Cross-border ambitions of two good neighbours

Belgian-Dutch Innovative Entrepeneurship & Finance Day

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Introduction

Belgium and the Netherlands: two highly competitive, open economies that roll on the waves of the world economy. Recently, global developments have become more subdued. World trade has stagnated and the ramifications of Brexit for the European economy are far from clear. For now, the Dutch and Belgian economies are humming along just fine, but challenges are looming, especially for the export growth engines of both countries.

Trends such as the circular economy, renewable energy, an ageing population and 3D printing will structurally change trade flows. The combined role of Belgium and the Netherlands as the gateway of Europe for raw materials, fossil fuels and finished products could come under pressure. The logistics and transport sectors – in the Netherlands and Belgium representing more than 10% of GDP – are facing big changes.

The Netherlands and Belgium are competitors in global markets, but there is much that binds the two countries. Aside from a shared history and geographical location with shared coastline and river deltas, both are mid-sized, open economies with a high potential to innovate and overlapping industrial and export composition. Given the globalizing, digitalizing and increasingly competitive international environment, it is perhaps time to explore opportunities for greater co-operation.

Both countries are already economically highly integrated. The potential for more bilateral trade seems limited. Mutual trade is much higher than one would expect based on distance and GDP levels. Opportunities to step up co-operation lie mainly in third markets. Of course, changing working relations in current markets is difficult. It is much easier to venture into new growth markets jointly, where there are fewer vested interests. In this report, we glance at two areas that provide ample opportunities for Belgium and the Netherlands to successfully join forces: water technology and the circular economy.

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Belgium still in (low) recovery mode

Recent developments

The first nine months of 2016 have been encouraging from an economic point of view. GDP increased by 1.0% from its end-2015 level, despite the terrorist attacks at the end of March that caused a 2-day lock-down of Brussels, and despite several days of strikes in June. Moreover, total employment increased by 21,000 net jobs since end-2015, sufficient to stabilise the unemployment rate at 8.2%.

Growth outlook

However, we don't expect any acceleration in the coming quarters. First, business confidence has shown some signs of weakness in recent months, particularly in the service sector. Moreover, as international trade growth remains subdued, any strong support from exports is unlikely. In this regard, we also expect some impact on business confidence and on bilateral trade with the UK from the Brexit negotiations that will start next year. As the UK is Belgian's fourth largest trade partner, the GDP impact could be tangible. Second, household consumption remains too weak. This is not surprising, as the 2% growth in the nominal gross disposable income of households has been entirely offset by inflation (see next paragraph). In other words, the purchasing power of households remains flat, leading to a weak consumption growth that will take time to recover.

The inflation outlier

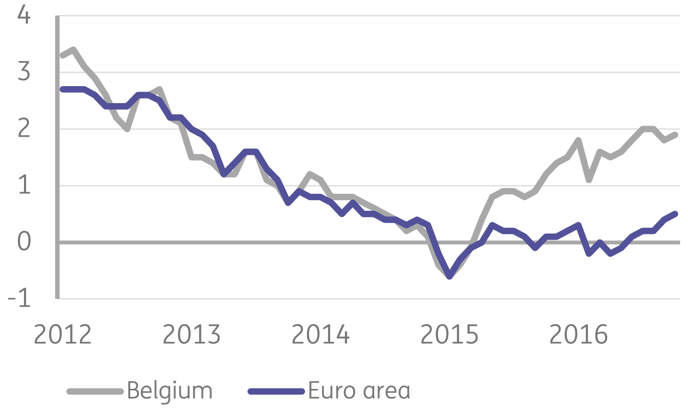
Inflation stood at 1.8% in October. Despite the fact that the temporary impact of several tax hikes is expected to abate, new inflation pressures are in evidence; with the oil price now higher than a year ago, energy prices contribution to inflation has become positive again. This is expected to last for the coming months. Inflation is also being supported by increases in the cost of alcoholic drinks (+9.7% in October), communication services (+5.8%) and even restaurants (+3.1%). These factors are likely to maintain headline inflation above 1.7% in the coming months, significantly above the Eurozone average.

