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Economic Developments and Outlook

DeNederlandscheBank

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Economic Developments and Outlook

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Summary

The Dutch economy is increasingly growing under its own steam. GDP growth in the Netherlands is projected to end up at 1.9% this year. Next year, growth should decrease slightly to 1.7%, to rebound to 2.2% in 2017. The slowdown in world trade growth will lead to a decline in the growth contribution of exports in the coming two years, despite the depreciation of the euro. The smaller contribution to economic growth from exports is mostly compensated for by a larger contribution from domestic spending. This is primarily underpinned by the surprisingly quick recovery of the housing market and the increasing purchasing power of households. The proposed tax plan for 2016 plays a key role in the latter aspect. The proposed tax cuts will positively impact consumption growth, not only in 2016 but also in 2017.

GDP growth will outpace potential growth for the projection horizon, but the economy will not yet run at full capacity in the years ahead. Firms will primarily increase production through higher output per employee. This is shown by employment growth, which is recovering at a slower pace than seen after previous recessions. Consequently, unemployment will only slightly go down, from 6.9% this year and next, to 6.7% in 2017. Inflation is set to remain low and will only pass the 1% mark in 2017.

The downward trend of the budget deficit will grind to a halt, due to the intended tax cuts, lower natural gas production, and the increasing number of asylum seekers. The structural budget balance will deteriorate sharply to -2.5% of GDP in 2017 from -0.7% of GDP in 2014. An explorative analysis shows that in the short term the influx of refugees will have a very small positive effect on economic growth, especially because of the spending effect of higher public outlays.

An alternative scenario analyses the consequences of stagnating growth in China, accompanied by additional uncertainty on the financial markets. This scenario has considerable repercussions for the Netherlands. The lower pace of export growth will dampen GDP growth by 0.7 percentage points and 0.5 percentage points relative to projections.

1 The Dutch economy in 2015-2017

The Dutch economy is recovering lost ground under its own power

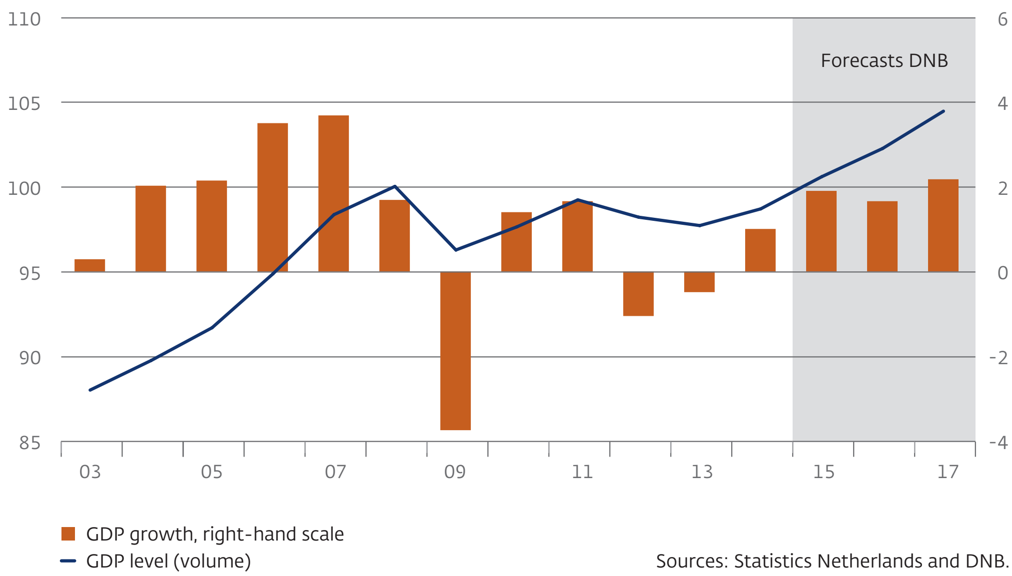
The Dutch economy is catching up. GDP in the Netherlands is projected to grow at 1.9% in 2015. Following a 0.5% slowdown in 2013 and a modest 1% recovery last year, the 2011-2013 recession is now definitely over. In the years ahead, GDP in the Netherlands is expected to keep outpacing its potential growth rate. Next year, growth is projected to fall slightly to 1.7%, in particular due to headwind from the international environment. However, the Dutch economy is increasingly growing under its own steam. Domestic spending is accelerating sharply on the back of the surprisingly quick recovery of the housing market and increasing household spending power. The tax plan for 2016 plays an important role in this respect. The projected tax cuts will positively impact consumption growth, in 2016 and 2017 alike. In 2017 GDP growth is projected to pick up again, reaching its highest level of the past ten years at 2.2%.

Recent slowdown in quarterly growth is a one-off

During the past year, quarter-on-quarter GDP growth fluctuated considerably (see Chart 1). The 0.9% peak seen in the last quarter of 2014 was counterposed by the disappointing 0.1% growth rate recorded in the second and third quarters of this year. Based on these figures, the recovery that started at the end of 2012 seems to be losing some of its pace. This needs to be qualified by the fact that growth was dampened in the second quarter by the cap on the production of natural gas. Without this adjustment, growth in the second quarter would have

Chart 1 Gross domestic product

2008 = 100 and year-on-year percentage changes



Sources: Statistics Netherlands and DNB.

come out at 0.6%, which is in line with the four preceding quarters. GDP growth in the third quarter remains somewhat disappointing, although the slowdown is expected to be temporary.

Economic outlook virtually unchanged from the previous projections

Primarily due to the lower than expected outcomes of the first three quarters, GDP growth this year and next is expected to come out one-tenth of a percentage point lower than projected in DNB's Economic Developments and Outlook six months ago. The outlook for GDP growth in 2017 is unchanged. Despite only minor variances in prospects, the assumptions underlying this projection vary substantially from the previous ones. For instance, the assumed cumulative growth of relevant world trade in the projection period is three percentage points lower. Exports will be negatively impacted by the sharply reduced production of natural gas. This will be counterbalanced by domestic adjustments boosting spending, including planned tax cuts in 2016. Together with the earlier tightening of the rules on tax relief on pension savings (the Witteveen framework) this will have an upward effect on the domestic contribution to economic growth.

More efficient use of production capacity

The potential growth pace of the Dutch economy, i.e. GDP growth adjusted for business cycle effects, is projected at 1.3% annually during the projection horizon. As actual growth undershot potential growth for a long time, the output gap widened to -3.4% in 2014. From this year, projected GDP growth will outpace potential growth for the first time since the credit crisis, which will cause the output gap to close gradually. The projected gap between potential and achieved output for this year is 2.7%. This will continue to narrow to 2.2% in 2016 and 1.5% in 2017, which means that the economy will not yet achieve its potential level in the coming years. In other words, there still is idle production capacity, of which the level of unemployment is an important indicator. Unemployment is projected to fall only very slightly to 6.7% on average in 2017, from 6.9% this year. In this environment, little tension is as yet to be expected in wage and price developments, and the output gap will continue to bring downward pressure to bear on inflation and wage growth, although this will wane steadily.

Domestic sector makes the largest contribution to growth

Table 1 lists the key economic data for 2014-2017.[1] GDP growth is projected to pick up modestly again at the end of this year, ending up at 1.9% for the full year. This is a marked improvement on 2014, which is among other things attributable to lower oil prices and the depreciation of

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 12 November 2015.

