INTERNATIONAL MONETARY FUND

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KINGDOM OF THE NETHERLANDS—NETHERLANDS

December 2014

2014 ARTICLE IV CONSULTATION—STAFF REPORT; PRESS RELEASE; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE NETHERLANDS

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2014 Article IV consultation with Netherlands, the following documents have been released and are included in this package:

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on December 3, 2014 , following discussions that ended on October 7, 2014, with the officials of Netherlands on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on November 18, 2014.
- An **Informational Annex** prepared by the IMF.
- A **Press Release** summarizing the views of the Executive Board as expressed during its December 3, 2014 consideration of the staff report that concluded the Article IV consultation with Netherlands.
- A **Statement by the Executive Director** for Netherlands.

The document listed below has been or will be separately released.

Selected Issues Paper

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

KINGDOM OF THE NETHERLANDS—NETHERLANDS

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION

November 18, 2014

KEY ISSUES

Addressing the Household Debt Overhang

The economy is slowly emerging from its balance sheet recession. Housing prices have steadied, exports are rising on expanding global trade, but consumption continues to contract on an annual basis, held down by household deleveraging and weak incomes.

The risks to the outlook are on the downside. Near term risks stem from euro area weakness and geopolitical spillovers, while medium-term growth prospects are clouded by the slow progress in addressing the large household debt overhang.

Addressing the household debt overhang is key to securing a robust recovery. Encouraging reprofiling of underwater mortgages, increasing intergenerational transfers, and reducing pension contributions for the young would support orderly household deleveraging.

Strengthening the banking sector would reduce housing risks and support credit in the recovery. Stronger capital buffers and more ambitious medium-term targets for reducing LTV ratios and mortgage deductibility would encourage more corporate lending and reduce the risks from the housing sector.

Expanding the rental market would ease pressures on home ownership. Deregulating private rentals, improving the targeting of social housing, and liberalizing zoning laws would create a more efficient and resilient housing sector.

Accommodative macro policies and structural reforms to raise productivity would support balance sheet adjustment and enhance potential growth. During deleveraging, fiscal policy should aim to be supportive by maintaining a structural balance over the medium term, while avoiding targeting headline balances. Structural reforms to strengthen the SME sector, address labor duality and expand the availability of equity financing are also needed to raise productivity.

Approved By
Mahmood Pradhan and Tamim Bayoumi

The mission took place in Amsterdam and The Hague, September 25–October 7, 2014. The team comprised of Messrs Kang (head), Mrkaic and Saksonovs and Ms. Hassine (all EUR). Ms. De Lint (OED) accompanied the mission and Mr. Snel (OED) joined the end of the visit. The mission met with Finance Minister Dijsselbloem, Dutch National Bank President Knot, other senior officials, finance industry, academic, and trade union representatives. On September 30, the team participated in a seminar at the DNB as a part of the EUR housing cluster project.

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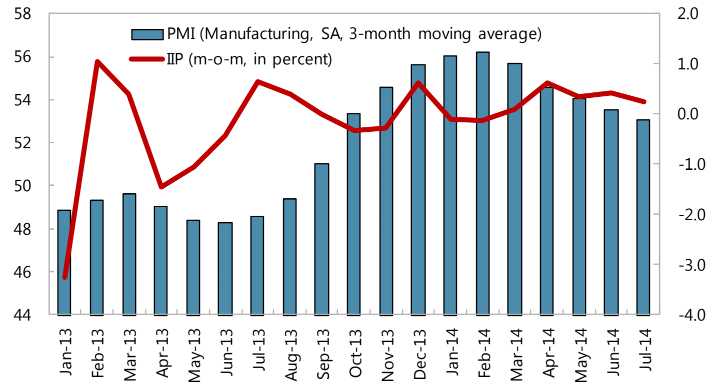
ANNEXES

