CPB Netherlands Bureau for
Economic Policy Analysis

Macro Economic Outlook 2020

Domestic spending responsible for Dutch economic growth. An ill wind sweeping in from abroad dampens GDP growth in 2020 to

1.5%

The labour market continues to be tight, leading to higher wages.

This fact, together with the alleviation of the tax burden, translates into a positive development for purchasing power.

For 2020, the budget surplus is projected to decrease to 0.3% of GDP.

The escalating **trade conflict** between the United States and China plays a key role, in the face of global uncertainty

In Europe, the approaching **Brexit deadline** and the political situation in **Italy** are also causes for concern

Will the lower interest rates provide more money for reform, for instance, by borrowing more?

Temporary boosts are an option, but they are not without risks.

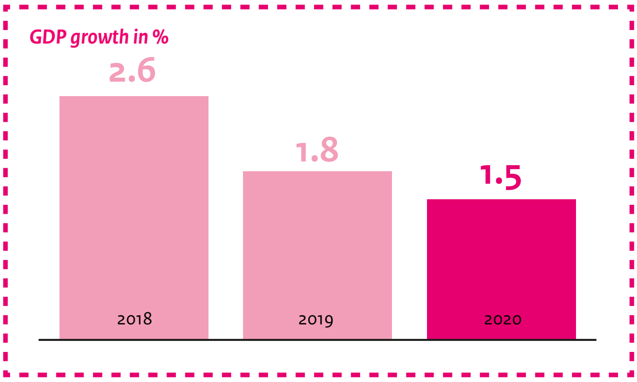
→ **Debt without penalties?** page 12

CPB Forecast

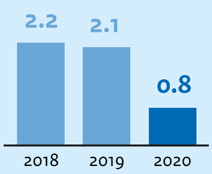
September 2019

CPB figures Prinsjesdag 2019

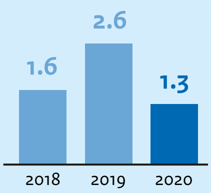
Dutch economic growth is declining due to the ill wind sweeping in from abroad and is driven by domestic spending



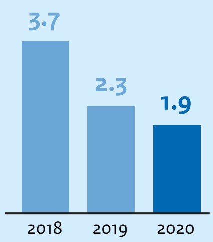
Employment
increase in hours, in %



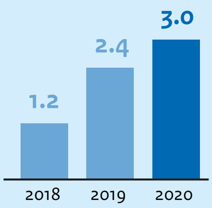
Inflation
HICP, in %



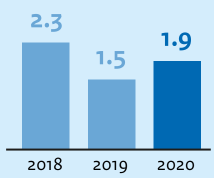
Export
growth in %



Public spending
growth in %



Private consumption
growth in %



Domestic

→ **housing investments** continue to increase, but despite scarcity, they are slowing down

→ growth in **business investments** is slowing down, even though financing costs are low

→ despite the agreement, **pension cuts** remain a real risk in 2020, due to particularly low interest rates

Abroad

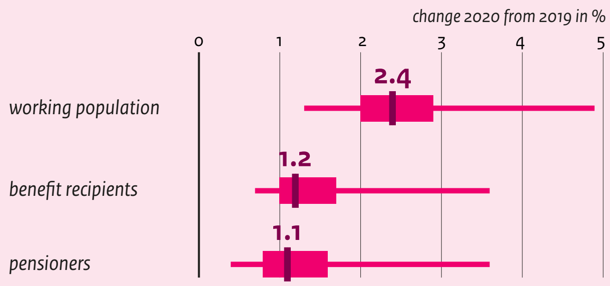
→ trade conflicts — particularly between the US and China — lead to large **policy uncertainties**

→ lower Chinese growth and reduced **budget stimulus in the US** are slowing down the global economy

→ in Europe, there are concerns about **Brexit**, **German industry** and the political situation in **Italy**

Purchasing power

Static purchasing power develops positively in 2020 as a result of policy and real wage increases



Will the lower interest rates provide more money for reform, for instance, by borrowing more? Temporary boosts are an option, but they are not without risks.

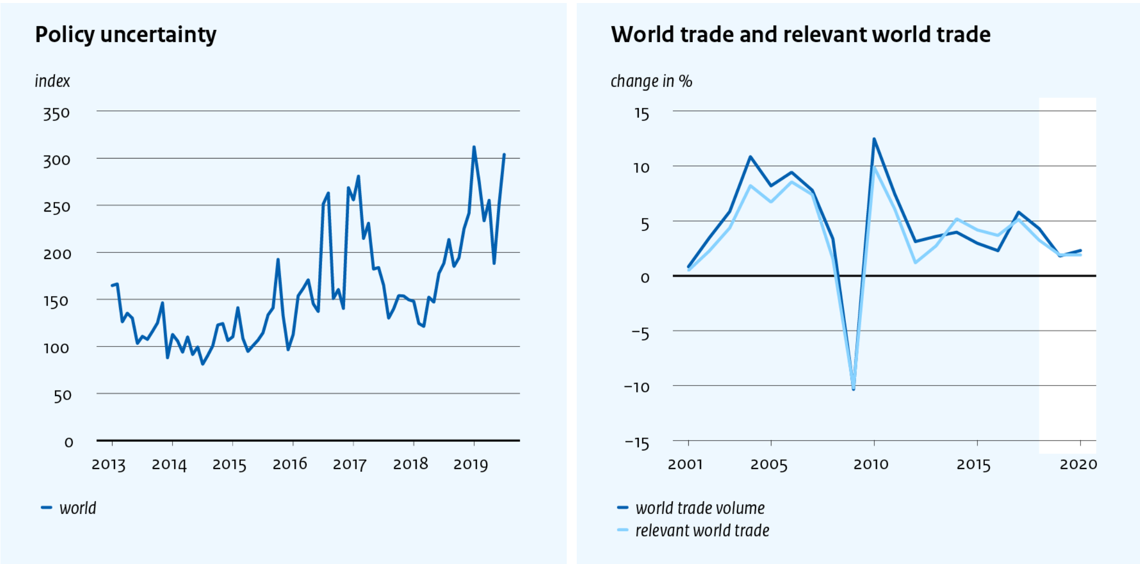
→ **Debt without penalties?** page 12

1 Summary and Analysis

1.1 The economy in 2019 and 2020

The global economy is slowing down due to increased uncertainty as a result of trade tensions. Global GDP growth is declining from 3.6% in 2018 to 3.1% in 2019 and 3.2% in 2020. As the growth in, particularly, import-intensive investments and sustainable consumer goods declines, the weakening of world trade is even more pronounced: from 4.3% in 2018 to 1.8% in 2019 and 2.3% in 2020 (Figure 1.1, on the right). The slowdown in growth is mainly due to trade conflicts, which lead to major policy uncertainties (Figure 1.1, on the left). The approaching Brexit deadline at the end of October also contributes to the uncertainty. In addition, the declining budgetary impact in the United States, the structural weakening of Chinese growth and problems in the German car industry also play a role. The main trade conflict is that between the United States and China. In May, early August and late August, the United States announced higher tariffs on Chinese imports and the Chinese Government subsequently took countermeasures[1]. Based on the currently announced tariffs, nearly 100% of US imports from China will be subject to import tariffs by the end of this year, with an average import tariff of 24%, compared to 3% in 2017[2]. The global slowdown in growth is accompanied by inflation below central banks' objectives. For example, for the eurozone, inflation is projected to be 1.3% by 2020.