The challenge of public finances

In such an environment, public finances remain under pressure. Government revenue is lower than expected, and past austerity measures are not bringing the promised correction to the budget deficit. Even if some measures are implemented, the budget deficit is likely to be around 3.0% this year and 2.3% in 2017. The debt ratio will fortunately remain under control, as it is likely to decrease next year.

Belgian inflation much higher than Eurozone average

Change year-on-year, in %



Sources: Thomson Datastream

Forecasts

	2015	2016	2017	2018
Belgium (%YoY)				
GDP	1.5	1.2	1.2	1.6
Consumption	1.1	0.6	1.1	1.2
Investment	2.4	3.4	2.2	1.8
Inflation (CPI)	0.6	2.0	1.7	1.6
Unemployment (% labour force)	8.5	8.2	8.0	7.7
Gov't budget balance (% of GDP)	-2.6	-3.0	-2.3	-1.9

Sources: Thomson Datastream, ING forecasts

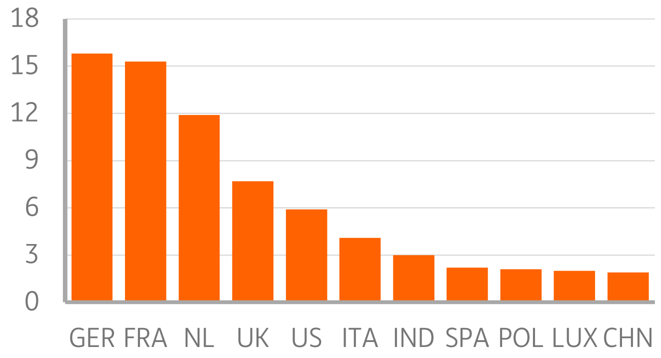
What to know about the economic structure

Growth model based on trade

Belgium is the archetype of the small open economy. Total external trade (exports + imports) is nearly 170% of GDP, which is one of the highest in the world. As a consequence, recessions and recoveries are traditionally kick-started by an external shock. In fact, net exports are one of the two pillars sustaining growth, domestic demand being the other. Belgium has a growth model between those of Germany (mainly driven by exports) and France (mainly driven by domestic demand).

Main export partners of Belgium

% of total, excluding re-exports, 2015



Source: NBB

A diversified structure of production

The Belgian economy is diversified: 78% of total value added is generated by the private sector, of which 21% from the industrial sector, 7% from the construction sector and the rest from the different services sub-sectors. Having said that, the share of the industrial sector has declined over recent decades, and this probably represents a big challenge for the future of the Belgian economy.

Many SMEs

99.9% of all companies (private sector, excl. financial sector) have less than 250 persons employed (EU-definition for SME), and are responsible for 62% of total value added and 69.8% of total employment. So, Belgium definitively relies on SMEs (more than 560,000 companies). Having said that, this also means that 0.1% of all companies (around 890 big corporates) are responsible for 38% of total value added, and 30.2% of total employment. Keeping these big companies in Belgium is also important.

Other main characteristics

- The savings ratio of households has recently declined strongly to 12% of gross disposable income. Nevertheless, it is historically still very high, and also much higher than the European average
- As a consequence, the net financial wealth of Belgian households is one of the highest in Europe.
- Belgium has a large public sector (including health sector). The total income of public administration represented 51.5% of GDP in 2015.

Challenges for the Belgian economy

The Belgian economy performed well over the last few years, but more recently growth has slowed and is now below the Euro area average. The following challenges limit chances for a swift rebound:

- **Ageing** is probably the most significant challenge for Belgium in the coming decades. On current projections, the labour force (aged 19-64) is expected to decrease by almost 40,000 people in the next decade, while the 65+ population is expected to increase by nearly 400,000. Ageing represents a huge potential increase in public spending and a challenge for the labour market.
- We see the **modernisation** of **infrastructure** (energy, mobility) and **the social and economic structure** (labour market, taxation) as an important challenge if the country wants to benefit from new technologies and innovations.
- In this regard, more efforts will have to be devoted to **R&D**, where Belgium, according to international rankings, could improve.

