CPB Netherlands Bureau for Economic Policy Analysis

Economy gathering steam | *Government stimulates*

CPB Policy Brief | 2018/06

Forecast

Central Economic Plan 2018

Summary

The Dutch economy is gathering steam. The economic boom is the result of a favourable international economy, low interest rates, expansive budgetary policy and a persistently strong housing market. These last two factors distinguish the Netherlands from other countries. Positive domestic dynamics between increasing employment, higher disposable income levels, higher consumption and more investments will lead to a 3.2% economic growth in 2018 and 2.7% in 2019. Over the 2017–2019 period, the Dutch economy is projected to outperform that of the eurozone by a yearly 0.6 percentage points on average.

The global economy is flourishing, but also faces certain risks. The global economy is projected to grow by 3.9% in both 2018 and 2019, and world trade will increase by 4.4% in both years. Growth will be broad based, with the exception of the United Kingdom that will lag behind the eurozone. The low pound sterling is affecting purchasing power of UK households and the Brexit is discouraging investments. However, the eurozone has its own vulnerabilities, such as a number of weak banks, the ECB's limited policy scope in case of a new shock, as well as political uncertainties. Despite the downward risks —also outside Europe— there are no concrete signs yet of a cyclical turning point in global economic growth.

The Dutch labour market is tightening. In 2019, unemployment will decrease to 3.5%, its lowest point since 2001. The strong growth in employment can easily absorb the increase in labour supply. Companies more often are offering permanent labour contracts and pay higher wages to either attract or hold on to staff. Rising labour costs and a higher low VAT tariff will cause inflation to increase to 2.3% in 2019. Median static purchasing power will increase by 1.6% in 2019, due to various fiscal measures — which is an improvement compared to the 0.6% increase in 2018.

The government budgetary balance is not improving, despite the economic boom. Already implemented policy, higher health care expenditure and increases in spending on education and defence will cause government expenditure to increase by 3.5% in 2018 and 2.4% in 2019. The already flourishing economy will be stimulated even further by increased spending on education and defence. In 2018 and 2019, budget surpluses will be 0.7% and 0.9% of GDP, respectively, following the 1.1% GDP budget surplus of 2017. Future decision-making around natural gas extraction from the Groningerveld will have a negative impact on public finances and economic growth — this has not yet been included in these projections, due to several uncertainties.

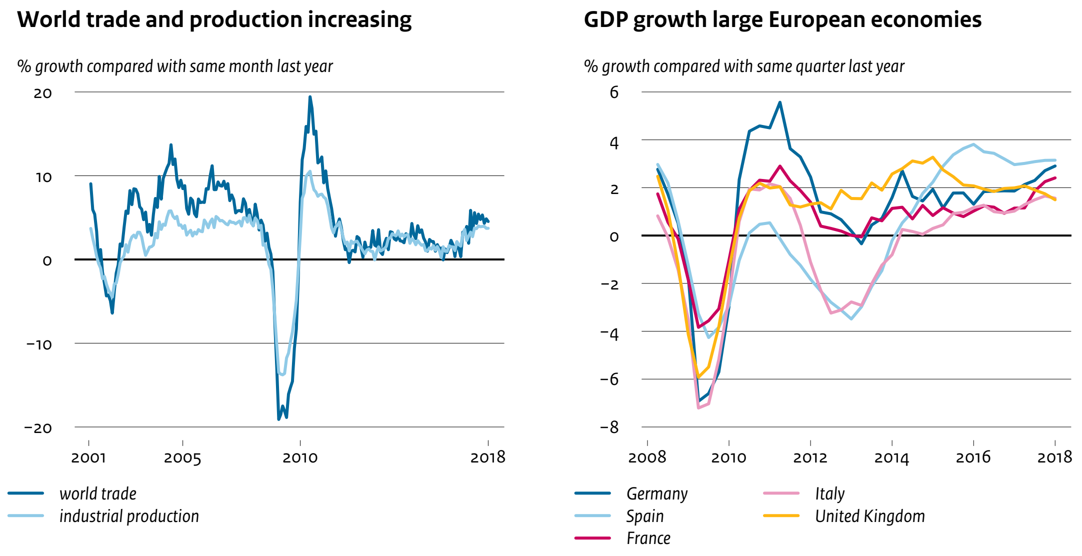
Static purchasing power projections provide a useful general insight into the effects of policies and economic developments, but they are less suitable for individual-specific predictions. Income policies effectively impact redistribution. There is however important uncertainty about the eventual effects of such policies in an uncertain economic environment.

1 The economy in 2018 and 2019

Global economic growth is robust and broad based. The 3.7% growth in 2017 was already the highest since 2011. For 2018 and 2019, the global economy is projected to grow by another 3.9%, in both years. The Asian economies show a high level of growth, and emerging economies such as those of Russia and Brazil are reviving again, after some years of recession. The continued expansive EU monetary policy and the expansive budgetary policy in the United States both support global economic development. Despite the recent correction of share prices, economic growth continues to be robust. Global economic growth involves a 4.4% increase in world trade, in both 2018 and 2019 (Figure 1) . This will benefit Dutch exports, although the high trade growth rates of the past decades will not be seen.

In the eurozone, too, the upturn is broad based. In 2017, economic growth also accelerated in countries that had previously been lagging behind, such as France and Italy (Figure 1) . The eurozone economy is projected to grow, both in 2018 and 2019, by 2.5% and 2.2%, respectively. This will cause unemployment in the eurozone to drop below the 10-year average of before the Great Recession. Currently, however, unemployment in Spain, Italy and France is still above this average. In 2019, growth is expected to level off because of the higher euro exchange rate and a tighter labour market.

Figure 1 Upturn in the global economy



Source: CPB, Eurostat (link)

The economy of the United Kingdom is lagging behind. For this important trade partner of the Netherlands, the IMF projects 1.5% growth in both 2018 and 2019. This is over a third lower than CPB's growth projections for the eurozone.[1] The lower pound increases inflation, which affects the purchasing power of UK households. Investments in the United Kingdom

[1] IMF, 2018, World Economic Outlook update, January (link).

seem to lag behind, due to the uncertainty about how Brexit will be finalised. The consequences of the coming Brexit are included in the central projections, although a more negative impact cannot be ruled out (see text box).