Figure 1.1 Major policy uncertainties dampen global trade growth



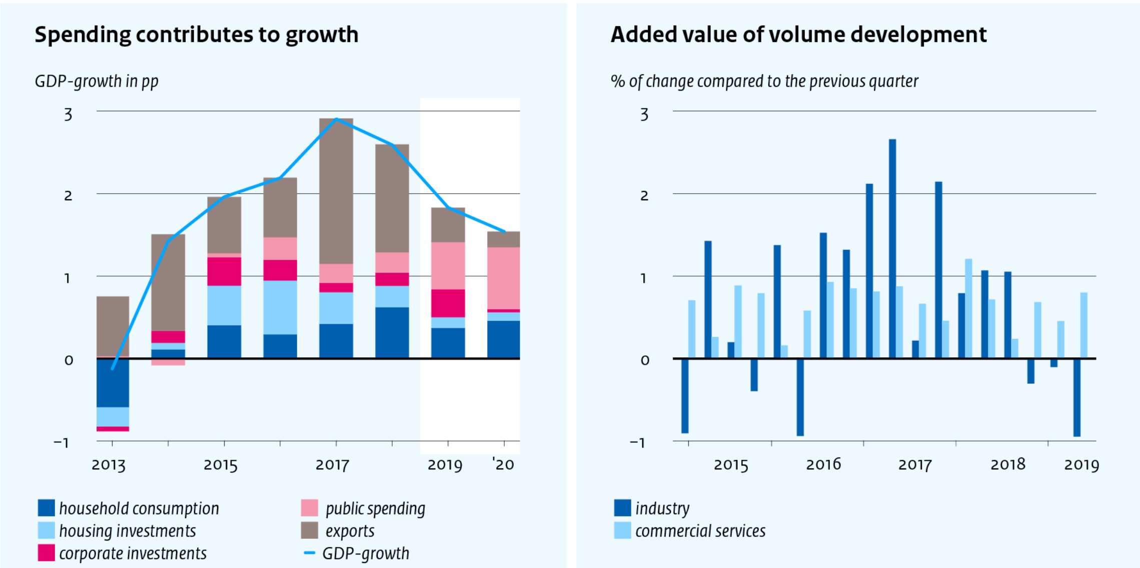
Source: Economic Policy Uncertainty and CPB (link).

[1] The technical projections for exchange rates, oil prices and interest rates are based on data from week 29 (15–19 July). Short-term and long-term interest rate projections are based on market expectations. See Ji, K. and D. Kingma, 2018, Forecasting long-term interest rates, CPB Background Document (link). The oil price is also based on market expectations, while the exchange rates after week 18 have been kept constant in the projections. The pension projections are based on interest rate level and solvency ratio at the end of June, which became available in mid July, Information on the international economy is included up to 5 August, i.e. including the announcement of certain additional US tariffs on imports from China, but excluding those announced by China and the United States on August 23. Information on the Dutch economy is included up to and including 14 August, i.e. including the CBS publication on GDP in the second quarter. The budget measures included in the Budget Memorandum have been included in this estimate. This also applies to the decision-making process at the end of August, which had not yet been included in the CPB's projections of 15 August.
[2] Bown, C.P., 2019, US-China Trade War: The Guns of August, PIIE blog (link).

Economic growth in the Netherlands will decrease to 1.5% in 2020 due to the ill wind sweeping in from abroad. After an annual growth level of at least 2% in each of the previous four years, GDP growth is expected to decrease to 1.8% in 2019 and 1.5% in 2020. The ill wind from abroad as a result of trade tensions will have a negative impact on export growth in the first instance, but also on producer confidence and on business investments, as well. The greater increase in imports than in exports, the developments of the balance of primary income from abroad, and the decline in natural gas exports are leading to a decline in the current account balance from a record level of 11.2% of GDP in 2018 to 8.7% in 2020. The surplus in 2020 is still very large, both historically and internationally. Lower export growth has mainly negative consequences for industry, while continued growth in domestic spending is positive for the services sector (Figure 1.2, on the right).

Domestic spending is responsible for economic growth. The growth in the disposable income of households remains solid, which has a positive impact on consumption (Figure 1.2, on the left). In 2019, disposable income will increase mainly as a result of the strong increase in employment, while next year this will mainly be due to the strong increase in real gross income per employee. The growth in business investments is slowing down, even though financing costs are low. The decline is due to a weaker growth in foreign sales and increased uncertainty. Investments in residential properties continue to grow, but at a slower pace despite the scarcity on the housing market. Measured against the change in the structural budget balance, the budget policy is expansionary. This contributes to economic growth — directly, through higher government spending and indirectly through a reduction in the tax burden.

Figure 1.2 Economic growth slows down due to lower export growth, with consequences mainly for industry

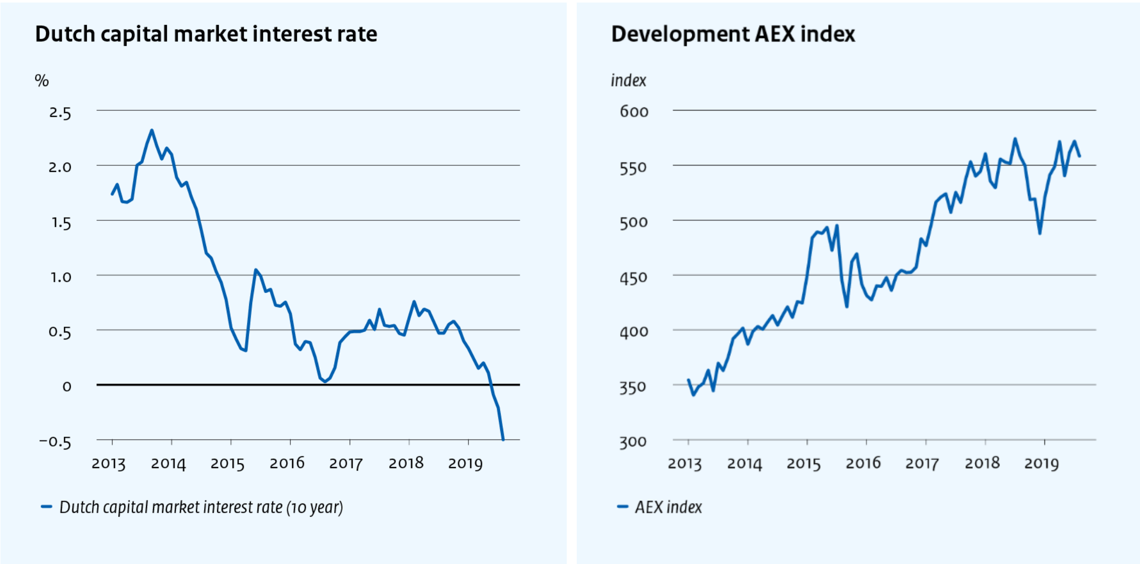


Source: CBS and CPB [(link).]()

