Economic Developments and Outlook

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Summary

Outlook for the Dutch economy

The outlook for the Dutch economy in the 2021-2023 period continues to be dominated by the COVID-19 pandemic, although large-scale vaccine availability and administration suggest that the end is now in sight. The second and third waves of the pandemic, which necessitated additional containment measures, caused the Dutch economy to dip into another recession from the autumn of 2020, albeit a minor one. With the third wave now having peaked, measures are gradually being relaxed. Economic recovery has therefore resumed. Following the sharp contraction in gross domestic product (GDP) by 3.7% in 2020, GDP is expected to grow by 3.0% in 2021, 3.7% in 2022 and 1.9% in 2023. We expect GDP to top its pre-pandemic level in the fourth quarter of 2021. This means projected recovery should be much swifter than that after the financial crisis.

Once support measures are scaled back after the third quarter of 2021, employment will initially decline slightly, only to pick up significantly over the course of 2022. At the same time, labour supply will temporarily show additional expansion, as job search opportunities improve. As a result, unemployment will grow from 3.6% on average in 2021 to 4.5% in 2022. As the economy recovers further, however, unemployment should fall back to 4.1% in 2023. On the back of higher oil prices HICP inflation is projected to go up from 1.1% in 2020 to 1.5% in 2021. In 2022 it should remain at 1.5% and rise to 1.8% in 2023, in line with increased labour market tightness. Public finances will still be strongly affected by the pandemic in 2021, with a deficit of 4.1% of GDP and a debt-to-GDP ratio rising to 56.4%. In 2022 and 2023, when our projections assume the pandemic will be under control, the deficit should shrink to about 0.5% of GDP in both years, as the debt-to-GDP quote falls to 52.2% in 2023. Information from the Ministry of Finance's Spring Memorandum became available after we had finalised our projections, and we have therefore not included it in the figures. The Spring Memorandum shows a significant increase in the budget deficit in 2021 due to higher-than-expected expenditures and a less favourable underlying macroeconomic situation.

Given the greater-than-usual uncertainty surrounding our projections, this report again includes two pandemic scenarios. In the mild scenario, annual GDP growth in 2021-2023 ends up 0.4 percentage point higher on average, compared with the central projection. In the severe scenario, annual GDP growth will on average end up 1.1 percentage points per year below the central projection. Rather than defining the upper and lower limits to possible outcomes, the scenarios show that the bandwidth of possible outcomes has narrowed compared with that of six months ago.

Policy recommendations related to the projections

The Dutch government's support measures have contributed significantly in limiting damage to the economy. As containment measures are being scaled down and the pandemic appears to come under control, the government should unwind its support packages. Extending these into the fourth quarter of 2021 would seem undesirable. However, the government's role in alleviating potential corporate debt problems should be clarified quickly. As the pandemic comes to an end, many business owners will want to reassess the viability of their enterprises going forward. This is why private creditors need to be given clarity on the position of the government as a creditor in debt restructuring. In addition to easing repayment terms for viable businesses, as announced earlier, we recommend that the government encourages its own agencies to share the burden with private creditors.

There is no need for austerity measures or tax hikes in the short term to accelerate the reduction in public debt, given that the deterioration of public finances remains contained. Nor is there a need to provide any further fiscal stimulus to the economy, which is expected to bounce back swiftly.

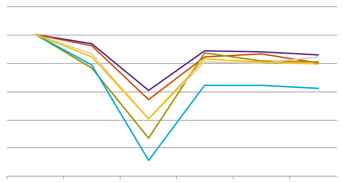
As the world emerges from the pandemic, it is becoming all the more obvious that the Dutch economy faces a number of structural challenges. Most of these had already presented themselves before the pandemic but had moved out of sight, while some were reinforced by the pandemic. It is important that the incoming government addresses these structural challenges.

Firstly, the Netherlands is lagging behind in terms of achieving the climate goals set. To achieve these goals, it is important not only to make public investment, but also to facilitate private "green" investment by combining improved emissions pricing, support to innovative sustainable investment (through grants, co-financing and guarantees) and regulation. Secondly, access to the housing market can be enhanced by increasing the supply of housing and phasing out favourable tax subsidies on home ownership that drive up prices, in an accelerated manner where possible. Transferring the treatment of home ownership to box 3 for income tax purposes and abolishing the gift tax exemption for home owners would be steps in the right direction. Thirdly, it is important to address flexibilisation in the labour market that has spun out of control, by closing the gap between permanent and flexible employment. The draft opinion which the Social and Economic Council of the Netherlands (SER) recently issued appears to provide a useful basis.

1 The Dutch economy in 2021-2023

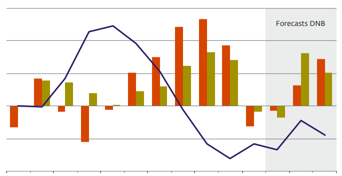
1.1 Economic growth

- Swift recovery after historical GDP contraction
- Major differences between business sectors



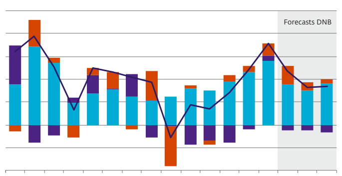
1.2 Employment

- Labour market prospects are brighter than expected
- Unemployment will not rise above 4.5%



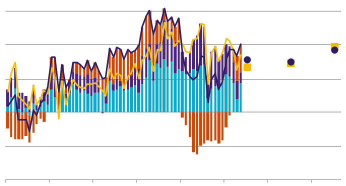
1.3 Wages

- Lower negotiated wage growth than in 2020
- Downward wage pressure remains subdued



1.4 Prices

- Inflation rates are strongly affected by the pandemic
- HICP inflation to reach 1.5% in 2021 and 2022



1.5 Housing market

- Housing market remains overheated
- House price increases to flatten after 2021 peak

Box 1 The basis for our projections

1.1 Swift recovery, but great uncertainty lingers

The Dutch economy contracted by 3.7% in 2020 due to the impact of the global COVID-19 crisis. This GDP contraction equals that seen in 2009, in the wake of the financial crisis. In particular, the contraction of 8.4% in the second quarter of 2020 (quarter-on-quarter) was of historical magnitude, as was the subsequent recovery of 7.7% witnessed in the third quarter, after the containment measures had been relaxed. However, the economy has experienced renewed setbacks since autumn 2020, due to the second (July 2020 to January 2021) and third COVID-19 waves (February to May 2021), which necessitated further containment measures. These nipped economic recovery in the bud in the fourth quarter of 2020. Since then, the third wave has peaked, and measures are gradually being relaxed. This is possible because the vaccination programme has gained steam and vaccines have shown to be effective in the fight against the pandemic. The Dutch economy has therefore resumed its recovery, although the outlook is still marked by the COVID-19 pandemic going forward. Chapters 1 and 2 describe our central projection, which, as usual, starts with an assessment of the current quarter (see Box 1). Given the greater-than-usual uncertainty caused by the pandemic, this report again includes two pandemic scenarios in addition to the central projection (see Chapter 3).[1]

Real GDP fell by 0.5% in the first quarter of 2021 relative to the fourth quarter of 2020. GDP had already contracted in the fourth quarter (-0.1%), meaning the economy dipped into a second recession, albeit a minor one. The first-quarter contraction was mainly due to the decline in private consumption. With measures having been tightened since mid-December, shops selling non-essential goods were virtually closed, resulting in a significant reduction in household spending on clothing, home furnishing and electrical appliances. By contrast, investment and exports grew, partly cushioning the GDP contraction.[2]

Measured by GDP developments since the fourth quarter of 2019 – shortly before the pandemic broke out – the Dutch economy is performing well internationally (see Figure 1). For example, Dutch GDP was 3.4% lower in the first quarter of 2021 than before the pandemic, compared with a 5.1% contraction for the euro area as a whole. There are several reasons why the Dutch economy has been less affected by the pandemic. Firstly, the Dutch economy is less dependent on the sectors most affected by containment measures, such as tourism. In addition, the public support packages have significantly helped to mitigate the economic downturn, and there are also indications that the Dutch economy is more digitalised than other European economies, which has allowed it to adapt more quickly to the changed circumstances. Finally, the surge in house prices has also underpinned the economy.

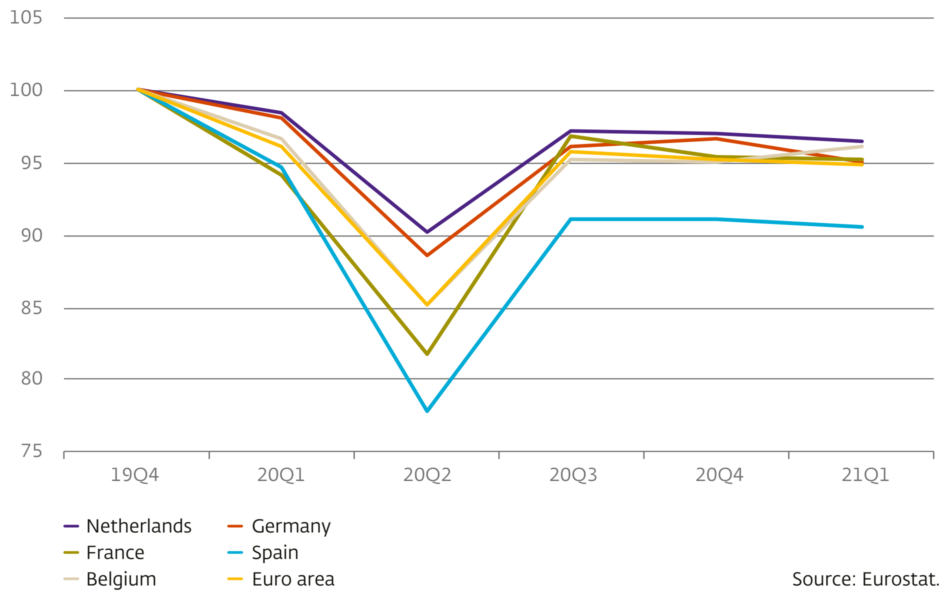
There are major underlying differences among sectors. Culture, recreation & other services are most affected by the pandemic and the containment measures. This sector comprises not only museums, theatres and sports, but also events and personal service providers such as hairdressers. Overall, the value added by this sector was almost 40% lower in the first quarter of 2021 than in the fourth quarter of 2019 (see Figure 2). The trade, transport & hospitality sector is also severely affected by the measures, resulting in a contraction of 8.3%. By contrast, the construction sector has been booming. In the first quarter of 2021, value added was 6.0% higher than prior to the pandemic. Since the fourth quarter of 2020, business owners in the construction sector have been the most optimistic of all sectors for

1 These projections are based on information available on 26 May 2021. 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, and we discuss them in Section 2.1. In global outline, the assumptions for the evolution of the pandemic and the containment measures were also adopted in an ECB context

2 The contraction seen in the first quarter of 2021 was smaller than we had projected in our interim projection, which estimated GDP to contract 1.2% quarter-on-quarter. The interim projection was an updated version of our December projection and, as such, it was not comprehensive. We therefore compare the current projection with the projection from December.

Figure 1 GDP developments in selected countries since the pandemic outbreak

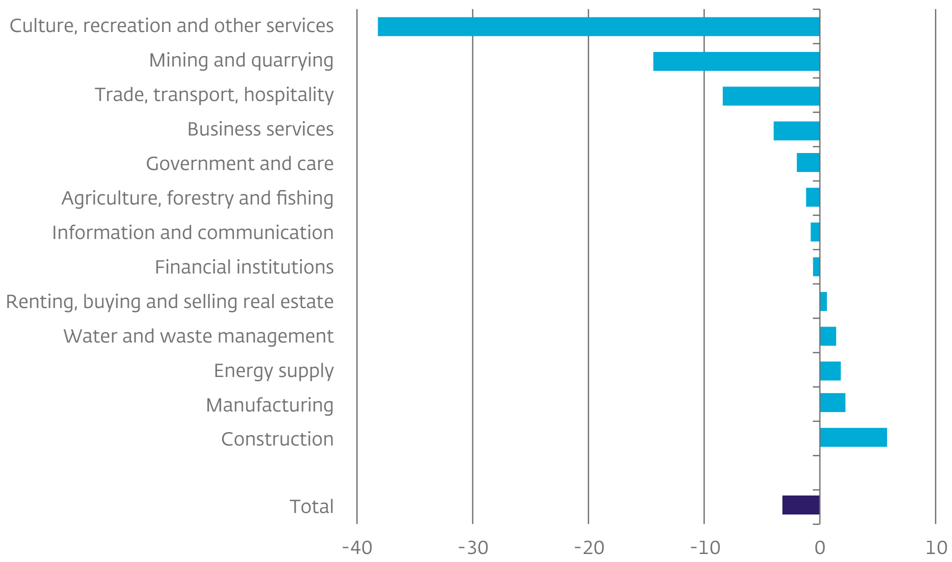
2019Q4 = 100; volume



Source: Eurostat.

Figure 2 Developments in added value since the pandemic outbreak

Percentage changes, 2021Q1 relative to 2019Q4; volume



Source: Statistics Netherlands.