OUTLOOK—AN UNEVEN BALANCE SHEET RECOVERY

1. **The recovery continues but remains sluggish.** After contracting in Q1 2014, GDP expanded in Q2 by 0.7 percent (q/q), led by growing exports.[1] High frequency indicators, such as PMI and industrial production, point to expansion continuing through, but at a slower pace. Exports are rising on expanding global trade, but consumption is still contracting on an annual basis as indebted households continue to save. Deleveraging pressures are expected to keep growth low at 0.8 percent this year before rising gradually to 1.2 percent in 2015, supported by rising exports and a modest recovery in housing prices. Investment is projected to remain sluggish due to weak domestic demand and reduced euro area growth. Over the medium term, headwinds from the large household debt overhang are expected to hold down growth to an average of 1.5 percent, compared to 2.3 percent during 2000-07.

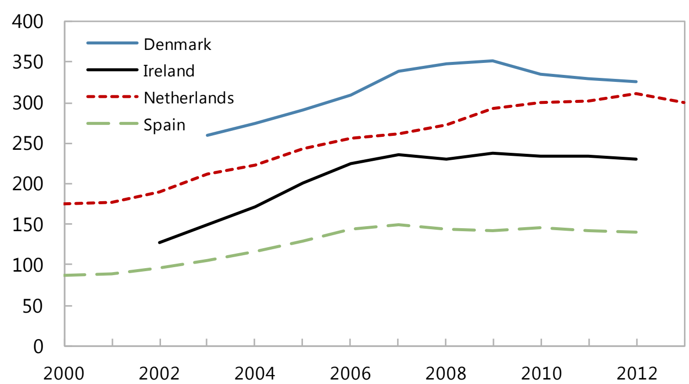
The Netherlands: High Frequency Indicators



Sources: Haver Analytics and Fund Staff calculations

2. **Progress in household deleveraging has been slow.** Following a decline of 27 percent in real terms, housing prices have held steady over the last year, halting the decline in household wealth. Household leverage, however, remains high, with debt to income ratios still around 300 percent, almost double the levels in the early 2000s. The loss of housing wealth has been significant at about 60 percent of GDP, concentrated mainly among younger cohorts where nearly two-thirds of mortgages are underwater.

The Evolution of Household Debt
(Percent of disposable income)



Sources: OECD and Fund Staff calculations

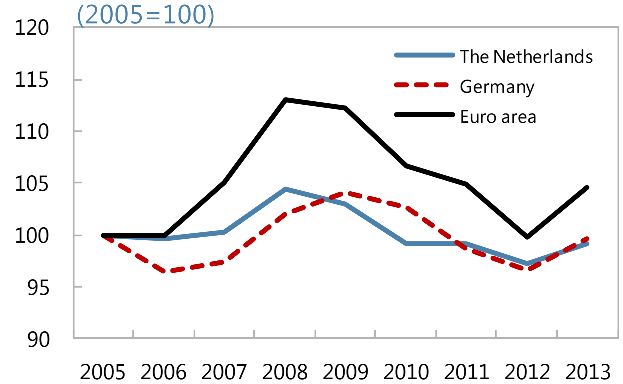
3. **Rising unemployment and declining inflation reflect the sizeable output gap.** While the unemployment rate barely rose during the early phase of the crisis, the rate has risen to 7.2 percent

[1] In March 2014, Statistics Netherlands started reporting national accounts data in according to the European System of Accounts (ESA) 2010. Under the newly adopted standard, GDP in current prices is nearly 8 percent larger than under ESA 95, mostly due to the inclusion of R&D costs in investments and new data sources.

in 2014, some 2 percentage points above its long term average. Labor slack and the large output gap (4½ percent of GDP) have pushed down core inflation close to zero, raising real interest rates and the burden of household debt.