The Netherlands continues to outperform the rest of the eurozone. In the second quarter, Dutch GDP increased by 0.5% from that of the previous quarter, compared to only 0.2% in the eurozone. In the previous six years, growth in the Netherlands was either higher than or equal to that of the eurozone as a whole, after slower growth in 2010–2012. For the rest of the current year and in 2020, growth levels in the Netherlands will continue to be higher. This is mainly due to a somewhat more flexible fiscal policy than in the rest of the eurozone, a more favourable development in the housing market, less of a burden related to the problems in the automotive industry, and the fact that Dutch exports are less affected by lower Chinese import growth. At 1.5% in 2020, GDP growth in the Netherlands is 0.3 percentage points higher than in the eurozone.

The situation on financial markets is out of the norm, with negative capital market interest rates. The Dutch capital market interest rate (10-year rate) was projected at 0% for 2020, on the closing date. This is unique; the average capital market interest rate for this century was 3.0%, with a minimum of 0.3% in 2016. Since June, the 10-year interest rate has been negative — with in August an average of -0.5%.[3][4] The interest rate on the Dutch 30-year government bonds has been negative (-0.1%) since August. Real capital market interest rates have been low for some time, consistently negative since 2017, and are on a downward trend. Nominal interest rates are exceptionally low due to the decline in the expected inflation level, potential growth, lower labour productivity growth and an ageing population, while the weak cyclical outlook also plays a role.[5] In addition, the ECB has indicated that it will keep its interest rates at their current low level or reduce them further until it has seen its inflation outlook converge to the inflation target. The low interest rate has a positive effect on investment, benefits the government budget through lower interest costs, and benefits homeowners, but has a direct negative effect on savers and makes insurers and pension funds vulnerable, with consequences for pensioners and contribution payers.[6] Macro-economically, it is also important that low interest rates put pressure on the exchange rate, with a positive effect on exports, and have an upward effect on share prices, with a positive impact on consumption.

Figure 1.3 Capital market interest rates negative since June 2019 at high but volatile stock prices



Source: Refinitiv data stream and Euronext (link).

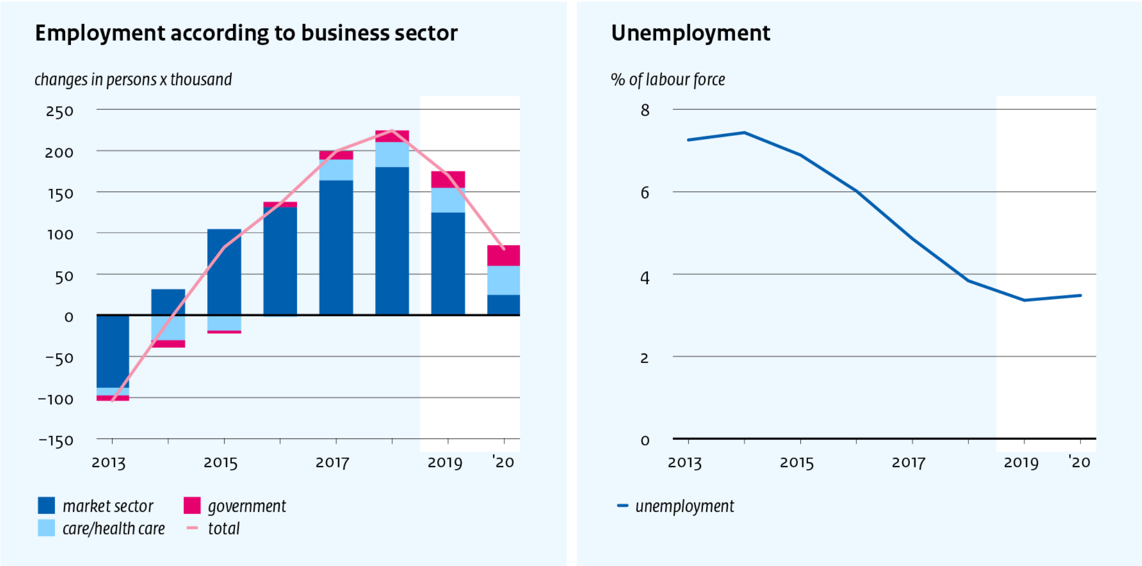
Labour productivity expected to recover next year. Despite lower output growth, the growth in employment at companies will hardly decrease in 2019. However, the lower production growth already seems to be reflected in a decrease in the number of new vacancies. The number of new vacancies fell slightly in the second quarter, after having reached a record level in the first quarter. The combination of weakening production growth and only a limited weakening of employment will even lead to a (marginal) decline in labour productivity in 2019, of 0.1% for companies. Next year, however, employment growth will respond to the continuing weaker output growth and will fall sharply in the corporate sector. For the overall economy, employment growth will decline from 2.1% in 2019 to 0.8% in 2020. As a result, companies' productivity growth will rebound to 0.8% in 2020.

[3] In 2016, the 10-year interest rate was negative for a few days, but monthly averages remained above zero.
[4] This is after the closing date for the interest rate projections. The technical projections of interest rates are based on data for week 29 (15–21 July). For details, see footnote 1.
[5] See Ciocyte, O., S. Muns and M. Lever, 2016, Determinants of long-term interest rates, CPB Background Document (link).
[6] CPB, 2019, Risicorapportage financiële markten 2019 [risk assessment financial markets], CPB Communication (link).

However, this is still below the average of 1.1% per year since 2000 and the average of 1.5% in the 1980s and 1990s.

