Low growth after a technical recession in the Netherlands

Dutch GDP is stagnating, with weak growth expectations of 0.3% for 2023. We forecast a technical recession for the first half of this year, followed by subdued growth during the rest of 2023 and 2024. Inflation is high but is expected to come down, providing some room for real income growth which should help household consumption

We expect weak growth in the Netherlands for the rest of the year following a technical recession in the first half of the year

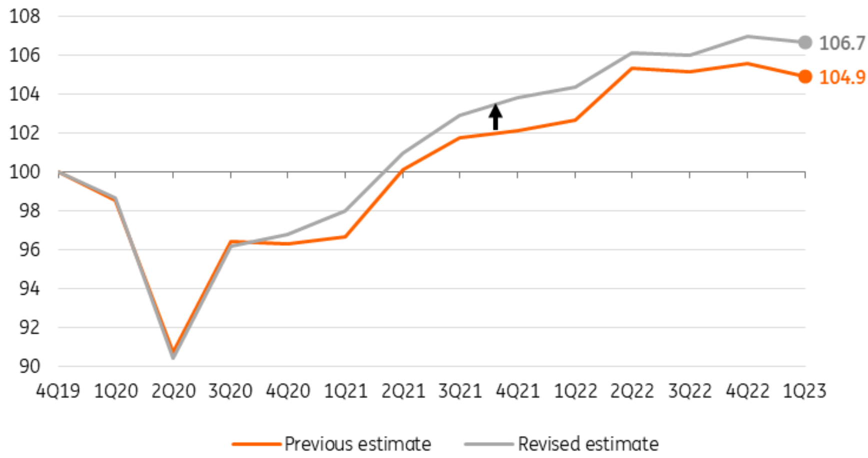
Covid recovery even stronger than originally estimated thanks to a stronger current account

National accounts data for the Netherlands were revised considerably, partially changing the narrative of the Covid experience for the Dutch economy. While the Covid trough in GDP in the second quarter of 2020 was a bit deeper than initially thought, GDP has been revised significantly upward. The quarterly figures for 2021, in particular, were revised higher, resulting in a GDP level in the first quarter of 2023 that was 1.7% higher than previously estimated. International trade was revised upwards strongly. The goods trade balance was an important contributor to the GDP revision. Consumption by households and inventories was also revised upwards, while public consumption was revised down a little.

The revisions made the contraction at the start of this year appear more modest: the quarter-on-quarter growth rate for the first quarter was revised from -0.7% seasonally adjusted to -0.3%. All this means that GDP was 6.7% higher in the first quarter of 2023 than in the fourth quarter of 2019, just before the pandemic. This makes the GDP development of the Netherlands since the start of the pandemic stand out even more in comparison to its peers. In addition, gross national income was revised strongly due to upward revisions of the balance of primary income. This was mostly the result of large upwards revisions of (retained) profits of listed companies.

Large upward revision to the Dutch GDP figure

Gross domestic product of the Netherlands*, index 4th quarter of 2019 = 100



Source: CBS, calculations ING Research

*Seasonally adjusted and in constant prices

Very weak start to the second quarter is likely to result in a technical recession