4. The external current account surplus now exceeds 10 percent of GDP, supported by a rising trade balance. Based on the ESR assessment, the external position is stronger than the level consistent with medium-term fundamentals and desirable policy settings by 0-4 percent of GDP. Relative to the euro area, the real effective exchange rate has declined since 2005. Other country specific factors include a fully funded pension system and high savings from household deleveraging (see Box). The large surplus reflects strong external demand, especially for intermediate goods for re-exports, significant fiscal tightening, high corporate savings and depressed domestic demand. The net international investment position (NIIP) has strengthened since 2008 to nearly 40 percent of GDP, mostly due to a higher FDI, and contraction in banking sector liabilities, primarily related to unwinding correspondent banking positions. Over the medium term, the current account balance is projected to remain above its pre-crisis levels, mainly due to weak domestic demand. Structural reforms to raise productivity and progress in repairing household balance sheets and the banking system will support domestic demand and contribute to reducing external imbalances. A slower pace of fiscal consolidation and shift towards more productive investment will also help in the rebalancing.

Real Effective Exchange Rate, ULC Based
(2005=100)



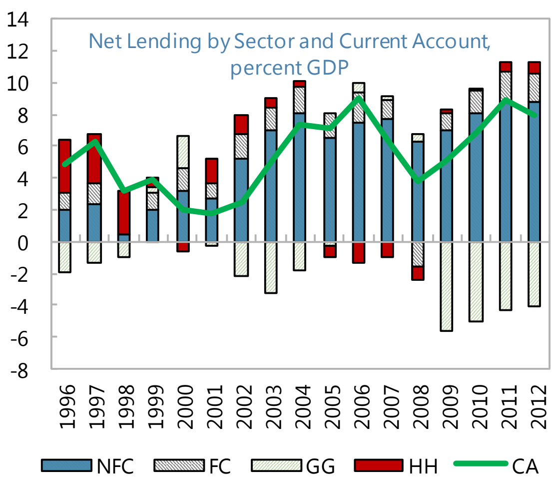
5. The risks to the outlook are mainly on the downside and if realized, are likely to interact, causing regional and global spillovers (see RAM).

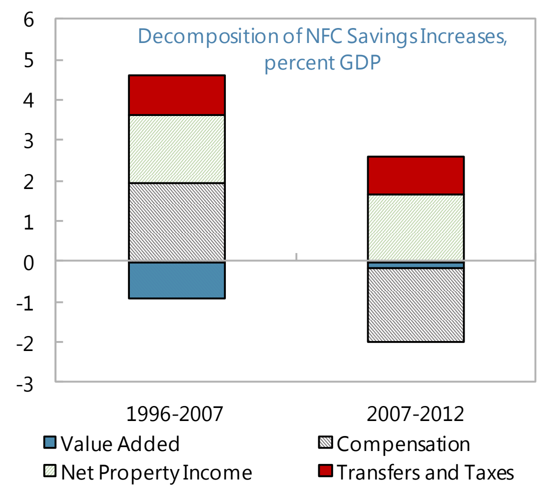
a. **Geopolitical tensions and euro area weakness.** An escalation of the Russia-Ukraine crisis that leads to more sanctions or higher fuel prices would hurt the Dutch economy, mainly through indirect spillovers and financial linkages with the rest of Europe. Russia is the fifth largest exporter to the Netherlands, supplying mostly crude oil and minerals. Dutch FDI in Russia is also sizeable (10 percent of GDP), mainly in the energy sector. The Netherlands is also exposed to weakness in the euro area which accounts for 60 percent of Dutch exports. Outward spillovers could occur through Dutch banks' exposures in Germany and the United States and their links to global trade finance.

Box 1. The Puzzle of the Netherlands' Current Account Surplus

The current account has been in surplus since 1981, reaching 10 percent of GDP in 2013 and reflects in part the Netherlands' growing role as a global trade hub for multinationals.

Over the past decade, the current account surplus has been driven by the net lending of Dutch non-financial corporations (NFCs). Corporate surpluses driven by strong profits and stagnant investment have pushed up the current account to above 10 percent of GDP, from around 4 percent of GDP in the late 1990s. This is mainly reflected in the trade balance, which reached 7½ percent of GDP over 2010-13, highlighting the Netherland's growing importance as a global trade hub.