Unemployment will be at its lowest level in 2019 and will remain low next year. The weakening employment growth under a continued increase in labour supply, means that the steady fall in unemployment has come to an end and unemployment will increase slightly in 2020. Refraining from raising the state pension age in 2020 will have a limited impact on labour supply (10,000 people). After declining from a peak of 7.4% in 2014 to 3.4% in 2019, the unemployment rate is expected to rise to 3.5% in 2020. This is still low from a historical and international perspective and indicates a tight labour market. Since the end of 2017, the tight labour market has also been reflected in a slight increase in the proportion of workers on permanent contracts, especially for the highly educated, after a continuous decline in previous years. As from next year, the development of the employment rate of the self-employed compared to that of employees will be slowed down by the reduction in the deduction for the self-employed. As a result of the flexibilisation of the labour market, the vulnerability of Dutch people to economic fluctuations has increased and the negative consequences of this have been distributed more unevenly.[7]

Figure 1.4 The pace of employment will slacken in 2020; unemployment at its lowest point in 2019 and remaining low in 2020.



Source: CBS and CPB (link).

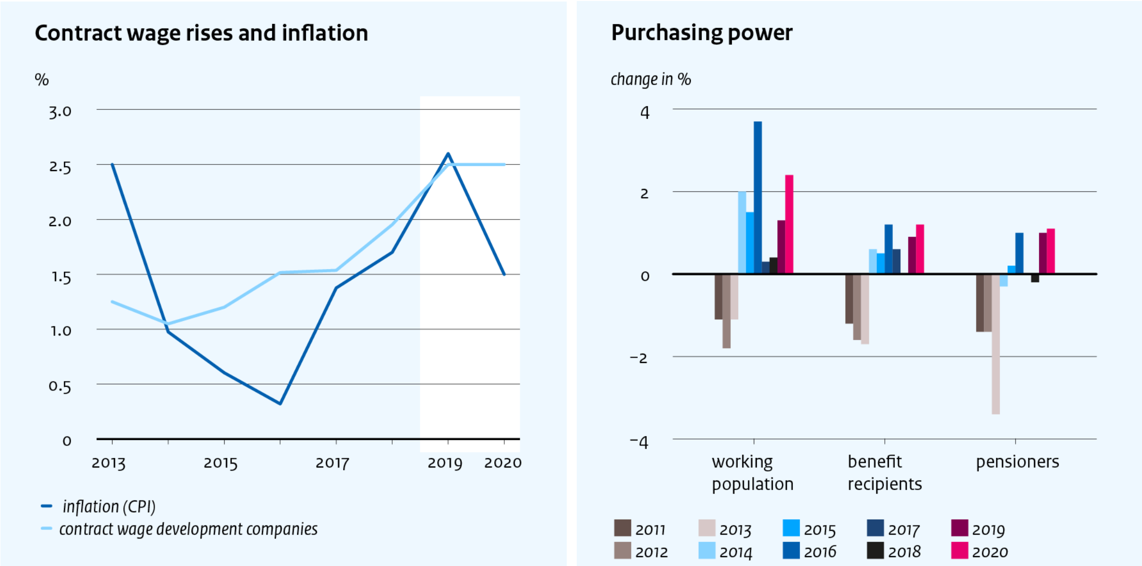
The higher wage increases due to the tight labour market will continue in 2020. As a result of the tight labour market, companies' contract salary increases as expected, from 2.0% in 2018 to 2.5% in 2019 and in 2020. Given the historically very low unemployment rate, this acceleration remains remarkably limited. In addition, real wage growth will continue to be structurally constrained by the low trend growth in labour productivity.[8] As a result of rising wage increases and limited productivity growth, the labour income share for companies will increase from 73.1% in 2018 to 74.9% in 2020.

Even with the pension agreement there will be pension reductions in 2020. Next year, there will hardly be any room for indexation of pensions and pension entitlements. In the event of long-term insufficient coverage, a reduction in pensions is also necessary. As a result of the pension agreement, the coverage level

[7] See CPB, 2019, What goes up, must come down, analysis in Central Economic Plan 2019 (link).
[8] Adema, Y. and I. van Tilburg, 2018, Vertraagde loonontwikkeling in Nederland ontrafeld, CPB Policy Brief 2018/12 (link).

below which this reduction is necessary has been reduced from approximately 104% to 100%. Nevertheless, based on the interest rate level and the solvency ratios of the pension funds at the end of June 2019, there will be a nominal discount in 2020 for a limited number of pension funds. This discount may be spread over 10 years. Since the end of June, capital market interest rates have decreased further. For the related impact, see Text Box 1 'Falling interest rates and stock market prices'.

Figure 1.5 Wages expected to rise more than inflation in 2020; purchasing power increases further for the employed.



Source: CBS and CPB (link).

In 2020, inflation will revert back to the low euro average. The increase in indirect taxes in January 2019 (increase in the low VAT rate, in the energy tax for households and in the ODE tax for businesses) will no longer show up in the inflation figures from January 2020 onwards. Next year, indirect household taxes will be reduced, although this will be offset by increases in indirect taxes for businesses. The fall in energy prices (oil and natural gas) is also having a dampening effect; on the other hand, there is an upward effect due to higher wages and rent increases. Inflation, as measured by the HICP, will be declining from 2.6% in 2019 to 1.3% in 2020 and, thus, is comparable again to that of the eurozone (1.3%).

Static purchasing power will continue to increase in 2020, as a result of policies and rising real wages. Static purchasing power is projected to increase, on average, by 2.1% in 2020, after an increase of 1.2% in 2019 and 0.2% in 2018. Half of the households will experience an increase in purchasing power of between 1.3% and 2.7%. The most important measures to increase purchasing power in 2020 are the adjustments to the labour tax credits and the increase in the general tax credit. The introduction of the two-bracket tax system has varying effects on different groups, and is particularly positive for the highest income groups. The increase in purchasing power is furthermore due to the 1.0% increase in real contract wages.

The strongest increase in purchasing power is seen for middle and high incomes and for the employed, partly as a result of policy choices. The purchasing power developments for these groups will be well above 2% in 2020, with a more than 1% increase in purchasing power for the lowest 20% of incomes, benefit recipients and pensioners. The working population and middle-income earners will benefit from the increase in labour tax credits and general tax credits, while higher incomes will benefit from the introduction of the two-bracket tax system. The 20% lowest incomes, benefit recipients and pensioners also benefit from the increase in the general tax credit, but on the whole are disadvantaged by the introduction of the two-bracket tax system.