Dutch growth continues, challenges ahead

Economy steams ahead

The Dutch economy has continued to expand at a solid pace in recent quarters. The Netherlands was even one of the fastest growing economies in the euro area. The increase in output was largely driven by domestic demand, but exports increased as well. Sector-wise, the recovery has been broad-based too.

Smaller firms have joined the recovery

The recovery has gained a foothold in small businesses. The ING Investment Index for SMEs currently stands above the neutral value of zero. Smaller firms are, on balance, positive about their financial position. Profitability is improving and credit demand from smaller firms has increased too.

More and more jobs

In line with rising business confidence, companies are hiring new personnel. Job growth has accelerated, pushing unemployment down. Leading indicators, such as hiring intentions and job vacancies point to further job growth.

Higher income stimulates consumer spending

Against the backdrop of increased job security, households have stepped up spending. This trend is unlikely to reverse soon. Disposable income is rising, helped by higher wages and low inflation. The consumer confidence index stands firmly above its long-term average.

Home sales to reach new record high

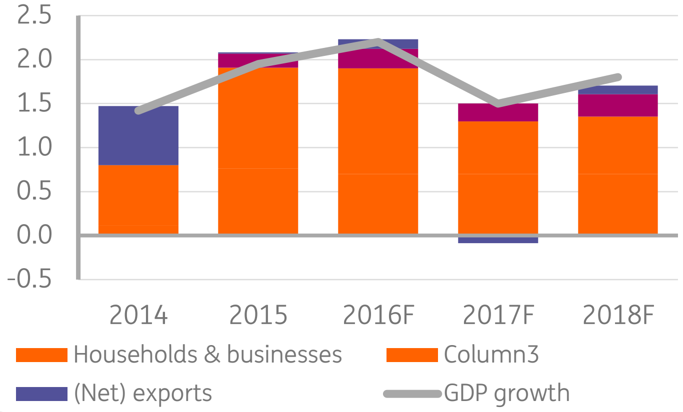
Spending on durable goods benefits from the stronger housing market. Helped by high confidence and low mortgage rates, home sales are on track to break the pre-crisis record of 2006 (250,000 sales of new and existing homes). Meanwhile, house prices are increasing to the tune of 6% year-on-year. Large cities such as Amsterdam and Utrecht, where supply is generally tighter, are leading the price recovery.

Temporary Brexit-dip in 2017?

Up till now, subdued global developments (stagnant world trade, Brexit fear) have had limited impact on the Netherlands. Export order books are still growing. Next year, the effects of Brexit are likely to intensify. After Germany, the UK is the most important destination for Dutch exports. As a result of weaker spending in the UK, GDP growth could temporarily fall to or below 1.5%. However, given the strong domestic dynamics, the Dutch economy is expected to rebound in 2018.

Domestic demand drives Dutch GDP growth

Contribution to GDP growth, in percentage points



Forecasts

	2015	2016	2017	2018
The Netherlands (%YoY)				
GDP	2.0	2.2	1.5	1.8
Consumption	1.8	1.5	1.6	1.6
Investment	9.9	6.7	2.5	3.2
Inflation (CPI)	0.6	0.3	0.9	1.1
Unemployment (% labour force)	6.9	6.0	5.2	4.9
Gov't budget balance (% of GDP)	-1.8	-0.8	-0.6	-0.4

Sources: Statistics Netherlands, ING forecasts

Excellent external position under pressure

Export champ

Just like Belgium, the Netherlands is an export champion. Despite being a relatively small, open economy, the Dutch were one of the 10 largest exporters in the world last year. Some 40% of total Dutch value added is owed to exports. This success is largely based on geographical location, business instinct, logistical skills, high product quality and the availability of gas supplies (see ING's Van een gouden verleden naar een gouden toekomst? [In Dutch only])

Re-exports and services gain importance

The Dutch economy is increasingly driven by services. In the last 20 years, the share of industrial and agricultural output declined from 25% to 17% of total GDP. Commercial services now account for 56% (was 50%) of GDP and the public sector for 22% (was 19%). This is also reflected in exports. 30% of the total export value comes from re-exports and 25% from services (advice, R&D-services and intellectual property rights). Less than half is now accounted for by domestically-produced goods.

