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THE GLOBAL FINANCIAL CRISIS AND ITS EFFECTS ON THE NETHERLANDS

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Abstract
With very low unemployment, a large and stable current account surplus, low government debt and a budget in surplus, the Dutch economy was assessed initially to be relatively well prepared to weather the financial and economic crisis. This view was reinforced when the Dutch economy seemed to remain comparatively unscathed by the overseas problems at the start of the crisis. Economic growth in 2007 remained robust at 3½%, which was above the euro area average of 2¾%. In 2008, however, the adverse effects of the financial crisis became more apparent and economic growth came to a grinding halt in the second quarter.

Dutch strengths, like its funded pension system and its strong position in world trade, now turned out to be vulnerabilities in the wake of the crisis and have negatively impacted consumption and investment. However, when looking beyond the crisis at structural developments, the Netherlands is still in a relatively good shape, most importantly because of its flexible labour market and limited dependency on foreign capital.

Keywords: Financial Crisis, Economic Growth.

Introduction
The initial signs of the financial crisis appeared in the summer of 2007 in the American financial system. Financial institutions had invested heavily in very risky assets, like subprime mortgages and related products. Moreover, these investments were primarily financed using short-term debt securities. With rapidly rising default rates in the subprime mortgage market, trust within the banking sector declined sharply and suddenly, leading to considerable problems in the market for interbank loans. The subsequent bankruptcy of Lehman Brothers in September 2008 triggered further confidence crisis in the financial sector. From then on not just the liquidity, but also the solvency of financial institutions was all of a sudden questioned. As result, banks had to limit their credit supply and the global economy went into recession.
Dutch public opinion concerning the EU response regarding the financial crisis shows a watershed between the period before and after the agreement on the EU economic recovery plan. Before the December European Council in Brussels, the Netherlands witnessed a strong national coherent sentiment to fight this crisis, which was perceived as being a legacy from foreign origin. Since most of the national measures to address the economic crisis had already been taken before the European plan was agreed upon, the general Dutch expectations of the EU vis-à-vis the crisis were moderate. In the Netherlands, they are perceived as a 'toolbox' for national policies in the field, a guidebook listing the possibilities and actions for the member states' governments.

Global Financial Crisis: Manifestations of the Global Financial Crisis

1. The interbank market spread – the premium that banks charge on loans to one another rose significantly in August 2007 and peaked in September 2008. This spread can be interpreted as a measure of trust and confidence of banks in one another. The immediate cause of the loss of trust was the increasing losses in the American subprime mortgage market in 2007. It is striking that this rather specific problem could grow into a global financial crisis. An important explanation is the increased complexity of financial products and markets, which resulted in uncertainty about which institutions would eventually bear the subprime losses. Nobody knew where the rotten apples were. This severely undermined the mutual trust in financial institutions, with confidence reaching an all-time low when Lehman Brothers collapsed in September 2008. The interbank market effectively dried up, since banks were wary of extending a loan to the next victim of the financial crisis.
2. The correspondence between stock market volatility and the interbank market spread illustrates the strong links between the financial and the real economy. The fragility of banks translated into a freefall of economic activity. To restore confidence, banks tried to increase their capital ratios, partly by extending less credit. At the same time, the demand for credit by firms and households diminished as a result of unfavorable economic prospects.

Trends in World Trade Following the Financial Crisis
A striking feature of the recent financial crisis was the collapse in world trade, which was highly synchronized across countries and regions. Between the third quarter of 2008 and the second quarter of 2009 global trade volumes declined by approximately 15% and, thus, much more steeply than world GDP, which fell by around 2% over the same period (see Chart A). This partly reflects the fact that global trade is more cyclical than global economic activity, because the more "trade-intensive" GDP components – such as private investment, durable goods consumption and inventories – experience larger

swings than non-traded goods and services over the business cycle. The increased presence of global supply chains in recent years may have further amplified this effect.

Trade levels are likely to remain below their pre-crisis trajectory for some time to come. First, trade-intensive sectors are credit-sensitive. As lending standards are unlikely to return to pre-crisis standards in the near future, persistent repercussions on the level of trade cannot be ruled out. Second, in several advanced economies, demand for non-tradable goods has increased somewhat relative to demand for durable goods, as consumers repair their balance sheets and thereby tend to reduce their expenditure on durable goods more than their spending on services. This is also likely to have a negative impact on global trade. In the longer term world trade growth can be expected to continue to outpace growth in economic activity, as emerging economies continue to integrate rapidly into the world economy. Overall, the vigorous recovery in global trade in recent quarters was partly a technical correction and is waning now, as suggested by recent survey data releases. Meanwhile, there is little evidence that global trade integration has been hindered by the financial crisis. While tight credit standards and balance sheet restructuring are likely to dampen trade growth for some time to come, in the longer term world trade prospects will largely depend on the outlook for global economic activity and the ongoing globalization process.

Financial sector

The vulnerability of the financial sector to the crisis can be gauged by indicators such as the size and composition of the financial sector, the importance of stock markets and the housing market. Figure shows the consolidated foreign claims of the banking sector at the end of 2007. It shows that at the start of the crisis, no other country within the European Union had a larger foreign claim than the Netherlands in % GDP.

