Centraal Planbureau

June Projections 2021

Limited permanent economic damage from the coronavirus crisis, but differences between sectors.

The outlook for the Dutch economy is favourable

The economy is recovering rapidly, now that new infections are declining and the vaccination coverage is increasing. GDP will grow by more than 3%, in both 2021 and 2022.

Public finances will improve again, next year

The public deficit will peak at almost 6% of GDP, this year. The phasing out of support measures and the increase in tax revenues will reduce the deficit to 1.5% of GDP in 2022.

Uncertainties include whether consumers will increase spending, inflation will rise, and new waves of infections may occur.

CPB Projections

June 2021

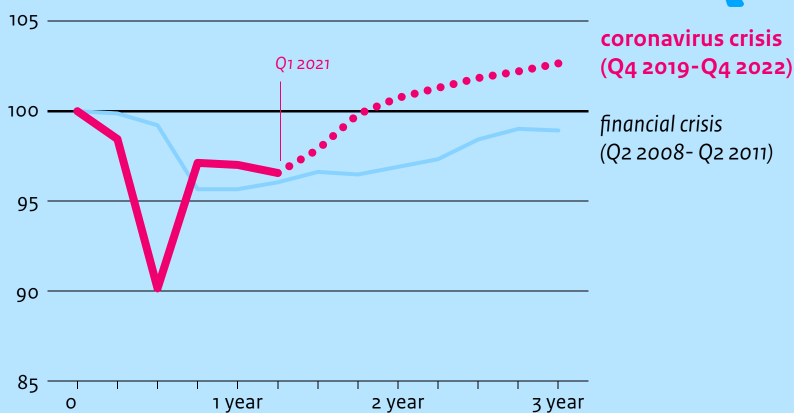
Outlook 2021–2022

The outlook is positive. The Dutch economy is improving from the second quarter onwards; and, next year, so are public finances.

Economy

Rapid recovery is expected to follow the deep double dip caused by the coronavirus crisis.

Gross Domestic Product, compared against the financial crisis (indexed)



Uncertainties

More consumption
Positive outlook may lead to additional consumption which will spur on the economy

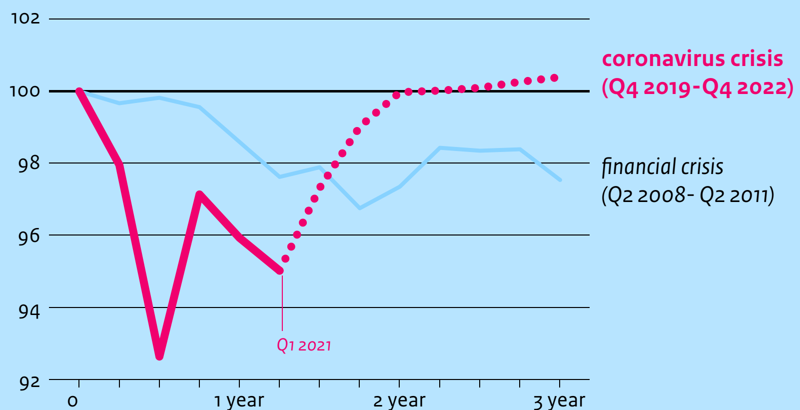
Coronavirus crisis
New waves of infection remain a possibility

In other countries
Uncertainties about inflation, EU budgetary rules, and the economic relationship between EU and UK, and China and US

Employment

Employment is also expected to return to its pre-pandemic level.

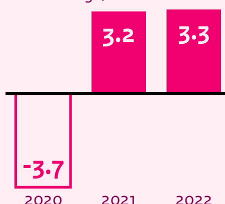
employment, in hours worked, compared against the financial crisis (indexed)