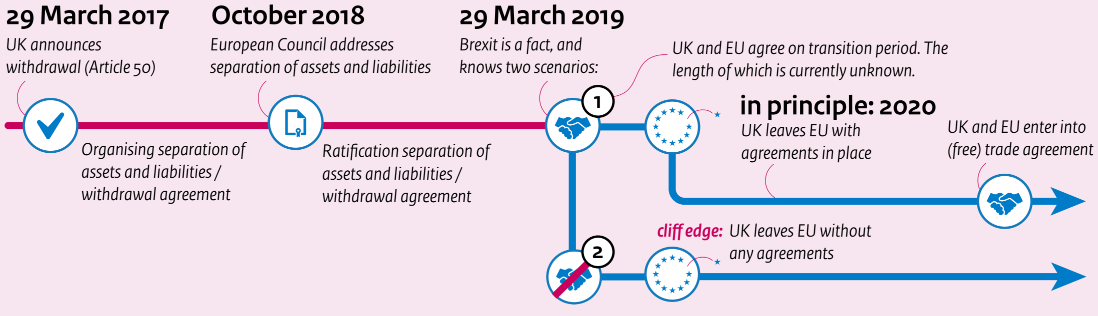
Brexit in the projections

One year from now, on 29 March 2019, the United Kingdom will leave the European Union. The main issue being negotiated is the Withdrawal Agreement in October 2018, so that this can be ratified on time by the European and British parliaments. Only after the United Kingdom leaves, the negotiations about a new relation between the EU and the United Kingdom can start. Currently, negotiations are also being conducted on a transition period (as part of the Withdrawal Agreement). The EU would like this period to end before the end of 2020. In addition, the parties are negotiating trade agreements and about subsectors (such as fisheries). Because free trade agreements usually take several years to complete, the United Kingdom in the interim will be able to proceed under regulations that apply to membership of the World Trade Organization (WTO). However, there is the risk that, by 29 March 2019, the United Kingdom and the European Union will not have been able to complete their negotiations or to agree on a transition period. In that case, they will part ways without any agreements in place and the United Kingdom will fall over the so-called *cliff edge*.

The baseline under the CEP projections consists of a scenario of a transition period with at the end a free trade agreement (FTA), similar to the earlier medium-term projections. The structural GDP loss involved in an FTA Brexit will be around 1% of GDP (a). The impact on annual economic growth will be limited because the losses will materialise gradually over time. The projections are surrounded by uncertainty; should innovation be hampered by lower trade, the structural impact may be nearly 50% greater. Under a WTO Brexit, the structural effects would be around 25% greater. In addition to gradually occurring structural effects, further increasing uncertainties as negotiations drag out may undermine trust and temporarily slow down economic growth.

A *cliff edge* or chaotic Brexit would involve very high costs, and is therefore a deterring prospect. Following a *cliff edge* Brexit, EU regulations clearly would no longer apply, but it is unclear which rules would then be in effect, for example, for aviation, financial transactions and contracts, and certain areas of trade. This lack of clarity may lead to —temporary— cessation of air travel and other transport between the UK and the EU. Long waiting lines would be created at ports. Such a situation may be rapidly resolved if this type of pressure would cause parties to agree to a transition period, after all. The costs, in the real economy, in that case would be short-lived and ultimately only limited. An exception would be the financial sector, where trust plays an important role and certain effects may prove to be irreversible. Also for intellectual property rights irreversible effects may occur. Projecting the costs of a *cliff edge* Brexit in practice is difficult because there is no historical precedent for such a scenario.

Preparing for the period after the actual Brexit is and remains important, not only for UK and EU governments, but also for businesses. This means investing in matters such as additional infrastructure, all types of border control (customs, food and product safety authorities, military law enforcement), and providing information to the business community. The Netherlands with the Port of Rotterdam will particularly need to make such investments. Some businesses will search for other markets. The sooner these preparations are started, the better the chances of being protected against possible negative effects from a *cliff edge* scenario.



(a) CPB Policy Brief 2016/07, Nederlandse kosten Brexit door minder handel (link).

Inflation in the eurozone is increasing, but remains relatively low. In 2018, inflation in the eurozone will be 1.4%. Higher oil prices have an upward impact, while the higher exchange rate of the euro will have a downward impact.[2] For 2019, the effect of the oil price and exchange rate is projected to be limited. In the ECB projections, the underlying core inflation will increase, gradually, to 1.5% in 2019,[3] but will remain low due to relatively moderate wage developments, among other things. In 2019, inflation —at 1.5%— will also remain well below the ECB's medium-term objective of just under 2%.

The global economy involves a number of important downward as well as upward risks. The eurozone still has a number of structural vulnerabilities, both of an institutional and an economic nature. Some European banks remain weak. This limits the availability of credit for growing businesses. The negative interaction between weak banks and government debt has been tempered rather than sufficiently addressed. Higher interest rates may increase the share of non-performing loans (NPLs) and, moreover, could revive doubts on the sustainability of government debts in countries such as Greece and Italy. This makes the timing of the exit of ECB's asset purchase programme a delicate matter.[4] Exiting too slowly may, for example, lead to overheating of the economy, rapidly increasing inflation and financial bubbles. Economic growth may be negatively affected by political uncertainties within the EU, such as by Brexit (see text box), the formation of a new Italian government, or the consequences of a new flow of migrants. The high level of the US budgetary deficit[5] under historically low unemployment leads to an imbalance on the current account. In case of another economic shock, the policy scope will be limited for governments and central banks. The timing of a possible turning point, however, is difficult to predict. However, there is also the positive scenario of greater economic dynamics, where higher employment, wage increases, more investments and increases in world trade enhance each other.

The Dutch economy continues to develop positively. There is a relatively strong increase in production and employment, while unemployment continues to decrease (Table 1). Wages increase more rapidly due to the tighter labour market. This, in combination with next year's VAT increase, will cause inflation to go up. The robust, widespread economic development is the result of a favourable international economy, expansionary fiscal policy, low interest rates, and a persistently strong housing market. These factors lead to positive domestic dynamics between increasing employment, higher disposable income levels, higher consumption and more investments. The confidence of consumers and businesses in future developments has a positive impact on consumption and investments, as is indicated by economic surveys. Economic growth is projected at 3.2% for 2018 and 2.7% for 2019, following a 3.1% increase in 2017 (Figure 2). The slight reduction in economic growth in

[2] The technical projections of exchange rates, oil prices and interest rates are based on data from Week 3 (15–19 January). Projections of short-term and long-term interest rates are based on market expectations (the respective futures interest rates and forward swap rates).
[3] ECB staff macroeconomic projections for the euro area, 14 December 2017 (link).
[4] In late 2017, the ECB announced a reduction in their expanded asset purchase programme, from 60 to 30 billion euros per month, between January and the end of September 2018.
[5] The Federal Government deficit will be more than 5% of GDP by 2019. Calculations are based on a deficit of USD 1,190 billion (CRFB, 8 February; link) and a GDP of USD 20,671 billion in 2019 (CBO, June 2017 Update to the Budget and Economic Outlook; link).

2019 will mainly be due to a smaller budgetary policy impulse and lower export growth; but there are no indications of an economic turning point. Bottlenecks in certain parts of the labour market make it more difficult to meet the increasing demand but are not expected to have a substantial downward impact on economic growth in 2019.

