January 2017
Number 12

Economic Developments and Outlook

DeNederlandscheBank

EUROSYSTEEM

Economic Developments and Outlook

January 2017, number 12

© 2017 De Nederlandsche Bank N.V.

Closing date: 24 January 2017

Publication and reproduction for educational and non-commercial purposes is permitted, with acknowledgement.

This publication contains a translation of the Dutch-language publication, except where indicated otherwise. In the event of discrepancies between the original Dutch-language version and this translation, the Dutch text shall prevail.

Westeinde 1, 1017 ZN Amsterdam – PO Box 98, 1000 AB Amsterdam, the Netherlands
Telephone (31)20 524 91 11 – Fax (31)20 524 25 00
Internet: www.dnb.nl

Contents

Summary

The Dutch economy will hold on to its upward trend of the past few years showing ongoing vigorous growth this year. Domestic spending will continue to serve as the prime growth engine. GDP is projected to end up at 2.3% in 2017, and will fall back slightly in 2018 to a still solid 1.7%. Consumer confidence is high, the upturn in the housing market is set to continue and the business sector has largely bounced back to its pre-crisis level.

Projected growth in both years is above potential growth, meaning that the output gap will have almost closed at the end of the projection horizon. This year and next, the unemployment rate will decline less sharply than in 2016, primarily because more people are expected to come on to the labour market. Inflation will accelerate to 1.4% in 2017, and 1.3% in 2018, from 0.1% last year. The economic upswing is boosting government finances. The budget deficit of 0.2% GDP seen in 2016 will revert to a 0.2% budget surplus in 2018.

An alternative scenario shows the consequences for the Dutch economy of a more accommodating budgetary policy in the United States than projected. Additional public investment and lower earnings taxes in the US may boost economic growth by 0.2 percentage points on average in 2018 and 2019.

This document uses data available up to 9 January 2017.

1 The Dutch economy in 2017-2018

Upward trend projected to continue

The Dutch economy is expected to continue on its upward trend of the past few years. In 2015, Gross Domestic Product (GDP) already grew by 2.0%, edging up to 2.1% last year. This year, growth is projected to accelerate to 2.3%. In 2018, growth will normalise to a somewhat more steady, but still solid, pace of 1.7%.

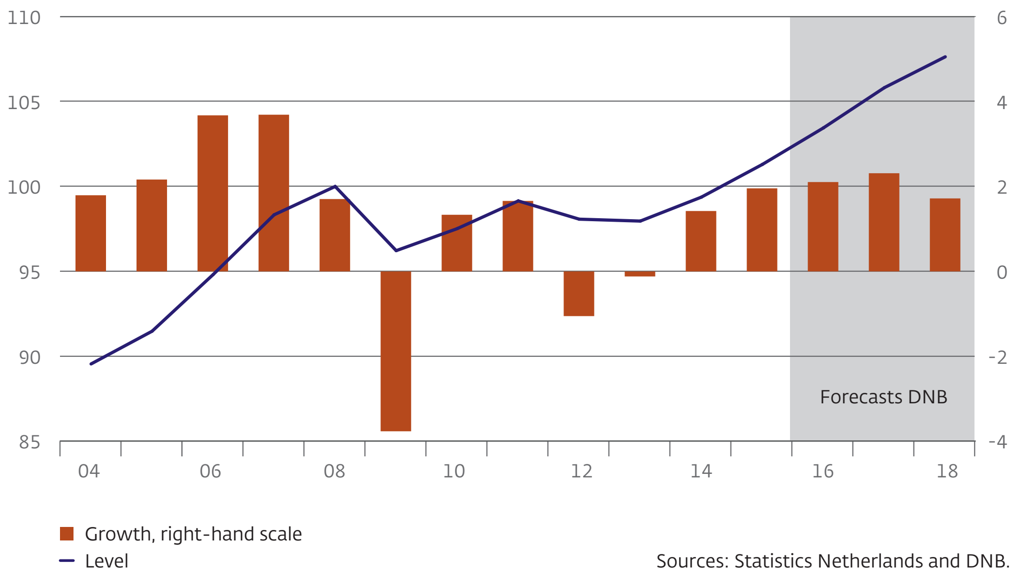
The Dutch economy has by now left its double dip firmly behind. Judging by real GDP, the economy in 2015 came back to its growth rate of just before the first deep recession in 2009 (Chart 1). The ongoing economic recovery will ensure that GDP in 2018 will be over 7% higher than its pre-crisis level. With projected growth outpacing potential growth over the entire projection horizon, the output gap will gradually close. This upbeat economic outlook will also be reflected in the labour market: the unemployment rate will fall to 5.3% in 2018, from 6.0% in 2016.

Surprisingly high GDP growth in 2016

Compared with the projections stated in the June 2016 issue of our Economic Developments and Outlook, GDP has shown surprisingly boisterous growth. At the time, we still projected a more modest growth of 1.5%. After that, we made two upward adjustments to the first-quarter growth figures, and unexpectedly strong growth figures for the second and third quarters

Chart 1 Gross domestic product

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



Sources: Statistics Netherlands and DNB.

followed. This upswing is expected to have continued into the last quarter, culminating in estimated growth of 2.1% for full-year 2016.

The strong growth of GDP was primarily driven by household consumption and housing investments. Owing to accelerating incomes and the quick recovery of consumer confidence, private consumption in the third quarter of last year increased by 2.0% on the preceding year. Together with 2014Q4, 2016Q3 saw the strongest rise in consumption since the outbreak of the crisis.

The international economic assumptions underlying our projections

The assumptions underlying our projections for 2017-2018 indicate ongoing international economic recovery.[1] Economic growth in the euro area is projected to continue at a steady pace in the years ahead, underpinned by the accommodative monetary policy stance, the progress made with balance sheet repair, and the sustained recovery of the labour market. The ECB estimates euro area GDP growth at 1.7% in 2016 and 2017, and 1.6% in 2018. The IMF recently issued a comparable forecast for the euro area (January 2017). It projects global economic growth to pick up to 3.4% in 2017 and 3.6% in 2018, from 3.1% in 2016. The underlying outlook for emerging market economies is that Russia and Brazil will recover from the 2015 and 2016 recessions. China will continue on its gradual adjustment towards a slower and more sustainable growth path.

The upswing in global economic growth is having a beneficial effect on world trade relevant for the Netherlands, which is expected to have grown by 2.4% in 2016, rising to 3.2% in 2017 and 3.7% in 2018. As always, this outlook is surrounded by several risks, such as policy uncertainty in the US following the presidential elections and the outcome of the Brexit referendum. More uncertainty may have repercussions for global economic growth, e.g. through higher risk premiums on financial assets. Besides this, potential disorderly unwinding of financial imbalances in China is still posing a substantial downward risk for world trade. The negative effects of possibly increasing protectionism and patriotism are expected to mainly manifest themselves in the somewhat longer term. An upward risk to world trade growth is the possibility of more stimulating economic policies in the US and China than currently foreseen, which may lead to higher growth in these countries. As this may occur in the US in the near future, a scenario in Section 3 shows how this may impact the Dutch economy.

1 The assumptions underlying the development of relevant world trade, exchange rates, international commodity prices, and interest rates are based on the information available on 9 January 2017.

After 18 months of decline, oil prices rose sharply in 2016. Between December 2015 and December 2016, the monthly average price of a barrel of Brent increased 44% to USD 55.70. Oil prices in our projection horizon are based on the average futures prices in the two weeks preceding the cut-off date, i.e. approximately USD 58.50.

Economic recovery set to continue in 2017 and 2018

Table 1 lists the key forecast data for the Dutch economy for 2015-18. Following the robust recovery seen in 2015, GDP growth in the Netherlands will continue accelerating in 2016 and 2017, to settle down at a more tempered, solid pace afterwards. The dynamics in the growth projections are primarily attributable to domestic spending. As domestic spending has been growing sharply since the second half of 2016, there is a considerable carry-over into growth figures for 2017. In 2018, domestic spending is projected to grow at a slightly slower pace. For private consumption, this will be due to higher inflation and the slowdown in the rise of house prices, which will dampen growth of household wealth. Growth of housing investments will also fall back to a more normal pace after the catch-up seen in the past years. In 2015, housing investments, consisting of newbuilding, renovation and transfer costs still grew by an exceptionally high 27%. In 2018, growth is expected to settle down at around its long-term average of approximately 5%.