FDI giant

The Netherlands is not only connected to the world via trade. The country is also one of the biggest cross-border investors. The total sum of in- and outward FDI was about US$6.5 trillion (2014; second to the US). This position is flattered by the presence of Special Financial Institutions. According to DNB, excluding these SFIs, the Netherlands remains in the top-10. The presence of multinational headquarters help to explain the strong position.

Challenges for the Dutch export model

In a rapidly changing and competitive international environment there are, however, several trends challenging the current Dutch business model:

Ageing – 70% of Dutch exports is destined for Europe, but best growth prospects are outside Europe. Nearly 40% of Dutch re-exports is destined for European markets, whose population by 2025 will be 2% smaller.

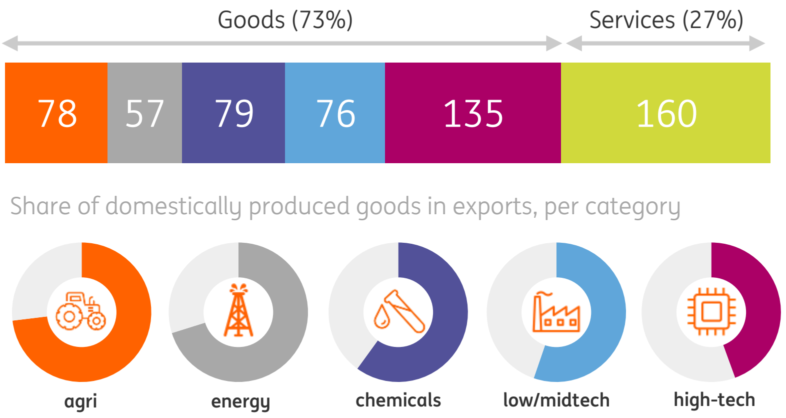
Digitalizing – 3D-printing leads to more local production, resulting in fewer inbound containers from Asia for Dutch, but also Belgian, ports. Meanwhile, the internet increases transparency, making it easier for buyers and sellers to link up. This undermines the role of the Dutch as global traders.

Circular economy – closed circle production chains and reuse of materials lead to less overseas supply of raw materials to Europe.

Renewable energy – Dutch trade relies heavily on fossil fuels. Surge in locally generated energy leads to less trade.

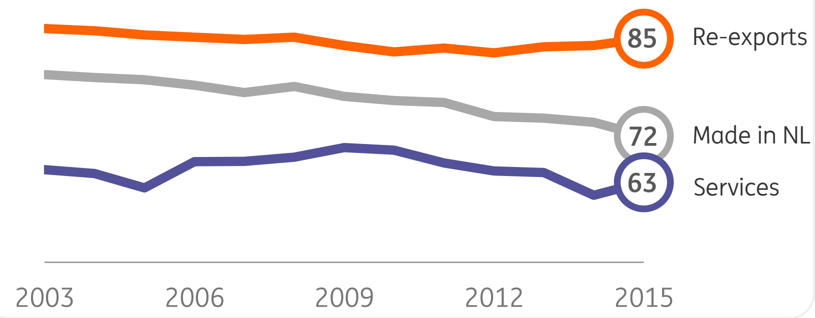
Almost €600 billion of Dutch exports in 2015

In billion euro



Dutch exports dominated by Europe

Share of Europe in exports, by type, in %



Sources: Statistics Netherlands, calculations ING

Strong economic ties

Merchandise trade between the Netherlands and Belgium has surged. The countries are each other's second-largest trading partner.

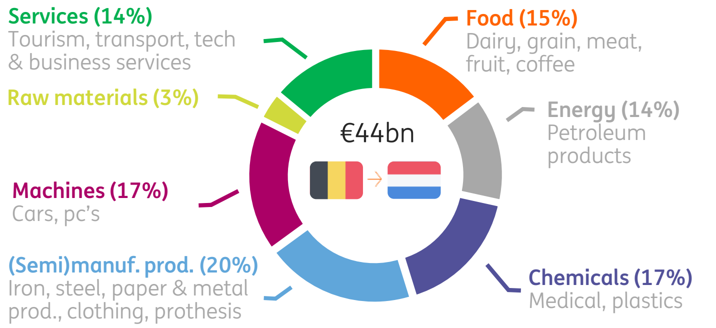
Belgian exports to the Netherlands are about €45 billion, which is 15% of total Belgian exports. 85% consists of goods.