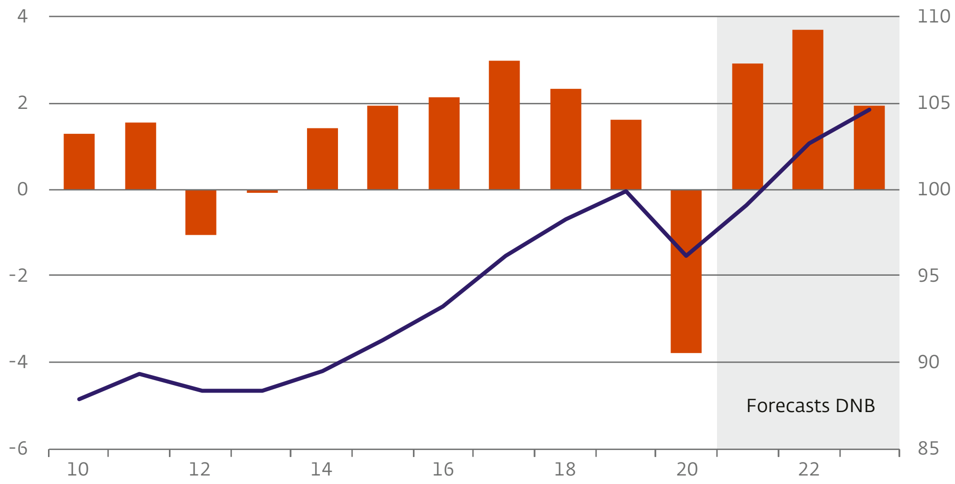
three consecutive quarters. Manufacturing industry is also performing relatively well, on the back of the rapid upsurge in international goods trade. After having experienced a sharp contraction in the first half of 2020 (-9.3%), its value added grew 2.3% in the first quarter of 2021 relative to year-end 2019.

Looking ahead, GDP is expected to recover by 3.0 % in 2021. The underlying assumptions are that containment measures will be gradually lifted in the Netherlands from May 2021 onwards, and that massive vaccination will eliminate their need in 2022.[3] We expect GDP growth to resume from the second quarter of 2021, driven by relaxed restrictions (see Box 1). Business confidence turned positive in April 2021 for the first time since the beginning of the pandemic. On the assumption of further relaxation,

3 This assumption is in line with the June Eurosystem staff projections, of which our projections form part. If containment measures are relaxed before 2021 is out, this could further drive up GDP growth for 2021 and 2022. See also Chapter 3.

Figure 3 Gross domestic product

Volume; year-on-year percentage changes and 2019 = 100



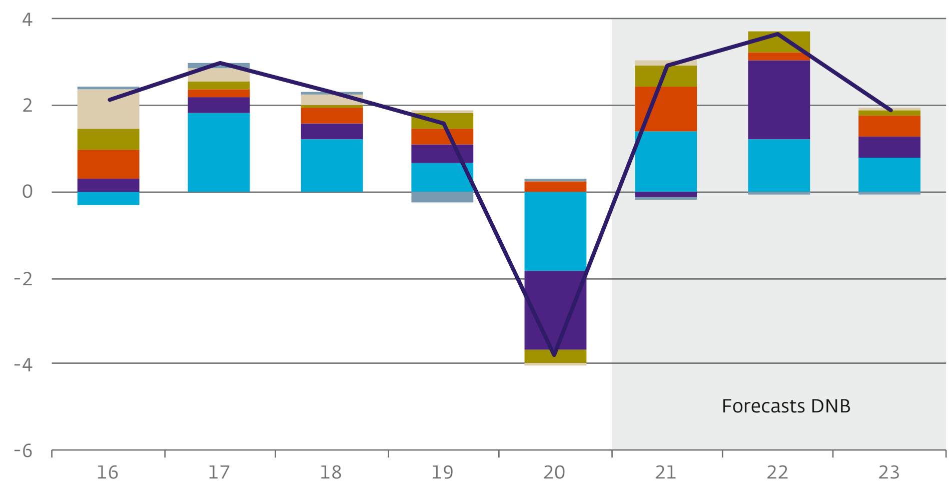
Sources: Statistics Netherlands and DNB.

recovery is on the cards for the second half of 2021. A large part of this higher growth will "spill over" to 2022, pushing GDP growth to 3.7%, above the figure for 2021 (see Figure 3). In 2023, growth will revert to the average rate seen in the period 2014-2019, at 1.9%. The output gap has been negative since 2020, but it will close in 2022 and climb to 1.5% in 2023.[4]

The resumption of GDP growth in 2021 will be largely driven by exports and public spending (see Figure 4). Where exports are concerned, this is linked to the rapid recovery in global goods trade, from which the Netherlands benefits greatly as an open economy. Public spending increases in 2021 mainly due to costs of fighting the pandemic, such as those of source and contact tracing, and of testing. In addition, public spending will be boosted by the National Education Programme, which seeks

Figure 4 Sources of GDP growth

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



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.

4 The output gap is defined as the difference between actual and potential GDP, expressed as a percentage of potential GDP.

to address COVID-19-related education gaps. GDP growth in 2022 will be driven mainly by the recovery in private consumption. As this should get under way particularly in the second half of 2021, it will be largely reflected in the 2022 annual growth figure due to "spill-over". In addition, business investment is expected to pick up significantly in 2021 and 2022, driven by the recovery in both external and domestic demand. For 2023, our projection anticipates a more balanced composition of GDP growth, similar to that before the pandemic. Growth projections for expenditure components can be found in the table Key data in projections for the Dutch economy.

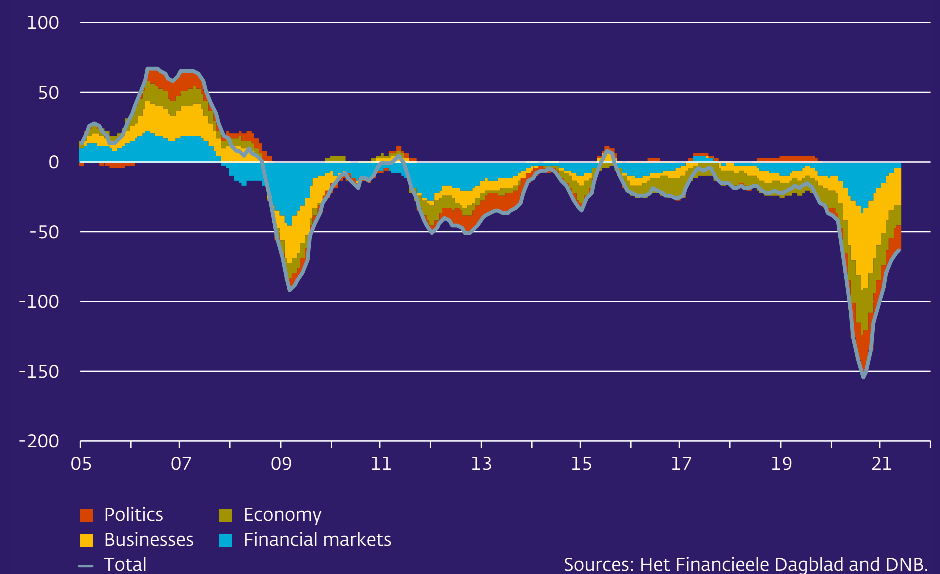
Box 1 The basis for our projections

An accurate assessment of the present situation is the starting point of any longer-horizon projection. Statistics Netherlands publishes initial growth estimates six weeks after each quarter-end. We use a model to obtain the most reliable picture of the current state of the economy. In addition, we have recently started looking at newspaper sentiment as a means to interpret current economic developments.

Estimating short-term economic growth is known as nowcasting. To do this, we use the dynamic factor real-time output growth model (DFROG). The indicators used in DFROG are both "hard" (based on actual outcomes) and "soft" (based on surveys). We have recently added newspaper sentiment, which helps us assess current economic conditions more accurately. At the beginning of the current projections exercise, we reassessed the sentiment indicator based on reports published in Dutch financial daily newspaper Het Financieele Dagblad. The sentiment indicator breaks down into four main topics on which this newspaper reports: economy, politics, business and financial markets. Figure 5 shows that newspaper sentiment is currently negative, but has improved significantly in recent months. Business news has made the biggest negative contribution over the past few months.

Figure 5 Newspaper sentiment by subject

Index; Long-term average = 0

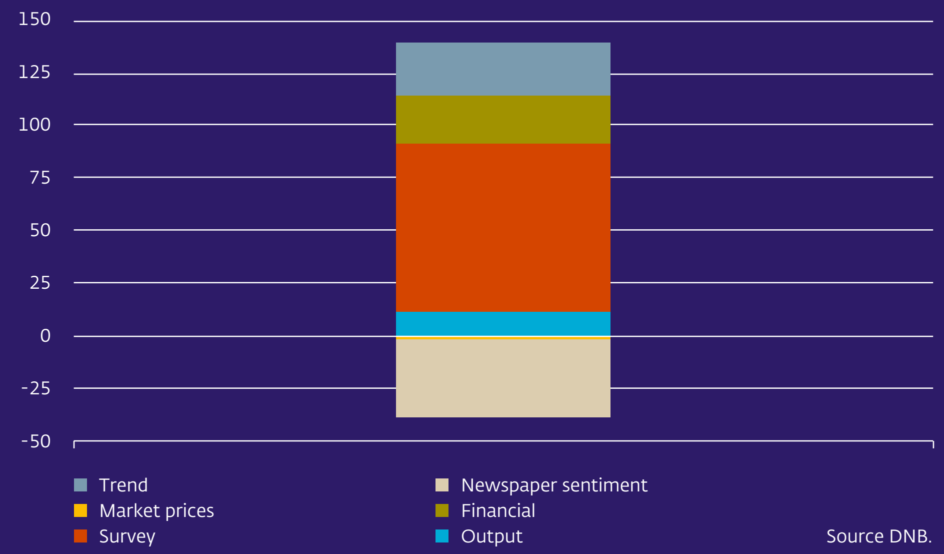


Sources: Het Financieele Dagblad and DNB.

Figure 6 shows the contributions of the various indicators to the DFROG forecast. The indicators break down into six categories: Survey, financial, production, market prices, newspaper sentiment and trend-based growth. Recent optimistic survey figures made the largest positive contribution. Overall, producers and consumers have become more positive about the economic outlook. Optimism in financial markets is also reflected in DFROG. The contributions from the financial indicators and recent production figures are also positive. Remarkably, newspaper sentiment has a negative impact on the DFROG forecast. This means that optimism in financial markets and among producers and consumers is not reflected in upbeat newspaper reports. Rather, newspaper reports highlight downside risks to the economy more prominently than financial markets and surveys do.

Figure 6 Component contributions to the GDP growth nowcast

Contributions in 2021Q2, total growth = 100



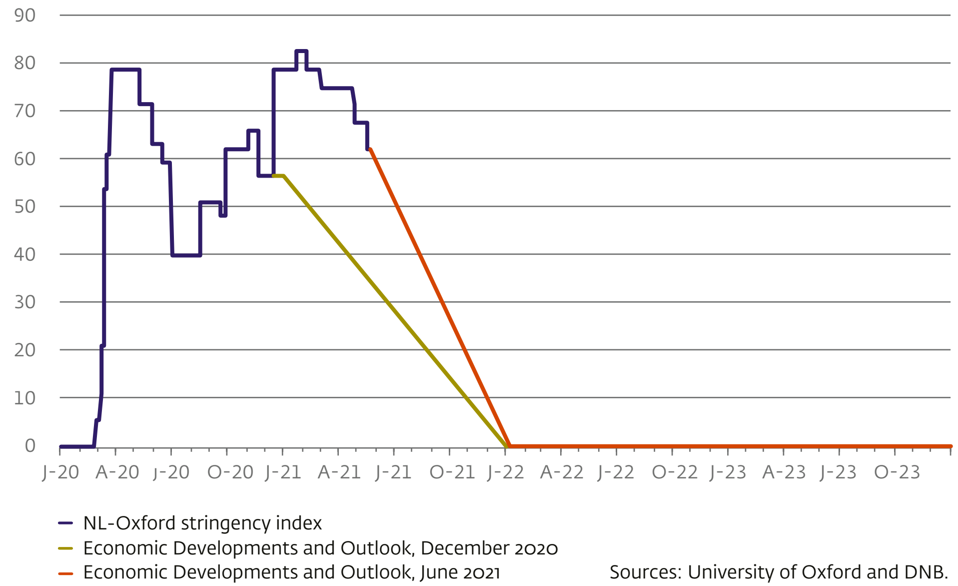
Source DNB.

Note: DFROG projections based on data available until 17 May 2021.

The economic outlook has brightened markedly compared with six months ago, even though the pandemic and related containment measures have developed less favourably than expected. For example, back in December 2020 we projected GDP growth of 2.9% for both 2021 and 2022, on the assumption that containment measures would be relaxed from the beginning of 2021. Instead, measures have been tightened since mid-December (see Figure 7). The fact that we nevertheless revised our projections upwards is due to a number of factors. One of these is the fact that GDP contracted less than expected in the fourth quarter of 2020 and the first quarter of 2021. Businesses and consumers have better accommodated to the containment measures, thereby reducing the burden of the pandemic on the economy since its second wave. A further key factor is the sharp rise in global goods trade seen since the third quarter of 2020. Lastly, we have revised the projections for world trade upwards on account of the Brexit deal and the new, comprehensive support package introduced by the US administration, which is expected to drive demand for Dutch products.

Figure 7 Developments in social distancing measures

Oxford stringency index

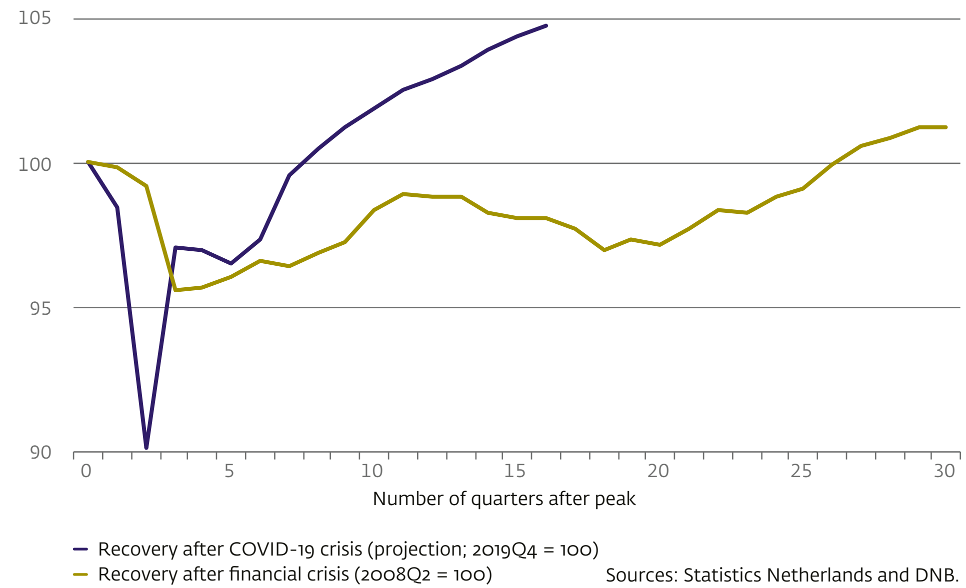


Sources: University of Oxford and DNB.

