



Slight
economic
recovery

*EMU balance
under
3 per cent*

**Central
Economic
Plan
2014**

Chapter 1
(translation)

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1 Summary

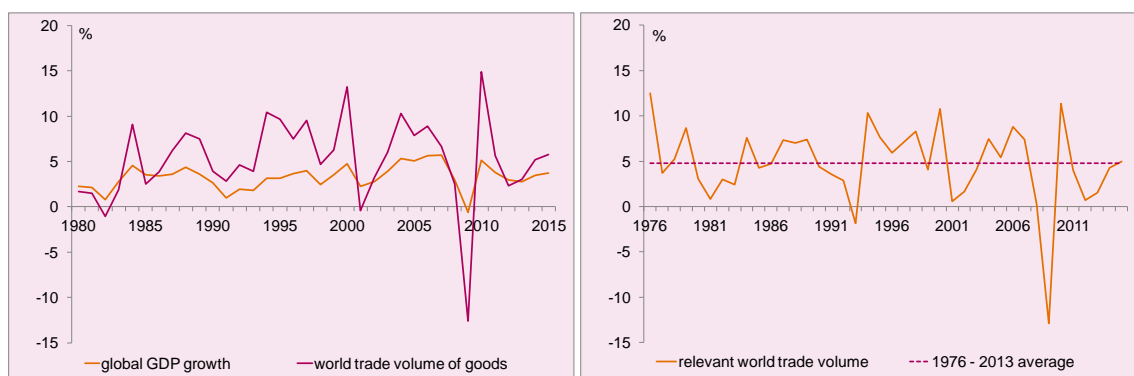
The world economy is improving, although growth in the euro zone lags behind that of other advanced economies. The Dutch economy is slowly on the path to recovery, in the slipstream of the euro zone, with a projected growth of $\frac{3}{4}\%$ this year and $1\frac{1}{4}\%$ for 2015. This growth will be largely due to exports, but domestic factors increasingly also contribute, particularly those related to investments. Companies are taking advantage of the first signs of economic improvement, this year, by increasing labour productivity; for the following year, also an increase in employment is projected. This year, unemployment is still set to increase due to declining employment opportunities, but for next year a slight drop in unemployment is projected, due to the recovering labour market. Inflation will be low, both this year and the next, in line with the rest of the euro zone. The low level of inflation will lead to a slight increase in real wages in 2015. Purchasing power this year will improve by $1\frac{1}{4}\%$, as a result of lower health care and pension fund premiums and a number of policy measures. For next year, an increase in purchasing power of just $\frac{1}{4}\%$ is expected, as a result of an increase in health care premiums. The government deficit this year will stabilise at 2.9% of GDP, and for 2015, this is expected to improve to 2.1%. The relatively strong improvement in government deficit from 2014 to 2015 is in line with the decrease that could already be seen in the earlier assessment of the Government Agreement of the Rutte–Asscher Cabinet. This decrease is partly the result of earlier budget agreements.

1.1 Summary and introduction

Increasing growth in world trade and the global economy

Leading indicators for the main advanced economies point to a recovery gaining ground. The global economy is accelerating, with a projected growth of 3½% for this year and 3¾% in 2015. World trade shows a comparable development, with increasing although still moderate growth. The phenomenon of world trade increasing more than GDP is following a normal pattern (Figure 1.1, left). In times of a growing global economy, the share of exports in global GDP increases and, thus, world trade grows faster than global GDP. The relevant world trade will increase from 4¼% this year to 5% in 2015, under the influence of increasing growth in the United States and the euro zone. This will bring the rate of growth of the relevant world trade in both years to the multi-annual average (Figure 1.1, right).

Figure 1.1 World trade is increasing faster again than global GDP (left), and the increase in relevant world trade is approaching the multi-annual average (right)



For this year, a growth of 1% is projected for the euro zone, and 1½% for next year. Germany, with above average growth levels in both years, is an important motor of this economic growth. This is beneficial for Dutch exports. In the southern European countries, circumstances vary, from only weak growth in Italy and Portugal to increasing growth in Spain and Greece. Inflation is projected to remain low, for both this year and the next. This is particularly due to the very low and in certain cases even negative price developments in a number of southern countries, where the wage decreases of the last years (both real and nominal) are calculated into the prices. Deflation for the entire euro zone, however, is unlikely, seeing the accelerating growth in various countries. For next year, inflation in the euro zone is projected to increase slightly again, as a result of the increasing economy and relaxed monetary policy. The text box describes various scenarios for the international economy and energy prices and their impact on the Dutch economy.

The projected image for the global economy contains both positive and negative risks. One of the negative risks is the described deflation scenario for the euro zone, but also that of a delay in the growth of the Chinese economy, further delays for other emerging economies, and further escalation of the Ukraine conflict.

Uncertain global economy: trade, inflation and energy prices

The growth in the relevant global economy has been upwardly adjusted, compared to the December projections, in line with positive developments in the international trade in goods over the second half of 2013 (see the CPB World Trade Monitor). The global economy may improve further, with an increase in international trade and an upward pressure on prices. However, since these calculations were made (4 March), inflation in the Netherlands has decreased further, and the political situation in Ukraine has developed more rapidly. At this time, the situation is uncertain and neither the political nor the economic consequences are very clear. Possible short-term consequences could be a rise in energy prices and a declining growth in world trade.