Table 1.1 Main data on the Netherlands, 2015–2020

	2015	2016	2017	2018	2019	2020
	mutations per year in %					
International economy						
Relevant world trade volume goods and services	4.2	3.7	5.1	3.2	1.9	1.9
Competitor prices (a)	5.0	-3.0	2.2	0.2	0.9	1.2
Oil price (in USD per barrel)	52.4	43.8	54.3	70.9	64.9	61.3
Euro exchange rate (USD per euro)	1.11	1.11	1.13	1.18	1.13	1.12
Long-term interest rate, the Netherlands (level in %)	0.7	0.3	0.5	0.6	0.1	0.0
Volume GDP and spending						
Gross Domestic Product (GDP, economic growth)	2.0	2.2	2.9	2.6	1.8	1.5
Household consumption	2.0	1.1	2.1	2.3	1.5	1.9
Public consumption	-0.1	1.3	0.9	1.6	2.2	2.9
Investments (including stocks)	29.1	-6.7	4.2	2.2	4.8	2.3
Export of goods and services	7.4	1.7	6.5	3.7	2.3	1.9
Import of goods and services	14.5	-2.0	6.2	3.3	3.1	2.9
Prices, wages and purchasing power						
Price level Gross Domestic Product	0.8	0.5	1.3	2.2	2.5	1.5
Export prices goods and services, excluding energy	1.5	-1.3	1.3	1.0	0.8	1.0
Price levels imported goods	-5.0	-4.5	3.6	2.7	-0.6	0.1
Inflation, Harmonised Index of Consumer Prices (HICP)	0.2	0.1	1.3	1.6	2.6	1.3
Wage rate business sector (per hour)	-0.2	0.7	0.9	1.8	3.1	3.0
Contract wages business sector	1.2	1.5	1.5	2.0	2.5	2.5
Purchasing power, static, median all households	1.0	2.5	0.3	0.2	1.2	2.1
Labour market						
Labour force	0.4	0.4	0.8	1.2	1.4	1.0
Working population	1.0	1.3	2.1	2.3	1.9	0.9
Unemployed labour force (x thousand persons)	614	538	438	350	310	325
Unemployed labour force (in %)	6.9	6.0	4.9	3.8	3.4	3.5
Employment (in hours)	1.0	2.4	2.0	2.2	2.1	0.8
Other						
labour income share (in %)	72.8	73.9	73.3	73.1	74.3	74.9
Labour productivity business sector (per hour)	0.8	-0.2	0.9	0.6	-0.1	0.8
Individual saving share (in % disposable income) (b)	2.8	3.9	3.0	2.8	3.2	4.0
Balance current accounts (in % of GDP)	6.3	8.1	10.8	11.2	9.6	8.7
	in % of GDP					
Public sector						
EMU balance	-2.0	0.0	1.3	1.5	1.2	0.3
EMU debt (ultimo year)	64.6	61.9	56.9	52.4	49.3	47.6
Public financial burden	36.9	38.4	38.6	38.7	39.2	38.8
Gross public spending	45.0	44.0	42.9	42.5	42.3	42.9

(a) Goods and services, excluding natural resources and fuels.
(b) Level; disposable family income includes public savings.

Falling interest rates and share prices

Interest rates and share prices fell in August. Pension cuts are imminent, but the impact on purchasing power is still limited. This text box examines the consequences for pensions and purchasing power if interest rates would fall by 0.5% and stock market prices by 5%.(a)

Approximately half of pensioners will face small pension cuts in 2020. Under the June level of interest rates and share prices, the number of pensioners who will be facing a pension cut is still limited. However, a further drop in interest rates and share prices will cause problems for a number of large pension funds, including APB and PFZW. On average, the solvency ratio is expected to fall by more than 6 points. For ABP and PFZW, this would mean that they would fall below the critical solvency ratio. A cut in pensions is then necessary, so that compliance with the required level of capital (*Vereist Eigen Vermogen (VEV)*) is expected to be achieved within 10 years. The size of the pension cut in 2020 is modest, because the cuts are not expected to take effect until September and because they may be spread over a period of 10 years. This would result in a pension cut of 0.2 to 0.3 percentage points for 2020. In addition, pension premiums will increase by approximately 0.2 percentage points due to the lower term structure of interest rates.

The economic impact is small. Investments will increase due to lower interest rates, and in their wake, employment, consumption and GDP will increase by 0.1%. Inflation and wages will not change. The effect of lower pension payments and higher premiums is not visible at the level of the economy as a whole; consumption levels are increasing rather than decreasing. These effects do not take into account any effect on consumer confidence; if small pension cuts implemented on a large scale have a negative impact on consumer confidence, consumption may decrease and GDP growth may slow down.

As a result of the pension cuts, the purchasing power of pensioners will decrease by 0.1%. This effect is limited by the spread of the cuts and by the fact that almost half of the income of pensioners consists of a state pension. For pensioners with more supplementary pension, the effects are greater, and may reach 0.2%. Employees are affected on two fronts: as a result of the pension cuts, their pension entitlements will shrink in the long term and higher pension premiums will affect their purchasing power in the short term.

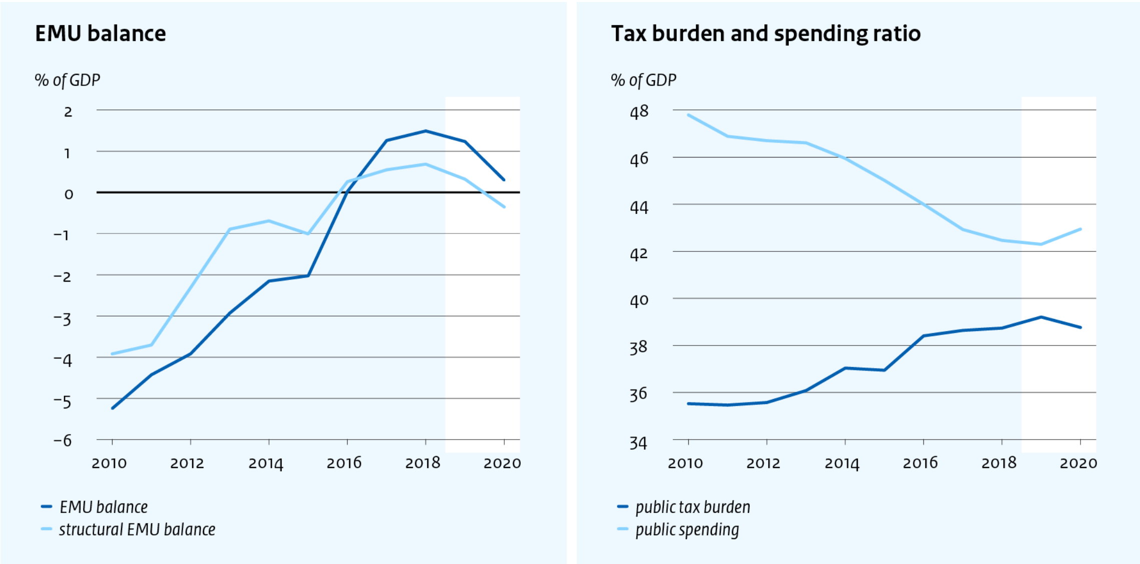
Effects of lower interest rates and share prices

	Deviations in 2020, in %
Contract wage companies	0.0
Consumer price index (CPI)	0.0
GDP, volume	0.1
Household consumption, volume	0.1
Investments, volume	0.7
Werkgelegenheid, gewerkte uren	0,1
Koopkrachtontwikkeling, alle huishoudens, mediaan	-0,1
Koopkrachtontwikkeling, gepensioneerden, mediaan	-0,1

(a) De berekening gaat uit van een 0,5% lagere rente en 5% lagere beurskoersen in de rest van 2019 en in 2020, ten opzichte van de stand waarop de MEV is gebaseerd.

