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Economic Developments and Outlook

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

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Summary

The Dutch economy continues to grow vigorously, while GDP growth is falling off. Having amounted to 3.0% in 2017, GDP growth is projected at 2.5% for 2018, followed by 1.7% in 2019 and 2020. Despite slightly lower growth figures, the Dutch economy will be running at full steam over the projection horizon, with actual output exceeding its potential. Public and consumer expenditure are delivering the largest contribution to economic growth. Households should benefit from a pick-up in wage growth, which will boost real disposable income in 2019 and 2020. The contributions to GDP growth made by exports and investment (including housing) are projected to fade as the projection horizon progresses.

Employment growth is projected to have been vibrant in 2018, and unemployment is set stabilise at a very low level of 3.6% of the working population in 2019. Since late 2017, employment has grown more sharply among employees on permanent contracts than among those on flexible contracts, causing the proportion of permanent employees to edge up for the first time in a decade. This trend is partly due to the very tight labour market. In the fourth quarter of 2018 over a quarter of businesses reported that their production was being hampered by staff shortages.

HICP inflation should reach 1.6% in 2018 before rising sharply to 2.7% in 2019 on increases in energy tax rates and the low VAT rate to 9% from 6%. An inflation rate of 1.8% is expected for 2020, but adjusted for food and energy it should amount to 2.0%, with the immediate effect of the VAT increase having worn off. In 2018, compensation per employee in the business sector is set to regain momentum, growing by 2.3%. Our projections show that it will be 3.0% in 2019 and 3.8% in 2020, assuming the usual wage-price dynamics.

A downward correction on the international financial markets may cause the economic outlook to deteriorate, as the pace of growth in the emerging market economies, including China, is projected to slow down. In this alternative scenario, which includes growing risk aversion and declining global economic growth and confidence, the Dutch economy will also be affected, showing 0.4 percentage points lower GDP growth on average annually in 2019 and 2020.

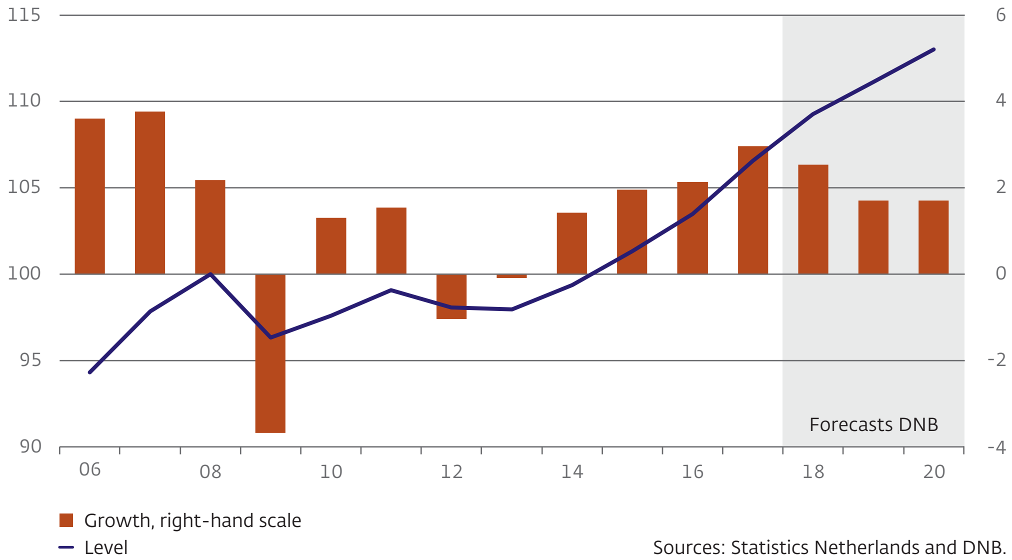
1 The Dutch economy in 2018-2020

Economic growth normalises

The economic boom is set to continue, but the Dutch economy will lose some of its dynamics in the years ahead. Gross domestic product (GDP) growth peaked at 3.0% in 2017 (Figure 1). GDP is projected to grow by 2.5% in 2018, whereby the output gap is expected to continue widening to 1.0% from 0.3% in 2017. GDP growth will recede to 1.7% in both projection years 2019 and 2020, approximating potential growth of around 1.6%. Employment has grown vigorously in 2018, and unemployment will stabilise at a very low level of 3.6% of the working population in the course of 2019.

In the last three quarters of 2017, GDP in the Netherlands grew by over 0.8% on average relative to the preceding quarter, to slow down to 0.5% on average in the first three quarters of 2018. The recent decline in quarterly GDP growth indicates that economic growth is slowing down gradually to a more normal growth pace, which is more or less in line with potential, trend-based growth. Other indicators are confirming this picture. Producer confidence for instance stagnated in early 2018 after having risen sharply since 2016. Since then, confidence has edged down slightly to what are still high levels historically speaking. Consumer confidence has also been displaying a slight downward trend since the start of 2018, but has nevertheless remained at high levels. Parallel to these domestic developments, it became clear at the start of 2018 that the vigorous international upswing seen in 2017 was of a temporary nature. At the time, world trade was growing at its highest pace in six years, to slow down at the start of 2018.

Figure 1 Gross domestic product
Volume; 2008 = 100 and year-on-year percentage changes



Sources: Statistics Netherlands and DNB.

Partly due to the slowing growth pace of world trade, the Dutch economy has been leaning more on domestic expenditure since the start of 2018. First of all, this is private consumption, which is driven by household income growth. Real disposable income is set to expand by 2.0% in 2018, the highest growth rate recorded since 2001. This is to a growing extent attributable to wage growth per employee, while the contribution of the increasing number of employees is projected to decline in the years ahead. In 2019 and 2020, public expenditure is projected to make a relatively substantial contribution to economic growth. Private investment (including housing) dipped in the third quarter of 2018, which will depress its contribution to economic growth in 2019. In 2020, too, investment is expected to make a limited contribution only to growth.

International economic activity is slowing down

Global economic growth peaked in the second half of 2017. The European Central Bank (ECB) projects global GDP growth, excluding the euro area, to slow down slightly to 3.5% in 2019, and 3.6% in 2020, from 3.8% in 2018.[1] This is related to the maturing economic growth cycles across a major part of the world. Flattening growth amid ongoing trade tensions and increasing protectionism will impact world trade growth, which is reflected in the confidence index for export orders of the European industrial sector (Figure 2). For our projections this signifies a sharp deceleration of growth in world trade relevant to the Netherlands to 3.2% in 2018, from almost 5% in 2017, followed by a slight recovery to 3.6% in 2019 and 3.8% in 2020.

Economic growth in the United States remains high, underpinned by tax reforms and the upbeat labour market. Ongoing monetary tightening and the trade tensions with China are, however, expected to depress GDP growth in the United States in the years ahead. GDP growth in Japan and the United Kingdom is expected to have remained modest in 2018 at 0.9% and 1.3% respectively. GDP growth in Japan is expected to weaken, due to fewer budgetary incentives and the tight labour market. Growth projections for the United Kingdom depend on how Brexit pans out. Our projections assume that an agreement with a transition period running to end-2020 will be concluded.

Growth in China should gradually abate due to the transition to a more balanced growth path and reduced budgetary incentives. Economic growth is expected to slow down in Argentina and Turkey, in the aftermath of the turmoil on the financial markets and ongoing political uncertainty. Growth prospects are more favourable for other large emerging economies like Brazil and Russia.