Since 2015, economic recovery in the Netherlands has been supported mainly by domestic spending, which will continue throughout the projection horizon. The net contribution of exports to GDP growth will remain fairly stable around 0.7 percentage points per year between 2016 and 2018 (Chart 2). Private consumption is projected to contribute 0.5 percentage points on average, peaking at 0.58 in 2017. This is partly attributable to the 2016 tax cut, although its effect on household income and expenditure is less prominent than projected. The contribution made by housing investments will slow down to 0.1 percentage point in 2018, from the exceptionally high 0.5 percentage points seen in 2015.

Full capacity utilisation is approaching

Accelerating economic growth has been pushing up the capacity utilisation rate. In the years following the outbreak of the financial crisis, the output gap widened to more than 3% in 2015. Economic slack will decrease in tandem with economic growth being above its potential annual growth rate (of some 1.2%).[2] This will be the case throughout the projection period. The output gap narrowed substantially to -2.3% last year, owing to the labour market pick-up. The output gap will gradually narrow further to an average of -0.7% in 2018, meaning

2 See also Box 1 in the June 2016 issue of our *Economic Developments and Outlook*.

Table 1 Key data in forecast for the Dutch economy

Percentage changes, unless stated otherwise

	2015*	2016	2017	2018
Volume of expenditure and output				
Gross domestic product	2.0	2.1	2.3	1.7
Private consumption	1.8	1.7	2.0	1.6
Public expenditure	0.5	0.4	1.5	0.9
Business investment	6.7	4.8	5.2	3.3
Housing investment	27.4	19.1	8.7	4.5
Exports of goods and services	5.0	3.2	3.2	3.9
of which domestically produced	3.4	0.6	1.7	2.9
of which re-exports	6.8	6.4	4.9	5.0
Imports of goods and services	5.8	3.8	3.9	4.3
of which domestically used	4.2	1.2	3.0	3.7
Wages and prices				
Negotiated wages, private sector	1.3	1.7	2.0	2.3
Compensation per employee, private sector	0.0	1.4	2.5	2.7
Unit labour costs	-0.8	0.8	1.3	1.7
Prices of domestically produced exports	-3.2	-2.6	0.9	1.7
Harmonised consumer price index	0.2	0.1	1.4	1.3
House prices, existing own homes	2.8	5.0	5.9	4.1
Labour market				
Employment (persons, growth)	1.0	1.1	1.3	1.0
Labour supply (persons, growth)	0.4	0.2	0.6	0.8
Unemployment (persons x 1,000)	614.4	538.5	487.9	471.6
Unemployment (% of labour force)	6.9	6.0	5.5	5.3
Public sector and financial				
EMU balance (% of GDP)	-1.9	-0.2	-0.2	0.2
EMU debt (% of GDP)	65.1	61.9	59.3	56.5
Current account (% of GDP)	8.5	7.5	8.2	8.3
Mortgage loans (based on end-of-period)	0.7	2.4	3.9	5.4
Bank lending to NFC (based on end-of-period)**	-4.4	0.0	0.2	1.5
International assumptions				
Volume of relevant world trade	3.6	2.4	3.2	3.7
Short-term interest rate in the euro area (%)	0.0	-0.3	-0.3	-0.2
Long-term interest rate in the Netherlands (%)	0.7	0.3	0.6	0.8
Euro exchange rate (USD)	1.11	1.11	1.05	1.05
Competitor prices	2.1	-3.2	2.6	2.2
Oil price (UK Brent in USD per barrel)	53.0	45.1	58.4	58.6
Commodity prices excluding energy (USD)	-16.5	-4.0	6.6	3.8

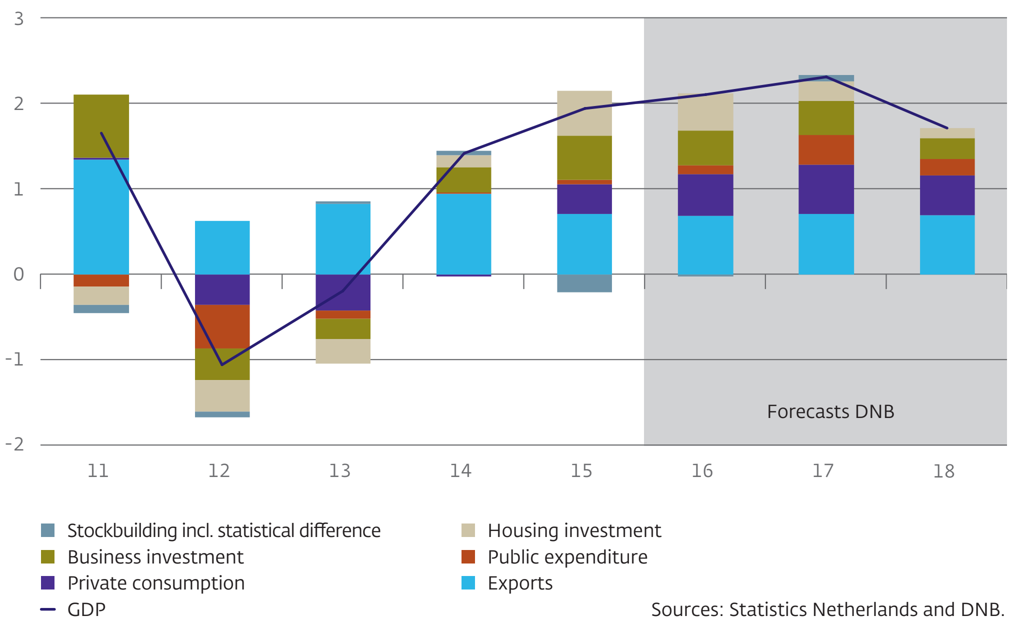
Sources: DNB and ECB.

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

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

Chart 2 Sources of GDP growth

Percentage changes and contributions in percentage points



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.

that the economy will almost reach its potential level of output by the end of the projection horizon in 2018. The gradually narrowing output gap implies increasingly tight labour and product markets, which in our projections leads to an upward effect on wages and prices.

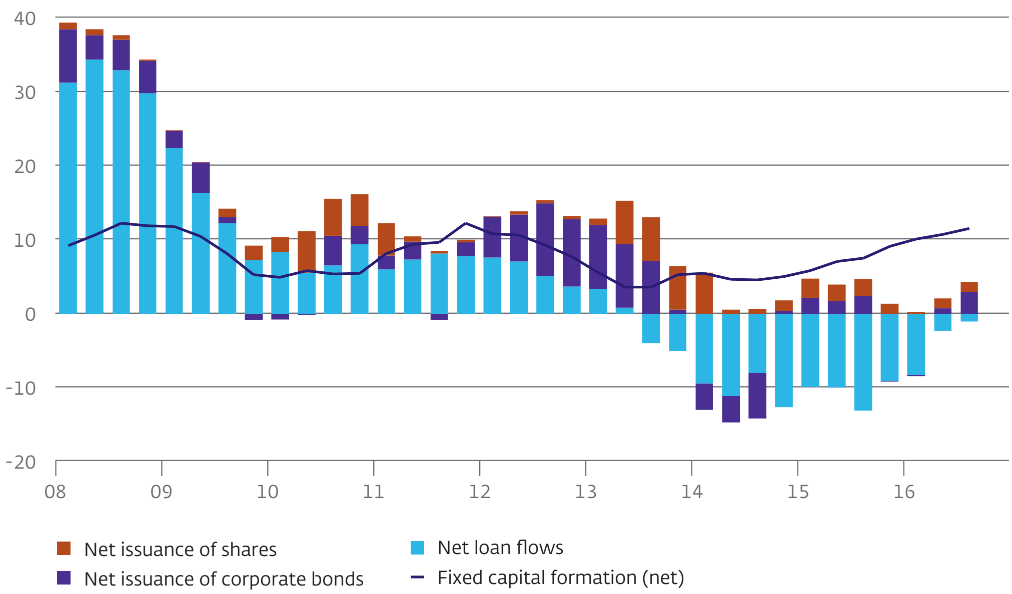
Corporate sector profits and lending

Profits of non-financial corporations have increased steadily since the last recession in mid 2013. Last year, net operating profits grew 3.5%. Relative to value added, profit margins ended the third quarter of 2016 at 26.6%, substantially above their 2010 low (25.3%), but still well below their pre-crisis level of around 30%.