The budget surplus will go down next year, as a result of expansionary policies and weaker economic growth. The budget surplus will be reduced from 1.5% of GDP in 2018 to 1.2% in 2019 and 0.3% in 2020. The structural EMU budget balance will fall to -0.4% of GDP in 2020, as a result of spending increases and a reduction in the financial burden. Denominator effects (nominal increase in GDP) will steadily continue to reduce public debt, despite the somewhat smaller actual surplus level. Public debt is already falling below 50% of GDP this year, i.e. to 49.3% of GDP, after which it will decrease further in 2020 to 47.6%. The government has adjusted the budgetary caps and the income framework. Spending caps have been lowered for 2019 and increased for 2020 to bring them into line with the actual possible pace of additional spending on infrastructure and defence. Furthermore, the cap on spending has been raised, from 2020 onwards, due to the pension agreement and the climate change agreement. Real government spending will increase by 2.4% in 2019 and 3.0% in 2020, outstripping GDP growth. This year, the 4.5 billion euro increase in the financial burden for companies is higher than the 0.6 billion euro alleviation of the financial burden for households, which means that the collective tax burden increases from 38.7% of GDP in 2018 to 39.2% in 2019. Next year, both households and businesses will experience an alleviation of the financial burden of 4.4 billion euros and 0.2 billion euros, respectively. As a result of these alleviations, the collective financial burden will decrease to 38.8% of GDP in 2020.

Figure 1.6 The budget balance will decline in 2020 as a result of weakening economic growth and expansionary policies.



Source: CBS and CPB (link).

The risks to the Dutch economy in these projections are mainly international and downward. The global economy could cool down even further than estimated in the central projections, due to US trade policy and its consequences, the Brexit, political developments in Italy and tensions in the Middle East. It is possible that the United States will introduce an additional tariff on imports of Japanese and European cars later this year. The European Commission has already indicated that it will come up with countermeasures. A chaotic Brexit at the end of October will mainly affect the British economy, but is also expected to have a negative impact on the Netherlands and the eurozone as a whole. The political situation in Italy is fragile and drafting a budget for 2020 will be difficult, with possible negative repercussions on the financial markets and for Italian economic growth. Increasing tensions around Iran could have a detrimental effect on the world economy and, thus, also on the Netherlands through higher oil prices. The ability of central banks, including the ECB, to reduce further growth deceleration is limited and not very effective in terms of inflation and economic growth. In addition, in certain parts of the eurozone, due to high public debt levels, the possibilities for more expansive budget policy are also limited, although the current ultra-low interest rate is dampening the debt effect. A different type of risk is related to the possible introduction of a digital currency by Facebook. The payments market in 2020 will enter exciting times when Facebook, together with various partners, introduces such a currency. Such financial initiatives may involve considerable risks that need to be addressed in a timely fashion and in an international context.

Domestic risks concern the housing market, the pension sector and the labour market. The timing and magnitude of a turnaround on the housing market after a period of strong price increases is difficult to estimate, but may have a significant economic impact through consumption and investment. The impact of the nitrogen decision by the Dutch Council of State[9] on investments in housing and infrastructure could be more rapid and thus greater than the limited impact currently included in the 2020 projections. The impact of the global slowdown on the Dutch services sector, so far, has been limited, but could be more significant next year than currently estimated. The impact of the labour market on wage increases has been not easy to predict in recent years; for next year, there are both upward and downward risks with delayed impact on consumption and economic growth. A continuation or tightening of the recent fall in capital market interest rates could lead to pension cuts being more substantial next year (see also Text Box 1 'Falling interest rates and share prices'), with a negative impact on consumption.

[9] Dutch Council of State, 2019, PAS may not be used as a basis for approval of certain activities, press release (link).

1.2 Debt without penalties?

Will low interest rates mean more money for the government? There is plenty to wish for, but money does not grow on trees. Zero debt is not the best debt, but borrowing is only successful if lenders believe that you will be able to repay your debt. The government — that lives forever — can achieve more in this respect than ordinary citizens, but here too the financial scope is not unlimited. Before the capital markets close down tight, high debts take their toll. Although academic scholars do not agree on the exact level at which growth will start to stall, sky-high debt ultimately leads to higher risk premiums in interest rates and to lower preparedness to invest. In addition, it is also wise for the government to create a buffer in the event of a downturn, to avoid having to cut spending if the economic situation changes; and to be able to carry out financial rescue operations in times of acute crisis. Moreover, if the various generations are to be treated equally, population ageing also needs to be taken into account; what today appears to be easy to finance can become rather difficult once more people become ready to 'enjoy' health care and state pensions than there are younger people paying taxes to provide the required revenues. Within the EU, fiscal rules have been made which all parties should adhere to, and one must, of course, set a good example. These are all well-known considerations and constraints to keep public finances healthy, but they originate from other times.[10] What happens when we go back to our times — the era of unprecedented low interest rates?

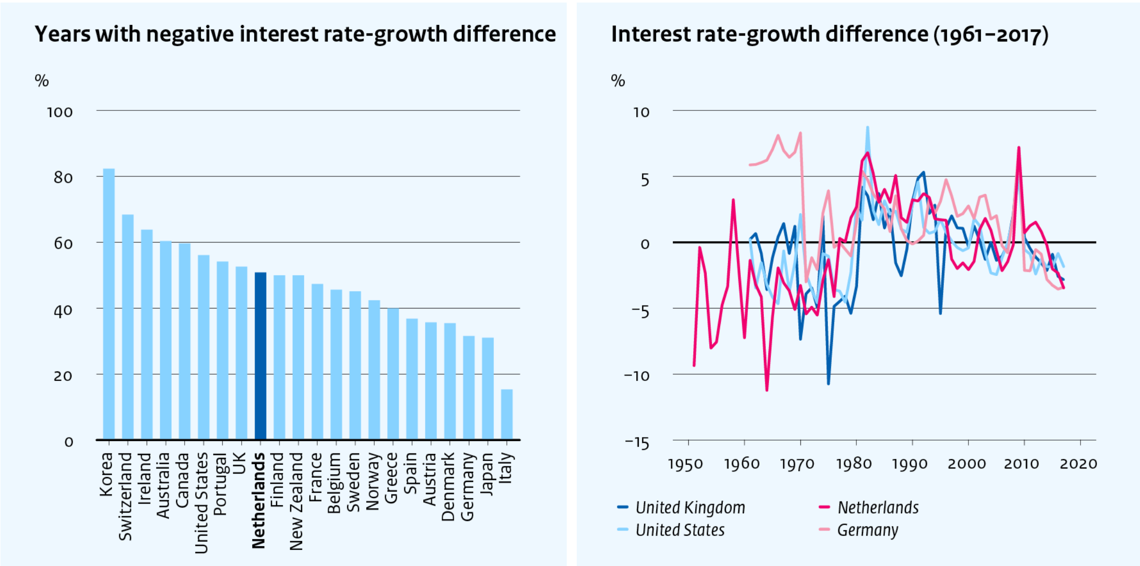
In a much quoted speech, Blanchard suggested that the welfare costs of high debt could be more manageable now that interest rates are low.[11] A well-known accounting law teaches us that a public debt does not explode as long as the interest rate is lower than economic growth (and the primary deficit is small enough to ignore it); if you postpone the interest payments, the debt will increase by less than the growth in GDP. And, according to Blanchard, interest rates had recently fallen below the growth rate in the United States and that was historically the rule rather than the exception.[12] The risk of crowding out private investment may therefore be smaller than expected for some countries; with a boost now, prosperity may be able to reach a higher level in the future. And as monetary policy reaches its limits and many countries struggle to bring public finances back to pre-crisis levels, additional scope to stabilise the economy is very welcome. And there is more room for productive investments. A disruptive and refreshing new perspective.

