

Economic Developments and Outlook

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Summary

The Dutch economy is set to continue performing above its capacity limits in the next two years, but growth will shift into lower gear. Gross domestic product (GDP) growth will come to 1.7% in 2019, down from 2.5% in 2018 and the 3.0% peak seen in 2017. Growth for 2020 and 2021 is projected at 1.4% and 1.1% respectively. While these percentages might seem low from a historical perspective, they are close to the Netherlands' potential GDP growth. As a result, the output gap should remain fairly stable at around 2%.

Unemployment is projected to edge up from 3.4% in 2019 to 3.6% in 2021, but the labour market will remain tight. The unemployment rate fell from 7.4% to 3.3% between 2014 and early 2019, acting as a drag on production growth in many sectors. In addition, the tight labour market contributes to rising wage costs, with negotiated wage growth projected at 2.6% in 2020 and 2.8% in 2021. The higher labour costs will be a key determinant in inflation, which would have landed at 1.4% for 2019, against 1.2% in 2018 without the increase in the low VAT rate and the energy tax hike. The higher indirect taxes will drive up HICP inflation to 2.7% in 2019, significantly above the 1.6% rate registered in 2018. In 2019, core inflation (HICP excluding energy and food) is expected to be around 1.9% and remain relatively high throughout 2020 and 2021, at roughly 2%.

Dutch exports will contribute far less to GDP growth over the next few years, primarily due to the faltering momentum in international economic developments. In 2019-2021, the largest contribution to growth will be made by domestic spending, most of which is accounted for by household consumption. Sharply lower consumer confidence levels and the transitory inflation increase have led to moderate growth in private consumption in 2019, at 1.4%. It is projected to accelerate to 2.0% in 2020 and 2.4% in 2021 on the back of lower income tax rates in 2020, among other factors. Beside household spending, public expenditure will also make a solid contribution to economic growth, notably in 2020. The EMU balance is projected to fall to 0.5% of GDP in that year, following three years featuring surpluses of 1.3% to 1.5% of GDP. The government budget surplus is expected to turn into a deficit of 0.2% of GDP in 2021. Residential investment growth is projected to soften to 2.9% in 2019, 1.5% in 2020 and 0.5% in 2021. The tightened nitrogen regulations are putting additional pressure on the number of new permits issued and, by implication, newbuilds. Their drag on GDP growth will be limited to around 0.1 percentage points a year in 2019-2021, primarily through lower investment.

Two alternative Brexit scenarios provide a picture of the bandwidth around the baseline projections. In the adverse "no-deal" scenario, economic growth in the Netherlands will drop significantly in 2020 and 2021, to 0.6% per year on average. In the favourable "remain" scenario, growth ends up 0.2 percentage points higher.





1 The Dutch economy in 2019-2021



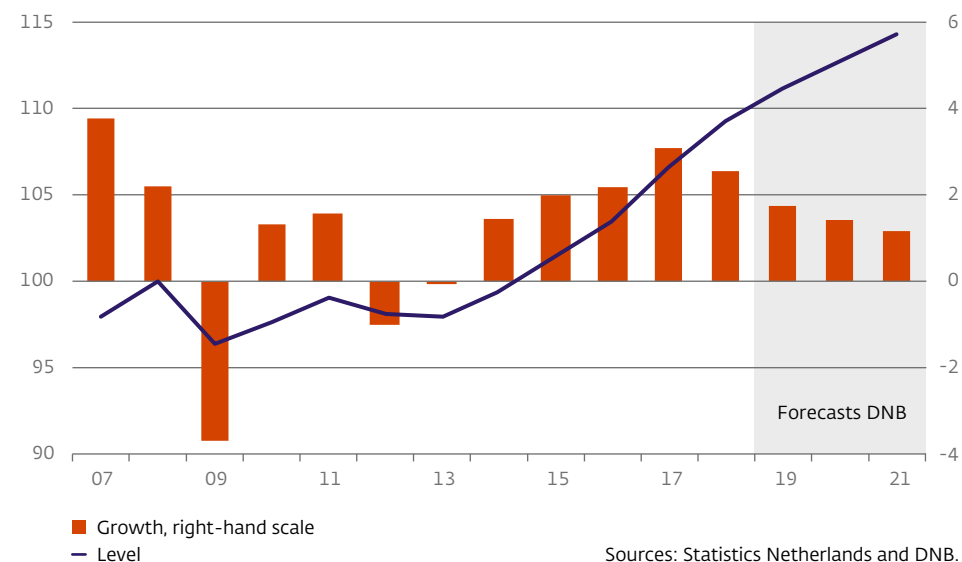
1.1 Growth rate falls as economy remains under strain

The Dutch economy is set to continue performing above its capacity limits in the next few years, but growth will slow further. Gross domestic product (GDP) growth will come to 1.7% in 2019, down from 2.5% in 2018 and the 3.0% peak seen in 2017 (Figure 1). Growth for 2020 and 2021 is projected at 1.4% and 1.1% respectively. While these estimates might seem low from a historical perspective, they are close to the Netherlands' potential GDP growth. The output gap should average 2.1% throughout 2019–2021, which is appropriate for a period of economic boom. The unemployment rate is projected to edge up from 3.4% in 2019 to 3.6% in 2020 and 2021, but the labour market will remain very tight. This will act as a drag on production growth in many sectors as wage costs are set to rise further on average.

Beside the tight labour market, other factors also cause economic growth in the Netherlands to shift into a lower gear. Between 2014 and 2019, the housing market recovery provided a major boost to household spending, which will no longer be the case in subsequent years. In a similar vein, consumer confidence has declined sharply since 2018, falling from 20 in 2018 to -2 currently, just below its long-term average. Added to this are two one-off factors. The Council of State's order to cut nitrogen emissions has caused construction projects to be halted or deferred, which should dampen annual GDP growth by some 0.1 percentage points between 2019 and 2021. The accelerated reduction in natural gas production is expected to depress GDP growth by around 0.1 percentage points in 2020. Lastly, the momentum in international economic developments is faltering and is not expected to pick up slightly until 2021. World trade relevant to the Netherlands is projected to grow by a mere 1.9% between 2019 and 2021, compared to an average of 4.1% a year in the 2014–2018 period following the Great Recession. The outlook for world trade is dominated by downside risks, notably related to international trade conflicts and Brexit (see also sections 2 and 3).¹

Figure 1 Gross domestic product

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



The key data present the projections for the components of GDP. Following relatively modest growth in 2019, at 1.4%, private consumption growth is set to pick up, reaching 2.0% in 2020 and 2.4% in 2021, on the back of lower income tax rates in 2020 and other factors. At 2.7%, public expenditure is projected to grow sharply in 2020. The EMU balance should fall to 0.5% of GDP in that year, following three years featuring surpluses of 1.3% to 1.5% of GDP. The government budget surplus is expected to turn into a deficit of 0.2% of GDP in 2021. Business investment (excluding housing) grew 5.9% in 2019, sharply up from 3.0% in 2018, owing to high data realisations for the first quarter of 2019. In line with more subdued production,

¹ The assumptions underlying the development of relevant world trade, exchange rates, international commodity prices and interest rates are based on information available on 25 November 2019.