For businesses, profits are an important source of financing their investments. An annual profit level of around EUR 55 billion (average since 2014) goes together with net investments of around EUR 7 billion. In addition, businesses use external funds, specifically equities, bonds and bank lending, to finance their operations (Chart 3). Total external funding slumped following the 2009 recession, and again in 2014. Debt financing through bank lending and bonds has been negative since the second half of 2013, with the exception of the third quarter of 2016.

Chart 3 External financing for non-financial corporations

In EUR billion; four-quarter sums



Sources: Statistics Netherlands and DNB.

This marked a measured turnaround in corporate funding behaviour, after a long period of corporate debt being repaid on balance.

Bank lending shrank 4.4% in 2015, with lending to small and medium-sized enterprises (SMEs) falling somewhat sharper still by -5%. Lending to businesses is expected to have stabilised in 2016. Total bank lending growth is projected to pick up again to 0.2% in 2017 and 1.5% in 2018, which is in line with the Bank Lending Survey (BLS). The majority of banks have reported a rise in corporate sector credit demand since the second quarter of 2015, including demand from SMEs. Our projections assume that banks will accommodate the pick-up in credit demand, but if they prove to become more reluctant to provide credit, this may come to stand in the way of external corporate sector funding. This may hit smaller businesses relatively harder, as their bigger counterparts have better access to other sources of funding besides bank lending.

Ongoing labour market improvement

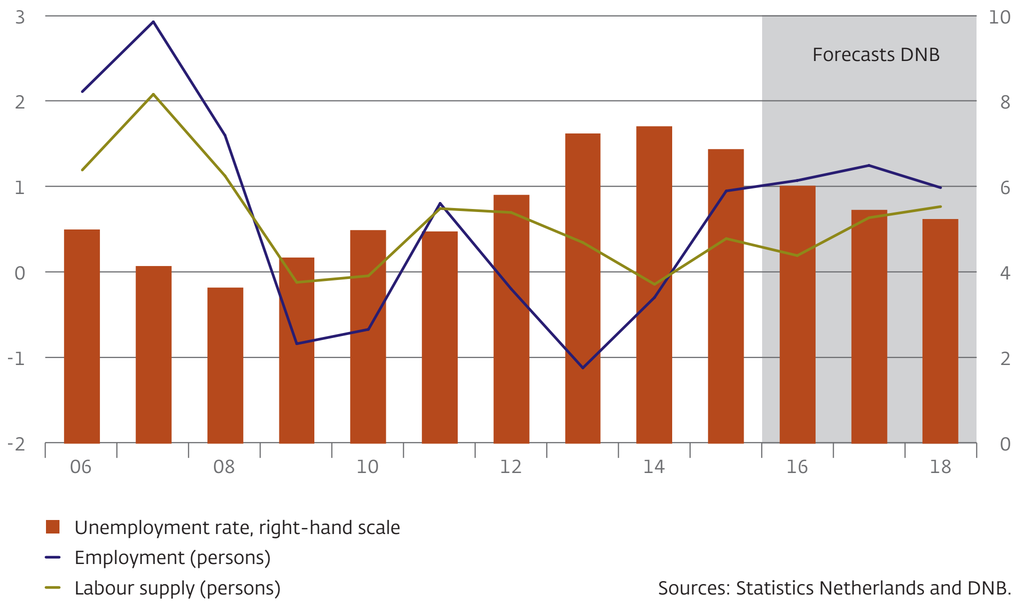
The labour market continues to provide us with positive surprises. Employment is expected to increase 1.3% this year and 1% in 2018 (Chart 4). Projected employment is outpacing the labour supply, which is growing by an annual average of 0.7%. As a result, unemployment will drop to 5.3% of the labour force in 2018; equal to 472.000 people.

Unemployment fell remarkably quickly in 2016. Last year, the labour supply grew only 0.2%, after increasing 0.4% in 2015, meaning that labour supply growth lagged relatively sharply behind employment growth. The positive labour market developments are expected to prompt people who are as yet inactive to enter the labour market. This means that labour supply growth will approach employment growth in 2017-2018, and the drop in unemployment will slow down somewhat.

The improved labour market situation is also confirmed by other indicators. In 2016, unemployment among older labour market participants and long-term unemployed fell for the first time in many years. Unused labour market potential (people who want to work, but are not actively searching, or who are not immediately available), fell to 472,000 in the third quarter of 2016, from 520,000 in 2015Q3. At the same time, the number of outstanding vacancies continues to grow steadily. At end 2013, immediately prior to the economic recovery, the number of unemployed was over seven times as large as the number of vacancies. This has by now been reduced to three unemployed to each vacancy. This shows that tension is rising slowly, although there is as yet no generic labour market tightness. Shortly before the crisis in 2008, the ratio between outstanding vacancies and unemployed people was almost one to one. Based on some indicators (the decline in submitted redundancy applications and the increase in hours worked by temporary staff), employment may rise somewhat quicker still than projected here. An alternative scenario contained in Section 3 discusses the effects this may have on the Dutch economy.

Chart 4 Labour market supply and demand

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



Sources: Statistics Netherlands and DNB.

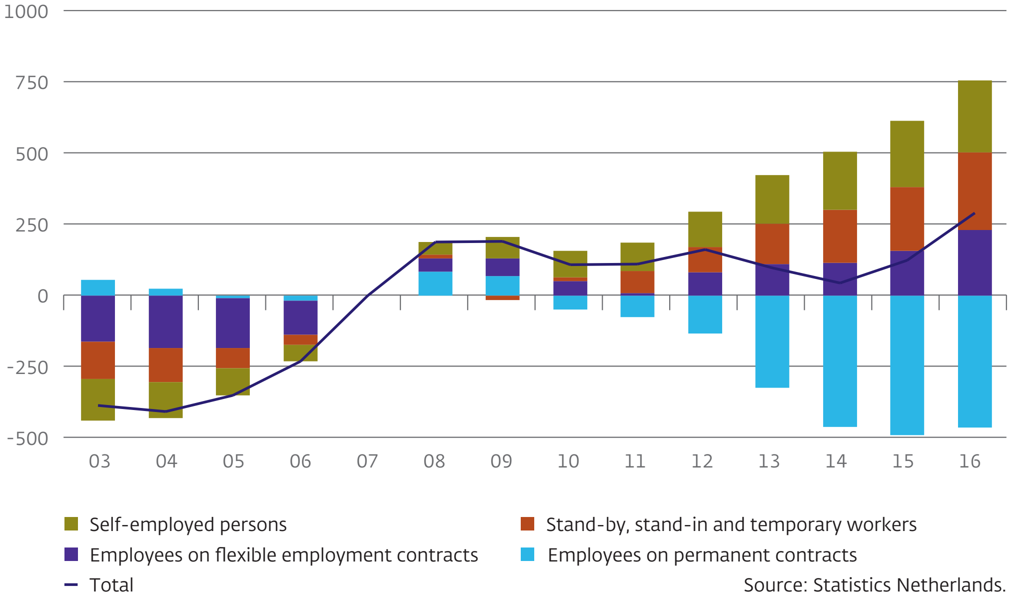
Flexible labour continues to increase

Since 2007, employment growth has fully manifested itself in flexible employment contracts. Relative to 2007, the number of people in flexible employment or working as self-employed grew by a little over 750,000 in 2016, while the number of people in permanent employment fell by over 450,000 (Chart 5). Last year, the total number of workers with permanent employment contracts rose again for the first time since the crisis broke out. The number of workers in flexible employment, however, grew even faster, meaning that there are as yet no convincing signs that labour market flexibilisation has come to a standstill.