Table 1 Key data in forecast for the Dutch economy

Percentage changes, unless stated otherwise

	2014*	2015	2016	2017
Volume of expenditure and output				
Gross domestic product	1.0	1.9	1.7	2.2
Private consumption	0.0	1.7	2.4	2.7
Public expenditure	0.0	0.6	1.2	1.7
Business investment	4.2	5.5	1.9	4.6
Housing investment	6.9	26.8	8.2	4.4
Exports of goods and services	4.0	4.6	3.9	4.5
of which domestically produced	2.0	3.8	1.9	2.7
of which re-exports	6.6	5.6	6.2	6.4
Imports of goods and services	4.0	5.3	5.3	5.5
of which domestically used	1.7	5.0	5.6	5.2
Wages and prices				
Negotiated wages, private sector	1.1	1.4	1.7	2.0
Compensation per employee, private sector	2.2	0.6	2.5	2.6
Unit labour costs	0.8	-0.9	1.3	0.9
Prices of domestically produced exports	-1.8	-1.4	-0.8	1.5
Harmonised consumer price index	0.3	0.3	0.7	1.4
House prices, existing own homes	0.9	2.7	3.4	3.2
Labour market				
Employment (persons, growth)	-0.2	0.8	0.5	0.6
Labour supply (persons, growth)	-0.1	0.3	0.4	0.5
Unemployment (persons x 1,000)	660	615	615	606
Unemployment (% of labour force)	7.4	6.9	6.9	6.7
Public sector and financial				
EMU balance (% of GDP)	-2.4	-2.0	-2.2	-2.2
EMU debt (% of GDP)	68.2	66.8	66.4	65.2
Current account (% of GDP)	10.7	10.6	11.1	10.8
Mortgage loans (based on end-of-period)	-0.2	0.6	3.3	3.5
Bank lending to NFC (based on end-of-period)	-5.6	-3.7	0.8	4.8
International assumptions				
Volume of relevant world trade	3.9	3.1	3.9	4.7
Volume of GDP US	2.4	2.4	2.7	2.6
euro area	0.9	1.5	1.7	1.9
emerging markets	4.5	3.6	4.2	4.7
Short-term interest rate in the euro area (%)	0.2	0.0	-0.2	-0.1
Long-term interest rate in the Netherlands (%)	1.5	0.7	0.9	1.2
Euro exchange rate (USD)	1.33	1.11	1.09	1.09
Competitor prices	-0.9	2.8	1.0	2.2
Oil price (UK Brent in USD per barrel)	99.3	54.0	52.2	57.5
Commodity prices excluding energy (USD)	-8.6	-18.7	-5.2	4.1

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

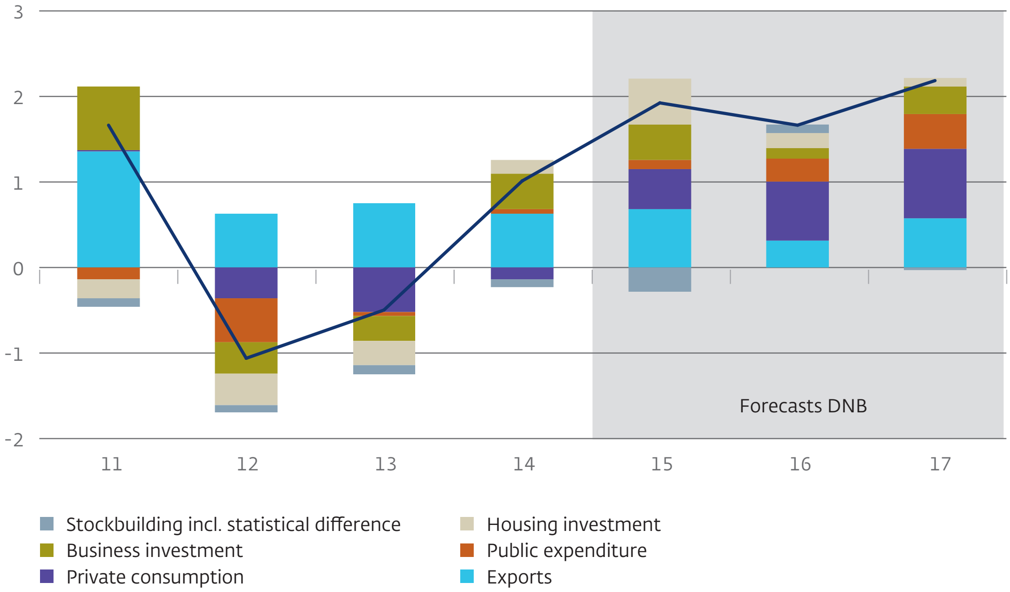
Sources: DNB and ECB.

the euro, partly due to the monetary policy pursued by the ECB. The housing market also staged a strong recovery, which benefits housing investment and household spending. In 2016 growth will fall off slightly to 1.7% as support from the international environment will decrease, due to the deceleration of world trade growth. On the other hand, projections include a EUR 5 billion tax cut in 2016, which will boost disposable income of households. The tax cut will continue to have an effect into 2017 as households increase their spending gradually. As world trade will also pick up again in 2017, GDP is projected to grow 2.2% in 2017.

Due to the deteriorating international economic climate, the foreign contribution to growth is set to decline. The domestic economy on the other hand will be boosted by the housing market recovery and easing of retrenchment combined with lower pension contributions and taxes. This will shift the emphasis to domestic contributions to economic growth, as reflected in Chart 2. For the 2015-2017 period, domestic spending will account for the largest contribution by far to economic growth. Much more than after the two previous recessions, recovery will be supported by domestic components. Contributions to growth made by private consumption in 2016 and 2017 will reach their highest level since 2000. Another important contribution to growth will be provided by housing investment, which is expected to surge by no less than

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.

27% this year. A large proportion of this surge is accounted for by a catch-up effect. After this acceleration, housing investment will still be 12% below its 2003 level and 29% below its peak of 2008.

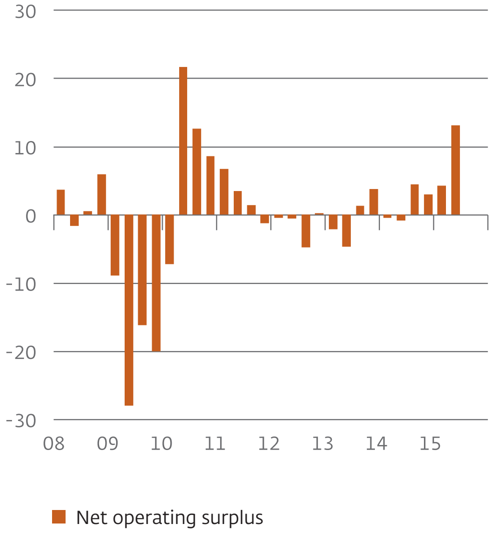
Corporate sector finances have improved; lending is still shrinking

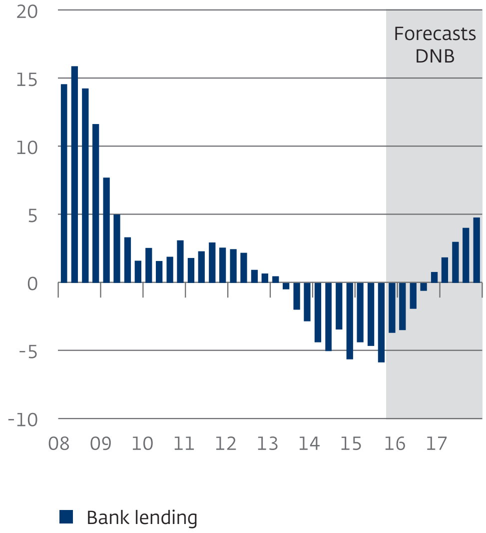
Corporate sector profits have increased sharply since mid-2014 in line with the economic pick-up. In the second quarter of this year, net operating profits gained over 10% (Chart 3, left axis). This development is closely related to unit labour costs, which still rose 0.8% in 2014, but are expected to decline 0.9% in 2015. The projections assume ongoing profit recovery. Although unit labour costs are projected to rise in 2016 and 2017, so will selling prices.

