# TD Economics

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**Netherlands election: Populism faces first defeat at the polls**

**Election Highlights**

- Yesterday Dutch voters rejected the populist, right-wing rhetoric of Geert Wilders of the Freedom Party (PVV), choosing to stand with the tried and true rule of a coalition of centrist parties. The People's Party for Freedom and Democracy (VVD), the centre-right leaning party whose leader is the incumbent prime minister, is currently projected to have won the most seats at 33 – eight seats less than it previously held (final results on the distribution of seats are expected within a week). While the PVV is projected to win the second most seats at 20, they are unlikely to be invited to participate in coalition talks. The Labour Party (PvdA) suffered a historic defeat, as voters supported less established left-leaning parties.

- While talks to form a new coalition government have begun, it could take months before a government is in place. In fact, since World War II it has taken an average of 72 days for a coalition government to form in the Netherlands. Although we won't know the exact composition of the coalition government, we do know that it will likely require the participation of at least four parties. Note that in the Netherlands a coalition government needs 76 out of 150 seats in the Dutch parliament for an absolute majority.

- Financial markets have reacted positively to the election result, with the EURUSD firming after exit polls in the Netherlands suggested that the PVV was not on pace to win much more than 20 seats. Moreover, bond spreads between Dutch and German bunds have narrowed a touch.

- The focus now shifts to the French Presidential elections, with the first round slated for April 23rd.

**Next steps for the new coalition government: budget finances, euro, and immigration**

- Now that the election is over, the difficult task of governing begins. The larger number of coalition partners will make it more difficult for the new government to appoint a cabinet and push through the structural economic reforms necessary to counter headwinds to growth from an aging labour force and weak productivity growth.

- Fortunately, government finances in the Netherlands have improved considerably since the Great Recession, with the primary budget deficit turning to a surplus for the first time last year. Undoubtedly, the return to surplus was largely driven by economic growth about twice its trend pace, estimated at about 1% in 2016.

- Despite this improvement, there are some signs of economic slack in the Netherlands. Most evidently, the unemployment rate has yet to return to its pre-recession average despite a pronounced decline in the participation rate similar to that experienced in the United States. Estimates of the output gap confirm that there is still excess supply. However, another year of 2% growth – twice the pace of trend – will likely eliminate it.

- Looking further ahead, the consensus forecast suggests that economic growth will slow to 1.3% by 2019, suggesting that the improvement in government finances coming from above-trend growth will soon have to yield to a more cost conscious, active management by fiscal authorities. This too could prove very challenging given the need for approval by a multitude of parties.

- The two main issues that the populist PVV heavily campaigned on were a referendum on the Netherlands remaining part of the EU and immigration reform. At this time, there is no indication that a coalition government will consider holding a referendum on EU or euro membership in the near future. However, in late February the Dutch legislature approved the investigation by the Council of the State (its legal advisor) to have it review whether it's legally possible for the Netherlands to withdraw from the euro. It should be noted that referendums in the Netherlands are advisory only, as stated in the Advisory Referendum Act. Moreover, referenda can only be held over newly adopted laws or treaties, making a referendum on changes to any past EU treaties illegal, barring legislative changes. Given the legislative challenges and lack of support in both houses of parliament, it's unlikely that the Netherlands will be able to hold a binding referendum on the euro or EU membership in the next couple of years.

- The other common theme amongst populist political parties in advanced economies involves a reduction in immigration. Population statistics for the European Union (EU) (as of January 1, 2015) suggest that about 11.8% of the Dutch population was born abroad: 3.1% in the EU, and the remaining 8.7% born in a country outside of the EU. The percentage of non-EU born citizens is similar to that of its immediate neighbours (Belgium: 8.5%; France: 8.6%). Much of the immigration into the Netherlands and elsewhere in core EU nations has been in the key 16-35 year old demographic, and the influx of youth is needed to help stave off the secular decline in the labour force. However, the perception of the newcomers' lack of desire to integrate will continue to sow anxiety amongst native born Dutch, particularly those who see themselves competing for jobs and housing. Should the Netherlands materially slow immigration, it would work against efforts to boost its labour force. According to OECD estimates, trend labour force growth has fallen from about 1.0% in the early 2000s to 0.4% in 2016. Given its importance to sustaining the labour force and helping the supply side of the economy, immigrant settlement and naturalization will have to become a priority not only for the new coalition government in the Netherlands, but other core EU nations facing similar structural declines.

**While the populist threat has been extinguished in the Netherlands, attention turns to France's election**

- France is set to vote in the first and second round Presidential elections on April 23rd and May 7, respectively. Recent polls suggest that Marine Le Pen, the leader of the Front Nationale (FN) party, could take the first vote, but is unlikely to win the second vote against any other candidate. While odds are low of a Le Pen victory, the experience of 2016 does suggest that anything can happen. Even if Marine Le Pen were to win the presidency, she would likely lack the support of the French legislature to push for a referendum on EU or euro membership. We will preview the French election in a forthcoming note.

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