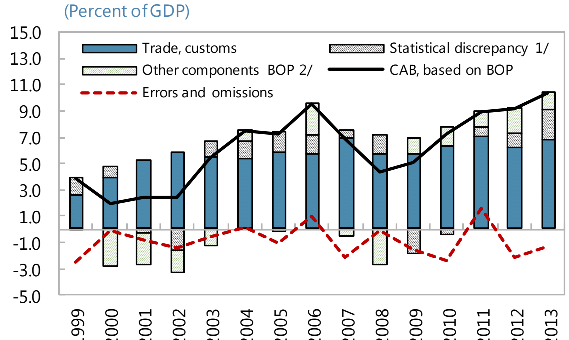




A favorable tax environment has supported the Netherland's role as a center for trade and FDI. The Netherlands benefits from a lower tax rate among OECD countries, with a number of tax provisions aimed at supporting trade and FDI. These include a large network of tax treaties, taxation mechanisms protecting exporters' cash flow, advance tax rulings, and reduced taxes on intangibles. In addition, group financing has a favorable regime for intra-company dividends, interest and royalties, and protective rules on netting of profits and losses between affiliates.

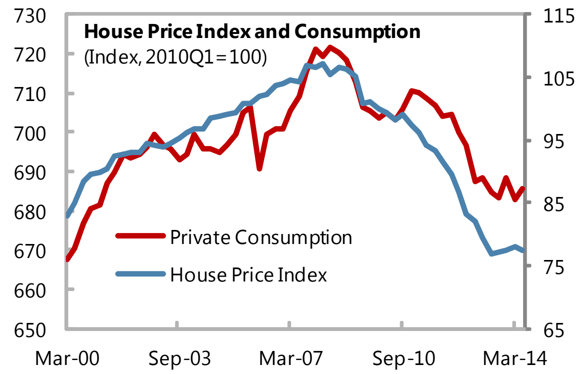
The accounting treatment of trade may also have contributed to the rising current account surplus. The introduction of Intra-stat reporting in 2003 removed mandatory reporting between EU countries, imposing a statistical correction for coverage and classification. Based on a sample of corporations reporting on goods, services, and current transfers, the statistical correction (reaching nearly 1 percent of GDP in 2013) may reflect the growing presence of multinationals whose recording of profits and transfers may have also helped push up the surplus.

Current Account Surplus and its Statistical Components
(Percent of GDP)



Notes: 1/ The statistical discrepancy reflects the treatment of methodology adjustment from custom-based trade to balance-of payments goods. 2/ Include trade in services, income, and current transfers.
Source: DNB and IMF staff calculations.

b. **A decline of house prices and low inflation.** With house prices as a key driver of private consumption, an unexpected decline in house prices would further weaken household balance sheets and spending. Over the medium term, low inflation would exacerbate real household debt burden and increase the risk of disorderly deleveraging.



Sources: Haver Analytics and Fund staff calculations.

c. **Financial stress.** Further weakness in housing prices or in SME loans where NPLs have reached 6 percent of total loans could spill over to banks and accelerate deleveraging. Given Dutch banks' large wholesale funding needs, such domestic shocks could also prompt banks to reduce further cross-border exposures.

d. **Recovery in net wealth.** On the upside, a faster pick up in house prices or lower energy prices could increase household net wealth and incomes.

Authorities' views on the economic outlook and risks

6. The authorities saw domestic demand playing a stronger role in supporting the recovery. The recovery arrived earlier than expected, led by stabilizing housing prices and a strong pickup in transactions which are up nearly 40 percent (y/y). The authorities saw policy measures to stabilize the housing market and reforms to the tax, labor and pension systems as helping to lift confidence and activity. In particular, the reduction in pension premiums and temporary gift tax exemptions boosted disposable income which increased for the first time since 2007. On lower inflation, the authorities highlighted falling global commodity prices as driving headline prices and saw the risks of deflation as low given the continued rise in real wages. Recent ECB liquidity support measures should also support prices mainly through its impact on the exchange rate.

7. Views differed on the drag of household debt on consumption. The authorities were generally more sanguine on the growth headwinds from household deleveraging. They highlighted studies that found that younger households had increased their savings in response to the fall in net wealth, but their overall impact on consumption was small.[2] Others, however, noted the impact of household deleveraging extended beyond the immediate borrower and generated negative externalities by reducing labor mobility and constraining credit through lower collateral values.

