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Contents

Summary 4

1 The Dutch economy in 2016-18 5

Box 1 Output gap closes only slowly in spite of lower potential growth 9

2 A closer look at spending and public finances 17

Box 2 Potential economic consequences of a Brexit 19

3 An alternative scenario for the Dutch economy 26

Summary

The Dutch economy is recovering at a solid pace, with domestic spending being the main driver of growth. Gross domestic product (GDP) is projected to grow by 1.5% in 2016, accelerating to 1.9% in 2017 and 2.0% in 2018. With projected growth outpacing potential growth, the output gap will gradually narrow. Unemployment should decline from 6.9% in 2015 to 5.7% in 2018. Inflation is set to reach 0.2% in 2016, creeping up to 1.2% in 2017 and 1.7% in 2018.

Set against the robust upswing witnessed in 2015 (2.0%), growth projected for 2016 could look somewhat disappointing at first sight. Underlying causes include slightly less buoyant growth in world trade compared with last year and the slowdown in energy exports and consumption seen mainly in late 2015, which will depress this year's growth. The latter were caused by the cap on natural gas production and the relatively mild winter. Moreover, investment growth saw a non-recurring peak in 2015 that was driven by amendments in tax legislation related to housing investment and corporate investment. Growth in private consumption will accelerate considerably over the projection period, chiefly precipitated by the tax cuts which are expected to fuel additional growth in spending in 2016 and notably in 2017. In addition, households will benefit from the upswing seen in the housing market and low mortgage interest rates.

The broad-based economic growth will work out well for the government's budgetary position. The public sector deficit is set to narrow gradually from 1.8% of GDP in 2016 to 0.7% of GDP in 2018. The structural deficit will go up from 0.8% of GDP in 2015 to 1.4% of GDP in 2016, before slowly diminishing in 2017 and 2018. Public debt will recede from 65.1% of GDP in 2015 to 60.8% of GDP in 2018.

An alternative scenario analyses the consequences of a more robust recovery in the housing market. Higher housing investment and concomitant steeper consumer spending and corporate investment will push up economic growth by 0.3 percentage points in 2017 and 0.2 percentage points in 2018 relative to projections.

1 The Dutch economy in 2016-18

Solid growth rate

The Dutch economy is recovering at a solid pace, with domestic spending being the main driver of growth. This already became apparent in 2015, when GDP growth was 2.0%. Economic growth will temporarily drop slightly to 1.5% in 2016, only to pick up again and reach 1.9% in 2017 and 2.0% in 2018 (see Chart 1).

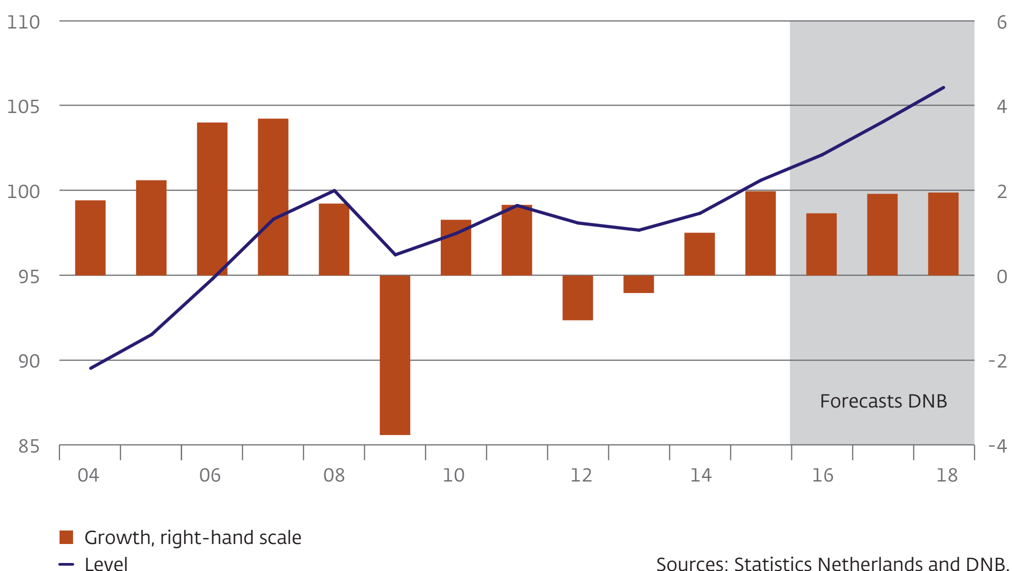
The recovery seen since the second quarter of 2014 means the Dutch economy is shrugging off the double-dip recession it went through between 2008 and 2013. Adjusted for price increases, GDP for the first quarter of 2016 was 1% above the 2008 pre-crisis peak, and quarterly GDP is set to climb to 6.4% above that peak by the end of the projection horizon. With projected GDP growth outpacing potential growth, the output gap will gradually narrow. The persistent catch-up growth is also reflected in the unemployment rate, which is projected to decline from 6.9% of the working population in 2015 to 5.7% in 2018.

Cap on natural gas production and mild winter dampened GDP growth in 2015 and 2016

In 2015 and 2016, the cap on the production of natural gas left an evident mark on the Dutch economy. As lower gas volumes were extracted for exports and domestic consumption, mining and quarrying made a smaller contribution to GDP growth. This depressed GDP growth by around

Chart 1 Gross domestic product

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



Sources: Statistics Netherlands and DNB.

0.4 percentage points in 2015. The slowdown in energy exports in the second half of that year will also depress export growth in 2016. Furthermore, the mild winter of 2015 weighed down on energy exports and consumption. As households spent less on energy, private consumption growth almost came to a standstill in the third and fourth quarters of 2015 on a quarter-on-quarter basis. To some extent, these effects had already been factored into the Economic Developments and Outlook we issued in December 2015. Growth projected for 2016 is also slightly lower due to the assumed growth in relevant world trade, which is 0.3 percentage points below our previous forecast.

GDP growth to slow down somewhat in 2016

Table 1 lists the key economic data for 2015-18.[1] Following the robust recovery witnessed in 2015, GDP will by and large continue to grow at a solid pace in subsequent projection years, notably in 2017 and 2018, fuelled in part by world trade growth gaining steam. Growth projected for 2016 could look somewhat disappointing at first sight. This is caused firstly by the expected growth in world trade, which is slightly lower than last year, contrary to the development expected in the December 2015 forecast. Furthermore, a slowdown in energy exports and consumption seen mainly in late 2015 will depress this year's growth. Also, investment growth showed a non-recurring peak in 2015, with housing investment growing at an exceptional rate of nearly 27%, driven in part by the strong rebound in the number of housing transactions. Part of the stark growth in housing investment was of a transitory nature, however, as investment was brought forward due to a VAT increase; VAT on labour costs for home renovations and repairs was raised from 6% to 21% on 1 July 2015. Likewise, corporate investment showed a once-only spike in 2015 as investment in company cars shot up in the fourth quarter of 2015 for tax reasons at the expense of growth in the first quarter of 2016. Overall, the growth differential between 2015 and 2016 is largely due to exceptional circumstances, such as the natural gas production cap, the mild winter and tax rules with respect to investment.

Domestic spending is the main driver of the recovery in 2016-18

The recovery in private consumption is set to accelerate substantially over the projection horizon, fuelled by tax cuts introduced at the beginning of 2016, which are expected to fuel additional spending growth in 2016 and notably in 2017. Additionally, households benefit from the sustained upswing in the housing market and the persistent decline in mortgage interest rates.

Chart 2 shows that the domestic contributions to growth increased sharply in 2015 and will be the largest among the contributions in 2016-18. Contributions from exports are projected to decline

1 The assumed trends in relevant world trade, exchange rates, international commodity prices and interest rates were formulated by the ECB in consultation with experts of the national central banks. The assumptions are based on information available on 17 May 2016.