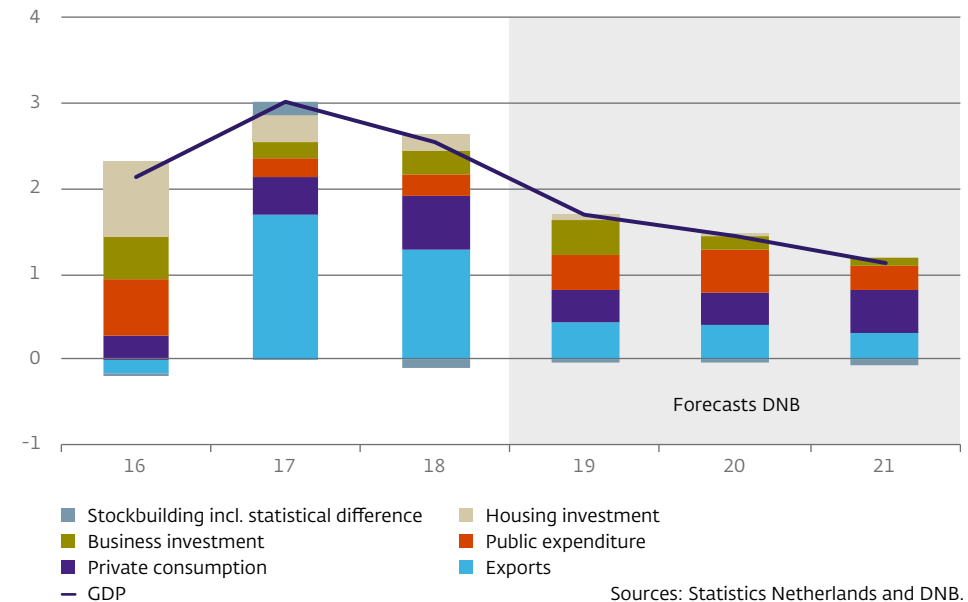
growth in business investment will moderate to 2.6% in 2020 and 1.9% in 2021. At 7.0%, residential investment growth in 2018 was already markedly below the 18.0% average growth rate seen between 2015 and 2017. The projections foresee further declines, to 2.9% in 2019, 1.5% in 2020 and 0.5% in 2021. This trend was already observed in early 2019, when the number of newly issued building permits receded. The stricter nitrogen regulations are putting additional pressure on the number of new permits issued and, by implication, newbuilds. Similarly, lower consumer confidence and the more moderate house price increases slow down residential investment growth. Export growth is projected to soften to 2.4% in 2019, from 3.7% in 2018. Set against developments in world trade, this stands out favourably, as re-exports will continue to grow. Total exports should expand by 2.3% in 2020 and 1.9% in 2021. Domestically produced exports, excluding energy, are expected to grow by 2.0% in 2020 and 1.7% in 2021, which is far below the 5.0% average for 2010-2018.

Figure 2 shows the composition of GDP growth, whereby the concomitant parts of final and intermediary imports have been deducted for each expenditure category. In 2017, GDP growth was largely driven by exports, whereas roughly half was accounted for by growth in exports of goods and services in 2018. Exports will contribute a quarter between 2019 and 2021, with re-exports accounting for the lion's share. As a consequence, the largest contribution to growth will be made by domestic spending in 2019-2021, most of which is accounted for by household consumption. Public expenditure will also make a solid contribution to economic growth, notably in 2020. From that year onwards, contributions of residential investment and business investment are set to be lower.

The output gap widened significantly to 2.0% in 2018, from 0.9% in 2017. This indicates that the Dutch economy performs well above its potential, similarly to previous periods of economic boom around 2000 and 2007. The projections show that the output gap will remain at this level of around 2% longer than usual.

Figure 2 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.

Many indicators confirm the current high utilisation of production resources. Utilisation rates in the manufacturing industry have fluctuated around 84% since 2018 and 2019, a level similar to the peak level seen since shortly before the credit crisis broke out. Also, almost a quarter of the firms surveyed reported labour shortages in late 2019.



1.2 Unemployment edges up as labour market remains tight

After peaking at 2.5% in 2018, employment growth is also expected to be solid in 2019, at 1.7%. It will subsequently decelerate to 0.6% in 2020 and 0.2% in 2021 (Figure 3). With employment growth lagging slightly behind labour supply growth in those years, unemployment is set to edge up from 3.4% on average in 2019 to 3.6% in 2021. This will mark the end of a period of sharp declines in unemployment rates from 7.4% in 2014 to 3.3% in the spring of 2019. But the labour market will remain tight – over the past four decades, only 2001 saw an annual average unemployment rate below 3.6%.

The fact that employment growth in 2019 is lower than in 2018 is related to the very tight labour market. Wage cost growth is accelerating (see paragraph 1.3 below) and employers find it increasingly difficult to find suitable staff. The number of unfilled vacancies reached a record level of 288,000 in the third quarter of 2019. Nevertheless, the number of persons finding a job after having been out of work a quarter previously remained more or less the same at 310,000 per quarter. In addition, the proportion of employers experiencing obstacles due to staff shortages remained high in the final quarter of 2019, at more than 24.5% compared with an average of 5.5% between 2012 and 2017.

The pick-up in the labour market has prompted many to enter the labour market over recent years. In the third quarter of 2019, the gross labour participation rate, which represents the share of the population of working age (aged between 15 and 75) having a job or looking for one, went up to 71.3%. At nearly a full percentage point above the figure for the third quarter of 2008 (70.5%), this is an all-time high. The increase is primarily driven by the 55–65 age category, whose gross labour participation rate increased from 52.8% in 2008 to 71.9% in the third quarter of 2019.

Figure 3 Labour market

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



Sources: Statistics Netherlands and DNB.

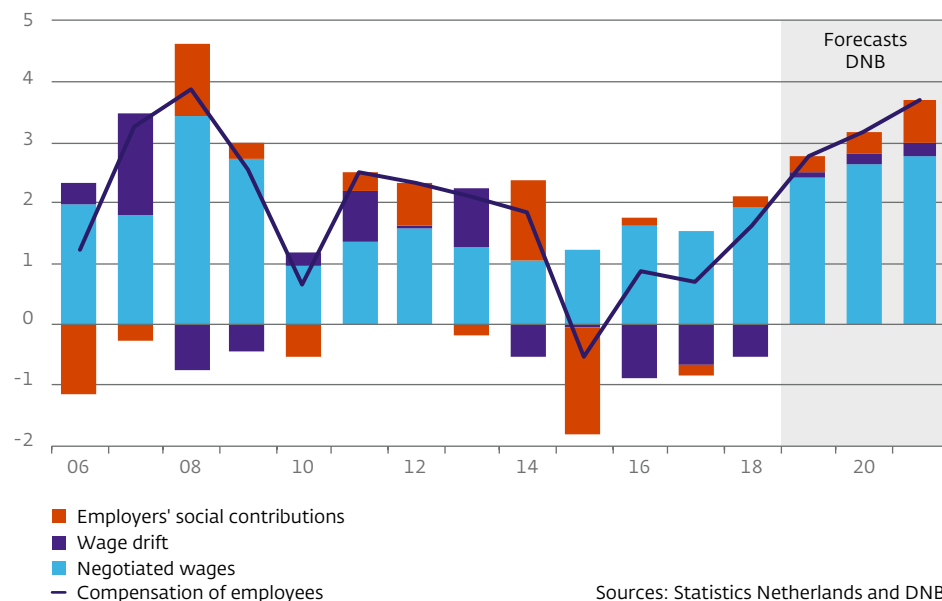
While the labour participation rate is expected to edge up further over the projection horizon, growth in labour supply will fall from 1.3% in 2019 to 0.3% in 2021 as the growth in the population of working age will come to a virtual standstill according to Statistics Netherlands projections. In the longer term, the population of working age will even diminish, acting as a drag on labour supply growth and, by implication, on potential GDP growth if the labour participation rate does not increase further to any significant extent. [Box 1](#) discusses the projections for potential GDP growth.

1.3 Wage growth accelerates and boosts inflation

Negotiated wages in the private sector are expected to have grown by 2.4% on average in 2019. Over the course of the year, growth in negotiated wages accelerated from 1.9% in January to 2.5% in November. It is set to accelerate further to 2.6% in 2020 and 2.8% in 2021, reflecting the tight labour market and higher inflation. Together with developments in employers' social contributions and wage drift, those in negotiated wages contribute to the growth in labour compensation. They will push up compensation per employee in the private sector by 3.7% in 2021 (Figure 4). Growth in compensation per employee is expected to outpace inflation throughout the projection horizon.

Figure 4 Compensation per employee (private sector)

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



Sources: Statistics Netherlands and DNB.

Wage drift is expected to start contributing to growth in compensation per employee in 2019 for the first time in five years. Its contribution turns positive again owing to shifts in the components of employment. Over the past years, employment increased mainly in relatively low-paid labour categories, such as young people, first-time employees and staff on flexible contracts. This has depressed the average wage, resulting in a negative growth contribution of wage drift. The continued tightness of the labour market will make it more difficult to find relatively low-paid staff, causing this effect to disappear over the projection horizon. Paragraph 2.4 discusses developments in flexible employment and wage differentials between permanent and flexible employment in more detail.

