

Dutch Macro Perspectives

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Budget battles: when the coalition's wish list meets reality

- The Netherlands Bureau for Economic Policy Analysis (CPB) released their economic and fiscal forecasts on the 26th of February, marking the beginning of discussions on the 'Voorjaarsnota', or Spring Budget, which encompasses the government's budgetary negotiations
- Recent weeks have witnessed intense debates in Parliament, during which it became clear that the coalition parties have differing viewpoints on important subjects
- The coalition is faced with significant challenges and choices, such as increasing defence spending, reducing nitrogen pollution, and expanding the electricity grid
- The four coalition parties also have various wishes that will come on top of these issues
- Although the estimated deficit has been revised, the 'musts' and 'wishes' appear to be structurally larger than there is room in the budget to accommodate them, which could lead to challenging discussions and decisions of the coalition
- In recent years, the CPB's estimate has been too pessimistic on the public finances and the method of estimation is currently being evaluated
- In anticipation of the results of this evaluation, two of the four coalition parties have proposed to already to take into account another year of overly pessimistic estimates into the budgets negotiations for this year
- However, the VVD is not in favour of this, which means that this subject may also lead to friction within the coalition
- The outcome of the Spring Budget negotiations as well as the expected higher defence spending will also have an impact on the DSTA's funding need
- Although we do not expect this to lead to an increase in the funding need this year, but it may do so in the coming years

Introduction

Generally, the Dutch government finances are in good shape. The estimated deficit for this and next year has recently been [revised down](#) by the Netherlands Bureau for Economic Policy Analysis (CPB). This is appears to be good news for the cabinet, which has now begun negotiations on the Spring Budget. The cabinet, which was formed with great difficulty and where relationships and differences of opinion on many subjects vary widely, still has many challenges and costly wishes. In addition, the geopolitical landscape has changed considerably in recent weeks, which means that defence spending in particular is expected to increase in the coming years. The negotiations are expected to be difficult, with the risk looming that the coalition will not reach an agreement and the government will be forced to resign.

In this note, we discuss the various factors relating to the Spring Budget negotiations, as well as the potential consequences this has on the Dutch state's announced funding need for 2025.

Negotiations for Spring Budget kicked off

The Netherlands Bureau for Economic Policy Analysis (CPB) released their economic and fiscal forecasts on the 26th of February, marking the beginning of discussions on the ‘Voorjaarsnota’, or Spring Budget, which encompasses the government’s budgetary negotiations. The revised budget is scheduled for completion by April 11th.

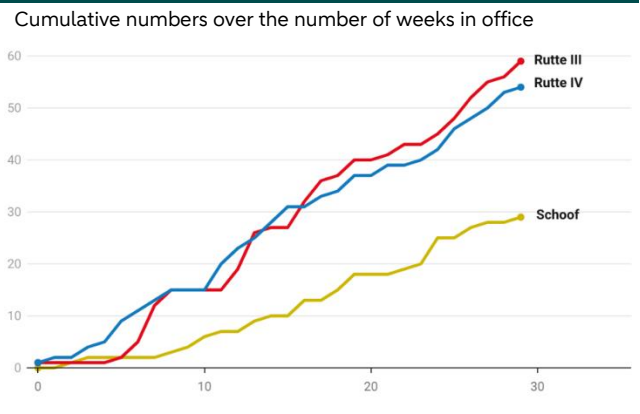
After an extended coalition formation process, the new cabinet, led by Prime Minister Schoof, assumed office on July 2, 2024. Since then, the cabinet has taken tentative steps, reflecting the diverse policy ambitions within the coalition. It has been less proactive than its predecessors and often delayed key decisions, as illustrated in the left chart below.

Recent weeks have witnessed intense debates over issues such as migration and nitrogen pollution. While the coalition has managed to withstand these challenges, the upcoming budgetary discussions are anticipated to be critical and could pose significant obstacles. With the possibility of new elections on the horizon, coalition parties might be inclined to focus on certain policies to appeal to their current and potential voter base.