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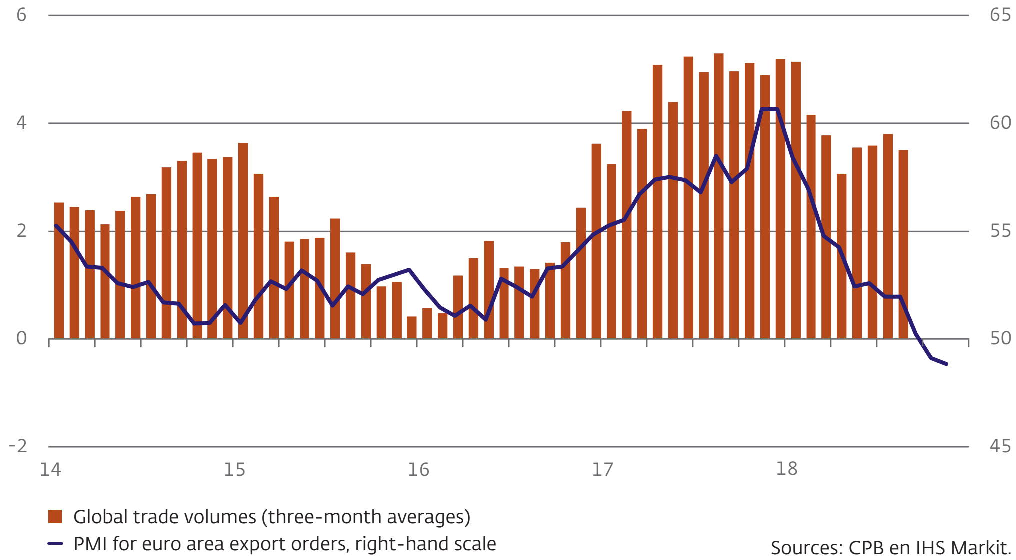
1 The assumptions underlying the development of relevant world trade, exchange rates, international commodity prices and interest rates are based on information available on 21 November 2018.

Figure 2 Global trade volumes and euro area export orders

Year-on-year percentage changes and diffusion index



Sources: CPB en IHS Markit.

The economic outlook for the euro area has deteriorated somewhat in the past six months, due to declining global economic growth and mounting uncertainties. Nevertheless, there are sufficient factors underpinning growth, including the ongoing accommodating monetary policy, reduced unemployment and the favourable trend of domestic demand. The ECB projects euro area GDP growth of 1.9% in 2018, and 1.7% in 2019 and 2020.

Oil prices fell back again in the autumn of 2018 to around USD 60 per barrel, having climbed continuously since early 2016 (from USD 28 per barrel). In the light of the geopolitical tensions, e.g. those between the United States, Saudi Arabia and Iran, the projected trend of oil prices is uncertain, which is posing a risk for the inflationary environment. Our projections assume a USD/euro exchange rate of USD 1.18 in 2018 and USD 1.14 in later projection years.

Downward risks in the international environment

A hard Brexit is a major downward risk for the Netherlands. At the time of writing this report, there is an agreement between the United Kingdom and the EU on the table that still needs to be approved by the British and European parliaments, however. If the agreement is approved, the risk of a hard Brexit at the end of March 2019 will have been warded off, and a transitional period will begin on 29 March, during which the two parties will negotiate their future relationship. Whatever happens, trade relations with the United Kingdom after the transition period will continue to be unclear for a long period of time. This means that Brexit remains a risk to the Dutch economy. If the agreement is rejected, the likelihood of a disorderly Brexit increases, which negatively impacts the economy.

Uncertainties surrounding ongoing protectionism continue, although the immediate risks for the Netherlands and the euro area seem to have waned slightly recently. Import tariffs will negatively impact the US and Chinese economies in particular. Several research reports have indeed revealed a limited positive effect on the euro area, owing to shifts in trade.

The transition in China to a more sustainable growth path may initially create some waves in the financial, product and commodities markets, which will negatively impact the global economy. In addition, broader turmoil in the financial markets of emerging economies may develop, in particular in response to an appreciating dollar and the tightening monetary policy pursued by the United States. Although countries with weak economic fundamentals, like Argentina and Turkey, are the most vulnerable to these developments, larger effects may also emerge if global financial turmoil develops. Section 3 discusses the effects this scenario has on the Netherlands.

Household spending and public expenditure are fuelling growth

Table 1 lists the key data for the Dutch economy for 2017-2020. The economic upswing, which started in 2014, is continuing, but the pace of GDP growth is slowing down gradually. Private consumption growth in 2018 will clock up an exceptionally high 2.7%, to decline to 1.7% and 1.6% in the two years thereafter. A sharper slowdown is visible in housing investment, which in 2017 increased by 12%, and less than half of this in 2018. In subsequent years, growth will stabilise at slightly over 3%. Housing investment is growing less sharply, owing to fewer existing homes being sold among other factors. Corporate investment growth (excluding housing) is also projected to have declined to 4.5% in 2018, from 5.7% in 2017. Partly due to slowing GDP growth, corporate investment is projected to fall off to 1.9% in 2019, to recover slightly to 2.7% in 2020. If domestic private spending is set to flatten in 2019 and 2020, the opposite holds true for exports. Exports are expected to have slowed down in 2018 relative to 2017, and should accelerate again from 2019 onwards.

Figure 3 shows the composition of GDP growth, whereby the concomitant part of imports has been deducted for each expenditure category. In 2017, almost half of GDP growth was contributed by exports. In our three-year projection horizon, GDP growth is largely accounted for by domestic expenditure. At 0.9 percentage points, private consumption made a large contribution to GDP growth in 2018, but this is set to decline to around 0.5 percentage points. The contributions made by corporate and housing investment will also decrease sharply. Having made substantial contributions in 2016-2018, the contribution made by housing investment will decline to 0.1 percentage points only in 2019 and 2020.

Table 1 Key data in forecast for the Dutch economy

Percentage changes, unless stated otherwise

	2017*	2018	2019	2020
Volume of expenditure and output				
Gross domestic product	3.0	2.5	1.7	1.7
Private consumption	1.9	2.7	1.7	1.6
Public expenditure	1.1	1.2	2.6	2.0
Business investment	5.7	4.5	1.9	2.7
Housing investment	12.0	5.9	3.0	3.1
Exports of goods and services	5.6	2.6	3.2	3.5
of which domestically produced	4.7	2.4	2.0	2.6
of which re-exports	7.0	3.0	4.9	4.8
Imports of goods and services	5.2	2.8	3.7	4.0
of which domestically used	3.9	2.7	3.0	3.6
Wages and prices				
Negotiated wages, private sector	1.5	2.1	2.6	3.0
Compensation per employee, private sector	0.9	2.3	3.0	3.8
Unit labour costs	0.5	1.8	2.5	2.3
Prices of domestically produced exports	3.1	1.8	1.3	1.7
Harmonised consumer price index	1.3	1.6	2.7	1.8
House prices, existing own homes	7.6	9.0	5.5	2.8
Labour market				
Employment (persons, growth)	2.2	2.4	1.3	0.4
Labour supply (persons, growth)	1.0	1.4	1.1	0.4
Unemployment (persons x 1,000)	438	351	334	342
Unemployment (% of labour force)	4.9	3.8	3.6	3.6
Public sector and financial				
EMU balance (% of GDP)	1.2	1.4	1.0	0.4
EMU debt (% of GDP)	56.9	52.4	49.3	47.0
Current account (% of GDP)	10.5	9.8	9.3	9.0
Mortgage loans (based on end-of-period)	1.4	2.1	3.2	2.9
Bank lending to NFCs (based on end-of-period)**	-2.6	-0.6	0.0	1.0
International assumptions				
Volume of relevant world trade	4.9	3.2	3.6	3.8
Volume of GDP US	2.2	2.9	2.5	2.0
euro area	2.4	1.9	1.7	1.7
emerging markets	4.4	4.4	4.2	4.6
Short-term interest rate in the euro area (%)	-0.3	-0.3	-0.3	0.0
Long-term interest rate in the Netherlands (%)	0.5	0.6	0.7	0.9
Euro exchange rate (USD)	1.13	1.18	1.14	1.14
Competitor prices	1.7	0.6	2.9	2.1
Oil price (UK Brent in USD per barrel)	54.8	72.1	67.5	66.8
Commodity prices excluding energy (USD)	7.9	3.0	-1.4	4.4