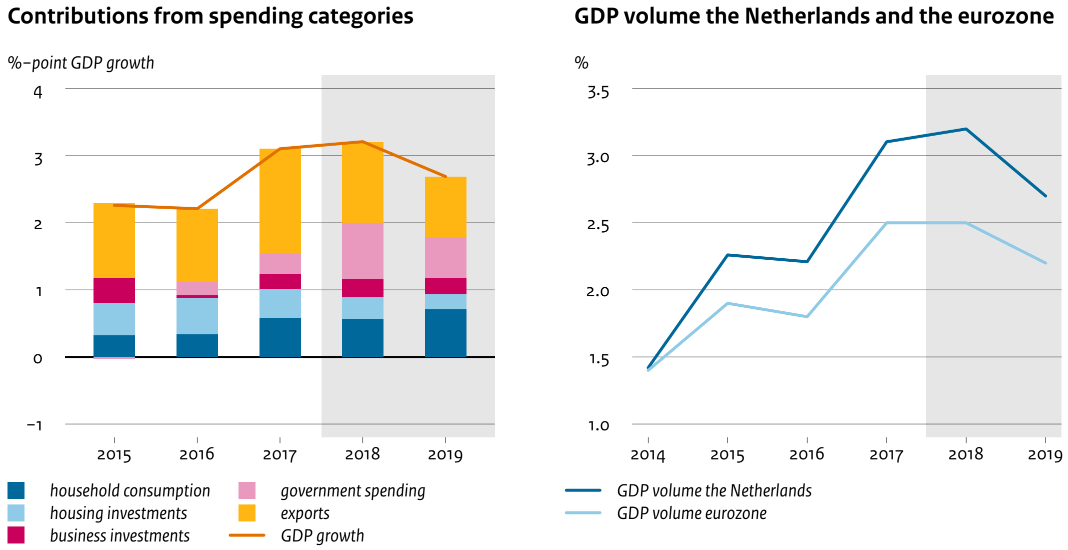
Table 1 Main economic indicators of the Netherlands, 2014–2019

	2014	2015	2016	2017	2018	2019
	mutations per year, in %					
International economy						
Relevant world trade volume goods and services	4.9	4.0	4.0	4.7	4.4	4.4
Competitor prices (a)	-0.5	6.1	-3.6	1.6	-0.2	1.1
Oil price (in USD per barrel)	97.8	52.1	43.5	54.0	67.7	63.6
Euro exchange rate (USD per euro)	1.33	1.11	1.11	1.13	1.22	1.22
Long-term interest rate, the Netherlands (level in %)	1.5	0.7	0.3	0.5	0.7	0.9
Volume GDP and spending						
Gross Domestic Product (GDP, economic growth)	1.4	2.3	2.2	3.1	3.2	2.7
Household consumption	0.3	2.0	1.6	1.8	2.1	2.5
Public consumption	0.3	-0.2	1.2	0.9	3.0	2.4
Investments (including stocks)	3.2	11.2	3.1	5.0	6.0	4.2
Exportation of goods and services	4.5	6.5	4.3	5.5	4.9	4.6
Importation of goods and services	4.2	8.4	4.1	4.9	5.1	5.2
Prices, wages and purchasing power						
Price level Gross Domestic Product	0.1	0.8	0.6	1.3	1.8	2.4
Export prices goods and services, excluding energy	-0.8	1.5	-0.9	1.9	0.6	1.4
Price levels imported goods	-2.7	-5.4	-4.4	4.5	1.0	0.3
Inflation, Harmonised Index of Consumer Prices (HICP)	0.3	0.2	0.1	1.3	1.6	2.3
Wage rate business sector (per hour)	1.0	-0.2	0.6	1.5	2.9	4.0
Contract wages business sector	1.0	1.2	1.5	1.6	2.2	3.2
Purchasing power, static, median all households	1.3	1.0	2.6	0.3	0.6	1.6
Labour market						
Labour force	-0.4	0.4	0.4	0.8	1.0	1.0
Working population	-0.6	1.0	1.3	2.1	2.0	1.5
Unemployed labour force (x thousand persons)	660	614	538	438	355	320
Unemployed labour force (in % of labour force)	7.4	6.9	6.0	4.9	3.9	3.5
Employment (in hours)	0.7	0.6	2.0	1.7	1.9	1.5
Other						
labour income share (in %) (b)	74.1	72.2	72.9	71.8	71.7	72.5
Labour productivity business sector (per hour)	0.9	1.5	0.4	1.6	1.4	1.3
Individual saving share (in % disposable income) (c)	0.3	-0.4	0.3	-0.3	0.0	0.2
Balance current accounts (in % of GDP)	8.9	8.3	8.7	9.5	9.4	9.2
	level in % of GDP					
Public sector						
EMU balance	-2.3	-2.1	0.4	1.1	0.7	0.9
EMU debt (ultimo year)	68.0	64.6	61.8	56.0	52.1	48.4
Collective financial burden	37.5	37.3	38.8	38.9	38.9	39.1
Gross public spending	46.4	45.2	43.8	43.1	42.6	42.2

(a) Goods and services, excluding natural resources and fuels.
(b) Starting with the MEV 2018, CPB will be using a new method for calculating labour income share. The way this new calculation method takes labour income of the self-employed into account has been improved and, therefore, is more in line with current economic reality. A joint publication (in Dutch) by CBS, CPB and DNB provides more information on the subject.
(c) Level; disposable family income includes public savings. Because personal pension fund management is also taken into account, the individual saving share was 0.6 percentage points lower in 2017, and will be 0.2 percentage points lower in both 2018 and 2019, see the text box in Chapter 1 of the MEV2017.

Dutch growth levels are high, from a European viewpoint, but not from a historical perspective. Growth levels have been surpassing those of the eurozone since 2014 (Figure 2). Average Dutch economic growth over the 2017–2019 period will be 0.6 percentage points higher, even more than the annual 0.3 percentage point difference in the three preceding years. In 2018 and 2019, growth levels in the Netherlands will surpass those of the eurozone, due to more expansive budgetary policy and a stronger housing market. Such growth percentages have not been seen since 2007. Over the period since 2007, however, average growth has remained historically low. In addition to the crisis, structural factors also have played a role, such as the smaller increase in the workforce, the no longer rising trend in women's labour participation, and a smaller structural productivity increase.[6]

Figure 2 Positive economic development continues



(a) The contribution of government spending to GDP growth only concerns direct spending effects of government consumption and investments. The effects from other government spending, including income transfers and subsidies, may contribute to growth via household and corporate spending. The last is also the case for taxation.

Source: CBS, Eurostat, CPB (link).

Steady growth in private consumption, due to increases in employment and purchasing power. Consumption is expected to increase by 2.1% this year and 2.5% next year, following a 1.8% increase in 2017. The growth in consumption is in line with the strong increase in disposable income. Income from labour is increasing due to increased employment and higher wage levels. Consumption growth is markedly higher than the average annual increase of 0.6% during the previous years of this century. The projected acceleration in 2019 is due to higher real wage increases and a greater reduction in the tax burden. The impact of raising the low VAT tariff, higher energy taxes and higher nominal healthcare premiums in 2019, will be more than countered by reductions in income tax and social premiums.

