14. THE NETHERLANDS
Domestic demand remains resilient as growth moderates

After solid growth of 2.6% in 2018, activity remained buoyant in the first half of 2019, supported by robust domestic demand and net exports. As the business cycle matures however, growth is forecast to moderate. The contribution from net exports is expected to turn negative against the backdrop of a weak external environment whereas domestic demand should remain resilient, supported by rising wages and private consumption. An expansionary fiscal policy is set to provide a further boost to disposable income as well as public consumption.

External demand weakens while domestic demand remains buoyant

After several years of above-potential growth, economic momentum in the Netherlands remained relatively solid in the first half of the year, with GDP increasing 0.4% (q-o-q) in both the first and second quarter. This was primarily driven by domestic demand as well as strong exports in the second quarter. GDP is forecast to grow at an annual rate of 1.7% in 2019 but growth is expected to be slower in the second half of the year, partly due to subdued prospects in major trading partners.

Net exports are expected to contribute negatively to growth over the forecast horizon. As a result, real GDP growth is set to slow to 1.3% in both 2020 and 2021. Despite low financing costs, business investment is projected to weaken because of heightened (trade related) uncertainty. Residential investment growth is also expected to moderate, in part due to capacity constraints.

Labour market remains tight, wage growth picks up

The labour participation rate is at a post-crisis high in the Netherlands but employment growth, which is expected at 1.8% in 2019, is forecast to slow to 0.3% in 2021. In conjunction with dynamic rates of labour supply growth, this should lead to a modest uptick in the unemployment rate from 3.5% in 2019 to 3.7% in 2020 and 4.1% in 2021.

With wage developments lagging the cycle, labour market tightness is now translating into higher wage increases, contributing to rises in household disposable income and thereby fuelling private consumption. This is also supported by fiscal measures that lower the tax burden on labour income from 2020 onwards.

Inflation set to moderate in 2020 and 2021

Increases in indirect taxes in 2019 have pushed inflation up to 2.6% this year. For 2020 and 2021 respectively, inflation is forecast to moderate to 1.4% and 1.5%, as these indirect tax increases will no longer be reflected in the inflation figures and the underlying trend is expected to remain flat. For 2020, real wage growth is expected to entail a pick-up in prices for services, although a lowering of energy related taxes for households should put downward pressure on energy inflation.

Fiscal expansion in 2020

The headline budget balance is forecast at 1.5% of GDP in 2019, and 0.5% and 0.4% of GDP in 2020 and 2021 respectively. In 2019, higher government spending is offset by higher tax revenues, partly on
the back of high wage and employment growth and corporate profitability and partly as a result of policy, in particular through a substantial increase in indirect taxes (around 0.4% of GDP).

In 2020, government expenditure is expected to continue rising following recent expansionary budget decisions relating to pensions and climate change, housing and youth care, on top of higher spending on infrastructure and defence. At the same time, the revenue-to-GDP ratio is expected to decrease by 0.4 pps. of GDP due to lower direct income taxes. The combination of these revenue and expenditure measures is forecast to drive the headline surplus down by one percentage point in 2020. In 2021, the headline surplus is set to decline to 0.4%, following further tax relief.

The structural budget balance is projected to decline by about ½ percentage points of GDP, leading to a roughly balanced budget in structural terms in 2020 and 2021.