As always, the facts are nuanced and rapid conclusions are risky; countries are not all the same, and one year is not like another, nor is the primary deficit always negligible. A simple data analysis for the years 1961–2017 shows that Blanchard's seductive idea for Europe cannot be applied in a straightforward manner.[13] For example, the average difference between interest rate increases for the 22 largest OECD countries in this period was not negative, but positive: 0.2%. The average for the EU Member States was 0.9%, but for the Netherlands -0.6% (and -0.8% for the period 1951–2017).[14] Looking beyond the averages, one can see that in about half of the years between 1961 and 2017 the difference is negative. Observations with a negative difference between interest rates and growth represent 49.7% of the sample (Figure 1.7, on the left).[15] In 51% of the years 1961–2071, there is a negative difference in the Netherlands (66% for the years 1951–2017), but for a country like Germany this percentage is much lower. In addition, the sign of the interest rates and growth

[10] Suyker, W., 2016, Opties voor begrotingsbeleid [options for budget policy], CPB Policy Brief 2016/02 (link).
[11] Blanchard, O., 2019, Public debt and low interest rates, *American Economic Review*, vol. 109(4): 1197–1229 (link).
[12] For his calculations, Blanchard uses ten-year interest rate, corrected for tax revenues from paid interest rates; Blanchard subtracts this from the interest rate. This increases the frequency of negative interest rate-growth differences.
[13] Data availability for multiple countries is leading for choices made over the period 1961–2017.
[14] OECD research from the 1990s concludes that the interest rate-growth difference is probably positive for the medium term and long term, see Blanchard, O., J.C. Chouraqui, R. Hagemann and N. Sartor, 1990, The Sustainability of Fiscal Policy: New Answers to an Old Question, Economic Studies 15 (link). New empirical analysis already leans more towards a possibly negative interest rate-growth difference, but does not rule out a positive difference for the long term, see Barret, P., 2018, Interest-growth differentials and debt limits in advanced economies, IMF Working Paper WP/18/82 (link).
[15] This analysis is in line with results from Wyplosz, see Wyplosz, C, 2019, Olivier in wonderland, VoxEU (link).

differential over time fluctuated, considerably (see Figure 1.7, on the right), with alternating periods of positive and negative scores.[16] In addition to the relationship between interest rates and growth, the other debt increases (the primary balance) are also relevant for the dynamics of debt.[17] Although debts decrease more often (67.8% of the time) than increase if the difference between interest rates and growth is negative, this is certainly not always the case. If the balance is positive, debts increase more often (68.0% of the time). Figure 1.8 on the left compares the estimated primary balance with the estimated public debt for 2019. For a large number of countries, we see a significant primary deficit in combination with a high level of public debt, which indicates that these countries are not immediately ready to be more relaxed about taking on additional debt.

Figure 1.7 Share of years with negative interest rate growth differential, and that for the Netherlands, Germany, United Kingdom, United States, 1961–2017



NB: r is the 10-year interest rate.
Source: World Bank, OECD (link).

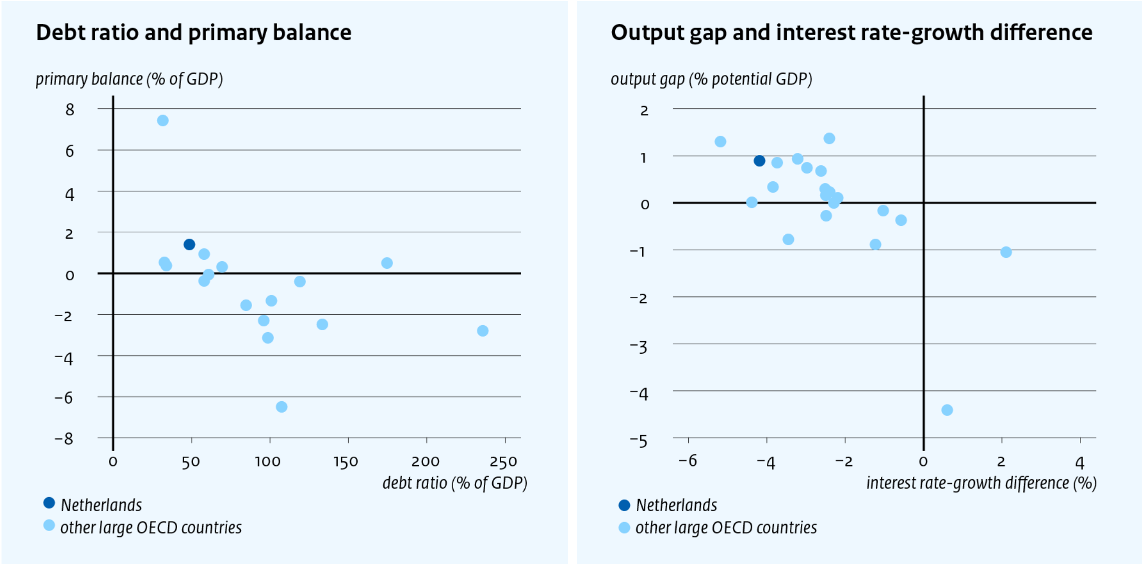
If you engage in additional spending or tax cuts in years with negative interest rate growth differential, then pro-cyclical policy is not inconceivable. Figure 1.8 on the right shows the estimated output gap against the estimated difference for 2019. For most countries, we see that the current negative difference is accompanied by a positive output gap.[18] That suggests that spending a large amount of money now could have a procyclical effect. But there is, of course, no need or obligation to implement this policy on an annual basis. In fact, estimating the economic situation is difficult, implementation takes time.[19] In other words, good reasons for medium-term policies with automatic stabilisers rather than active budget policies.