Model simulations, using NiGEM and Saffier, provide some insight into these uncertainties and the possible consequences for the Dutch economy. The simulations first investigate the possible consequences of a stronger economic recovery in the industrial countries, with a faster growth in spending in 2014, with GDP in 2015 remaining at that higher level.¹ This boost in spending would lead to price increases, causing a gradual increase in inflation in these countries, and therefore also in export prices and competitor prices. Such a spending boost would lead to an additional increase of 1.9% in relevant world trade, in 2014. The increasing world trade and competitor prices are good for Dutch exports. Higher import prices lead to a shift in spending patterns, in favour of nationally produced goods. The market sector profits from both of these effects, production and employment levels will increase and so will investments. This, in turn, pushes up domestic prices and wages. Ultimately, domestic prices will increase as fast as international ones and this will not improve the price competitiveness position.

The current unrest in the Ukraine has not yet had any clear economic impact. Oil and gas prices increased briefly on 4 March, but decreased again a few days later. However, it is not unimaginable that the situation in the Ukraine escalates further, with larger economic impacts. One of the possible consequences is a drop in spending, in Russia and the Ukraine, as well as in western countries. At a drop in spending of 1%, the impact will be comparable to the above scenario, but in the reverse, causing lower economic growth and inflation. Another possible consequence of a further escalation would be an increase in oil and gas prices – the level and duration of which is difficult to estimate. An approximate scenario of the possible consequences is one in which energy prices increase by 10% for at least two years in a row. This would lead to higher global inflation and reduce spending and world trade. For the Netherlands this would mean less economic growth, particularly due to lower export levels and less investment. Employment would go down, causing unemployment to increase further, and the higher energy prices would cause inflation to go up.

The consequences for the Netherlands of positive global economic developments and increasing energy prices (cumulative deviations from current projections, in percentage points)

	International boost in spending		Higher energy prices	
	2014	2015	2014	2015
Volume relevant world trade (excl. energy)	1.9	1.6	-0.6	-1.2
Competitor price (excl. energy)	0.1	0.7	0.4	0.9
Import price of goods	0.2	0.5	1.9	2.2
Gross domestic product (market prices)	0.5	0.6	-0.2	-0.5
Household consumption	0.1	0.3	-0.1	-0.3
Investments	0.9	2.2	-0.1	-1.4
Export of goods and services	1.5	1.3	-0.4	-1.0
Import of goods and services	1.3	1.3	-0.4	-1.0
Market sector production	0.7	0.8	-0.2	-0.7
Employment (employment years)	0.2	0.5	-0.1	-0.3
Unemployment percentage (% of GDP)	-0.1	-0.4	0.0	0.2
Contract wages market sector	0.2	1.0	0.2	0.2
Consumer price index (CPI)	0.1	0.4	0.3	0.6
EMU government balance (% of GDP)	0.2	0.4	0.2	0.0

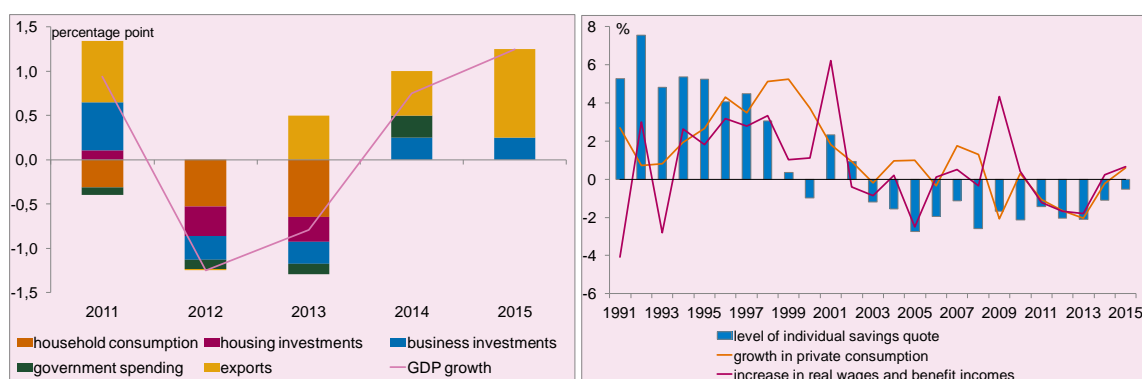
¹ Simulations were conducted using [NiGEM](#), the global economic model of the *National Institute of Economic and Social Research (NIESR)*. The chosen spending boost of 1% in 2014 was limited to a number of important trading partners, for practical reasons (i.e. Japan, United States, United Kingdom, Belgium, Germany and France).

This year, the ECB will conduct a *Balance Sheet Assessment (BSA)*, consisting of an *Asset Quality Review* and a *stress test*. If bank balances are found to be insufficient and the response by authorities inadequate, this would be a risk factor for the European economy. A positive outcome of the BSA, however, could in fact contribute to restoring trust in the euro zone. Other upward risks, in particular, would be an accelerated economic growth in the United States, Japan, the United Kingdom and Germany, in combination with an acceleration of the increase in world trade (also see the uncertainty scenarios in the text box).