[2] See for example van Es, Bonenkamp, Lanser and Ciocyte: *Consumers in distress: Consumption, income and wealth,* Chapter 6 in the book Road to Recovery, CPB (2014) and van Beers, Bijlsma, and Mocking, *House prices and consumer savings: results based on Dutch administrative data* (forthcoming, 2014).

Netherlands: Risk Assessment Matrix and Transmission Channels

(Potential deviations from baseline)

Risk: Trigger Event (green=low, yellow=medium, red=high)	Risk: Vulnerabilities	Impact if realized (green=low, yellow=medium, red=high)	Policy Response
	Fiscal: Headline deficit still within 1 percentage point of the EDP limit	Lower fiscal revenues could lead the authorities to tighten fiscal stance and lower growth	- Refrain from additional fiscal tightening - Maintain adherence to medium-term structural fiscal targets
	Lower revenue / Lower demand		
Protracted period of slower growth in advanced and emerging economies Significant disruptions associated with increased geopolitical tensions surrounding Russia/Ukraine An unexpected decline of house prices	**Real**: - Weak houshold consumption due to debt overhang, indebted SMEs - High dependence on exports - Possibility of disorderly household deleveraging	Amplified effects of debt overhang, higher unemployment will complicate efforts to reduce household debt Falling external demand will hurt exports; disruptions to energy supply interfere with production.	- Implement comprehensive strategies to reduce household debt overhang - Shift to neutral fiscal stance and rebalance labor market tax wedge - Deregulate housing market - Strengthen bank capital buffers - Offer liquidity support to SMEs and exporters if the Ukraine-Russia related sanctions lead to a credit squeeze and undermine growth
	Credit crunch / Asset quality		
Further weakness in housing prices or in SME loans	**Banks**: - Low provisioning coverage - Large wholesale funding needs - Still sizeable capital needs	Stress on banks leads to higher funding costs, falling credit, and slower growth, and reduction of cross-border exposures.	- Ensure sufficient capital and liquidity buffers - Ease acces to liquidity - Accelerate structural reforms to improve productivity (labor, and product markets) - Strategy to assist SMEs

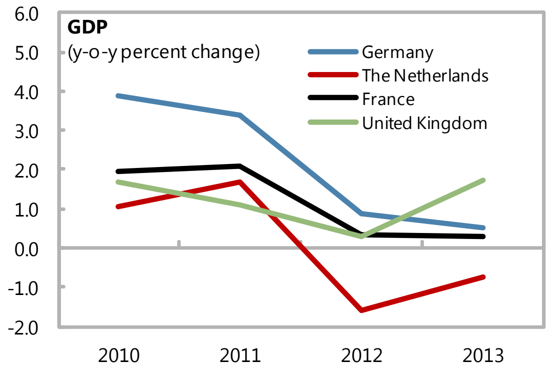
1 The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability of 30 percent or more). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

8. Instead, the authorities saw the main risks as a slowdown in the euro area. In particular, an unanchoring of inflation expectations in the euro area would affect the Netherlands through lower external demand and its impact on domestic prices. The authorities also noted potential downside risks from geopolitical tensions, but saw these so far as moderate. If the Russia-Ukraine conflict were to escalate, spillover channels would be mainly indirect through weaker demand from the rest of the euro area and greater uncertainty.

9. On the external current account, the authorities saw the surplus as being driven primarily by growth in multinational profits and re-exports, as well as household deleveraging and did not expect these factors to subside in the near term. They saw few signs of a significantly undervalued exchange rate as inflation pressures remain weak and real wages are rising. Nevertheless, they agreed that policies to address the household debt overhang and increase investment, especially by SMEs, would over the longer term bring down the surplus.