[6] Also see CPB (2017), text box *Green signs against a grey background* in the Macro Economic Outlook 2018. (link)

The growth rate of housing investments is slowing down. Since the beginning of the economic crisis, housing investments have shown much larger fluctuations than any other spending categories. The collapse, with annual reductions of 12% over the 2009–2013 period, was followed by a spectacular recovery of 15% per year, over the 2014–2017 period. In 2018 and 2019, the growth rate of housing investments will gradually decline to a respective 9% and 6%. The continued growth is related to an increase in disposable income, low capital costs, further increases in house prices, and the positive mood of consumers. Compared to 2008, housing investment levels in 2019 will have recovered fully. Bottlenecks on the labour market are projected to curb growth in the construction sector. The tighter housing market causes house price increases to continue over the projection period, while clear regional differences will remain.

Conditions are perfect for business investments. The capacity utilisation is high, entrepreneurs are positive about their expected turnover, capital costs are low and profitability is robust. Business investments (excluding housing) will increase by 4.6% this year and 3.8% in 2019.

Exports are benefiting from the favourable international economy, even though the strong euro poses a slight disadvantage. Goods and services exports are projected to increase by 4.9% this year and 4.6% next year. This is slightly lower than in 2017 (5.5%), due to a slightly decreasing growth in relevant world trade and a deterioration of the competitive pricing position because of the appreciation of the euro. Re-exports will continue to show above-average increases, causing the market share of Dutch exports to continue to increase. Higher domestic spending in combination with more exports means that also import levels will increase: by 5.1% this year and 5.2% next year, which is a fraction higher than the growth in exports. This will contribute to a slight decrease in the current account balance, from 9.5% of GDP in 2017 to 9.2% in 2019 — which is still high, from an international perspective.

Unemployment continues to fall. The strong growth in employment hours will continue: 1.7% in 2017 and 1.9% in 2018. It will be slightly lower in 2019, with 1.5%, due to lower economic growth and less growth in employment in the public sector. In 2018, employment in the public sector will accelerate, as a result of envisaged spending increases. However, attracting qualified new staff within a short period of time is a difficult task. After all, the economic boom leads to a tighter labour market, which makes it increasingly more difficult to find qualified staff. Currently, the labour market is not quite as tight as it was just before the crisis of 2008. At that time, there were 32 vacancies per thousand jobs, whereas in the first quarter of 2017 this number was 27. Early 2018, one in five companies indicated they were facing staff shortages, which is twice as many as one year ago.[7] For 2019, the unemployment percentage is projected to decrease to 3.5%, the lowest level since 2001. The number of unemployed has been decreasing for four years in a row, to under 400,000 by late 2017. Long-term unemployment is also decreasing, substantially. After 2015, it was halved from 2.9% to 1.5% by late 2017 (Figure 3).

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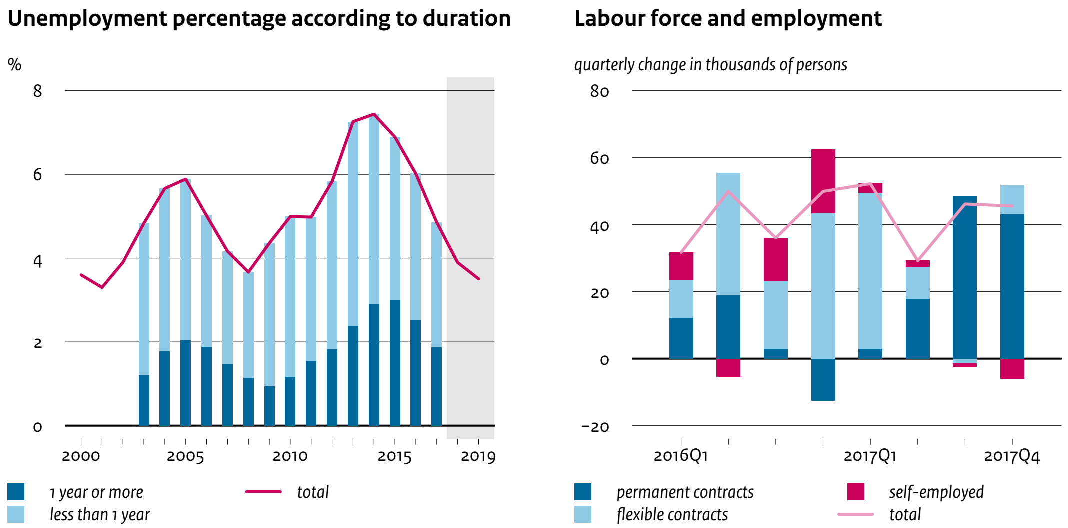
[7] Excluding financial businesses and utility companies.

Employers more often offer permanent contracts and are raising wages, although to a lesser degree than in the past. Over the course of 2017, the labour market experienced an important turning point; growth in employment shifted from flexible labour —both the self-employed and employees on flexible contracts— to staff on permanent contracts (Figure 3). However, the increase in the number of permanent contracts of 146,000, since the lowest point in the third quarter of 2015, is still relatively modest. After all, between the 2009 crisis year and that lowest point in 2015, the number of permanent contracts declined, almost continually, in total by 623,000. Labour shortages and rising prices also lead to higher wage claims. The wage rate for businesses is projected to increase, from 1.5% in 2017 to 2.9% in 2018 and 4.0% in 2019. Unit labour costs will increase in 2019 —for the first time since 2012— by more than 2%. Contract wage rises will increase from 1.6% in 2017 to 2.2% in 2018 and 3.2% in 2019. Moreover, in the tight labour market, employees more often receive a bonus or a higher wage scale, and they change jobs more often, which also increases incidental wage rises.

Figure 3 Lower unemployment and more permanent contracts



Source: CBS, CPB (link)

Inflation will rise further, due to continuing oil price increases and increasing labour costs. Last year, inflation increased mostly due to the higher oil price, from 0.1% to 1.3%. Further increases are projected for this year, to 1.6%, with the appreciation of the euro against the US dollar weakening the impact of oil price increases. In 2019, inflation will continue to increase to 2.3%, which is clearly higher than elsewhere in the eurozone. The increase in the low VAT tariff, together with higher taxation of energy and ODE (sustainable energy storage), drives inflation up by 0.5 percentage points. In addition, wage cost increases will be passed through on prices.

Median static purchasing power will see a moderate increase in 2018 and a stronger increase in 2019. For 2018, median static purchasing power is projected to improve by 0.6% (Table 2). The purchasing power outlook for 2019 will be relatively favourable, with

1.6%, partly due to measures in the Coalition Agreement to reduce the tax burden. Lowering of tax rates in the second, third and fourth bracket of income tax will have a positive impact particularly on the employed, as will the maximum increase of 110 euros in labour tax credits. Welfare benefit recipients and pensioners will particularly benefit from the maximum increase of 140 euros in general tax credits. Purchasing power of benefit recipients will lag behind, due to the annual lowering of the social welfare benefit (particularly in 2018) and the increase in the tax rate in the first bracket, in 2019. In 2018 and 2019, pensioners will benefit from the increase in pensioner credits for lower incomes, but they will also be disadvantaged by the limited indexation of supplementary pensions. The employed, in particular, will benefit from the increase in real contract wages. The increase in the low VAT tariff and ODE tax will be unfavourable for purchasing power — these have been included in the calculations of inflation. In both 2018 and 2019, households without health insurance subsidy will be disadvantaged by the increase in health insurance premium of 22 and 96 euros, respectively.