Notes: Data for the Oxford stringency index are based on the Coronavirus Government Response Tracker of the University of Oxford.

Figure 8 GDP recovery after financial crisis and COVID-19 crisis (projection)

Index, GDP volume level



Sources: Statistics Netherlands and DNB.

The Dutch economy is projected to recover much more rapidly than in the wake of the financial crisis. Our projection shows that real GDP will have topped pre-pandemic levels already in the fourth quarter of 2021, which is after eight quarters. This is more than three times faster than the recovery that took place in the aftermath of the financial crisis. At the time, it took 27 quarters to return to the pre-crisis GDP growth seen in the second quarter of 2008 (see Figure 8). The difference in the pace of recovery can be explained by the different natures of the two crises. Unlike the financial crisis, the COVID-19 crisis was not caused by excessive growth in corporate and household indebtedness. Nor did it involve any bursting equity or housing market bubbles. Instead, the current crisis originates outside the economy.
In addition, direct public support of businesses and workers has averted a sharp rise in unemployment and bankruptcies. We expect these factors to allow for a rapid recovery once the pandemic is fully contained.

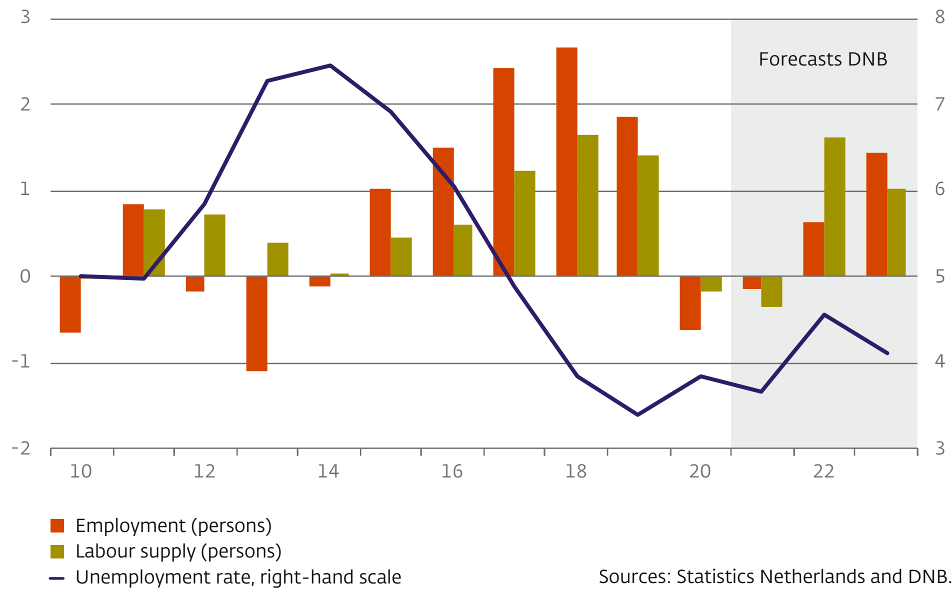
1.2 Labour market develops more favourably than previously anticipated

As in 2020, movements in the pandemic and the related containment measures are causing strong labour market dynamics in 2021. In the first quarter of this year, the number of employed persons declined by 71,000 from a quarter earlier. This was mainly due to fact that shops selling non-essential goods were closed in mid-December and to previously introduced restrictions facing businesses in the hospitality, recreation and culture sectors. On balance, almost 80% of all job losses (56,000) were in these sectors, where young people were particularly affected by the restrictions in place. During the initial months of 2021, more than half of all job losses were in the age group up to 25.

Total employment (in persons) is projected to decline by 0.2% on average in 2021 (see Figure 9). Following the steep fall observed in the first quarter, employment should pick up again in the next quarters, as businesses such as shops and restaurants gradually reopen. This is already reflected in the growing number of vacancies. In the first quarter of 2021, vacancies went up by 26,000, a large portion of which (6,000) were in the hospitality sector. We do expect employment to fall back, however, once public support measures have been scaled down. Inevitably, a number of businesses will still go bankrupt or face restructuring, which in itself is in line with normal economic dynamics. All in all, the decline in employment in 2021 will be much smaller than we anticipated six months ago. Furthermore, it is also more subdued than during the financial crisis in 2009 (-0.8%) or the sovereign debt crisis in 2012 (-1.1%). This is largely due to the government's generous support policy and the shorter duration of the current crisis. In addition, businesses are reluctant to cut their workforce, given the tight labour market conditions prior to the crisis. The sustained economic recovery should drive up total employment (in persons) by 0.6% in 2022 and 1.4% in 2023.

Figure 9 Labour market supply and demand

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



Sources: Statistics Netherlands and DNB.

Better-than-expected employment figures have prevented unemployment from rising sharply. The trend in unemployment has been surprising in recent months. After having gone up initially from 2.9% in March 2020 to 4.6% in August 2020, the unemployment rate showed an unexpected decline in the autumn. By April 2021, it had reached 3.4%. Partly due to the low level seen in the initial months of 2021, unemployment is expected to average 3.6% for the full year. This is only slightly above the pre-crisis level of 3.4% recorded in 2019. It should be noted, however, that unemployment rose only moderately from the autumn onwards partly due to a growing number of discouraged workers in the labour market. For example, some people withdrew from the labour market due to poor economic prospects, while others refrained from entering it, such as recent graduates and students.

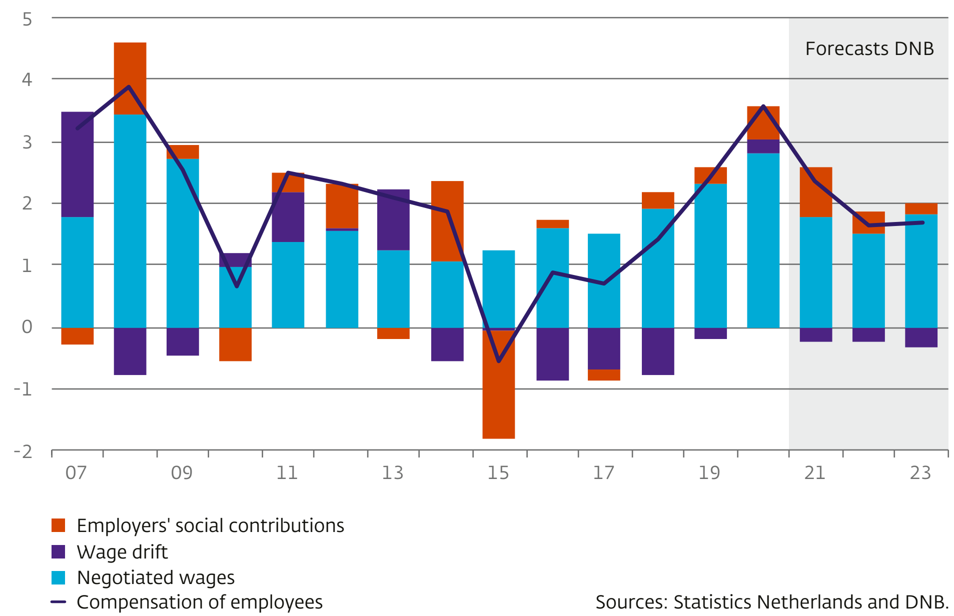
2022 will see unemployment rise, however, to 4.5% on average, representing a relatively large increase compared with 2021. This increase will mainly be driven by labour supply growth. Unemployment will be fuelled by groups of people losing their jobs and those starting to seek jobs. Labour supply fell sharply in the fourth quarter of 2020 and the first quarter of 2021. As noted above, some people who had become jobless decided to leave the labour market due to a lack of job search opportunities. These discouraged workers and other economically inactive persons are expected to return to the labour market as the economy reopens and the number of vacancies grows. Labour supply growth should peak over the projection horizon, at 1.6% in 2022, while employment will grow by a mere 0.6% in the same year. This will push up unemployment. 2023 will see the situation reverse, as employment growth is expected to outstrip the increase in labour supply, causing unemployment to drop to 4.1%.

1.3 Downward pressure on negotiated wages remains limited

Negotiated wage growth will decline to 1.8% on average in 2021, after having peaked at 2.8% in 2020 (see Figure 10). This is in spite of the fact that growth in negotiated wages still reached 2.3% on average in April 2021 relative to a year earlier, but around 40% of all collective labour agreements are still up for renewal this year. As in 2020, collective bargaining is progressing less smoothly than usual this year. In the years before the crisis, some 70% of all collective agreements had typically been renewed in spring. For the collective agreements still to be concluded this year, we assume average annual negotiated wage growth between 1.0% and 1.5%. The contrast with the previously concluded collective agreements reflects a dichotomy that can be accounted for by the pandemic. According to Dutch employers' association AWVN, half of the employees that come under a collective labour agreement concluded in 2021 are not getting any pay increase for this year. This applies in particular to

Figure 10 Compensation per employee (private sector)

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



Sources: Statistics Netherlands and DNB.

businesses in sectors that have been hit hard by the COVID-19 crisis, such as transport, culture and hospitality.

Growth in remuneration per employee, comprising contractual wages, wage drift and employers' social contributions, should reach 2.4% in 2021. The largest factor in this increase is a positive contribution from increased social contributions to national insurance schemes. In 2021 and beyond, the contribution from wage drift will be negative due to lower bonuses and a negative composition effect. The latter is due to the fact that employment growth will mainly take place among young people and workers on flexible contracts, who are paid less on average.

In 2022, negotiated wage growth will decelerate to 1.5% on average. While this is in line with the expected rise in unemployment, it exceeds the figure we projected in December 2020 (0.7%). This upward revision is related mainly to the improved labour market situation. The decline in employment in 2021 will be much more muted than we had expected in December, and the peak in unemployment will be correspondingly lower. In 2023, the unemployment rate is projected to decline again, and an increasingly tight labour market should push up negotiated wage growth.

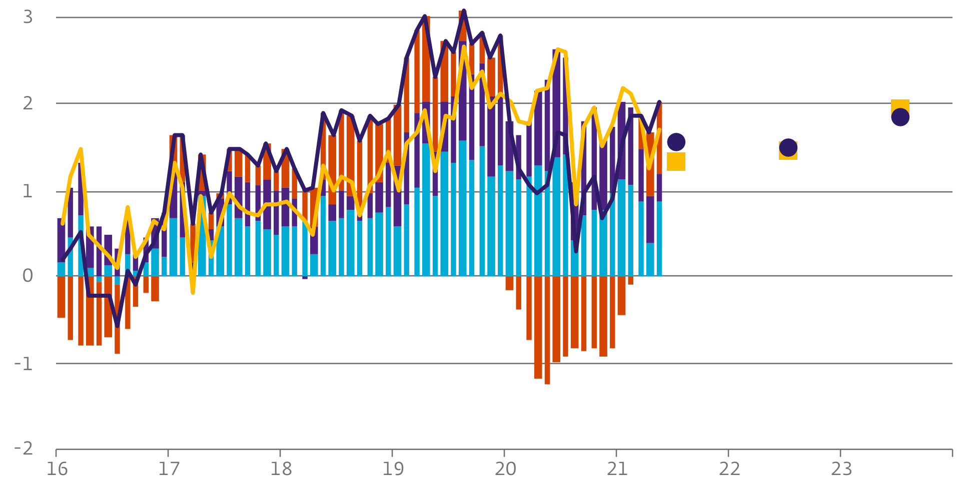
1.4 Inflation rates are strongly affected by the pandemic

HICP inflation is expected to reach 1.5% in 2021, while core inflation, which excludes food and energy prices, should land at 1.3%. The pandemic is having a major impact on inflation rates in 2021.

Firstly, this is reflected in energy prices, which in 2021 will on average be 6.8% above those recorded in 2020. The slump in international demand caused oil prices to fall sharply in March 2020, with US oil prices briefly turning negative in April 2020. Oil prices have now returned to pre-pandemic levels, and energy prices have again been making positive contributions to HICP inflation since March 2021 (see Figure 11). In the wake of the pick-up in energy prices, broader producer prices have also risen since the end of 2020. As with oil prices, this is partly due to the improved outlook for the world economy. In addition, specific distortions in production chains contribute to higher prices, such as semiconductor and container shipping capacity shortages. However, international research shows that, with the exception of energy and food, higher producer prices pass through to consumer prices only to a limited extent.[5] In each stage of the production chain, a producer's profit margin absorbs part of the price change, while another part is passed on to the customer with a delay. In the case of food and energy, fewer intermediate stages are needed to reach consumers. This makes changes in producer prices and consumer prices more closely linked.

Figure 11 Inflation (HICP) and core inflation

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



Sources: Statistics Netherlands and DNB.

Note: Core inflation = total excluding food and energy.

If prices of capital goods and intermediate goods change, more intermediate steps are generally needed to reach the consumer. As a result, such price changes are scarcely reflected in consumer prices.

