Dutch government presents mildly expansionary budget for 2019

The cabinet decided to spend more on education, defence, security and health care, while raising the corporate income tax base. Unexpectedly, households also face a net increase in taxes, mainly driven by a higher VAT-rate and health care premiums

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Higher spending, but surplus remains

On the third Tuesday of September, the third Rutte government experienced its first annual budget memorandum day, presenting the government plans and budget for 2019. The budget shows that the government will spend EUR295 billion in 2019 (36% of GDP) and expects EUR305 billion (almost 38% of GDP) of revenues. Due to economic tailwinds, the government is receiving more revenues, but at the same time has decided upon extra discretionary spending (among other things on education, defence, security and health care) and a reduction in some taxes (such as on labour). The budget surplus will amount to 1.0% of GDP.

Higher taxes for both households and businesses

Policy-driven taxes for households will increase in 2019 by EUR0.8 billion (0.1% of GDP), while businesses will have to swallow EUR4.4 billion (0.5% of GDP) of extra tax measures. For households, a VAT-hike, higher energy taxes and increasing health care premiums are not fully compensated by lower labour - and income taxes (which are part of a shift towards a two-tariff-system). Businesses face lower corporate income tax rates, but due to a broadening of the tax base will face a higher corporate tax bill. Businesses will also pay higher social security premiums and also pay part of the higher energy tax bill.

Economy keeps growing above potential, but is not strongly overheating yet

CPB Netherlands Bureau of Economic Policy Analysis published its new macro-economic projections also on budget memorandum day, still painting a rosy outlook yet pointing at downside risks such as a hard Brexit. While the economy keeps cruising at a considerable speed, the degree of overheating is still limited. CPB-projections confirm the picture of our own ING forecasts (2.8% in 2018, 2.5% in 2019).

Public finances in the long run almost in balance, despite expansionary budget

At the same time, the budget for 2019 cannot be considered as strongly expansionary. This can be concluded by the deterioration of the structural budget balance of 0.2% GDP in 2018 to -0.4% GDP in 2019. This structural balance corrects for the business cycle.

For a more fundamental view on public finances in the long run, one, however, should review the sustainability balance, rather than judge the fiscal balance in one specific year. This sustainability balance is close to neutral (-0.4% GDP), as was calculated by CPB Netherlands Bureau of Economic Policy Analysis shortly after the release of the medium-term coalition agreement in 2017. The 2019 budget has most likely not changed that judgement significantly. The reduction of gas production is estimated to have a minor negative effect on the sustainability balance.

Economic growth will provide more space for wage increases

In line with the continuing growth in the economy, the labour market is becoming tighter and tighter. One in four businesses is currently reporting a lack of workers as a factor limiting production. This has already contributed to some higher wage growth earlier this year and further labour market pressure will result in even higher wage growth next year.

The solid GDP growth number of 2.6% expected in 2019, however, doesn't mean that profits for businesses are massive. Profits have admittedly risen, but not much faster than economic growth. CPB Netherlands Bureau of Economic Policy Analysis forecasts productivity growth of 1.2% for non-financial businesses and an accompanying price increase (of the value added deflator) of 2.0%. This summed up is often considered as a proxy to give space for wages to increase. So the total estimated room for wages to rise in 2019 is 3.2%. This is lower than the 5% wage offer increase the largest trade union has put on the table. CPB projects a wage growth of 4.0% for 2019.

Give that profit margins (as estimated by the gross operating surplus as a share in value added) of non-financial businesses have not caught up to the levels of the previous boom, it seems that there is not much more space for much higher wage increases than 3.2%. A much stronger wage increase may slow down economic growth, by discouraging further investment. Compared to 2017 and 2018 the wage increase is a significant improvement for workers. The stronger wage growth contributes to the fact that 95% of households will see an increase in real disposable income.

Investment and eliciting extra working hours can raise growth potential

Due to ageing, a larger share of economic growth will originate from productivity growth. It is a challenge for the Dutch economy to boost labour supply on top of that. Admittedly many Dutch citizens are participating in the labour market, but in average hours worked per worker the Netherlands is clearly not an international front-runner. Facilitating longer working hours for the approximately 400,000 part-timers who would like to work longer can mitigate the increasing tightness of the labour market and raise growth potential. In this view, it is favourable that the budget for 2019 contains some productivity-enhancing investments, such as extra spending on education, research & development and infrastructure.

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