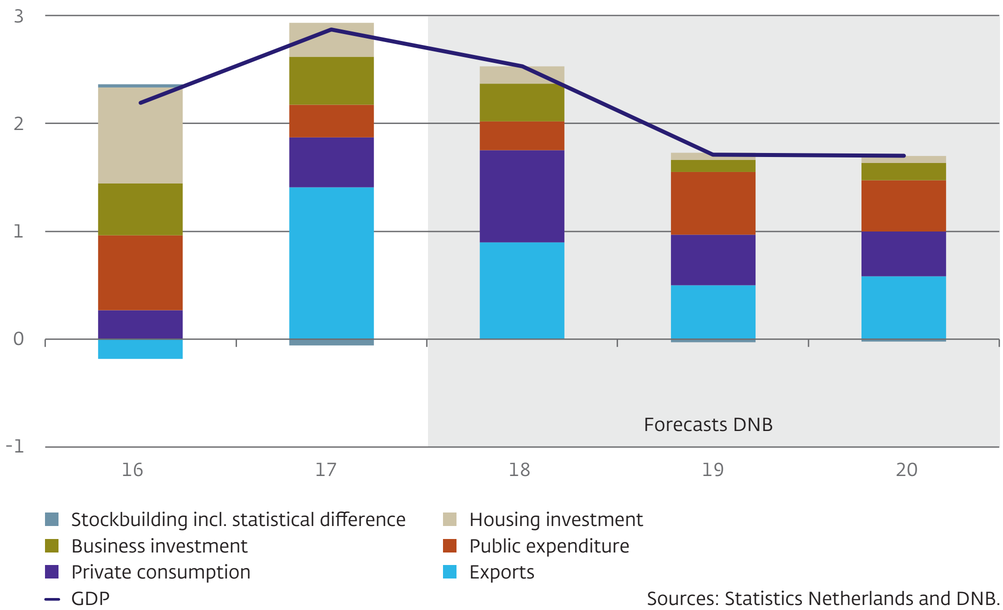
Sources: DNB and ECB.

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

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

Figure 3 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.

The contribution made by public expenditure will show a remarkable doubling to 0.6 percentage points in 2019 from 0.3 percentage points in 2018. Although substantial additional spending is planned in the Government's policy programme, realised growth of public expenditure in 2018 is disappointing. In 2018, public expenditure is projected to have made about the same contribution to GDP growth as in 2017. Our projections show that the planned additional expenditure in 2019 will make a substantial contribution to GDP growth, but it remains to be seen how much of the increase will be realised. Box 1 discusses an uncertainty variant with respect to public expenditure, and shows the effect on our projections of an alternative development in house prices in the Netherlands.

Businesses activity at high levels

GDP growth has been above projected potential growth since 2014. This has improved the output gap, which was negative almost without interruption since 2009. The output gap became positive again in 2017, and is projected to amount to 1% in 2018. As projected GDP growth in 2019 and 2020 is closer to potential growth, the output gap will widen less sharply in the years ahead. This indicates that great demand is being made on the available corporate production capacity. In the fourth quarter of 2018, the capacity utilisation rate in the manufacturing industry came to 84.0, above the peak recorded shortly before the credit

Box 1 Domestic uncertainty variants for the Dutch economy

The trend of house prices is a major determining factor for household spending. The projection assumes a slowdown in house price rises relative to the previous years (see also section 2). House price rises may conceivably take longer to slow down, and may remain at their current level of 9% in 2019 and 2020. If this happens, GDP growth will be higher in those years, driven by higher growth of housing investment and private consumption. Relative to the projection, GDP growth in 2019 will end up 0.2 percentage points higher at 1.9%, and 0.4 percentage points higher at 2.1% in 2020 (Table 2). An important qualification accompanying these positive expenditure effects is that this level of economic growth is unsustainable in the longer term. Financial imbalances and risks will increase and first-time buyers will find it increasingly difficult to enter the market.

To date, the announced increase in public expenditure has proved difficult to realise. This is related to the tense business cycle. The labour market for trained professionals is tight and there are long delivery times for materials and commodities. The current projections assume that public expenditure has grown by 1.2% in 2018, which is considerably below the previous projections made in June 2018 of 2.5%. In the coming two years, the growth rate of public expenditure may again be disappointing. In order to chart the impact this would have, we have assumed that volume growth of public consumption and investment taken together will not increase further in 2019 and 2020, but remain unchanged from the level seen in 2018 (1.2%). Relative to the projection, GDP growth will end up 0.3 percentage points lower at 1.4% in both 2019 and 2020 (Table 2).

Table 2 Domestic uncertainties

Percentage changes

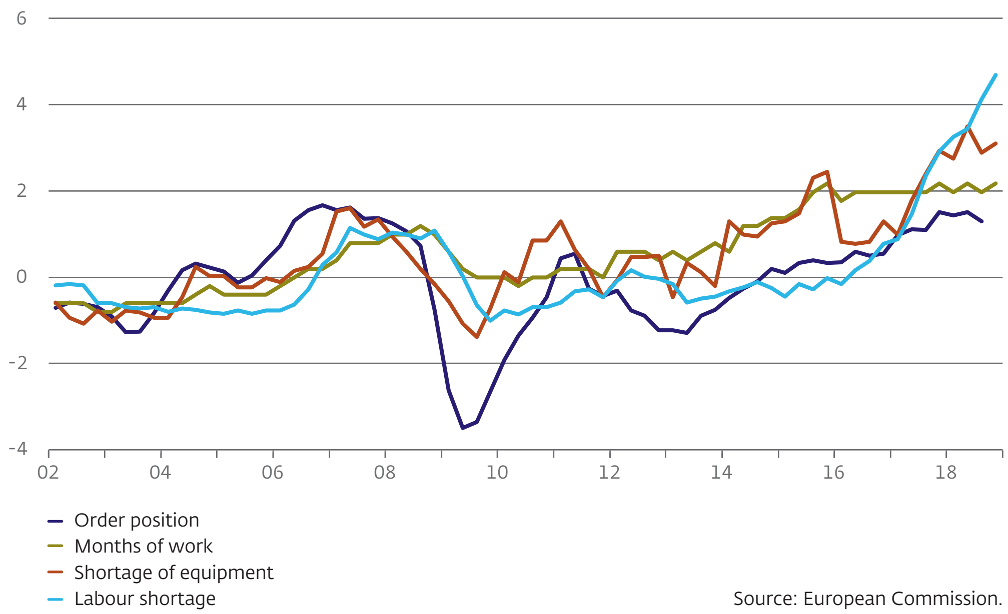
	2019	Deviation from projection	2020	Deviation from projection
Variant of sustained increase in house prices				
Harmonised consumer price index	9.0	(4.5)	9.0	(6.2)
Gross domestic product	1.9	(0.2)	2.1	(0.4)
Variant of lower growth in government spending				
Public expenditure	1.2	(-1.4)	1.2	(-0.8)
Gross domestic product	1.4	(-0.3)	1.4	(-0.3)

Source: DNB.

crisis broke out and close to the highest level measured since the year 2000. Corporate sector orders in the first three quarters of 2018 were at the highest level attained since the start of measurements in 1985 (Figure 4). Between 2010 and 2016, the number of months of work increased sharply and has since been at high levels fairly consistently.

Figure 4 Firms' constraints increase

Standard scores



Source: European Commission.

Note: Series have been normalised on the basis of averages and standard deviations for the entire observation period.

The ongoing economic boom has also led to businesses experiencing more and more supply constraints in their production processes. At year-end 2013, 3% of the surveyed businesses reported to have a shortage of resources. By the fourth quarter of 2018, this had increased to slightly over 10%. In addition, in the fourth quarter of 2018, almost 26% of entrepreneurs reported shortages of staff as a production constraint. Two years earlier, this had been around 8%, from barely 3% at the start of the economic recovery five years ago.

Labour market continues to be upbeat

Labour market trends continue to be solid. In 2018, the increase in the number of employed persons should amount to 2.4%, the largest rise in ten years (Figure 5). Particularly on the back of lower economic growth, employment growth will subsequently slow down, to 1.3% in 2019 and 0.6% in 2020. In addition, the lower growth pace of employment is related to the labour market tightness. This will make it more difficult to fill job vacancies and will fuel the rise in real wage costs, thereby depressing demand for labour. This is as yet not reflected in

Figure 5 Labour market supply and demand

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

Sources: Statistics Netherlands and DNB.

the trend of vacancies, which are currently at a record high. In addition to this, the vacancy rate – the number of vacancies on 1,000 persons employed – in the third quarter of 2018 came to 31, close to its pre-crisis level of 32. Employers report that they are finding it increasingly difficult to fill the outstanding vacancies. Four in ten vacancies are now difficult to fill, against a little more than three in ten in 2017. This means that vacancies are outstanding for longer periods of time and employment growth may be dampened.