Secondly, the expected increase in negotiated wages in 2021 is below that in previous years due to the COVID-19 crisis. In addition, as described above, wage drift is also lower.

5 See Willie J. Belton & Usha Nair-Reichert (2007), Inflation regimes, core inflation measures and the relationship between producer and consumer price inflation, Applied Economics, pp 1295-1305.

Thirdly, consumption patterns changed significantly in 2020 as a result of the pandemic. As a consequence, the expenditure weights of some components in the shopping basket of the 2021 HICP were significantly reduced, such as airline tickets (from 0.9% to 0.2%) and package holidays (from 1.4% to 0.3%). This has caused their usual summer peak to weigh less heavily. This will temporarily depress inflation in the third quarter of 2021.

Fourthly, the demand for certain services, such as hospitality and holidays, should go up significantly once the containment measures are relaxed, whereas the potential to increase their supply will be limited. As the resulting higher prices of holidays will be imputed to the months in which holidays are taken, this will especially have an upward effect on inflation in the second half of 2021. The specific effects of the pandemic will fade out after 2021, and core inflation should gradually increase throughout 2022 and 2023, predominantly on the back of the anticipated economic recovery. HICP inflation will average 1.8% in 2023.

1.5 Housing market remains overheated

The housing market has been overheated for some time now, which is reflected, among other things, in steadily rising house prices. In April 2021, the annual rate of increase in the price of existing homes was 11.5%, the highest in 20 years. Recent increases are well above the rates we had anticipated at the time of our December 2020 projections. The significant price increases reflect a combination of overall better-than-expected developments in household disposable income and limited housing supply. Disposable income is determined by the state of the labour market, purchasing power and mortgage interest rates. All these factors have developed more favourably than we had anticipated six months ago. Unemployment has fallen since December 2020, in marked contrast with our projected increase, which was a factor in the stronger-than-projected wage increase. Mortgage interest rates on new loans have declined somewhat further over the past six months. In addition, tax regime changes have had an impact on house price developments. The abolition of property transfer tax for first-time buyers under 35 years of age is expected to have had a one-off effect of driving up prices. Apart from these demand developments, new housing supply remains limited. The government is expected to miss its target of building an average of 90,000 homes per year until 2030 again in 2021 (Rabobank, 2021). The supply of existing homes is also very limited. According to figures from Dutch real estate agents association NVM (available in Dutch), only 17,500 houses were for sale halfway through the first quarter of 2021. This is the lowest number since 1995, when NVM started recording supply statistics.

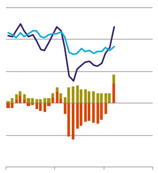
Tightness in the housing market is expected to persist throughout the projection horizon. For 2021, we project house prices to increase by 10% on average. As unemployment increases in 2022 and mortgage interest rates edge up in line with slightly rising capital market rates, household disposable income will be depressed. As a result, we expect housing prices in 2022 to increase less steeply than in 2021, at 5.5%, which is still a hefty increase from a historical perspective. In 2023, average mortgage interest rates are expected to edge up further in 2023, thereby flattening house price increases to 3.5%.

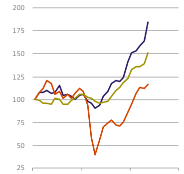
The robust price increases in the housing market are particularly bad news for first-time homebuyers. Higher prices put further pressure on the affordability of owning a home. This means first-time homebuyers need to take out larger loans in proportion to their income. Increasingly, they choose to take out a riskier interest-only type of mortgage loan (see also our spring 2021 Financial Stability Report). Access to the housing market can be enhanced by increasing the supply of housing and phasing out favourable tax subsidies on home ownership that drive up prices. Supply must be expanded by building more owner-occupied and rented housing. In addition, we recommend that home ownership and renting are treated equally for tax purposes. Transferring the treatment of home ownership from box 1 to box 3 for income tax purposes and abolishing the gift tax exemption for homebuyers would be steps in the right direction.

2 A closer look at expenditure and the labour market

2.1 International assumptions

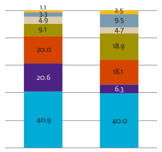
- Global recovery unevenly distributed across countries
- Price pressure to rise globally

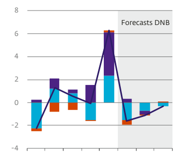




2.2 Exports

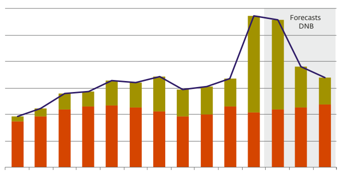
- Market share of Dutch exports will normalise
- Dutch current account surplus stabilises





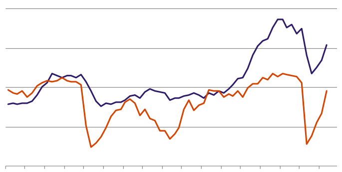
2.3 Households

- Private consumption to recover strongly
- Saving rate will fall sharply after having risen



2.4 Businesses

- Business investment to rebound sharply
- Support packages mitigate the pandemic's impact on solvency

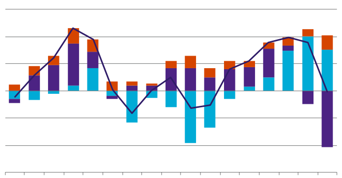


2.5 Public finances

- Deterioration of public finances remains contained
- Debt-to-GDP ratio to decline steadily after 2021 peak

2.6 Labour market

- Further flexibilisation of the labour market is looming
- Staff shortages differ widely between sectors



Box 2 Increased savings: will they be spent any time soon?

Box 3 The financial position of SMEs one year after the COVID-19 outbreak

Box 4 Public finances: differences relative to the 2021 Spring Memorandum explained

2.1 International assumptions

According to projections from the European Central Bank (ECB), global GDP (excluding the euro area) should expand by 6.2% in 2021, following a contraction of 2.4% in 2020. In the second half of 2020, the global economy recovered more strongly than anticipated six months ago. Major contributing factors were not only generous support from governments and central banks, but also more specifically targeted measures to contain the virus and the adaptability of economies. By contrast, containment measures in most non-euro area countries were stricter in the first half of 2021 than we had anticipated in our December projection. On balance, the upward revision of global GDP growth in 2021 relative to the outlook back in December 2020 remains limited to 0.4 percentage point.

For the euro area, the ECB projects GDP to increase by 4.6% in 2021 and 4.7% in 2022, before slowing to 1.4% in 2023. This is on the assumption that containment measures will be gradually relaxed from the second quarter of 2021 onwards and fully or almost fully unwound in early 2022. Relaxed containment measures will broaden household consumption opportunities and allow international travel to bounce back. The latter will particularly benefit economies that depend relatively strongly on tourism, such as Spain and Italy.

Global economic recovery is unevenly distributed across countries, mainly due to differences in vaccination roll-out speeds and fiscal headroom. Among the developed economies, the rate of vaccination is highest in the United States and the United Kingdom, apart from Israel. According to the projection, US GDP will grow by 6.6% in 2021, while UK GDP should expand by 6.5%. These are sizeable upward revisions (of 2.8 and 2.6 percentage points, respectively) compared with the projection issued six month ago. This improved outlook is also due to the comprehensive fiscal stimulus in the United States worth USD 1,900 billion, or some 9% of GDP, and the conclusion of a trade deal between the United Kingdom and the European Union.

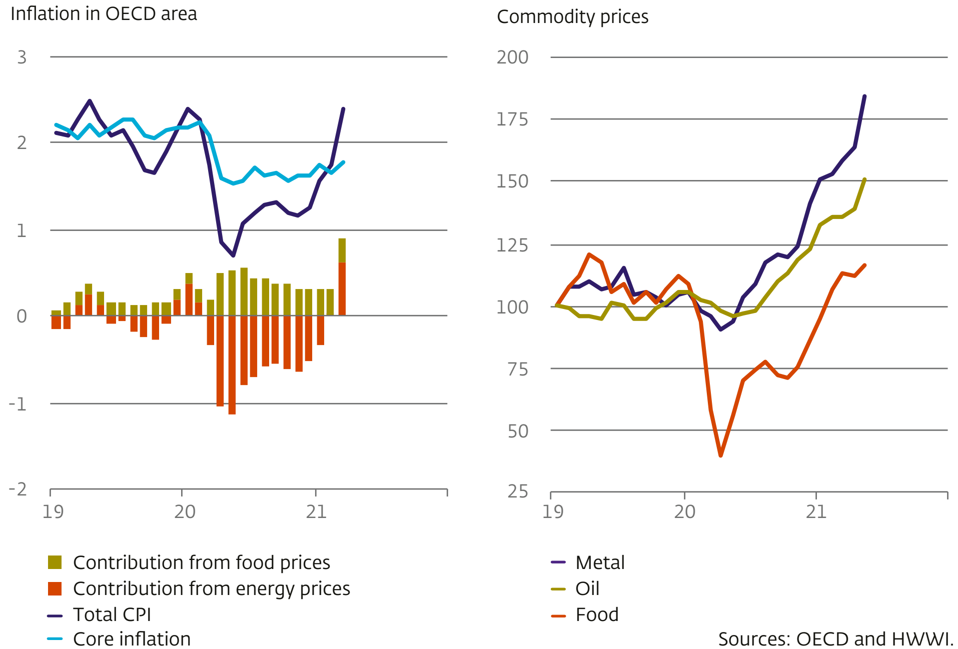
The high rate of vaccination in some developed countries is counterbalanced by the delays in vaccination roll-outs seen in most emerging and developing countries. These countries typically have limited fiscal headroom, which is a further factor in their lagging economic recovery. It is therefore important that vaccines become widely available and affordable for emerging and developing countries.

Global inflation has risen since the beginning of 2021 in a trend that is expected to continue over the coming months (see Figure 12, left). Price pressures are increasing as oil prices and other commodity prices recover (see Figure 12, right). Transient factors also play a role, such as stock shortages of semiconductors and increasing transportation costs. Core inflation, however, which excludes the highly volatile food and energy prices, is still below pre-COVID-19 crisis levels in most countries. For the world as a whole, inflation is expected to increase only temporarily, as production capacity will not be fully utilised in the years ahead and the labour market remains slack. Global inflation will go up temporarily, from 2.2% in 2020 to 2.9% in 2021, before gradually returning to the pre-crisis level of 2.5% in 2023.

Nevertheless, concerns have been raised in the United States about a lasting elevated level of inflation due to the US support package announced in March. As a result, the dollar initially appreciated against the euro in March 2021, but by the cut-off date of these projections the euro exchange rate had returned to its early-2021 level of USD 1.22. The ECB reckons the impact of the sizeable US support package on inflation in the euro area will be limited to 0.15 percentage point, cumulative throughout the entire 2021-2023 projection period. The projection assumes that the euro rate remains stable on average at USD 1.21 over the projection horizon. As for oil prices, the ECB anticipates that, following the steep fall in 2020 to USD 43.4 per barrel, these will average USD 66.0 per barrel in 2021 and edge slightly lower thereafter to USD 61.9 per barrel in 2023.

Figure 12 Inflation in OECD area and commodity prices

Year-on-year percentage changes, contributions in percentage points and january 2019 = 100



Sources: OECD and HWWI.

Note: Core inflation = total CPI excluding food and energy.

2.2 Market share of Dutch exports will normalise

Prospects for the international environment are of great importance to the open Dutch economy, and they are reflected in the projections for world trade relevant to the Netherlands. This is expected to increase by 8.0% in 2021, following a contraction of almost 10% in 2020 (see Table 1). The latter was due mainly to a sharp decline in trade in services, which has been severely affected by international travel restrictions.

By contrast, global trade in goods proved resilient, exceeding pre-crisis levels as early as October 2020. The projected recovery in relevant world trade in goods and services in 2021 is based on the assumption that containment measures will be relaxed from the second quarter of the year onwards, thereby boosting international travel. In 2022, relevant world trade is expected to grow by 6.1%, after which growth in 2023 should normalise towards the long-term average (2012-2019) of around 3%.

Table 1 Dutch exports and competitiveness

Percentage changes

	2020	2021	2022	2023
Volume				
Relevant world trade (1)	-9.9	8.0	6.1	3.4
Exports of goods and services (2)	-4.3	6.3	4.9	3.1
domestically produced	-7.0	4.2	4.7	2.8
re-exports	-0.2	9.0	5.1	3.4
Trade performance (2-1)	6.3	-1.6	-1.1	-0.3
Exports of goods and services excl. energy	-4.0	6.6	4.8	3.0
domestically produced (3)	-6.1	5.0	4.6	2.7
re-exports	-0.9	9.0	5.1	3.4
Market performance (3-1)	4.3	-2.8	-1.3	-0.7
Price				
Competitor prices (4)	-3.0	3.0	1.4	1.1
Exports of goods and services	-2.5	3.8	1.6	0.7
domestically produced excl. energy (5)	-1.0	3.0	1.5	1.4
Price competitiveness (4-5)	-2.0	0.0	-0.1	-0.3

Sources: DNB and ECB.