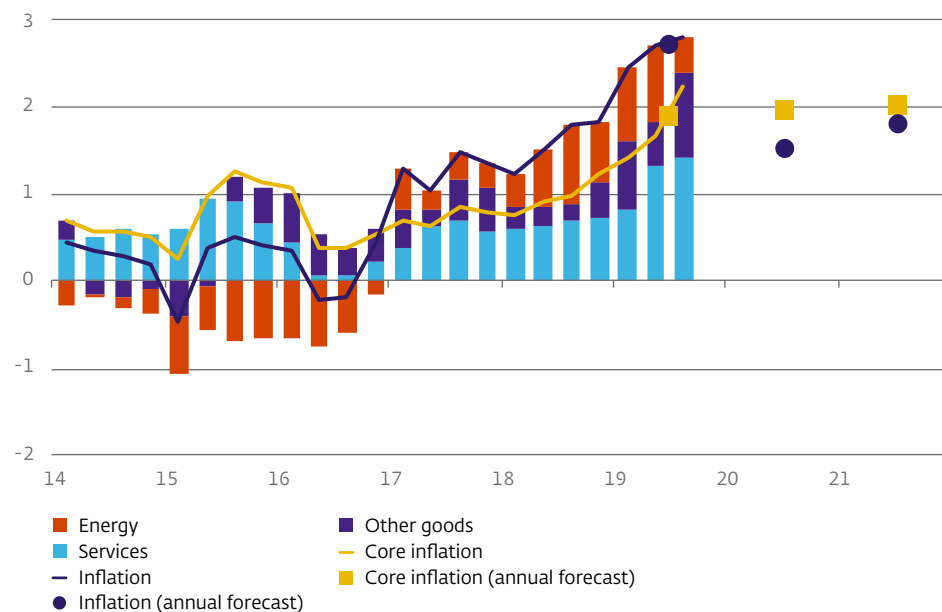
HICP inflation is projected to land at 2.7% in 2019, a sharp rise on the 1.6% year-earlier level (Figure 5). Much of this is accounted for by the rise in indirect taxes, including VAT. Without the increase in the reduced VAT rate from 6% to 9% and the energy tax hike, inflation would have landed at 1.4% for 2019, against 1.2% in 2018. The higher energy tax and oil price rises are sending prices of energy products almost 8% higher in 2019. In 2019, core inflation (HICP excluding energy and food) is expected to be around 1.9%. Adjusted for indirect taxes, this is 1.1%. In 2020 energy prices, including energy tax, will drop again, and HICP inflation will slide back to 1.5%. Core inflation is projected to remain high after 2019, however, at roughly 2%.

Developments in labour costs are an important determinant of inflation in the projection years. Unit labour costs are expected to have risen 2.9% in 2019. Labour productivity growth will accelerate in 2020 and 2021, causing unit labour costs to go up less rapidly than in 2019, by 2.4% in 2020 and 2.6% in 2021.

Inflation in the services sector is projected to land at close to 3% in 2019, for the first time since 2013. The fact that services inflation remained low until recently can largely be attributed to developments in the trend component. A recent study has

Figure 5 HICP inflation 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.

found that the trend in services inflation has been downward since 2002.² In 2002, trend inflation for services stood at 2.9%. By 2017, it had fallen to 1.7%. The underlying causes are complex and uncertain. Frequently cited factors include globalisation, diminishing negotiation power of trade unions, demographic developments,

technology and e-commerce, and financial factors. The downward trend can be observed for various services, such as communication, transportation and accommodation (rental services). It seems to have reversed from the second quarter of 2019 onwards, however. Between April and October 2019, services inflation adjusted for taxes averaged 2.2%, a rate not seen since 2013. It would appear, therefore, that 2019 marks the end to the downward trend in services inflation.

1.4 Housing market is cooling as residential investment slows

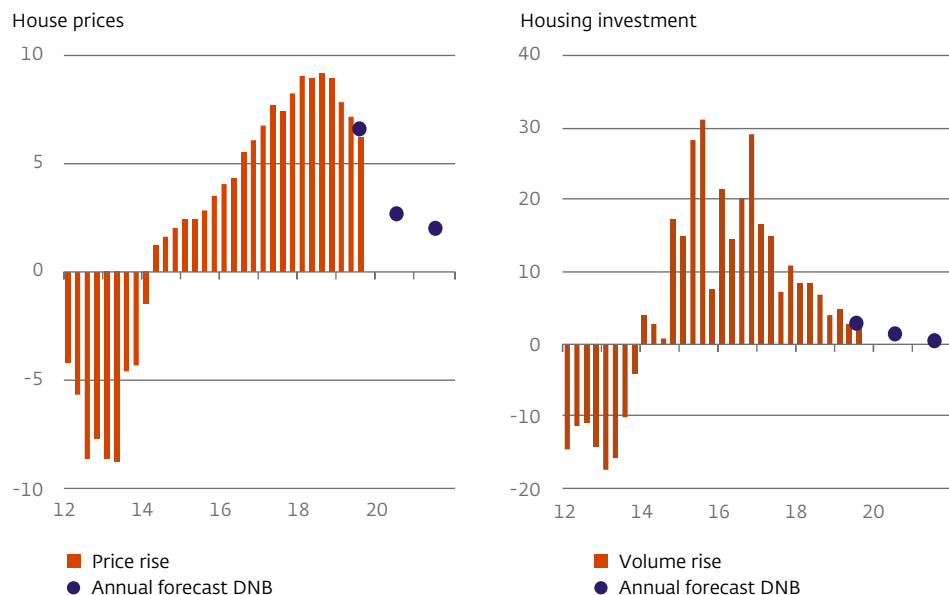
Price increases of existing owner-occupied properties have shown signs of moderation over the past year. In the third quarter of 2018, price rises averaged 9.2%. A year later, the average stood at 6.3%, measured as the year-on-year increase in the house price index. Any price movement tends to be stronger in the Netherlands' major cities. Price increases in Amsterdam receded to 3.8% in the third quarter of 2019, from 13.1% a year earlier. Given that price movements in Amsterdam also tend to lead developments nationwide, they are an important indicator suggesting that prices might be reaching calmer waters across the Netherlands. That said, circumstances are still favourable for potential buyers, with low mortgage interest rates, low unemployment and rising income levels. The projection therefore shows that prices continue to rise, but at a gradually declining pace. Prices are expected to rise 2.6% on average in 2020, and 1.9% in 2021 (Figure 6, left).

2018 marks a turnaround in the number of houses sold, heralding a period of cooling for the Dutch housing market. Twelve-month transaction volumes fell by over 10% between January 2018 and January 2019 and have been virtually flat since then, at roughly 210,000. The average selling period did not change to any significant extent either in 2019 – at 38 days it was still very short in the third quarter of 2019. Home-

² 'Inflation in the euro area since the Global Financial Crisis', DNB, 2019.

Figure 6 Housing market: house prices and housing investment

Year-on-year percentage changes



Sources: Statistics Netherlands, Kadaster and DNB.

owning consumers remain optimistic. Their confidence, as measured by the Dutch Home Owners Association's market indicator dipped below the "neutral" value of 100 in the first quarter of 2019, but has climbed to 103 since then.

The growth rate projected for mortgage lending increases from 2.2% in 2019 to 3.8% in 2020 and 2021. As in the past few years, growth in mortgage lending is dampened

somewhat by early repayments. On the other hand, mortgage interest rates remain low, and income levels show solid increases. Also, most banks have eased their lending conditions. As a percentage of disposable household income, mortgage indebtedness should edge down, from 188% in 2019 to 186% in 2020 and 2021. Total household indebtedness, which includes short-term debts, is expected to decline from 221% in 2019 to 214% in 2021. In 2010, it stood at 261%.

Residential investment is expected to have grown 2.9% in 2019, representing a marked slowdown from the 7.0% registered in 2018. Trends in residential investment are closely related to the number of new building permits issued. The most recent low was in 2013, when 27,000 permits were issued. The subsequent recovery saw 70,000 permits issued in 2017. Issuance stalled in the final months of 2018, however, only to drop sharply since then. Residential investment has been further depressed by the impact of the nitrogen rulings made by the Council of State and the European Court of Justice since May 2019. They have prompted deferrals in newbuilds, in particular large housing projects. The resulting drag on residential investment growth is projected at over 1 percentage point in both 2020 and 2021. Residential investment growth is estimated at 1.5% in 2020 and 0.5% in 2021 (Figure 6, right).

The estimated impact of the tightened environmental regulations resulting from the nitrogen ruling is based on information about project delays provided by the construction sector.³ It was partly compensated by the previously announced easing of regulations governing permit issuance. In addition, construction firms will likely be able to use the capacity freed up from impacted projects to engage in other construction activities. In the fourth quarter of 2019, only 8% said their activities were in insufficient demand. Moreover, 20% said their activities were hampered by staff shortages.