The Dutch economy: also domestic recovery

The Dutch economy is slowly recovering from the double dip recession, with a growth of $\frac{3}{4}\%$ this year and $1\frac{1}{4}\%$ in 2015. Because of the increase in world trade, export levels are growing, both of domestically produced and re-exported goods. These exports are mainly responsible for the economic growth, but from this year onwards, investments and government spending (only in 2014) are also contributing (see Figure 1.2, left). As a result of the deficit-reducing measures of the Government Agreement, the contribution of government spending will decline again in 2015. This, incidentally, only refers to the direct impact of the spending that is related to government consumption and investment. The effects from tax measures and other government expenditures, such as income transfers and subsidies, also have an impact on economic growth through household and business spending. The indicator for the contribution of government spending, therefore, cannot be interpreted as the total impact of government policy on economic growth.

Figure 1.2 Contribution of domestic spending to economic growth is positive (left) and consumption levels rise with increasing wages and benefits (right)



In the figure on the left, the bars for the projection years not always add up to the horizontal line. This is because the bars and the line have been independently rounded off at quarter percentages.

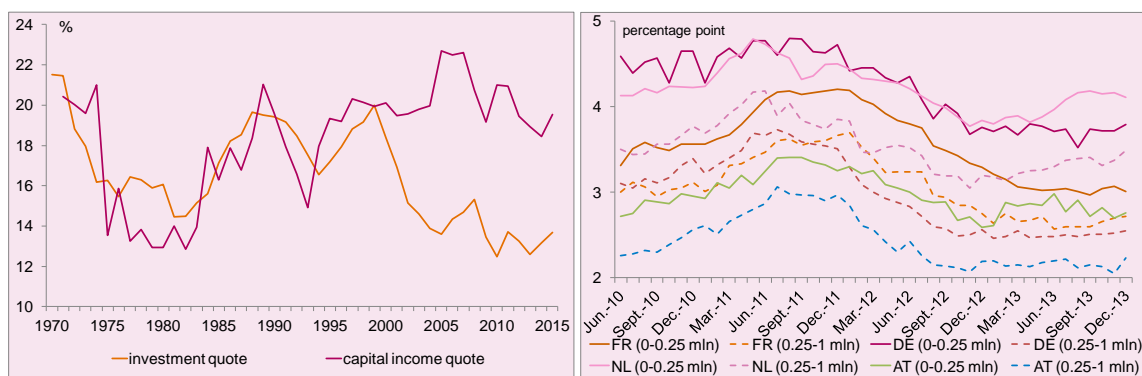
The decrease in private consumption levels that could be seen since 2010 will turn into a small increase next year (Figure 1.2, right). Over the last years, there was a strong relationship between the developments in wages and benefit incomes and consumption. This is also projected for 2014 and 2015, which can be seen in the concurrent increases in incomes and consumption. For the first time since 2010, developments in real disposable income are moderately positive for both this year and the next, with increases of $\frac{3}{4}\%$ and $1\frac{1}{4}\%$, respectively. The increase in disposable income in 2014, under a decrease in employment, is particularly driven by an increase in purchasing power. For 2015, the reverse is projected, when especially employment will increase, but developments in

purchasing power will be moderate – partly due to policy. Consumption projections include an increase in the individual savings quote, as a result of the increase in other income. For 2014 in particular, other income is projected to increase, because of the return on capital. This income is largely saved and not or hardly used for consumption.

A decrease in pension premiums is one of the factors behind the increase in disposable income in 2014. Over the past years, increases in pension premiums and incomplete indexation or nominal reductions in pension payments all contributed to a decrease in disposable income and consumption. This year, pension premiums will decrease due to a lowering of the maximum annual pension accumulation and a higher occupational pension age. Premiums will decrease next year as a result of a cap on the deductibility of pension accumulation for incomes over 100,000 euros. Up to that level, on average, pension premiums will remain constant. Furthermore, due to the increase in funding ratios this year, fewer pension funds will implement cut backs, and other funds will resume indexation or reverse earlier cut backs. Thus, there will be less downward pressure from pension premiums and benefits on consumption than has been the case in recent years.

This is also true for developments in housing prices, which are projected to stabilise this year and the next. Recent price decreases may have led to lower consumption levels at a faster rate than in the past. In that case, households by now will already have taken the capital losses and the economy may experience a faster recovery. A downward risk for consumption is that of households wanting to balance their finances to a larger degree than foreseen, due to the decrease in housing prices over the last years. There are signs that some households have used their savings to repay part of their debt and thus have shortened their balance. This trend is one of the reasons not to expect a strong recovery of consumption growth.

Figure 1.3 Investment quote is low, but increasing (left), and the interest on small loans is relatively high (right)