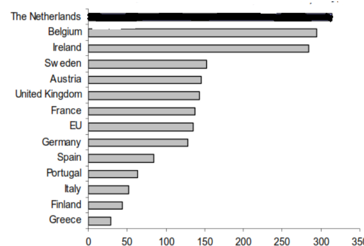

Chart A

A second important indicator on the impact of problems in the financial sector is the stock market valuation. The financial crisis led to a strong decrease in the stock markets on a global scale. Most European indices lost about half of their value during the first year of the crisis. The size of the investment in stocks, however, differs strongly. Dutch households only possess a relatively limited amount of stocks, just totaling about 40% of GDP in 2007, which is low in the European context. In Belgium for example, this figure was over 100% of GDP, in Italy over80% and in both France and Germany around 50%. However, this excludes the indirect holdings of stocks through occupational pension funds which are very high for the Netherlands. Total assets of these funds reached 130% of GDP in 2007, by far the highest in Europe. This compares with a total wealth of stocks amounting to almost 350% of GDP in 2007 in the Netherlands, which was markedly higher than in other countries. In Belgium, this figure was 250%, in France 230%and in Germany only 190% of GDP.

Confidence

The third channel through which the financial crisis affects demand is via the confidence channel. Dutch consumer confidence followed the European trend until the end of 2008, but showed a stronger decline from the beginning of 2009 onward. Although developments in producer confidence in the Netherlands stayed in line with EU average, the level used to be somewhat more positive than in other European countries in previous years, which implies that the drop was somewhat larger for the Netherlands. The impact of confidence effects on the real economy is not straightforward and it is difficult to determine whether the effects in the Netherlands would be larger than in other countries. A fact is that in any case, both private consumption and investment suffered more in the Netherlands than in other European countries. For 2009, private consumption is expected to decline by 2¾%in the Netherlands, compared to a relatively mild 1% decline for the euro area. That a part of this decrease can be explained by confidence effects is supported by the fact that, despite some recent positive wealth effects through a rebound in the stock markets and a (tentative) stabilization of house prices, private consumption still showed a quarter-on-quarter decrease of0.4% in the third quarter of 2009.

Capacity to recover

The Dutch economy seems to have been highly exposed to the effects of the financial crisis, both in absolute and in relative terms. Some of the main characteristics of the Dutch economy, like the considerable export sector, the internationally oriented financial sector and the vast pension funds caused an increased vulnerability to the financial crisis. The situation

after the crisis depends on both the determinants of the recovery and on the capacity of the Dutch economy to recovers in structural terms.

Conclusion

At the outbreak of the global financial crisis, the Dutch economy was assessed to be relatively well prepared to weather the storm, given its very low unemployment level, large and stable current account surpluses, a low government debt level and, at that time, a budget in surplus. The fact that the Netherlands seemed to remain untouched by the (then) overseas problem, supported this view. Economic growth remained robust and above the euro area average throughout 2007. However, the negative effects of the financial crisis became more apparent in 2008 and economic growth came to a grinding halt in the second quarter. For 2009, GDP growth is expected to show the sharpest contraction ever and to be below the euro area average. In the wake of the crisis, typical Dutch strengths, like the pension system and its strong position in world trade, now have turned out to be vulnerabilities. On the other hand, the capacity of the economy to recover seems to be relatively robust in the Netherlands. It has a highly flexible labor market, a low unemployment and Avery high participation rate. Furthermore, the government's budget surpluses of the past years enabled the government to allow the full working of the automatic stabilizers and to implement stimulus measures. Also, the low level of government debt enabled the government to intervene in the financial markets. Furthermore, the considerable current account surplus diminishes the Dutch dependency on foreign capital, making the country less dependent on changes in international capital flows.

Dutch Economy Fully Recovers From Financial Crisis

By the end of this year the Dutch gross domestic product is expected to top the real level seen in 2008 for the first time since the financial crisis. According to De Nederlandsche Bank's latest half-yearly forecast. According to the forecast, the Dutch economy will grow a projected 2 percent this year, the highest figure recorded since 2008. The bank expects that the Dutch economy will, on average, maintain this growth pace in 2016 and 2017, which means that the economic activity will develop more favorably than previously foreseen.

Exports remain the driving force behind the economic growth. The bank expects that the international environment will improve further, partly due to the depreciation of the euro, low level of oil prices and a pick-up in world trade growth.

Domestic spending will also contribute to economic growth – a development unseen since 2011. Private consumption will show a significant increase of 2 percent this year, for the first time since the credit crisis broke out. This can be attributed to a strong increase in real disposable income and improved sentiment.

According to the forecast, unemployment should decline from 7.4 percent in 2014 to 7 percent this year and 6.9 percent and 6.7 percent in 2016 and 2017 respectively. The reason for the moderate decline is that the pick-up in job creation will go hand in hand with a growing labor supply. Government finances are expected to benefit from the improved economy.

The deficit is expected to drop from 1.6 percent of the GDP this year to 0.6 percent of GDP in 2017. The government debt is also expected to decrease from 68.9 percent of GDP to 64.9 percent of GDP over the same period.

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