due to economic growth and inflation. Nominal GDP growth has a downward effect of around 4 percentage points on the debt-to-GDP ratio in 2023, but this effect is halved in 2025. In tandem with the rising deficit, the debt-to-GDP ratio continues to edge lower in 2024, before rising slightly in 2025. The debt in that year amounts to around 50% of GDP. In addition to the development of the budget deficit, GDP growth and inflation, there is a slight downward effect on debt from the repayment of deferred tax debts.

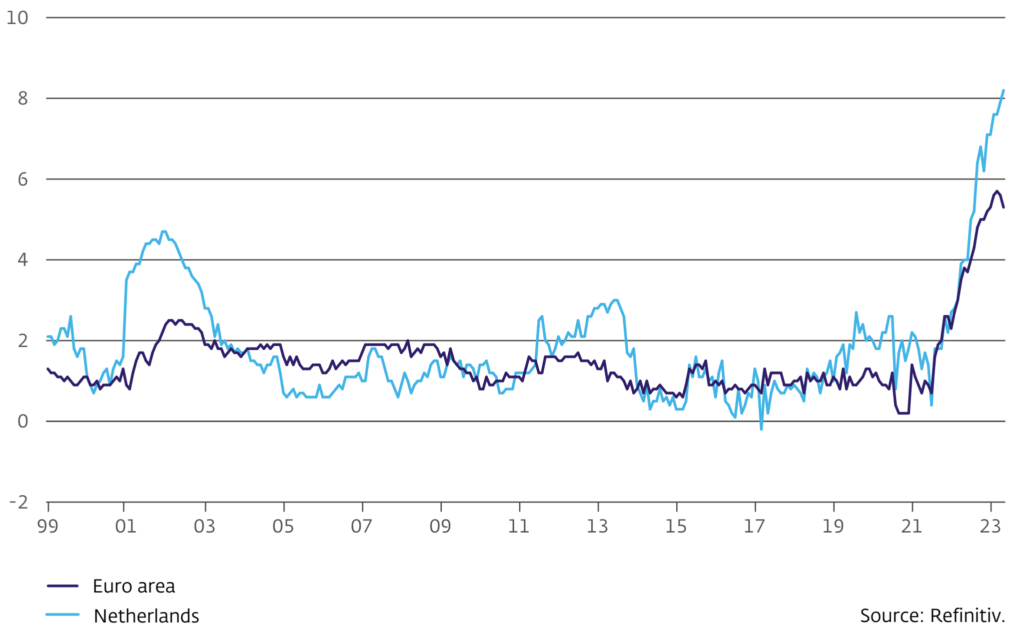
Higher core inflation for longer: an alternative scenario

Although HICP inflation has eased considerably in recent months, the underlying price pressure remains high. In September 2022, HICP inflation in the Netherlands peaked at 17.1% and in October it peaked in the euro area at 10.6%. Inflation then started to fall, mainly due to lower energy and commodity prices, lower transport costs and an easing of bottlenecks in international production chains. However, Figure 6 shows that core inflation (excluding energy and food) continued to rise in both the euro area and the Netherlands, hovering around 5.5% and 7.7%, respectively, in the first months of 2023. Current core inflation rates are the highest since the introduction of the euro in 1999, and their evolution over the projection horizon remains highly uncertain. Due to factors such as the current labour market tightness, with high wage growth, challenges in the areas of sustainability and deglobalisation, and an uncertain geopolitical backdrop, there is a risk that core inflation could prove more persistent and remain high for a protracted period. In that case, the ECB will have to raise interest rates further to dampen the wage-price dynamics and bring inflation back to 2%. As a result, the economy in the euro area and the Netherlands will cool more strongly.

This alternative scenario assumes that wage-price dynamics have a stronger-than-normal impact on core inflation and persist for longer.[11] To this end, we have simulated the impact of 1 percentage point of additional core inflation in the euro area in the second half of 2023.[12] This is accompanied by higher wage demands. The interaction between higher prices and higher wage and other costs causes both core and HICP inflation to be more persistent and higher than in the baseline projections. Besides stronger wage-price dynamics, energy prices pose an additional upside price risk. We assume that gas and electricity prices will rebound due to ongoing geopolitical tensions and will

Figure 6 Core inflation, euro area and the Netherlands

Year-on-year percentage changes



Source: Refinitiv.

11 We have simulated this scenario using DNB's DELFI macroeconomic model and NIESR's NiGEM global model, with the assumption that economic agents form their expectations rationally ("forward-looking").
12 This 1 percentage point price impact from 2023Q3 is spread over four quarters.

be 50% higher than in the baseline from the final quarter of 2023.[13] In addition to the direct effects on HICP inflation, higher energy prices may also feed through to core inflation indirectly, for example through higher costs in supply chains and possible second-round effects through wages and profits as well as rising inflation expectations. We assume that, on the basis of a standard reaction function (the Taylor Rule), the ECB will hike interest rates in response to the higher HICP inflation.

