NETHERLANDS

A NEW GOVERNMENT AND A NEW PURCHASING POWER FRIENDLY AGREEMENT

The Dutch economy was confronted with a new decline of its GDP in the first quarter of 2024, due to an unexpected drop in exports. The future does not look too gloomy though, since a new coalition was formed and presented friendly purchasing power measures that are likely to support private consumption. The agreement however plans to limit the budget deficit to 2.8% of GDP through spending cuts which could deteriorate the country's productivity in the longer run.

A new right-wing government has been appointed, after months of intense negotiations. The new coalition is made of election winner PVV (far-right), VVD (liberal centre-right) and newcomers the Framer Citizen Movement (BBB, right) and New Social Contract (NSC, centre-right). The four parties have presented their policy plans for the next four years. When it comes to the negotiations, it seems clear that the PVV has given up on a lot of their plans. The PVV's party program was Eurosceptic, advocated deficits of more than 4% of GDP, and was anti-climate and opposed support for Ukraine. Instead, the coalition agreement keeps climate policy largely intact, solidifies support for Ukraine, and is less Eurosceptic than expected. Moreover, there is a clear commitment to maintain fiscal prudence, with a deficit set to stay below 3% of GDP. In a nutshell, the new coalition reduces spending on funds originally earmarked for enhancing productivity growth (e.g. the National Growth Fund), promoting research and science, addressing nitrogen-related issues, and financing climate measures. Instead, that money will be primarily allocated to purchasing power for households, infrastructure development, housing, the agricultural sector, and nuclear energy. Structural reforms on the labour market and in the tax system are absent. The coalition puts heavy emphasis on restrictive measures on migration, improving livelihood security for all, by building more houses and by improving household purchasing power.

BOOST TO PURCHASING POWER

The agreement is titled 'Hope, Courage and Pride'. It features an ambitious set of policy goals in different areas. Starting with households, purchasing power is supported in the short run by a small tax relief for households (EUR 2 bn) and from 2027 onwards by halving mandatory healthcare contributions (EUR 4/5 bn).

Businesses, especially in the agricultural sector, welcomed the accord. Some planned tax increases, such as the energy tax increase and a tax on share buy-backs, have been reversed. The new agreement indicates that restoring the business climate is a policy goal of the incoming government. The coalition claims that 'work must pay' and calls for 'no additional levelling of the income distribution'. The agreement nevertheless looks more supportive of lower incomes, due to increases in welfare benefits, health care and child-related allowances aimed at reducing child-poverty.

The budget deficit is set to remain lower than what was previously announced by Geert Wilders during the election campaign. Some measures to allow this are cuts in the number of civil servants, cuts in education and innovation worth EUR 6.2bn from 2025 to 2028 and EUR 12.6bn by 2031. Other measures include changes in taxation, with, for instance, an end of the reduced VAT on cultural goods and that of subsidies for EV purchase by 2025.

ECONOMIC ACTIVITY

The Dutch economy unexpectedly contracted, again, by 0.5% on a q/q basis in Q1 2024. This contraction contrasts with figures from neighbouring countries. The German economy grew by 0.2% q/q and the Eurozone as a whole grew by 0.3% q/q. The contraction in the Netherlands was largely driven by a decline in net exports, further stock depletion and a drop in total investment. The contraction in goods exports was driven by weakness in the manufacturing sector. The sharp decline in inventories also hurt growth, but the cycle of stock depletion seems to be reaching its end, in line with the bottoming-out of the industrial sector.

GROWTH AND INFLATION

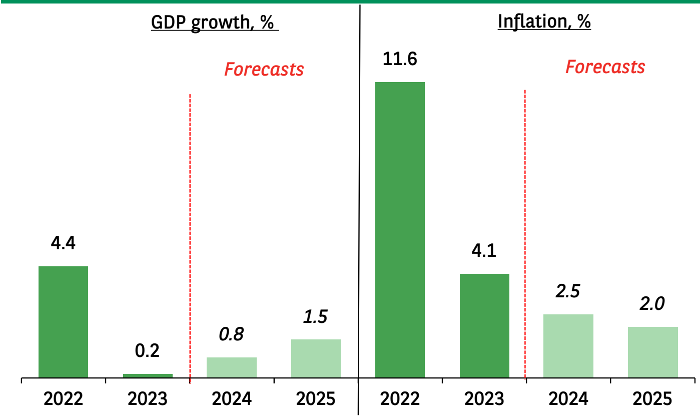

CHART 1

SOURCE: EUROPEAN COMMISSION, BNP PARIBAS

Despite the downside surprise, the published figures support the view of a Dutch economy being supported by private consumption, which rose by 0.7% q/q as households benefitted from a recovery in real incomes on the back of strong wage growth, facilitated by the tight labour market. The Dutch economy operates near full employment, with the unemployment rate at 3.5% in May 2024. Government consumption also increased by 0.6% q/q. Despite formation talks, the caretaker government continued to contribute to growth through spending on healthcare, education, and defense. Investments surprised to the downside in the first quarter, which confirms that businessmen's optimism regarding the future is not so strong and is undermined by the uncertain geopolitical climate and the high interest rates that limit the rationale for investments, except when it comes to replacing existing facilities in transportation and machinery. Finally, the real estate sector confirmed its sharp recovery, with prices rising by as much as 8.6% y/y in May, up from the 6% drop registered a year earlier.

Looking forward, the outlook for 2024 remains rather positive. Growth is expected to be driven by domestic demand. Later in 2024, as financial conditions ease further and external demand increases, growth is forecast to pick up, from 0.2% in 2023 on an annual average basis to reach, respectively, 0.8% and 1.5% this year and next according to the European Commission's spring forecasts. As elsewhere in Europe, inflation is proving stickier than thought, with prices rising back since the start of the year, at +2.7% in May 2024 versus -1% in October 2023. This sharp acceleration in inflation is the result of base effects given what happened to Dutch energy prices when the war started in Ukraine. Dutch HCPI inflation hit +17.5% y/y in September 2022, which was the highest rate observed in the Euro-Area. All in all, the European Commission now expect inflation to reach 2.5% and 2% this year and next.

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