Bank lending to non-financial companies continued to grow until mid-2013. After the recession, lending started to shrink, moving at between -4 and -5% year-on-year since mid-2014 (Chart 3, right axis). At an average of -5.2% in the first half of 2015, the decline is somewhat larger still for lending to SMEs. Total lending in 2015 will decline even more than previously projected. Some companies are apparently still able to take recourse to other forms of funding, mainly retained earnings. The projections include a gradual slowdown in the shrinkage of lending to 0.8% next year (year-end 2016 relative to year-end 2015). This gradual pick-up

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

Year-on-year percentage changes





Note to right-hand chart: Adjusted for breaks and securitisations. Change based on seasonally adjusted end of period data.

Sources: Statistics Netherlands and DNB.

in lending is supported by the Bank Lending Survey (BLS). The majority of banks reported rising corporate sector credit demand in the second and third quarters of this year. That said, the projected credit growth is still well below the levels recorded until 2009. The projection assumes that banks will be able to meet credit demand from businesses and households. If banks unexpectedly make less progress with their capital reinforcement than projected, this may hamper lending. It cannot be excluded that smaller businesses will be hit relatively more severely, as their larger counterparts have better access to other sources of funding besides bank lending.

International pick-up will weaken temporarily

In the past years, the Dutch economy profited from the favourable international environment. Since mid-2014, this effect has been magnified by the depreciation of the euro. However, the recovery of the world economy has been showing some cracks recently, which is fuelling uncertainty about its robustness. The sharp drop in commodity prices to sustained low levels has hit many countries that depend on exports of commodities. In addition, China seems to be embarking on the long anticipated shift from an exports-based economy towards a more domestic consumption-driven economy. This is having its effect on other emerging economies, which act as suppliers of commodities and intermediate goods. Although growth has been picking up in the mature economies outside Europe these past few years, it is not sufficiently robust to offset the slowdown in the emerging economies. So the European economy's recovery is primarily accounted for by domestic spending. The ECB projects economic growth in the euro area to accelerate to 1.5% in 2015, from 0.9% in 2014. For 2016 and 2017, GDP growth is expected to pick up slightly to 1.7% and 1.9%, respectively.

These international developments also have repercussions on demand for Dutch exports products. Whereas world trade relevant to the Netherlands still expanded by 3.9% in 2014, growth is expected to contract to 3.1% this year. It may bounce back to 3.9% next year, followed by 4.9% in 2017, which approaches the long-term average. The risks surrounding this assumption are mainly downwards. The outlook for the emerging economies may continue to deteriorate, with the risk of a hard landing in China being most prominent. A scenario contained in Section 3 discusses the repercussions this may have on the Dutch economy. The geopolitical situation also remains vulnerable in several areas.

Falling oil prices and euro exchange rate have a favourable effect on projections

In the second half of 2014 oil prices fell by almost 60%, to recover slightly in the first half of this year to a maximum of USD 65 per barrel in May. Since then, prices have fallen back again to around USD 45 per barrel. Our projections assume a 46% drop in oil prices relative to 2014.

This will continue to have a beneficial effect in the years ahead. Projections for 2016 assume oil prices of over 3% lower than the average recorded in 2015. Based on prices of oil futures, oil prices should increase 10% in 2017.

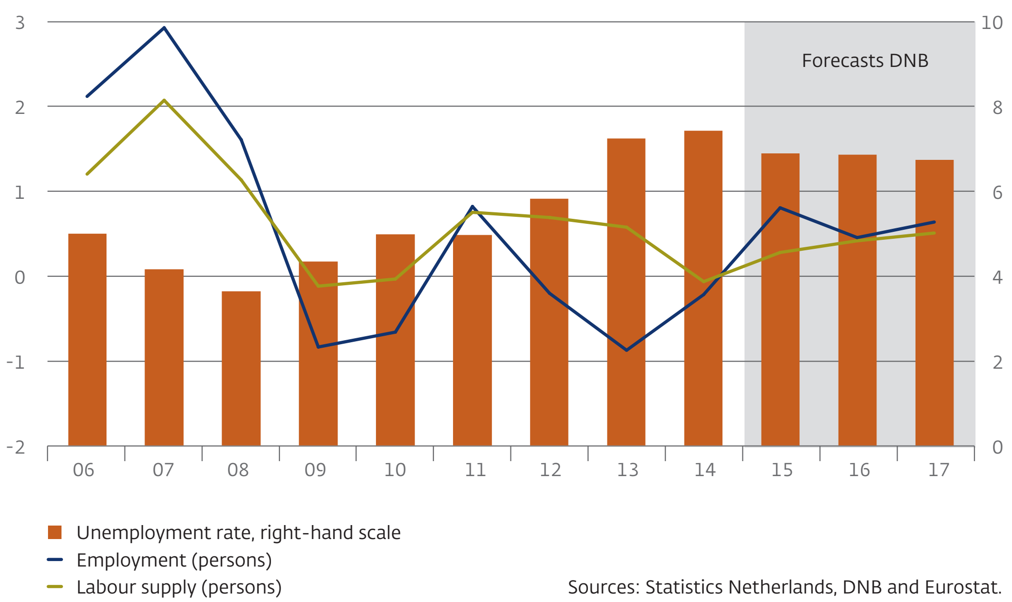
Besides oil prices, the euro exchange rate also fell in the second half of 2014. This year, the euro-dollar exchange rate was over 16% lower on average than in 2014. Despite the strong fluctuations seen in the past month, our projections for this year assume an exchange rate of USD 1.11 to the euro, which is virtually unchanged from our previous projections. Relative to this year's average, the euro exchange rate is expected to drop slightly to USD 1.09 in 2016 and 2017.

Employment is growing modestly; unemployment is falling slowly

Following three consecutive years of falling employment, the number of people in employment is projected to grow 0.8% in 2015 (see Chart 4). Employment growth is expected to slow down in 2016 and 2017 to around 0.5% annually. Employment growth will lag behind GDP growth, which is not unusual during economic upswings. Many companies start the recovery phase with overcapacity, meaning that it will take some time before new staff is taken on. Upturns are also accompanied by underlying structural shifts, which means that unemployed people are not always able to quickly rejoin the workforce in their former sector of employment.

Chart 4 Labour market supply and demand

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



Sources: Statistics Netherlands, DNB and Eurostat.

Employment in the construction and the public sector is still shrinking. To date, employment growth has still been almost fully attributable to the business services sector. In turn, a large proportion of this is attributable to the temporary staffing sector. Confidence indicators are not yet pointing towards growing employment in the industrial sector. The number of vacancies in that sector has also hardly risen from the low seen during the previous two recessions.