Rising inflation and higher interest rates cool the euro area economy, with negative consequences for the Netherlands. More expensive energy and higher core inflation lead to rising wage and production costs. Businesses pass on these costs in domestic prices and higher import and export prices, both within and outside the euro area. Higher domestic prices, rising financing costs and growing unemployment weigh on spending by households and businesses, and hence on economic growth in the euro area. To halt the upward price pressure – and manage inflation expectations – we assume that the ECB will be compelled to tighten monetary policy further, pushing its key policy rate 1.8 percentage points higher in 2024 in this scenario than in the baseline. For the Netherlands, the cooling European economy causes a fall in exports: world trade relevant to the Netherlands is about 0.7% lower in 2024 than in the baseline (Table 4). The economy then recovers slightly from 2025.

Table 4 Assumptions for core inflation scenario

Percentage deviations from baseline scenario unless stated otherwise

	2023	2024	2025
Relevant world trade	-0.1	-0.7	-0.5
Euro exchange rate (USD)	0.6	0.2	-1.2
Competitor prices	-0.1	0.6	1.0
Gas price (EUR per MWh)	12.5	50.0	50.0
Short-term interest (in pp)	0.6	1.8	0.8
Long-term interest (in pp)	0.1	0.1	0.0

Note: Assumptions simulated with NiGEM v1.23.

Source: DNB.

13 This scenario takes into account the impact of the energy price cap on energy inflation in the fourth quarter of 2023, but not its relatively limited fiscal impact. For the sake of convenience, it has been assumed that oil prices do not respond to growing uncertainty surrounding the availability of natural gas.

The decline in relevant world trade leads to lower exports of Dutch goods and services. In addition, domestic prices are driven higher by rising import prices, more expensive energy and stronger wage-price dynamics. HICP inflation is 3.1 percentage points higher in 2024 (Table 5). The simulated sharp interest rate hike by the ECB helps keep rising HICP inflation in check, but in this simulation it fails to meet the medium-term price stability target. Partly due to higher wage growth and the delayed pass-through of energy prices, core inflation becomes more persistent and is on average 0.6 percentage points higher in the scenario for 2024 and 2025 than in the baseline. Although nominal wage growth keeps pace with core inflation, households' purchasing power declines sharply due to high energy inflation and reduced economic activity. Growth in consumer expenditure consequently falls by over 1 percentage point in 2024. As a result of lower demand and higher financing costs due to rising interest rates, corporate investment also decreases. The low point of this scenario occurs in 2024, when economic growth in the Netherlands is 0.7 percentage points lower than in the baseline.

Employment initially holds up, but the fall in demand causes unemployment to rise gradually above 4% in 2025, or 0.5 percentage points higher than in the projection. In line with higher unemployment, rising prices and declining economic growth, this alternative scenario also sees declining consumer confidence. This brake on confidence combined with rising interest rates and lower housing investments triggers a further cooling of the housing market. The rise in house prices in 2024 is around 1 percentage point lower than in the baseline. Party because unemployment barely rises in 2023 and 2024 and nominal tax revenue initially holds up due to higher prices, the effect on public finances is limited in this simulation.

Table 5 Results of core inflation scenario

Percentage changes, unless stated otherwise

	2023	Difference vs projection	2024	Difference vs projection	2025	Difference vs projection
Gross domestic product	0.7	(-0.1)	0.6	(-0.7)	0.8	(-0.3)
Private consumption	1.5	(-0.1)	-0.3	(-1.2)	0.3	(-0.6)
Business investment	3.0	(0.0)	0.4	(-1.0)	1.3	(-0.4)
Housing investment	0.7	(0.0)	-5.8	(-1.1)	-0.6	(-1.2)
Exports of goods and services	0.8	(-0.1)	1.9	(-0.6)	2.7	(0.0)
Imports of goods and services	1.1	(-0.1)	2.1	(-0.7)	3.1	(-0.1)
Consumer confidence (level)	-37.1	(-0.7)	-31.5	(-8.7)	-18.3	(-5.1)
Compensation per employee, private sector	6.0	(0.1)	6.2	(0.7)	5.5	(1.3)
Harmonised index of consumer prices	4.3	(0.1)	6.8	(3.1)	2.8	(0.3)
HICP excluding energy and food	7.0	(0.2)	4.4	(0.8)	3.2	(0.4)
HICP energy	-25.7	(0.0)	30.9	(26.0)	0.7	(0.0)
Price index for existing own homes	-5.2	(-0.1)	-4.7	(-0.9)	0.0	(-0.2)
Unemployment (% of labour force)	3.6	(0.0)	3.8	(0.1)	4.3	(0.5)
EMU balance (% of GDP)	-2.2	(0.0)	-2.5	(0.2)	-2.7	(0.0)

Source: DNB.