³ The projections for 2020 and 2021 also foresee a limited downward impact on business investment and public investment, beside residential investment. These estimates are based on information provided by the Economic Institute for Construction and Housing (EIB). See its Dutch-language report "Stikstofproblematiek" (The nitrogen issue), October 2019.

Box 1 Potential GDP growth set to decline

Table 1 shows potential GDP growth between 1996 and 2025, which is a measure for the rate of GDP growth at a constant utilisation rate. It shows a gradual decrease from over 3% a year on average in the late nineties to 1.6% on average since the turn of the century. For the 2020-2025 period, potential GDP is projected to grow by 1.3% a year on average. As potential GDP growth cannot be observed, it is estimated on the basis of actual GDP, the labour force and inflation using an unobserved components model (UCM). The model shows that the decrease in potential growth seen between 1996 and 2019 can largely be attributed to reduced contributions of technical progress (total factor productivity, TFP). The contributions made by capital and employment held up fairly well. Within the contribution made by employment, growth in structural labour supply slowed on the one hand, while the negative impact of part-time employment has decreased, on the other, as hours worked by women went up on average. Following a transitory pick-up in recent years, a further decrease in potential growth is projected for the next few years. This is due mainly to the fact that the anticipated labour force contraction will not be fully compensated by higher productivity growth (TFP). According to Statistics Netherlands' population projections, growth in the population of working age (aged between 15 and 75) will grind to a halt in the years ahead, with contraction expected to set in from 2022 onwards. Potential growth could end up higher in the years ahead if the labour force participation rate, productivity or both develop more favourably than currently foreseen.

Potential growth forecasts depend on assumptions that are uncertain. Scenario analyses can help chart the impact of those assumptions. For example, population growth in the years ahead is driven mainly by net migration. The uncertainty surrounding the projected net migration figures is assessed by comparing Statistics Netherlands' earlier projected net migration figures for 1996 to 2018 with actual outcomes.⁴

Table 1 Composition of potential output, 1996-2025

Percentage changes and percentage point

	1996- 2005	2006- 2013	2014- 2017	2018- 2021	2022- 2025
Potential output	2.7	1.2	1.2	1.6	1.1
of which Potential employment (hours)	0.6	0.5	0.5	0.6	0.1
of which Structural growth in labour supply (persons)	0.9	0.5	0.3	0.6	-0.1
of which Change in equilibrium unemployment	0.0	0.0	0.1	0.0	0.0
of which Growth in part-time employment	-0.3	-0.1	0.2	0.0	0.1
of which Capital	0.6	0.4	0.5	0.5	0.6
of which Total factor productivity	1.5	0.3	0.1	0.4	0.5

Source: DNB.

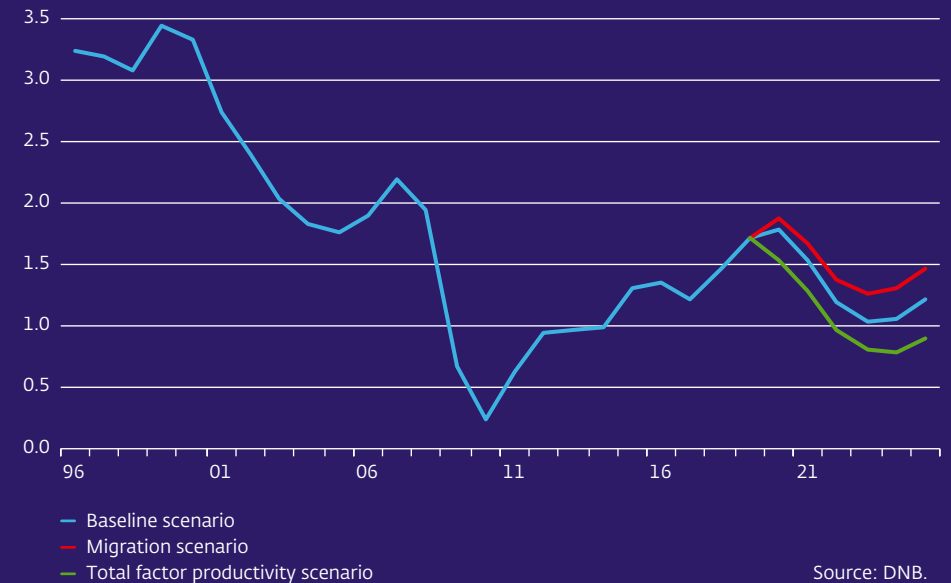
⁴ <https://opendata.cbs.nl/statline/#/CBS/nl/dataset/70737ned/table?dl=2B525>



Figure 7 shows the upward risk as a scenario in which movements in net migration between 2020 and 2025 are increased by one standard deviation of the historical prediction error, which increases from 15,000 in 2020 to more than 47,000 in 2025. The fact that technical progress (TFP) may pick up not quite so rapidly as currently assumed (from 0.4% in 2019 to 0.6% in 2025) represents a downward risk. The scenario shown in the figure assumes that the contribution of TFP to potential growth does not increase any further between 2020 and 2025 but remains flat at the level seen over the past five years. This shows that uncertainties surrounding potential growth forecasts are significant. At the same time, the scenarios illustrated in Figure 7 suggest that the GDP growth figures seen before the Great Recession are not likely to return any time soon.

Figure 7 Scenarios for potential GDP growth

Year-on-year percentage changes



Source: DNB.





2 A closer look at expenditure and public finances



2.1 International economic developments are muted

The world economy's growth momentum slowed further in 2019. The European Central Bank (ECB) expects global real GDP growth (excluding the euro area) to decelerate to 2.9% in 2019, from 3.8% in 2018. Like the IMF, it revised its projections for global growth downwards compared to six months previously. Continuing uncertainty over trade policies, in particular due to the trade dispute between the United States and China, prove to have a greater impact on global activity than previously anticipated. This is reflected in continued manufacturing weakness, and world trade has likewise been under increased pressure.

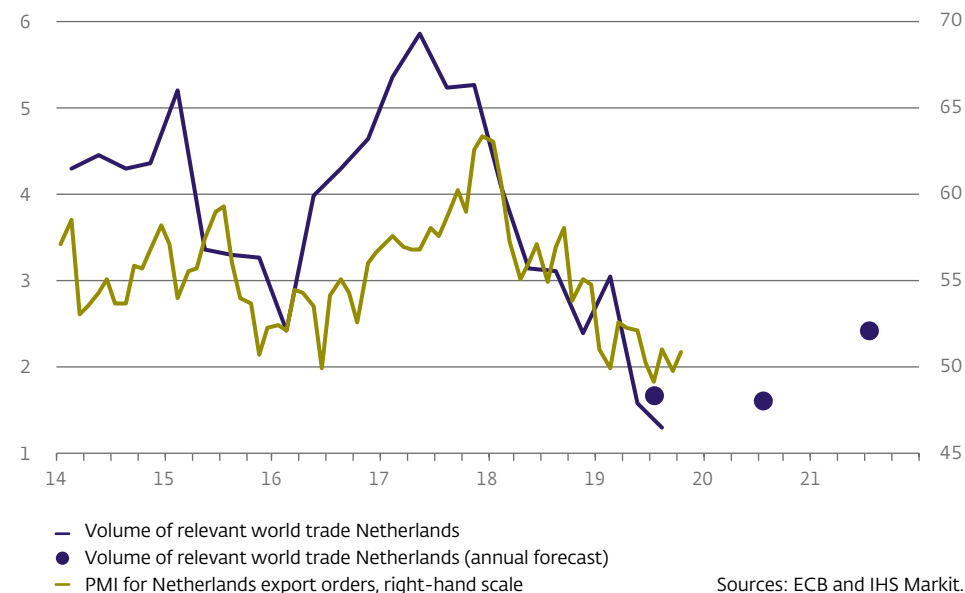
The ECB expects global GDP growth to pick up slightly, to 3.1% in 2020 and 3.3% in 2021, primarily on the back of an expected recovery in emerging market economies, such as Turkey and Brazil. This will be counterbalanced by a gradual softening in Chinese growth due to a government policy of debt reduction. Likewise, many advanced economies face a cyclical slowdown resulting in lower growth figures. Combined, this causes the anticipated growth rate for the global economy to be well below its long-term average of 3.8%.