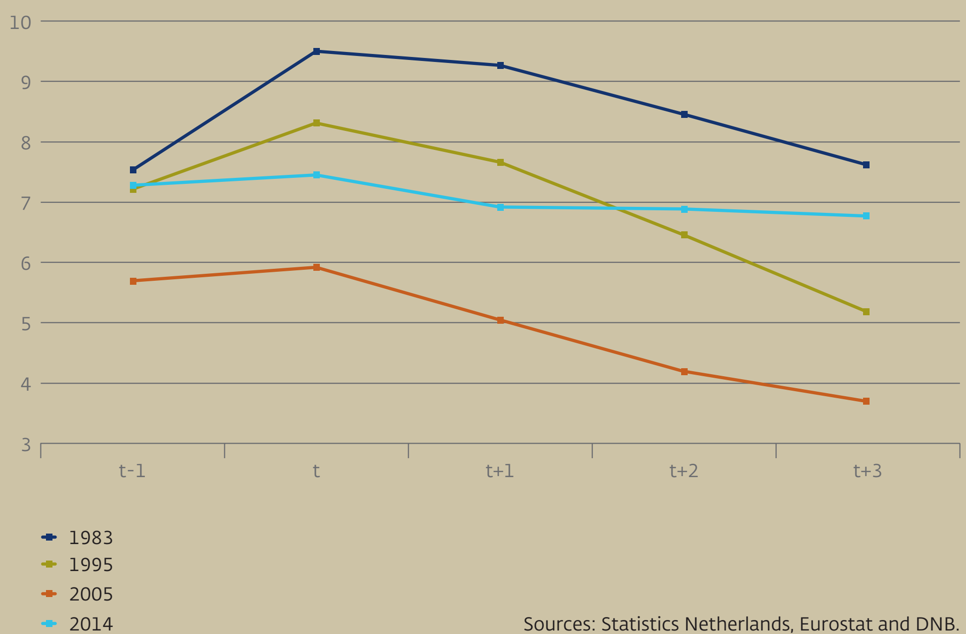
When employment growth accelerates more people enter the labour market, partly because of the improved chances of finding a job. On balance, unemployment will be at 6.9% this year and next, to decline slightly to 6.7% on average in 2017. Unemployment is falling at a slower pace than seen after previous recessions. Box 1 discusses this in detail.

Box 1 Unemployment is falling at a slower pace than usual

Unemployment is projected to fall by 0.7 percentage points between 2014 and 2017. In the first years following three previous recessions, unemployment fell at a quicker pace of almost two percentage points on average (see Chart 5). During the projection horizon, employment will hardly outpace labour supply. This is not so much due to the labour supply growing more strongly than usual, but rather to employment growing

Chart 5 Development of unemployment in various periods of economic recovery

Percentage of labour force



Sources: Statistics Netherlands, Eurostat and DNB.

at a relatively modest pace. This is being caused by developments in the public sector, the health-care sector, the relatively modest economic recovery, and the increasing number of older unemployed people.

Projected employment in both the public and the health-care sector is not or hardly increasing. While employment in these sectors grew especially sharply during previous periods of recovery, this time employment growth is almost fully accounted for by the market sector. Another difference with previous recoveries is that economic growth is relatively modest compared with the structural increase in labour productivity. GDP in the Netherlands is projected to grow by around 2% annually in the years ahead. At this rate, a large proportion of production growth can be achieved by more efficient and productive use of current staff. During previous periods of recovery, the economy often grew by between 3 and 4% annually. This increased the need for extra staff and fuelled employment growth. Companies may also have increased their efficiency by deploying more productive capital goods. Despite the crisis, investment in productivity-boosting ICT equipment continued unabated for instance. And last but not least, the number of older unemployed has grown quickly in the past few years. By now, more than one fifth of the total number of unemployed is aged 55 and over, from one tenth ten years ago. This is partly attributable to policy changes launched earlier, making early retirement less easy, which means that older people are available for the labour market longer. The large number of older unemployed people is holding back the decline of unemployment. They often find it difficult to rejoin the workforce. This is partly due to a perceived lack of topical knowledge and skills, but the relatively high wage costs and employers' perceptions are also playing a role here. The weak labour market position of older job seekers is for instance reflected in the unemployment rate in the 55 and over age bracket. This has hardly changed since its 2014 peak, and even accelerated shortly at the start of this year.

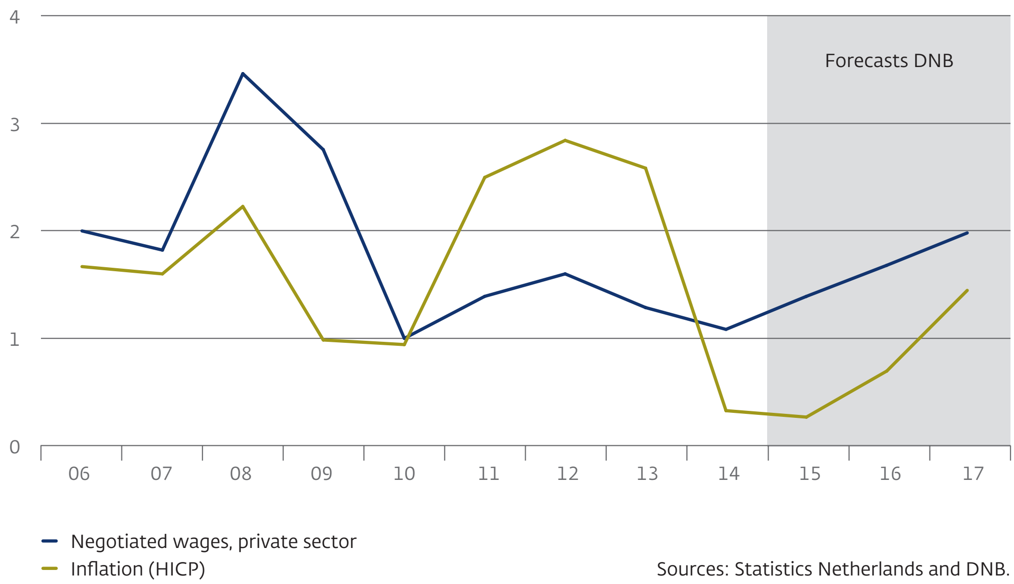
Wage growth is outpacing inflation

Contract wages have been growing at a steady and moderate pace for some time. During the first five years following the credit crisis (2010-2014) contract wages on average rose 1.3% annually. This is expected to accelerate to 2.0% in 2017, via 1.4% in 2015 and 1.7% in 2016. This projection is based on achieved growth of contract wages, assuming a slight acceleration of wage growth, thanks to labour productivity growth and a slow pick-up in inflation. As in 2014, corporate sector contract wage growth will continue to outpace inflation during the entire projection horizon (see Chart 6).

The general trend of contract wages hides large discrepancies between business sectors. Wage growth in the industrial sector as a whole will end up at just over 1% this year, but the

Chart 6 Negotiated wages and inflation

Year-on-year percentage changes



Sources: Statistics Netherlands and DNB.

building sector recently negotiated a 5.5% wage rise over two years (from the second half of 2015). After hardly moving between 2011 and 2014, contract wage growth in the public sector is catching up. Public-sector wages are expected to climb by 1.9% this year and 2.5% in 2016 in line with the most recent agreements made on 5% wage growth spread over two years.