Table 1 Key data in forecast for the Dutch economy

Percentage changes, unless stated otherwise

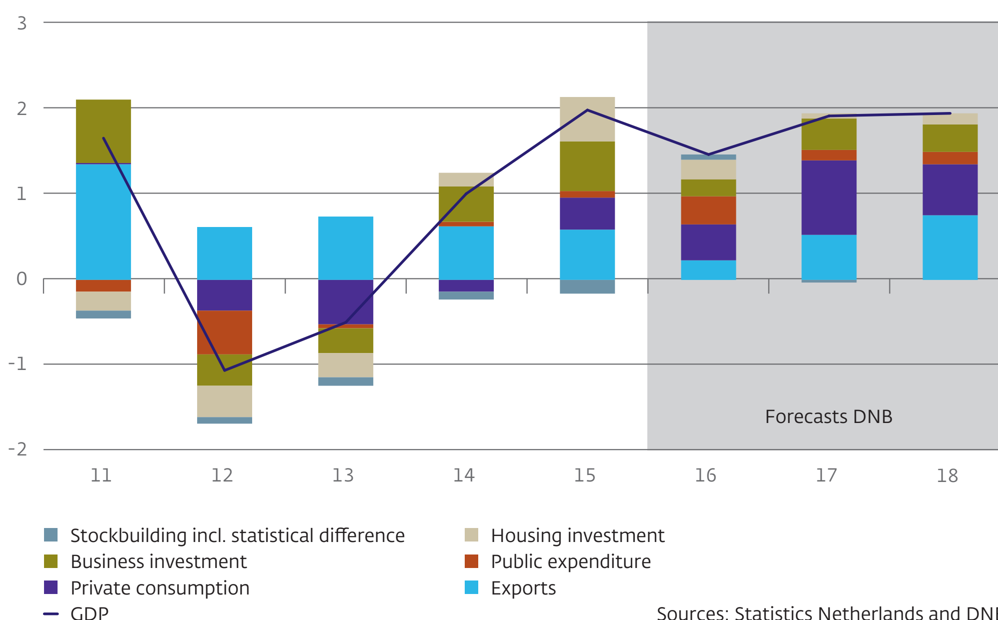
	2015*	2016	2017	2018
Volume of expenditure and output				
Gross domestic product	2.0	1.5	1.9	2.0
Private consumption	1.5	1.7	2.9	2.0
Public expenditure	0.5	1.4	0.6	0.7
Business investment	7.9	3.0	5.0	4.3
Housing investment	26.9	10.4	2.7	5.4
Exports of goods and services	5.3	4.8	3.7	4.6
of which domestically produced	6.3	3.2	1.8	3.5
of which re-exports	4.1	6.7	5.8	5.8
Imports of goods and services	6.4	6.4	4.5	5.1
of which domestically used	8.5	6.2	3.4	4.5
Wages and prices				
Negotiated wages, private sector	1.3	1.8	1.9	2.0
Compensation per employee, private sector	0.8	1.9	2.4	2.3
Unit labour costs	-0.7	1.4	1.2	1.4
Prices of domestically produced exports	-2.7	-2.0	1.5	0.9
Harmonised consumer price index	0.2	0.2	1.2	1.7
House prices, existing own homes	2.8	4.2	4.7	4.5
Labour market				
Employment (persons, growth)	0.9	0.9	0.9	1.2
Labour supply (persons, growth)	0.4	0.3	0.7	0.7
Unemployment (persons x 1,000)	614	561	554	509
Unemployment (% of labour force)	6.9	6.3	6.2	5.7
Public sector and financial				
EMU balance (% of GDP)	-1.8	-1.8	-1.3	-0.7
EMU debt (% of GDP)	65.1	64.8	63.0	60.8
Current account (% of GDP)	9.2	8.9	8.9	8.9
Mortgage loans (based on end-of-period)	0.8	4.0	4.2	4.6
Bank lending to NFC (based on end-of-period)**	-10.3	0.5	1.0	3.6
International assumptions				
Volume of relevant world trade	3.8	3.6	4.3	4.5
Volume of GDP US	2.4	1.9	2.5	2.3
euro area	1.6	1.6	1.7	1.7
emerging markets	3.6	3.8	4.4	4.6
Short-term interest rate in the euro area (%)	0.0	-0.3	-0.3	-0.3
Long-term interest rate in the Netherlands (%)	0.7	0.4	0.5	0.7
Euro exchange rate (USD)	1.11	1.13	1.14	1.14
Competitor prices	2.2	-2.7	2.1	2.0
Oil price (UK Brent in USD per barrel)	53.0	43.5	49.1	51.3
Commodity prices excluding energy (USD)	-19.9	-3.3	4.3	4.6

* Annual figures have been calculated based on seasonally adjusted quarterly figures and may therefore deviate marginally from the most recent National Accounts.
** New series, including *cash pooling*, adjusted for securitisations and breaks. See footnote 3.

Sources: DNB and ECB.

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.

until the end of 2016, due in part to falling energy exports, only to pick up again on the back of an upswing in world trade. The contribution from private consumption to growth as forecast for 2017 is the highest since 2000, while that from housing investment will return to more customary levels following the exceptionally large contribution seen in 2015.

Production capacity still not fully utilised

The potential growth pace of the Dutch economy, i.e. GDP growth adjusted for business cycle effects, will be approximately 1.3% annually during the 2016-18 projection horizon. As actual growth undershot potential growth during the period following the financial crisis, the output gap widened to -3.1% in 2014, but it narrowed again in 2015, for the first time since 2011. In the projection years, projected GDP growth will also outstrip potential growth, causing the output gap to narrow gradually, from -2.4% in 2016 to -0,8% in 2018. This means the economy will still not achieve its potential by the end of the projection horizon, as the production capacity will still not be fully utilised. Even so, the creeping tightness in product markets will in 2018 have an upward effect on inflation of around 0.2 percentage points. Box 1 shows potential growth and output gaps over a longer period.

Box 1 Output gap closes only slowly in spite of lower potential growth

Potential growth comprises the increase in potential employment and that of structural labour productivity. Table 2 shows potential growth for 1998-2021 as calculated with DELFI, DNB's macroeconomic model. Moderate potential growth is expected over the next few years, rising from an average 1.2% per annum in 2014-17 to 1.4% per annum on average in 2018-21, which is significantly below growth rates observed in 1998-2005. This is caused first of all by a smaller contribution to growth from potential employment, as the working population and the labour participation rate will only increase to a limited extent. In addition, structural labour productivity is expected to develop less favourably. Growth in structural labour productivity already decelerated noticeably before the financial crisis, due to causes as yet unknown. Some believe the impact of IT on productivity growth has worn off. The slowdown could, however, be temporary, caused for example by reallocation of labour between economic sectors (e.g. shifting from manufacturing to services), resulting in a temporary increase in mismatches between demand for and supply of specific types of labour. In due course, retraining and continuing education may well get productivity growth back on track. Growth in structural labour productivity is not expected to return to pre-crisis levels over the projection horizon.

The output gap is the percentage discrepancy between actual and potential output, and serves as a measure of the cyclical position of a country's economy. Normally speaking, recessionary and expansionary periods alternate in quick succession. DELFI shows that the average duration of periods with a negative output gap is slightly below four years, whereas periods with a positive output gap last just over four years. Since 2012, the output gap has been negative, and it stood at -2.8% in 2015. The forecast potential growth shown in the table implies that, if actual growth is just over 2.0% in 2019, the output gap will be virtually closed by then. The exceptionally prolonged recessionary period suggests that potential output for the years ahead may well be overestimated. A recent study shows that it is not so much a sharp recovery in actual output, but rather lower potential output that causes the output gap to close following a deep recession such as the financial crisis.[2]

Table 2 Potential growth, 1998-2021

Percentage changes

	1998-2005	2006-2013	2014-2017	2018-2021
Potential growth (added value, basic prices)	2.6	1.4	1.2	1.4
growth in potential employment (man years)	0.9	0.5	0.9	0.2
structural growth in labour supply (persons)	1.1	0.7	0.8	0.4
contribution of change in equilibrium unemployment	0.0	-0.2	0.2	-0.1
contribution of growth in part-time work	-0.2	-0.1	-0.1	-0.1
growth in structural labour productivity	1.7	0.9	0.3	1.2

Source: DNB.

2 Martin, R., Munyan, T., and B.A. Wilson, 2015, Potential output and recessions: are we fooling ourselves?, International Finance Discussion Papers no. 1145.