The coalition faces significant challenges and choices. For example, recent remarks by President Trump [indicate](#) a reduced US commitment to NATO, compelling European nations to significantly increase their defence spending. Furthermore, Trump’s decision to suspend military aid to Ukraine has prompted the EU to boost its defence expenditure in support of Ukraine. There seems to be a broad majority in the coalition to maintain and even expand support for Ukraine, and to increase the defence budget following a debate last week in parliament. Prime minister Schoof has [announced](#) a support package of EUR 3.5bn to Ukraine, which sparked [discussions](#) in the coalition as Geert Wilders’ PVV has been particularly critical of the decision to continue supporting Ukraine unabated. However, and in contrast to other European countries, no additional concrete plans have yet been presented to increase defence spending in the short and long term. The Dutch defence budget for 2025 is EUR 22bn, which is just under the NATO guideline of 2% of GDP. If this budget is increased to 3.5% of GDP, the defence budget will rise to EUR 41bn, an increase of almost EUR 20bn compared to the current budget. At this moment, we expect that these expenditures will be structural and will lead to a gradual increase in the deficit and the debt-to-GDP ratio in the coming years. We have previously published two notes in which we discuss this in more detail (see [here](#) and [here](#)). However, we expect the budget to increase gradually, especially from next year onwards.

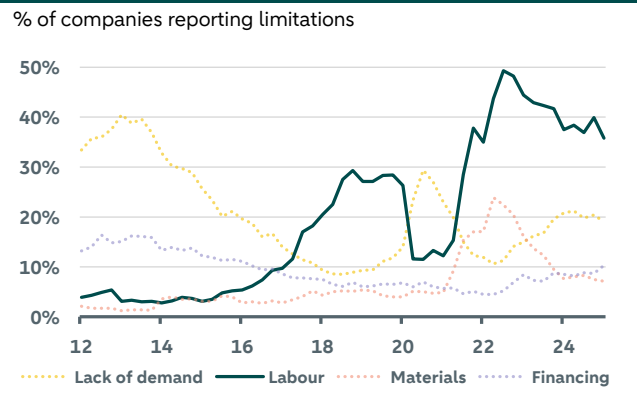
Additionally, other areas that need increased funding include the expansion of the electricity grid to meet climate objectives and the reduction of nitrogen pollution to achieve the established environmental targets.

Legislative preparations since taking office



Source: De Groene Amsterdammer

Labour market tightness risks underspending



Source: CBS, ABN AMRO Group Economics

Musts and wishes vs the budget

The cabinet is confronted with a range of ‘musts’ that need to be addressed in the budget, including the significant challenges mentioned above. For 2025, additional financial hurdles [include](#) finding compensation for eliminating the originally planned tax increase on sports and culture, which approximately cost EUR 1.3bn a year, a one-off loss from the tax on savings and investment (so-called box 3) estimated at EUR 2.6bn, an extra EUR 700mn EU contribution due to stronger-than-expected economic growth, and reversing planned cuts in the healthcare sector.

There are also various wishes from the four coalition parties, such as reducing tax on groceries (PVV), increasing childcare support (VVD), increasing funding for disabled individuals (NSC), and extra investments in housing construction (BBB). Reaching consensus on these matters could prove challenging.

The CPB has revised its estimated deficit for 2025, from -2.5% to -1.8% of GDP, largely due to stronger expected growth of the Dutch economy. Communication by the coalition members seems to imply that this translates to an additional EUR 8bn available for spending in 2025. However, it is [important to note](#) what the coalition intends to do in case of under- or overspending. The coalition is committed to adhering to the Stability and Growth Pact limits, cutting spending if the anticipated deficit exceeds 3%. This ‘spending brake’ contradicts with the traditional Dutch budget principles, which advocate for a separation between spending and revenue, even in the case of financial setbacks. Therefore, if the coalition wishes to increase spending for 2025 due to this windfall, they need to find agreement on this matter first.

Would this all be feasible?

The current budget negotiations are conducted based on the CPB projections. However, as illustrated in the left graph below, the CPB’s projections have been overly pessimistic in recent years. This has led NSC and BBB to initiate an investigation into the accuracy of the CPB’s financial estimates, with the results expected in mid-March. The spring forecast, in which the CPB indicates that it expects a lower deficit for 2025 and 2026, includes an analysis explaining why past estimated deficits were larger than actual deficits. It states that GDP from 2021 has been underestimated due to a faster than expected recovery of economic activity after the Covid-19 crisis and subsequently the inflation shock as a result of the energy crisis. Because economic activity has been greater than estimated, tax revenues have risen proportionally, while this was less the case for expenditures as budgets were based on the original estimates. Additionally, the tight labour market prevented the government from utilizing all allocated funds, so called underspending, resulting in budget postponements to the future (see right graph above).

CPB forecasts are still subject to contextual changes, such as Trump’s tariff threats. Their current forecasts do not consider the possibility of a 25% tariff on the EU, Mexico, and Canada, which [could potentially lead to](#) a -1.6pp effect on GDP over the next two years, which would further constrain the available budget.

