

# The netherlands economy overview economics essay



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The Netherlands is one of the most densely populated countries in the world, with more than 16 million people living in an area of just 41,785 square kilometres. The country is bordered by Germany to the east, Belgium to the south and by the North Sea to the north and west. The Netherlands is a prosperous country, with a well-educated, flexible, motivated and multilingual labour force. The quality of life can be said to be very high. The country has an open economy with a strong focus on international trade.

Given its strategic position, the Netherlands enjoys an important role as the 'gateway to Europe'. It has outstanding infrastructure, with a widespread network of roads and motorways and it has one of the busiest rail networks in Europe. The port of Rotterdam, located in Netherlands, is the largest harbour in Europe and one of the busiest in the world. It is served by an extensive network of inland waterways to facilitate transshipment, with waterborne transport (maritime and inland) making a significant contribution to the Dutch economy.

### **Netherlands Economy overview:**

The Netherlands economy is the fifth-largest economy in the euro-zone and is highly dependent on an international financial sector and international trade. The Dutch economy is noted for its stable industrial relations, moderate unemployment and inflation, a sizable trade surplus, and an important role as a European transportation hub. Industrial activity is primarily in food processing, chemicals, petroleum refining, and electrical machinery. After 26 years of uninterrupted economic growth, the Dutch economy contracted by 3.5% in 2009 as a result of the global financial crisis. During this period, the government tried to boost the domestic

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economy through stimulus programs such as accelerating infrastructure programs, offering corporate tax breaks for employers so that they retain their employees, and expanding export credit facilities. However, these programs and bank bailouts resulted in a government budget deficit of 5.3% of GDP in 2010 that contrasted sharply with a surplus of 0.7% in 2008.

The service sector is the most dominant and biggest contributor to Netherlands' economy. The service sector contributes as much as 73.7% to the GDP and generates employment opportunities for 80% of the workforce. Industry and agriculture are the other two main sectors contributing 24.2% and 2.7% to the country's GDP. Historically, from 1988 until 2012, Netherlands GDP Growth Rate averaged 0.55 Percent reaching an all time high of 2 Percent in June of 1996 and a record low of -2.20 Percent in March of 2009. The international reserves are US\$ 54.680 billion and GDP is US\$ 709.5 billion. The real GDP growth has declined by 0.5% in 2012. The negative annual growth is seen only for the second time in the past decade, 2009 being the other year with negative GDP growth. For the year 2012 the inflation and unemployment were at 2.4% and 6.8% respectively.

Some of the largest companies in the Netherlands are Royal Dutch Shell, ING group, Unilever, Schlumberger, Aegon, Philips, EADS, KPN and Ahold.

### **European Central Bank:**

The Netherlands is a part of Eurosystem and the European central bank. The ECB is the central bank for Europe's single currency, the euro. The ECB's main task is to maintain the euro's purchasing power and thus price stability in the euro area. The euro area comprises the 17 European Union countries

that have introduced the euro since 1999. The European system of Central banks comprises the ECB and the national central banks (NCB) of all the 27 European Union members.

Tasks and responsibilities of ECB:

ECB focuses on formulating the policies and on ensuring that the decisions are implemented consistently by the NCBs. Some of the responsibilities of ECB include:

Defining Eurosystem policies – The ECB is in charge of the monetary policy for the Euro.

Deciding, coordinating and monitoring the monetary policy operations

Adopting legal acts within closely defined limits and issues guidelines and instructions to ensure decentralised operations are carried out by the NCB's.

Authorising the issuance of banknotes

Buying and selling of currencies on the foreign exchange markets

The operation of payment systems and the oversight of payment and other financial market infrastructures

The ECB participates in all meetings of the IMF's Executive Board on issues relevant to Economic and Monetary Union.

Statutory reports – The ECB produces a Monthly Bulletin, a consolidated weekly financial statement of the Eurosystem and an Annual Report.

Monitoring financial risks which involves assessing the risks of securities

Fulfilling advisory functions for Union institutions and national authorities

Running the IT systems - A number of common operational systems have been established between the ECB and NCBs to make it easier to carry out decentralised operations.