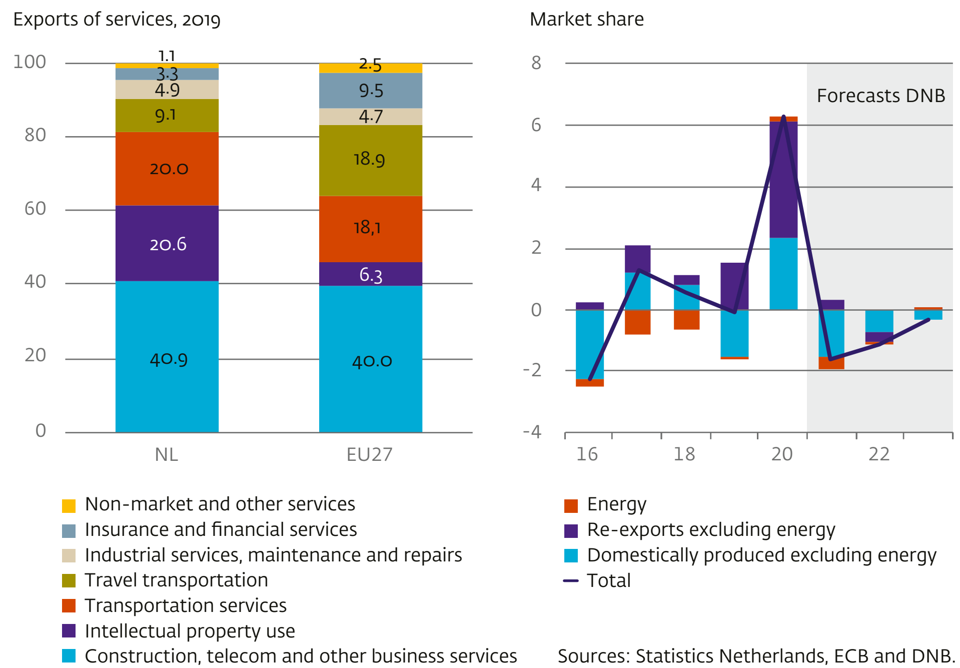
In 2021, Dutch exports of goods and services are expected to grow by 6.3%, which is below that of relevant world trade. Several factors account for this, including the fact that the specific composition of Dutch exports was relatively unfavourable in 2021. The opposite was the case in 2020, when income from travel services, such as expenditure on accommodation and entertainment by foreign travellers, fell sharply due to the pandemic, while the share of these services in Dutch services exports is relatively small (see Figure 13, left). As a result, Dutch exports contracted much less in 2020 than relevant world trade, thereby significantly increasing market share. However, the small share of travel services in Dutch services exports implies that Dutch exports will benefit relatively little from the recovery in international travel in 2021. This will cause the market share of domestically produced exports (excluding energy) to slide in 2021, after the sharp increase seen in 2020 (see Figure 13, right).

Exports of goods and services are expected to grow by 4.9% in 2022. Underlying energy exports should expand by 5.5% as a result of growing activity in the international environment and the resulting demand for energy. In 2023, the growth rate of total exports is projected to slow to 3.1%, broadly in line with growth in relevant world trade. This does not apply to growth in domestically produced exports (excluding energy), which will decelerate to 2.7% in 2023, with further globalisation and the expected deterioration in price competitiveness acting as a drag. At the end of the projection horizon the market share of 'Made in Holland' exports should be broadly back to pre-COVID-19 crisis levels (see Figure 10).

Expected developments in exports will also impact the Netherlands' current account balance. After it had declined sharply in 2020, the current account balance should stabilise throughout the projection horizon. In 2020, it fell back 2 percentage points to 7.8% of GDP, due mainly to a decrease in the external income balance (see Figure 14). In particular, profits from foreign equity holdings declined sharply. Profits realised by foreign businesses on their participating interests in the Netherlands were also lower throughout the year, but their decrease was significantly

Figure 13 Composition of services exports and market share of goods and services exports

Percentage shares, year-on-year percentage changes, and contributions in percentage points



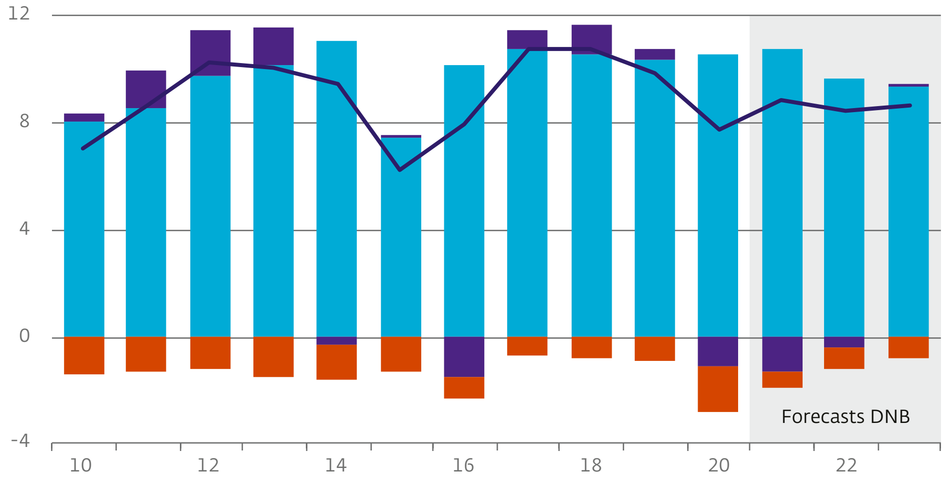
Sources: Statistics Netherlands, ECB and DNB.

Note: The percentage change in total market share is defined as the percentage change in total exports less the percentage change of relevant world trade. The bars show the contributions of the three components of total exports to the change in market share.

more subdued. Current transfers also contributed to the decline in the current account surplus, and these were strongly impacted by a one-off income transaction effected by a Dutch-based multinational corporation. The balance of current transfers is assumed to recover to pre-pandemic levels over the projection horizon.

Figure 14 Current account surplus

Percentage of GDP



Sources: Statistics Netherlands and DNB.

Note: Income transfers include correction of changes in pension rights.

As a result, the current account surplus should climb to 8.8% of GDP in 2021. The assumption is that profits from foreign equity holdings recover in subsequent years, driving up primary income earned abroad. As a counterweight, the trade balance is declining, as import growth outpaces the increase in exports over the projection horizon. Overall, the current account surplus should remain broadly stable in 2022 and 2023, at a level slightly below that in the years preceding the COVID-19 crisis.

2.3 Household consumption to recover strongly amid relaxed measures

The pandemic affected not only external demand but also domestic spending. For example, private consumption shrunk 6.4% in 2020, more than three times as much as the decline seen in 2009, during the financial crisis. The decrease was driven mainly by the slump in services consumption. In both the second and fourth quarters of 2020, the fall in services consumption outstripped that in consumption of durable goods, such as cars, electronics, textiles and clothing. As containment measures were relaxed in the third quarter of 2020, consumption of durable goods increased sharply, exceeding in fact the pre-crisis level of the fourth quarter of 2019. Subsequently, as measures were again tightened in mid-December in response to the second wave of the pandemic, private consumption slid further in the first quarter of 2021. Consumption of durable goods also fell off again, as all shops selling non-essential goods were closed.

The decline in household consumption was offset by increased savings. Compared with 2019, household disposable income went up 3.8%, or €14 billion, in 2020. This was largely caused by public support measures aimed at averting dismissals and bankruptcies. As income grew significantly while consumption fell sharply, household non-contractual savings climbed steeply in 2020. For example, the individual saving rate, which expresses non-contractual savings as a percentage of household disposable income, surged from 2.4% in the fourth quarter of 2019 to a record 14.4% in the second quarter of 2020. Throughout the year, the individual saving rate increased by 8,6 percentage points from the fourth quarter of 2019. These additional non-contractual savings, also referred to as “excess savings”, amounted to €32.6 billion in 2020. Further analysis shows that the vast majority of these excess savings were involuntary (see Box 2). This means a large portion of household savings were driven by a lack of opportunities for consumer spending. In addition, almost €5 billion in household savings were of a precautionary nature in response to increased economic uncertainty.

Box 2 Increased savings: will they be spent any time soon?

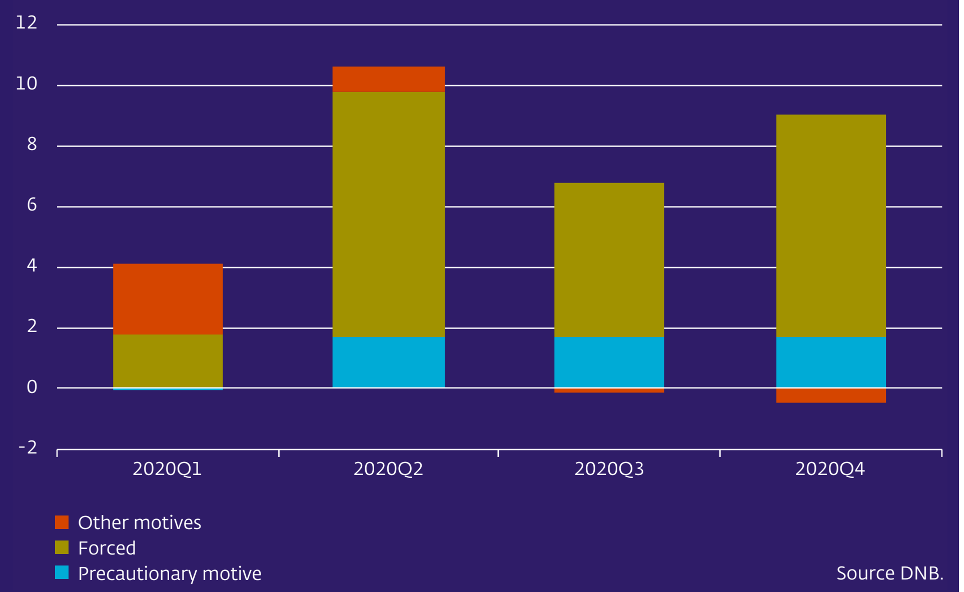
To explain the record spike in the total saving rate of Dutch households in 2020, we estimate a simple quarterly model between 2003 and 2020.[6] Firstly, the model contains the standard drivers of household savings: household income, household financial wealth and credit conditions for households. Precautionary savings are estimated on the basis of households' unemployment expectations. Secondly, we use the Oxford stringency index, which is a measure of the stringency of containment measures, as an indicator of forced savings. Figure 15 shows a breakdown of the additional savings (the difference between the saving ratio in 2020 and 2019Q4) according to the model results. It follows that, on average, 70% of the additional savings were forced in 2020, while 15% were precautionary. These "excess" savings are a potential source of pent-up demand.

There are several factors that limit the use of additional savings to unleash pent-up demand. Firstly, Beraja & Wolf (2021) show that recovery in the aftermath of a recession that mainly affects the services sector is weaker than that following a recession whose predominant impact is on the goods sector. Indeed, the purchase of goods can be held off more easily until after a recession compared to the purchase of services. Although some pent-up demand can be expected for services as soon as containment measures are relaxed, such as paying a visit to the hairdresser or booking an expensive holiday, but probably less than for durable goods.

Secondly, Rabobank survey results (available in Dutch) indicate that savings are primarily concentrated in high-income groups, which may limit the potential for a rebound in consumption. High-income groups have a higher share in the spending categories most affected by the COVID-19 crisis, such as hospitality, recreation and culture, and transport. This means the majority of forced savings are likely to be found in those groups. The relatively low marginal propensity to consume in high-income groups acts as a drag on pent-up demand.

Figure 15 Motives driving additional household savings

Percentage points of gross disposable income, difference in savings quotes relative to 2019Q4



Source DNB.

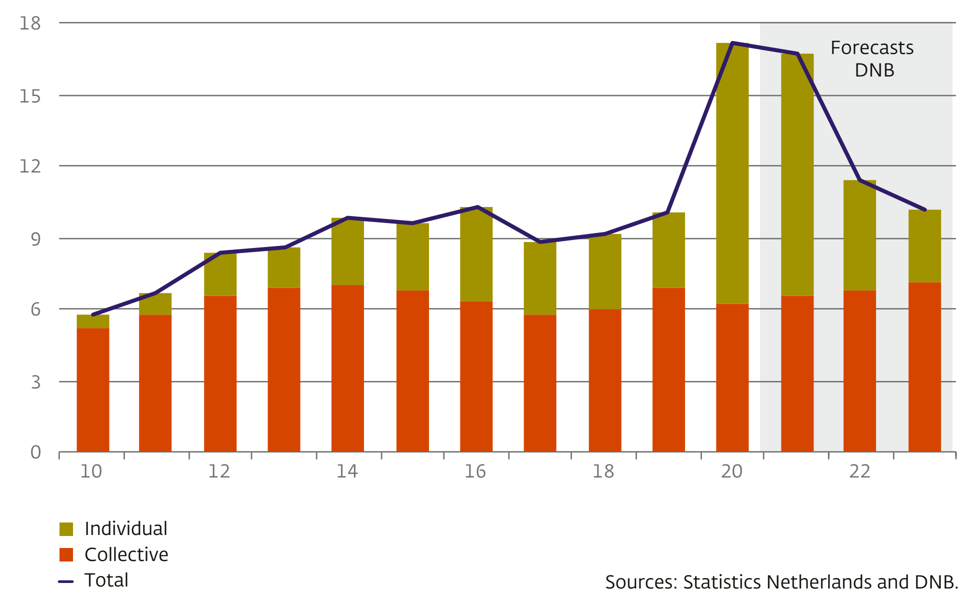
6 Based on ECB Economic Bulletin Issue 6, 2020, Box 5 "COVID-19 and the increase in household savings: precautionary or forced?"

Thirdly, precautionary savings are not spent immediately. Based on our model, we find that the increase in precautionary savings during the COVID-19 crisis was similar to that seen in previous crises (2003, 2009 and 2013). On average, it takes two years for confidence to be sufficiently restored and for the precautionary motive to lose its relevance. Moreover, the contribution of the precautionary motive to savings becomes negative only during a period of economic boom. Only then do consumers draw down their savings. This is also reflected in bank deposit data of Dutch households. Net deposits peak during economic downturns, but are rarely negative during upturns.