Dutch exports to Belgium amount to 10% of total exports. The overall structure looks quite similar.

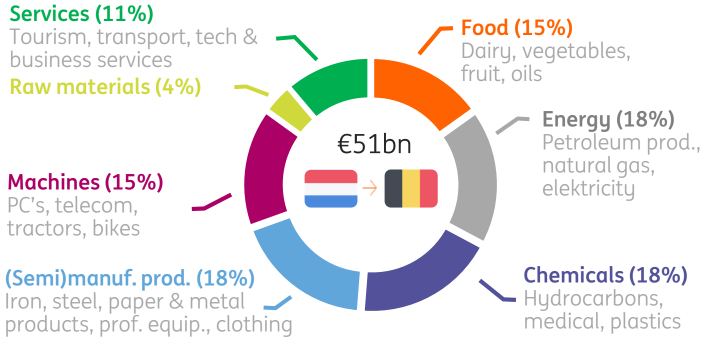
Trade in goods between Belgium and the Netherlands, in euro billions

Distance and GDP level are two very good indicators for bilateral trade volumes. Based on this, NL and BEL are trading **1.8 times as much as expected** (source: CBS)

Breakdown of Belgian exports to the Netherlands, 2015



Breakdown of Dutch exports to Belgium, 2015



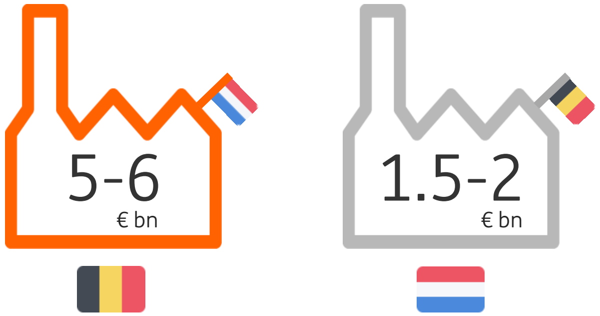
30% of trade between the countries is (low-value adding) re-exports. Still, bilateral trade provides a substantial boost to the economy.

10% of foreign-owned companies in the Belgian business sector* has a Dutch owner. These firms boost Belgian GDP by €5-6bn per year.

In the Netherlands, most Belgian-owned firms are in trade-related sectors, but in industry these firms add the most value.

Total value added through bilateral trade, per year

Total value added by Belgian and Dutch firms, per year



Breakdown of Belgian companies in NL, in %, 2014

	# firms	Value added
Industry	13	29
Construction	6	8
Wholesale, transport & logistics	37	27
Retail (incl. car dealers)	8	4
ICT services	9	10
Specialized business services	17	3
Other	10	19

