Euler Hermes Economic Research

Country Report

The Netherlands

Keep the positive momentum

General Information

GDP	USD752.5474bn (World ranking 17, World Bank 2015)
Population	16.94mn (World ranking 65, World Bank 2015)
Form of state	Constitutional Monarchy
Head of government	Mark Rutte until a new governing coalition is established
Next elections	2019 (Senate)

Strengths

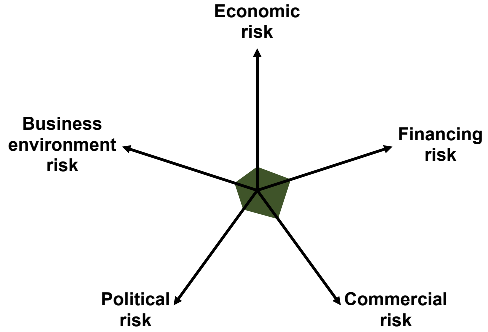
- Favorable business environment
- Consumer and business confidence at a 9-year high
- Key trade hub in Europe
- Among the largest exporters of crude oil in the world, and the second-largest producer and exporter of natural gas in Europe
- High current account surplus
- Sound (and improving) public finances

Weaknesses

- High indebtedness of Dutch households
- Housing sector remains volatile
- High correlation with Eurozone economic cycle
- Political fragmentation: nearly half of the 28 parties in the 2017 election race were created less than three years ago

Country Rating

AA1



Source: Euler Hermes

Trade Structure

By destination/origin (% of total, 2015)

Exports		Rank		Imports
Germany	21%	1	21%	Germany
Belgium	13%	2	12%	Belgium
United Kingdom	10%	3	8%	China
France	7%	4	7%	United States
Italy	5%	5	6%	United Kingdom

By product (% of total, 2015)

Exports		Rank		Imports
Refined Petroleum Products	9%	1	7%	Refined Petroleum Products
Pharmaceuticals	6%	2	6%	Crude Oil
Computer Equipment	5%	3	6%	Computer Equipment
Plastic Articles	4%	4	5%	Pharmaceuticals
Telecommunications Equipment	4%	5	5%	Telecommunications Equipment

Source: Chelem

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Economic Overview

GDP growth outperforming the eurozone average (+2.1% in 2016; +1.9% in 2017)

Real GDP growth accelerated in 2016 to +0.7% q/q on average (up from +0.3% in 2015). Yet growth slowed down in Q4 (+0.5% q/q) bringing the annual figure to +2.1% (see Figure 1). Nominal GDP growth has continued to recover reaching +3% in 2016, one of the highest rates in the Eurozone, up from +2% in 2015.

Construction investment expanded at a strong rate (+6.2%), as house prices reached in 2016 levels last seen in late 2011 (see Figure 2) and confidence is the highest since October 2008.

After decreasing in H1 2016, the issuance of new construction permits increased again in H2. This could mean that the government struggles to curb housing sector growth and household debt. Measures aimed at reducing loan-to-value ratios and mortgage interest rate tax deductibility may be less effective than hoped.

The Netherlands has the second highest household debt-to-GDP ratio among OECD countries, due to tax incentives that encouraged leverage. According to the European Commission, 30% of homeowners had negative equity in early 2016.

Due to strict restructuring legislation, private consumption has remained subpar (below 2%). This is despite the housing market wealth effects, the pick-up in real wages and the marked fall in unemployment. At 6.4% in January 2017, the latter has reached its lowest level in five years.

Capacity utilization rates reached their long-term average at end-2016 (82.2%) and helped private investment grow at a strong rate of close to 5%. Yet rising commodity prices and bottoming-out bank interest rates can hamper investment growth in 2017.

Tax reforms and better pricing power in 2017

The government's 2017 Tax Plan should make the Netherlands' favorable business environment (ranking 28th worldwide in the World Bank's Ease of Doing Business Index) even more attractive. The 20% corporate income tax threshold will be progressively raised from currently EUR200,000 (and 25% for the excess) to EUR350,000 in 2021. In addition, the current dividend withholding tax exemption will be extended to shareholders residing in a country that has signed a tax treaty with the Netherlands.

Deflationary pressures have eased and inflation started to pick up in October 2016. It is expected to reach +1.6% on average in 2016 mainly due to base effects linked to a pick-up in food and energy prices. However, labor market improvements and wage increases have boosted core inflation to +1.2% y/y in January 2017.