Main figures

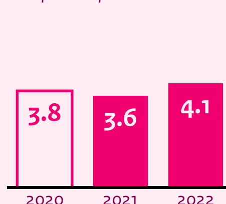
Economy

GDP change, in %



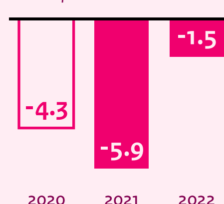
Unemployment

% of labour force



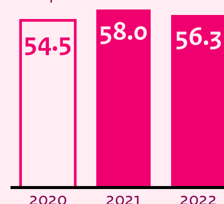
EMU balance

in % of GDP



Government debt

% of GDP



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Summary

The Dutch economy is projected to improve, from the second quarter onwards, due to the lifting of COVID-19 restrictions and higher vaccination coverage among the population. In the fourth quarter of 2020 and the first quarter of 2021, the second and third coronavirus waves still caused GDP to decrease, but to a much lesser extent than during the first wave. Since the second quarter of 2021, consumption has been on the rise again, as shops, restaurants and the cultural sector have gradually been reopening. Once a large share of the population has been vaccinated, there are good reasons for being optimistic about the pandemic remaining under control, with positive effects on consumer and producer confidence. As household savings have been increasing substantially since the coronavirus outbreak, consumption could recover in the coming quarters. Business investments are also increasing, following optimistic revenue expectations. Similar positive economic developments can be seen elsewhere in the eurozone, and in the United States, the upward trend already started earlier. For the fourth quarter of 2021, GDP in the Netherlands is projected to exceed its level of two years earlier, which will be slightly ahead of other countries in the eurozone. GDP will increase by 3.2% in 2021 and 3.3% in 2022, following a decline of 3.7% in 2020. These projections are based on the government's current policy proposals, in which support measures are set to expire in late September of this year.

Support measures again bolster the economy, and particularly the labour market, in 2021. This especially applies to the first two quarters.[1] In May, the Dutch Government extended its support measures up to the end of the third quarter. Support measures such as the NOW wage cost subsidy scheme and the TVL compensation of fixed costs for SMEs keep pace with business turnover levels. As turnover levels are recovering strongly, the impact of support measures on the government budget in the third quarter will be lower than in the first six months of the year. A positive impulse to domestic demand also comes from spending on vaccinations and COVID-19 tests, although this is offset by a negative impulse from the crowding out of regular health care, especially at the beginning of the year. Moving up infrastructural works and additional spending on education to eliminate educational disadvantage will also boost the economy. The National Growth Fund will have hardly any effect in 2021, but, in 2022, the related spending levels will become substantial.

The Netherlands will also benefit from economic recovery elsewhere in Europe and in the United States. This international recovery is the result of coronavirus-related measures being lifted and expansionary budgetary policy. Goods exports, which already exceeded pre-COVID-19 levels at the end of 2020, will continue to grow both this year and the next, driven by an increasing foreign demand for Dutch products. Exportation of services is still far below the pre-pandemic level and, also in the second half of the year, will continue to face setbacks due to restrictions on international travel and tourism. Total exports are projected to increase by 4.9% in 2021 and 4.5% in 2022, following a 4.3% decrease in 2020.

The GDP level is projected to be higher in 2025 than originally estimated in CPB's Central Economic Plan in March 2021, but will still be lower than estimated before the coronavirus outbreak. Together with its current projections through 2022, CPB is also publishing an update of its Medium Term Outlook to 2025 (see Appendix B to the full Dutch report). GDP volume in 2025 will be 1.5% below that in the March 2020 projections, which did not yet take COVID-19 into account. The lower GDP level is mainly due to a weaker trend in labour productivity growth as a result of missed investment opportunities due to the coronavirus-related recession. The negative impact is smaller than in the update of the Medium Term Outlook in March 2021, which assumed a negative impact of 3%. The impact has been revised upwards, given recent economic

[1] Also see Schellekens, M., R. 't Jong and A.L. Cnossen (2021), Coronasteun compenseerde flink deel reguliere omzetverliezen [Corona-related support compensated large part of regular turnover losses (in Dutch)], ESB. (link)

developments and the more favourable short-term outlook as well as new analyses of the structural effects of the coronavirus outbreak, including those by the IMF and OECD. The economy is currently showing great resilience again after relaxation of the lockdown measures, which means that the degree of permanent damage is likely to be small. The continuing moderate trend in unemployment and the low number of bankruptcies also point to only limited permanent damage.

Slight increase in unemployment in 2022, despite the recovery in production. Production growth, from the current quarter onwards, is mainly reflected in the increase in the number of hours worked per person and in labour productivity. The number of hours worked per person declined sharply during the coronavirus-related recession, partly due to the NOW wage subsidy scheme. A return to normal in the services sector and the phasing out of support measures after the third quarter, will see the return of normal dynamics of companies closing down and starting up. This return will also involve a slightly higher unemployment level. For 2021, unemployment is expected to average out at 3.6% of the labour force and, for 2022, this is projected to be 4.1%. This is a clearly downward revision from the projections published in March 2021 of 0.8 percentage point for 2021 and 0.6 percentage point for 2022, which is primarily due to the better-than-expected realisations and the upward revision of economic growth.

