Euro Watch

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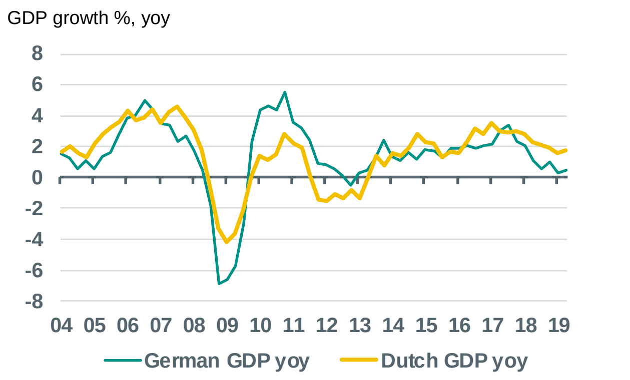
Dutch-German growth gap will reverse

- **There has been a large gap between GDP growth in the Netherlands and Germany in 2018-2019**
- **This can largely be explained by differences in the types of goods the two countries export, with Germany mainly focussed on industrial goods and the Netherlands on goods related to wholesale and retail trade, …**
- **… as well as by the destination of exports, with Germany more exposed to China and other EM and the Netherlands more orientated towards Europe**
- **We expect growth in Germany to pick up moving into 2020, while the Dutch economy will lose momentum**
- **Consequently, the growth gap should disappear**

Germany sneezes, but no cold for the Netherlands

'When Germany sneezes, the Netherlands catches a cold' is an often heard phrase in the debate on the Dutch business cycle. Germany is the most important export partner of the Netherlands and moreover seen as the producer powerhouse of the eurozone. Yet, while Germany is slowly recovering from its sneezing, the incubation time for the Netherlands to get the flu has been overdue. In this publication we explain why the Dutch economy barely felt the problems in the German economy and why it is unlikely that it will in the future.

Divergence between Dutch and Germany GDP growth



Source: Central Planning Bureau (CPB), ABN AMRO Group Economics

Dutch versus German GDP

Source: Central Planning Bureau (CPB), ABN AMRO Group Economics

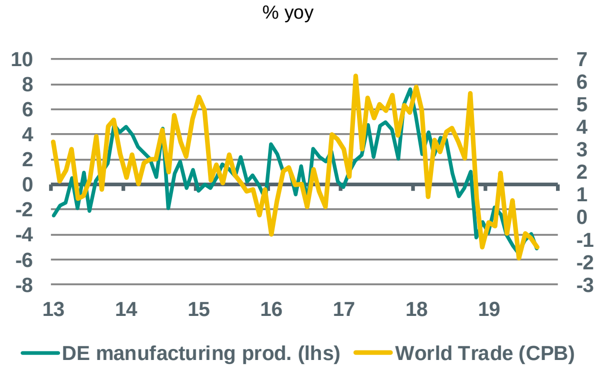
The Dutch economy has outperformed the German over the last quarters

Germany has only just avoided a recession over the past few quarters. GDP growth increased by 0.1% qoq in 2019Q3 on the back of higher household and government spending. The Q2 results were revised down from -0.1% to -0.2%, while the Q1 results were revised up from 0.4% to 0.5%. Meanwhile, the Dutch economy printed 0.4% growth in all three quarters of this year.[1] In 2018, the Dutch economy also outperformed that of its eastern neighbour by over 1%. While Germany grew by 1.5%, Dutch GDP surged by 2.6% in 2018. There appears to be a divergence in growth between the two economies (see left-hand graph below), as the Dutch economy continues to outperform Germany. Why? Compared to the Netherlands, Germany has been hit relatively hard since the start of 2018 by the weakness in global trade, the decline in global industrial production and the slowdown in global fixed investment growth. This is because of the difference in export destinations and the difference in export partners of the German and Dutch economies.

Divergence due to differing export goods

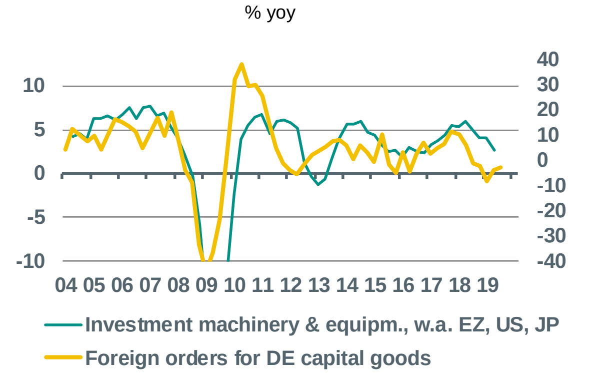
If we look in more detail at the type of goods that each country exports, we see that in **Germany**, exports are mainly focussed on manufacturing products (see graphs below). A large part (about one-fifth) of Germany's manufacturing output consists of cars and other vehicles. As a result, cars and vehicle parts also make up a large part of total German exports (around 17%). Another major export product is machinery and equipment, which has a share of around 30% in Germany's total exports. Car production collapsed in September 2018 due to the introduction of new emission standards. It has since bounced back, but the overall trend has remained negative. Production of motor vehicles contracted by 2.4% qoq in 2019Q3, following a decline of 1.6% in 2019Q2. Moreover, sentiment in the car industry, as measured by the Ifo Institute, has remained at levels well below the historical average, while foreign orders for cars contracted in Q3 of this year. On top of that, the contraction in global trade and global industrial production has resulted in a slowdown of global fixed investment growth since the start of 2018, which has weighed on exports of machinery and equipment.