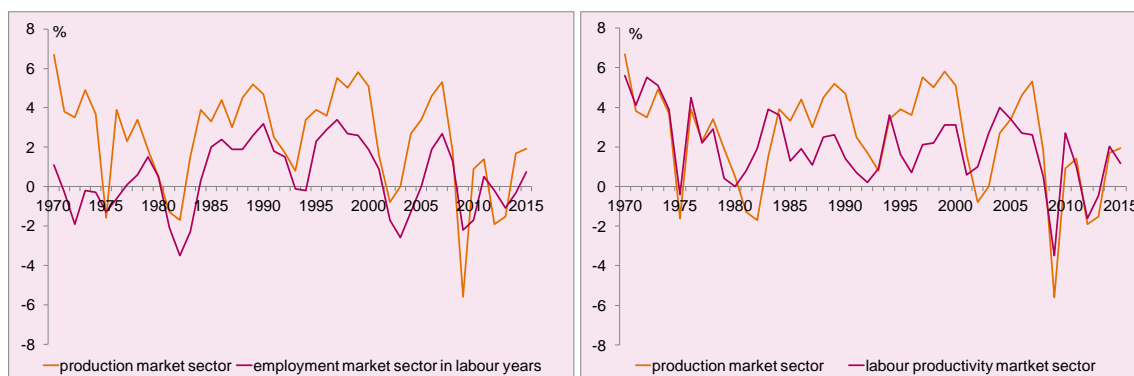
(a) The capital income quote for 2014 is distorted downwards, due to the measure of limiting the use of severance pay insurance funds. The economic impact of this measure has been taken into account. Without this measure, the capital income quote for 2014 would have been 19% instead of 18½%, and 20% instead of 19½ for 2015.

Following two years of decline, investments are also expected to increase this year and the next, due to an improving economy, an increasing industrial production level and a higher rate of capacity utilisation. However, from a historical perspective, investments in 2015 will still be on a low level (Figure 1.3, left). The decline in investments over the last years, in part, can be attributed to reduced demand; because of the low rate of capacity utilisation, the need for expansion and investment was reduced. In addition, it is likely that, at least for SMEs, also the increase in restrictions on the supply side have played a role. There are signs that the costs of SME credits, although slightly reduced, nevertheless are high from an international perspective (see Figure 1.3, right), and that the number of small loans issued in the Netherlands has sharply declined over the last years.¹ The acceptance criteria applied by Dutch banks when giving out loans to businesses have become slightly more stringent in the last quarters, although less than in the previous period. The limiting of credits provided to high risk sectors is likely related to the aftermath of the financial crisis and its impact on bank balances (see also the discussion in Section 1.2).

Labour market recovery will follow later

The decrease in production of 2013 is having a delayed impact on employment. Moreover, companies first respond to economic improvements by utilising the existing production capacity, thus increasing their profitability. This improvement in labour productivity implies that employment will not recover straight away; a pattern that could also be seen in the past (Figure 1.4, left). In this economic phase, therefore, the fear of a lengthy jobless recovery in the Netherlands would be premature. In the past, the labour productivity increase peaked in the first year of a recovering economy (Figure 1.4, right). This is also true this time: in 2014 labour productivity in the market sector will see a 2% recovery, while a projected ¾% increase in employment in labour years will not occur until 2015.

Figure 1.4 Employment lags behind production (left), while labour productivity peaks immediately (right)



¹ Steering committee credit facility, Credit facility for SMEs, report 25, June 2014 ([link](#)).

Table 1.1 Main economic indicators for the Netherlands, 2010–2015 (e)

	2010	2011	2012	2013	2014	2015
	annual mutations, in %					
International economy						
Relevant world trade	11.3	4.0	0.7	1.9	4¼	5
Competitor prices	7.9	6.3	4.1	-1.6	-1	½
Oil prices (Brent. USD per barrel)	79.5	111.3	111.7	108.7	108	108
Euro exchange rate (USD per euro)	1.33	1.39	1.28	1.33	1.36	1.36
Long-term interest rate in the Netherlands (in %)	3.0	3.0	1.9	2.0	2.3	2.6
Volume GDP and spending						
Gross Domestic Product (GDP, economic growth)	1.5	0.9	-1.2	-0.8	¾	1¼
Household consumption	0.3	-1.1	-1.6	-2.1	-¼	½
Government spending	0.5	0.2	-0.7	-0.5	½	-¼
Investments (including stocks)	-2.0	6.5	-2.7	-7.1	4¼	3¼
Export of goods and services	11.6	4.1	3.2	1.3	2¼	4¼
Import of goods and services	10.3	4.2	3.3	-0.5	2½	4
Prices, wages and purchasing power						
Price level Gross Domestic Product	0.8	1.1	1.3	1.8	¾	1¼
Export prices domestically produced goods (a)	5.3	6.5	1.7	0.8	-½	½
Prices imported goods	8.0	5.1	2.7	-1.7	-1¼	¾
National Consumer Price Index (CPI)	1.3	2.3	2.5	2.5	1½	1½
Contract wage level private sector	1.0	1.4	1.6	1.5	1½	2
Purchasing power, static, median all households	-0.4	-1.0	-2.3	-1.1	1¼	¼
Labour market						
Labour force	-0.3	0.0	1.5	0.8	-¼	¼
Working population	-1.0	0.0	0.6	-0.7	-1	½
Unemployed labour force (in thousand persons)	390	389	469	602	650	635
Unemployed labour force (in % of the labour force)	4.5	4.4	5.3	6.7	7¼	7
Market sector (b)						
Production	1.1	1.4	-1.9	-1.5	1¾	2
Labour productivity (in labour years)	2.9	0.9	-1.7	-0.5	2	1¼
Employment (in labour years)	-1.7	0.5	-0.2	-1.1	-¼	¾
Wage rate (c)	1.7	1.9	1.7	2.2	3½	1¾
Labour income quote (in %) (c)	79.0	79.0	80.5	81.1	81½	80½
Other						
Individual savings quote (in % of disposable income) (c,d)	-2.1	-1,4	-2,0	-2,1	-1	-½
Balance current account (in % of GDP)	5.0	7,4	7,7	9,7	9½	9¾
	in % of GDP					
Public sector						
EMU balance	-5.1	-4,3	-4,1	-2,9	-2,9	-2,1
EMU debt (end of year)	63.4	65,7	71,3	74,3	74,6	74,7
Taxes and social security contributions (in % of GDP)	38.9	38,6	39,0	39,6	40,7	41,3

