The Netherlands - Recession knocking on the door

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- **The contraction in Q3 seals the deal for a recession in the second half of 2022. We expect GDP to contract slightly in Q4 2022 and Q1 2023 as well, after which growth is expected to resume. Following 4.2% growth expected in 2022, we see the economy expanding by just 0.5% in 2023**
- **Inflation will cool significantly on the price cap and receding global price pressures, but the pass-through of energy will persist and further push up core inflation. HICP will average 4.1% in 2022**
- **Monetary headwinds, a cooling housing market, the tight labour market, plus energy and environmental constraints will mean a tepid recovery, with below trend growth of 1.2% in 2024**

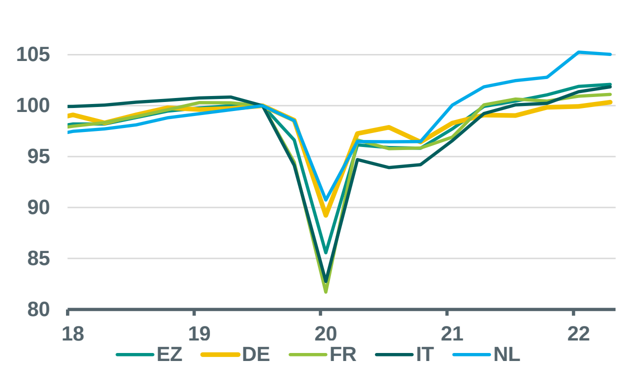
Q3 contraction to continue in coming quarters, with growth to resume later in 2023

With the energy crisis driving record high inflation in the Netherlands, we had already anticipated a recession at the end of 2022. However, with third quarter GDP growth already slightly negative (-0.2% qoq), primarily driven by investment, the recession is knocking on the door already. As high, primarily energy driven inflation weighs on domestic consumption, and weakening activity in the Eurozone does not bode well for external demand, we expect GDP to contract in Q4 2022 as well. This will tip the Dutch economy into a technical recession before the end of the year. We expect 2023 to start weak as well, with a small GDP contraction in the first quarter. From Q2 2023 onwards, growth will return, supported in part by generous government support such as the energy price cap – which dampens the real income shock – and above trend wage growth.

Consumption remained robust up until September. Although real goods consumption was already slowing, pandemic related catch-up spending in services kept total consumption afloat. Since September, however, we see this catch-up effect fade and total consumption slowing considerably. This supports our view that consumption will contract in Q4. True, still significant savings are bolstering household financial positions. These cannot, however, stop consumption from contracting, as households – with consumer confidence at historic lows – are reluctant to use these savings for consumption. Instead, we assume savings to flow into the economy at a more gradual pace over the coming years. For 2023 however, the unequal distribution of savings, mostly geared towards higher incomes, combined with a generous government package primarily supporting lower income groups, are supporting consumption.

After outperformance, NL is the first to contract

GDP; 2019Q4=100



Source: Refinitiv, ABN AMRO Group Economics

Catch-up in services is behind us

Index; 2021=100, 3m moving average

Source: CBS, ABN AMRO Group Economics

Investment is weak, despite ambitious government plans

The weak outlook for demand, coupled with financial headwinds in the form of higher interest rates and the tightening of financial conditions, are not supportive of investment. Indeed, with roughly 20% of private investment being real estate related – and hence highly sensitive to interest rate changes – investment is set for a weak year. Public investment should limit the slowdown, as there is an ambitious public investment agenda. The government, however, also faces considerable constraints. The most prominent constraint comes from binding nitrogen limits which hampers construction, but also the tight labour market limits investment execution and has already led to underspending relative to government plans in 2022.

Still, businesses have been more resilient than expected in the face of the energy crisis. Bankruptcies are still well below pre-Covid levels, and Dutch industry, in particular, has achieved remarkable energy savings while keeping industrial production relatively stable. Whereas energy-intensive industries are already grappling with the full rise in energy prices, the pass-through to SMEs is still ongoing. This also means core inflation is likely to continue rising.