Germany hit by global trade collapsing



Source: EIU

… and global investment slowdown



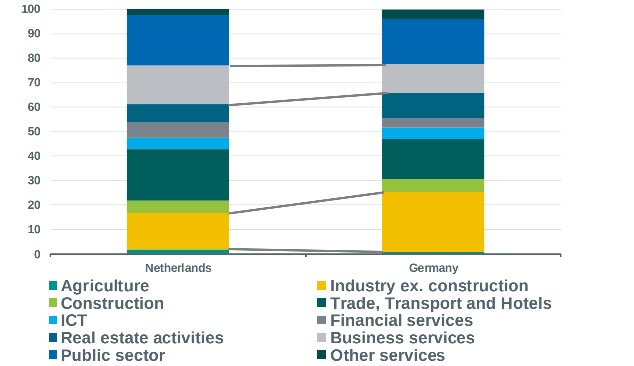
Source: Thomson Reuters Datastream, ABN AMRO Group Economics

In **the Netherlands**, however, wholesale and retail make a larger contribution to exports. These sectors are more consumer-centric and hence less affected by the decline in global industrial production. Consumption in developed markets has been relatively resilient and has benefited from a tight labour market, combined with muted inflation. Moreover, Dutch exports are more service-oriented than German exports. Around 30% of the country's total exports are services, which represent around 11% of GDP. In contrast to weak manufacturing and trade, the service sector across much of the globe has remained relatively strong. While manufacturing PMI's in developed markets have been declining since the end of 2018, service PMI's have been relatively strong and stayed above the neutral level of 50.

[1] Thereby also outperforming the eurozone as a whole, where growth dropped to just 0.2% in 2019Q3.

Dutch economy less reliant on manufacturing

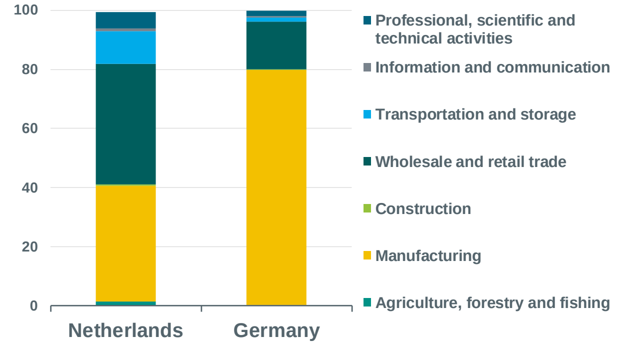
Nominal GDP by industry, value SWDA



Source: EIU

Dutch exports less reliant on manufacturing

Total exports, thousand EUR per sector



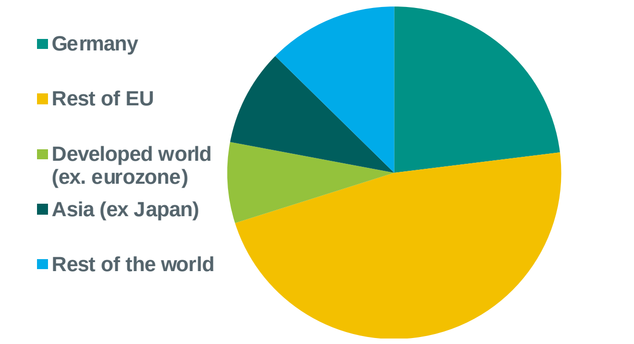
Source: Eurostat, ABNAMRO Group Economics

Divergence linked to export destination

Germany and the Netherlands also differ with regard to the destination of exports. Germany exports a relatively larger share to emerging markets (EMs), specifically Southeast Asia. In general, the uncertainty surrounding the trade war and the turmoil in EMs since mid-2018 has had a large impact on EM demand for German exports, among others. Moreover, China is experiencing a gradual slowdown, while the escalation of the trade war has proven to be a clear headwind (see Short Insight: China wanted trade deal and more stimulus).