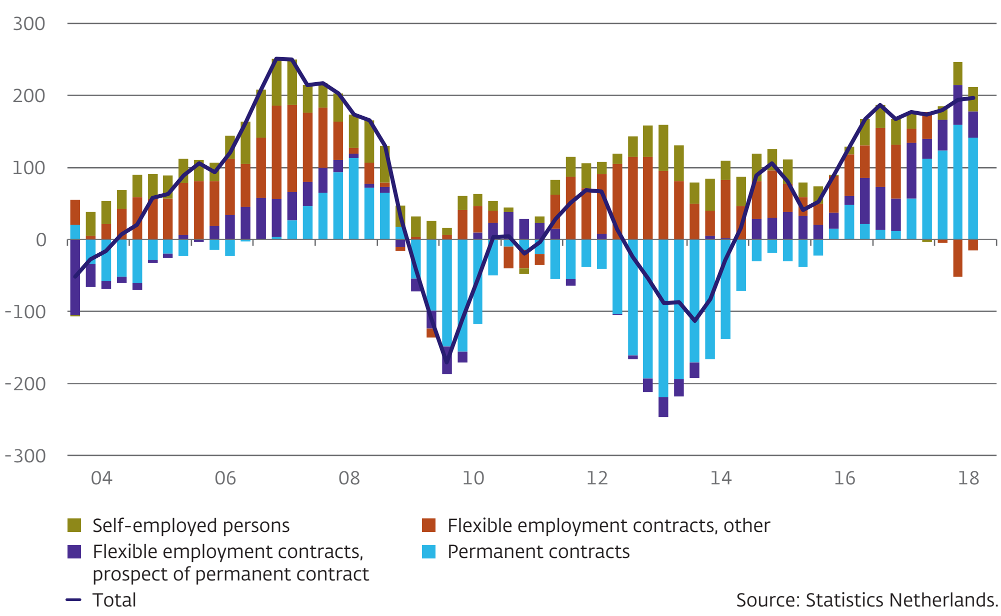
The improved labour market conditions are encouraging more people to make themselves available to the labour market or to continue doing so. That there is scope for growth in the supply of labour is reflected in the labour participation rate for the 25-45 age group, which currently is about 1.5 percentage points lower than in 2008. The supply of older people is also still increasing steadily. The labour supply is projected to grow by 1.1% on average between 2018 and 2020, while in the first recovery years (2014-2016) the labour supply increased by just 0.2% annually on average. In 2018, labour supply growth will considerably lag behind employment growth, which will cause unemployment to fall again by a little over 1 percentage point to 3.8% of the labour force on average. In 2019 and 2020 the growth rates of labour supply and demand will be close together. Unemployment is set to stabilise at 3.6% by that time, the lowest level seen in 45 years, with the exception of the 3.3% recorded in 2001.

Substantial increase in permanent employment contracts in 2018

The increase in the number of employees on permanent contracts, which began in 2017, has continued in 2018 (Figure 6). In the third quarter of 2018, the number of employees on permanent contracts was 141,000 higher than a year earlier, a 2.7% rise. For employees on flexible contracts this was only 22,000, a 1.1% rise. This means that the proportion of employees on permanent contracts has edged up again for the first time in ten years, to 73% in 2018 from 72% in 2017, having gradually declined from 80% in 2008. The recent rise is partly attributable to increasingly tight labour market conditions, where permanent contracts may serve as a means to tie employees to the company. The increase in the number of flexible workers in the first three quarters of 2018 was largely accounted for by temporary contracts with a prospect of a permanent contract. The number of employees holding other types of flexible labour contracts in the first three quarters even declined on balance. These are contracts with no prospect of permanent contracts, temping, on-call, and zero-hours contracts. The number of self-employed persons (mainly self-employed with no staff) continued growing in 2018, having come to a temporary standstill in 2016.

Figure 6 Growth in active working population by type of employment relationship

Thousands of persons; year-on-year changes

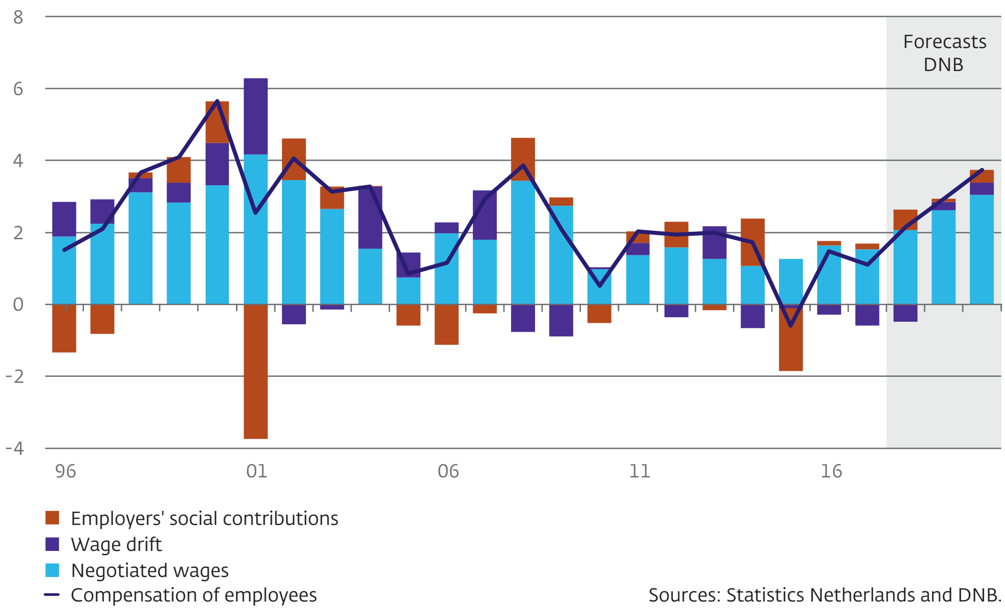


Source: Statistics Netherlands.

Accelerating wage growth

Contract wages are expected to have grown by 2.1% in full-year 2018. This is expected to increase to 3.0% in 2020, driven by accelerating inflation and the tightening labour market. Together with employers' contributions to social insurance and wage drift, contract wages make up the total wage and salary bill. Total compensation per employee is expected have risen by 2.3% in 2018 (Figure 7). In 2018, the contribution of wage drift will be negative for the

Figure 7 Breakdown of wage developments in the private sector
Year-on-year percentage changes and contributions in percentage points, number of persons



Sources: Statistics Netherlands and DNB.

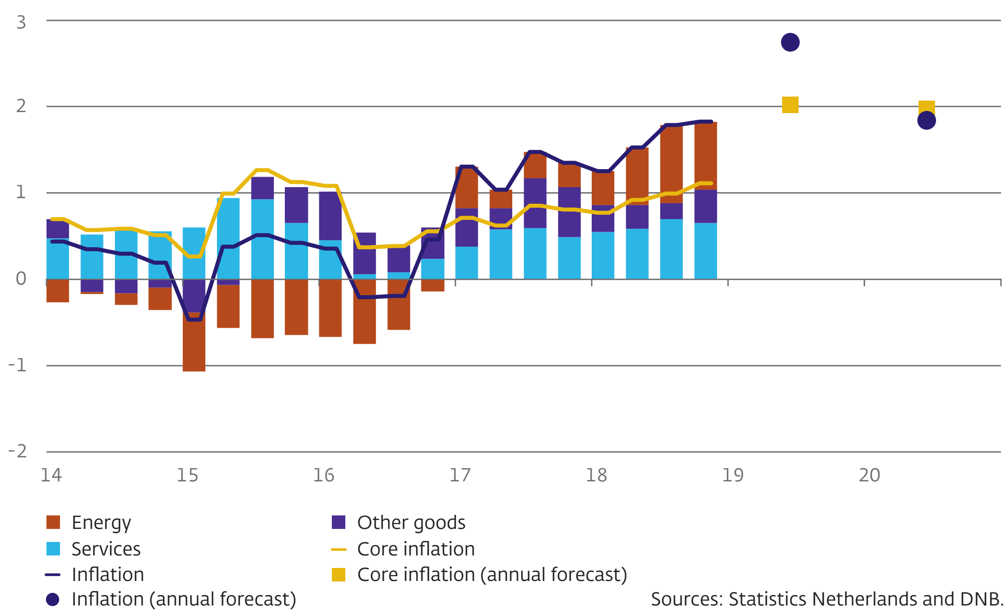
fifth consecutive year (-0.4 percentage points). In the coming years, this is expected to turn positive again, due to increasing labour market tightness. This will partly materialise at an individual level, by means of extra promotions, salary increments and bonuses. In addition, the composition of increasing employment, which in the past few years contained an above-average proportion of young people, first-time jobs and flex workers, is changing. The tight labour market is causing employment growth to shift towards more experienced workers and employees in permanent employment, i.e. more expensive labour. This will in turn cause wage drift to become positive, and the increase in the compensation per employee will accelerate to 3.0% in 2019 and 3.8% in 2020.