Corporate sector profits are up and bank lending is shrinking

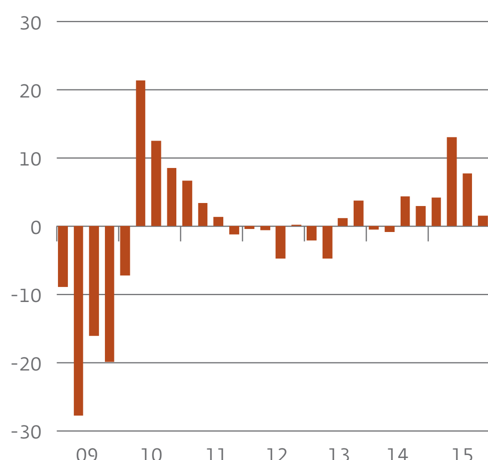
Corporate sector profits have increased since mid-2014, in line with the economic upswing (see Chart 3), showing sharp growth in 2015 in particular. The net operating surplus of the corporate sector went up by 6% from the year before, which is the highest growth rate seen since 2011. This is closely related to unit labour costs, which declined by 0.7% in 2015, largely due to lower pension costs on the back of the tightened rules on tax relief for pension contributions (the "Witteveen framework"). Our projections do not assume ongoing profit recovery at the same rate, as 2016 will see wage costs outpace selling prices. This situation will turn around in 2017 as price increases and productivity growth pick up steam.

Part of the corporate sector uses increased profits as a source of funding, for example to fund investments. In addition, the corporate sector on balance repaid outstanding bank credit. Bank lending to businesses shrank by 5.8% in 2014 and by another 4.2% under the definition used to date in 2015.[3] The decline is somewhat larger still for lending to SMEs. Our projections show that growth in lending will gradually pick up speed, from 0.5% in 2016 (year-end 2016 relative

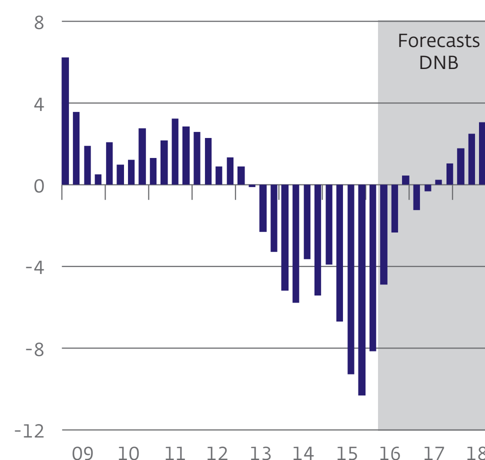
Chart 3 Profit and bank lending (non-financial corporations)

Year-on-year percentage changes

Net operating surplus



Bank lending



Note to right hand chart: New series, including *cash pooling*, adjusted for securitisations and breaks. See footnote 3.

Sources: Statistics Netherlands and DNB.

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3 The ECB recently adopted a broader definition when recording credit figures. This accounting change means that adjustments are no longer made for cash pooling. According to this newer definition, lending was down by 10.3% in 2015, as reported here in Table 1 and Chart 3. More background details can be found in http://www.dnb.nl/en/news/news-and-archive/statistisch-nieuws-2015/dnb332980.jsp.

to year-end 2015) to 3.6% in 2018. This pick-up in lending is supported by the Bank Lending Survey (BLS). The majority of banks have reported a rise in corporate sector credit demand since the second quarter of 2015. That said, projected credit growth is still well below the levels recorded until 2009. Banks will be able to meet credit demand from businesses and households, but if they unexpectedly make less headway in strengthening their capital positions than projected, this may hamper corporate lending. It cannot be excluded this will hit smaller businesses more severely, as their bigger counterparts have better access to other sources of funding besides bank lending.

International developments are surrounded by downward risks

Global growth lagged at the end of 2015 and the beginning of 2016 due to weaker domestic demand, notably in the United States and Japan, and strong volatility erupted in financial markets around the world. With the latter now eased, available indicators suggest the dip in global growth was transitory.

During the projection horizon, growth in the mature economies is set to remain robust on the back of sustained low oil prices, easy monetary conditions and favourable developments in the labour market. In addition, growth in the United States will pick up, rebounding from the negative impact of the stronger dollar and the lower investment caused by the low oil prices. The ECB projects growth in the euro area to accelerate slightly, from 1.6% in 2015 and 2016 to 1.7% in 2017 and 2018. The emerging economies are slowly recovering from the string of shocks that hit them over the past years. Among them are the sharp decline in oil prices and the tightened monetary conditions, due in part to policy normalisation in the United States. China is expected to continue its transition onto a slower but more sustainable growth path.

World trade relevant to the Netherlands expanded by 3.8% in 2015 and is expected to go up 3.6% in 2016. It may bounce back to 4.3% in 2017 and 4.5% in 2018, which is still somewhat below the long-term average. This scenario assumes the UK's unchanged European Union membership, although it is likely that the risks of a negative outcome of the UK referendum to world trade have already affected recent exchange rates and equity prices to some extent (see also Box 2 in Section 2). The other risks surrounding the assumptions for world trade are mainly downside risks, with the projected recovery in the emerging countries potentially taking place more slowly than expected, against the backdrop of high private indebtedness in many countries. Further downside risks include a hard landing in China and geopolitical developments.

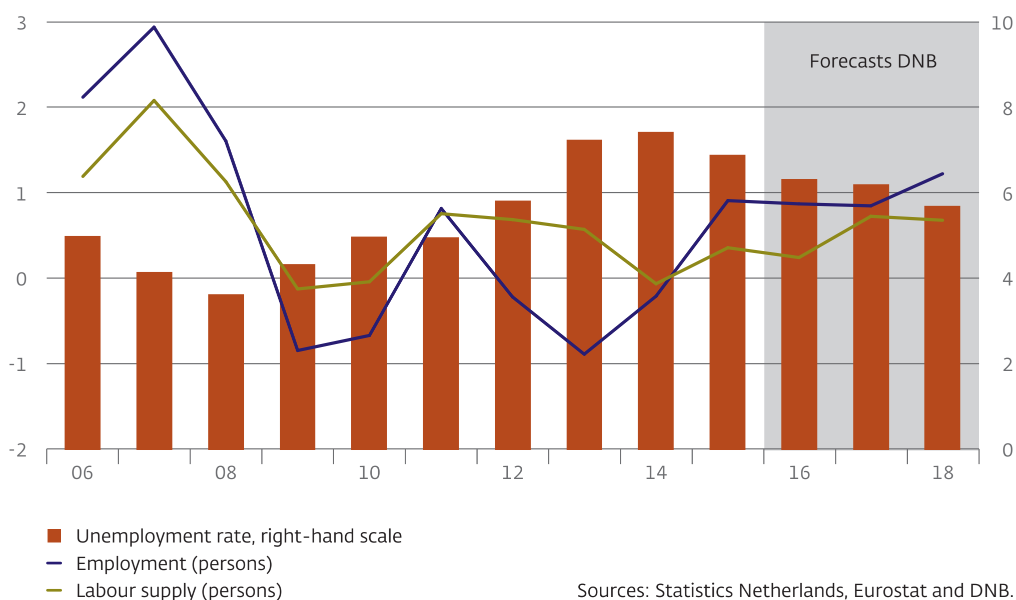
Employment growth driven mainly by increase in flexible jobs

Following three consecutive years of falling employment, the number of people in employment grew 0.9% in 2015. The same growth figure is projected for both 2016 and 2017, after which employment growth is expected to pick up some more speed at 1.2% in 2018 (see Chart 4). This means labour market prospects have improved relative to the December 2015 projections, in spite of the slightly lower economic growth prospects. Positive leading indicators, such as more vacancies and hours worked by temporary staff and falling bankruptcies, support this.

The final quarter of 2015 in particular showed unexpectedly robust growth in employment. In early 2016, however, thousands of workers lost their jobs due to bankruptcies of several large retail chains, including Macintosh, V&D and USG. Even so, unemployment declined further in the first quarter of 2016, to reach 6.5%, from 7.1% in 2015. This is not to say that the labour market is rapidly tightening, however, the unused labour potential remaining elevated. A less rosy picture also emerges from data provided by the Employee Insurance Administration Agency (UWV), with 89,000 more persons registered as job seekers in 2015 than the year before and the number of unemployment benefits failing to drop.[4] The previous recovery

Chart 4 Labour market supply and demand

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



Sources: Statistics Netherlands, Eurostat and DNB.

4 With the Work and Security Act (*Wet Werk en Zekerheid – Wwz*) having entered into force on 1 July 2015, a new unemployment benefits system based on income settlement now applies, which drives up the number of unemployment benefits on a permanent basis.

phase (2005-08) saw unemployment as well as the number of unemployment benefits and job seekers follow the same trend without any major lags. The recent picture of the labour market is therefore mixed, which may suggest more slack than indicated by the unemployment rate.