Germany biggest Dutch export partner

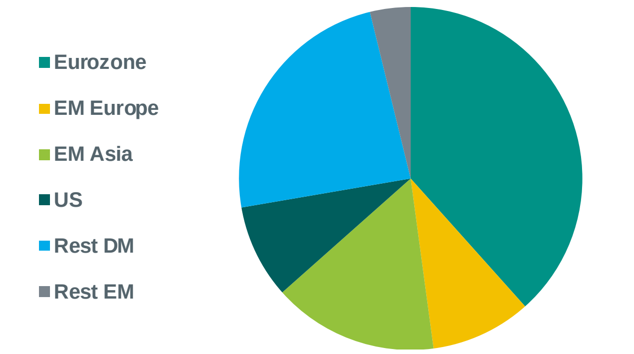
Dutch exports to various regions, value terms in EUR



Source: CBS

EMs are important trading partners for Germany

German exports to various regions, value terms in EUR

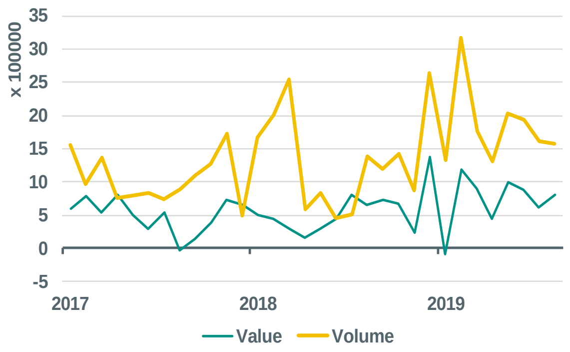


Source: Thomson Reuters Datastream, ABN Amro Group Economics

Exports contribute more to GDP in the Netherlands than in Germany, however exports in the Netherlands are mainly focused on the country's direct neighbours, including Germany. Because the Netherlands is more dependent on domestic demand in other eurozone countries, it is shielded from the uncertainty created by the trade war and the slowdown in China and other emerging markets. In fact, China comprises only around 2% of the total export of Dutch goods, whereas 23% of exports go to Germany. So far, because the labour market in Germany and the eurozone has been resilient and real wage growth has picked up, the slowdown in private consumption has been contained and there have been limited spill-over effects from Germany's weakness to the Netherlands. Indeed, net exports from the Netherlands to Germany have actually seen an increasing trend in volume terms since mid-2018 (see graph below).

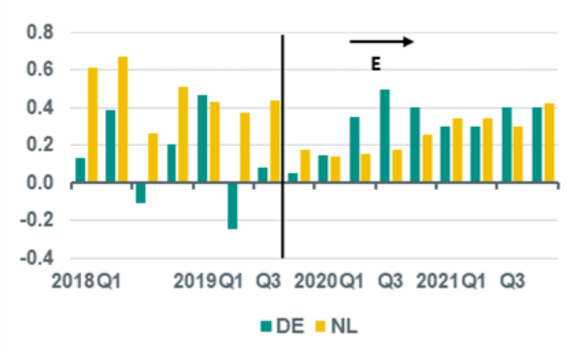
Dutch net exports to Germany have increased

Dutch net exports to Germany, value terms are in EUR



Source: Bloomberg

GDP growth in Germany and the Netherlands



Source: Thomson Reuters Datastream, ABN Amro Group Economics

To summarize, the Dutch economy is relatively shielded from the issues in global trade compared to Germany because of their sorts of exports and their export destinations.

Economic growth in Germany will pick up, but remains subdued …

Looking forward, GDP growth in Germany is expected to pick up in 2020. Exports should regain strength around the start of the year, but we do not foresee a spectacular rebound. Importantly, we think that foreign trade and the global industrial sector are currently bottoming out, although the improvement is likely to remain rather lacklustre. In fact, global fiscal and monetary policy stimulus has been rather modest since the start of the global slowdown in early 2018 and is not expected to result in a sharp rebound of the global economy. Moreover, uncertainty related to the trade conflict continues to weigh on the global economy. With respect to Germany's domestic demand, we expect fixed investment to remain weak for a while, as a delayed result of the contraction in the industrial sector and weaker profit growth. Private and government consumption, however, should grow solidly as both are supported by real wage growth and expansionary fiscal policy. We expect 0.6% yoy growth in 2020 and 1.5% yoy growth in 2021.

… while the Netherlands will lose some momentum …

The expected pick-up in global trade will be more beneficial to Germany than to the Netherlands. On top of that, we expect some Dutch-specific factors to contribute negatively to growth in the Netherlands. These include the 'nitrogen crisis', which we estimate will have a dampening effect on growth in the construction, transport and agricultural sectors. For the Netherlands, we expect 0.9% yoy growth in 2020 and 1.2% yoy growth in 2021 (see: Outlook Netherlands 2020).

…. again converging the countries' growth paths

Indeed, according to our expectations, the growth divergence will slowly fade away and we expect Germany to grow faster than the Netherlands in 2021. The bottoming out of the global industrial sector will be slightly more beneficial from Germany than for the Netherlands. Moreover, Dutch specific factors will suppress future growth, bringing it closer to Germany's growth path. Also, from a statistical perspective, the divergence we have seen over the last two years is not unprecedented. There have been periods in the past where German and Dutch GDP diverged more than is currently the case. In other words, when Germany sneezes, the Netherlands catches a cold, does not always hold.