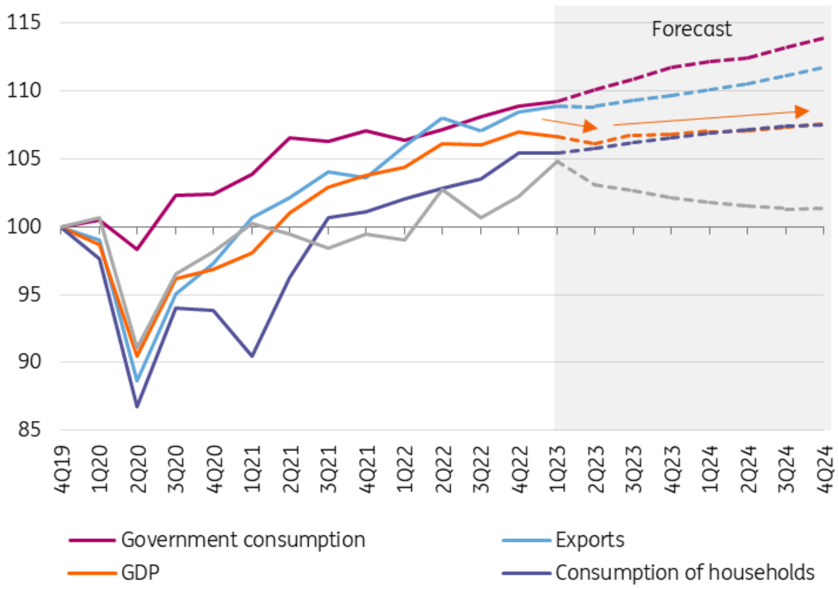
All else being equal, the revisions would have boosted the Netherlands' annual GDP growth forecast for 2023. However, we are revising it slightly downwards to 0.3% quarter-on-quarter due to the very weak data that we've seen for the start of the second quarter. The hard (seasonally-adjusted) data for April and May on a month-on-month basis was especially disappointing:

- Construction production contracted by -5.3% MoM in April.
- Manufacturing production contracted by -3.9% MoM in April, while rising only 1.9% in May.
- Retail sales excluding motor vehicles (Eurostat definition) stagnated at 0.1% MoM both in April and May, while retail sales also excluding petrol stations and pharmacies (Statistics Netherlands definition) contracted by -0.1% MoM in April and -1.4% in May.
- Gross capital formation on fixed assets contracted -2.9% MoM in April.
- Goods imports rose 7.2% MoM in April (to some degree due to the propping up of gas storage).
- Goods exports contracted -0.5% MoM in April.
- Domestic consumption stagnated at 0.0% MoM in April and expanded by 1.0% in May, being a positive outlier so far.
- Prices of existing homes fell -1.0% MoM in April and -0.6% in May.

At the same time, sentiment data worsened in April, May and June. Also, we expect the inventory reduction cycle to continue in the second quarter, albeit at a lower rate than in the first quarter, since firms still consider their inventory levels as too high. Our second quarter GDP forecast calls for a contraction of -0.5% QoQ. This implies a technical recession in the first half of 2023.

Technical recession and then weak growth

Expenditures*, index 4th quarter of 2019 = 100



Source: Macrobond, forecasts ING Research from 2Q23

*Seasonally adjusted and in constant prices

Second half growth is expected to be too weak for a decent growth rate for 2023

The technical recession will, in our view, be followed by weak growth. Investment is expected to be the main drag on growth during the remainder of the year, as higher funding costs and weak sales expectations kick in. GDP growth in the second half of 2023 needs to come from the expansion of service consumption by households, higher service exports due to a further rebound of inbound tourism (especially in the third quarter) and public expenditures. We also forecast goods exports to pick up again, but only sluggishly. Public expenditures are assumed to rise a bit less than initially anticipated, due to the recent fall of the government: this is likely to put a stop to the execution of a number of policy plans.

Consumption of households so far has held up well during the energy crisis, even though the Netherlands also experienced a terms of trade loss due to the high prices of imported gas and therefore the loss of consumer purchasing power. Very strong employment growth (+6.4% compared to pre-pandemic) and high net nominal income growth for lower-income households (who have a high marginal propensity to consume) explain why.

As inflation is coming down in the second half of 2023 while wage increases remain high, household consumption is forecast to continue its (mild) growth, even though employment growth will not be as strong as in the past. Saving rates are coming down from still elevated levels, also providing support for consumption to remain decent. Despite this support for consumption, GDP is forecast to expand by only 0.3% for the full year 2023, adjusted for working days.