Strategic and tactical management of the ECB's foreign reserves

### **Euro Currency:**

The euro is the second largest reserve currency as well as the second most traded currency in the world after the United States dollar. Apart from the Netherlands, 16 other member states of the EU use Euro as their currency. Therefore the exchange rate of Euro depends on the policies and developments of all the member countries. Currently 1 EUR equals 1.31 USD (17th March, 2013). The exchange rate for the Euro and USD from its inception is shown in the table below.

Source: <http://www.statistics.dnb.nl/index.cgi?lang=uk&todo=Koersen&data=21&cur=e&type=y&begin=19990000&end=20120000&s=1&service=download>

### **Fiscal developments of the Euro area in 2012 and 2013:**

As per the European commission, fiscal consolidation is expected to continue in 2013. The Euro area government deficit is expected to have declined to 3.5% of GDP in 2012. It is projected to decrease further in 2013 and 2014. At

the same time, the debt-to-GDP ratio is projected to increase, although at a slowing pace, to reach 95. 2% of GDP in 2014.

According to the European Commission's first fully-fledged winter 2013 European Economic

Forecast, The euro area general government deficit is expected to have declined from 4. 2% of GDP in 2011 to 3. 5% of GDP in 2012. This improvement in the deficit is due to a 0. 9 percentage point rise in the revenue-to-GDP ratio to 46. 3% of GDP in 2012 (particularly owing to higher income, wealth and indirect taxes), while the expenditure-to-GDP ratio increased marginally. The financial support to the Euro area countries and government assistance to the financial sector continued which reflected in an increase in the Euro area general government debt to GDP ratio to 93. 1% of GDP.

Looking ahead, the fiscal deficit is projected to fall to 2. 8% of GDP in 2013, and to decline marginally further to 2. 7% of GDP in 2014. The continued fiscal consolidation is expected to be driven by higher revenues (until 2013) and gradual cuts in discretionary spending (e. g. wages and salaries, public investment and intermediate consumption). Regarding the debt outlook, the general government debt-to-GDP ratio is expected to increase over the next two years although at a slowing pace. The increase debt ratio is due to the continued positive impact of the interest growth differential and by comparatively but still positive financial assistance to the Euro area countries. A brief review of the budgetary developments in the largest Euro area countries are discussed below.

In Germany, according to preliminary national accounts data, the nominal budget balance of the general government reached a surplus of €2.2 billion (0.1% of GDP) in 2012. This was driven mainly by a reduction of the deficit in the government sector excluding social security and a slight increase in the surplus of the social security system. Based on this improvement of the general budget balance, Germany is likely to have reached its structural medium-term budgetary objective in 2012. For 2013, the central government's budget does not foresee any major new fiscal measures.

In France, the 2013 budget law, which contains fiscal consolidation measures mainly reliant on tax increases amounting to around 1.2% of GDP, was approved by Parliament on 20 December 2012. However, the proposed taxation of high income households (i. e. a 75% personal income tax) has in the meantime been challenged by the Constitutional Council. According to the Commission's 2013 winter forecast, the fiscal deficit in 2013 is projected to reach 3.7% of GDP, which implies that without additional measures the excessive deficit will not be corrected by the 2013 EDP deadline.

With regard to Italy, on 1 March 2013 the national statistical agency (ISTAT) released the first estimate of the general government deficit of 3% of GDP in 2012. If confirmed by Eurostat, this should lead to an abrogation of the EDP procedure in Italy initiated in 2009. At the same time, according to ISTAT, the debt ratio reached 127% of GDP in 2012. These estimates were broadly confirmed in the Commission's winter 2013 forecast.