For the euro area the ECB foresees GDP increasing by 1.2% in 2019 and 1.1% in 2020, after which growth should increase to 1.4% in 2021. These forecasts represent cumulative downward revisions of 0.3 percentage points in 2019 and 2020. These are related to weaker global trade caused by factors that include uncertainties surrounding the trade dispute and Brexit. In the medium term, growth in the euro area benefits from monetary stimulus, a slight fiscal impetus and easing global uncertainties.

The muted global economic activity affects the Dutch economy through relevant world trade, which is expected to show a slowdown in growth to 1.6% in 2020, from 1.7% in 2019, before recovering somewhat, to 2.4% in 2021. The marked deceleration

Figure 8 World trade

Year-on-year percentage changes and diffusion index



of growth in global trade is reflected in the confidence index for export orders of the European industrial sector (Figure 8). The risks surrounding global trade projections remain downward. For example, a disorderly Brexit can still not be excluded (see section 3), and the danger of further escalating trade conflicts is still lurking. Although the deadline for the United States to impose tariffs on European car imports has expired, the risk of Europe getting involved in a trade dispute with the United States remains real.

The short-term and the long-term interest rate projections have been revised downwards compared to six months previously, reflecting recent adjustments to

monetary policy by both the ECB and the Federal Reserve (the Fed). Prompted by an inflation outlook that was lower than previously anticipated, the ECB in September 2019 decided to lower the short-term interest rate further, from -0.4% to -0.5%. It also decided to resume its net purchases under the asset purchase programme (APP). The Fed likewise eased its monetary policy by lowering its key interest rates for the third time in succession in October 2019. These measures were taken to protect the economic growth cycle from downward risks in the international environment.

Oil prices slid further over the past six months, to USD 62 per barrel in the third quarter of 2019. Like the projections for international growth, those for oil prices have also been revised downwards. Crude oil is now expected to stand at USD 57.40 per barrel in 2021. As concerns the euro exchange rate, the projections now assume USD 1.10, which is below the USD 1.18 average exchange rate seen in 2018 and slightly below the USD 1.12 rate anticipated six months ago.

2.2 Exports and current account

Growth in goods and services exports from the Netherlands in 2019 weakened to 2.4%, from 3.7% in 2018 (see Table 2). Thereafter, a further slowdown is projected, to 2.3% in 2020 and 1.9% in 2021. Export growth in 2019 and 2020 outstrips growth in relevant world trade and, by implication, total Dutch exports gain market share (Figure 9). The underlying components of the Dutch market share show a diverging pattern.

The Dutch market share gains in 2019 and 2020 are strongly driven by re-exports, which were already sharply up in the first and second quarters of 2019. Although growth in re-exports should ease in 2020 and 2021, they will continue to contribute significantly to the Dutch market share. By contrast, the market share of Dutch energy exports will shrink due to the cap on the production of natural gas. As a

Table 2 Dutch exports and competitiveness

Percentage changes

	2018	2019	2020	2021
Volume				
Relevant world trade (1)	3.2	1.7	1.6	2.4
Exports of goods and services (2)	3.7	2.4	2.3	1.9
domestically produced	3.8	0.4	1.6	1.1
re-exports	3.4	5.6	3.3	3.0
Trade performance (2-1)	0.5	0.7	0.7	-0.5
Exports of goods and services excl. energy	4.4	2.5	2.5	2.3
domestically produced (3)	4.1	0.5	2.0	1.7
re-exports	4.9	5.6	3.3	3.0
Market performance (3-1)	0.9	-1.2	0.4	-0.7
Price				
Competitor prices (4)	0.9	1.9	1.9	1.9
Exports of goods and services	2.2	0.6	0.7	1.2
domestically produced, excl. energy (5)	1.4	1.0	1.1	2.2
Price competitiveness (4-5)	-0.5	1.0	0.8	-0.2

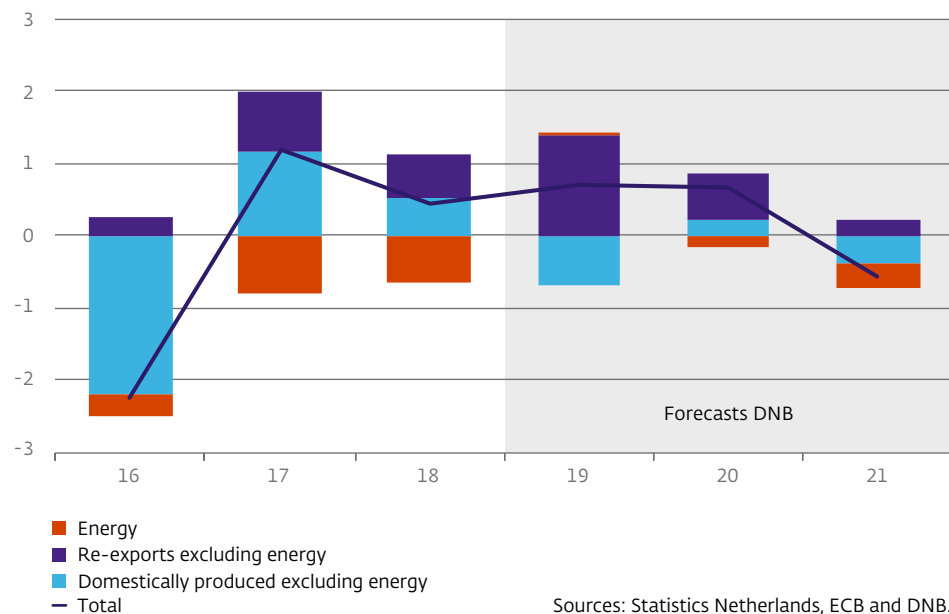
Sources: DNB and ECB.

consequence, energy exports are expected to decrease by 2.5% in 2021, whereas energy imports will go up 2.8%.

Although the Netherlands' price competitiveness will improve in 2019 and 2020, the market share of domestically produced exports (excluding energy) is expected to shrink on balance. This is related to the declining demand for Dutch goods and services outside the euro area in 2020. The strong slowdown in domestically produced exports in 2019 is largely attributable to one specific multinational

Figure 9 Market share exports of goods and services

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



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.

corporation, which relocated part of its operations abroad in the fourth quarter of 2018. While this has muted export growth in 2018 and 2019, it will not affect 2020 and 2021.

The Netherlands' current account balance fell from 11.2% of GDP in 2018 to 7.9% of GDP in 2019. The sharp reduction in the primary income balance registered in the first six months of 2019 was the main cause of the lower surplus. During this period,

foreign investors in Dutch non-financial corporations saw their dividends increase more than in the converse situation. The decline of the current account surplus was also driven by a lower visible trade surplus. The trade surplus is also expected to decrease in 2020 and 2021 as growth in goods and services imports will outpace export growth. Together with the earlier reduction in the primary income balance, the current account surplus should land at 7.1% of GDP in 2021.

2.3 Private consumption should pick up as incomes grow

Private consumption is expected to have grown by 1.4% in 2019, markedly lower than in the preceding two years. Growth will gain some momentum in the following two years, reaching 2.0% in 2020 and 2.4% in 2021. The transitory growth dip in 2019 can be explained in part by lower natural gas consumption due to mild weather conditions in Europe in the first quarter. 2018 had seen above-average natural gas consumption due to cold winter weather. Consumption growth was also moderated in 2019 due to the significant decrease in consumer confidence in 2018. This confidence effect will also make its mark in 2020, while consumption growth will also slow down because unemployment will no longer decrease and house prices will rise at a more gradual pace. The rebound in private consumption that is nevertheless expected for 2020 is related to the favourable income trend.

As wages and employment pick up, households have as a whole experienced marked increases in disposable income for some years. Between 2014 and 2018 real disposable income on average rose 1.8% annually. Figure 10 shows that compensation per employee makes increasing contributions to household income growth over the entire 2019-2021 period. In 2019, this was partly offset by relatively high inflation, causing real income growth to stall at 1.8%. In 2020, projected income growth is 3.7%, however, as inflation will be lower than in 2019 and income tax is reduced in 2020. In 2021 growth in disposable income will fall back to 1.8%, as inflation is slightly higher and the effect of tax reductions fades away.

Figure 10 Real disposable household income

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



Sources: Statistics Netherlands and DNB.

2.4 Number of employees on flexible contracts is falling

For several years, the heightening tension in the Dutch labour market has been accompanied by an increase in the number of permanent jobs. 2019 sees flexibilisation of the labour market (active working population) come to a halt, both in relative and in absolute terms. From the first quarter of 2019 onwards the number of employees on flexible employment contracts has receded. In the third quarter, the number of flexible jobs fell sharply as the number of employees on flexible contracts declined by 60,000 compared to a year earlier (Figure 11). By contrast, the number of employees on permanent contracts went up sharply in the same quarter, by 213,000.