The Dutch state's public finances are currently strong, with limited budget deficits over the past two years and a debt ratio of around 40% of GDP, well below the 60% benchmark. Nonetheless, the outlook for public finances suggests further deterioration, with higher budget deficits and an increasing debt ratio. For long-term fiscal sustainability, the Budgetary Framework Study Group (‘Studiegroep Begrotingsruimte’) recommends reducing the structural budget deficit to 2% of GDP, which requires improving the revenue and expenditure balance¹.

Overall, the ‘musts’ and ‘wishes’ appear to be structurally larger than there is room in the budget to accommodate them, which could lead to challenging discussions and decisions of the coalition.

¹ The [Studiegroep Begrotingsruimte](#) has published its advice in December 2023.

Economy under capacity constraints

The budget deficits are happening against the backdrop of an economy that performs [close to its capacity limits](#), with a historically tight labour market. This has important implications. As in the last few years, the risk of underspending remains high. Especially in labour intensive areas such as police. Moreover, compared to many other eurozone countries (Germany being the exception given the new government's plans) the Dutch government is pursuing an expansionary fiscal policy stance, while the general trend is contractionary. The government adds directly to growth via consumption and investments, for instance in the areas of defence and infrastructure, but also indirectly via purchasing power support. These factors have contributed to higher inflation in the Netherlands compared to other countries in the eurozone.

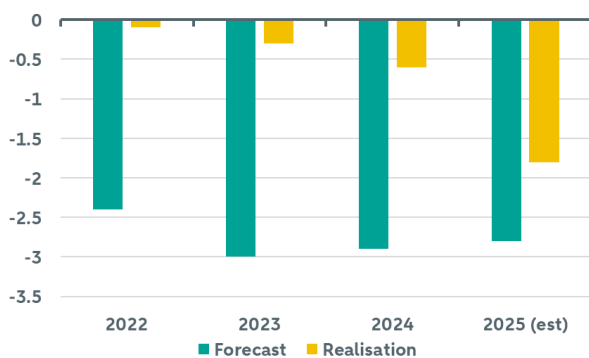
[On the longer term](#) the growth potential of the Dutch economy is under pressure, amongst others due to the [greying labour force](#). This context is also important for the type of choices that the government makes in where to spend their funds. Is it improving structural growth or does it have a short-term focus?

DSTA funding need

The CPB forecasts are also used by the Dutch State Treasury Agency (DSTA) to determine funding need. Based on this forecast, the DSTA announces in December of each year how much it intends to borrow on the capital and money markets. When determining the financing requirement for the coming year, the DSTA does not want to deviate from the announced call on the capital market during the year because it uses predictability and consistency of the issuance policy as core values. This makes it important that the forecasts of the expected budget deficit are reliable.

Budget projections tend to be too pessimistic

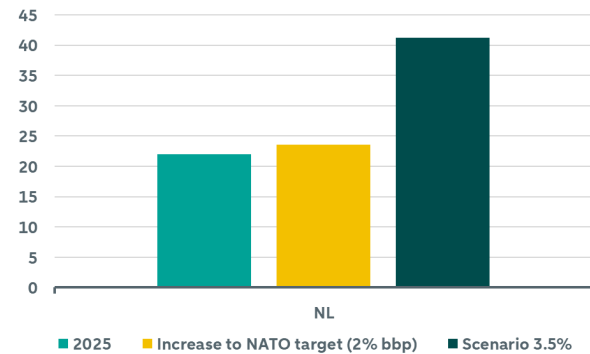
Budget deficit in % of GDP



Source: DSTA, CPB, ABN AMRO Group Economics

Defence spending will increase significantly

Defence budget in EUR bn



Source: Ministry of Defence, ABN AMRO Group Economics

The funding need for this year is also expected to be lower than the figure announced by the DSTA at the end of December. The DSTA is currently still assuming that the total funding need will amount to EUR 106bn, of which EUR 40bn will be financed by issuing DSLs. However, during the Outlook event in December, the DSTA itself indicated that the funding need is expected to be lower and that this will result in a lower call on the money market. The DSTA could already adjust the funding need downwards with the publication of the Quarterly Outlook at the end of March, but any adjustment may not take place until May after the Spring Budget has been adopted.

As described earlier in this note, the CPB has also indicated that the risks to the Dutch economy have increased. The CPB forecast does not include the potential US import tariffs, however, the likelihood that the US will impose a 25% tariff on EU goods has increased. In addition, the geopolitical situation changed considerably in recent weeks, which means that EU countries are expected to rapidly increase their defence spending. Although both will result in a higher budget deficit, the question is whether this will happen in the short term. It is expected that defence spending will lead to higher spending in the medium

to long term, while the impact of higher tariffs on the economy is expected to be felt from the second half of this year. This means that these developments will mainly affect the funding need for next year and less so for this year.

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