Growth of the number of self-employed workers halted in the course of 2016, which may be due to ongoing economic recovery, which increases the likelihood of finding regular employment. It is as yet too early to determine to what extent the recent policy changes, like the Assessment of Employment Relationships (Deregulation Act) (Wet *Deregulering Beoordeling Abeidsrelaties - DBA*) are playing a role here. The recent trend in the number of self-employed workers varies significantly according to professional group (Chart 6), so that we cannot speak of a generic downward trend. Between the third quarter of 2015 and the third quarter of 2016, the number of self- employed construction workers grew by almost 10,000. The number of self-employed business consultants coming on to the market also rose. The contraction in the number of self-

Chart 5 Active working population according to type of employment relationship

In thousands of persons; cumulative growth since 2007



Source: Statistics Netherlands.

Note: 2016: Third quarter of 2016.

employed workers was most visible among authors, artists, in trade and industry, and in the agricultural sector. Developments in the health care sector are less clearly defined.

Wage growth back at pre-crisis levels

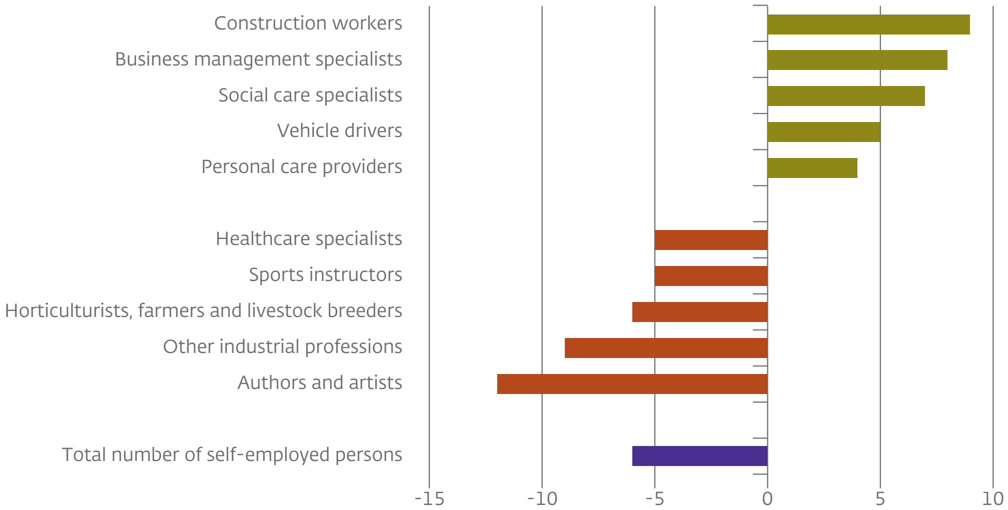
After the outbreak of the crisis, the rise in corporate sector contract wages fell back rapidly. Between 2010 and 2015, annual growth remained limited to 1.3%. Higher inflation, the labour market upswing and productivity growth have been pushing up the pace of wage growth recently. Contract wages have grown by 1.7% in full-year 2016. The most pronounced wage growth was seen in the construction sector, with contract wages increasing almost 3%. Contract wages in the financial sector grew less than 1% annually.

Wage growth for the business sector as a whole is estimated at 2.0% in 2017 and 2.3% in 2018. Contract wages in the public sector are catching up, having substantially lagged the market sector between 2011 and 2014. Public sector wage growth has ended up at 3.4% for 2016 as a whole; the estimated growth pace is expected to slow to around 1.75% in 2017 and 2018. Contract wages for the entire economy, public and private sector, are projected to grow 2.0% and 2.2% annually in these two projection years, respectively.

The projected rise in contract wages will go hand in hand with a virtually constant labour income share (LIS). Although accelerated wage growth will push up real labour costs, this will be offset

Chart 6 Five professions with the largest increase and decrease in number of self-employed

In thousands of persons; 2016Q3 compared to 2015Q3



Source: Statistics Netherlands.

by growing labour productivity. The labour income share during the projection period will remain below the long-term average. This suggests that from a macro-economic perspective there is scope for further growth in remuneration of employees and self-employed workers alike.

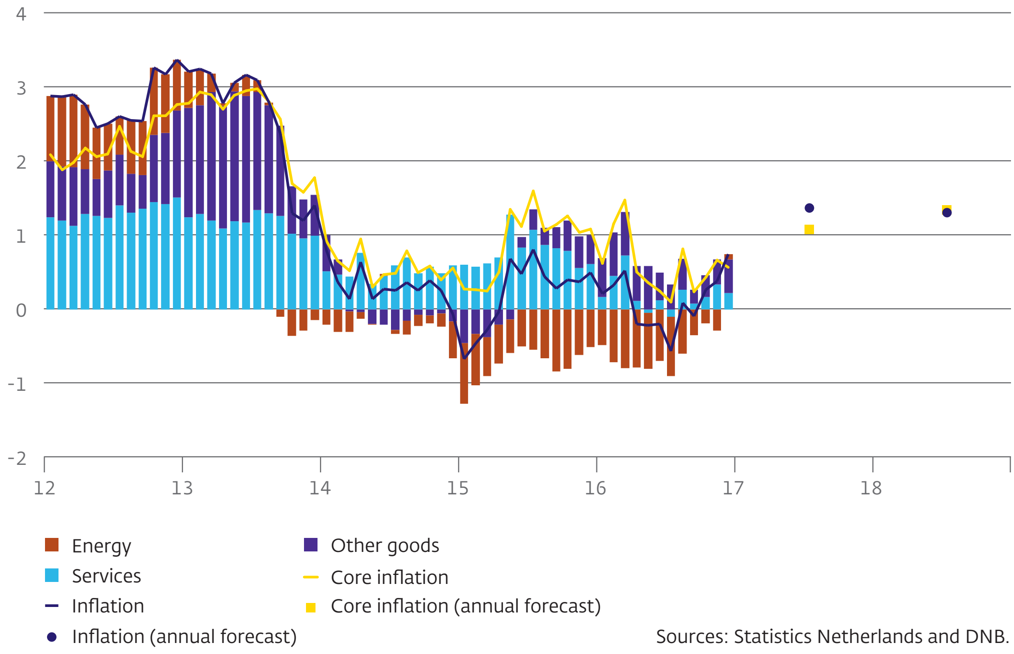
Inflation is edging up amid remarkably low services inflation

At 0.1% in 2016, HICP inflation was below 0.5% for the third consecutive year; inflation stood at 0.3% and 0.2%, respectively in 2014 and 2015. This is mainly attributable to oil prices, which fell over the entire period. Oil prices in the first quarter of 2016 were 66% below average prices in 2013, after which they embarked on a quick recovery. In line with these developments, inflation in the fourth quarter of 2016 stood at 0.5%, following two consecutive years of falling prices. Estimated inflation for the years ahead is among other factors based on a gradual further recovery of oil prices. HICP inflation is estimated to climb to 1.4% this year and to 1.3% in 2018 (Chart 7).

At 0.6%, core inflation (HICP excluding food and energy), was also at a low level in 2016. Inflation in the services sector, a major component of core inflation is remarkably low. Services usually

Chart 7 HICP inflation

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



Sources: Statistics Netherlands and DNB.

Note: Core inflation = total excluding food and energy.

make a considerable contribution to total inflation. From 2012 through 2015, services for instance contributed an average of 1.0 percentage points to inflation, but the contribution in 2016 came to no more than 0.2 percentage points. The bulk of the decline was attributable to the costs of holidays abroad and mobile phones. Child care expenses also fell in 2016. Generally speaking, lower services inflation can have several underlying causes, such as productivity growth in the services sector that dampens labour costs, and increasing online sales of services, see also Box 1.

Our projections assume that core inflation will rise to 1.1% in 2017 and 1.3% in 2018.
The narrowing output gap is increasing pressure on prices. This also applies to the rise in production costs, which is set to accelerate between 2016 and 2018. Unit labour costs in particular are projected to rise to 1.7% in 2018 from 0.8% in 2016. Growth of unit labour costs is in turn mainly determined by accelerating wage costs, as labour productivity increases fairly steadily by some 1% annually.