Given the persistently low unemployment rate and ongoing tightness in the labour market, this trend is likely to continue in the short term. Not only does this give employees enhanced income security, it can also contribute to higher wage growth. On average, employees on permanent contracts have higher hourly wages. At a macro level, the shift towards more permanent jobs makes a positive contribution to wage drift through what is known as the composition effect. Box 2 discusses wage differentials between employees on permanent and flexible contracts.

The slowdown in growth of flexible employment contracts is broad-based. In the first three quarters of 2019, the number of temporary contracts, both with and without prospect of a permanent contract, remained more or less flat compared with the first three quarters of 2018. The decline in flexible contracts was primarily attributable to temporary work agencies. Their staff fell by 17,000 in the second quarter of 2019 compared with a year earlier, and by no less than 41,000 in the third quarter. A decline in contracts in temporary work agencies is sometimes considered an indicator of an impending recession. However, given the tight labour market and strong growth in job numbers so far, it is equally likely that many staff of temporary work agencies have meanwhile moved on to other jobs on temporary or permanent contracts.

Growth in the number of self-employed persons continues steadily. While the economic boom has offered "involuntary" self-employed persons greater opportunities to find a job in paid employment, it has also offered others the chance to start out in self-employment on a voluntary basis. Between 2008 and 2018, the number of working persons whose main activity was in self-employment increased by 264,000 to almost 1.1 million. This comprises approximately 12% of all working persons. Added to this are several hundreds of thousands of self-employed persons who also have a job as an employee. In 2018, most self-employed persons worked in the business services sector (25%), healthcare (11%), construction (10%) and trade (10%). Self-employment grew particularly sharply in business services (+103,000), healthcare (+29,000) and education (+28,000).

Figure 11 Growth in active working population by type of employment relationship

Thousands of persons; year-on-year changes



2.5 Corporate profits increase, but investment growth is subdued

In the first six months of 2019, corporate profits increased sharply. Net pre-tax profits of non-financial corporations were up 12% year-on-year, against 3.5% in the first half of 2018. Growing profits on average reduce firms' need for external financing and prompt them to repay debts on balance and buy back shares. The first two quarters of 2019 have seen external finance contract less strongly, while net bond issuance turned slightly positive again (Figure 12).

The net flow of bank loans to firms has declined since 2013. In 2018, lending shrunk by only 0.9%, while a 1.2% contraction is projected for 2019. Lending could show some growth again in 2021. According to the ECB's Bank Lending Survey for the euro area, the majority of banks say they have eased their credit standards since the third quarter of 2018. In the fourth quarter of 2019, however, banks said they planned to tighten credit standards for loans to small and medium-sized enterprises (SMEs) for the first time in three years. The ECB's SAFE survey shows that SMEs found it harder to obtain access to bank lending in 2019. Growth in lending to SMEs slowed from 3.2% in the first quarter of 2018 to -0.5% in the second quarter of 2019.

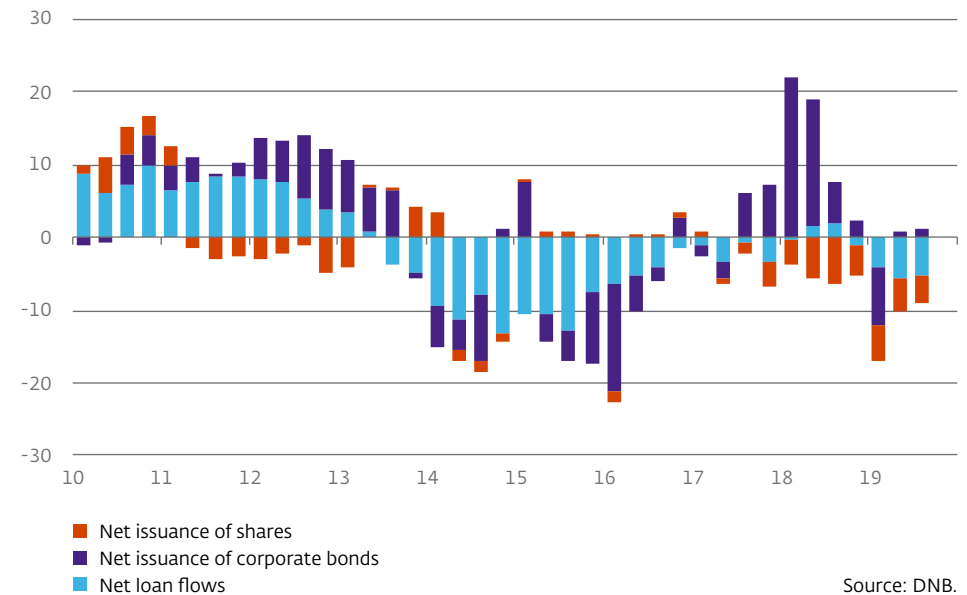
Business investment (excluding residential investment) was up 3.0% in 2018. Growth was markedly higher in the first three quarters of 2019, with the third quarter registering year-on-year growth of 8.1%. Based on total investment (including public-sector investment), investment in means of transport, including aircraft, showed relatively strong growth. The projections show that business investment should grow 5.9% in full 2019, before slowing further to 2.6% in 2020 and 1.9% in 2021.



Survey data on planned business investment support the expectation of decelerating investment growth. In late 2019, on balance only 5% of the surveyed firms said their investment would increase in the year ahead, against 8.5% a years earlier. Underlying factors include more subdued economic growth and a slower widening of corporate profit margins owing to rising labour costs. Planned investment fell back even further among construction firms. In late 2019, a mere 6% expected their investment to go up in the next year, against 18.9% in late 2018. Particularly in this industry, uncertainty about future revenues has increased due to the nitrogen ruling, which has caused construction projects to be halted or deferred. In the projections, this depresses business investment even further through lower investment in buildings.

Figure 12 External financing for non-financial corporations

In EUR billion; four-quarter sums



Source: DNB.



2.6 Budget surplus to turn into deficit, while debt-to-GDP ratio continues to decline

The EMU balance is expected to land at 1.5% of GDP in 2019, before falling to 0.5% in 2020 and turning into an 0.2% deficit in 2021 (Table 3). Over the same projection horizon, the structural balance should show a cumulative decline of 1.6 percentage points. This shows that budgetary developments are highly policy-driven and hardly depend on cyclical changes.

Public expenditure as a percentage of GDP is expected to rise over the 2019-2021 period. Among the factors pushing up public expenditure are increasing healthcare spending, the higher cost of state pension benefits due to demographics and the pension agreement, and additional outlays, including on defence and under the climate agreement. Taxes and social security contributions will still rise in 2019 on the back of favourable economic conditions and the hike in the low VAT rate. They should fall on balance in 2020 and 2021, however, thanks to policy measures that include reductions in direct taxes that affect households, and corporate taxes. Among the causes of the fall in other income shown over the projection horizon are reduced natural gas revenues due to the accelerated reduction of gas production in the province of Groningen.

Public debt as a percentage of GDP is expected to continue its decline, reaching 45.6% of GDP, primarily driven by budget surpluses in 2019 and 2020 and the nominal GDP growth.

Table 3 Public sector key data

Percentage of GDP

	2018	2019	2020	2021
Public expenditures	42.0	42.4	42.8	43.3
Taxes and social security contributions	38.7	39.4	38.9	38.8
Other income	4.8	4.6	4.4	4.3
Primary balance	2.4	2.3	1.2	0.5
EMU balance	1.5	1.5	0.5	-0.2
Structural balance (EC method)	1.0	0.8	-0.1	-0.6
EMU debt	52.4	49.0	46.8	45.6

Source: DNB.

Box 2 Wage differentials between employees on permanent and on flexible contracts

The number of employees on flexible employment contracts – employees on temporary contracts as well as temping agency and on-call workers – has substantially increased over the past few years. The proportion of employees on such flexible contracts was roughly 16% back in 2003 but had risen to 27% by 2018. Beside heightened job and income insecurity, flexible employment also involves lower wages on average. A micro data file from Statistics Netherlands containing salary data for jobs at Dutch employers between 2006 and 2018 shows that gross hourly wages of employees on flexible contracts were on average 34.7% below those of employees on permanent contracts. Moreover, the wage differential widened from 32.7% in 2006 to 37.2% in 2018.