Table 2 Purchasing power developments in 2018 and 2019

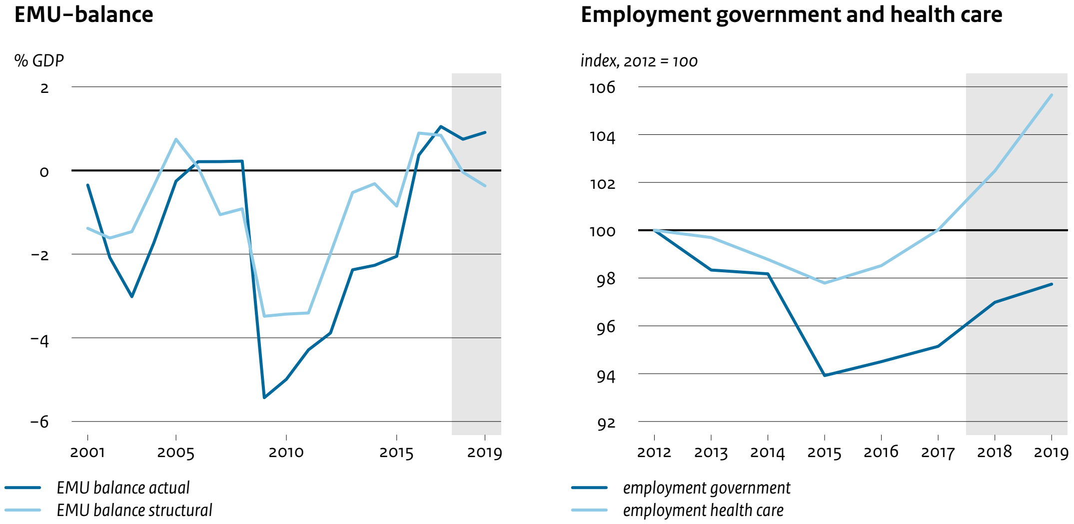
	2018	2019	
	Median purchasing power mutation in % (a)		Size in % total (b)
Income level (c)			
< 175% nmw	0.3	1.3	38
175%–350% nmw	0.6	1.8	37
350%–500% nmw	0.9	1.8	14
> 500% nmw	1.1	1.8	11
Income source (d)			
Working population (e)	0.8	1.8	63
Welfare benefit recipients	0.1	0.8	9
Pensioners	0.4	1.3	26
Household type			
Two-income households	0.8	1.7	51
Single-person households	0.4	1.4	43
Single-earner households	0.6	1.8	6
Household composition (f)			
With children	0.9	1.8	25
Without children	0.5	1.7	50
All households	**0.6**	**1.6**	100

(a) Static purchasing power mutations, excluding incidental income mutations.
(b) Percentage of total number of households in 2018.
(c) Gross income from labour or welfare benefits, on household level; gross national minimum wage (nmw) in 2018 is around 20,600 euros.
(d) The categorisation according to income source is based on the highest income source on household level, whereby households of which the head or partner has an income from profits have been categorised under the working population. Households on early retirement pensions or student financing as their highest income source were excluded.
(e) For the purchasing power mutation of the working population, incidental wage mutations, such as bonuses received or lost, were not taken into account.
(f) The categorisation according to household composition is based on the presence of children up to the age of 18 and excludes pensioner households.

Economic dynamics, the implementation of proposed policy, wage developments and the housing market all carry both positive and negative risks related to economic growth. Greater dynamics can be achieved where additional spending, higher employment and more investments have a stronger positive impact on each other. Foreign demand may also be greater, although here the risks mentioned earlier apply. Dutch economic growth will turn out lower if the intended policy measures will not, or only partly, sort out the desired effect. The proposed policy measures imply sizable increases in employment in the public sector and the healthcare sector, which will be difficult to realise under a tight labour market. Lower wage increases, despite the tight labour market, could have a negative impact on consumption. On the other hand, a stronger wage increase will have a positive impact on both consumption and economic growth. House price increases may continue for longer and affect growth, both this year and the next, but may also be a sign of overheating. Natural gas extraction levels from the Groningerveld gas field pose a certain risk for economic growth. The projections do not yet include a strong decrease in natural gas production, in anticipation of decision-making on this subject.

The budgetary balance will not improve, despite the economic boom. For 2017, 2018 and 2019, respective budgetary surpluses are expected of 1.1%, 0.7% and 0.9% of GDP (Figure 4). In this year and the next, surpluses are related to the favourable economy, but are tempered by expansive budgetary policy. The 2017 balance was upwardly affected, because less was spent than budgeted for, and because the balance sheets of local governments saw a more positive development than expected. The decreasing structural balance, from 0.8% of GDP in 2017 to 0.0% in 2018 and -0.4% in 2019, illustrates the expansive budgetary policy.[8] This will further stimulate the booming economy, while fewer buffers will be created for less profitable years.

Figure 4 Expansive budgetary policy, as yet, will not lead to a deficit



Source: CBS, CPB [(link)]

[8] The structural budgetary balance, which is at the core of the EU budgetary regulation, thus is above the medium-term objective (MTO) of -0.5% of GDP.

The lower budgetary balance of 2018 and 2019 will predominately be the result of higher government spending. Already implemented policy, spending increases in education and defence, together with increased spending on health care, will cause government spending to grow by 3.5% in 2018 and 2.4% in 2019. Spending increases on defence are mostly in equipment, while other increases, such as in education, particularly concern additional employment (Figure 4). The question here is whether this additional employment could easily be translated into newly attracted staff. In case the growth in public employment would be lower than expected, this would have both a tempering effect on the economy and a positive impact on the government budget. Although tax revenues are projected to increase in 2018, they will do so less rapidly than government spending. In 2019, the budgetary balance will improve compared to 2018, despite lower income tax revenues, because of lower interest rate charges and additional tax revenues from raising the low VAT tariff and increases in energy taxation.

The situation around gas production from the Groningerveld is surrounded by much uncertainty. This applies to the gradual reduction in the level of natural gas extraction, as well as to the size and timing of financial compensation payments and reinforcements, the distribution of costs between government and oil companies[9] and the related figures in the budget. The projections currently are based on the technical Cabinet assumption about an extraction level from the Groningerveld of 21.6 billion standard cubic metres (in Dutch: Nm^3). Following the recent earthquake at Zeerijp, the Dutch State Supervision of Mines (SSM) recommended that the extractions from the Groningerveld would be wound down to 12 billion Nm^3. Every 4 billion Nm^3 less natural gas will – leaving all other things unchanged – lead to a lower economic growth of 0.1% of GDP, and a decline in the government budgetary balance of 0.1% of GDP.