Private consumption growth is projected at 0.5% in 2021, 7.2% in 2022 and 2.1% in 2023. This is in line with the assumption that containment measures will be gradually relaxed in 2021 and will no longer be needed from 2022 onwards. As a result, private consumption is expected to recover rapidly to pre-pandemic levels in the second half of 2021 and in 2022. The projected rebound is supported by pent-up demand from part of the Dutch households. Pent-up demand occurs when households spend more, and thus save less, than they would do under normal conditions. However, this effect is expected to be limited at the macro level. This is due, firstly, to the fact that the potential for pent-up demand for services is lower than for durable goods. Secondly, involuntary savings are found predominantly in higher-income households, which typically have a relatively low marginal propensity to consume (see Box 2). Thirdly, pent-up demand is depressed at the macro level by the fact that some households, such as self-employed workers, will try to restore their drawn-down buffers through additional savings. Lastly, precautionary savings will be higher than before the pandemic due to rising unemployment and growing insecurity, thus keeping a lid on pent-up demand. Is it therefore rather uncertain how significant pent-up demand will be. The mild scenario in Chapter 3 assumes higher pent-up demand, resulting in a lower individual saving ratio. Overall, the 2022 projected individual saving ratio will fall sharply to 4.6%, reaching the 2019 pre-crisis level of 3.1% in 2023 (see Figure 16).

Figure 16 Individual and collective savings households

Percentage of disposable income (including adjustment for net equity in pension funds reserves)



Sources: Statistics Netherlands and DNB.

2.4 Business investment to rebound amid growth in lending

The reduction in domestic and foreign sales induced by the pandemic substantially depressed business turnover in 2020. However, the extent to which businesses and sectors were affected varies widely. For example, businesses in the hospitality and the transport and storage sectors recorded sharp reductions in turnover in 2020, whereas construction companies saw their figures go up. Overall, negative production and sales developments contributed to a 4.7% reduction in fixed capital formation last year. The wide discrepancies among sectors are clearly reflected in the financial position of businesses (see Box 3). The support packages seem to have helped to mitigate the impact of the COVID-19 crisis on solvency among small and medium-sized enterprises (SMEs), which could underpin investment growth going forward.

Box 3 The financial position of SMEs one year after the COVID-19 outbreak

Many SMEs have seen turnover plummet due to the COVID-19 crisis. While the support and recovery package is providing some relief, the financial positions of many SMEs have suffered from the crisis. A severely weakened financial position of businesses could negatively impact economic recovery, for example through a sharp increase in bankruptcies, leading to rising unemployment, or through lagging investment.

To examine this, we analysed the financial situation of Dutch SMEs in early 2021, using micro data from Statistics Netherlands. SMEs are defined as businesses with a workforce below 250 and total assets of less than €40 million.[7] We used business-specific data from financial statements (balance sheets and profit and loss accounts) as at year-end 2019 and figures on business turnover, workforce and the amounts received under the support and recovery package (NOW, TOGS and TVL) in 2020. We limited our analysis to the approximately 186,000 private limited companies in the SME segment.

We used these data to estimate the operating result (i.e. profit or loss) for 2020 for each individual business. Where a business' loss exceeded the liquid assets held at the beginning of the year, we assumed it had a liquidity deficit. This enabled us to estimate the number of businesses that needed to find additional liquidity due to the crisis. We then estimated how many businesses had an equity deficit due to their loss for 2020.

It follows from this analysis that the COVID-19 pandemic and the related containment measures have pushed up the proportion of companies suffering a liquidity deficit by 5 percentage points (pp) to a total of 9,300 businesses. This represents an increase relative to the hypothetical situation in which we assumed that the year 2020 would have been comparable with 2019 in terms of turnover. Without support measures, the increase would have been higher, at 7 percentage points (pp).
The increase in the number of businesses that have a liquidity deficit is strongly concentrated in sectors most affected by the containment measures, such as food and beverage service activities (37 pp), travel agencies (36 pp), wellness (14 pp), sport & recreation (18 pp) and the arts sector (12 pp). However, their relatively small share in the economy dampens the overall impact. In the analysis, we do not take into

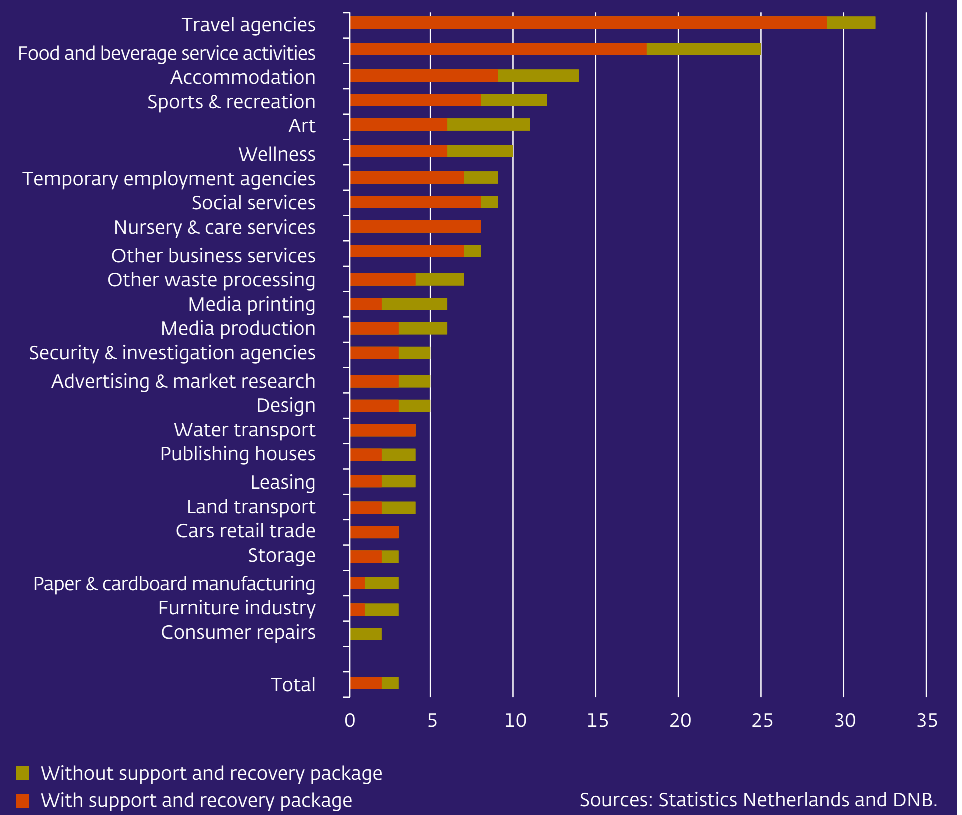
7 For a more detailed discussion of the analysis, see Winter and Volkerink, 2021, *De financiële positie van het Nederlandse MKB één jaar na de Covid-19 uitbraak*, DNB Analyse 2.

account the option of applying for a tax holiday, which the government has granted. As a result, we are likely to slightly overestimate the proportion of businesses that have liquidity deficits.

In the sectors most affected by the containment measures, the solvency positions of SMEs have deteriorated significantly, whereas the pandemic's impact on solvency is much smaller in other sectors (see Figure 17). This is because, for 2020 as a whole, projected operational losses for many businesses were relatively small compared to equity as disclosed in their balance sheets. As a result, the proportion of SMEs whose equity turned negative grew to a limited extent only, by 2 percentage points, to around 3,700 businesses. Again, the increase was more pronounced in sectors that were hit relatively hard by the COVID-19 pandemic. In these sectors, the support and recovery package had a relatively large and positive impact. Although the crisis hit certain sectors significantly over the past year, the support packages seem to have helped to mitigate the impact on the financial position of Dutch businesses as a whole. This seems consistent with the evolution of the number of bankruptcies in the Netherlands so far.

Figure 17 Sectors with the largest increase in the share of SMEs with equity deficits

Changes in percentage points from scenario without COVID-19 pandemic



Sources: Statistics Netherlands and DNB.

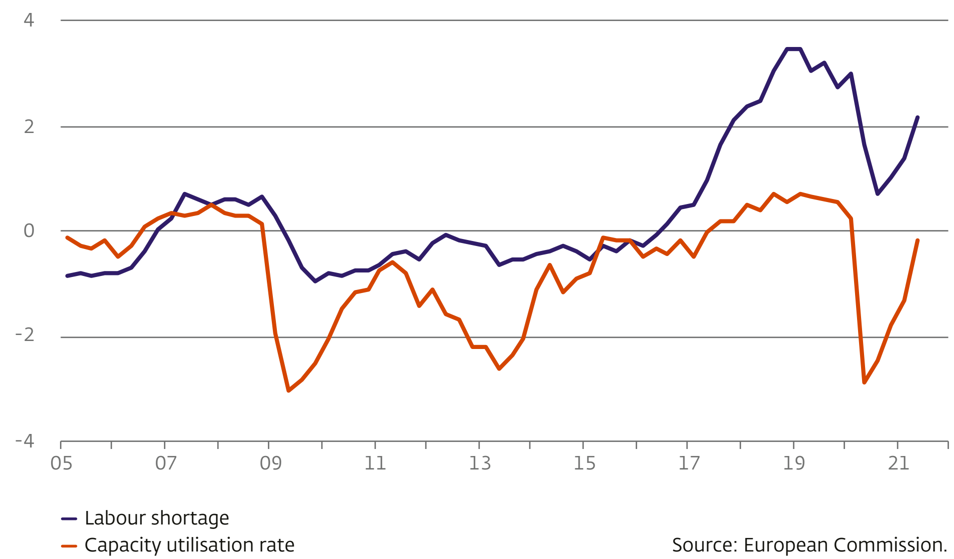
Note: The scenario without COVID-19 pandemic assumes that turnover, profits and costs in 2020 are unchanged from 2019. Only sectors with more than 150 companies in 2019. Percentage of businesses with equity deficits = number of businesses with equity < 0 / total number of businesses.

According to the Business Survey Netherlands (COEN), business confidence increased further in April 2021, turning positive for the first time since the beginning of the COVID-19 crisis. While business confidence was up in almost all sectors, there are wide differences across sectors. Business confidence was the most positive in the construction sector for the third time in a row, while it was the most negative in the hospitality sector. However, even businesses in the hospitality sector were already much more upbeat in the second quarter of 2021 than in the preceding quarter, in part because of improved turnover prospects. Improved business confidence and increased capacity utilisation among industrial businesses (see Figure 18) also translate into higher expected investment. Statistics Netherlands' survey on expected investment shows that businesses expect they will invest 6% more in tangible fixed assets in 2020 relative to 2020. Part of this investment was held off last year. Our projection reflects this, as the 2020 business investment slump (-4.7%) turns into investment growth of 7.0% in 2021 and 6.8% in 2022. In 2023 we expect investment to climb 2.0%.

Lending to businesses edged down in the first quarter of 2021, with bank lending to SMEs contracting by 0.7%. Since the COVID-19 crisis broke out, corporate lending has been supported by monetary policy and domestic measures. For instance, the government introduced guarantee schemes and DNB lowered the banks' systemic buffer requirement. The ECB directly supported bank lending in the euro area, including in the Netherlands, by expanding its lending facilities. Banks can borrow money from the ECB on favourable terms through the targeted longer-term refinancing operations (TLTROs) programme, provided they do not scale back their lending. This enables and incentivises banks to maintain lending to businesses. The ECB has eased the terms for this facility in response to the pandemic, and euro area banks have used it extensively. Dutch banks were among them, but not all banks were able to maintain lending levels, sometimes due to insufficient demand.

Figure 18 Production constraints and capacity utilisation rate in industrial firms

Standard scores



Source: European Commission.

Business and bank surveys suggest that growth in lending to SMEs in the Netherlands has evolved differently than elsewhere in the euro area. Dutch SMEs have experienced more obstacles to obtaining credit since the outbreak of the COVID-19 crisis, whereas an opposite trend was observed elsewhere in the euro area. This is apparent from the ECB's survey on the access to finance of enterprises (SAFE). In addition, SMEs' demand for bank lending in the Netherlands has also gone down, whereas it has increased in all other euro area countries. In the ECB's Bank Lending Survey (BLS), Dutch banks also reported that they had considerably tightened their credit standards for SMEs since the second quarter of 2020 and that demand had slackened.

The way in which emergency business support has been set up most likely explains part of the lagging credit growth in the Netherlands relative to that in the rest of the euro area. In the Netherlands, most support measures took the form of wage support, while credit guarantees were more often used elsewhere. By contrast, credit guarantees were scarcely used in the Netherlands. This may be due to the fact that businesses tend to prefer tax holidays or regular loans over credit guarantees due to the hassle of applying or to avoid commission fees. Businesses in other euro area countries made greater use of guarantee schemes, which has reduced credit risk for banks.

Overall, corporate lending in the Netherlands is expected to increase somewhat. Bank lending to non-financial corporations is projected to grow by 1.2% in 2021 and by around 1.5% in 2022 and 2023, predominantly on the back of economic recovery and higher business investment. This would be in line with the banks' own expectations: according to the BLS, credit standards should remain unchanged in the second quarter of 2021, while demand for credit will pick up.

2.5 Deterioration of public finances remains contained

Through the effect it has on economic development and on support and recovery policies, the COVID-19 crisis also greatly impacts public finances. General government debt went up from 48.7% of GDP to 54.5% in 2020, and it is expected to rise to 56.4% in 2021. This is mainly due to increased public spending to fight the impact of COVID-19 on public health and the economy. The government has acted sensibly in allowing public debt levels to rise temporarily, one of its aims being to head off lasting damage to the economy. It also makes sense for the government to continue supporting workers and businesses until the virus is under control. Any damage done to public finances is not of a structural nature, meaning they should recuperate quickly from 2022 onwards. The public deficit is projected to fall sharply in 2022, when public debt will also start to decline (Table 2).