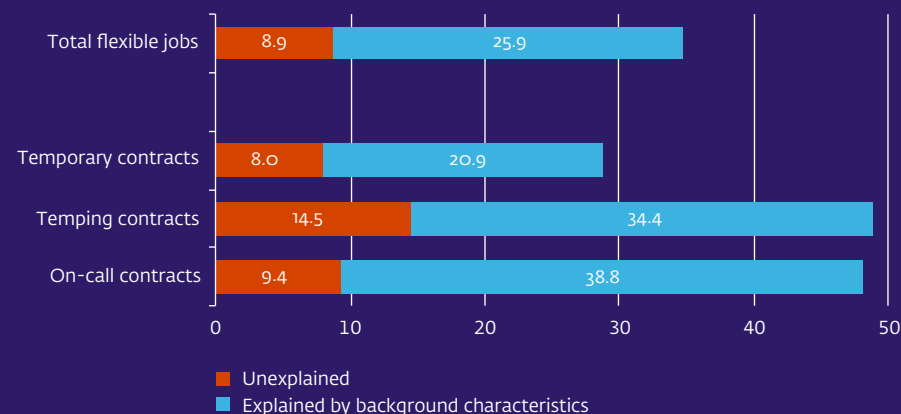
Background characteristics explain a large part – roughly three quarters – of the differential (Figure 13). On average, employees on flexible contracts are relatively young with lower levels of education on average, and are more often employed at lower professional levels. After adjusting for personal and job characteristics, however, wages of all employees on flexible contracts combined were still 8.9% below those of employees on permanent contracts.⁵ Wages of temping agency workers were 14.5% lower. The adjusted wage differentials remained roughly unchanged between 2006 and 2018. The widening referred to above was primarily caused by shifts in background characteristics. Accordingly, the favourable developments in the labour market and declining unemployment did not narrow the wage differential of employees on flexible contracts.

At first sight, the observed wage differential would appear to be counter-intuitive from an economic perspective. After all, according to the theory of perfect competition, uncertainty and flexibility have their price. By implication, employees

on flexible contracts would be compensated in the form of higher wages. Potentially, selection effects and unobserved productivity differences explain the lower wages of employees on flexible contracts on average, as employees on permanent contracts have demonstrated their productivity and therefore deserve higher wages. The analysis has not been adjusted for such unobservable characteristics. An alternative hypothesis posits that employees on flexible employment contracts are in a more unfavourable negotiating position. They moderate their wage demands to prevent their contracts from being terminated.

Figure 13 Wage differential compared with permanent employment contract

Percentages



Sources: Microdata from Statistics Netherlands and DNB.

⁵ The analysis adjusts not only for employment type but also for age, gender, migration background, type of household, education level and orientation, job level and orientation, management position, employment duration, part-time work and urbanisation of the residential environment. The directions of the coefficients for these regressors are as expected and in line with other literature.

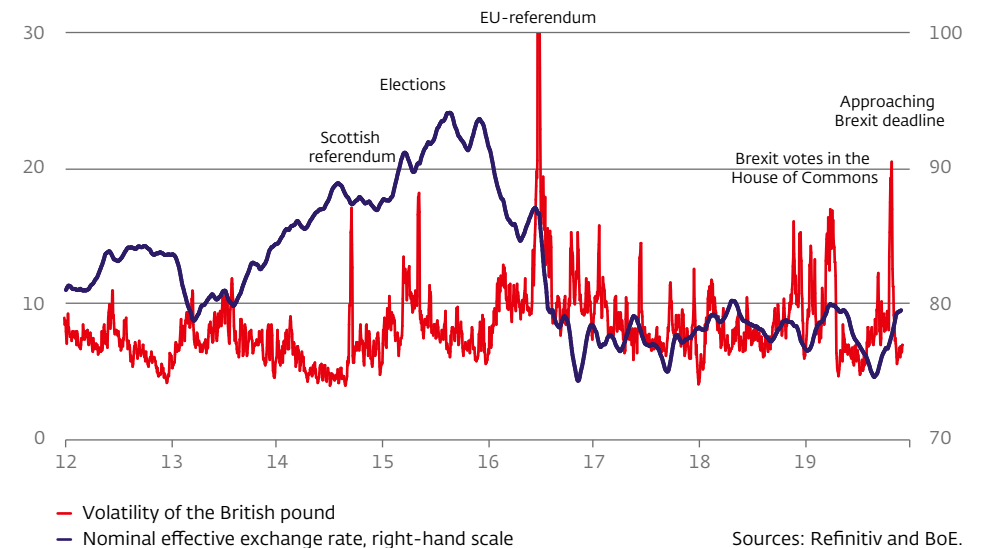
3 Economic impact of Brexit – two scenarios

In a referendum held on 23 June 2016, citizens of the United Kingdom (UK) voted to withdraw from the EU. Although it is still unknown whether Brexit will materialise and in what manner or form, its economic impact will hinge on the substance of the agreements governing trade relations between the UK and the EU. The assumption that underlies the projections is that the UK leaves the EU on 31 January 2020, followed by a transitional period until 31 December 2020. An agreement will then enter into force that imposes relatively few restrictions on trade in goods and services.⁶ This section analyses the impact on the Dutch economy in 2020 and 2021 of two highly divergent Brexit scenarios to provide a picture of the bandwidth around the baseline projections.⁷ The most favourable scenario for the Netherlands economically speaking is that in which the UK continues to be a full member of the EU. This "remain scenario" features the continued free movement of goods, services, capital and persons. At the other side of the spectrum is the unfavourable "no-deal scenario", in which no withdrawal agreement is reached with effect from 31 January 2020 and trade between the UK and the EU immediately reverts to the minimum trade terms of the World Trade Organisation (WTO). This scenario causes mounting financial insecurity and declining confidence in the short term.⁸

The EU is the UK's biggest trading partner, accounting for 47% of its exports and 52% of its imports in 2018. The UK is the Netherlands' third largest trading partner, after Germany and Belgium. Viewed from the Dutch perspective, 6% of imports originate from and more than 8% of exports are destined for the UK. The persistence of uncertainties surrounding Brexit, rising risk premiums and volatility of the pound sterling may prompt Dutch exporters to defer investment

Figure 14 British pound exchange rate

Percentages and January 2005 = 100, daily figures



Note: Implied volatility of the British pound relative to the US dollar (1 week).
Nominal effective exchange rate based on trade weights, 21-day average.

decisions and harm trade with the UK. Figure 14 shows that the exchange rate has fallen appreciably since the elections in May 2015, with volatility peaking sharply surrounding specific political developments relating to Brexit.

⁶ The Brexit agreement as assumed in the projections that should enter into effect in 2021 is based on the recent Comprehensive Economic and Trade Agreement (CETA) between Canada and the EU. It remains to be seen whether the UK and the EU can conclude such a comprehensive trade agreement about goods and services before the end of 2020.

⁷ Due to the complexity of the scenarios, the results should be considered as an illustration of the impact that will occur. No statement is made as to the likelihood of either scenario. Economically, they represent the upper and lower boundaries, and the impact of any other Brexit variants will most likely be within these boundaries.

⁸ It cannot be excluded either that the planned negotiations from 31 January 2020 onwards fail during the transition period without a trade agreement being reached. The economic impact will be similar to that of the no-deal scenario, but it will materialise at a later point in time.

Recent empirical studies show that trade between the UK and the EU in 2020 and 2021 would on average be more than 20% lower than projected due to import tariffs and higher non-tariff barriers (Table 4).⁹ In addition, rising trade costs would make the UK less attractive as a final destination for investment abroad, causing the volume of foreign direct investment (FDI) in the UK to be roughly 25% a year lower. Based on recent demographic projections, the assumption is for net migration to decline by around 100,000 persons a year, given that a no-deal Brexit will hamper the free movement of persons between the UK and the EU. Continuing uncertainty about future trade relationships will drive up risk premiums by 35 basis points on average in 2020 and 2021. Additionally, producer and consumer confidence will drop by 10% in 2020 and 2021.¹⁰ The assumption is that labour productivity will fall by 1.6% in the longer term, i.e. after 2021, due to reduced trade, declining investment and lower labour migration.