Inflation will edge up due to a rise in VAT and higher labour costs

HICP inflation is projected to end up at 1.6% in 2018, a modest rise on the year-earlier level (1.3%). As in 2017, this acceleration of inflation is partly attributable to energy prices, which rose in the second half of 2018 (Figure 8). In 2019, inflation is projected to amount to 2.7%, partly owing to the increase in the low VAT rate to 9% and the energy taxation hike. Our projections assume that higher indirect taxes will be directly passed on into prices. Without said tax measures, inflation would amount to 1.6% in 2019, from 1.2% in 2018. In 2020, energy price rises will disappear from the equation, and the direct price effect of higher VAT will also have worn off. HICP inflation will then slide back by almost one percentage point to 1.8%.

Figure 8 HICP inflation

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



Sources: Statistics Netherlands and DNB.

Note: Core inflation = total excluding food and energy.
2018-IV = average for October and November.

In 2018, core inflation, excluding energy and food, will amount to only 0.9%, due in part to lower prices for industrial goods, before accelerating considerably to 2.0% in 2019 and 2020. Initially, this will be attributable to the increase in indirect taxes in 2019, supplemented by the rise in unit labour costs. In 2018, total compensation per employee in the corporate sector will grow by 2.3%, followed by 3.0% and 3.8% in subsequent years. Given the trend of corporate sector labour productivity, unit labour costs are expected to have risen by 1.8% in 2018, increasing to around 2.3% in the two subsequent projection years. Normally speaking, higher labour costs take some time to filter through into consumer goods prices, which means that the most pronounced effect on core inflation is to be expected in 2020.

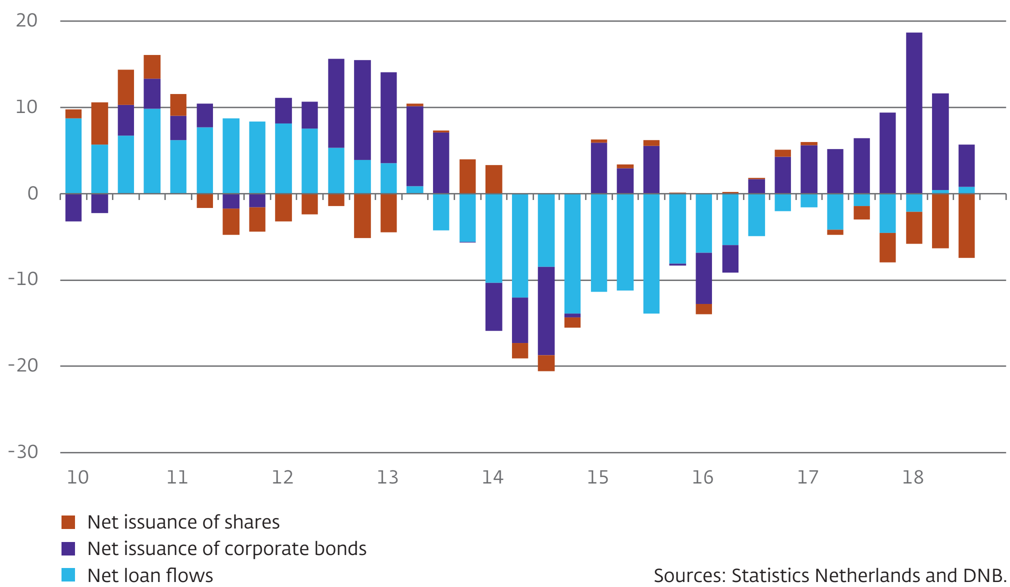
The corporate sector is raising an increasing amount of funding, also from banks

Net lending has been shrinking annually since 2013, albeit at a gradually declining pace since 2016. Banks are extending more new loans, but the amounts taken out still lag behind repayments on existing loans. Bank lending to the corporate sector shrank by 2.6% on balance in 2017. In the course of 2018, monthly lending figures, however, began to indicate a measured year-on-year increase, meaning that the shrinkage is expected to be limited at -0.6% in 2018.

Despite contracting bank lending, the corporate sector's net funding requirement has been climbing steadily since mid-2016, partly owing to accelerating corporate investment (Figure 9). Larger corporations in particular increasingly resort to equity and bond issues to raise capital. Small and medium-sized enterprises (SMEs), however, continue to depend mainly on bank loans. Bank lending to SMEs has been growing again since the end of 2017, for the first time since 2014 (the first year of our observations). Preliminary figures indicate that year-on-year growth of SME lending came to 2.4% in the first two quarters of 2018. The increase is fully attributable to large loans of EUR 1 million and over, as smaller SME loans are still shrinking.

Figure 9 External financing for non-financial corporations

In EUR billion; four-quarter sums



Sources: Statistics Netherlands and DNB.

In recent surveys for April through September 2018, fewer SMEs again reported that they were having difficulties in obtaining bank loans. Since mid-2013, the percentage of businesses reporting lending obstacles has decline by two thirds. Significantly fewer businesses saw their loan applications rejected, either fully or in part. In 2013, this held true for 10% of the SME firms, which number has declined to less than 1% currently.

Our projections show that (total) bank lending should continue growing. This is partly based on positive underlying developments. In the third quarter of 2018, banks on balance relaxed their acceptance criteria for business loans, for the first time since 2015. For the fourth quarter of 2018, the majority of banks also expects ongoing relaxation of acceptance criteria, including SME loans. On the demand side of the lending market, the majority of banks expect demand for business loans to have increased in the fourth quarter of 2018, a trend that started in early 2017.

2 A closer look at expenditure and public finances

Export growth follows world trade

After growing buoyantly in 2017, world trade growth relevant to the Netherlands will decelerate to 3.2% in 2018, to recover somewhat in the years thereafter (Table 3). Growth in exports of goods and services from the Netherlands slowed down in 2018 in line with foreign demand, and will partly bounce back in 2019 and 2020.

Within exports, the declining trading performance is partly driven by exports of energy, which will shrink in 2018 and the two subsequent years, due to the cap on the production of natural gas. The production restriction is expected to have made the Netherlands a net importer of natural gas in 2018. This has never happened before in all the years that data have been analysed. Primarily due to disappointing growth figures in the first half of the year, growth of re-exports excluding energy will have slowed down to 3% in 2018, just below the growth rate of relevant world trade. In the years thereafter, the pace of growth will recover and market share of re-exports will increase, as is usual (Figure 10). Having expanded substantially in 2017, the market share of domestically produced exports excluding energy will have remained virtually