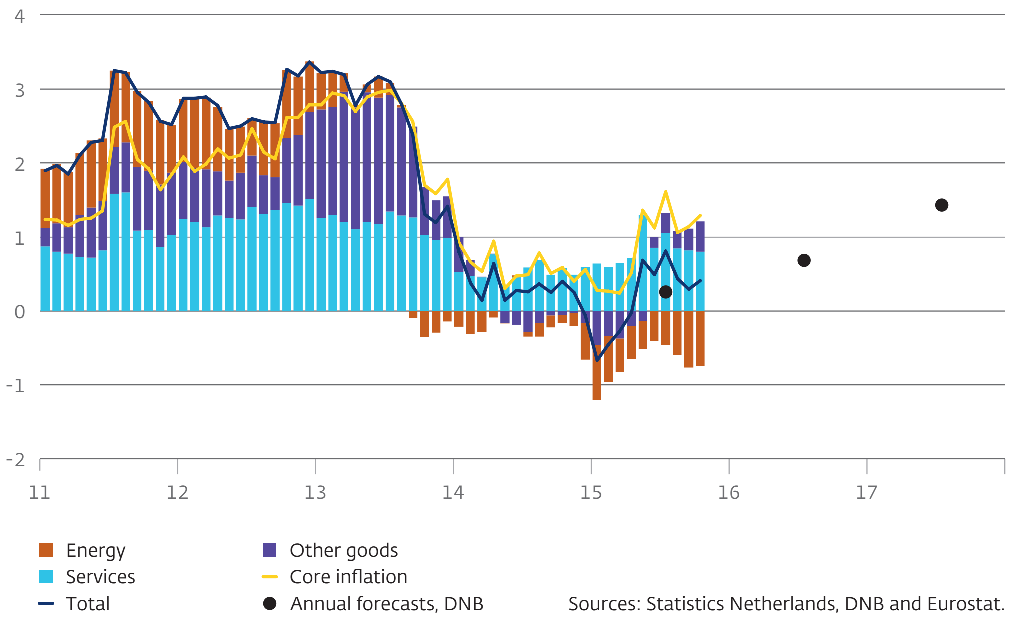
Inflation not expected to break the 1% barrier until after 2017

In 2014, HICP inflation ended up at the exceptional low of 0.3%. The sharp drops in the prices of oil and other commodities, as well as slumping food prices, contributed to this number (see Chart 7). At year-end 2014, inflation took another dive to below zero in the first three months of 2015, to rise again to 0.8% in July and 0.4% in October, primarily owing to accelerating price rises of unprocessed foodstuffs.

Core inflation, inflation excluding food and energy prices, has been outpacing HICP inflation since early 2014. At the start of 2015, core inflation fell to 0.2%, to bounce back to above 1% in May of this year, where it has remained since. This level of core inflation is an important indication that deflationary developments are off the cards for now. Remarkably, the services sector's contribution to inflation has declined in the past two years. During previous economic cycles, services inflation provided a floor for inflation, so to speak. Although the floor is still

Chart 7 HICP inflation

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



Sources: Statistics Netherlands, DNB and Eurostat.

Note: Core inflation = total excluding food and energy.

there, it seems to have lost some of its firmness. A part of this lower rate of inflation in the labour-intensive services sector can be explained by modest wage growth.

The full-year projection for HICP inflation for 2015 is 0.3%, unchanged from 2014. Inflation is expected to have climbed somewhat at the start of 2016, as the past drop in oil prices will have disappeared from inflation numbers by then. Slowly accelerating wage growth will also have an upward effect on inflation in 2016 and 2017, but this is expected to remain small for the time being as wage costs will not rise excessively, owing to the labour productivity growth that the business sector will manage to achieve. Inflation will also pick up thanks to the somewhat more pronounced projected increase in import prices. All in all, this means that inflation should edge up to 0.7% in 2016 and 1.4% in 2017. Historically, these are still low levels, but they are in line with the output gap that will still not have closed by that time.

Limited economic impact from the influx of refugees

The current refugee crisis is a humanitarian issue above all, but it also has an economic impact. It for instance influences government outlays, the labour market, housing production, and possibly even consumer confidence. The eventual effect on public finances and the labour market will primarily be determined by the labour participation of refugees, their length of stay, and the accessibility of collective services. The size of the stream of refugees and the resulting asylum migration are uncertain. The projection assumes 60,000 asylum seekers in 2015 and 2016 and 40,000 in 2017, and 80% of asylum applications being granted. This represents 80,000 migrants more than projected in June 2015.

In the short term, the extra influx of refugees will be accompanied by additional government outlays. Each stage of the asylum process involves costs, e.g. for housing, health care and legal support. If the asylum application results in a residence permit, the applicant has a right to social assistance benefits and other social security provisions. These extra government outlays will give a temporary boost to the economy, as they are not offset by revenue measures or retrenchments in the near term. In the long term, refugees in employment or owning a business may provide an additional positive impetus to the economy. The initial effect on the labour market will be small as labour participation is as yet low.[2]

Our projections include these two effects on public finances and the labour market. Housing investment may also get a boost from the influx of refugees. And the refugee crisis may have a temporary effect on consumer confidence. To assess the potential impact of these four effects on the Dutch economy, we ran a simulation in DELFI, DNB's macro model. Table 2 shows that

Table 2 Impact of additional influx of refugees in 2016 and 2017

Percentage changes, unless stated otherwise

	GDP		Unemployment (%)		EMU balance (% of GDP)	
	2016	2017	2016	2017	2016	2017
Public expenditure	0.05	0.04	-0.03	-0.04	-0.08	-0.13
Labour market	0.00	0.02	0.04	0.07	0.00	-0.01
Housing investment	0.01	0.11	-0.09	-0.17	0.03	0.10
Consumer confidence	-0.06	-0.02	0.00	0.03	-0.01	-0.04
Total	0.00	0.14	-0.07	-0.11	-0.06	-0.08

Source: DNB.

Note: Simulations based on 80,000 additional refugees, 20% labour participation, extra man-years construction of 7,000 and 9,000 FTE.

2 During their first years of residency, on average less than 20% of residence permit holders found their way to paid employment. The effect on the labour supply is further reduced by the fact that between 20 and 25% of asylum seekers is under 18 and will attend school first.

the macro-economic influence of the four described factors is very small. GDP growth will edge up a bit thanks to the additional government outlays, the increased labour supply, and housing investments, but this will be offset by a slight negative effect on consumer confidence. The latter is in line with the trends seen in earlier refugee streams, which witnessed a small and short-lived effect on consumer confidence. If all four effects occur together, this will boost GDP growth by 0.14 percentage points in 2017. In line with these developments, unemployment will decline by 0.1 percentage points in 2016 and 2017. The EMU balance is deteriorating by 0.1% of GDP, mainly due to the additional public spending. Further positive effects on the economy generated by increased labour participation by migrants with asylum status are only expected to manifest themselves after some time.

