Netherlands

Slowing towards potential

GDP growth is slowing due to the strong deceleration in global trade. Nevertheless, the economy continued to operate close to its potential until 1Q 2019 thanks to the strength of domestic demand, underpinned by strong disposable income growth and an expansionary fiscal policy. As the government has lost its majority in the Senate, it needs the cooperation of the opposition parties for passing new legislation. However, a government crisis is not imminent. Even if GDP growth is expected to slow below its potential in the coming quarters, public finance metrics will continue to improve up to 2020.

Clouds in the (blue) sky

Up to mid-2018, economic growth has been quite strong, largely above potential growth. It has however steadily declined from 3% in H1 2018 to 1.7% in 1Q 2019 and a new deceleration is expected in Q2, as reflected by the deterioration of CBS business cycle indicator. Until 1Q2019; the level of economic activity was still operating well above potential. Labour shortages have increased as the unemployment rate has declined to less than 3.5%. In Q1 2019, despite a stagnation in real wages caused by an increase in the reduced VAT rate (from 6% to 9%) and firmer oil prices, real household disposable income still rose by a decent 2.4% y/y, underpinned by strong employment growth (2.4%). This has stimulated private consumption and boosted housing prices. In April, household consumption (in volume terms) was 2% higher from last year. Moreover, in May house prices rose by 7.2% y/y, reaching a new historical high.

However, the Dutch economy is suffering from the gloomier external environment. In the manufacturing sector, production is declining (in April, industrial production was 1% lower than a year earlier) and orders books are thinning. Producer confidence is at its lowest level since 2016.

Government has lost majority in the Senate

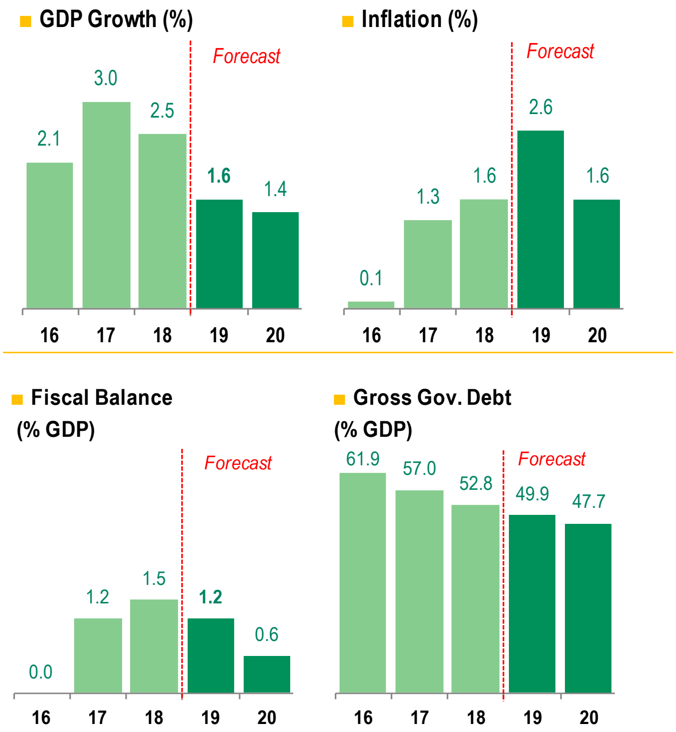
The centre-right coalition is not doing well in the polls and could lose almost one third of its seats if an election were to be held. Following severe losses in local elections, the government already lost the majority in the Senate. Even though the Senate cannot force the government to resign, it can block legislation. As a result, the government is forced to negotiate with the opposition parties to avoid gridlock. Even though the government has only a small majority in the second chamber of parliament, a political crisis is not imminent. The next general election should be held in March 2021.

Recently, the climate law passed both houses of parliament with an overwhelming majority. The law sets emission targets. The ultimate aim is to reduce greenhouse gases by 95% from the 1990 level by 2050. However, the law does not include measures to achieve this target, nor sanctions in the case of non-compliance.

Fiscal support

The economy will decelerate further in the coming quarters. Rising uncertainty has affected consumer and producer confidence and undermined investment spending. Nevertheless, growth should remain close to its potential rate thanks to strong growth in consumer spending, underpinned by a still supportive real disposable income growth (thanks to a normalisation in inflation) and an expansionary budget policy.

1- Key indicators



Source: National Sources, EU Commission, BNP Paribas

Indeed, the government finances are in excellent shape. In 2018, the budget surplus amounted to 1.5% of GDP and the debt/GDP ratio has declined to less than 50%. This has allowed the government to pursue a fiscal expansionary policy, although less than initially planned. Indeed, major spending plans in infrastructure and defence have encountered considerable delays.

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