The gross public debt will decrease over the coming years, to further below the Maastricht cap of 60% of GDP. In 2017, with 56.0% of GDP, the government debt was below 60%, which was for the first time since 2010. For 2018, the government debt is projected to decrease further to 52.1% of GDP, which takes it even further below the Maastricht Treaty maximum budget deficit. Because of the denominator effect due to the increase in GDP, the budgetary surplus and certain financial transactions, the government debt will continue to decline in 2019, to 48.4% of GDP.

Main differences to the previous projections

- According to preliminary figures by Statistics Netherlands (CBS), economic growth in 2017 was 3.1%, which is 0.1 percentage point below CPB's December projections. The projections have been adjusted upwards for 2018, by 0.1 percentage point.
- GDP projections for 2019 (2.7%) are higher than those in the updated medium-term outlook of November last (1.9%). This is because current projections do include cyclical conditions for 2019, while these were not included in the medium-term outlook.
- The projected inflation (HICP) for 2018, compared to the December projections, has been adjusted upwards by 0.1 percentage point, to 1.6%. Measured in US dollars, the oil price

[9] See the parliamentary minutes of the Dutch House of Representatives of 16 January 2018. (link)

has been adjusted upwards; in euros, the adjustment is smaller because the euro exchange rate (dollars per euro) was adjusted upwards.

- Purchasing power development in 2018, when considering all households, has remained unchanged, compared to CPB's December projections as well as its Macro Economic Outlook 2018. The outlook has been adjusted downwards for pensioners (by 0.1%) and welfare benefit recipients (by 0.2%), compared to the Macro Economic Outlook 2018. All groups are negatively affected by the upward adjustment of inflation, by 0.2% (cpi definition). However, the middle and higher incomes benefit from the downward adjustment of the health insurance premium development in 2018.
- The 2017 government balance has been adjusted upwards by 0.6 percentage points, particularly due to lower spending levels than were budgeted for, and the fact that the balance sheet of local governments is projected to develop more favourably than previously estimated. For 2018, the upward adjustment will be 0.2 percentage points because of taxation windfalls and the more positive balance sheet of local governments. Compared to the medium-term outlook, the EMU balance for 2019 has not been adjusted, despite the upward adjustment of GDP. This is partly due to the fact that this upward adjustment is caused by higher investments and larger export levels and because the downward adjustment of wages and social benefits has a negative impact on tax revenues.

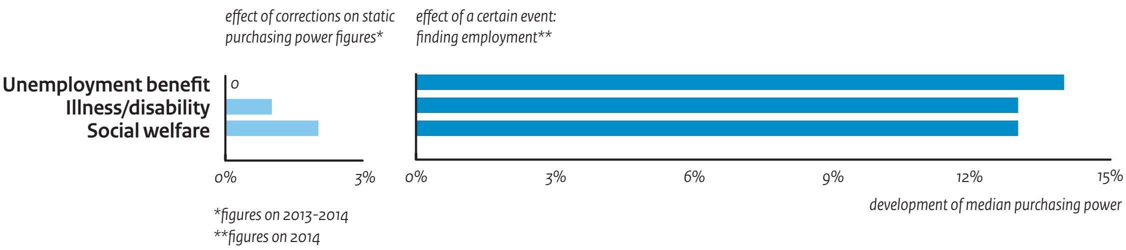
2 Purchasing power projections: what does it get you?

We dislike inequality, we say[10][11]. The Netherlands is the land of Jan Tinbergen, the man who never set the standard of 1 to 5 for acceptable wage differences, but who nevertheless became known because of it[12]. Attention for differences in income not only can be found at the Social and Economic Council (SER), but also in policy — a solid budget and well-balanced distribution of income are often mentioned together in Coalition Agreements. They are also in the building blocks for policy: for over fifty years now, CPB has been producing purchasing power figures[13], first only for the fictitious household of the average worker, but these days for a range of groups based on a representative sample. Purchasing power figures are presented in assessments of general election manifestos and Coalition Agreements with the Gini — an indicator for income inequality — as the final illustrative tool. And each year, purchasing power plays a role in the debates around the Day of the King's Speech. All in all, this equals a large amount of attention and activity, but what does it get you?

Purchasing power outlook: a still life

Purchasing power outlook present a stylised version of reality. How much more, or less, will households have to spend, next year, if the economy and policy develop according to plan *and* no other changes take place? In the calculation of the purchasing outlooks it is assumed that you will not find a job or get a promotion, not deliver children, nor divorce or retire. Although the dynamic effects of all those events have a far greater impact (see Figure 1), the projected purchasing power outlook only deals with changes in the economy and government policy. In addition, we are all assumed to consume the same stuff: a package of consumables that corresponds with the composition of the consumer price index. Static purchasing power outlooks[14] provide policymakers with general insights, but they are less suited to be translated to anyone's personal wallet.