After two years manufacturing sector firms' turnovers returned to positive growth in Q4 2016 (+0.2% for the whole year) due to the Eurozone and oil prices recovery. Improved turnovers (+1.1% in 2017 and +2.0% in 2018) should boost profitability in the coming quarters after it has plateaued in 2016 (see Figure 3).

In Ireland (+1.6pp), Belgium (+1.4pp) and Italy (+0.5pp) firms profitability rose in 2016 thanks to labor reforms or low oil prices and favorable financing conditions. Yet the Netherlands lagged behind (margins stable at 41.7% of value added). A slight improvement is expected (+0.4pp in 2017 and +0.2pp in 2018) on the back of lower taxes and the rise in turnovers.

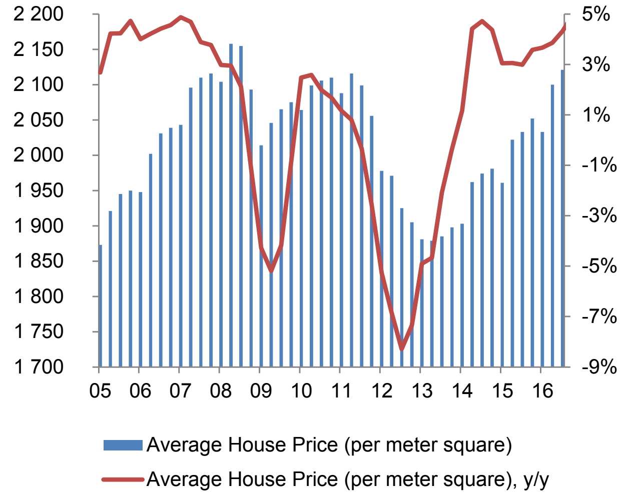
Figure 1 – Key economic forecasts

Netherlands		weights	2015	2016	2017	2018
GDP		100%	2.0	2.1	1.9	1.6
Consumer Spending		43%	1.8	1.7	2.2	2.1
Public Spending		25%	0.2	1.0	0.8	0.6
Investment		21%	9.9	4.8	2.5	4.7
Stocks	*	0%	-0.7	0.0	-0.4	-0.9
Exports		85%	5.0	3.3	4.2	3.9
Imports		74%	5.8	3.6	3.9	4.0
Net exports	*	11%	0.0	0.2	0.7	0.4
Current account	**		55	58	62	66
Current account (% of GDP)			*8.1*	*8.3*	*8.7*	*8.9*
Employment			1.0	2.0	1.4	1.3
Unemployment rate			8.6	7.3	6.8	6.8
Wages			1.5	1.9	2.0	2.3
Inflation			0.2	0.1	1.6	1.8
General government balance	**		-14	3	2	1
General government balance (% of GDP)			*-2.0*	*0.4*	*0.3*	*0.1*
Public debt (% of GDP)			*65.1*	*62.8*	*60.9*	*61.0*
Nominal GDP	**		677	697	716	736

Change over the period, unless otherwise indicated:
*contribution to GDP growth
**EUR bn

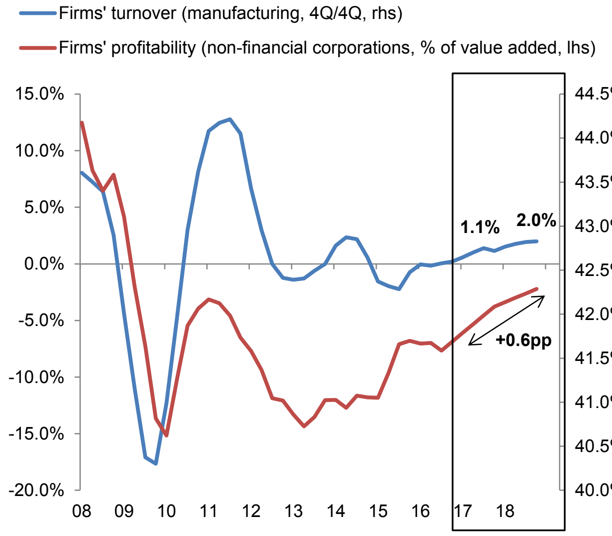
Sources: National sources, IHS, Euler Hermes

Figure 2 – House prices



Sources: NVM (Dutch Association of Real Estate Agents), Euler Hermes

Figure 3 – Profit shares of non-financial corporations, % of value added vs turnover for manuf. sector (y/y)



Sources: Eurostat, Euler Hermes

Business insolvencies fell by -17% in 2016 to 5012 cases. They still remain 9% above the 2007 level and should decrease some more in 2017 (-5%) before an increase in 2018 (+2%). Reasons include a bottoming-out after a long and steady decrease and the high number of companies established between 2012 and 2015 which should kick in soon.