Table 3 Dutch exports and competitiveness

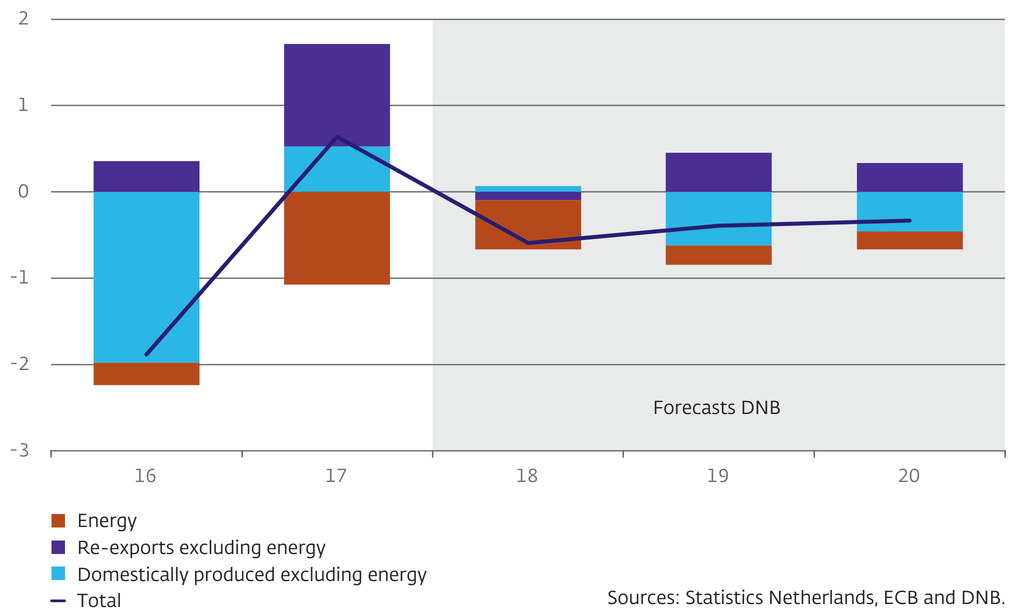
Percentage changes

	2017	2018	2019	2020
Volume				
Relevant world trade (1)	4.9	3.2	3.6	3.8
Exports of goods and services (2)	5.6	2.6	3.2	3.5
domestically produced	4.7	2.4	2.0	2.6
re-exports	7.0	3.0	4.9	4.8
Trade performance (2-1)	0.6	-0.6	-0.4	-0.3
Exports of goods and services excl. energy	6.9	3.2	3.4	3.7
domestically produced (3)	5.9	3.4	2.5	3.0
re-exports	8.5	3.0	4.9	4.8
Market performance (3-1)	0.9	0.1	-1.1	-0.8
Price				
Competitor prices (4)	1.7	0.6	2.9	2.1
Exports of goods and services	3.1	2.0	1.7	1.3
domestically produced, excl. energy (5)	1.9	-0.2	1.0	2.0
Price competitiveness (4-5)	-0.1	0.7	1.8	0.1

Sources: DNB and ECB.

Figure 10 Market share exports of goods and services

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



Sources: Statistics Netherlands, ECB and DNB.

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

unchanged in 2018. During the projection horizon, made-in-Holland exports will receive a positive impetus from price competition, which is set to improve in 2019, owing to the relatively strong increase in competitor prices. Market share will nevertheless shrink in 2019 and 2020, which is partly trend-based and related to ongoing globalisation.

The current account balance will decline to 9% of GDP in 2020 from 10.5% in 2017, mainly due to the declining goods and services trade surplus excluding energy. This means that the surplus on the Dutch current account will remain high in both a historical and an international perspective. At 10% of GDP on average in the last ten years, the lion's share of the surplus consists of goods excluding energy. This underlines the solid international competitive position of the Netherlands, which is partly determined by price, quality and the business climate. Net lending shows that since the turn of the century, the current account balance has largely been driven by the increasing profitability of non-financial corporations, combined with relatively low profit distributions.

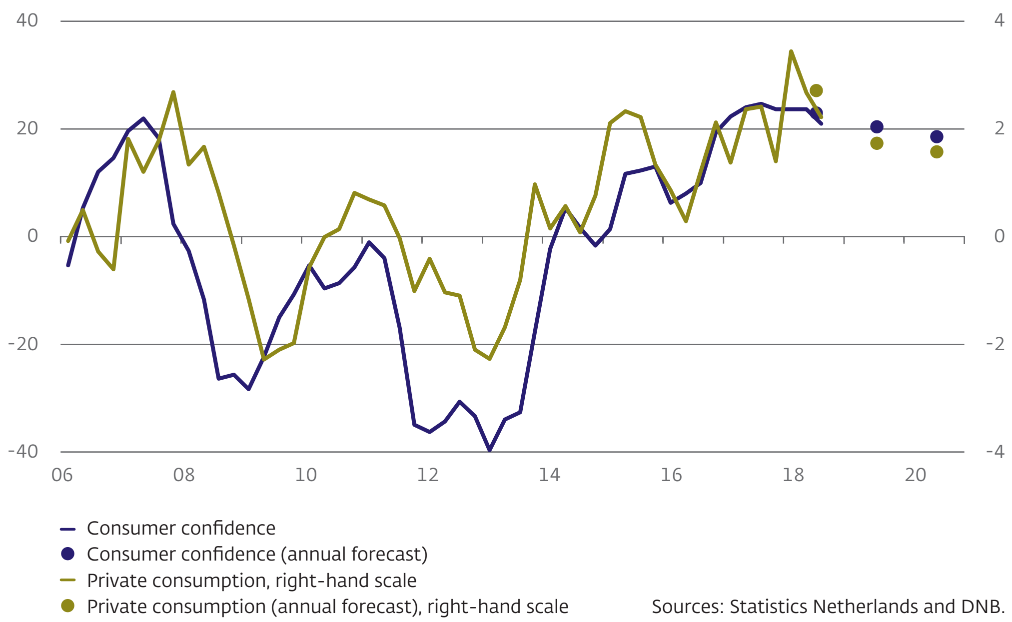
Private consumption continues to grow robustly

As in the past three years, private consumption continues to grow robustly (Figure 11), thanks to the underlying favourable trend in employment, the booming housing market and consumer confidence. Consumption is expected to have grown by 2.7% in 2018, a figure not seen since 2000, and largely already achieved in the first quarter of 2018 when quarterly growth came to 1.4%. In part, this high growth rate was driven by additional gas consumption due to relatively low temperatures, but spending on cars and other durable consumer goods also increased.

In 2019 and 2020, consumption will grow less vigorously than in the preceding year, although at 1.7% on average, the pace of growth is still robust. Employment growth and house prices will have a less pronounced upward effect on consumption towards the end of the projection horizon, but this will be offset by income tax cuts from 2019 onwards. Inflation is also set to increase, which will bring an end to the upward effect of consumer confidence on consumption. Consumer confidence sharply increased between 2013 and 2017, and has now been fairly stable at a high level for well over one year. The projections show a slight decline in the years ahead, especially because unemployment will not improve further and house prices will rise less sharply.

Figure 11 Consumer confidence and private consumption

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



Sources: Statistics Netherlands and DNB.

Household income is growing thanks to higher wages

Disposable household income is the key determinant of private consumption (Figure 12). In the projection years 2018-2020, real disposable income is set to gain 2.0% annually on average. This is a considerable improvement compared with the average growth rate of 0.2% per year recorded between 2002 and 2013. By 2020, real disposable income should have risen 13% from its 2013 level.

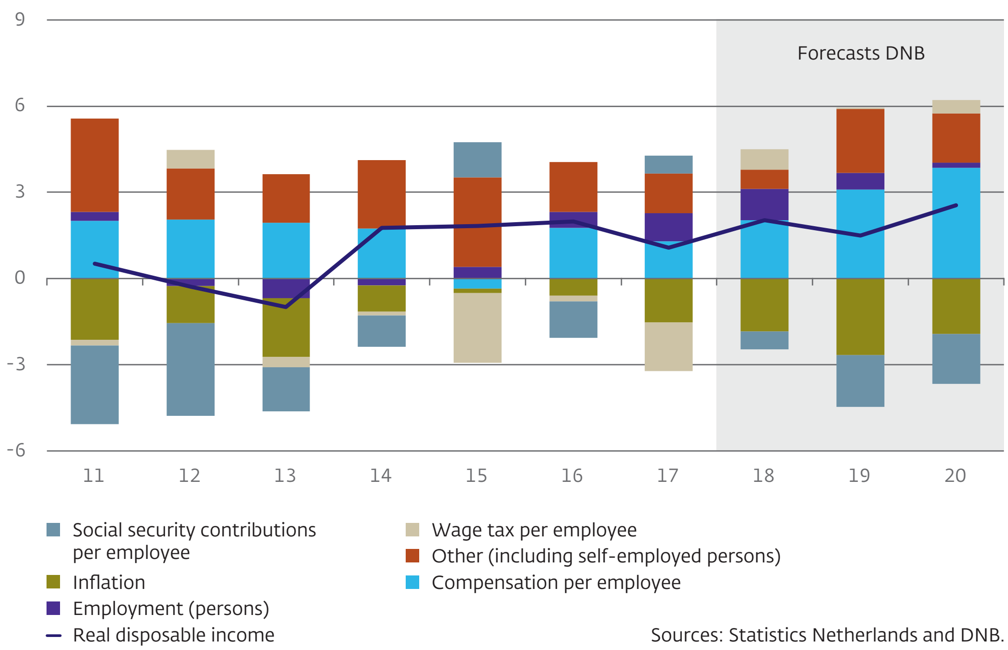
In the projections of real disposable income, the contribution to growth made by compensation per employee is set to grow in particular. In 2019, this will be partly offset by sharply higher inflation. The contribution of employment to disposable income growth should gradually diminish from 1.1 percentage points in 2018 to 0.2 percentage points in 2020. A positive impetus from lower wage taxation can be discerned during the entire projection horizon. Other income will continue to make positive contributions, also owing to the rising number of self-employed persons.