Figure 5 Dynamic versus statistic purchasing power effects

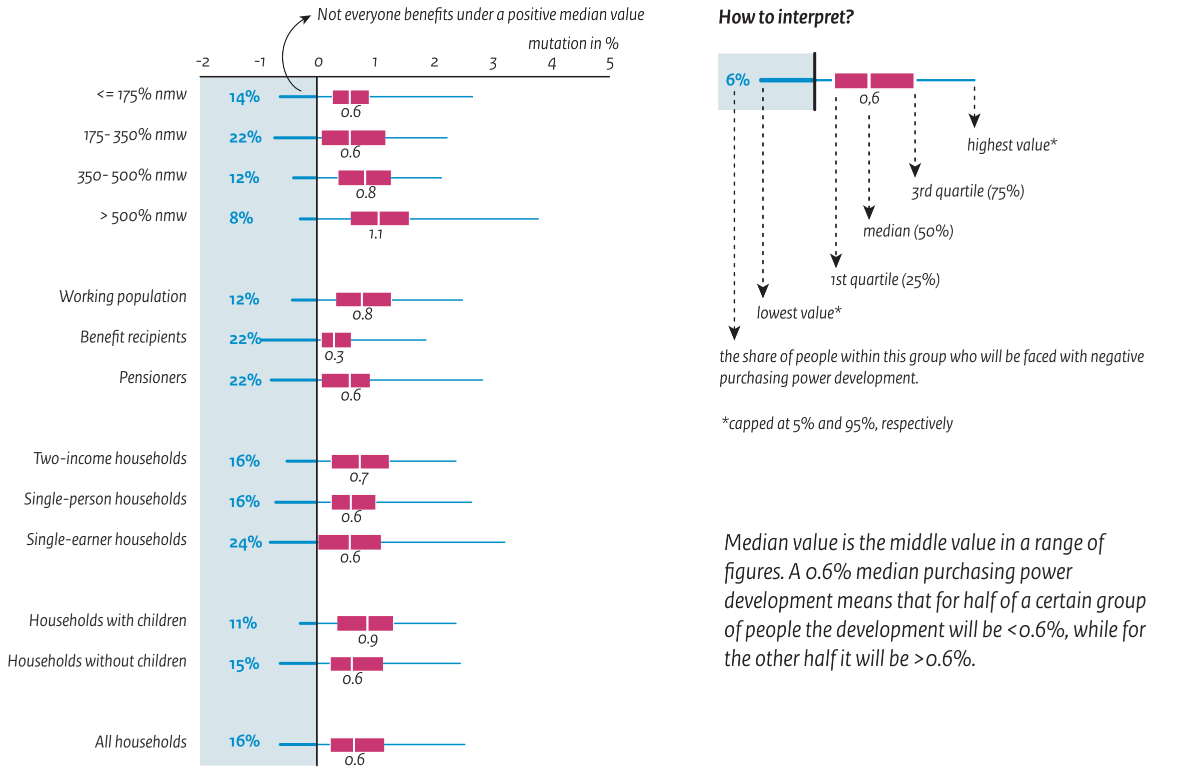


[10] Dutch newspaper article about the taboo that still rests on salary transparency https://www.nrc.nl/nieuws/2015/11/21/pssstwat-verdien-jij-1562127-a65818.
[11] For more information on income inequality (in Dutch), see: http://www.cpb.nl/publicatie/vermogensongelijkheid-in-nederland-2006-2013.
[12] Dutch article about the 'Tinbergen standard': http://www.mejudice.nl/docs/default-source/bronmaterialen/op-zoek-naar-bron-tinbergennorm.pdf.
[13] Dutch article on purchasing power trends: https://www.tpedigitaal.nl/artikel/koopkrachtplaatje-31.
[14] Dutch CPB press release 'Statistic purchasing power figures better suited to provide clarity about policy impact' http://www.cpb.nl/persbericht/3215387/statische-koopkrachtcijfers-beter-geschikt-om-beleidseffecten-inzichtelijk-te-maken.

Source: Statistics Netherlands (CBS)

CPB reports the median development, which means that half the people in the group will be financially worse off than the figure given, and the other half will do better that this figure. The median purchasing power development covers a —usually substantial— variation, which also differs between population groups. A median of 0.6% for all households in 2018 (see last line Figure 2) does not mean that all households will be better off. Around 16% of them will in fact be worse off. And there will also be households that will benefit by more than 2% or even 3%. Fulfilling the ambition for all households to do better is often much more expensive than a median of zero for all the households in a purchasing power table. This variation is another reason why it is difficult to compare a figure in the table to a person's individual situation.

Figure 6 Range around the median: projections MEV 2018



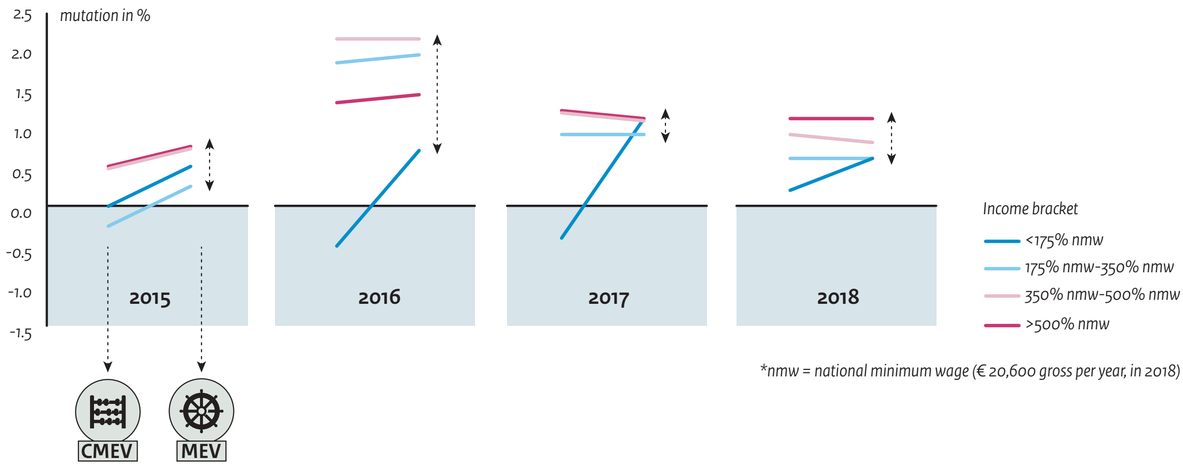
The projected purchasing power is surrounded by substantial uncertainty. Projecting contract wage development, inflation and nominal health insurance premiums (three important factors) appears a challenging task that becomes even more challenging as projections are further into the future (Figure 6). In the current year (in the figure, this is 2017), uncertainties are smaller, because there is already a large amount of information available on wages, inflation and the health insurance premium. Projection errors are a third reason why people, in practice, are either better or worse off than expected on the Day of the King's Speech (Prinsjesdag).

Fine-tuning purchasing power

Purchasing power plays an important role in high points of the budgetary process, irrespective of whether this concerns election manifestos, government coalition agreements or the King's Speech on Prinsjesdag. In addition to correcting the general purchasing power outlook (the median), an important part of the decision-making process is focused on whether purchasing power is developing in a balanced way for the various population groups. Political views determine what is understood by 'balanced' and which groups will be looked at. It is therefore not surprising that the purchasing power tables cover a large number of groups, ranked according to income level, source of income, and household composition. From this perspective, it is also no wonder that the Netherlands finds it difficult to realise the ambition of a simple streamlined system of taxes, premiums, credits and subsidies in practice. When comparing purchasing power figures before and after decision-making, two aspects are notable[15].

Redistribution of purchasing power effects makes sense. The range in purchasing power of the groups is usually reduced (Figure 3).

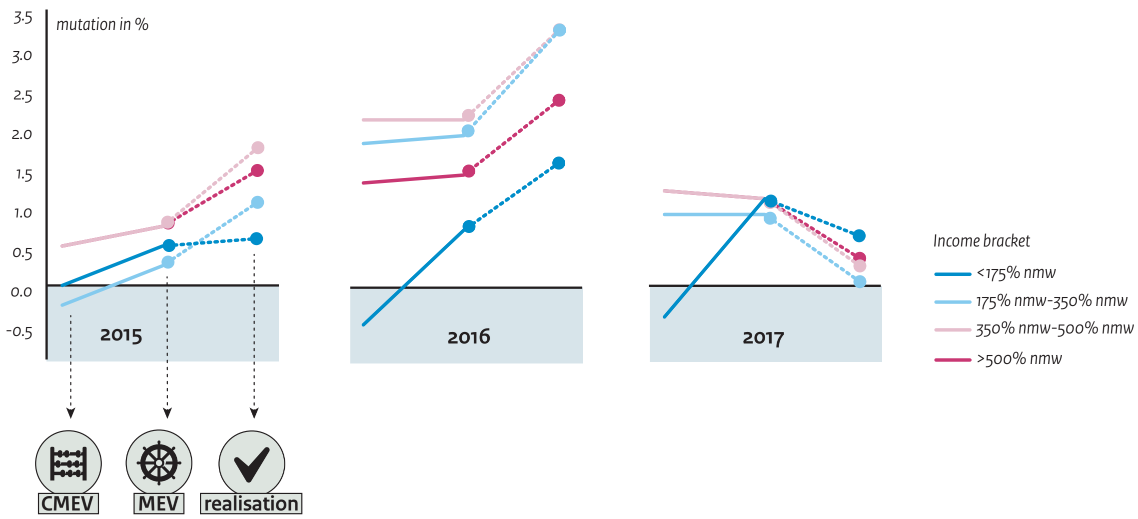
Figure 7 Reducing the range: median purchasing power, 2015–2018, cMEV versus MEV



And often with success. Groups that were intended to benefit the most according to the policy measures announced in the King's Speech on Prinsjesdag (in the MEV) indeed do so in practice (Figure 4). And the range is in fact being reduced.

