THE NETHERLANDS

BOGGED DOWN IN PETTY POLITICS

Following the gradual lifting of health restrictions, the economy rebounded strongly in Q2 and this dynamism continued in Q3. Despite the favourable economic climate and the satisfactory state of public finances, the political parties are still struggling to form a government even six months after the legislative elections. Nonetheless, the outlook remains bright, especially thanks to the rapid expansion of world trade.

GROWTH MOMENTUM IS SLOWING AFTER STRONG Q2

In Q2, economic activity rebounded strongly by 3.8% from the previous quarter, due to the gradual lifting of the lockdown in the Netherlands and the surrounding countries. Household consumption and exports grew strongly. Yet, persistent uncertainty concerning the pandemic weighed down on investment (-1.6%). In Q3, the CBS business cycle indicator continued to strengthen. However, business and consumer confidence are showing signs of levelling off, partly because of political uncertainties. Moreover, purchasing power is affected by the rapid increase in energy prices. In August, they were almost 16% higher from a year earlier. Nevertheless, core inflation has remained rather tame, only 1.7%, because of the freezing of social rents on 1 July. By contrast, the housing market has showed signs of overheating. In Q2, house prices were 20% higher from a year earlier and about 80% of dwellings were sold at a higher amount than the asking price. In combination with the housing shortage, it is one of the unintended consequences of the ECB ultra-loose monetary policy. It has limited access to the housing market for first-time buyers, who often opt for cheaper but more risky interest-only mortgages.

GROWTH AND INFLATION (%)

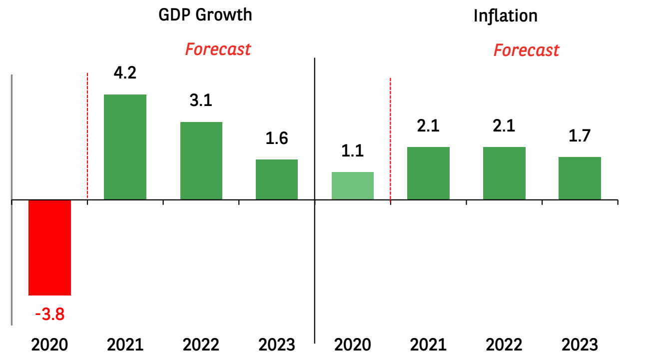

CHART 1

SOURCE: BNP PARIBAS

COALITION TALKS IN GRIDLOCK

Since January, the country is ruled by a centre-right caretaker government. The two liberal parties of the outgoing coalition, the VVD (conservative-liberals) and D66 (social-liberals), were the great winners of the general election in March. As these parties have less than 40% of the seats in parliament, they have been looking right and left for possible coalition partners in the past few months. Real negotiations about a coalition programme have not started even six months after the election. It is not excluded that the parties of the outgoing coalition decide to continue their cooperation in a new government despite frictions between them. New elections might be necessary if the gridlock in the government formation cannot be solved.

In September, finance minister Wopke Hoekstra presented the budget for 2022. The context is more favourable than in 2020, as the economy has been less affected by the corona crisis than initially feared. For 2022, Mr Hoekstra forecasts the budget deficit at 2.4% of GDP and the debt-to-GDP ratio at only 57.7%, both well within the limits Maastricht criteria, which are at the moment temporarily suspended. The major problem is the lack of ambition, which is inherent to the caretaker status of the cabinet. The government has reserved EUR 7 bn for environmental measures and EUR 1 bn for housing. During the debate on the budget, Parliament agreed on increasing spending by EUR 2 bn.

FIRING ON ALL CYLINDERS

Despite the political difficulties, the economic prospects look very good. As the pandemic is waning and the vaccination rate has reached close to two-thirds of the population, the government has decided to a further easing of restrictions by abandoning social distancing rules and the introduction of a vaccine pass. This is likely to boost activity in the coming months. At the same time, the government is also withdrawing support to companies, a rather delicate operation, which could increase the number of bankruptcies. As a consequence, unemployment, almost down to pre-crisis levels, might increase somewhat in the next few months.

Next year, growth will be broadly based. Private consumption is boosted by the opening of the services sector and the savings rate is projected to decline to pre-Covid levels. The accumulated savings during the crisis are unlikely to boost consumption significantly, as they have in particular benefited the high-income households with a relatively low propensity to consume. Moreover, these households might have used their additional savings to invest in the housing market. By contrast, low-income earners in the services sector that have been drawing down their savings during the crisis are likely to restore their buffers again.

Exports are projected to rebound thanks to the stronger expansion of world trade and external markets of relevance to the Netherlands. The current account could even reach 9% of GDP, which is only slightly lower than before the Covid crisis. Business investment is set to rebound strongly on the back of robust growth prospects. However, investments could be delayed because of supply disruption.

The main risk for the economy is the absence of a government that has sufficient support in parliament to handle the challenges that the country faces on climate change, housing, education and security.

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