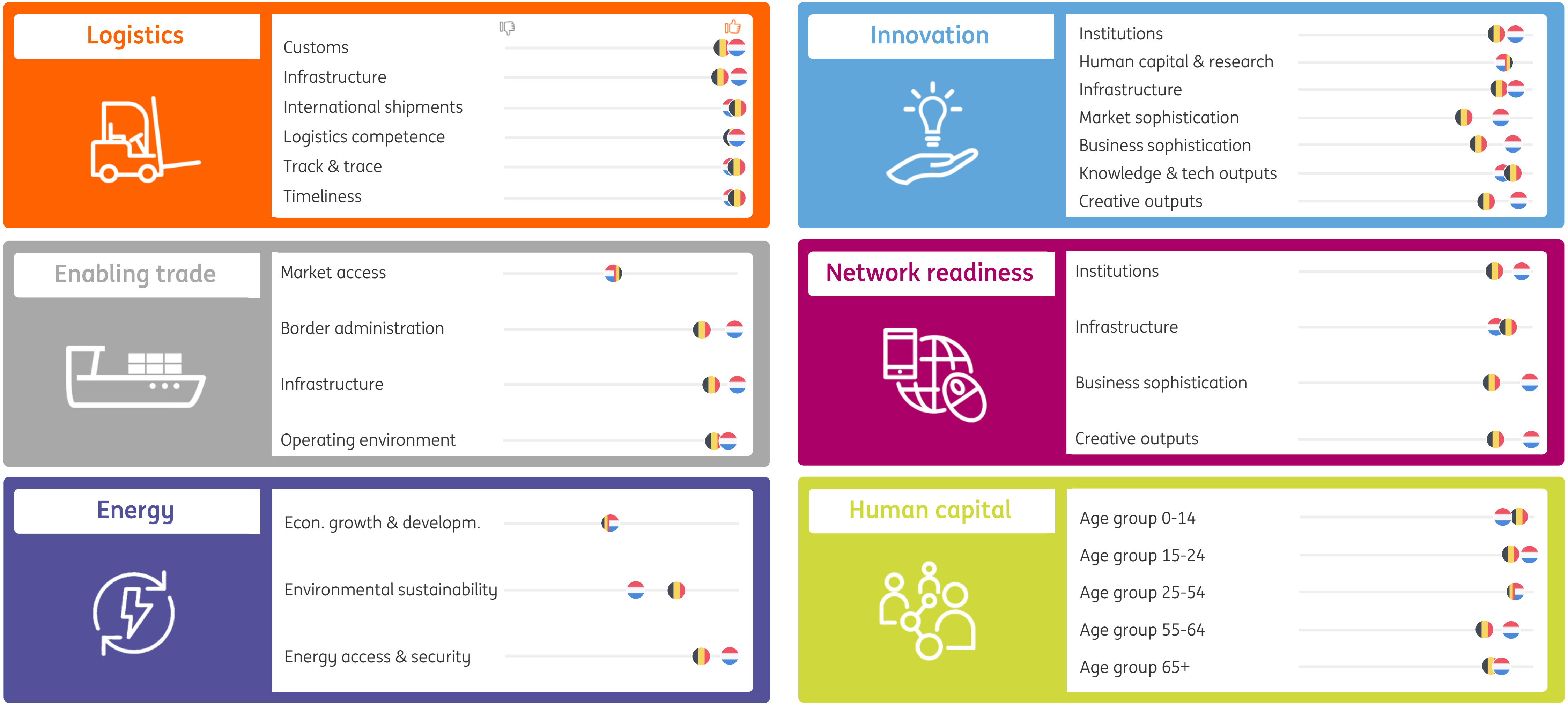
Sources: Statistics Netherlands, WIOD, Eurostat, calculations ING.

*All commercial sectors excluding financial services and agriculture

Strongly positioned to benefit from global challenges

Joining forces

How do Belgium and the Netherlands score in international rankings?



Relative scores based on Innovation Index 2016, Network readiness Index 2016, Enabling Trade Index 2014, Logistics Performance Index 2016, Global Energy Architecture Performance Index 2016 and Human Capital Index 2016

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Building a Dutch-Belgian brand

Co-operation? Nothing really new

The Netherlands and Belgium share a long history. Between 1815 and 1830 they even formed one country. In 1944, an international customs agreement was signed, resulting in the Benelux. Together with West Germany, France and Italy, the Benelux later formed the European Coal and Steel Community; the very first predecessor of the current European Union. This underlines the very long cooperation between Belgium and the Netherlands.

Partners ...and competitors

Being autonomous economies, the two countries are of course also competitors (certainly in sectors such as the chemical industry and the food industry). They compete in each other's markets, but being heavily active in world trade, they also cross swords on third markets. For example, both countries have Germany as their main trading partner. They are both European gateways for goods imported from the rest of the world, but also function as large suppliers of semi-finished products to German industry.

Existing collaboration

This doesn't mean the two countries cannot work together, or share best practices. In 2013, for the first time, the Netherlands and Flanders went on a joint trade mission to the US. More than sharing the same language, the idea was to promote the Dutch and Belgian ports and chemical industries. In 2015, a second joint mission to the US centred around fintech, cybersecurity and smart logistics. Other collaborations are imaginable. Part of the success of Dutch industrial companies is related to their capacity to differentiate their production from competitors. Meanwhile, Belgian companies appear better connected to emerging markets. So why not share best practices in order to conquer new markets or improve existing positions?