2 A closer look at spending and public finances

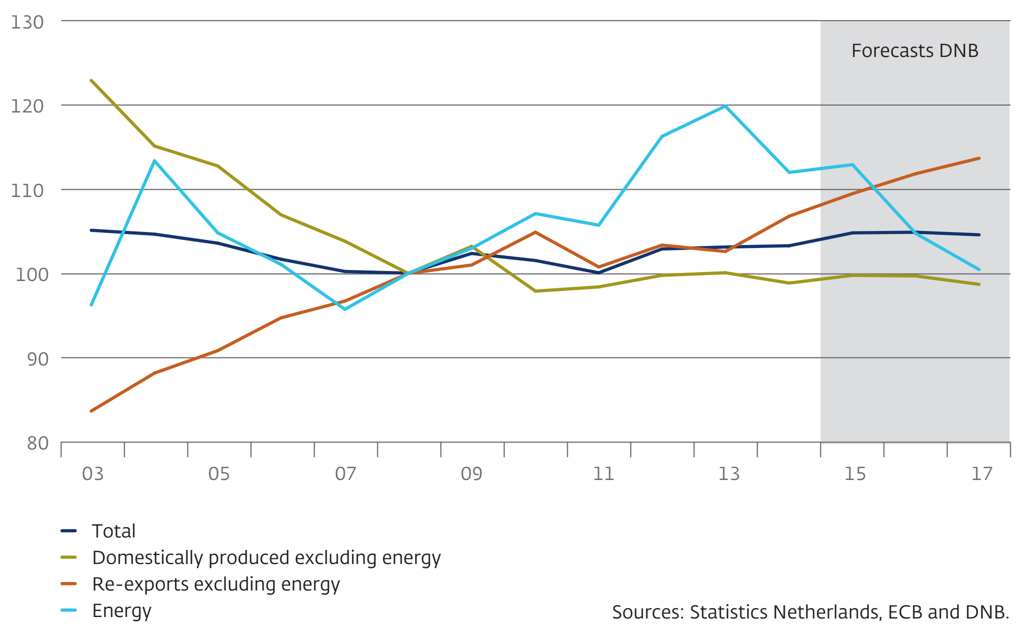
Market share of Dutch exports is edging up

After two disappointing years, worldwide demand for goods and services started to pick up again in 2014 (3.9%). In 2015, world trade growth will decelerate to 3.1%, after which it is projected to recover gradually towards the long-term average. Cumulatively, Dutch exports of goods and services will grow 13.7% until end-2017. This is slightly above the growth rate for world trade relevant to the Netherlands (12.2%). The growth discrepancy between exports and world trade will entirely manifest itself in the first half of 2015 (see Chart 8).

The trend of exports is largely driven by energy and re-exports. Due to the natural gas production cap, exports of energy will decline by over 3.5% during the projection horizon. The bulk of this decline will materialise at the end of 2015. As is usually the case, growth of re-exports will outpace world trade. Cumulative growth over the projection horizon will amount to over 16%. This part of exports has only a minor effect on GDP growth, as re-exports are offset by imports of roughly comparable size.

Chart 8 Market share of exports

2008 = 100; volume



Sources: Statistics Netherlands, ECB and DNB.

Note: Index is the category in question divided by relevant world trade.

After adjustment for energy and re-exports, domestically produced exports excluding energy remain. These 'made in Holland' exports will grow relatively sharply in 2015 (4.0%), compared with world trade growth (3.1%). Over the projection horizon, domestically produced exports will show cumulative growth of 9.4%. In the years ahead, exports will profit from an improved price-competitive position, among other things owing to the depreciation of the euro. The decline in unit labour costs this year will continue to depress export prices in 2016 and 2017, which will improve the price-competitive position (Table 3).

Table 3 Dutch exports and competitiveness

Percentage changes, unless stated otherwise

	2014	2015	2016	2017
Volume				
Relevant world trade	3.9	3.1	3.9	4.7
Exports of goods and services	4.0	4.6	3.9	4.5
domestically produced	2.0	3.8	1.9	2.7
re-exports	6.6	5.6	6.2	6.4
Exports of goods and services excl. energy	5.0	4.7	4.9	4.9
domestically produced	2.6	4.0	3.8	3.7
re-exports	8.2	5.6	6.2	6.4
Price				
Competitor prices (1)	-0.9	2.8	1.0	2.2
Exports of goods and services	-1.8	-2.5	0.7	1.7
domestically produced, excl. energy (2)	-0.3	4.1	0.0	1.4
Price competitiveness (1-2)	-0.7	-1.3	1.0	0.8

Sources: DNB and ECB.

Private consumption is rapidly recovering...

After stagnating last year, private consumption will grow vigorously this year. Households will see their disposable income rise, partly on the back of accelerating employment. Consumer confidence and house prices are also on the up. In March of this year, consumer confidence for the first time since 2007 broke the zero line, meaning that there are now more optimistic than pessimistic consumers. Since then confidence has climbed further to a value of 9 in November. In 2014 and 2015, the increase in consumer confidence had an annualised effect of 0.5 percentage point on consumption growth. Consumer confidence has increased thanks to the slight dip in unemployment and higher house prices, but a substantial part of improved consumer confidence in 2015 cannot be attributed to financial or economic developments. There also seems to be a general upswing in consumer sentiment.

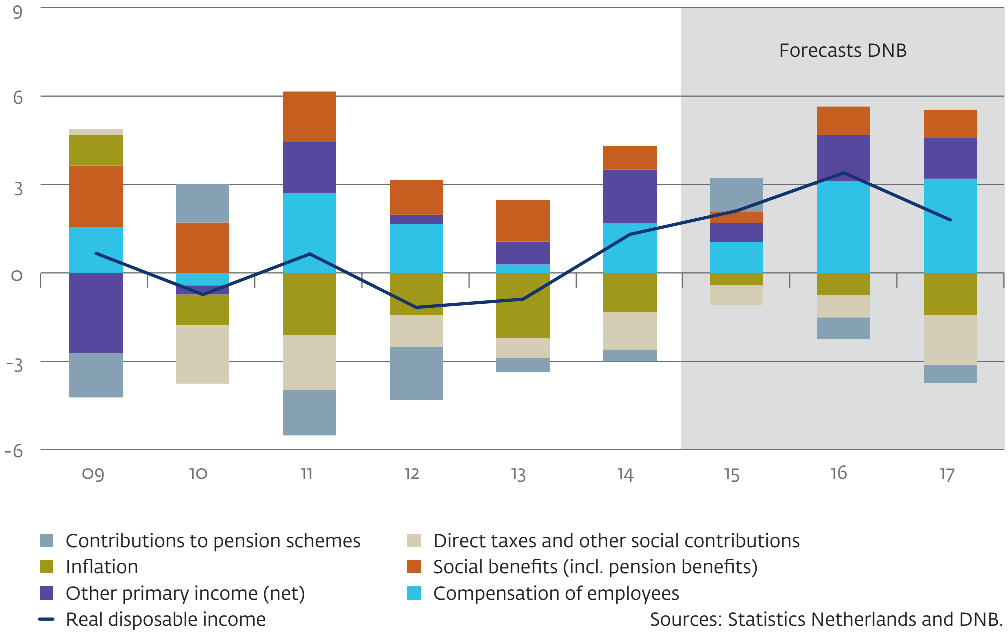
In addition to influencing confidence, the improved housing market also has a direct effect on consumer spending. Whereas declining house prices have been putting a brake on household spending since 2008, the pick-up in the housing market is now having the opposite effect. This year and next, the rising value of housing assets will boost consumption growth by almost one percentage point. All in all, this means that households in 2015 will have increased their spending for the first time since 2011, upping their expenditure by 1.7%. Consumption growth is projected to accelerate in the years ahead. In 2016 and 2017, private consumption should grow by 2.4% and 2.7% respectively, numbers last seen in 2000.

...mainly on the back of strongly accelerating household income growth

Following a prolonged period of stagnation between 2011 and 2013, real disposable household income started growing again in 2014 (1.3%). For this year growth of 2.1% is anticipated, followed by 3.4% in 2016, the highest level seen since 2001. This strong upswing in average household income is primarily attributable to the fact that employment is expanding again. This, and higher real remuneration has provided for a strong contribution from employee compensation (see Chart 9).