UK exports will drop substantially as its products will be more expensive in the European market in the no-deal scenario. Higher import prices will send UK inflation higher and erode purchasing power. Lower consumer spending, reduced business investment and higher unemployment will depress UK real GDP by 2.0% and 2.8% in 2021 compared to the projections.¹¹ Lower UK spending and the sharply depreciated pound sterling will have a downward impact on the EU.

The strong decline in UK imports and indirect negative trade effects on other countries cause the volume of world trade relevant to the Netherlands to be substantially below that in the projections. In the no-deal scenario, this will send export volumes of Dutch goods and services sharply lower (Table 5). Sluggish demand and falling confidence will also depress business investment.

⁹ See for example NIESR (2018, 2019), Bank of England (2018, 2019) and OECD (2019) for recent Brexit analyses.

¹⁰ Any budgetary effects of Brexit, including those relating to the termination of annual EU contributions and the one-off settlement of future commitments to the EU known as the divorce bill will not have an impact until late 2021.

¹¹ It is assumed that monetary policies in the UK and the EU have accommodative effects and that economic agents have rational expectations ("forward-looking"). Further, unchanged budgetary policies in the UK are assumed. The scenario was simulated using the global NiGEM model and DNB's macroeconomic DELFI model.

Table 4 Brexit assumptions: 'no deal' and 'remain'

Percentage deviations from baseline scenario, unless stated otherwise

	No deal		Remain	
	2020	2021	2020	2021
For UK:				
Trade with EU	-15	-28	0	0
FDI	-24	-24	0	0
Net migration (persons x 1,000)	-100	-200	0	0
Market uncertainty (premium in basis points)	50	20	-25	-50
Confidence (%)	-10	-10	10	10
Impact on UK:				
Gross domestic product	-2.0	-2.8	0.6	1.6
Private consumption price index	2.5	3.6	-0.3	-1.2
Real disposable household income	-3.8	-5.7	0.5	1.3
Unemployment (% of labour force)	0.6	2.1	-0.3	-0.1
British pound exchange rate (US dollar, level)	-15.3	-18.2	2.2	2.8
Impact on EU:				
Gross domestic product	-0.3	-0.4	0.1	0.1
For the Netherlands:				
Relevant world trade	-2.4	-3.5	0.2	0.4
Euro exchange rate (USD, level)	-3.5	-4.1	0.3	0.3
Competitor prices	-0.6	-1.1	0.2	0.3
Oil prices	-1.5	-1.6	0.2	0.2
Equity prices	-2.3	-2.3	0.1	0.1
Confidence (%)	-10	-10	10	10

Source: DNB.

Notes: Impulses are based on NIESR (2018, 2019), effective 2020Q1 for 'no deal' and 2020Q3 for 'remain'. UK outcomes and Netherlands assumptions are based on NiGEM (version: 4.19). Confidence concerns producer and consumer confidence. GDP, components of expenditure and world trade are in real terms.



Economic growth in the Netherlands will drop significantly in 2020 and 2021, to 0.6% per year. Unemployment will be 0.5 percentage points higher than projected in 2021. Lower real disposable incomes, negative wealth effects and higher unemployment will depress consumer spending, notably in 2021. Although import prices will go up, their effect on inflation will be limited due to loss of demand and lower wages. In line with lower economic growth and higher unemployment, public finances are set to deteriorate, resulting in a budget balance of -0.7% of GDP in 2021, which is 0.5 percentage points lower than in the projections.

In the remain scenario it is assumed that market uncertainty reduced swiftly from 2020 onwards, depressing risk premiums and boosting producer and consumer confidence (Table 4). A steeper recovery in the UK's labour productivity is also assumed. This scenario paints a much more favourable economic picture, although it differs less markedly from the projections in the short term than the no-deal scenario. This is due to the fact that the trade agreement assumed in the projections is not very much more restrictive than that in the remain scenario. In due course, the benefits of the remain scenario will become more prominent as the favourable productivity effects fully feed through into the economy. Increased confidence and lower risk premiums will provide an impetus to UK investment and cause real wages to increase more strongly than in the projections. On average, real GDP growth in the UK will be around 1 percentage point higher. The beneficial impact on the EU and the Netherlands will be limited. Economic growth in the Netherlands will end up 0.2 percentage points higher than projected, primarily driven by higher business investment (Table 5).



Table 5 Results of the Brexit scenarios

Percentage changes, unless stated otherwise

	No deal				Remain			
	2020	Deviation from projection	2021	Deviation from projection	2020	Deviation from projection	2021	Deviation from projection
Gross domestic product	0.7	(-0.7)	0.5	(-0.6)	1.6	(0.2)	1.3	(0.2)
Private consumption	1.9	(-0.1)	1.9	(-0.5)	2.0	(0.0)	2.5	(0.1)
Business investment	1.4	(-1.2)	-0.5	(-2.4)	3.6	(1.0)	3.0	(1.1)
Exports of goods and services	0.2	(-2.1)	0.8	(-1.1)	2.5	(0.2)	2.1	(0.2)
Imports of goods and services	1.7	(-1.7)	1.7	(-1.3)	3.7	(0.3)	3.3	(0.3)
Consumer confidence (level)	-5.5	(-3.9)	-9.5	(-8.1)	1.2	(2.8)	2.7	(4.1)
Negotiated wages, private sector	2.6	(0.0)	2.5	(-0.3)	2.6	(0.0)	2.9	(0.1)
Harmonised consumer price index	1.5	(0.0)	1.7	(-0.1)	1.5	(0.0)	1.8	(0.0)
House prices, existing own homes	2.6	(0.0)	1.5	(-0.4)	2.6	(0.0)	2.0	(0.1)
Unemployment (% of labour force)	3.7	(0.1)	4.1	(0.5)	3.6	(0.0)	3.5	(-0.1)
EMU balance (% of GDP)	0.3	(-0.2)	-0.7	(-0.5)	0.6	(0.1)	-0.1	(0.1)

Source: DNB.

Key data in forecast for the Dutch economy

Percentage changes, unless stated otherwise

	2018*	2019	2020	2021		2018*	2019	2020	2021
Volume of expenditure and output					Public sector and financial				
Gross domestic product	2.5	1.7	1.4	1.1	EMU balance (% of GDP)	1.5	1.5	0.5	-0.2
Private consumption	2.3	1.4	2.0	2.4	EMU debt (% of GDP)	52.4	49.0	46.8	45.6
Public expenditure	1.2	1.9	2.7	1.6	Current account (% of GDP)	11.2	7.9	7.3	7.1
Business investment	3.0	5.9	2.6	1.9	Mortgage loans (based on end-of-period)	2.1	2.2	3.8	3.8
Housing investment	7.0	2.9	1.5	0.5	Bank lending to NFCs (based on end-of-period)**	-0.9	-1.2	-0.6	0.4
Exports of goods and services	3.7	2.4	2.3	1.9					
domestically produced	3.8	0.4	1.6	1.1					
re-exports	3.4	5.6	3.3	3.0					
Imports of goods and services	3.2	3.2	3.4	3.0					
domestically used	3.2	1.9	3.5	2.9					
Wages and prices					International assumptions				
Negotiated wages, private sector	2.0	2.4	2.6	2.8	Volume of relevant world trade	3.2	1.7	1.6	2.4
Compensation per employee, private sector	1.6	2.8	3.2	3.7	Volume of GDP US	2.9	2.3	2.0	1.8
Unit labour costs	1.8	2.9	2.4	2.6	euro area	1.9	1.2	1.1	1.4
Prices of domestically produced exports	2.4	0.5	0.9	1.7	emerging markets	4.4	3.4	3.8	4.1
Harmonised consumer price index	1.6	2.7	1.5	1.8	Short-term interest rate in the euro area (%)	-0.3	-0.4	-0.4	-0.4
House prices, existing own homes	9.0	6.6	2.6	1.9	Long-term interest rate in the Netherlands (%)	0.6	-0.1	-0.1	0.0
Labour market					Euro exchange rate (USD)	1.18	1.12	1.10	1.10
Employment (persons, growth)	2.5	1.7	0.6	0.2	Competitor prices	0.9	1.9	1.9	1.9
Labour supply (persons, growth)	1.5	1.3	0.8	0.3	Oil price (UK Brent in USD per barrel)	71.7	64.0	59.6	57.4
Unemployment (persons x 1,000)	350	319	346	351	Commodity prices excluding energy (USD)	4.1	-3.8	3.8	2.6
Unemployment (% of labour force)	3.8	3.4	3.6	3.6					

* 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.

Bron: DNB en ECB.



Figures

Data