Subdued investment growth

Corporate investment (excluding housing) decreased unexpectedly in the second and third quarters of 2018. Not only will this have a downward effect on investment growth in 2018, but this will continue into 2019. There is no specific explanation for the recent dip in investment growth.

Figure 12 Real disposable household income

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



Sources: Statistics Netherlands and DNB.

The increasing international uncertainty in the course of 2018 may have played a role. In addition to this, investment in infrastructure and other capital goods may have been hampered by rising delivery times and shortages in materials and expert staff, like technicians. This impacts investment costs. Producer prices and confidence indicators for purchase prices already jumped in the course of 2017.

This development will continue in our projections, whereby the normalisation of production growth, the higher labour costs, and the end to falling interest rates will have a dampening effect. Corporate investment (excluding housing) is projected to grow by 1.9% in 2019, and 2.7% in 2020. In addition to the cost factors mentioned, the projected investment growth is determined by the accelerator effect whereby investment responds to changes in economic activity. This way, the projected normalisation of GDP growth will also feed through to investment growth.

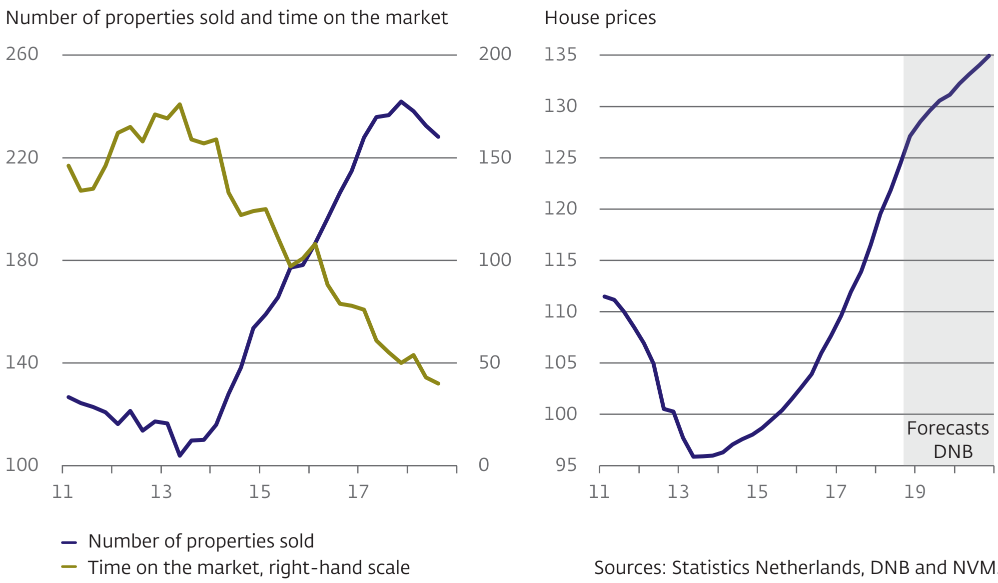
House price rises set to slow down

The Dutch housing market has completed its fifth year of buoyant growth after the deep crisis of 2008-2013. In 2018, house prices are expected to have risen by 9%, the sharpest increase by far since 2001. Average nominal house prices are now almost 4% above the level recorded shortly before the outbreak of the crisis, but are some 10% below that level when adjusted for inflation. At the same time, the average time that homes are for sale has declined to a mere six weeks, from six months at the 2013 low (Figure 13, left). Nevertheless, the revival has recently become less pronounced. The number of homes sold has for instance been falling since the start of 2018, and optimism among consumers, measured by the Dutch Home Owners Association's market indicator, had already started to turn in early 2017. Both the very tight housing market and the booming house prices are at play here. Financing costs have consequently become an obstructing factor for a growing proportion of potential buyers. Growth of mortgage lending has remained remarkably subdued during this revival (see Box 2). Our projections assume that mortgage debt will have grown by 2.1% in 2018, followed by 3% on average in 2019 and 2020.

House prices are expected to grow less sharply in the years ahead than they did in 2017 and 2018. The projected price rises are 5.5% in 2019 and 2.8% in 2020 (Figure 13, right). This development is in line with the estimated declines in economic growth and consumer confidence. In addition, the decline in mortgage interest rates has stalled, amid already very subdued growth of mortgage debt outstanding. The housing market tightness is nevertheless set to continue, and the slowdown in house price rises may after all fail to materialise for somewhat more time to come. An uncertainty variant in Box 1 illustrates the effects of such an alternative development on our projections.

Figure 13 Housing market: transactions and prices

Four-quarter sums in thousands, number of days, 2015 = 100



Sources: Statistics Netherlands, DNB and NVM.

The fact that the housing market is steering into calmer waters is also visible in housing investment. Following the very buoyant 12% expansion recorded in 2017, 5.9% growth is projected for 2018. The pace of growth flagged particularly in the third quarter of 2018, recording a decline relative to the preceding quarter. Flagging growth is first of all related to the declining number of housing transactions, as costs of civil-law notaries and estate agents are allocated to housing investment. In addition, newbuilding is facing increasing obstacles, due to a shortage of labour and materials, and rising costs. The number of newly issued building permits over the past twelve months in February 2018 amounted to 71,000, which number had fallen to 66,500 by September 2018. In the coming year, housing investment will gradually grow less sharply by 3.0% and 3.1% in 2019 and 2020, respectively.

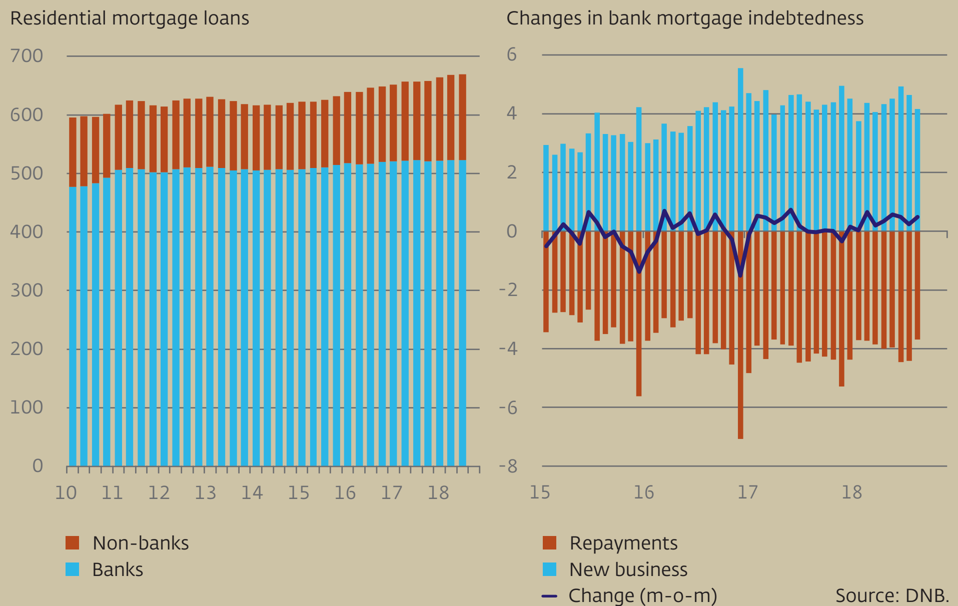
Box 2 Subdued growth of mortgage lending

Since the housing market revival, mortgage debt outstanding has grown at a modest pace: 1.6% on average annually between 2013 and 2017. At first glance, this seems to be at odds with the sharp rise in house prices (4% per year on average) and the increase in the number of homes sold (over 20% per year). Recently, in the second quarter of 2018, total mortgage debt outstanding again grew by a modest 1.7% year-on-year, a much lower growth pace than before the crisis. In addition, growth in total mortgage debt outstanding mainly occurred in the non-bank lending segment (Figure 14, left).