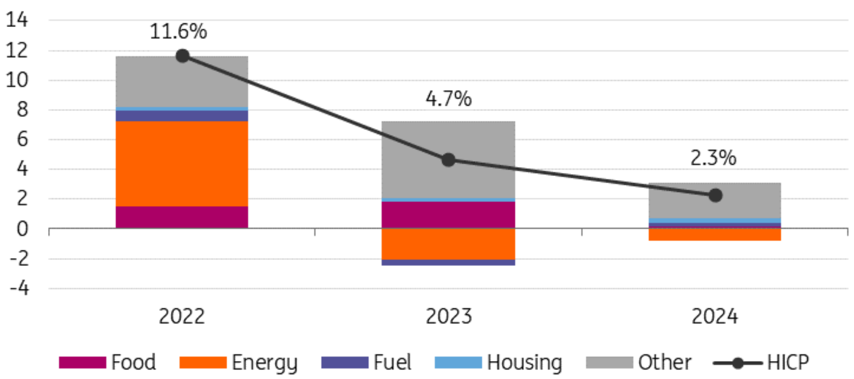
Inflation is falling in 2023 thanks to energy base effects

Although lower than the inflation rate of 11.6% in 2022, our forecast for 2023 is still at a high of 4.7%. Food and bars and restaurants are important contributors to the higher price level in 2023. Yet, inflation has been falling throughout the year. Headline consumer price inflation fell recently, from 6.8% YoY (HICP) in May to 6.4% in June. Core inflation (inflation excluding volatile items like energy and food) came down from 8.2% in May to (a still high) 7.1% in June. The deceleration in June was due to services and fuel, industrial goods and food, beverages and tobacco.

For energy and fuel, the fall in prices was smaller than in May due to statistical base effects, i.e. due to movements in the price level in 2022: the month-on-month changes in June 2023 were slightly negative. Such base effects for energy are the main reason we project the headline year-on-year inflation rate to move close to 2% in the last quarter of 2023.

Inflation falling with large negative energy base effects

Change in harmonised index of consumer prices for the Netherlands year-on-year in % and contributions in %-points



Source: Macrobond, forecasts as of 2023 by ING Research

Firms signal lower selling price inflation

We see overall inflation pressures falling in the near future: selling price expectations of businesses for the next three months fell for the eighth month in a row in June. There is one major exception: services. Inflation of services is not forecast to decelerate as quickly as for food and industrial goods. For now, we are working with the assumption of wages decelerating in 2024 compared to the high numbers (of around 6% for bargained wages) of 2023. The forecast for headline inflation to fall to 2.3% in 2024 depends on that assumption. This scenario has become more likely now that demand for personnel from the public sector might slow a bit, as the government is adopting a caretaker mode for many months to come.

New method for measuring energy inflation distorts headline picture

June was the first month in which Statistics Netherlands (CBS) used a new method for measuring energy inflation. While it used to only look at the prices of new contracts, it is now also taking existing (fixed-term) contracts into account. If this new method was used in the past, the 2022 inflation rate would have been a lot (i.e. more than 3%) lower than actually recorded, while for 2023 the rate of change would be much higher than observed now.

Since Statistics Netherlands is not legally allowed to revise historical inflation figures, this means that all year-on-year inflation rates are somewhat distorted. As of June 2024, this issue is gone. Fortunately, the price levels of the old and new methods have been already quite similar in recent months. As such, the introduction of the new method had only limited effects on our recent forecasts.

The Dutch economy in a nutshell (%YoY)

	2022	2023F	2024F	2025F
GDP	4.3	0.3	1.3	1.1
Private consumption	6.5	2.1	1.5	0.7
Investment	1.8	2.4	-2.2	0.6
Government consumption	1.6	2.5	2.4	2.4
Net trade contribution (%-point)	1.0	-0.6	-0.4	0.0
Headline HICP	11.6	4.7	2.0	1.6
Unemployment rate (%)	3.5	3.6	4.0	4.2
Budget balance (% of GDP)	-0.1	-2.2	-2.8	-2.9
Government debt (% of GDP)	50.1	48.7	50.0	52.2

Source: Macrobond, all forecasts ING Research estimates

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