Inflation will increase, this year, mainly due to higher commodity prices. The global economic recovery and the continuing supply constraints by OPEC have led to oil prices rising from just above USD 20 per barrel at the end of March 2020 to just over USD 70 in early June 2021 — representing an increase of more than 200%. After the oil price had temporarily depressed inflation in 2020, it is currently having an upward impact. A slight decrease in the oil price is assumed for 2022. Other commodities are currently also seeing strong price increases because of the global economic recovery which — similar to the oil prices — also have a delayed impact on consumer prices. Other factors are also contributing to higher prices, such as certain bottlenecks in container transport, semiconductor shortages and other supply problems due to sudden increases in the demand for specific products. Remaining restrictions, such as the 1.5-metre social distancing measure, are limiting capacity, particularly in the hospitality industry. This will have a cost-increasing effect. The consumer price increase is expected to rise from 1.1% in 2020 to 2.0% in 2021. The projected inflation's uncertainty margin has increased. It is difficult to draw conclusions about whether or not the current rise in inflation will be temporary: on an international level, some point to the possibility of a new wage–price spiral. At this moment, CPB expects inflation to level off again at 1.8% in 2022.

Since the outbreak of COVID-19, collective wage agreements (CAOs) are containing lower wage increases. The positive economic turning point, from the current quarter onwards, is not yet reflected in the collective wage agreements. The CAO-related wage increases are smaller than those before the coronavirus outbreak. Wage increases in new CAOs are being dampened by the weaker position of companies, particularly in the services sector. These effects will continue into 2022. For the market sector, CAO-related annual wage increases will decline from 2.8% in 2020 to 1.7% in 2021 and 1.8% in 2022. This means that the CAO-related increase for companies in 2021 will be lagging behind the increase in prices. CAO-related wage increases in the market sector and price increases will balance each other out in 2022, but wage increases in the public sector will lag behind. In part, this will cause the increase in static purchasing power to decline, from 2.5% in 2020 to 0.6% in 2021. Under current policy assumptions, purchasing power in 2022 is projected to decline by -0.3%.

Government deficit to decrease next year. Next year, the government deficit will be 1.5% of GDP, which is well below that of 4.3% in 2020 and 5.9% in 2021. The decrease in the deficit next year will be due to the discontinuation of covid support measures and higher tax revenues as a result of the rebounding economy. The debt ratio, after having increased by a total of 9.3% of GDP in the two previous years, will decrease by 1.7% of GDP in 2022. This decrease in 2022 is due to the smaller government deficit under a strong increase in

nominal GDP (denominator effect). In 2021, because expenditures continue to increase sharply, the EMU balance will fall, despite the improving economy.

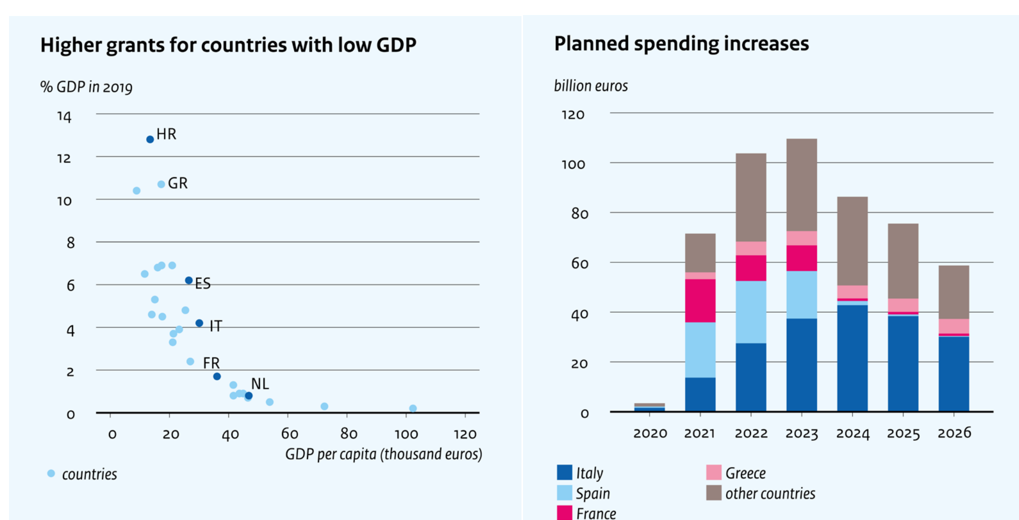
The main uncertainties in these projections concern the course of the pandemic and the development of the savings rate. Vaccinations are bringing the pandemic under control in rich countries, although regional outbreaks remain a possibility, especially in regions with low vaccination coverage. In poorer countries, the pandemic is certainly not yet under control. The risk of new virus variants, therefore, is high and the current types of vaccinations may not be effective enough against some new virus variants. Such variants may lead to new waves of infection, cautious behaviour amongst households and new restrictions by governments, with negative consequences for the economy. Household saving levels, on average, have increased sharply due to the closure of shops, restaurants and the cultural sector. It is uncertain how quickly households will bring their savings back to pre-coronavirus levels. It is also uncertain to what extent the excess savings since the beginning of 2020 will be spent. The full Dutch report elaborates on these uncertainties.