At the same time, the nature of new employment is changing. The number of employees on permanent contracts has steadily declined since the crisis. This does not mean that no new permanent employment contracts are concluded, but more permanent contracts are terminated than concluded. This means that employment growth is mainly achieved in flexible forms of employment. Chart 5 illustrates this for the period beginning in the first quarter of 2014, when the labour market recovered and unemployment fell for the first time. On a cumulative basis, the active working population increased by 142,000 through the first quarter of 2016, including 69,000 workers on fixed-term contracts, 62,000 stand-by, stand-in and temporary workers, and 63,000 self-employed persons, who are almost exclusively sole traders. By contrast, the number of workers on permanent contracts fell by 52,000.

Chart 5 Cumulative increase in active working population

In thousands; from Q1 2014

Source: Statistics Netherlands.

Wage growth accelerates

Between 2010 and 2015 negotiated wages on average rose 1.3% annually. This projection foresees a slight pick-up in speed from 2016 onwards: 1.8% in 2016 and 1.9% and 2.0% in 2017 and 2018, respectively. The higher growth rates are related primarily to the predicted increase in inflation, but unemployment will decline and labour productivity will accelerate.

Growth in negotiated wages came to nearly 2% in 2015, with wage increases of as much as 2.4% negotiated in the government sector, where wages had lagged far behind during recent years. In the financial sector negotiated wages rose 1.0% on average. A notable feature in the corporate sector was the sharp increase in incidental wages, at 1.5%. Businesses may have used part of the scope for wage increases that resulted from lower pension contributions. Growth in negotiated wages in the corporate sector came to 1.7% in the first quarter of 2016, with 1.8% forecast for the full year.

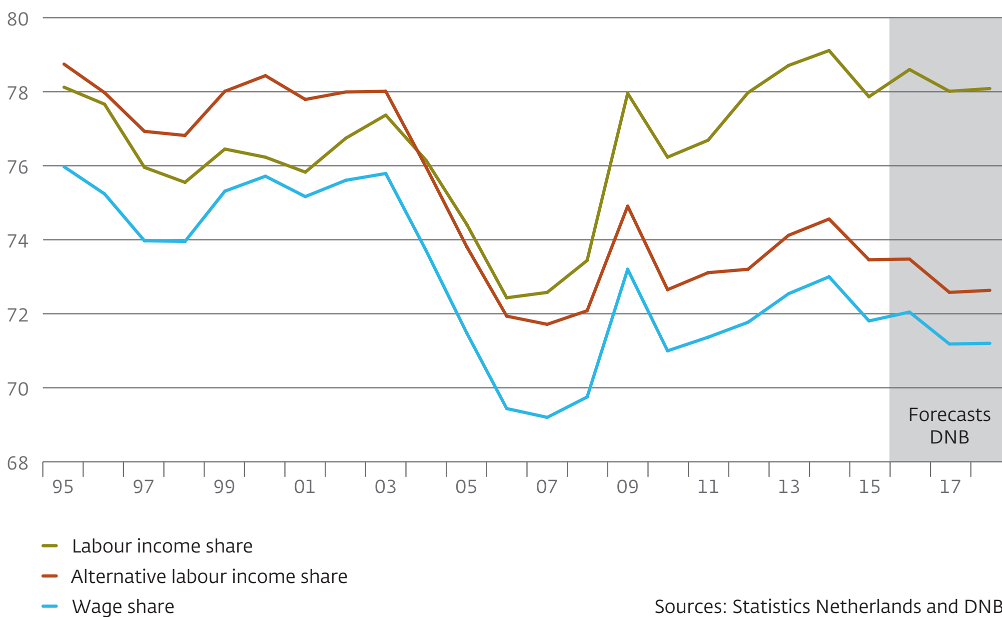
Alternative LIS remains low from a historical perspective

The regular labour income share (LIS) has gone up sharply since the crisis (see Chart 6), based on the assumption that the earned income of self-employed persons is in line with the average compensation earned by employees. The alternative LIS, for which the labour income of self-employed persons was approximated by taking their total income (mixed income), grew significantly slower over the same period. This was caused predominantly by the greater pressure on their hourly rates following the crisis relative to employee compensation. As a result, the labour income of self-employed persons is upwardly distorted as a component of the regular LIS. The LIS for employees only, which abstracts from self-employment income, has also grown less than the regular LIS since the crisis. This wage share reflects the share of employee wages in net added value less total self-employment income.

The alternative LIS and the wage share are expected to be 0.8 and 0.6 percentage points lower, respectively, than in 2015, a decline which will entirely manifest itself in 2017, when labour productivity is set to outpace labour costs. During the projection horizon, both the alternative LIS and the wage share will be below their long-term (1995-2015) averages of 75.4% and 73.1% respectively.

Chart 6 Labour income share for business sector

Percentages



Sources: Statistics Netherlands and DNB.

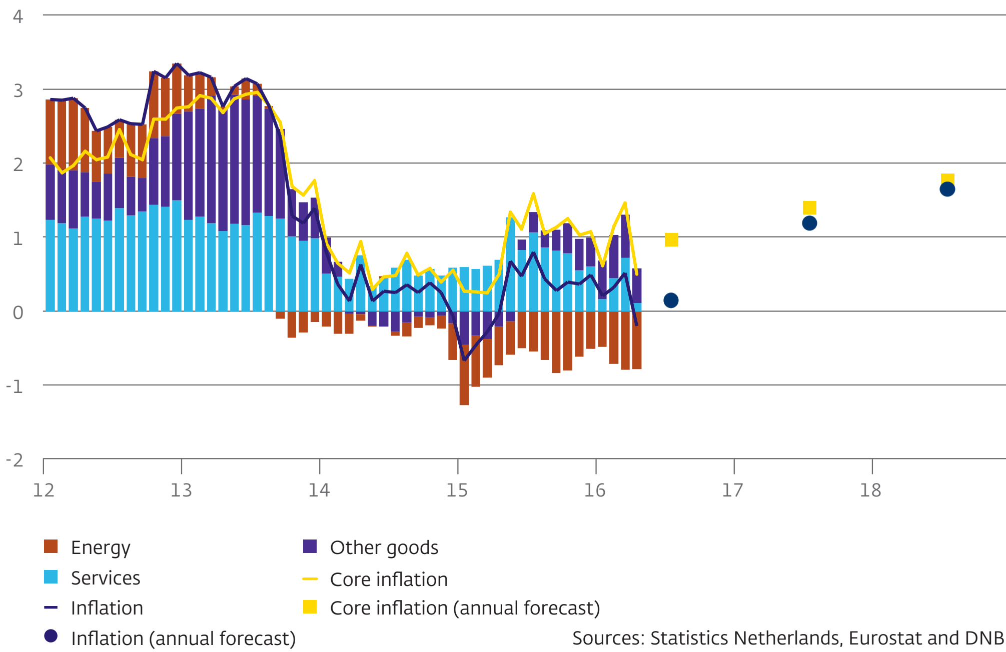
Inflation on the rise

HICP inflation was exceptionally low during the past two years, at 0.3% in 2014 and 0.2% in 2015 (see Chart 7). The drop in the prices of oil and other commodities, as well as slumping food prices, mainly contributed to this. HICP inflation is also projected to be 0.2% in 2016, with inflation still suffering the downward impact of the decline in oil prices in the earlier part of the year. Energy prices fell 6.8% in the opening quarter of 2016 relative to that of 2015.

Core inflation, HICP excluding food and energy prices, is expected to be 1.0% in 2016, and our projections indicate that it is set to go up to 1.4% in 2017 and 1.8% in 2018. This will be driven by the gradually increasing costs of production, which are largely determined by labour costs. The latter are projected to go up by an average 1.3% annually over the projection horizon. The accelerating wage growth will be dampened in part by an increase in labour productivity, which should grow by 0.7% in 2016 and by 1.5% and 1.2% in 2017 and 2018, respectively. Other factors driving up core inflation will be the narrowing output gap, notably in 2018, and slightly stronger increases in import prices, in 2017 and 2018. All in all, this means that inflation should edge up to 1.2% in 2017 and 1.7% in 2018.

Chart 7 HICP inflation

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



Sources: Statistics Netherlands, Eurostat and DNB.

Note: Core inflation = total excluding food and energy.

2 A closer look at spending and public finances

Market share of Dutch exports is shrinking

The growth rate projected for relevant world trade will edge up from 3.6% in 2016 to 4.5% in 2018 (see Table 3). This does not take account of the potentially adverse impact on world trade of the increased uncertainty surrounding the outcome of the UK referendum. Box 2 addresses the possible consequences should the UK leave the European Union (Brexit). World trade is expected to outstrip Dutch exports between 2016 and 2018, resulting in loss of market share over the projection horizon following the remarkable growth seen in 2015 (see Chart 8). That growth was almost entirely accounted for by domestically produced exports, excluding energy. These "made in Holland" exports grew 6.3% in 2015, compared with a 3.8% increase in total relevant world trade. This can be explained in part by price effects: the price-competitive position improved by 1.1% in 2015, among other things owing to the depreciation of the euro. Also, unit labour costs declined, depressing export prices in 2015.