(a) Excluding energy.
(b) Companies, excluding health care, mineral mining and the real estate sector.
(c) The figures on wage rates in the market sector, labour income quote, as well as the individual savings quote are upwardly distorted due to the measure that limits the use of severance pay insurance funds. Severance pay is paid directly to those involved, instead of being paid into such a fund. This means there will be a single accounting incidental wage increase, the economic impact of which has been taken into account. Statistics Netherlands is investigating how this measure will be incorporated in the National accounts of 2014. Without this measure, the wage rate of the market sector in 2014 would have been 2½% and in 2015 2%, the labour income quote 81% (2014) and 80% (2015), and the individual savings quote -¾% (2014) and -¾% (2015).
(d) Level; disposable family income, including public savings.
(e) The layout of the Main data table has changed, see explanation on the CPB website ([link](#)). Data not yet include the revision of the National accounts, as announced by Statistics Netherlands.

Over the course of this year and the next, employment is projected to increase slightly. Various indicators point to a turn around, such as increasing vacancies and hours worked in temporary employment, and decreasing numbers of bankruptcies and dismissal applications. Labour supply this year will remain unchanged, and for next year it is expected to increase less rapidly than in previous years, due to a worsening labour market situation. Unemployment for this year is projected to increase further to 7¼%. The slight increase in labour demand in 2015 will be a little larger than the increase in labour supply, which on balance causes unemployment to decrease slightly to 7%. Last year, unemployment increased much more rapidly than the number of unemployment benefit recipients. Over the past months, this has reversed and the inflow into the unemployment benefit has increased strongly. This year, under decreasing employment, the relatively strong increase in the number of unemployment benefit recipients is expected to continue.

Low inflation and a slight recovery in real wages and purchasing power

Because of the large labour market – high unemployment under a low vacancy rate – contract wages have developed only moderately. For this year, contract wages are projected to increase by 1½%, which equals inflation. Next year, an improved labour market and lower social financial burden for employers will enable a rise in contract wages of 2%, under an inflation rate of 1½%. This real wage increase, next year, will occur without it being at the expense of company profits. Over a long time horizon, the average wage developments are in line with the developments in productivity.

Inflation (CPI) is low but stable and will be 1½% for both 2014 and 2015. In terms of the Harmonised Index of Consumer Prices (HICP), inflation this year will be 1% and 1¼% in 2015 – below the ECB's target value of below but close to 2%. The development of Dutch inflation, according to this definition, is largely in line with the euro zone's average inflation. Because of the Dutch Cabinet's rent policy, rents in the Netherlands are increasing by more than in the rest of the euro zone, but this is more or less offset by low labour costs and profit margins that reduce inflation. In the euro zone, inflation is currently low due to the moderate economic growth and the decreasing resource prices on global markets. In the Netherlands, margins are under pressure, following a period of economic downturn. These margins will improve because of the recovering economy and the increase in productivity, without causing an immediate rise in inflation.

For 2014, median static purchasing power is projected to increase by 1¼% under unchanging real wage levels; contract wage increase and inflation will both be 1½%. Households all benefit from the temporary reduction in the tariff of the first tax bracket and the raised general tax deduction. The working population has the additional advantage of the increase in working tax credit and lower pension fund premiums. Furthermore, health care premiums in 2014 are also around 100 euros less than they were in 2013. Middle and higher incomes benefit from this fact. In 2015, the median static purchasing power will improve by ¼% and real wages will increase by ½%. Compared to this year, next year's increase in median purchasing power will be limited. This is particularly due to increasing health care premiums and the termination of certain measures that have temporarily increased purchasing power (e.g. the temporary lowering of the tariff in the first tax bracket). In

addition, two large reform measures are planned: the implementation of the household allowance and the reform of child-related benefits and regulations.

Public finances improving rapidly, but budgetary uncertainties are relatively large

The government deficit is projected to stabilise this year at 2.9%, and to decrease in 2015 to 2.1% of GDP. Thus, in 2015, the deficit will clearly be below the Maastricht Treaty maximum budget deficit of 3% of GDP, after having increased to 5.6% in 2009, due to the crisis. Tax revenues will increase this year as well as the next, both because of policy and the improving economy. Public spending will drop, in percentage of GDP, in 2014 and 2015. This is the balance resulting from an increase in social security expenditure and a decrease in expenditures on health care, due to restrictions and transfers of claims related to the reform of the long-term care system. On balance, particularly in 2015, there will be a substantial reduction in deficit. This reduction is in line with the decrease that could already be seen in the assessment of the Government Agreement of the Rutte-Asscher Cabinet.² This decline was already largely included in the baseline of that Government Agreement. For 2014, the structural government deficit is projected to decrease by 0.2% of GDP, and for 2015 by 0.4%. The government debt will stabilise in 2014 and 2015 at around 75% of GDP.