Traditionally, the Netherlands has opted for a structural focus, with a view to the future. Debt is entered into for a longer period of time. This does not mean looking blindly at today's figures, but thinking about

[16] For example, the interest rate–growth difference in the 1980–2017 period came to 1.3% for the Netherlands.
[17] Source: World Bank, OECD. Wyplosz, C, 2019, Olivier in wonderland, VoxEU (link) contains a similar table.
Cochrane, J, 2019, The value of government debt, NBER Working Paper 26090 (link) shows that part of the variation in debt ratio is ex ante linked with the variation in the discount rate. It does not find a connection ex post.
[18] The ECB has a similar analysis, see Checherita-Westphal, Interest rate growth differential and government debt dynamics, ECB Economic Bulletin, Issue 2/2019 (link).
[19] See Hers, J. and W. Suyker, 2014, Structural balance: a love at first sight turned sour, CPB Policy Brief 2014/07 (link).

what the world may look like in the long term and what that would means in terms of the here and now. Projections are difficult, especially when it comes to the future, but we are not completely naive.[20]

Figure 1.8 Relationship between debt ratio and primary balance in 2019 (left) and interest rate growth differential and output gap in 2019 (right)



Source: IMF World Economic Outlook database, OECD, AMECO (link).

For example, we know that the Netherlands is ageing and that this is putting pressure on the primary balance and the debt. The ageing of the population is already making itself felt and the size of this cohort of the population can be predicted relatively well. Provisions such as pensions and care offer the prospect of a dignified old age, but they do have to be paid for. The ratio between active and inactive citizens is becoming more unfavourable for this purpose. Looking only at interest rates and growth figures presents a short-sighted picture.

A prudent outlook also takes into account the systematic risk in an economy and therefore uses a risk-weighted discount rate.[21] For example, the tax base is not a stable factor, but rather depends on the economy, the capital markets and the mobility of the tax base. The economy is growing thanks to education, innovation, risk-taking and entrepreneurship — typical activities that involve uncertainty and ups and downs. Some of the future taxes in the Netherlands also depend on the return on pension capital. Pensions are only taxed with income tax when they are being paid out, and VAT and excise duties are levied when this income is consumed. CPB's calculations related to ageing explicitly take these uncertainties into account by using a higher discount rate for future budget flows than that of the risk-free interest rate. The risk-weighted discount rate is also decreasing, but for now remains higher than the growth rate.[22] Only glancing at the risk-free interest rate would mean you would be skirting around the problem of the uncertain future.

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[20] This quote is attributed to many people, yet the person who coined the phrase remains unknown (link).
[21] Working group on discount rates 2015 (link).
[22] The ageing study will include an update of the relevant risk-weighted discount rate and growth rate. The discount rate is determined by the wealth and debt of Dutch households, see the the methodology of the Working Group on Discount Rate, 2015, (link). Based on the estimated yields by the Commission Parameters, 2019, (link) and other current data suggest a risk-weighted discount rate larger than the growth rate.

So, what would be the solution? Subtle facts do not lend themselves to drawing dazzling conclusions. Finding the right viewpoint is difficult. The ageing calculations at the time of the Coalition Agreement showed a certain deficit and there is no reason for optimism with respect to the December update.[23] A lower discount rate may make it easier to find a project with a positive cost-benefit analysis (CBA).[24] Unfortunately, a lower discount rate also means it is more difficult to make public finances sustainable, as the return on the piggy bank for later (for the costs related to ageing) will be lower. And an investment that increases the productivity of the economy leads to larger financial resources in the future, but also, counterintuitively, to a deterioration of sustainability. [25] Many public expenditures are linked to growth or wages, resulting in higher productivity leading to more public spending, higher health care costs, higher wages and higher indexation of the state pension. Passing this larger financial resource on to a growing population cohort of elderly people is therefore more expensive.

At the same time, the current nominal interest rate is low or even negative, partly due to low risk premiums on government bonds, and the markets think that this will continue to be the case for some time to come. The reputation of the budget hawk is paying off. The Dutch debt (49.3% of GDP this year and 47.6% next year) is relatively low, whether you look at EU regulations or the desired buffer in case of crisis. Irrespective of whether analyses show that the Netherlands is more sensitive to shocks than an average economy, we can handle it.[26] Internationally as well, for years, the Netherlands has had a substantial surplus on its current account. The European fiscal rules contain arrangements for financing the transition costs in the event of a structural reform. Opting for incidental budget entries means the primary balance will not be subject to a structural burden.[27] And if these temporary plans are funded via long-term financing, the current interest rate can be fixed for a considerable period of time. A deviation from the Musgrave criterion of equal arrangements for future generations — the standard in the calculation on ageing — is ultimately a political choice, in certain forms (productivity, environment) perhaps less vulnerable to generational debate than in others.

A route of temporary impulses is not without risk. Capital markets do not believe in fairy tales, and voters are not fooled: there is no such thing as free money. There are risks involved in investing, and this applies to the government as well as to the business community. In addition, the government can often only partially turn the proceeds of profitable public investments into ready cash for the budget. Furthermore, nothing is as permanent as a temporary measure. The United States has many temporary tax reductions that are continued indefinitely, and the Netherlands is not lily white on this point either.[28] The problem of perpetual temporariness is, of course, less acute in the case of measures that have an intrinsic end. Certain parts of the energy and climate transition may meet these requirements. Experience has also shown that the distinction between intensification and investment — at first so clearly visible — fades over time. Fiscal rules and funds may offer protection against this type of temptations, but the more sophisticated the rules, the more difficult compliance appears to be. The road to hell is paved with good intentions 😉.

[23] See CPB, 2019, *AOW variant en Arbeidsaanbod*, CPB Communication, 5 June 2019 (link). This states: 'From the presented partial effects no conclusion can be drawn about the size and direction of the adjustment of the sustainable balance later this year. It is expected that certain other developments, such as in health care, will have an opposite and possibly larger impact of the sustainable balance.' The positive effects indicated in the partial analysis have since largely been implemented.
[24] The discount rate is weighted against the capital shares of the relevant portfolio and, therefore, is not identical for CBAs or studies on population ageing.
[25] See CPB, 2014, Minder zorg om vergrijzing [Fewer worries about population ageing], CPB Book 12 (link). Particularly, see Section 5.2.2.
[26] See the Budget Memorandum 2019, Appendix 18, Schokproef overheidsfinanciën 2019 [shock-proof public financing] (link).
[27] And hardly the long term sustainability of public finances..
[28] The temporary IOW has been extended multiple times, the reduction in health insurance subsidy postponed each time. The temporary lowering of VAT for labour-intensive services has become structural.