Economics 4.0 is a big challenge

The fourth industrial revolution that is taking place is disruptive. Challengers or even start-ups can defy big players. As the organisation of the economy evolves, new sectors of activity are emerging while existing sectors are disrupted by new technologies. This evolution has an enormous impact on the economy as a whole and on almost all companies. This is even more true as technological innovations are absorbed with accelerating speed. While economics 4.0 is often strongly linked to shaking up sectors and labour markets, the transformation of the economy also offers opportunities for companies and their employees to develop activities and to use their knowledge in order to sell and exports new technologies, new concepts and new solutions.

Size matters

Starting new collaborations and extending existing ones has an added value. In an increasingly competitive international landscape, Belgium and the Netherlands can jointly benefit from economies of scale and efficiency gains. Sharing R&D efforts lowers costs, while applying a technology to a larger network increases the ability to extend it further. Collaborating and developing common knowledge in new technologies between the Netherlands and Belgium would help companies to export their technologies to other markets. All in all, in a rapidly changing, globalizing and competitive international environment, size matters. It increasingly becomes imperative to join forces in order to be heard and taken into account, both politically and economically.

Circular economy: logistics is key and BEL & NL excel

Opportunity

Compelling business case

Both the Netherlands and Belgium are already leading in waste management within Europe as most of the waste is recycled, composted or used for energy purposes and hardly any waste is landfilled. In such an environment the shift towards a circular economy spins off several new commercial opportunities and business innovation as it shifts the focus from a 'take, make and waste' way of production to a 'reduce, reuse and recycle' mentality. In doing so, it provides a new and compelling business case of sustainability. Compelling because it materializes the financial, economic and environmental benefits and costs in an integrated way. Also compelling because it is an appealing concept and easy to understand how all stakeholders, society and the environment can benefit from it.

From linear to circular

Most Belgian and Dutch companies in the linear economy currently have a sales based business model in which the responsibility of the producer ends after the product is sold. A maintenance model adds a first circular element by retaining the quality of products so the life span can be extended. The service model goes a step further as the manufacturer remains the owner of the product and as such the product is returned after its life span. This is only one step away from a full circular business model in which the manufacturer gives the components or materials a second life through reuse or recycling.

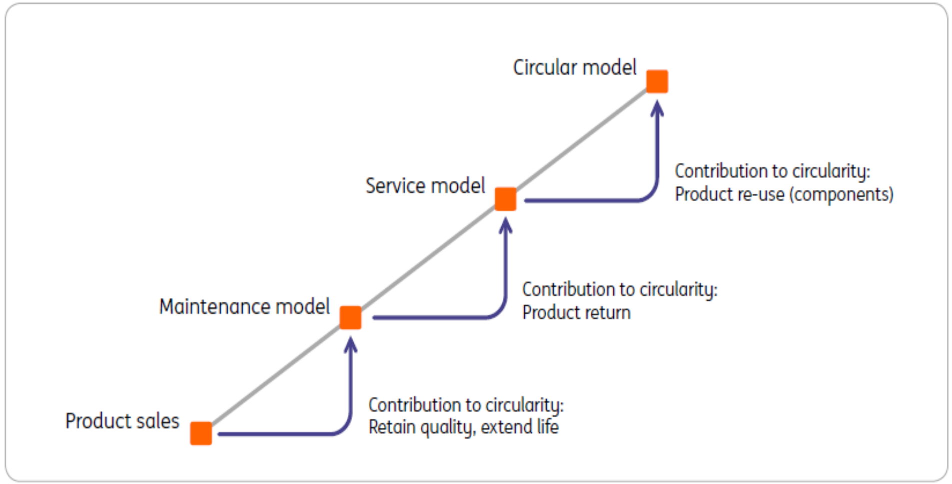
Less transit, more local waste flows

The Dutch and Belgian transport and logistics sectors are heavily focused on imports of raw materials and fossil fuels, for domestic production but also for re-exports to Europe. More efficient use and reuse of materials will, however, result in less inbound flows. At the same, local waste flows will increase. This opens up possibilities for logistics to facilitate the circular flows of other industries. Logistics as a 'supply chain manager'. This requires in-depth knowledge, excellent infrastructure and innovative skills, in which both countries excel.