Table 2 Public sector key data

Percentage of GDP

	2020	2021	2022	2023
Public expenditures	48.1	47.7	43.8	43.9
Taxes and social security contributions	39.7	39.6	39.3	39.6
Other income	4.1	4.0	3.9	3.9
Primary balance	-3.6	-3.5	0.0	0.2
EMU balance	-4.3	-4.1	-0.5	-0.4
EMU debt (based on end-of-period)	54.5	56.4	54.0	52.2

Source: DNB.

Note: Information from the Ministry of Finance's Spring Memorandum became available after we had finalised our projections. We have therefore not included it in the public finance figures.

In 2021, the deficit remains at a similarly high level as in the previous year, at 4.1% of GDP. A major factor in this is spending on economic support measures, partly because the government broadened the scope of the support package in several steps and extended its duration until the third quarter of 2021.[8] Our projections assume the government will cut its support after the third quarter. The deficit is expected to narrow rapidly in 2022 as a result, supported by the economic recovery that should gain steam from the second half of 2021 onwards. We project deficits of 0.5% and 0.4% of GDP for 2022 and 2023 respectively. Information from the Ministry of Finance's Spring Memorandum (available in Dutch) became available after we had finalised our projections, and we have therefore not included it in our figures. The Spring Memorandum shows a significant increase in the budget deficit in 2021 due to higher-than-expected expenditure and a less favourable underlying macroeconomic situation. Box 4 discusses the differences in further detail.

8 Our projections take account of the adjustments to the support measures which the government announced on 27 May 2021.

Box 4 Public finances: differences relative to the 2021 Spring Memorandum explained

The 4.1% of GDP budget deficit we project for 2021 is significantly lower than the 7.5% expected in the Ministry of Finance's Spring Memorandum (available in Dutch). This also explains the difference in debt levels in 2021 (56.4% of GDP in our projections, versus 60% of GDP in the Spring Memorandum). A full list of differences between the two projections cannot be given, as the Spring Memorandum is based on the expenditure figures taken from the budgets of the various ministries, whereas our own projection is based on the National Accounts. For example, our projection shows that reduced government consumption in the first quarter of 2021 will have a downward impact on government expenditure according to Statistics Netherlands' Quarterly Accounts. This cannot be observed in the Spring Memorandum, because it is based on the budgets of the ministries.

Besides the differences in composition between the two projections, several other factors contribute to the discrepancies in their balances (see Table 3). The Spring Memorandum mentions several lower-than-expected income items and additional items of expenditure measures that became available after the we had finalised our projection. This concerns, for example, the budgetary impact of the administrative agreements reached with regard to natural gas production in the province of Groningen, as well as higher-than-expected costs in the youth welfare sector, and both COVID-19-related and non-COVID-19-related care expenditure. Taking this information into account would have reduced the EMU balance for 2021 in our projections by roughly 1 percentage point of GDP. The lower budget deficit we project is also related to the more favourable underlying macroeconomic outlook.[9] This causes public revenue to end up higher, pushing up the EMU balance by 1 percentage point. The economic rebound also leads to lower-than-expected expenditure on support measures, such as the NOW and TVL schemes. This, together with the assumption that it will take time to spend the funds earmarked for the National Education Programme, will have a positive impact on the EMU balance in terms of expenditure – roughly 0.7 percentage point.

Table 3 Explaining the EMU balance discrepancies: DNB projections and Spring Memorandum

Percentage of GDP

	2021
Spring Memorandum	-7.5
EDO (DNB projections)	-4.1
Discrepancy	3.4
Probable causes of discrepancies	
Latest data in Spring Memorandum (setbacks and additional information)	±1
Higher-than-projected revenues resulting from more favourable economic picture	±1
Lower projected expenditure on COVID-19 support measures (NOW, TVL and NPO)	±0.7

Sources: DNB and Dutch Ministry of Finance's 2021 Spring Memorandum.

9 The Spring Memorandum assumes 2.2% GDP growth for 2021, based on the Central Economic Plan issued by the CPB Netherlands Bureau for Economic Policy Analysis. Based on the European Commission's methodology, 1 percentage point in higher GDP growth has an impact on the EMU balance of around 0.6 percentage point. This effect is not constant, and currently it is likely to be higher, given that the support measures move with economic developments.

Public expenditure as a percentage of GDP will remain elevated throughout 2021, after which it is projected to decline by 4 percentage points in 2022. This is mainly driven by economic support measures, which are largely on the expenditure side. The main expenditure measures in 2021 are the wage cost subsidies (NOW) and the contribution towards fixed costs (ATV). Healthcare expenditure also plays an important role in 2021, the vaccination programme being one of the main factors. Public investment will go up significantly in 2021 and 2022, including as a result of the National Growth Fund and the investment which the government has accelerated. Lastly, the National Education Programme also contributes to public expenditure in the years ahead. If policies remain unchanged, taxes and social insurance contributions will by and large remain at the same level in the coming years.

After two years in which it rose sharply, the debt-to-GDP ratio is set to decline again from 2022 onwards. This is caused by the lower budget deficit and the strong economic recovery, which in turn will lead to lower debt as a percentage of GDP through the denominator effect. Deleveraging will take longer as deferred taxes will start to be repaid in 2022 rather than 2021 and will be spread over five rather than three years. Public debt is expected to land at 54.0% of GDP in 2022 and 52,2% in 2023. This means that, contrary to previous projections, the debt level should remain well below the European Union's 60% threshold.

There is no need for austerity measures or tax hikes in the short term to accelerate the reduction of public debt, given that the deterioration of public finances remains contained. Nor is there a need to provide any further budgetary stimulus to the economy, which is expected to pick up swiftly.

Dutch public debt remains well below the average debt ratio in the euro area, which is now above 100% of GDP. Reaching agreements at a European level about credible reduction of high and excessive national debt levels will be key to safeguard economic and financial stability in the euro area. The previously announced review of the Stability and Growth Pact offers a great opportunity to do so.

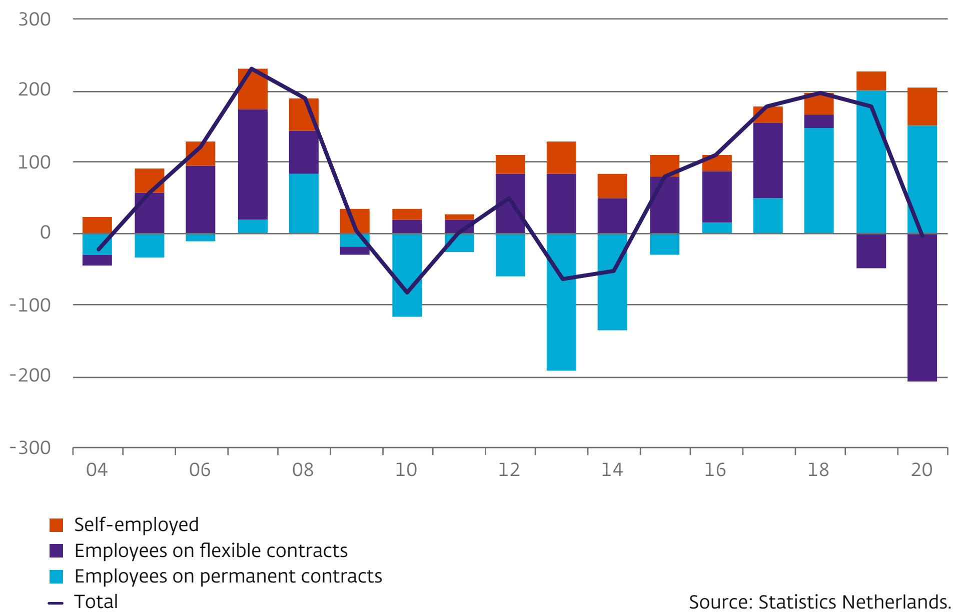
2.6 Flexibilisation and differentiation of the labour market

The effects of the pandemic on spending and public policies described above are also felt in the labour market. They vary widely between categories of workers and between industries. For example, job losses in 2020 were concentrated among workers on flexible contracts. In 2020, the number of workers with flexible jobs was on average 206,000 lower than in 2019, while the number of workers on permanent contracts and self-employed workers went up (see Figure 18). The sharp contraction in the number of workers on flexible contracts seen in 2020 is not surprising, given that they enjoy less redundancy protection than permanent staff. While employers can also benefit from wage support for workers in flexible jobs under the NOW wage subsidy scheme, the simplest and financially most attractive thing for them to do is let temporary contracts expire and terminate temping agency contracts.

Following the sharp contraction in the number of workers in flexible jobs in 2020, sharp growth is likely to be on the cards in the years ahead. The growth in flexible labour observed in the aftermath of the financial crisis in 2009 and the sovereign debt crisis in 2012 seem to point at such a development. As in 2019, during the economic boom of 2007 and 2008 prior to the financial crisis, growth in flexible labour decelerated, while the number of workers on permanent contracts went up (see Figure 19). When the crisis broke out, this trend reversed. Employment growth was mainly driven by workers in flexible jobs and self-employed workers. Overall, the number of permanent contracts fell sharply after the financial crisis, particularly in the period around the sovereign debt crisis. In some respects, labour market developments are different during the COVID-19 crisis. For example, the generous public support policy in fact caused the number of permanent contracts to go up in 2020. With economic recovery materialising faster than previously anticipated, we expect the decrease in the number of permanent workers to be less pronounced or fail to materialise altogether. Nevertheless, we expect employment growth in the coming years to consist mainly of flexible jobs. In the first quarter of 2021, some 7 out of 10 new jobs were created under flexible contracts.

Figure 19 Development in active working population by type of employment relationship

Thousands of persons; year-on-year change



Source: Statistics Netherlands.

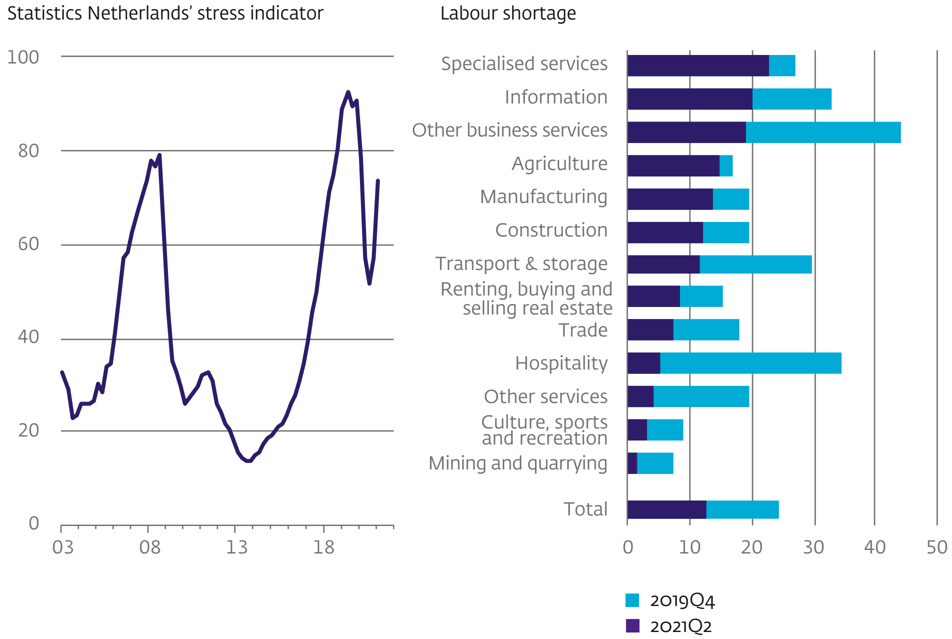
In itself, growth in flexible labour is not merely unfavourable, as flexible forms of contract can contribute to faster employment growth and foster the reallocation of resources that will be needed. On the flip side, however, the COVID-19 crisis has painfully exposed the job and income insecurity associated with flexible employment. Many workers on flexible contracts have lost their jobs, and many self-employed workers have applied for income support under the TOZO scheme. It is therefore important that workers on flexible contracts are given opportunities to move on to permanent jobs wherever this is hampered by differences in laws and regulations or by tax-related and other incentives. The measures proposed in the draft opinion which the Social and Economic Council of the Netherlands (SER) issued in June 2021 appear to represent an important step in the right direction. The COVID-19 pandemic also highlights the need for a wider social safety net. At present, workers on flexible contracts and self-employed workers in particular experience great reductions in income when major economic shocks occur.

In the first quarter of 2021, vacancies went up, while unemployment fell. As a result, labour market tension increased, according to Statistics Netherlands. In the first quarter of 2021, there were 73 vacancies for every 100 unemployed, against 57 in the preceding quarter (see Figure 20, left). Both figures, incidentally, are substantially above the long-term average of 42 for 2003-2020.

The rising labour market tension and declining unemployment in the first quarter of 2021 are at odds with the simultaneous falls in employment and labour supply. According to the Business Survey Netherlands (COEN), in the second quarter of 2021 an average of 12.8% of Dutch businesses experienced production restraints due to staff shortages (see Figure 20, right). Back in 2019, this figure still stood at 24.5%. Viewed from this perspective, the labour market does not seem to be very tight. Insufficient demand (16.1%) and other causes (22.3%) are currently more prominent bottlenecks. There are large differences between sectors, however. As containment measures are being relaxed and pent-up demand for specific services is unleashed, some sectors that have not experienced any staff shortages until recently, such as hospitality and recreation, may face substantial shortages in the near future.

Figure 20 Statistics Netherlands' stress indicator and labour shortage

Number of vacancies per 100 unemployed; seasonally adjusted, and percentage of businesses



Source: Statistics Netherlands.

3 Alternative scenarios for the Dutch economy

The uncertainty surrounding our projections remains higher than usual due to the pandemic. Much will depend on the rate of vaccination and the effectiveness of vaccines against new COVID-19 variants. To reflect that uncertainty, this chapter presents two alternatives to the central projection discussed in the previous chapters. They differ from the central projection mainly in terms of the assumptions of how the pandemic evolves and is contained and how vigorously the economy bounces back. Rather than defining absolute upper and lower limits to potential outcomes[10], they illustrate a bandwidth which, incidentally, has narrowed again in comparison with the outcomes of six months ago.