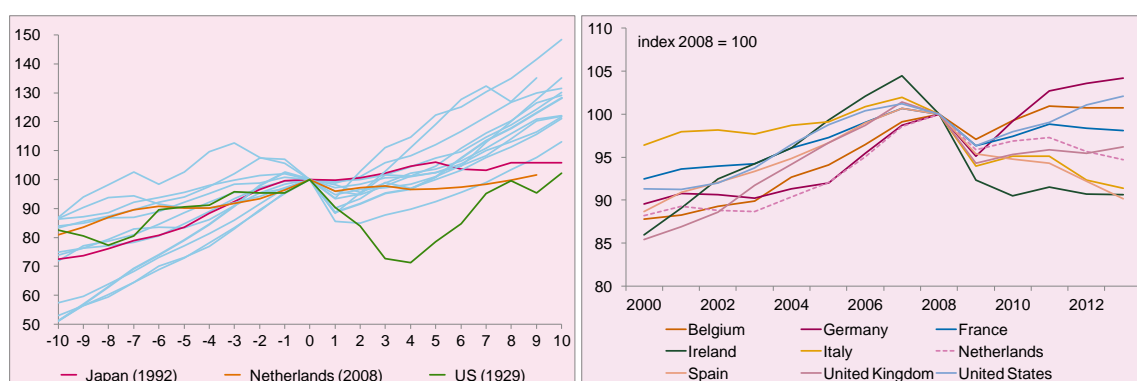
Uncertainties around the budgetary projections for 2014 and 2015 are relatively large. These uncertainties concern developments in the expenditure on curative care and long-term care, and incidental revenues from the temporary reduction in the 'box 2' tax tariff and the severance pay insurance. Furthermore, there is the statistical uncertainty that results from the revision of the National accounts.

² According to the assessment of the Government Agreement, the deficit was projected to decrease from 2014 to 2015 by 0.7% of GDP. See the CPB report (2012) on the actualisation of the Dutch economy up to 2017 (*Actualisatie Nederlandse economie tot en met 2017 (verwerking Regeerakkoord* (in Dutch)), CPB Communication, 29 November ([link](#)).

1.2 Analysis

After a period of low and negative growth, recovery has finally set in for the Dutch and European economies. Growth projections for this year and the next, however, are anything but exuberant. For 2015, the Dutch economy is projected to still be below the 2008 level. This is not unusual; after a financial crisis, GDP decreases sharply and such a decrease generally is not made-up for by a subsequent period of catch-up growth. As a rule, it takes a relatively long time – six to eight years – for GDP to get back to its level of before the financial crisis.³

Figure 1.5 Growth in various economies following the crises⁴



Japan was also affected by a financial crisis, in the early 1990s. This was followed by a long period of low and sometimes even negative growth, while the banks were writing off loans, between 1992 and 2005, with a total value of 19% of GDP.⁵ Figure 1.5 (left) compares growth in countries that have experienced a banking crisis, with the base year being the first year of that crisis. The figure shows that, since 2008, the Dutch economy has been lagging behind the Japanese economy after it had its crisis. Figure 1.5 (right) compares growth in a number of countries since 2008 (base year). This also shows an image of the Dutch economy not recovering particularly well after the financial crisis. The only countries worse off are those that were affected by a combination of problems in their financial sectors, bursting real estate bubbles and troublesome government debts, such as Spain, Ireland and Italy.

A lagging growth performance after a financial crisis may be explained by the fact that a financial shock subsequently also impacts the real economy through various transmission channels. Here, a distinction can be made according to the mechanisms that work via bank balance sheets (*bank lending channel*) and those that work via the balance sheets of companies or households (*financial accelerator* or *balance sheet channel*).

³ For example, see Cerra V. and S.C. Saxena, 2008, Growth Dynamics, the myth of economic recovery, *American Economic Review*, pp 439–457 and Reinhart C.M. and K. Rogoff, 2014, Recovery from financial crises: evidence from 100 episodes, NBER Working paper 19823 ([link](#)).

⁴ Conference Board Total Economy Database, CPB calculations.

⁵ T. Hoshi and A.K. Kashyap, 2010, Will the US Bank recapitalization succeed? Eight lessons from Japan, *Journal of Financial Economics*, Volume 97, Issue 3, pp 398–417.

The bank balance sheet is the first channel along which a financial shock is transmitted to the real economy. When banks need to recapitalise after a capital shock, they may do so by reducing the number of loans they issue, by increasing the interest rate on loans, by withholding dividend payments, or by issuing new share capital. In practice, banks prefer not to issue new equity because this is costly to existing shareholders and instead opt for a reduced number of new loans or for increased interest rates. This then puts pressure on credit available to firms and consumers. This negative impact of capital shocks on available credit is well-researched and found to be rather strong.⁶ In addition to the pressure on credit facilities, a weakened capital position may also lead to *evergreening* – the phenomenon of banks holding on to bad loans to loss-making companies, instead of writing them off, in the hope of better days to come. This also reduces the available credit for potentially healthy companies and starters.⁷ Furthermore, the economic downturn following a financial shock also involves an increase in the number of loans that are written off, thus reducing the bank's equity capital even further.