New business models don't stop at the border

Companies in circular supply chains often co-operate beyond traditional buyer-supplier relationships that characterize linear supply chains. They operate within a network of companies and institutions that often involve a strong element of collaboration and co-creation.

Gradual transition to circular model



This does not stop at country borders. Dutch-Belgian supply chains need to be considered collectively in order to reap the full benefits of the circular economy.

Gradual, but transformative process

While talks about a circular economy often include visionary end pictures, transition in practice is gradual. There are many parties involved, with vested interests. Also, the transition needs to be financed and significant opportunities could require significant investment.

Sources: ING's Rethinking Finance in a Circular Economy and ING's From Assets to Access

Water: linking water solutions to circular economy

Opportunity

A long standing tradition

Belgium and the Netherlands are well known examples of river delta countries. Both countries have an extensive coastline and major international rivers, such as the Schelde and the Maas. Both Antwerpen and Rotterdam are important international harbours and the Dutch-Belgian coast is a hot spot for tourism. For centuries both countries have been used to the benefits and dangers of living close to the water. As such, they have extensive knowledge of water solutions that is exported and implemented all over the world.

The world is in need of water solutions

Global fresh water demand is expected to increase by 2% a year. The existing accessible, reliable and sustainable freshwater supply is estimated at 4,200 billion m^3, which leaves a wide gap of 50% versus projected future demand of 6,400 billion m^3 in 2040 in a business as usual scenario. This clearly calls for responsible use of water across sectors and businesses. Demand for Dutch-Belgian water solutions will be increasing as a result.

Extending the water-energy-food nexus

Traditionally water competes with food and energy for its application. However, research by ING shows that the vast majority of water intensive activities, such as mining, agriculture, textiles and food & beverage production, take place in water stressed countries. Other necessities of life, such as clothing, base metals and chemical products compete with water as well. Many industries in water stressed countries are in competition for precious water resources.

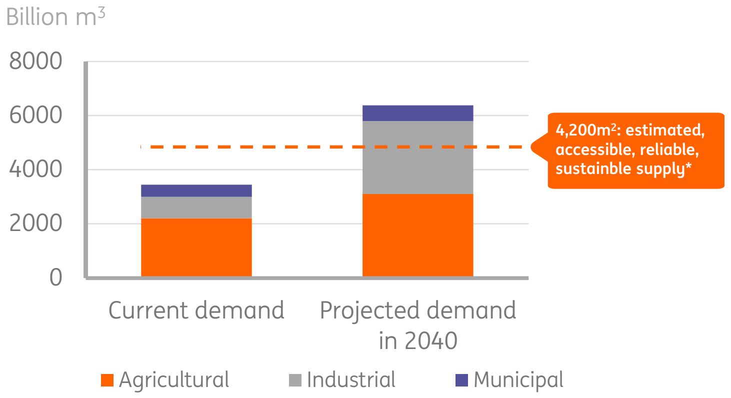
Circular economy provides solution

Many claim that water problems come from dysfunctional political and economical systems or ill-defined markets in which water is priced too cheaply. The real – and neglected – issue is that water is put in a linear model in which it gets more polluted and wasted as it travels through the system. Water is seldom lost but its usability diminishes as the quality deteriorates.

The solution therefore is to turn water into a circular model where the 'take, make and waste approach' is replaced by the 'reduce, reuse and recycle' approach; a model in which water use is reduced, contamination minimised, uncontaminated water reused and contaminated water purified and recycled. This provides opportunities for Belgium and the Netherlands to use their collective knowledge on water solutions and the circular economy to sustain water supply chains across the globe.

Stylized map of Dutch-Belgian river delta

Freshwater demand keeps on rising, mostly in industry



* Supply estimate based on McKinsey (existing supply which can be provided at 90% reliability, net of environmental requirements)

Sources: ING calculation based on IFPRI, Aquastat. ING's Too Little Too Late , McKinsey - Charting our water future

Want to know more?

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