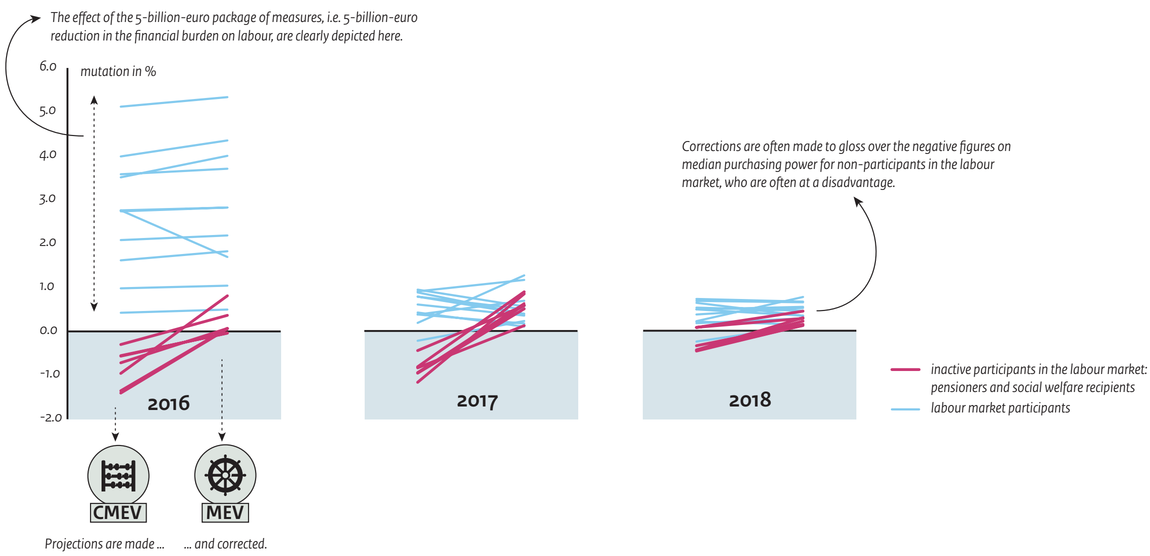
[15] Here illustrated by the Day of the King's Speech: the cMEV is published before decision-making, the MEV is after decision-making has been completed.

Figure 8 Range of median purchasing power, 2015–2018, cMEV, MEV and realisation



Policy making on the basis of exact outcomes would ignore the many uncertainties that surround purchasing power and would come at the price of complexity. Decision-making aims to use limited budgetary means to achieve a balanced purchasing power outlook. This results in frequently conducted calculation rounds during the government formation process and decision-making before Prinsjesdag. During the assessment of the election manifestos (Charted Choices), the political parties called for a third —additional— calculation round for purchasing power. Looking at the purchasing power tables in Charted Choices, and the overviews of household examples in the documents of the Ministry of Social Affairs and Employment, and the standard purchasing power tables in CPB's CEP and MEV suggests that they all use a lower limit of 0.0.[16] In light of projection uncertainties as mentioned earlier, this use of the zero value is noteworthy (Figure 6).

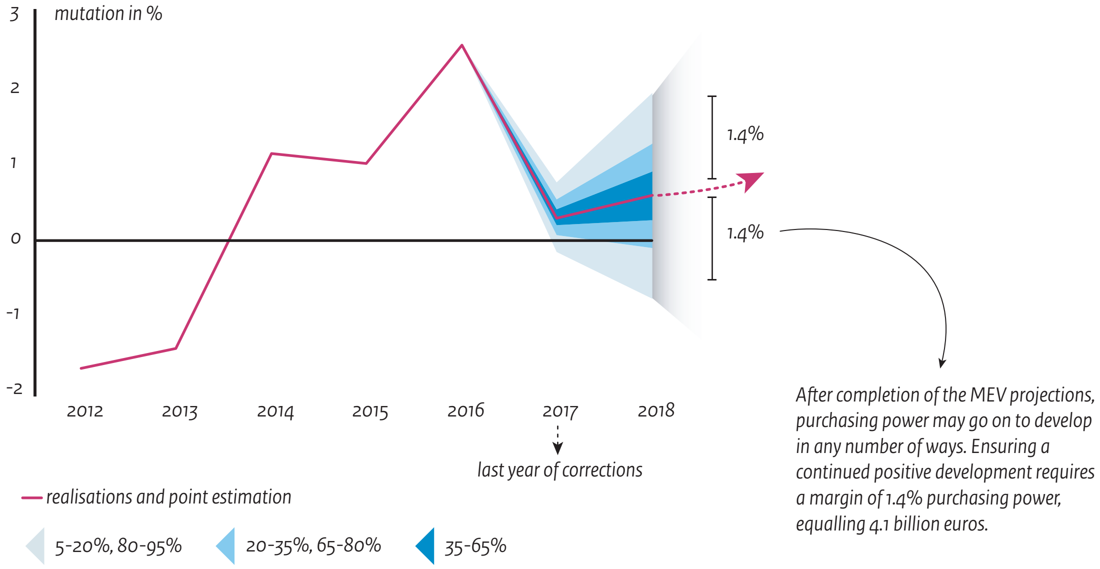
Figure 9 Making corrections on the basis of specific outcomes: household examples



[16] Remaining negative figures appear intentional, or unavoidable due to overall budgetary tightness.

Ensuring that median purchasing power development in 2018 at least equals zero[17] requires a margin of around 1.4% purchasing power (costing 4.1 billion euros). The more detailed your policy objectives, the more important the exact setting of tariffs, tax credits and deductions will be. Very detailed decision-making is the result, as can be seen in het usually long list of policy measures to explain purchasing power development, the introduction of new pathways to create or reduce tax deductions, and the repeated decelerations of implementation pathways towards introducing policy.

Figure 10 Uncertainty around median static purchasing power in the MEV 2018: the fan chart



Politicians and civil servants spend large amounts of time and energy on fine tuning the purchasing power outlook. It is a hot topic in the assessment of the election manifestos, as well as in the election debates, government formation process, and in the annual General Political Considerations. The sobering news is that other events than the outcome of static purchasing power outlooks, such as getting married and having children, will have a much bigger impact on the average worker's purchasing power. Striving for an exact outcome, down to a tenth of a per cent, does not combine well with the uncertainties that are inextricably linked to any projection. The good news, though, is that insight into purchasing power figures may contribute to a more equal distribution of income, although achieving this comes at the price of a complex system.

[17] On the basis of 95% confidence interval.

Publisher:

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March 2018