The second channel is through the balance sheets of companies and households. Companies may reduce the costs of financing by offering some of their assets as collateral. A financial shock, however, may cause those assets (production facilities or real estate) to lose part or all of their value, which means that the companies involved will be able to borrow less money or only against higher costs, in turn causing a further decrease in company value. This results in a self-enhancing process (which explains the term of *financial accelerator*).⁸ For households there is also a balance-sheet effect from an unexpected devaluation of residential housing and financial assets, following a financial shock. These reductions in wealth, made more severe by the rise in crisis-related unemployment, cause households to reduce their debts as well as their level of consumption.⁹

An important question here is that of the degree to which these mechanisms lately have played a role in the Netherlands. The answer is not simple, as balance sheet effects are not the only explanation for a decrease in credit facilities for companies and households. The economic downturn due to a financial crisis, after all, also leads to less need for investments (e.g. in expansions) or less demand for credit (e.g. for mortgages); in addition to the supply effects there is also a lower demand.

⁶ See Bijlsma M. and G. Zwart, 2010, Zijn strengere kapitaal-eisen kostbaar? [Are stricter capital requirements costly? (in Dutch)], CPB Document 215; and Anthony J., and P. Broer, 2010 ([link](#)), Linkages between the financial and the real sector: A literature survey, CPB Document 216 ([link](#)) for a description of the mechanisms and an overview of the empirical literature. Bijlsma M., Dubovik and B. Straathof, 2013, How large was the credit crunch in the OECD?, CPB Discussion Paper ([link](#)) show that the financial crisis has had a larger negative impact on companies that are strongly dependent on external funding.

⁷ This phenomenon has played a role in Japan in the 1990s, for example, see Caballero R.J., T. Hoshi and A.K. Kashyap, 2008, Zombie lending and depressed restructuring in Japan, *American Economic Review*, pp 1943–1977.

⁸ Empirical evidence suggests that this mechanism occurs in actual practice. For example, see the studies by Gertler M. and C.S. Lown, 1999, The information in high yield bond spreads for the business cycle: evidence and some implications, *Oxford review of economic policy*, pp 132–150. Mody A. and M.P. Taylor, 2003, The High-Yield Spread as a Predictor of Real Economic Activity: Evidence of a Financial Accelerator for the United States, IMF staff papers vol. 50 ([link](#)), in which a negative and non-linear connection was found between spreads of company bonds and economic activity.

⁹ Also see CPB, *Macro Economic Outlook 2014* ([link](#)), pp. 30 (in Dutch).

In the absence of recent empirical research on the Netherlands, an international comparison of various indicators may give an impression of the importance of the various mechanisms. Information about bank balances shows that risk-weighted capital ratios of Dutch banks are about average, from an international perspective. Unweighted capital ratios, however, are relatively low, compared to those in other countries (Figure 1.6, left).¹⁰ The image of the capitalisation of Dutch banks, therefore, is a mixed one. For some banks, their market value has recovered, while others – depending on the composition of their loans portfolio – have to write off more than expected on loans to firms. Whether banks are *evergreening* in the Netherlands is unknown. Apart from their position compared to those in other countries, empirical research based on international data suggests there are indications that banks with leverage ratios of above 4% have been continuing their credit facility, whereas banks with ratios below 4% were found to have substantially reduced their credit facility. This would mean that ratio levels also are of importance.¹¹ The conditions that the European Commission has set for government support operations, have limited the competitiveness on the Dutch market in the short term¹²; a market that, from an international perspective, already was characterised by a high degree of concentration.

In the Netherlands, large companies have a savings surplus and sufficient means to invest. However, credit facility indicators do show that SMEs are finding it difficult to obtain credit.¹³ For example, a relatively high percentage of loan refusals is being reported in a standardised survey among companies (Figure 1.6, right)¹⁴, interest rates of small loans are high from an international perspective (Figure 1.3, right), and slowly but surely the volume of small loans has been declining in the Netherlands since 2010.¹⁵ Here, the strong decrease in credit demand also has played a role over the last years, as a result of the economic recession.¹⁶ The housing capital of households has been hit hard, from an international perspective, because of the relatively large decreases in house prices.¹⁷

¹⁰ Source: IMF Financial Soundness Indicators. The risk-weighted assets were calculated on the basis of Basel II regulatory standards and national guidelines of supervisors. The Basel committee, recently, proposed a completely new definition of leverage. This benchmark could change the relative position of the Netherlands.

¹¹ See Schoenmaker, D. and T. Peek, 2014, The State of the Banking Sector in Europe, OECD Economics Department Working Papers, no. 1102 ([link](#)).

¹² Schinkel M.P. and M. Dijkstra, 2013, Hollands hoge hypotheekrentes [The Netherlands' high mortgage rates (in Dutch)], *ESB* ([link](#)), pp 594–597.

¹³ Veer K. van de, and M. Hoeberichts, 2013, The level effect of bank lending standards on business lending, DNB Working Paper 396 ([link](#)).