The support policies were aimed at preserving employment, whereas recovery policies should focus on adaptability in the face of long-term challenges. This concerns facilitating adjustments in the economy and supporting recovery. Things will not completely get back to how they were before the COVID-19 outbreak. Some parts of consumer behaviour and work processes will have changed, permanently. This creates problems for certain sectors and companies, but also offers opportunities that can be utilised if the economy is able to adapt to the new situation (i.e., restructuring companies, retraining workers). Long-term challenges, such as with respect to the energy transition, nitrogen issues, the housing market, the quality of education, and the dichotomy of the labour market also require economic restructuring and adjustments. In addition, there are challenges with regard to feasibility and policy comprehensibility. Recovery policy also includes helping viable companies where necessary; for example, with targeted debt cancellations in public-private partnerships. Given the uncertainty about the long-term consequences of the COVID-19 crisis for public finances, it is not advisable to impose an additional structural burden on the budget. Structural spending increases and reductions in the tax burden, therefore, should be balanced with spending cuts or increases elsewhere in the budget. Based on the current outlook for 2022, there is no need for additional demand stimulus in the short term.

Will the EU's Recovery and Resilience Facility come too late?

The European Commission's recovery fund is to contribute to the economic recovery from the coronavirus crisis in the short term, and to structural strengthening in the medium term. This *Recovery and Resilience Facility* contains 672.5 billion euros in grants and loans which Member States can draw on. At least 37% of this money needs to be spent on climate policy and another 20% on further digitisation of the economy. In addition, EU Member States must implement the reform measures recommended by the Council of the European Union. Member States with a low GDP per capita will be able to apply for larger grants from this fund (figure, on the left). To date, 23 countries have applied for a grant from Brussels. The Netherlands has not yet done so.

Figure Allocation of recovery fund, per country (left) and the timeframe of national recovery plans (right)



Source: CPB based on recovery plans and Stability and Convergence Programmes (link, link), EC and Eurostat (link, link)

The usefulness of the recovery fund for economic stabilisation is limited. According to the planning, most of the support packages will be spent in 2022 and 2023 (figure on the right). It is notable that Spain and France plan to spend the money mainly in the first years, while Italy, the largest recipient, intends spreading the grant over the entire duration of the fund. Many countries plan to use the money for infrastructure and housing projects. However, implementation of such plans takes time. According to the European Commission's Spring 2021 Economic Forecast, the EU output gap will still be negative in 2021 and 2022. In Italy and Spain, countries that receive large amounts of money from the fund, the output gap is narrowing rapidly. If the money will be spent in 2021 and 2022, the fund will contribute to economic stabilisation. If the money is spent later, however, it is more likely that the economic situation will have improved by then, which increases the risk of procyclical policies.

At the same time, the recovery fund can contribute to achieving long-term goals. This includes, for example, increased spending on the energy transition. A cost-benefit analysis may be of use in assessing measures intended to achieve long-term goals. In addition, the fund is aimed at reform measures, such as those to improve the functioning of the labour market in the Netherlands. This is a long-term process, for which grants from the fund can be a source of support.