Chart 9 Real disposable household income

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



Sources: Statistics Netherlands and DNB.

Note: The size of each coloured area in a column indicates the contribution of an income component to total growth. Inflation is based on the private consumption deflator.

This year, disposable household income will also be boosted by the fact that lower pension contributions will be made on balance. This is in turn being prompted by the tightening of the rules on tax relief for pension contributions (the Witteveen framework). Employers and the employed will together pay 2% lower pension contributions. This will contribute 1.1 percentage points to income growth in 2015, representing a little over half of the total increase in real disposable household income. Next year, disposable income will get another boost from the anticipated EUR 5 billion tax cuts. The projected 3.4% income growth is largely accounted for by this tax reduction.

Personal savings return to the black

Owing to growing disposable income, households are once again able to save part of their income. From 2004 through 2013 the individual savings ratio was negative each year. During these years, households on balance withdrew their savings to supplement their disposable income. In addition to this, a substantial part of income is earmarked for obligatory collective savings. The collective savings ratio, the balance of pension contributions paid and received as a percentage of disposable income, will fall from 2015 onwards, among other factors due to the reduction of pension contributions mentioned above (see Chart 10). In 2016, the increase in disposable income will accelerate further, owing to the lower tax burden.

Chart 10 Individual and collective savings

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

Sources: Statistics Netherlands and DNB.

This will initially cause the savings ratio to increase further, as households will only gradually adjust their spending to the extra income growth. In 2017, the savings ratio will decline again, as a larger proportion of income growth will be used for consumption.

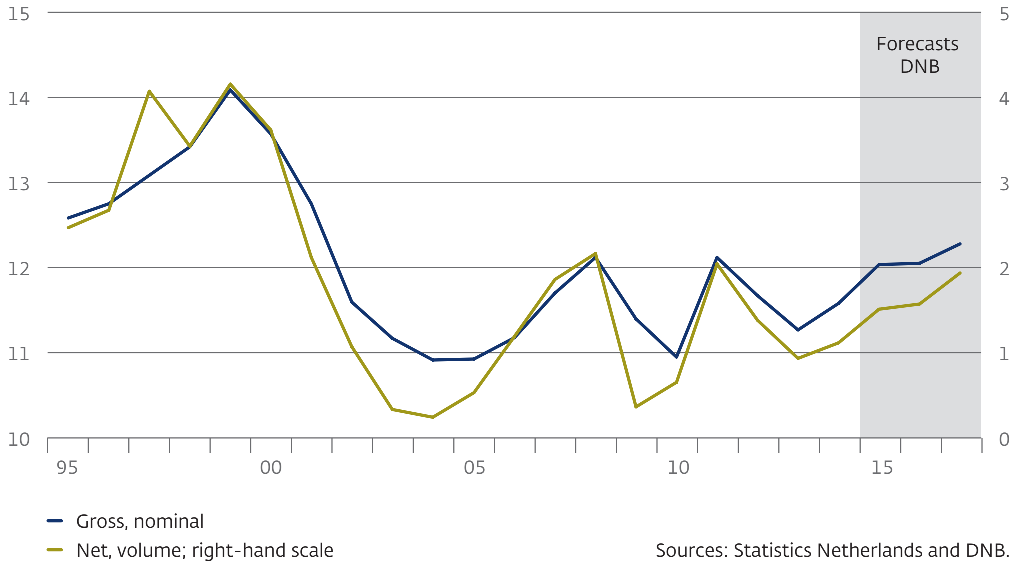
Steady growth of business investment

Business investment has been showing an upward trend since 2014. Following two years of contraction, investment last year grew by 4.2%, with 5.5% expansion foreseen for this year. Next year, investment growth will decelerate to 1.9%, in order to re-embark on its previous expansion rate, growing by 4.6% in 2017. The dip in investment growth anticipated for 2016 is related to lower GDP growth that year.

The investment ratio, the ratio between nominal investment and GDP, will edge up during the projection horizon (see Chart 11). In 2014, the investment ratio came to 11.6%, which equals the average level seen in the past 15 years. The investment ratio is projected to climb to 12% in 2015 and 2016, and will edge up to 12.3% in 2017, its highest level since 2001. Taking into account the price trend of investment goods relative to the GDP deflator, the net investment ratio proves to increase somewhat stronger still (expressed as percentage change). In itself this is a positive development; a low net investment ratio is an indication of a slowly rising stock of capital goods, which may put a break on production capacity in the longer term.

Chart 11 Business investment

Percentage of GDP



Sources: Statistics Netherlands and DNB.

The deceleration in investment growth in 2016 is prompted by non-recurring factors. Additional investments in transport equipment are foreseen for the fourth quarter of 2015, due to the announced increase in the addition to taxable income for private use of company cars in 2016. Businesses are bringing forward the purchase of company cars, resulting in an investment peak around the end of this year, and a slight dip at the start of 2016 as a result.

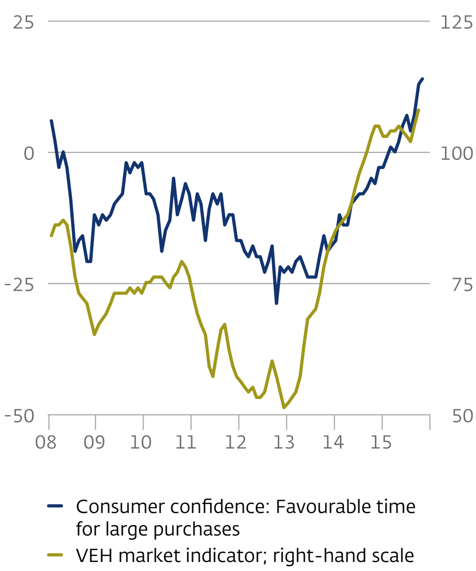
Housing market is recovering surprisingly rapidly

After shedding 22% in five years, house prices in the Netherlands have been bouncing back since mid-2013, gaining 6.8% on average (October 2015). The subdued price recovery to date – in comparison with the 22% total decline – means that for a large number of households the price of their home is still below its purchase level. This is dampening the number of housing transactions, especially due to the mortgage debt that remains after possible sale. Confidence in the housing market has since been restored. Chart 12 shows two indicators pointing towards a strong recovery of confidence since the turning point in 2013.

In line with increased confidence, the number of transactions has bounced back to the numbers recorded before prices started to fall. In October, the six-month average was 16,000

Chart 12 Housing market recovery

Balance of answers, index, twelve-month sum in thousands



Note: VEH market indicator: value between 0 en 200, in which 100 represents a 'neutral sentiment'.

Sources: Statistics Netherlands, Kadaster and Dutch Home Owners Association VEH.

a month, which equals the level seen in mid-October 2008. The current transaction average is only slightly below the year-end 2005 peak of 19,000. At the end of last year, the number of transactions also peaked as a result of the anticipated adjustment of tax rules, falling back slightly at the start of 2015.

The sharp upturn in housing transactions is contributing to the revival of housing investment. Housing investment is not only made up of investment in new building and renovation, but also of costs related to the sale of existing homes. In the fourth quarter of 2014 housing investment gained a remarkable 14% on the preceding quarter. Growth lost some momentum in the following quarters, dipping to 5% and over 8%, respectively. An exceptional 27% growth rate is projected for this year, after which growth is expected to return to more normal levels of 8% in 2016 and 4% in 2017.