A weaker EUR (1.07 against the USD in 2017), improving global momentum (+3.1% for global trade volume), and the recovering prices should boost total Dutch exports. We expect gains for goods and services to reach EUR30bn from EUR5bn in 2016 (see Figure 4). This would be their highest level since 2012.

Political uncertainty, if prolonged, could negatively impact economic growth

Results based on 93% of votes in the Dutch election (Mars 2017) show incumbent PM Rutte's Liberal Party winning 33 seats out of 150 (8 seats less than in 2012). The turnout stood at a high 77.6% vs. 74.6% in 2012. The Liberal Party is expected to form a coalition with the Christian Democrats and Centrist D66 (each won 19 seats and gained 4 seats compared to 2012). Yet, this coalition is still 5 seats short of a majority. The beleaguered Labor Party (9 seats, down 29 seats) or the emboldened Greens (16 seats, up 12) might bridge this gap. Based on past episodes, we estimate that protracted negotiations – should these occur –and hence uncertainty could shave -0.2pp from GDP growth. The main impact would be to lower firms' investment (-0.8pp, see Figure 5).

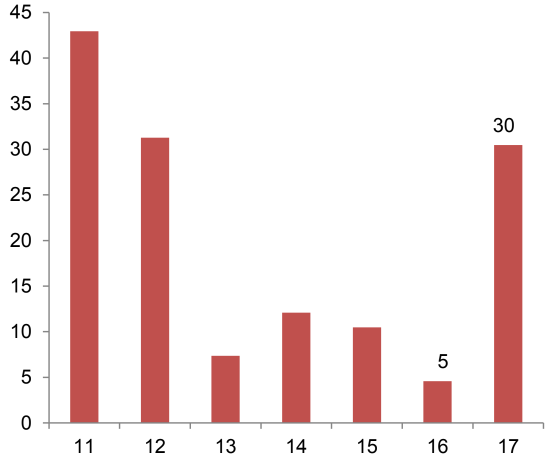
Brexit could have a high economic and political effect

The Netherlands is the European country most sensitive to a "Brexit effect". It is highly exposed to the British economy through trade in goods and FDI flows. 12% of the UK's outward investment flows to the Netherlands, while the UK receives in turn 17% of total FDI from the Netherlands (second partner after the US). In total around –EUR8bn could be lost between 2017 and 2021, the year when we expect a final trade deal with EU to be effective.

The negative economic implications of Brexit could harm Dutch companies invested in the UK. Yet the Netherlands' favorable tax environment might make it more attractive for UK companies in the medium-term.

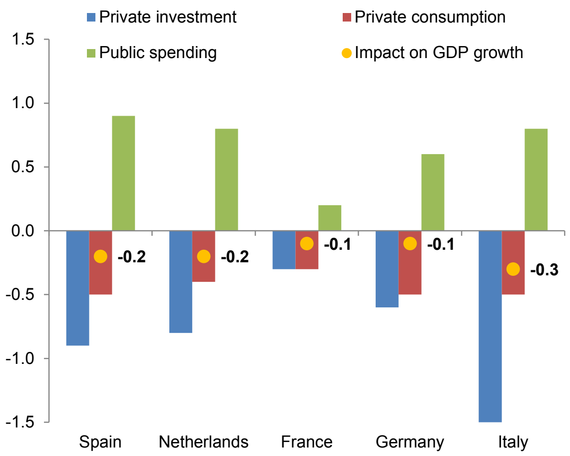
The sterling depreciation -16% additional between 2017 and 2021, would trigger up to –EUR4.6bn cumulative losses for Dutch exporters. Imports from the UK (6% of total imports) would also be subject to tariffs in 2021 (if the UK established the same WTO schedules as the EU they could average 3%). Overall, Dutch GDP growth should lose as much as 1.8pp between 2017 and 2021.

Figure 4 – Export gains (goods and services, EURbn)



Sources: National sources, Euler Hermes

Figure 5 - Impact of political uncertainty per calendar year (pp)



Sources: policyuncertainty.com, Euler Hermes

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