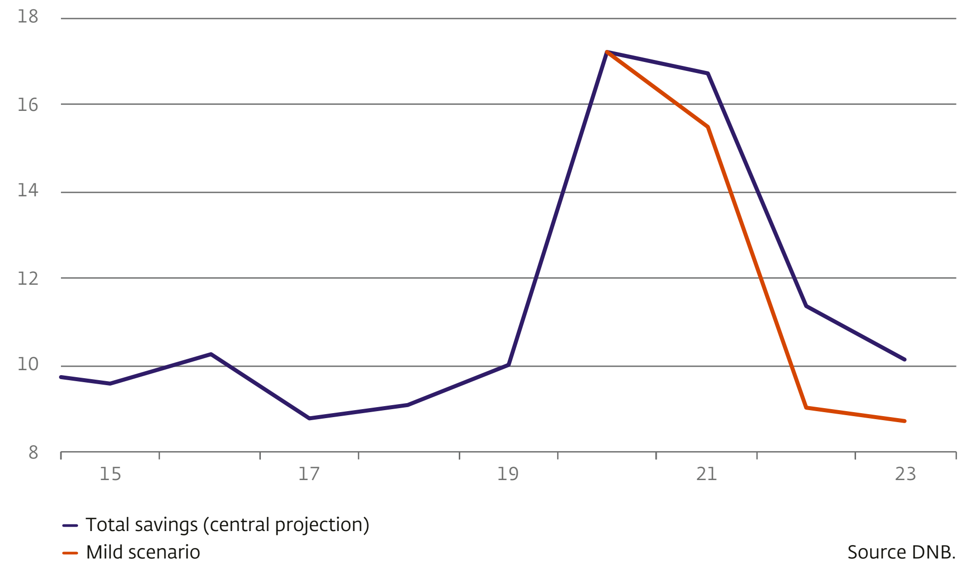
Mild scenario

It is not inconceivable that the economy will recover faster than expected in the central projection. The mild scenario assumes that the pandemic is brought under control sooner, causing uncertainty among households and businesses to decrease and allowing economic activity to gain traction more rapidly. The underlying idea is that vaccination proceeds more smoothly than expected in the central projection, with vaccines also proving effective against newly emerging COVID-19 variants. As a result, containment restrictions are rapidly relaxed and completely lifted in the autumn of 2021, on the assumption that the COVID-19 virus or any variants do not flare up afterwards.

As consumer confidence increases, households spend a larger share of their excess savings, resulting in pent-up demand at the macro level. The assumption is that roughly one third of these additional savings – estimated at €32.6 billion in Box 2 – feed back into the economy at a faster pace in the form of additional consumption. Prudence among households turns into exuberance, causing the elevated saving ratio to go down faster, before returning to the level seen prior to the COVID-19 crisis as soon as early 2022 (see Figure 21).

Figure 21 Total household savings

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



Source DNB.

10 No statement is made in this chapter as to the likelihood of either of these alternative scenarios materialising.

Not only the Dutch economy is displaying resilience, economic development abroad is also more favourable than anticipated in the central projection. As world trade growth ends up higher in the mild scenario, in particular in 2021 and 2022, Dutch exports develop significantly more favourably in those years (see Table 4). Driven by increased confidence, growing consumer spending and a pick-up in exports, businesses ramp up their investments, most notably in 2022. GDP growth ends up around half a percentage point higher on average, at 3.6% in 2021 and 4.2% in 2022. Unemployment drops to 3.5% of the labour force by 2023. In line with the stronger recovery and additional consumer spending, inflation also goes up somewhat further. On average, consumer prices are around 30 basis points per year higher than in the central projection, while inflation ends up above 2% at the end of the projection horizon in the mild scenario.

Economic growth is robust in the last two quarters of 2021, particularly because the pandemic is brought under control earlier and excess savings are turned into additional consumption sooner. Thereafter, quarter-on-quarter growth rates gradually normalise. Figure 22 suggests that total output losses are ultimately contained in the mild scenario, as measured by the cumulative difference with the level of GDP in the latest projection prior to the COVID-19 crisis (December 2019)[11].

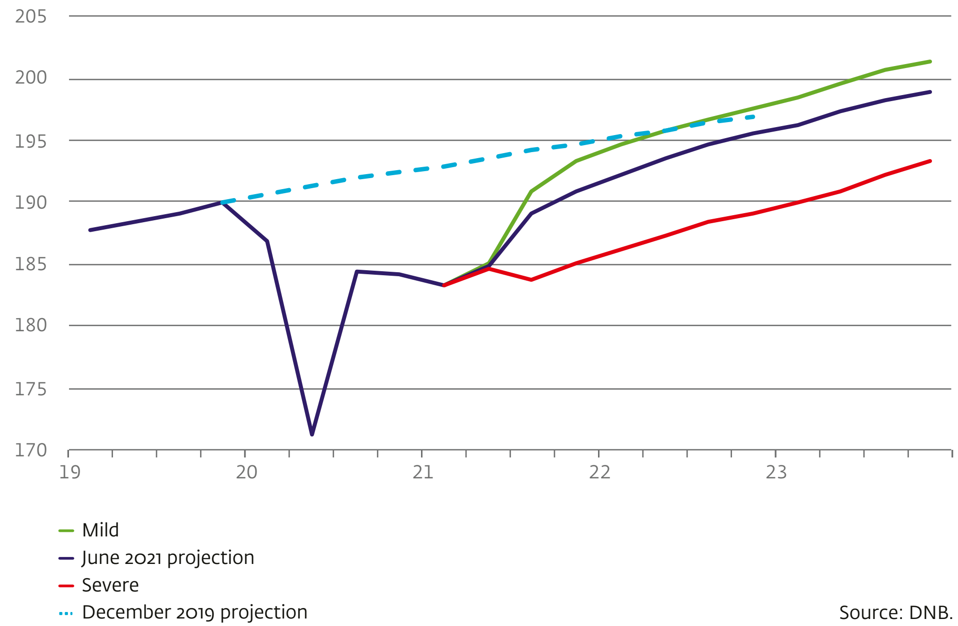
Severe scenario

The severe scenario assumes that protracted containment measures remain in place, as the spread of the virus and new variants cannot be halted. Only from January 2022 are the measures gradually relaxed, but new waves of infection keep emerging from time to time. Persistent uncertainty, increased financial stress and negative confidence effects are persistently holding back economic activity.

Not until mid-2023 is the virus brought under control, allowing containment measures to be lifted and the economy to bounce back.

Figure 22 Output loss caused by COVID-19 pandemic

GDP volume; EUR billions, base year 2015



Source: DNB.

11 We did not adjust our December 2019 projection for the possible effects of other non-COVID-19-related shocks to the economy, such as Brexit, Joe Biden's election as US President and the recently announced US fiscal stimulus package.

Table 4 Outcome of COVID-19-scenarios

Percentage changes, unless stated otherwise

	Mild						Severe					
	2021	Deviation from projection	2022	Deviation from projection	2023	Deviation from projection	2021	Deviation from projection	2022	Deviation from projection	2023	Deviation from projection
Gross domestic product	3.6	(0.6)	4.2	(0.5)	2.0	(0.1)	1.4	(-1.6)	1.9	(-1.8)	2.1	(0.2)
Private consumption	1.9	(1.4)	9.2	(2.0)	1.5	(-0.6)	-2.2	(-2.7)	4.6	(-2.6)	3.2	(1.1)
Business investment	7.1	(0.1)	9.4	(2.6)	2.7	(0.7)	6.3	(-0.7)	0.1	(-6.7)	2.6	(0.6)
Exports of goods and services	7.5	(1.2)	6.3	(1.4)	3.3	(0.2)	3.4	(-2.9)	1.8	(-3.1)	3.1	(0.0)
Imports of goods and services	8.1	(1.4)	9.1	(2.6)	3.5	(0.0)	3.8	(-2.9)	2.7	(-3.8)	3.8	(0.3)
Consumer confidence (level)	-8.6	(4.7)	-1.5	(9.2)	1.1	(4.2)	-16.8	(-3.5)	-22.4	(-11.7)	-5.6	(-2.5)
Negotiated wages, private sector	1.8	(0.0)	1.9	(0.4)	2.5	(0.7)	1.8	(0.0)	0.8	(-0.7)	0.2	(-1.6)
Harmonised consumer price index	1.8	(0.3)	1.7	(0.2)	2.1	(0.3)	1.4	(-0.1)	1.2	(-0.3)	1.7	(-0.1)
House prices, existing own homes	10.0	(0.0)	5.9	(0.4)	4.1	(0.6)	10.0	(0.0)	4.9	(-0.6)	2.6	(-0.9)
Unemployment (% of labour force)	3.6	(0.0)	4.1	(-0.4)	3.5	(-0.6)	3.7	(0.1)	5.7	(1.2)	6.1	(2.0)
EMU balance (% of GDP)	-3.9	(0.2)	0.1	(0.6)	0.3	(0.7)	-5.1	(-1.0)	-2.9	(-2.4)	-2.0	(-1.6)
EMU debt (% of GDP, based on end-of-period)	55.7	(-0.7)	52.1	(-1.9)	49.5	(-2.7)	58.4	(2.0)	60.0	(6.0)	59.1	(6.9)
International assumptions												
Volume of relevant world trade	9.3	(1.3)	7.4	(1.3)	3.4	(0.0)	4.5	(-3.5)	2.6	(-3.5)	4.1	(0.7)
Competitor prices	3.9	(0.9)	2.7	(1.3)	1.3	(0.2)	1.8	(-1.2)	0.1	(-1.3)	1.2	(0.1)

Sources: DNB and ECB.

The severe scenario also features an international outlook that is significantly more clouded than anticipated in the central projection. Global trade growth is around 3.5 percentage points lower in 2021 and 2022 (see Table 4). This leads to a much lower volume of Dutch goods and services exports. Reduced external demand and sluggish growth in business investment and consumer spending contain GDP growth at a mere 1.4% in 2021 and 1.9% in 2022. Although assumed new fiscal support packages soften the blow for businesses and households, the unemployment rate ends up 2 percentage points higher in 2023 than in the central projection. In line with lower growth in 2021 and 2022, longer-term expenditure on support packages and higher unemployment, public finances deteriorate sharply. As a result, budget balances end up just under 2 percentage points of GDP per year lower in 2022 and 2023, compared with the central projection. Public debt increases to around 60% of GDP in 2022, which is 6.0 percentage points higher than expected in the central projection. As the pandemic is brought under control in mid-2023, consumer spending and business investment rebound sharply, allowing economic growth to normalise.

In the severe scenario, the economy sustains substantially more damage than in the central projection, with GDP not returning to the end-2019 level until early 2023. Not only is the overall loss of output due to the pandemic much higher in the severe scenario than in the central projection, its negative effects on economic growth are more persistent (see Figure 22).

Key data in forecast for the Dutch economy

Percentage changes, unless stated otherwise

	2020*	2021	2022	2023
Volume of expenditure and output				
Gross domestic product	-3.7	3.0	3.7	1.9
Private consumption	-6.4	0.5	7.2	2.1
Public expenditure	0.4	5.1	2.1	2.3
Business investment	-4.7	7.0	6.8	2.0
Housing investment	-2.7	4.8	0.8	1.6
Exports of goods and services	-4.3	6.3	4.9	3.1
domestically produced	-7.0	4.2	4.7	2.8
re-exports	-0.2	9.0	5.1	3.4
Imports of goods and services	-4.3	6.7	6.5	3.5
domestically used	-6.8	5.2	7.5	3.5
Wages and prices				
Negotiated wages, private sector	2.8	1.8	1.5	1.8
Compensation per employee, private sector	3.6	2.4	1.7	1.7
Unit labour costs, private sector	8.0	-1.3	-1.8	1.2
Prices of domestically produced exports	-1.9	3.4	1.7	1.3
Harmonised consumer price index	1.1	1.5	1.5	1.8
House prices, existing own homes	7.8	10.0	5.5	3.5
Labour market				
Employment (persons, growth)	-0.6	-0.2	0.6	1.4
Labour supply (persons, growth)	-0.2	-0.4	1.6	1.0
Unemployment (persons x 1,000)	357	338	436	401
Unemployment (% of labour force)	3.8	3.6	4.5	4.1

	2020*	2021	2022	2023
Public sector and financial				
EMU balance (% of GDP)**	-4.3	-4.1	-0.5	-0.4
EMU debt (% of GDP, based on end-of-period)**	54.5	56.4	54.0	52.2
Current account (% of GDP)	7.8	8.8	8.5	8.7
Mortgage loans (based on end-of-period)	1.9	2.6	1.9	0.8
Bank lending to NFCs (based on end-of-period)***	0.5	1.2	1.6	1.5
International assumptions				
Volume of relevant world trade	-9.9	8.0	6.1	3.4
Volume of GDP US	-3.5	6.6	3.8	2.3
euro area	-6.5	4.6	4.7	2.1
emerging markets	-1.5	6.4	4.5	4.5
Short-term interest rate in the euro area (%)	-0.4	-0.5	-0.5	-0.3
Long-term interest rate in the Netherlands (%)	-0.4	-0.1	0.2	0.4
Euro exchange rate (USD)	1.14	1.21	1.21	1.21
Competitor prices	-3.0	3.0	1.4	1.1
Oil price (UK Brent in USD per barrel)	43.4	66.0	64.6	61.9
Commodity prices excluding energy (USD)	3.2	39.0	0.1	-8.0

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.

** Information from the Ministry of Finance's Spring Memorandum became available after we had finalised our projections. We have therefore not included it in the public finance figures.

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

Figures

Data