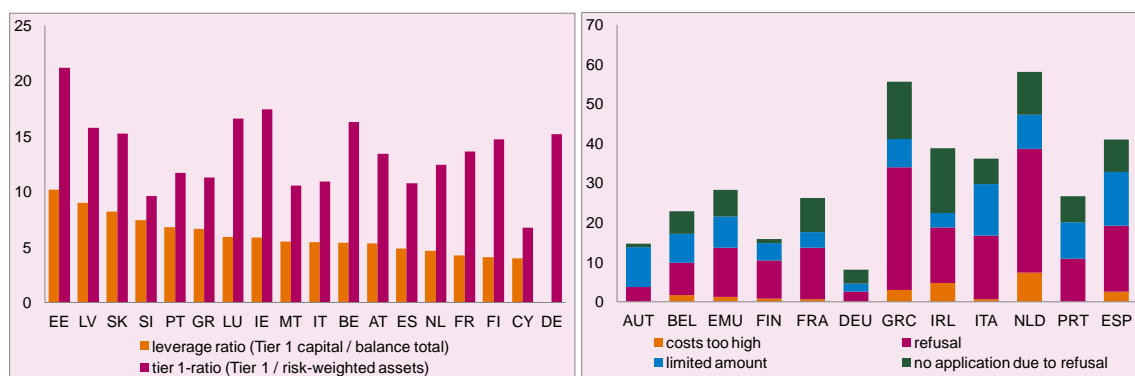
¹⁴ The degree to which selection effect could explain the international differences is unclear.

¹⁵ Steering committee Credit facility, Kredietverlening aan het mkb [Providing credit to SMEs (in Dutch)], report 25 June 2013 ([link](#)).

¹⁶ Veer, K. van de, 2013, Banken beperken zakelijke kredietverlening [Banks are limiting corporate lending (in Dutch)], *Economische Statistische Berichten*, vol. 4651.

¹⁷ For example, see CPB, The Dutch housing market - mortgage interest rates, house prices and consumption, CPB Communication ([link](#)) 14 February 2013.

Figure 1.6 Mixed image for the capital ratios of banks (left), credit standards SMEs are stringent (right)



All things combined, the Netherlands does certainly present an ambiguous picture in the international comparison. On the basis of the available information it was not possible to quantify the relative importance of supply and demand effects, but it stands to reason that the mechanisms described above play some role in explaining the mediocre performance of the Dutch economy since 2008.

In the case of companies, it can be stated that a sufficient capitalisation of banks is an important factor in the availability of credit. The projected increase in economic growth will also help, as this will increase the value of company assets and thus also their ability to borrow money for investments (which is the *financial accelerator* working in the right direction). At the same time, a rising stock exchange and an increase in the price of capital assets and real estate also make it more attractive for banks to provide credit. These mechanisms, therefore, reduce the need for additional policy to encourage credit facilities or other forms of business financing, provided there is a return of economic growth. It is, however, conceivable that due to the anticipation of additional regulations (Basel III) and possible structural behavioural changes of banks because of the financial crises, the costs related to bank financing particularly for SMEs will remain higher for a longer period of time. This situation could encourage these companies to look for and use alternative forms of financing. A comparison with the United States suggests this would mean that the companies' amount of own capital must improve; the average ratio between own capital and total assets in Europe is half that of the United States.¹⁸ Such an adjustment period will take time and therefore will not be painless.

This time is different?

For this year, an Asset Quality Review (AQR) by the European Central Bank (ECB) and a stress test by the European Banking Authority (EBA) are foreseen. If both tests would involve stringent criteria, the results will provide clarity about the quality of bank balances and the degree to which *evergreening* is being practiced. The incentives for a more stringent

¹⁸ Sebnem Kalemli-Ozcan, Bent Sorensen, Sevcin Yesiltas, Leverage across firms, banks, and countries, *Journal of International Economics*, 88 (2012) 284–298. Incidentally, the ratio between own capital and borrowed capital, in the Netherlands, is better than in the surrounding countries. In 2009 (source: Bach database), the ratio between total assets and own capital for companies with a turnover of less than 10 million euros in the Netherlands was 1.8, in Belgium 2.2 and in France and Germany 3.1. Data on these countries show that these figures have not changed much.

test are stronger than before, as the execution of the AQR is being led by the future supervisor, independently and at a certain distance from national governments (the ECB). The design of the Resolution mechanism and the accompanying emergency fund, however, could lead to uncertainty and speculation about the strictness and the results of the AQR and stress test. Uniformity among countries, independent observers in the form of peer reviews and transparency about conditions and execution may add more credibility. The AQR offers clarity about the quality of bank balances, thus making it potentially easier to attract capital. If, however, remaining problems are detected, the lesson from earlier financial crises has been that a forced, rapid and ambitious recapitalisation of banks is much preferred over careful incremental policy; no shrinking of the balance sheet, but fresh capital. The proposed resolution framework provides a clear pecking-order: if bankruptcy is inevitable for a bank, the first contributions should be from the private sector – via a *bail-in* of shareholders and creditors – and only after these possibilities have run out should the government get involved. The Dutch Government, as shareholder in four of the seven banks that will fall under the regime of the ECB, is thus in a special position. Should the ultimate remedy of government support be inevitable, then the additional conditions of the European Commission are not to undermine market competitiveness.

Properly executed AQR and stress tests that set the bar for banks high, would help to further reduce the probability a Japanese scenario. If the results would require balance improvements, then a forced and rapid capitalisation has proven effective, in the past. The direct costs of careful, incremental policy may be less visible, but the social costs in terms of meagre growth, bankruptcies and unemployment are higher.



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