Furthermore, Dutch exports are largely driven by energy exports and re-exports. A key factor in energy exports is the natural gas production cap imposed in 2015, which not only depresses exports, but also creates additional imports needed to meet demand for domestic consumption purposes. Our projections show that energy exports will contract by 6.2% and energy imports will grow by 11.4% in 2016, in a pattern that is set to continue into the years ahead, albeit slightly less pronounced.

Table 3 Dutch exports and competitiveness

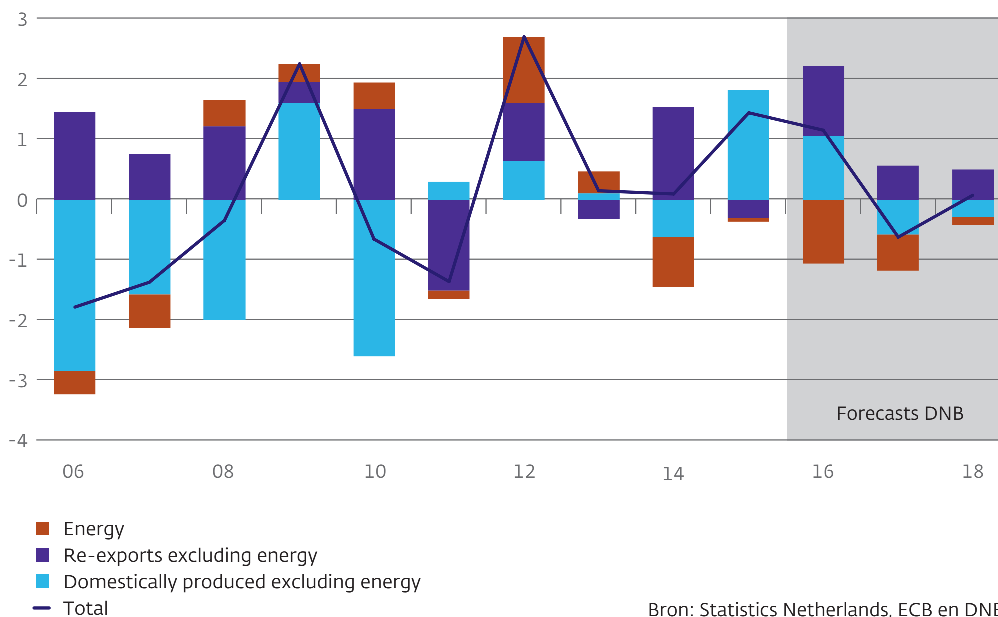
Percentage changes, unless stated otherwise

	2015	2016	2017	2018
Volume				
Relevant world trade	3.8	3.6	4.3	4.5
Exports of goods and services	5.3	4.8	3.7	4.6
domestically produced	6.3	3.2	1.8	3.5
re-exports	4.1	6.7	5.8	5.8
Exports of goods and services excl. energy	5.5	6.2	4.3	4.7
domestically produced	7.6	5.8	3.1	3.9
re-exports	3.0	6.7	5.8	5.8
Price				
Competitor prices (1)	2.2	-2.7	2.1	2.0
Exports of goods and services	-2.9	-2.3	2.1	1.1
domestically produced, excl. energy (2)	1.1	-0.6	1.0	0.8
Price competitiveness (1-2)	1.1	-2.1	1.1	1.2

Sources: DNB and ECB.

Chart 8 Market share exports of goods and services

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



Bron: Statistics Netherlands, ECB en DNB.

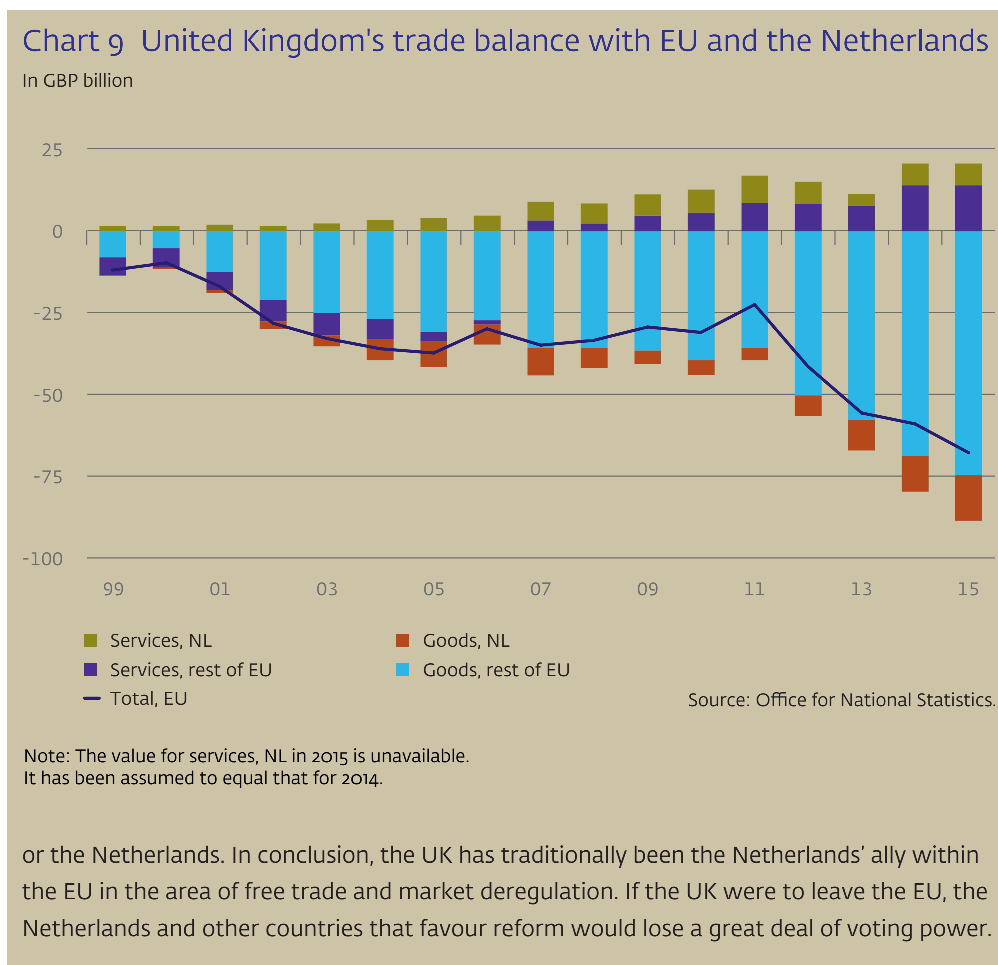
Note: The percentage change in total market share is defined as the percentage change in total exports less the percentage change of relevant world trade. The bars show the contributions of the three components of total exports to the change in market share.

Box 2 Potential economic consequences of a Brexit

On 23 June 2016, the UK is to hold a referendum on its EU membership. When estimating the consequences of the UK leaving the European Union, the key question is which trade treaties it will conclude. On one side of the spectrum, the UK may remain a member of the European Economic Area, with trade rules similar to the current ones in the EU. On the other side, it may revert to bare adherence with the minimum rules set by the World Trade Organisation (WTO). Increased trade restrictions will do the UK greater economic harm. Various studies show that the impact on the UK economy will most likely be limited to -1 or -2% of GDP in the short term, i.e. over the next two years. The Netherlands and the EU will suffer an even smaller impact, of -0.1% to -0.35% of GDP, caused primarily by lower exports to the UK. In the longer term, however, the adverse impact on the UK economy is likely to be more substantial, due, among other factors, to the negative impact on productivity growth. Businesses with a greater focus on exports are generally more productive, which means that weakened trade may affect productivity growth in the longer run. Studies commissioned by the OECD and HM Treasury indicate that GDP in the UK could be 5-6% smaller by 2030.