In Spain, the government has announced that the 2012 general government deficit – excluding the impact of support to the banking sector – was 6.7% of

GDP, down from 9.0% of GDP in 2011. This was above the target set in the latest EDP recommendation (6.3% of GDP), but slightly below the expectations of most external observers. Capital transfers to be recorded in view of government injections of capital into banks in the context of Spain's financial sector programme amount to 3.3% of GDP, bringing the overall general government deficit in 2012 to 10.0% of GDP. Centrally administered tax receipts in 2012 (on a cash basis) were in line with the forecast contained in the 2013 state budget.

In Greece, the 2012 general government primary balance in cash terms – excluding the impact of financial sector support – saw a surplus of €434 million (0.2% of GDP), while the overall deficit was €12.5 billion (6.4% of GDP), down from €20.5 billion (9.9% of GDP) in 2011. The improvement compared with 2011 was due to the impact of the consolidation measures adopted in the context of the second EU/IMF adjustment programme, which more than compensated for the adverse effects from worsened macroeconomic conditions. The general government cash deficit was also well below 2012 budgetary targets as the revenue shortfall was overcompensated by the under execution of operational and investment expenditure.

In Portugal, excluding the impact of bank recapitalisation, authorities expect the deficit to be slightly below 5% of GDP in 2012, in line with the EU/IMF adjustment programme target. This estimate includes receipts from the sale of an airport concession for which the statistical treatment has not been yet decided. Should the statistical authorities classify the sale as a non-financial



operation with no impact on the headline deficit, the deficit would be around 5.5% of GDP.

In Cyprus, fiscal cash data indicate a cash deficit of around 5% of GDP for 2012. According to the Commission's winter 2013 forecast, the general government deficit is expected to stand at 5.5% of GDP in 2012, which suggests that the 2012 EDP deadline was not met. Parliament recently approved a sizeable fiscal adjustment package over the period 2013-15, which includes cuts in public sector wages and social benefits as well as increases in VAT and excise taxes.

### **Netherlands economic projections:**

The Netherlands is expected to see growth resume only slowly, implying further increases in unemployment in the short term. Current fiscal targets imply a pro-cyclical stance for the next couple of years. In the medium term, economic performance will be affected by continued globalisation and ageing of the labour force. The Commission's winter 2013 forecast projects a decline of the general government deficit from 4.1% of GDP in 2012 to 3.6% of GDP in 2013. In the Netherlands exports will prevent the economy from contracting in 2013. The government of Netherlands will continue its stringent austerity program and the extent of fiscal tightening is unprecedented. The factors will have a significant impact on the private consumption which is expected to decline further in 2013. In Netherlands the corporate investment is forecasted to rebound slightly but will remain well below pre-crisis levels.

## **Forecasting rate of exchange for Euro (Dec31 2015):**

There are many ways of forecasting exchange rates, but none of them have an upper hand on the other. This can be attributed to the difficulty in generating an exact forecast. The most popular methods for forecasting exchange rates are the purchasing power parity method and International Fisher effect model.

Purchasing power parity model: This is one of the oldest exchange rate models. This model assumes that the exchange rates will change to offset relative prices levels between countries. Countries with relatively high inflation rates will show currency depreciation whereas countries with low depreciation will experience currency appreciation. In equilibrium, the amount of depreciation or appreciation will be equal to the inflation differential. Since we are finding out the exchange rate for Euro we have to take the inflation rate of the Euro region as a whole.

The inflation in the Euro area currently is 1.8%. From the qualitative analysis done on the monetary policy of ECB and the fiscal policies of the individual countries in the Eurozone we can expect that the inflation rate to increase in 2013 and 2014. The countries of the Eurozone have come up with many policies to come out of this economic slump and they expect to have positive growth and gradual pick up of the Euro. As per PricewaterhouseCoopers, the inflation rate prediction for the eurozone and USA is at 1.9%. Since the differential inflation rate is zero, I expect the Euro to hold on to its current value. The EUR/USD on Dec 31st, 2015 is forecasted to be equal to 1.31.

**Conclusion:**

Since forecasting techniques are always subject to considerable uncertainties owing to the various macroeconomic factors that may take place in the future. Therefore I would like to conclude that EUR/USD in 2015 will be between 1.25 - 1.35.