Key data in forecast for the Dutch economy

Percentage changes, unless stated otherwise

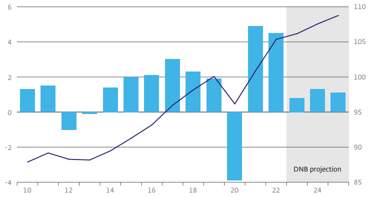
	2021*	2022	2023	2024	2025
Volume of expenditure and output					
Gross domestic product	4.9	4.5	0.8	1.3	1.1
Private consumption	3.6	6.5	1.6	0.9	0.9
Public expenditure	4.3	0.9	2.7	3.0	1.7
Business investment	4.7	5.2	3.0	1.4	1.7
Housing investment	3.2	0.6	0.7	-4.7	0.6
Exports of goods and services	5.2	4.7	0.9	2.5	2.7
domestically produced	1.5	4.4	-0.1	1.5	1.8
re-exports	10.6	5.1	2.0	3.8	3.9
Imports of goods and services	4.0	4.2	1.2	2.8	3.2
domestically used	-0.2	3.6	0.5	2.2	2.8
Wages and prices					
Negotiated wages, private sector	2.0	3.0	5.7	5.4	3.7
Compensation per employee, private sector	2.2	4.0	5.9	5.5	4.2
Unit labour costs, private sector	-1.3	2.3	7.2	4.6	3.3
Price of domestically produced exports	8.6	16.0	1.1	0.5	0.8
Harmonised index of consumer prices	2.8	11.6	4.2	3.7	2.5
Core inflation (HICP excl. energy and food)	1.8	4.8	6.8	3.6	2.8
House prices, existing own homes	15.2	13.6	-5.1	-3.8	0.2
Labour market					
Employment (persons, growth)	2.0	3.9	1.8	0.5	0.1
labour supply (persons, growth)	1.3	3.2	1.9	0.7	0.3
Unemployment (persons x 1,000)	408	349	365	385	404
Unemployment (% of labour force)	4.2	3.5	3.6	3.7	3.8

		2021*	2022	2023	2024	2025
Public sector and financial data						
EMU balance (% of GDP)		-2.4	0.0	-2.2	-2.7	-2.7
EMU debt (% GDP, based on end-of-period)		52.5	51.0	49.3	48.9	49.7
Current account (% of GDP)		7.3	4.4	4.0	4.4	4.1
Residential mortgage rate (based on end-of-period)		4.4	3.5	0.4	0.5	1.4
Bank lending to NFC's (based on end-of-period)**		4.0	3.6	-0.5	0.0	0.9
International assumptions						
Volume of relevant world trade		9.9	7.8	0.6	3.2	3.0
Volume of GDP	United States	5.9	2.1	1.0	0.6	1.6
	euro area	5.4	3.5	0.9	1.5	1.6
	emerging markets	7.3	3.7	4.1	4.1	4.1
Short-term interest rates in the euro area (%)		-0.5	0.3	3.4	3.4	2.9
Long-term interest rates in the Netherlands (%)		-0.3	1.4	2.8	2.9	2.9
Euro exchange rate (USD)		1.18	1.05	1.08	1.09	1.09
Competitor prices		8.2	16.7	-0.8	2.5	2.3
Oil price (UK Brent, USD per barrel)		70.8	99.1	78.1	72.6	70.4
Commodity prices, excluding energy (USD)		42.1	6.6	-11.5	-2.0	1.3

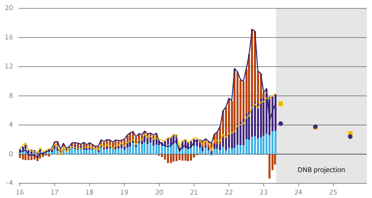
* Annual figures have been calculated based on seasonally adjusted quarterly figures and may therefore deviate marginally from the most recent National Accounts.

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

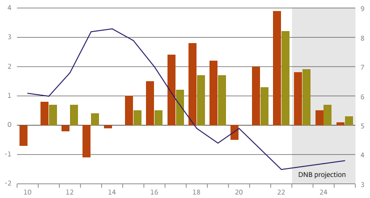
Figures



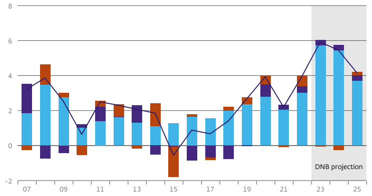
1 Gross domestic product



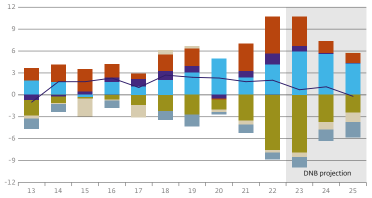
2 HICP inflation and core inflation



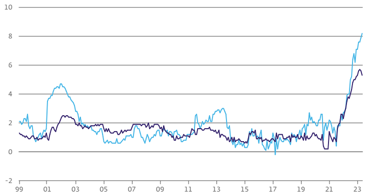
3 Labour market



4 Compensation per employee (private sector)



5 Real disposable household income



6 Core inflation, euro area and the Netherlands

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