When zooming in on these figures, we see that the movements in mortgage lending outstanding on balance consist of sizeable flows of gross debt creation on the one hand and redemptions on the other (Figure 14, right). No direct quantitative data on redemptions are available, but an approximation can be made for the banking sector.[2] As the chart on the right shows, both new contracts and redemptions have increased during the period under review, and more or less balanced each other out. Various factors are at play in the substantial and rising redemptions, including the rising proportion of annuity-based mortgage loans, voluntary redemptions also thanks to the gift tax exemption, and the low interest rates paid on savings balances.

Figure 14 Residential mortgage loans in the Netherlands

EUR billion



Source: DNB.

Note: Banks = monetary financial institutions (MFIs), including SPVs of MFIs.
This does not include SPVs of mortgage lending subsidiaries of banks.
New business excluding renegotiations.

2 Redemptions may be approximated by calculating the balance of new contracts and renegotiated contracts subtracted by the movements in mortgage loans outstanding of banks and special purpose vehicles (SPVs).

Fifth consecutive year without budget deficit foreseen

Over the projection horizon, the budget deficit is projected to fall to 0.4% of GDP in 2020, from 1.2% in 2017 (see Table 4). This means that public finances would be in the black for five consecutive years after 2016, which has not occurred since the beginning of the nineteen fifties. The structural balance should decline to -0.3% of GDP from 0.7% over the same period of time. The decline is related to the Government's expansive budgetary policy.

Public expenditure as a percentage of GDP is set to decrease on balance over the projection horizon, due to additional outlays on healthcare, education and defence among other factors. The burden of taxes and social insurance contributions will go up through 2019, on the back of the cyclical upswing and measures aimed at raising taxes and contributions, including the hike in the low VAT rate. From 2020 onwards, the burden of taxes and social security contributions will on balance decline, also owing to the phased reduction of the corporate and personal income tax rates.

Public debt is set to shrink to 47.0% of GDP in 2020 from 56.9% in 2017. The bulk of the decline will be driven by budget surpluses and economic growth, and some additional factors including further reduction of the public holding in ABN AMRO.

Table 4 Public sector key data

Percentage of GDP

	2017	2018	2019	2020
Public expenditures	42.5	42.2	42.7	42.6
Taxes and social security contributions	38.7	38.8	39.1	38.6
Other income	5.0	4.8	4.5	4.4
Primary balance	2.2	2.3	1.8	1.2
EMU balance	1.2	1.4	1.0	0.4
Structural balance (EC method)	0.7	0.7	0.0	-0.3
EMU debt	56.9	52.4	49.3	47.0

Source: DNB.

3 Flagging growth due to worldwide financial turmoil: an alternative scenario

A significant slowdown in the growth of the world economy is a risk to the Dutch economy. Such a slowdown may be caused by a downward correction on the international financial markets, amid rising risk premiums. The higher risk aversion will subsequently have negative repercussions for the growth rate of emerging market economies (EMEs). This section explores the possible impact of such a scenario.

A concurrence of uncertainties may be underlying this scenario: uncertainty about the path of interest rate normalisation, both in the United States and the euro area, and its impact on the dollar exchange rate; uncertain economic prospects in China in the light of flattening domestic consumption and credit growth; uncertainty about the outcome of the trade conflict between the United States and China, and uncertainty about the economic impact of Brexit. Ongoing market uncertainty and volatility may at a given moment cause sharp price corrections in the equity markets. Equities are relatively expensive in the United States in particular.[3] A price correction in the US equity markets will also impact other Western countries.

At first glance, the direct consequences for the Netherlands appear to be limited as only 7% of Dutch exports in 2017 was destined for EMEs. Claims of the Dutch financial sector directly outstanding on EMEs – some 5% of the total – are relatively limited. The negative effects for the Netherlands may nevertheless be substantial, due to the danger of contagion, indirect trade effects and reduced confidence in the economy.

This scenario assumes that risk aversion will grow across the globe, with risk premiums rising by 100 basis points (Table 5). This leads to an abrupt downturn in equity prices and waning consumer and producer confidence.[4] This will impact growth of domestic demand in EMEs. The uncertain outlook for the Chinese economy (the largest of the EMEs) plays an important role, in view of the impact that China has on world trade and demand. This brings additional pressure to bear on the economic outlook of other emerging economies. All of this will result in capital outflows from EMEs and a sharp depreciation of their currency exchange rates. Ultimately, the volume of world trade relevant to the Netherlands will end up 1.2% lower than projected in 2019 and 1.4% lower than projected in 2020.

3 At the time of issuing this report, overvaluation of US and European equities roughly amounted to 20%, measured by the Shiller cyclically adjusted price-to-earnings (CAPE) ratio.

4 These rising risk premiums and falling equity prices are not uncommon from a historical perspective, and are for instance similar to the market's response to the announcement of the reduction of the US purchase programmes in May 2013, known as the "taper talk".

Table 5 Assumptions underlying the scenario of global financial turmoil

Percentage deviations from baseline scenario, unless stated otherwise

	2019	2020
International		
Domestic demand of EMEs	-2	-2
Exchange rates of EMEs (USD)	-10	-10
Risk premium, globally (bps)	100	100
Producer confidence, globally	-10	0
US equity prices	-8.8	-5.7
For the Netherlands:		
Volume of relevant world trade	-1.2	-1.4
Competitor prices	-1.6	-1.9
Oil prices	-1.6	-1.1
Equity prices	-14.0	-9.0

Sources: DNB and ECB.

Notes: Prolonged shocks applied from 2019-IV onwards; assumptions based on historical analysis and ECB calculations; without monetary policy adjustments in EMEs; producer confidence as measured by the EU Economic Sentiment Indicator (ESI); assumptions for the Netherlands based on the NiGEM multi-country model.

This worldwide financial turmoil will have a substantial impact on the Netherlands (Table 6). Lower growth of relevant world trade will translate into a downward effect on GDP growth through exports. GDP growth will respectively end up 0.5 percentage points and 0.3 percentage points lower than projected in 2019 and 2020, causing unemployment to grow sharply in 2020 to just above 4% of the labour force. In addition, lower production growth and waning producer confidence will depress business investment, especially in 2020. Lower equity prices, lower house prices, declining consumer confidence and rising unemployment will have a strong dampening effect on private consumption in 2020. Falling demand, lower import prices and lower oil prices will keep down inflation, which will fall back by 0.2 percentage points in 2020. In line with lower economic growth and higher unemployment, public finances are set to deteriorate, resulting in a budget balance of -0.1% of GDP in 2020, which is 0.5 percentage points lower than in our projections.

Table 6 Results of the scenario of global financial turmoil

Percentage changes, unless stated otherwise

	2019	Deviation from projection	2020	Deviation from projection
Gross domestic product	1.2	(-0.5)	1.4	(-0.3)
Private consumption	1.5	(-0.2)	1.1	(-0.5)
Business investment	1.1	(-0.8)	1.4	(-1.3)
Exports of goods and services	1.9	(-1.3)	3.2	(-0.3)
Imports of goods and services	2.7	(-1.0)	3.6	(-0.4)
Consumer confidence	16.3	(-4.2)	12.7	(-6.0)
Negotiated wages, private sector	2.6	(0.0)	2.7	(-0.3)
Harmonised consumer price index	2.7	(0.0)	1.6	(-0.2)
House prices, existing own homes	5.4	(-0.1)	2.6	(-0.2)
Unemployment (% of labour force)	3.7	(0.1)	4.1	(0.5)
EMU balance (% of GDP)	0.8	(-0.2)	-0.1	(-0.5)

Source: DNB.

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