Why domestic demand is driving our cautious optimism on the Dutch economy

The Dutch economy is finally experiencing growth again, but the expected expansion for the remainder of 2024 remains lacklustre thanks to weak investment and a slowdown in major export markets. We expect public and private consumption to be the main sources of growth in 2025, driven by expansionary fiscal policy and real market income growth

The Dutch economy is back on a cautious growth path, and we think consumers could be its driving force

Domestic demand main growth driver

In the second quarter of 2024, the Dutch economy emerged from a period of seven quarters of mild contraction and stagnation related to the energy crisis and setbacks in the global economy. Growth during this quarter was primarily due to recovering exports and ongoing expansion of the public sector.

For the rest of 2024, growth will largely depend on domestic demand. Continued growth in government expenditures will contribute to the economy's expansion. In 2025, households will benefit from measures that boost purchasing power – albeit less than initially announced in the headline coalition agreement. In the medium term, expenditure on healthcare, social security, and public administration are expected to rise, while spending on climate and environment, education, and subsidies will decrease. As this results in a rising fiscal deficit and public debt ratio, the European Commission may recommend that the Dutch government reduce spending in the medium term.

Household consumption took a step back in the second quarter of 2024, partly due to temporary factors such as bad weather and an inflation scare caused by announcements of higher home rent increases and the implementation of higher tobacco taxes. However, consumption is trending upward again and is expected to be a major force of growth in the near future. After a temporary setback in consumer confidence and a corresponding rise in the savings rate, we forecast that consumption will benefit from income growth that is significantly higher than inflation.

Inflation remains high, but just low enough to allow gains in purchasing power

While inflation remains high, it is low enough to allow gains in purchasing power. Inflation has been decreasing significantly since the peak of the energy crisis in autumn 2022, but returning to the normal “below 2%” level is proving to be a long process. This is mainly due to persistent core inflation, which excludes volatile energy and food prices.

Service inflation remains high due to rising wage costs. Inflation is also higher in the Netherlands than in most other parts of the eurozone due to policy changes, such as increased excise taxes on alcohol, beverages, and tobacco, higher charges for infrastructure, and expansionary fiscal policy in 2024. Additionally, inflation and wage-linked home rental regulations led to a 30-year high spike in rents.

In 2025, the normalisation of the fuel tax will have an upward effect on inflation, while in 2026, the low VAT rate on cultural, recreational, and hospitality services will rise to the standard rate. HICP consumer price inflation is expected to drop from 4.1% in 2023 to 3.3% in 2024 and 2.8% in 2025. While this is still higher than usual and limits consumption growth somewhat, it is low enough for consumers to increase their purchases.

Businesses investment still under pressure

The downside of stronger wage cost growth compared to inflation is that business profitability is under pressure. A slowdown in major export markets – such as the eurozone and the US – limits demand expectations. Businesses are still reducing inventories, but less than before, and the normalisation process seems to be in its final stages.

The manufacturing sector was a major contributor to the recent positive turnaround in GDP in the second quarter of 2024 but its capacity utilisation rate is still low, and export expectations remain below historical averages. This results in a limited appetite for increasing investment. Additionally, low construction activity signalled by the small number of building permits, firms refinancing at higher interest rates, and overall non-buoyant sales expectations further dampen investment developments.

Labour market strain eases slightly

The unemployment rate is expected to rise slightly from 3.6% in 2023 to 3.7% in 2024 and a still-limited 4.1% in 2025. Contractual wage increases have already peaked but remain high at around 6.5% in 2024 and 4% to 4.5% in 2025. This impacts the demand for labour, with the vacancy rate already falling. Certain sectors such as retail, bars and restaurants may experience job losses related to bankruptcies and firm exits due to difficulties with existing tax debt. Semi-public employment continues to expand despite the new government's goal to reduce the number of civil servants. Additionally, the lack of labour supply growth related to ageing keeps the rise in the unemployment rate in check.

A gradual return to normal growth

As the second half of 2024 remains quite sluggish, we forecast the pace of the GDP expansion to accelerate towards normal over the course of 2025, as investment and external demand also gain a bit more traction once again. All in all, we forecast that the Dutch economy will expand at a slow pace of 0.4% in 2024 and will grow at a normal rate of 1.6% in 2025.

Upward risks to the Dutch economy may arise from stronger housing market momentum, consumer confidence, business investment, and quicker-than-expected execution of ambitious public spending plans, as well as positive surprises in global trade. Major downward risks to demand are clearly external. Geopolitical tensions could bring more trade and investment barriers, supply chain disruptions and higher prices for oil, gas, and other commodities. This could lead to higher risk premia, higher inflation, production disruptions, loss of competitiveness and/or lower demand.

Domestically, downward risks include slow growth due to a lack of personnel (including access to labour migrants), electricity connections and land for businesses and housing, and slow productivity growth. Less investment due to higher benchmark interest rates in response to concerns about the government is also worth noting, as well as continuing stubborn inflation or a further increase in the savings rate suppressing consumption and a higher rate of bankruptcies leading to unexpected jumps in unemployment.

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