The EU is the UK's biggest trading partner, accounting for 44% of its exports and 53% of its imports in 2014. The Netherlands accounts for around 7% of both the UK's imports and its exports. Viewed from the Dutch perspective, 7% of imports originate from and 9% of exports are destined for the UK. The UK's trade balance with the EU showed a GBP 60 billion deficit in 2014 (see Chart 9). This trade will in the near term be affected by uncertainty, as the exchange rate will be volatile and businesses put decisions on hold. Moreover, exchange rate volatility and a possible depreciation of the pound sterling may harm European exports to the UK. In the longer run, too, a Brexit will pose a risk to trade between the UK and the EU, with negative consequences for both trading partners. The extent of those consequences will depend on the actual exit scenario adopted. Of fundamental importance to the UK will be the terms on which financial and other services may be exported to the UK. A Brexit will also affect the UK's trade with non-EU countries, as it will also need to negotiate new treaties with those countries. "Leave" campaigners consider EU regulations to be overly protectionist, seeing opportunities for more liberal trade with emerging economies, for example in the area of agriculture. However, countries such as the United States and China are unlikely to enter into more favourable treaties with the UK than with the EU.

The UK is Europe's largest beneficiary of foreign direct investment (FDI). The Netherlands has GBP 208 billion in FDI outstanding in the UK. Many businesses consider the UK as a gateway to the European continent. Should a Brexit materialise, they may decide to relocate headquarters, potentially to a country that has a relatively similar position, such as Ireland



or the Netherlands. In conclusion, the UK has traditionally been the Netherlands' ally within the EU in the area of free trade and market deregulation. If the UK were to leave the EU, the Netherlands and other countries that favour reform would lose a great deal of voting power.

Private consumption continues to grow

Household consumption is expected to exceed pre-crisis levels at some point in 2017. Between 2008 and 2014 private consumption fell by 4.4% in real terms, after which a vigorous recovery set in, with growth reaching 1.5%. Our projections show sustained recovery with growth rates of 1.7% in 2016, 2.9% in 2017 and 2.0% in 2018. Concealed behind these annual figures are the dynamics in private consumption seen recently. Consumption growth in the third quarter of 2015 was a mere 0.1% (quarter-on-quarter) and came to a full standstill in the fourth quarter. This can be explained first and foremost by the mild weather, causing energy demand to plummet.

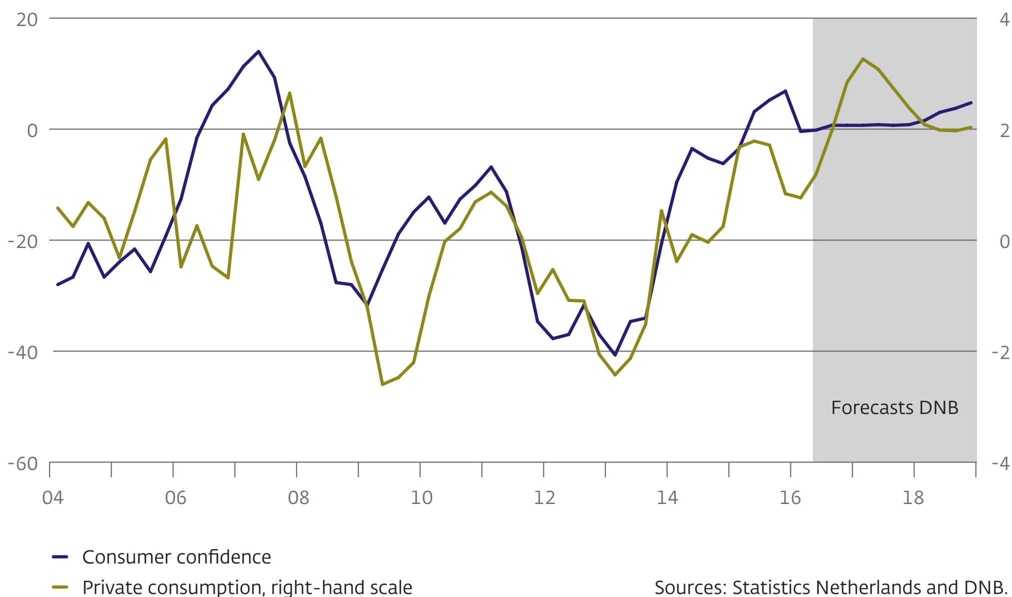
In addition, November 2015 saw a period of more than two and a half years of almost incessant growth in consumer confidence come to an end. Consumer confidence is a key determinant for private consumption (see Chart 10). In early 2015, consumer confidence for the first time since 2007 broke the zero line, meaning that optimistic consumers now outnumber their pessimistic

counterparts. Confidence was up mainly on the back of lower unemployment and the upswing in the housing market, continuing its upward trend to reach 9 in November 2015. It subsequently slipped back somewhat, to 1 in April and May 2015, which is still amply above the average figure for the past 30 years, which is -6.6.

The development in house prices also drives up consumption, as higher prices boost home owners' net assets, upping their expenditure. The rising value of housing assets will increase consumption growth by almost one percentage point in each of the projection years.

Chart 10 Consumer confidence and private consumption

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



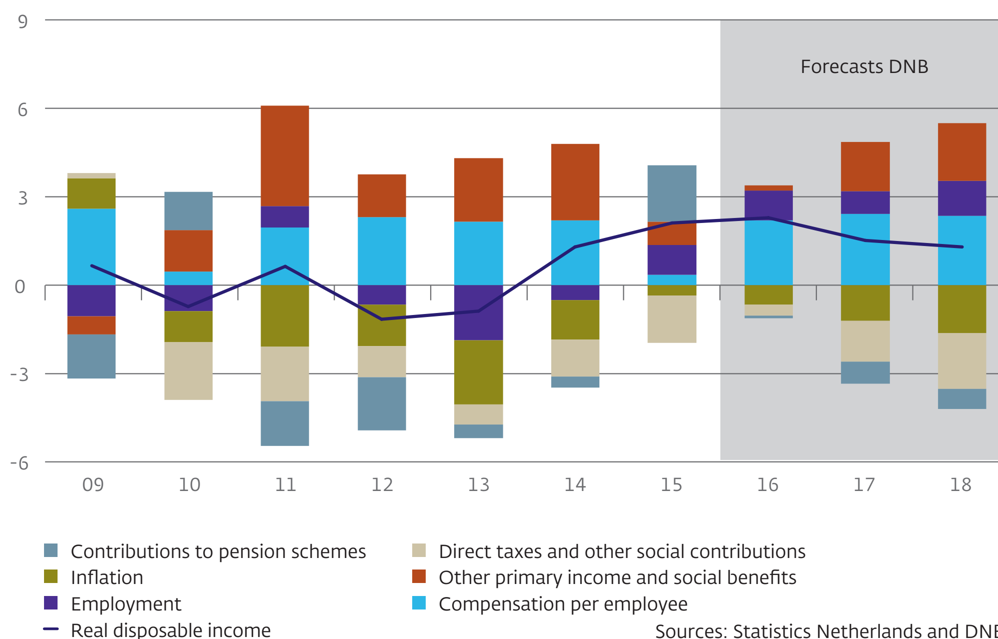
Sources: Statistics Netherlands and DNB.

Household income growth persists

The principal determinant for the recovery in private consumption is the persistent growth in real disposable income, which set in at 1.3% in 2014 and was 2.1% in 2015. Lower pension contributions were a key income boost in 2015, and real disposable income is projected to go up 2.3% in 2016. This increase, which is the biggest since 2001, will be largely accounted for by the EUR 5 billion tax cuts made in 2016. Income growth will level off somewhat in 2017 and 2018, due mainly to inflation creeping up. Also, the negative contributions of taxes and pension contributions will make themselves felt again. Index-linking for pension benefits is not assumed in the projections, but nominal benefit curtailments are not either. On balance, projected real disposable income growth is 1.5% in 2017 and 1.3% in 2018 (see Chart 11).

Chart 11 Real disposable household income

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



Sources: Statistics Netherlands and DNB.