Stagnating improvement in public finances after 2015

In itself the economic rebound is having a beneficial effect on public finances, but this is offset by some other developments, both on the revenue and the expenditure side. Falling unemployment will reduce expenditure on unemployment benefits, mainly in 2015, and tax revenue is developing favourably. Private consumption, which brings in relatively high tax revenue, is set to increase sharply in the years ahead. The policy measures announced and launched earlier, including cutbacks in curative health care and the reform of long-term care, are for instance dampening expenditure growth, and interest expenditure will continue to fall.

The decline in budget deficits will nevertheless stagnate during the projection horizon. For a significant part this is due to the envisaged EUR 5 billion package of tax cuts, which will cause the financing balance to deteriorate by 0.7% of GDP from 2016. The production of the Groningen natural gas field has been assumed to remain stable at 27 billion cubic metres in conformity with the 18 November 2015 ruling of the Council of State. The cap on the production of natural gas will cause public revenue to decline by 0.3% of GDP relative to the production ceiling of 39.4 billion cubic metres, which formed the basis of our previous projections. And finally, the increased number of asylum seekers will involve additional public expenditure. These costs have two aspects. On the one hand, there are immediate costs for the intake of asylum seekers, which are estimated at 0.1% of GDP in 2016 and 2017. And on the other, there are outlays for status holders (asylum seekers with residence permits). Status holders have a right to social security and other collective services. Based on the relevant assumptions, these additional public outlays will climb to around 0.2% of GDP in 2017.

All in all, the public deficit is projected to fall to 2.0% of GDP in 2015, from 2.4% in 2014 (see Table 4), to rise slightly again to 2.2% of GDP in 2016 en 2017. Public spending growth will lag behind nominal GDP growth, and taxes and social insurance contributions will decline in 2016, due to the announced tax cuts. The structural budget balance is set to deteriorate to

-2.5% in 2017 from -0.7% of GDP in 2014, as a consequence of the tax cuts, lower natural gas revenue and the additional expenditure related to the influx of refugees. Owing to nominal GDP growth, the public debt as a percentage of GDP is set to decline during the projection horizon, although budget deficits will continue to exist. We have also assumed that ABN AMRO will be privatised further in the years ahead. As a result, the EMU debt is set to be reduced to 65.2% of GDP in 2017 from 68.2% in 2014

Table 4 Public sector key data

Percentage of GDP

	2014	2015	2016	2017
Public expenditures	46.2	45.2	44.6	44.3
Taxes and social security contributions	37.5	37.4	37.1	37.0
Other income	6.4	5.9	5.4	5.1
Primary balance	-0.9	-0.7	-1.0	-1.1
EMU balance	-2.4	-2.0	-2.2	-2.2
Structural balance (EC method)	-0.7	-1.1	-2.1	-2.5
EMU debt	68.2	66.8	66.4	65.2

Sources: Statistics Netherlands and DNB.

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3 An alternative scenario for the Dutch economy

Growth deceleration in China causes financial turbulence

Vulnerabilities in the recovery of the world economy will present a downward risk for the Dutch economy. A stronger than anticipated hiccup in the pace of growth in China may be a trigger for such downward risk. The following scenario explores the possible consequences of a stronger than anticipated slowdown in China, combined with increasing uncertainty on global financial markets. At first glance, an economic slowdown in China would have limited consequences for the Netherlands as only 1.5% of Dutch exports were destined for China in 2014. The direct claims that the Dutch financial sector has on China are also relatively small. Nevertheless, negative effects for the Netherlands may become significant through contagion by means of other emerging economies, indirect trade effects, financial turbulence, and deteriorating economic sentiment.

This scenario assumes that economic growth in China will slow down substantially in 2016 and 2017, as a result of the unexpectedly quick transition towards a more consumption-driven economy in that country. In addition, China is being faced with the challenge of reducing the accumulated imbalances following years of high credit growth and overinvestment. Consequently, growth in China in this scenario is expected to decline by over 1 percentage point annually.[3] As a result, the economic outlook of other emerging economies will also deteriorate,

Table 5 Scenario assumptions (growth slowdown in China)

Percentage deviations from baseline scenario, unless stated otherwise

	2016	2017
International:		
Domestic demand, China	-3	-7
Exchange rate, EMEs	-10	-10
Global risk premium (bps)	75	75
Global producer confidence	-2.5	0.0
Netherlands:		
Volume of relevant world trade	-1.2	-1.7
Euro exchange rate (USD)	-2.0	-3.3
Competitor prices	-2.1	-3.6
Oil price	-0.5	-0.5
Equity prices	-9.7	-8.9
Consumer and producer confidence	-2.5	0.0

Source: DNB.

Note: Assumptions based on historic analyses and calculations by the ECB; not adjusted for monetary policy. Producer confidence measured by the EU Economic Sentiment Indicator (ESI). Dutch assumptions based on NiGEM.

3 This slowdown corresponds with the recent analyses made by the Bank of England and the OECD about the negative spillover effects from the Chinese economy.

leading to outflows of capital and falling exchange rates. This will be accompanied by increasing risk averseness also in the mature economies, and rising risk premiums causing share prices to drop and consumer and producer confidence to decline. Ultimately, the volume of world trade relevant to the Netherlands will end up 1.2% lower than projected in 2016 and 1.7% lower than projected in 2017. Table 5 depicts the quantification of international assumptions and the resulting assumptions for the Netherlands, based on the global NiGEM model.

This global economic slowdown will have considerable consequences for the Netherlands (see Table 6). Lower growth of relevant world trade will translate into a downward effect on GDP growth by means of exports. GDP growth and exports will respectively end up 0.7 percentage points and 0.5 percentage points lower than projected, causing unemployment to grow sharply in 2017 to 7.2% of the labour force. In addition, lower production growth and waning producer confidence will considerably depress business investment in 2016 and 2017. Lower house prices, lower share prices, declining consumer confidence, and rising unemployment will have a delayed dampening effect on private consumption in 2017. Falling demand, lower import prices and lower oil prices will keep down inflation, which will fall back by 0.6 percentage points in 2017. Increasing unemployment will cause public finances to deteriorate, which will cause the budget deficit to rise to 2.7% of GDP.

Table 6 Scenario results (growth slowdown in China)

Percentage changes, unless stated otherwise

	2016	Deviation from projection	2017	Deviation from projection
Gross domestic product	1.0	(-0.7)	1.7	(-0.5)
Private consumption	2.2	(-0.2)	2.1	(-0.6)
Business investment	0.1	(-1.8)	3.3	(-1.3)
Housing investment	6.6	(-1.6)	3.8	(-0.6)
Exports of goods and services	2.4	(-1.5)	3.3	(-1.2)
Imports of goods and services	4.0	(-1.3)	4.3	(-1.2)
Consumer confidence (level)	1.9	(-5.1)	-0.6	(-5.3)
Negotiated wages, private sector	1.7	(0.0)	1.5	(-0.5)
Harmonised consumer price index	0.5	(-0.2)	0.8	(-0.6)
House prices, existing own homes	3.2	(-0.2)	2.4	(-0.8)
Unemployment (% of labour force)	7.0	(0.1)	7.2	(0.5)
EMU balance (% of GDP)	-2.3	(-0.1)	-2.7	(-0.5)
Current account (% of GDP)	10.3	(-0.8)	9.3	(-1.5)

Source: DNB.

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