Box 1 The rise of e-commerce has limited influence on inflation

A possible underlying cause of the low level of inflation seen in the past years is the rise in online sales of goods and services to consumers (e-commerce). E-commerce sales in the Netherlands are expected to have grown by EUR 3.7 billion to around EUR 20 billion in 2016 (source: thuiswinkel.org). This means that e-commerce would have accounted for roughly 50% of private consumption growth in 2016 (EUR 7.6 billion in current prices). The increasing popularity of e-commerce may have a two-pronged dampening effect on consumer prices. First of all, online retailers have lower production costs as they spend less on operating a shop in terms of rent and staff. Secondly, e-commerce may fuel competition between retailers, owing to increasing price transparency, as consumers can for instance easily compare prices on the internet.
A DNB survey among Dutch households revealed that two thirds of online consumers believe they can save money on their purchases by shopping online rather that in a traditional shop. Of this group of respondents 70% says to have achieved price discounts of between 1 and 10%. On average, all consumers expect that prices in online shops will be 6.5% lower than in traditional shops.
As the share of e-commerce in private consumption is still relatively small, its dampening effect on inflation will also be limited in the short term. Of total private consumption in 2016 (EUR 309 billion in current prices) 6% was contributed by online household purchases. Given the trend of online spending seen in 2015 and 2016, and based on the 6.5% price discount perceived by consumers, the dampening effect on inflation is estimated at approximately 0.1 percentage points. As long as the share of e-commerce continues to expand, which is very likely to happen in the years ahead, we may expect it to have a permanent dampening effect on inflation.

2 A closer look at spending and public finances

Growth of domestically produced exports is falling behind

Growth of world trade relevant for the Netherlands last year fell to 2.4%, from 3.6% in 2015 (Table 2). As it was outstripped by Dutch exports (3.2%), the total market share of Dutch exports also increased (Chart 8). Word trade growth is expected to pick up slightly in the years ahead to 3.2% this year and 3.7% in 2018. Dutch exports are projected to grow at about the same pace. As component part of total exports, re-exports in particular are growing vigorously as usual, also compared with relevant world trade. The counterpart of re-exports, domestically produced goods and services, in 2016 lagged significantly behind world trade growth. Disappointing growth of these 'made in Holland' exports (1.1%) went hand in hand with a deterioration of the price-competitive position in 2016. We project growth of domestically produced exports (excluding energy) to pick up to 3.9% in 2017 and 3.5% in 2018. The production cap on natural gas continued in 2016, which will limit growth of energy exports in 2017 (spill-over effect).

Table 2 Dutch exports and competitiveness

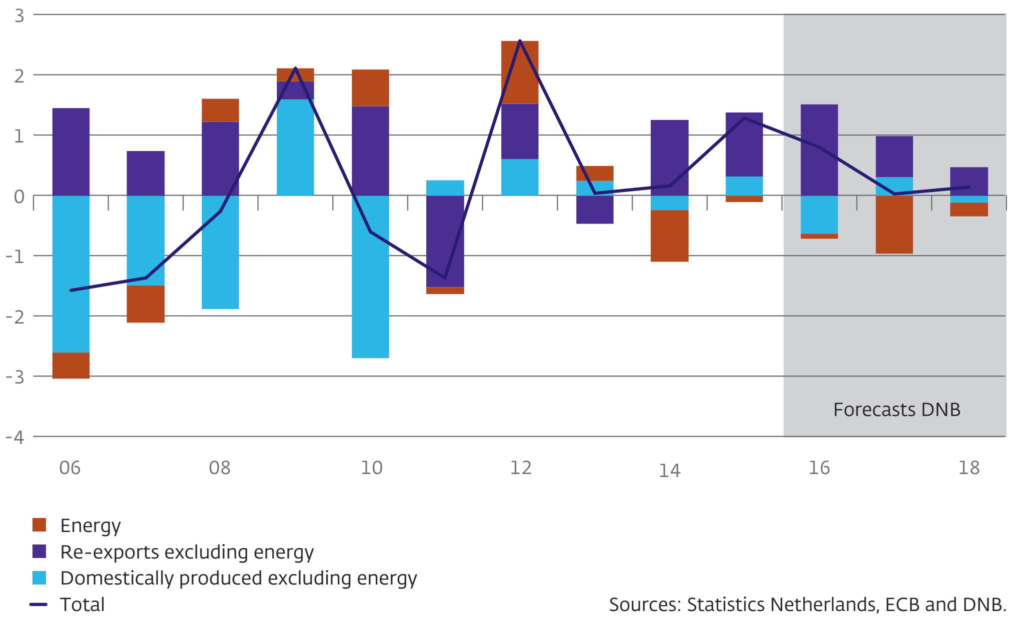
Percentage changes, unless stated otherwise

	2015	2016	2017	2018
Volume				
Relevant world trade	3.6	2.4	3.2	3.7
Exports of goods and services	5.0	3.2	3.2	3.9
domestically produced	3.4	0.6	1.7	2.9
re-exports	6.8	6.4	4.9	5.0
Exports of goods and services excl. energy	5.2	3.4	4.4	4.2
domestically produced	4.3	1.1	3.9	3.5
re-exports	6.4	6.4	4.9	5.0
Price				
Competitor prices	2.1	-3.2	2.6	2.2
Exports of goods and services	-2.9	-3.2	2.8	1.9
domestically produced, excl. energy	-0.8	1.7	0.4	1.5

Sources: DNB and ECB.

Chart 8 Market share exports of goods and services

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.

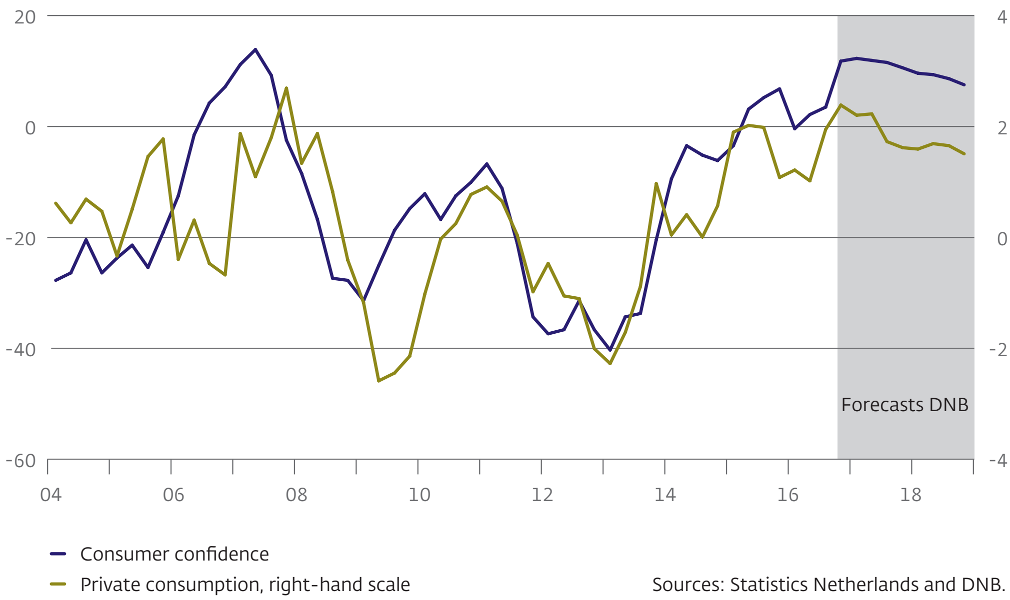
Private consumption continues to grow vigorously...

Real private consumption in the third quarter of last year returned to its end-2008 peak. After the outbreak of the financial crisis, household consumption contracted for more than five years (except for 0.2% growth recorded in 2011). Since the last low of early 2014, household consumption volumes accelerated quickly, by 4.4% in total (up to and including 2016Q3). We project consumption to continue growing vigorously, showing growth rates of a little above the long term average of about 1.5%. From the macroeconomic perspective, real disposable income of households will increase, house prices will recover sharply and consumer confidence has already risen to above pre-crisis levels. Consumption is projected to have grown 1.7% in 2016, will pick up to 2.0% this year, and fall off slightly to 1.6% in 2018, primarily due to rising inflation and a projected slowdown in house price rises (Chart 9).

Consumption growth last year showed a volatile pattern, with a sharp decline in quarterly growth in the second quarter (0.3% against 0.7% on average in the remaining quarters). The decline followed on an also temporary decline in consumer confidence, which had been on an upward trend since 2013. Consumer confidence in the first few months of 2016

Chart 9 Consumer confidence and private consumption

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



Sources: Statistics Netherlands and DNB.