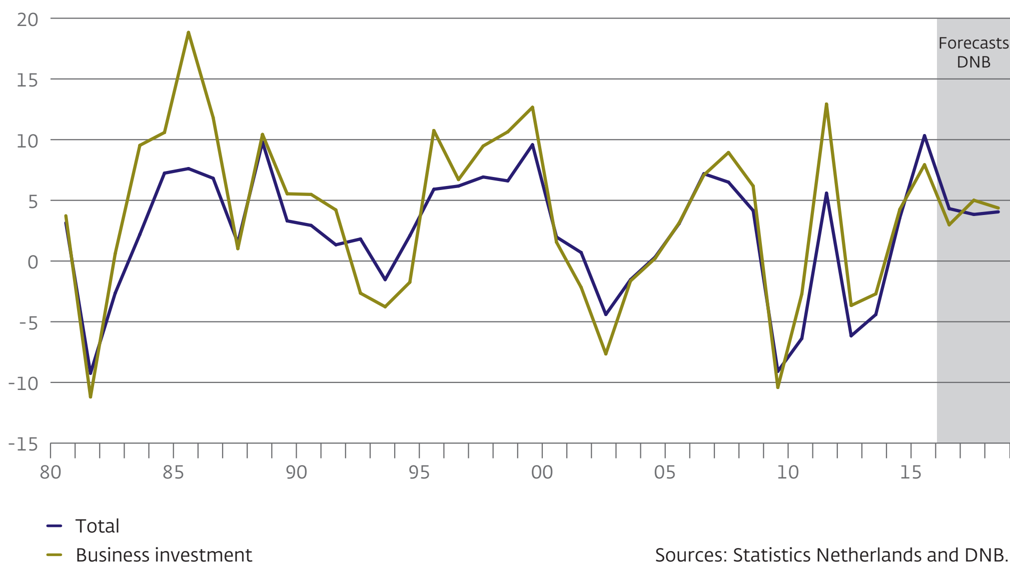
Steady growth in business investment

Investment in the corporate sector showed remarkably vigorous growth in 2015, at 7.9%, driven in part by a non-recurring event. The addition to taxable income for private use of leased and company cars was raised in early 2016, prompting businesses to bring forward part of their investment from 2016 to 2015. For this reason, investment growth is projected to be somewhat lower in 2016, at 3.0%. In line with the pick-up in GDP growth, investment growth is set to accelerate over the coming years.

Chart 12 illustrates that, viewed over a rather more prolonged period, the projected investment growth does not differ very much from average growth figures registered between 1978 and 2015, which are 3.6% for business investment and 2.1% for total investment. A different indicator for assessing investment is the real investment ratio, which is the ratio of investment to GDP (in real terms). In 2015, the investment ratio stood at 12.6%, significantly above the average level on record since 1978 (10.8%). In our projections, the investment ratio will go up to 12.8% in 2016, progressing further to 13.5% in 2018. This is a customary feature in a period of economic recovery, in which businesses speed up their investment as sales expectations brighten.
The projected growth rate for business investment is in line with that for previous periods of cyclical expansion.

Chart 12 Investment

Volume; year-on-year percentage changes



Sources: Statistics Netherlands and DNB.

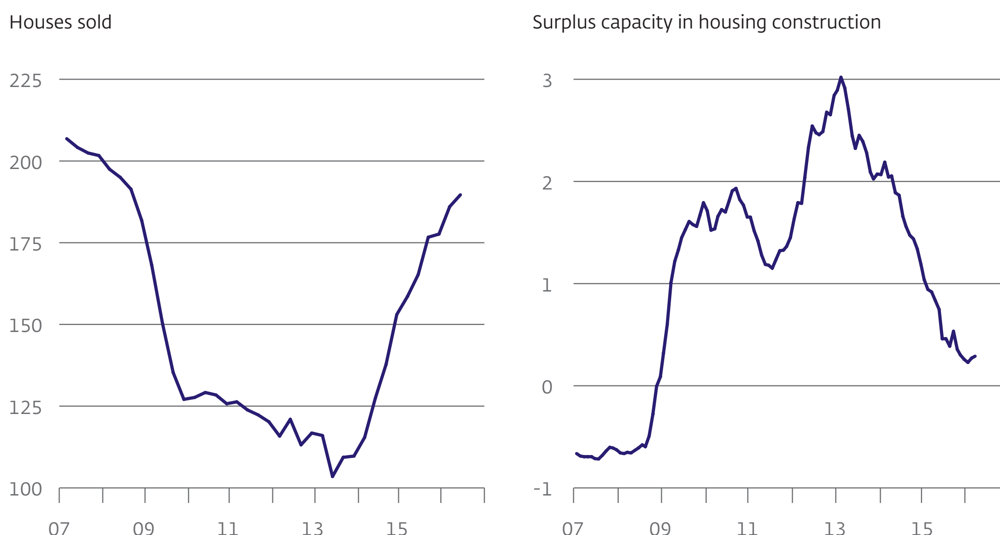
Robust upswing in the housing market

Since mid-2013, the Dutch housing market has seen a strong rebound following the significant fall that started in 2008. Although there are large differences, convincing recovery has begun in almost all regions. Since the low was reached, average house prices have risen by 8.8% (April 2016). Amsterdam is an outlier, with house prices already exceeding pre-crisis levels and transactions now being closed above ask prices. In addition, across the country the time needed to sell one's house has rapidly gone down and the number of housing transactions over the past twelve months amounted to 190,000 (April 2016). This is almost identical to the number of transactions in August 2008, shortly before the outbreak of the financial crisis (see Chart 13, left-hand scale). Over the projection horizon, the sharp decline in mortgage interest rates will be a dominant factor in the recovery in the housing market, as it has been over the past years. Low rates enable consumers to contract higher mortgage debts, thereby boosting demand for houses and driving up house prices. Income increases also fuel the growth in mortgage indebtedness and, with it, house prices.

The upturn in the housing market is also reflected in housing investment. Until recently, confidence among many construction businesses was depressed by sluggish demand (see Chart 13, right-hand scale). The number of businesses reporting this has declined rapidly since 2013 and is meanwhile approaching the level seen before the crisis. Housing investment in 2015 showed an exceptional 27% growth rate, fuelled not only by a tax-related cause, but also

Chart 13 Housing market: transactions and surplus capacity

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



Sources: European Commission and Statistics Netherlands.

Note: Houses sold in Q2 2016 represents twelve-month sum through April 2016. Surplus capacity concerns subquestion ('insufficient demand') in confidence survey in construction sector. Normalised over historical length of series.

by a sharp rise in the number of homes sold. The transaction costs involved form part of housing investment. Furthermore, it must be remembered that the level of housing investment had dropped to a historical low by 2014. As a proportion of GDP is stood at 3.6% in 2014, having averaged 6.9% in de period between 1978 and 2008 in real terms. Our projections show a further recovery in housing investment to 4.9% of GDP in 2016 and 5.1% in 2018, but more rapid growth cannot be excluded either, seeing that actual housing investment figures have consistently exceeded the projections since the turning point was reached. The housing market scenario described in Section 3 shows the economic consequences of a more vigorous upswing in the housing market.

Solid improvement in public finances

The broad-based economic growth works out well for the government's budgetary position. Falling unemployment rates make for lower unemployment benefit expenditure. The policy measures announced and launched earlier, including cutbacks in curative health care and the reform of long-term care, are also dampening expenditure growth, and the government's

interest expenditure is at an all-time low owing to the sustained low interest rate levels. The favourable economic developments are also reflected in the government's income, as growing employment and swelling private consumption boost tax revenues.

However, the favourable economic developments are not fully reflected in the government's budgetary position, due to a number of measures on the income and expenditure sides that depress the financing balance. For example, the EUR 5 billion package of tax cuts will dampen the improvement of the financing position by around 0.7% of GDP in 2016. Also, lower natural gas production will depress gas revenue and, with it, government revenues. On the expenditure side, the increased number of asylum seekers will involve additional public expenditure of around 0.2% of GDP in 2016. On balance, the public sector deficit is set to narrow gradually from 1.8% of GDP in 2016 to 0.7% of GDP in 2018 (see Table 4). Public spending as a percentage of GDP is expected to fall over the 2016-18 period. Taxes and social security contributions are set to remain flat in both 2016 and 2017 and edge up in 2018. The structural deficit will widen in 2016 due to the measures that depress the financing balance, from 0.8% of GDP in 2015 to 1.4% of GDP in 2016, before slowly diminishing in 2017 and 2018. The nominal GDP growth and ABN AMRO's privatisation have set the debt to GDP ratio on a downward path. Public debt will recede from 65.1% of GDP in 2015 to 60.8% of GDP in 2018, approaching the European 60% debt ceiling.

Table 4 Public sector key data

Percentage of GDP

	2015	2016	2017	2018
Public expenditures	44.9	44.3	43.7	43.0
Taxes and social security contributions	37.5	37.3	37.3	37.5
Other income	5.5	5.2	5.1	4.8
Primary balance	-0.6	-0.7	-0.2	0.4
EMU balance	-1.8	-1.8	-1.3	-0.7
Structural balance (EC method)	-0.8	-1.4	-1.1	-0.8
EMU debt	65.1	64.8	63.0	60.8

Source: DNB.