Price cap to push headline inflation lower; ongoing broadening of price pressure keeps core elevated in 2023

The November HICP inflation figure showed a step in the right direction (at 11.2% yoy). Inflation came down by over 5 pp compared to October, due to lower energy prices and base effects. For 2023, the planned cap on energy prices plays a dominant role in our forecast. Since roughly 90% of gas and electricity consumption falls under the price cap, household energy bills, and in turn energy inflation, will drop and push headline inflation down significantly. However, core inflation is expected to continue moving upward. Despite receding global inflationary pressures – stemming for instance from supply bottlenecks and lower commodity prices – the pass-through of energy into goods and services will continue well into 2023. This will keep core inflation elevated and above headline inflation, while exceeding the ECB target for the remainder of 2023. We expect HICP inflation to average 4.3% in 2023.

Business and consumer confidence is weakening

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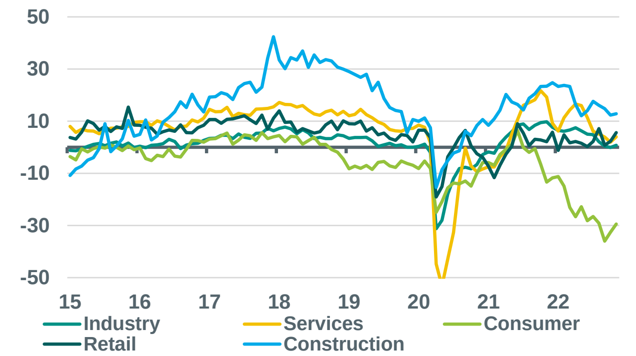
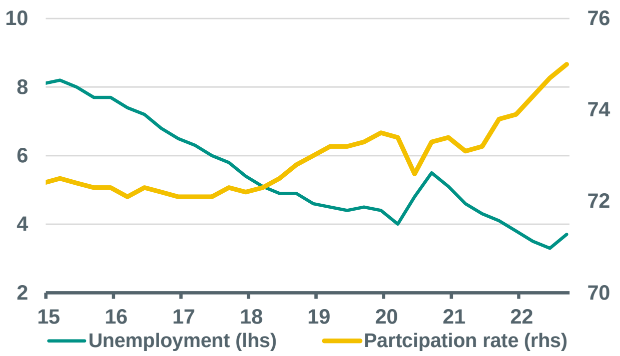


Source: EC, ABN AMRO Group Economics

Unemployment slowly rising, participation very high

Unemployment rate and participation rate, both in %



Source: CBS, ABN AMRO Group Economics

Sizzling hot labour market starts cooling off

Tightness in the Dutch labour market peaked in the second quarter, with 1.4 vacancies for every unemployed person. Since then, unemployment has crept up, albeit slowly. Going forward, we expect the recession to reduce labour demand and put slight upward pressure on unemployment. The labour market, however, remains tight, as employers continue to hoard labour, public labour demand increases and demographics reduce labour supply. We expect unemployment to increase from 3.6% this year to 4.3% next year.

Energy support causes small increases in government debt ratio in 2023

Labour market tightness combined with other capacity constraints, such as nitrogen emission limits, have hampered government policy execution and have led to underspending, for example in infrastructure and military spending. As these constraints are structural, they will also limit government spending in 2023. Extra spending next year will come from the energy support package, which will contribute to a higher budget deficit. Public finance forecasts are subject to considerable uncertainty, as final spending related to this package will depend on energy market prices and whether the government succeeds in its ambition to fund the package mostly by cutting spending elsewhere. We expect the EMU budget balance to be -3.1% of GDP in 2023, and government debt to increase slightly to 50% of GDP.

2024 cyclical headwinds and structural constraints lead to below trend growth

Going forward, the current macro situation will remain uncertain. We expect growth to stay below trend. The further cooling of the housing market is a drag on consumption. The ECB is also not yet done with monetary tightening, and given the usual lags in the transmission of monetary policy, headwinds are expected to persist throughout 2024. Finally, structural issues, such as environmental and labour market constraints, will also limit growth.

Key forecasts for the Netherlands				
	2021	**2022e**	**2023e**	**2024e**
Economic outlook (% yoy)				
GDP	4.9	4.2	0.5	1.2
- Private consumption	3.6	5.8	-0.2	0.9
- Fixed Investment	3.2	2.7	-0.2	1.4
- Exports	5.3	4.4	0.8	1.7
- Imports	4.0	3.5	1.0	1.7
Unemployment rate	4.2	3.6	4.3	4.2
Inflation (HICP)	2.8	11.6	4.3	4.0
Budget balance (% GDP)	-2.6	-1.1	-3.1	-2.2
Governerment debt (% GDP)	52.4	49.7	50.0	50.1

Source: ABN AMRO Group Economics