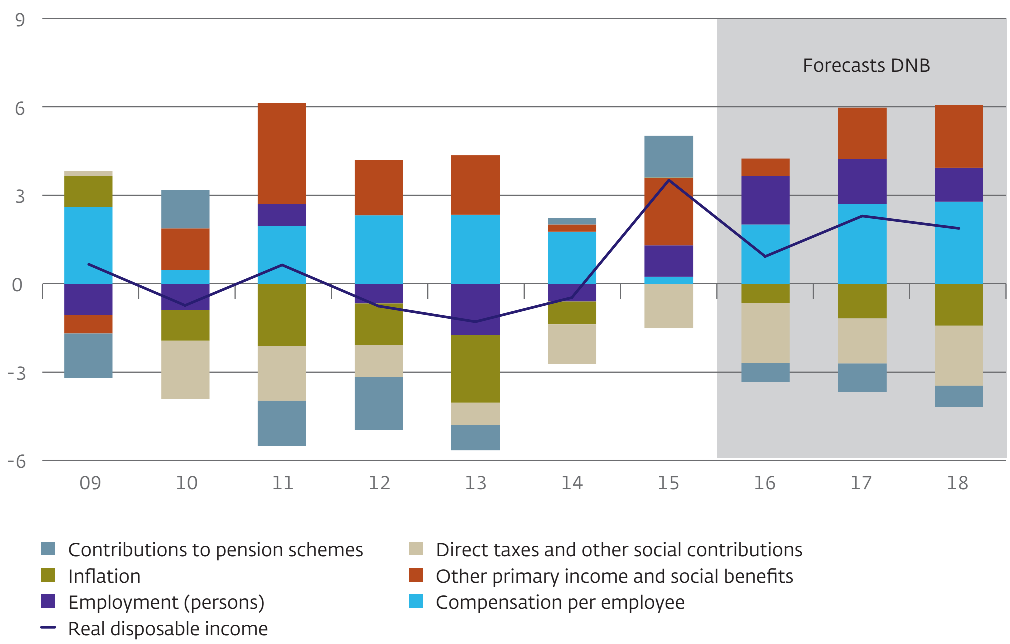
fell to -4 from 6. Almost in tandem with flagging consumer confidence, the outlook for unemployment deteriorated (the percentage of consumers that expect unemployment to increase in the next 12 months). In the second half of the year, consumer confidence bounced back to end the year at 12, the highest level recorded in the past thirty years.

... as household income is increasing

Solid consumption growth in 2017 will not only be driven by consumer confidence, disposable income of the household sector will be even more important. Real disposable household income has been growing again since 2015, after a prolonged period of stagnation. Between 2008 and 2014, this income still contracted by an annual average of 0.4%, accelerating to 3.5% and 0.9% in 2015 and 2016, respectively. Household income will continue growing throughout the projection period, by 2.3% and 1.9%, respectively, lifting real disposable income more than 7% above pre-crisis levels in 2018. Chart 10 shows the developments underlying income growth. Since 2015, accelerating employment has been giving the main upward stimulus to household incomes. Policy measures are also having an underlying effect, specifically the tightening of tax rules on relief for pension savings (Witteveen framework) in 2015 and the 2016 tax cuts (5 billion package).

Chart 10 Real disposable household income

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



Sources: Statistics Netherlands and DNB.

The distribution of national income in 2001-2015

Between 2001 and 2015 real household disposable income hardly moved, and its growth lagged significantly behind the trend of real GDP. In itself, this would mean the share of households in net national income in the Netherlands has declined.[3] Since the turn of the century, net disposable national income rose to EUR 549 billion in 2015, from EUR 378 billion in 2001. The share of households, which had still been at 62% in 2001, had fallen to 55% by 2015, as depicted in chart 11 (dark line). The drop is primarily attributable to the sharp rise in the burden of taxes and social security contributions. The government used its income from the rise in taxes and contributions to finance additional spending on healthcare and education (individual government consumption), which in the end benefit households directly.

In order to reflect the distribution of national income across businesses, households and the public sector more adequately, individual government consumption has been allocated to the households that benefit directly. The share of individual government consumption in total household income rose to 26% in 2015, from 19% in 2001. The largest component, healthcare, is

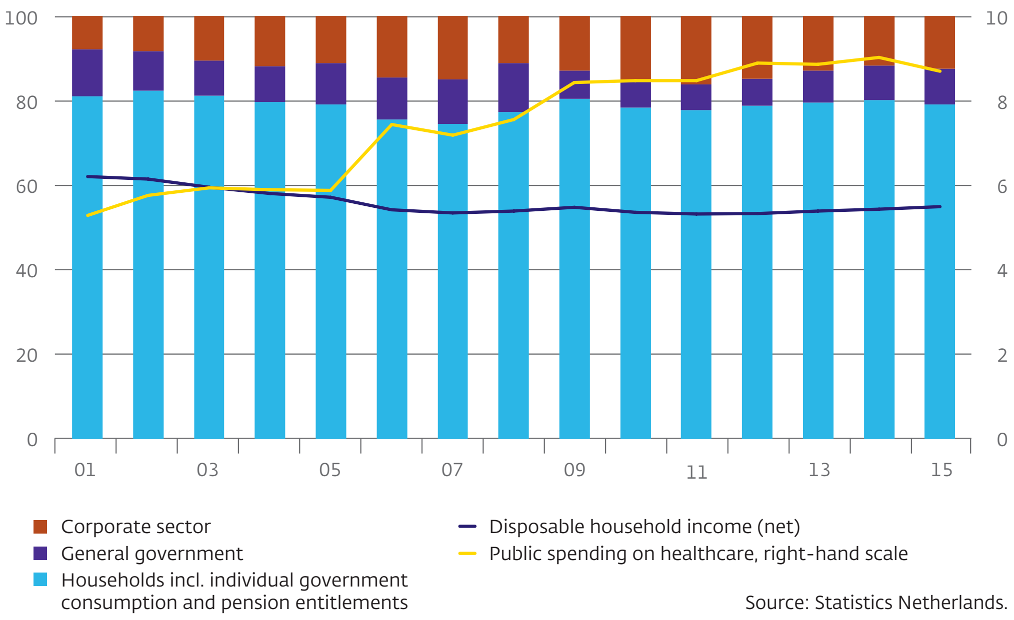
3 This refers to net disposable national income. This is GDP less depreciation plus the external income balance (including transfers).

depicted by the light coloured line in Chart 11. The balance of pension contributions and benefits has also been allocated to households as these funds will eventually be paid out to them. The bars in the chart reflect the resulting distribution.[4] The share of households in net national income in the Netherlands adjusted for individual government consumption and pensions, proves to have remained fairly constant, hovering around 80%.

The share of the corporate sector in net national income in the Netherlands rose by four percentage points in the period under review to 12% in 2015. This is among other things due to higher income from subsidiaries abroad, and the subdued growth of labour costs. The latter is reflected in the declining labour income ratio of businesses. Since the crisis, the government's

Chart 11 National income by sector

Percentage of net disposable national income



Source: Statistics Netherlands.

4 The share of households in net disposable income consists of income from employment, operating results of the self-employed, pension benefits, income transfers, the pension provision adjustment, individual government consumption, less contributions, pension contributions and taxes. The government share in income roughly breaks down into received taxes and social security contributions, less income transfers and individual government consumption. The proportion of income that is not accounted for by households or the public sector is allocated to businesses. This part mainly consists of profits less taxes and social security contributions paid by the corporate sector and the pension provision adjustment. Income from dividends and business profits is fully allocated to the corporate sector, meaning that no account is taken of the fact that a part of this ends up with households.

share decreased to 8% in 2015, from 11% in 2008. The most pronounced decline occurred in 2009, when the EMU balance deteriorated by 5.6% of GDP. In the years after 2009, the budget deficit decreased gradually, which is reflected in the steady rise of the government share.

Corporate investments are growing at above-average rates

Due to the changes in tax rules (company cars) and non-recurring high investments in aeroplanes, corporate investments showed a volatile pattern in the course of 2015 and 2016. Year-on-year investment growth was nevertheless robust. At 6.7% in 2015, and an expected 4.8% in 2016, recent growth of corporate investments is above the average recorded in the past forty years.