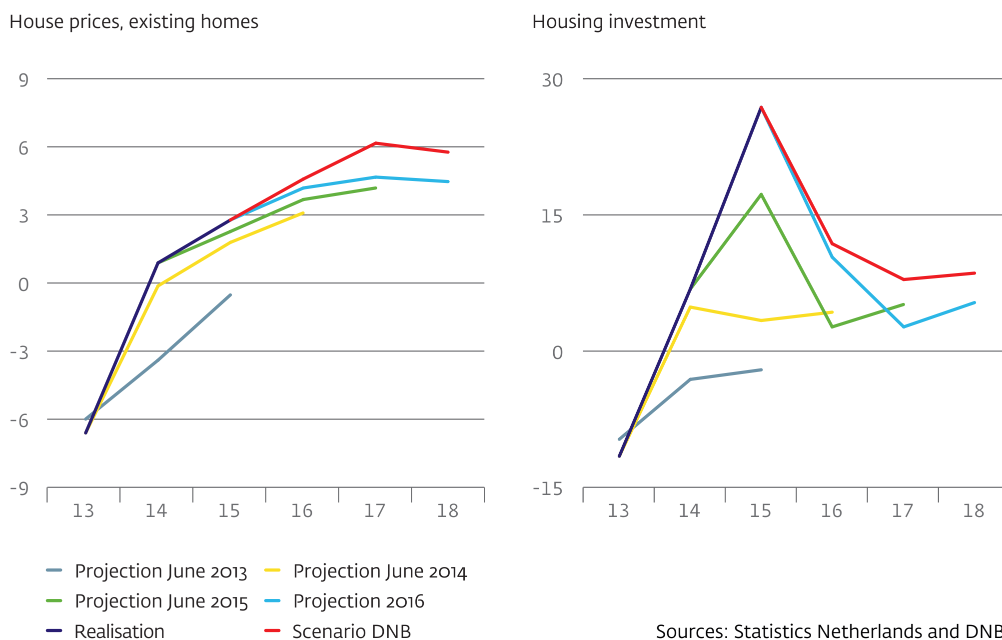
3 An alternative scenario for the Dutch economy

Speedier recovery of housing market cannot be excluded ...

The housing market has shown a surprisingly vigorous recovery since mid-2014. The market for owner-occupied homes has become more attractive to first-time buyers, as homes have become significantly more affordable: price levels are still nearly 15% below the August 2008 peak and mortgage interest rates have hit an all-time low. Furthermore, soaring house sales – over 16% more than in 2014 – and increased newbuilds – 24% in 2015 as reported by the Construction Economics Research Institute (EIB) – support the notion that increasing numbers of tenants are now looking to buy a home. The recent increase in house prices has reduced the risk of asset losses, whereas the availability of rental homes has hardly increased and rental homes often fail to meet the demands of those looking to move house. Greater pent-up demand from first-time buyers and increased dynamics among those moving house may cause the recovery in the housing market to gain even more speed that foreseen in our projections. Chart 14 shows how developments in the housing market have consistently exceeded the projections. In addition, a European Commission study shows that during expansionary phases in the housing market prices may rise quickly, with annual increases averaging 8-10% being no exception. Chart 15 illustrates the developments in real house prices during various expansionary phases of eight quarters following the turning points. Remarkably, prices have developed reasonably moderately since 2014 in comparison with the two previous expansionary phases.

Chart 14 Housing market: projections and scenario

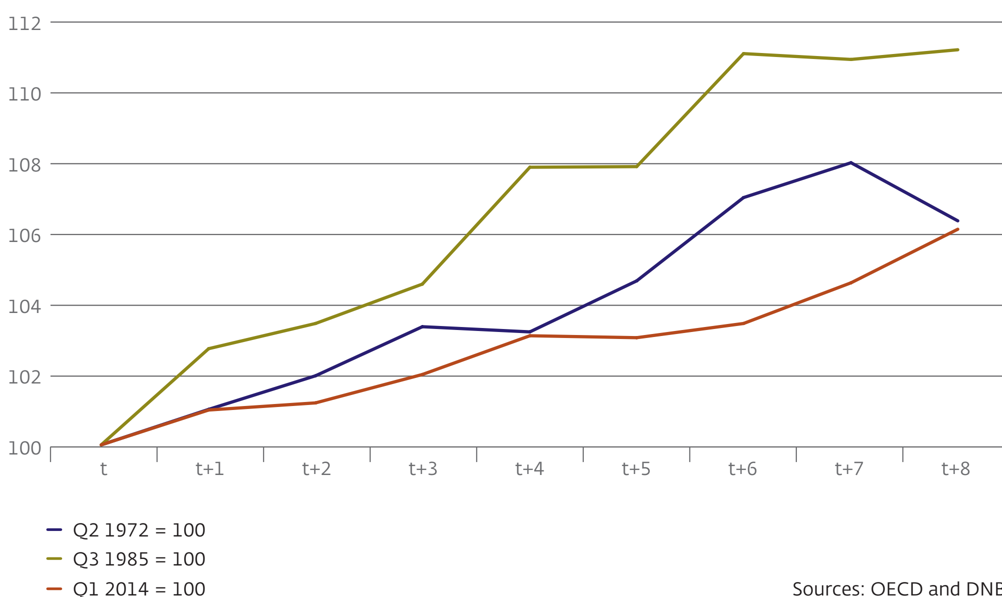
Percentage changes



Sources: Statistics Netherlands and DNB.

Chart 15 Housing market: upward phase in development of real house prices

Index; quarterly figures



Sources: OECD and DNB.

Note: deflated by private consumption deflator.

… and will have a beneficial impact on economic growth

The scenario assumes that the number of house sales and granted building permits return to pre-crisis levels during the projection horizon,[5] providing a boost to housing investment, which comprises newbuild and renovation, as well as transfer costs involved in sales of existing houses. On top of this, housing investment is accompanied by additional spending on home furnishing and household appliances, which causes private consumption to gain momentum. In this scenario, house prices rise around 1.4% more than in our projections in both 2017 and 2018 (see Table 5). The price increases cause private housing assets to develop more favourably than foreseen in our projections, and consumer confidence also grows, which has an additional beneficial effect on private consumption. Also, increasing house prices and higher housing investment have an upward impact on growth in mortgage lending, which is more than 0.8 percentage points higher than projected. Expectations are that the credit supply of banks and non-banks is adequate to accommodate this additional demand. With asset

5 Between 2000 and 2008, the annual number of building permits granted averaged 96,000, while the annual number of housing transactions averaged 197,000. In 2015, around 54,000 permits were granted, while 178,000 existing houses changed hands.

and confidence effects passing through with some delay, the effects of a speedier recovery in the housing market will manifest themselves mainly in 2017 and 2018. Higher housing investment and concomitant steeper consumer spending and corporate investment will push up economic growth by 0.3 percentage points in 2017 and 0.2 percentage points in 2018 relative to projections. The unemployment rate will decline to 6.1% in 2017 and 5.5% in 2018, while the budget deficit will reach 0.5% of GDP in 2018. The domestic spending boost causes imports to pick up more substantially than exports, due to which the current account balance is lower than projected.

Table 5 Housing market scenario

Percentage changes, unless stated otherwise

	2016	Deviation from projection	2017	Deviation from projection	2018	Deviation from projection
Gross domestic product	1.6	(0.1)	2.2	(0.3)	2.2	(0.2)
Private consumption	1.8	(0.1)	3.4	(0.5)	2.4	(0.4)
Business investment	3.0	(0.0)	5.3	(0.3)	4.9	(0.6)
Housing investment	11.9	(1.5)	7.9	(5.2)	8.6	(3.2)
Consumer confidence (level)	3.1	(2.8)	3.9	(3.0)	6.2	(2.8)
Harmonised consumer price index	0.2	(0.0)	1.2	(0.0)	1.8	(0.1)
House prices, existing own homes	4.6	(0.4)	6.2	(1.5)	5.8	(1.3)
Unemployment (% of labour force)	6.3	(0.0)	6.1	(-0.1)	5.5	(-0.2)
EMU balance (% of GDP)	-1.8	(0.0)	-1.2	(0.1)	-0.5	(0.2)
Current account (% of GDP)	8.8	(-0.1)	8.5	(-0.4)	8.2	(-0.7)
Mortgage loans	4.1	(0.1)	5.1	(0.9)	6.1	(1.5)
Bank lending to NFC	0.5	(0.0)	1.2	(0.2)	4.0	(0.4)

Source: DNB.

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