Broadly speaking, the economic environment for the Dutch corporate sector is comparable to the situation just before the outbreak of the financial crisis. The number of bankruptcies, which peaked in 2013, has now returned to below the level recorded in 2008. At the end of 2016, producer confidence (PMI), which returned to the black in 2014 and rose steadily after that was close to levels observed before the outbreak of the crisis in 2008. Businesses are mainly upbeat about their order books. The relevant indicator climbed further in 2016, and is now just below its 2008 level. The capacity utilisation rate in the manufacturing sector stood at 82.1% in the fourth quarter of last year, which is in line with the average recorded since 1989, and shows a quick recovery from the low of 76.6% observed in 2013. These favourable circumstances are translating into planned investments. In December 2016, manufacturing businesses expected that they would make additional investments in 2017 of 13% nominally, from 4% at end-December 2015.

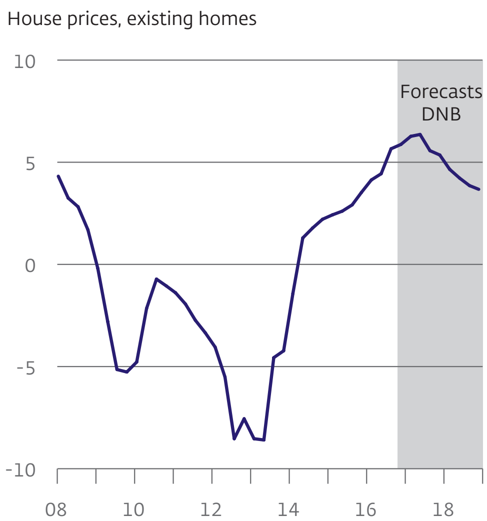
The projections for the years ahead assume ongoing investment growth at above-average rates, in line with GDP growth. At 5.2%, corporate investments will grow somewhat more strongly than last year. Next year, growth is expected to fall back somewhat (3.3%), in line with lower economic growth. Based on these projections, the investment ratio - the ratio of real corporate investment to real GDP will edge up to 13.1% in 2018. This means that the investment ratio will rise above the level recorded in the past forty years. The last low, during the financial crisis, was 10.9%.

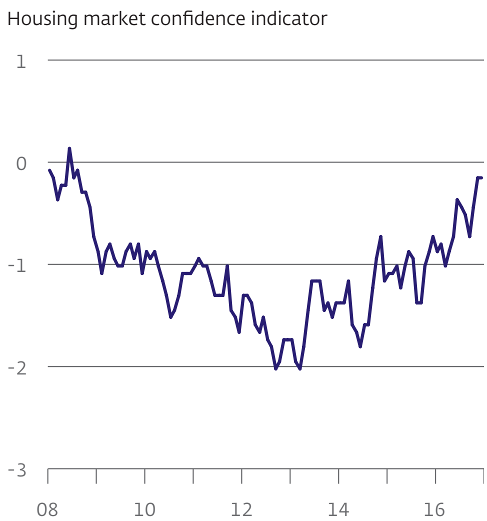
Housing market recovery continues

The housing market recovery which began in 2013 will continue at a brisk pace. Up to the fourth quarter of 2016, average house prices had risen by more than 12% from the trough in 2013 (Chart 12, left). The number of transactions, which also bottomed out in 2013, has also made a quick recovery since then. The monthly number of housing transactions recently returned to above pre-crisis levels. Judging by other indicators, the housing market has left the crisis behind, and has even emerged stronger on some points. Although by now more mortgage loans are being taken out than before the crisis, new home owners on average have a less heavy mortgage burden than before. Owing to the stricter mortgage lending standards, new mortgage loans have lower loan-to-value ratios, meaning that home owners have more financial buffers left. This also applies to existing mortgage loans as additional redemptions were made on these loans in the past quarters. Macro-economic risks have also diminished. The ratio of total mortgage debt to household income fell to 213% in 2016, from 226% in 2010. We project a rise to 218% in 2018. The expansion of mortgage debt is primarily driven by increasing disposable income, given the currently very low level of mortgage interest rates. Confidence in the housing market, which in 2013 had fallen to its lowest level since 1984, in December 2016 bounced back to the level observed in early 2008, just before house prices turned around (Chart 12, right-hand scale).

Chart 12 Housing market: prices and consumers' expectations

Year-on-year percentage changes and three month averages





Note to right-hand chart: Expects to buy a home within the next two years, balance of positive/negative responses; normalised.

Source: Statistics Netherlands.

Ongoing improvement in government finances

The economic upswing is boosting government finances. The 0.2% GDP budget deficit recorded in 2016 will turn into a budget surplus of 0.2% of GDP in 2018 (Table 3). This will be mainly attributable to higher revenues from income tax, corporate tax and VAT, partly as a result of the economic upturn, but income is also brought forward by the more efficient issue of provisional tax assessments among other things. The share of government spending in GDP will decline over the entire projection horizon, also owing to the sharp fall in unemployment and the lower interest burden. The discount that the Netherlands has been given on its contribution the EU, will have dampened government spending further by almost EUR 3 billion in 2016. A part of higher revenues has been used for additional spending on defence, safety, and healthcare. Government policy on balance contributes to reduction of the budget deficit thanks to retrenchment measures contained in the budget agreement, which among other things lead to cutbacks in healthcare.

Government debt will fall sharply to 56.5% of GDP in 2018, from 61.9% of GDP in 2016, putting it well below the European debt threshold of 60% of GDP. Not only is this attributable to the economic upswing, but also to further sales of shares in ABN AMRO and ASR, which came into government hands as a consequence of the financial crisis.

Table 3 Public sector key data

Percentage of GDP

	2015	2016	2017	2018
Public expenditures	45.1	43.9	43.4	43.1
Taxes and social security contributions	37.7	38.6	38.3	38.5
Other income	5.5	5.1	4.9	4.8
Primary balance	-0.6	0.9	0.8	1.2
EMU balance	-1.9	-0.2	-0.2	0.2
Structural balance (EC method)	-0.9	0.1	-0.1	0.2
EMU debt	65.1	61.9	59.3	56.5

Source: DNB.

3 Alternative scenarios for the Dutch economy

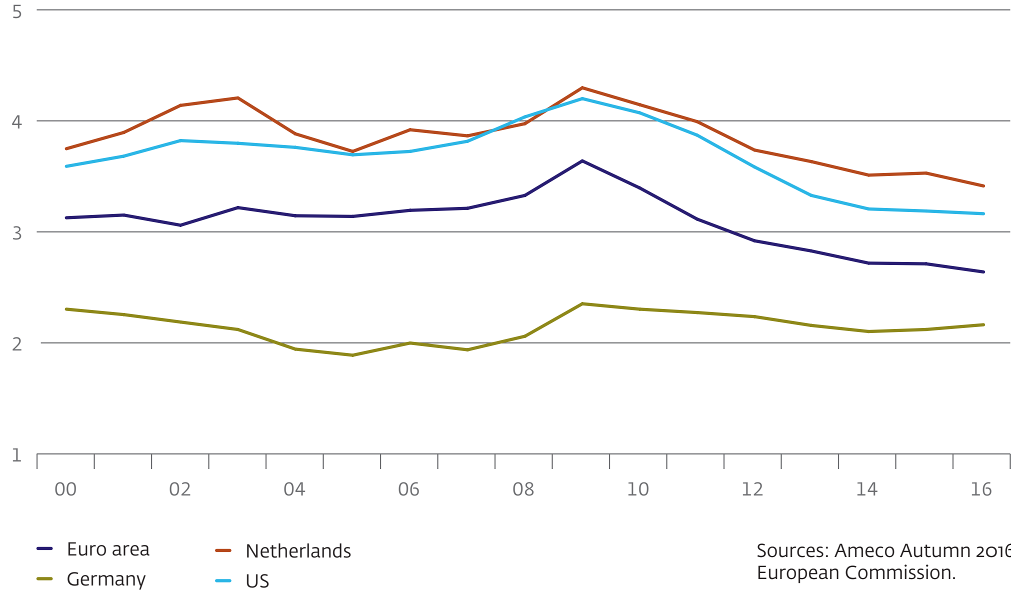
Scenario 1: More accommodating budgetary policy in the US

US President Donald Trump has announced his intentions of steering a different economic course with respect to trade politics, immigration and government finances. There are as yet no details available. This scenario concerns a part of the plans: a more accommodating budgetary policy, including tax cuts, and additional government investment in infrastructure. Chart 13 shows that since the crisis, the public investment ratio in the US has fallen to 3% of GDP, from just 4.5% in 2009. The proposed tax incentive will reverse the falling trend and may provide an additional boost to the US economy, and have a positive impact on world trade in the short term. In addition to the direct influence through exports to the US (good for 4% of Dutch exports in 2015), the Dutch economy may profit from increasing demand from other countries besides the US.

This scenario explores the possible effects of an annual 1% of GDP increase in US government investment for a period of four years, combined with a permanent 10 percentage point reduction in the average tax rate. The US stimulus package totals around USD 900 billion, which will initially be financed by debt. As both tax reform measures and the launch of investment projects are waiting for further decisions and consideration by Congress, the scenario will become relevant from the third quarter of 2017 onwards. This means that the peak of additional spending will occur in 2018 and 2019.

Chart 13 Public investment

Percentage of GDP



Sources: Ameco Autumn 2016 European Commission.

The expansive budgetary policy will first of all give a boost to economic activity in the US.[5] Corporate investments will rise significantly, unemployment will fall having a beneficial effect on disposable incomes, which will in turn give a boost to private consumption. At the same time, government finances will deteriorate, but this will be partly offset by ensuing positive revenue effects. Consumer prices will start edging up, due to increasing economic tension. In the longer term, when policy rates and long-term interest rates start rising, the positive effects will wane.

US imports will increase, owing to the sharp rise in consumer spending, which has positive spillover effects to the rest of the world. The spending impulse in the US will push up global economic growth; world trade relevant to the Netherlands will end up some 1.5% higher annually in 2018 and 2019 in real terms (Table 4). This has a beneficial effect on Dutch GDP through exports. A part of higher economic growth will leak to other countries because of higher imports. As employment is accelerating further and contract wages are slightly outpacing inflation, real disposable incomes will increase, which will have an upward effect on private consumption. Consumer confidence will also be boosted by rising equity prices in 2018, which may push up house prices somewhat further. Higher production growth will also benefit corporate investments. On balance, economic growth in 2018 and 2019 should be 0.2 percentage points higher than projected (Table 5). Inflation in 2019 will rise 0.2 percentage more than projected thanks to rising oil prices and the increasingly tight labour market.

Table 4 Scenario assumptions

Percentage deviations from baseline scenario, unless stated otherwise

	2017	2018	2019
US			
Public investment (% of GDP)	1	1	1
Profits tax (pp)	-10	-10	-10
Netherlands:			
Volume of relevant world trade	0.4	1.6	1.5
Real effective exchange rate	0.0	0.1	0.1
Competitor prices	0.0	0.3	1.1
Oil price	0.0	0.6	2.3
Equity prices	0.1	1.2	-0.2

Source: DNB.

Note: Dutch assumptions based on NiGEM, without two-year monetary policy response.

5 As in Europe, monetary policy in the US is assumed not to react immediately to tax incentives, but only after two years. We have also assumed that economic agents will adaptively adjust their forecasts (backward-looking).

Table 5 More expansive budgetary policy in the United States

Percentage changes, unless stated otherwise

	2017	Deviation from projection	2018	Deviation from projection	2019	Deviation from projection
Gross domestic product	2.4	(0.1)	2.0	(0.3)		(0.1)
Private consumption	2.0	(0.0)	1.7	(0.1)		(0.3)
Business investment	5.2	(0.0)	3.9	(0.6)		(0.6)
Housing investment	8.7	(0.0)	4.6	(0.1)		(0.4)
Exports of goods and services	3.5	(0.3)	5.0	(1.1)		(0.3)
Imports of goods and services	4.2	(0.3)	5.4	(1.1)		(0.4)
Consumer confidence (level)	11.7	(0.0)	9.6	(0.6)		(1.2)
Negotiated wages, private sector	2.0	(0.0)	2.4	(0.1)		(0.2)
Harmonised consumer price index	1.4	(0.0)	1.3	(0.0)		(0.2)
House prices, existing own homes	5.9	(0.0)	4.1	(0.0)		(0.3)
Unemployment (% of labour force)	5.5	(0.0)	5.2	(-0.1)		(-0.3)
EMU balance (% of GDP)	-0.2	(0.0)	0.3	(0.1)		(0.3)
Current account (% of GDP)	8.3	(0.1)	8.5	(0.2)		(0.4)

Source: DNB.

Note: A central projection is not available for 2019, the column only shows the difference compared to the estimate.

Scenario 2: Increasing tension on the Dutch labour market

Corporate employment has been increasing again since the second quarter of 2014, and unemployment fell to 6.0 in 2016, from 7.4% on average in 2014. Unemployment is projected to stabilise around 5.4% in 2017 and 2018. There are signs that unemployment may in the short term fall somewhat quicker still than projected in the outlook. Since end 2012, the number of hours worked by temporary staff has increased almost 25%, and the number of redundancy applications slumped by more than 70%. Based on these 'leading indicators' a scenario has been developed in which the two indicators will improve further in line with recent developments, which will in turn give extra momentum to corporate sector employment. The stronger fall in unemployment will then boost consumer confidence and household incomes, which makes for even more robust projected growth of private consumption. At the same time, the increasingly tight labour market will push up wages and prices.

In this scenario, the number of temporary hours will climb further by 4% on average after 2016, and the number of redundancy applications made will fall by 10% per year on average. These percentages are not unusual from a historical perspective, also in the light of the realisations to date. Based on the estimated link between temporary hours worked and redundancy applications, corporate employment is expected to grow additional growth of 0.4 percentage points per year.[6] The effects that this has on the Dutch economy were subsequently mapped out using DELFI, our macro-economic model.

Due to the delayed pass-through effect of positive income and confidence effects, the economic impact of the stronger labour market will become visible in 2018 in particular. In 2018, GDP growth will end up 0.2 percentage points higher (Table 6), mainly on the back of extra consumer spending and housing investments. Growing consumer confidence will also positively impact house prices, which will gain an additional 1.2 percentage points in 2018. Higher domestic spending will boost demand for foreign products, which will cause the balance on the current account to decline a bit more than projected to 8.0% of GDP in 2018. Unemployment will continue to fall owing to increasing employment and will dip below 5% in 2017, dropping to 4.4% of the labour force in 2018. Rising tension on the labour market will cause upward pressure on inflation and contract wages. The sharper than projected fall in unemployment and higher economic growth will lift the budget surplus to +0.7% of GDP in 2018.

Chart 14 Indicators: temporary staff hours and redundancy applications

2010 = 100 and thousands

Sources: Statistics Netherlands and Employee Insurance Agency (UWV).

6 Calculated as 0.07*4% + (-0.008)*(-10.0%) = 0.4% per year, amid 0.07 and -0.008 short-term elasticity of temping hours, respectively, redundancy applications related to corporate employment (in FTEs).

Table 6 Stronger growth of employment in the Netherlands

Percentage changes, unless stated otherwise

	2017	Deviation from projection	2018	Deviation from projection
Gross domestic product	2.4	(0.1)	1.9	(0.2)
Private consumption	2.3	(0.3)	2.3	(0.7)
Housing investment	8.8	(0.1)	5.5	(1.0)
Consumer confidence (level)	14.2	(2.5)	13.1	(4.1)
Negotiated wages, private sector	2.2	(0.2)	2.8	(0.5)
Harmonised consumer price index	1.5	(0.1)	1.6	(0.3)
House prices, existing own homes	6.2	(0.3)	5.3	(1.2)
Unemployment (% of labour force)	4.9	(-0.6)	4.4	(-0.9)
EMU balance (% of GDP)	0.0	(0.2)	0.7	(0.5)
Current account (% of GDP)	8.1	(-0.1)	8.0	(-0.3)

Source: DNB.

DeNederlandscheBank

EUROSYSTEEM

De Nederlandsche Bank N.V.
PO Box 98, 1000 AB Amsterdam
(31)20 524 91 11
dnb.nl