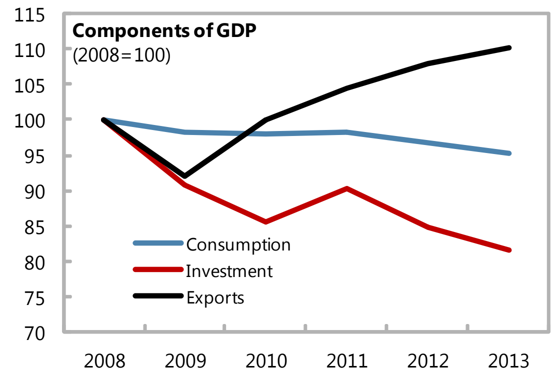
Figure 1. Sluggish and Uneven Recovery

After the great recession, Dutch economy has underperformed relative to its peers...



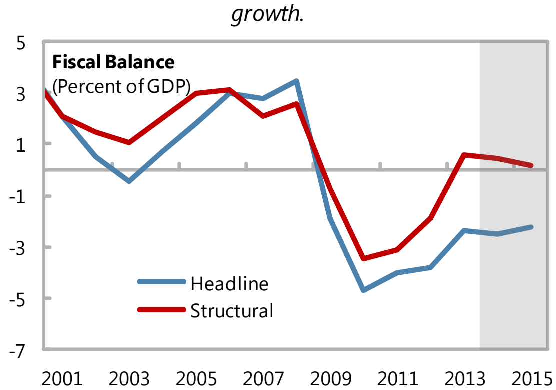
Sources: Haver Analytics and Fund staff calculations.

...mostly due to weak investment and private consumption.



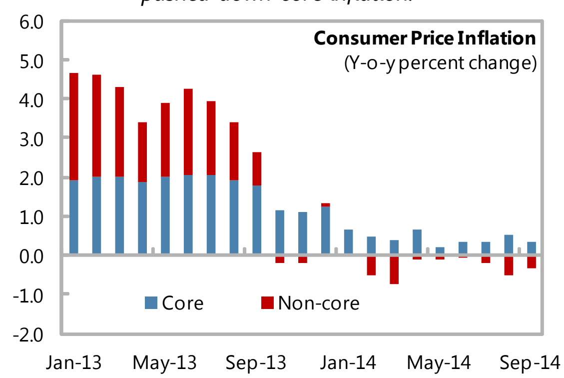
Sources: Haver Analytics and Fund staff calculations.

The significant consolidation has weighed on growth.



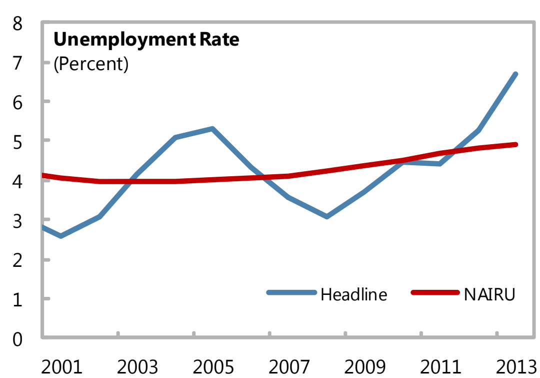
Sources: IMF *World Economic Outlook*.

Deleveraging and large output gap have pushed down core inflation.



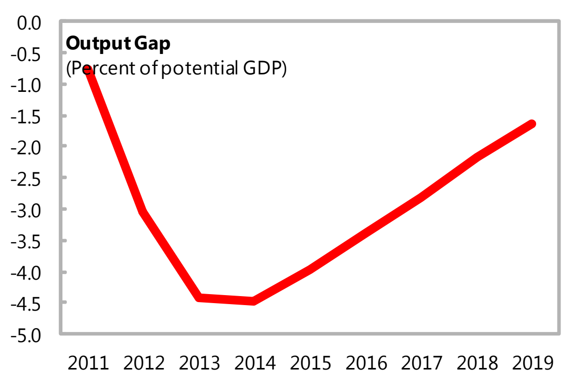
Sources: Haver Analytics and Fund staff calculations.

The end of labor hoarding has led to an upsurge in unemployment.



Sources: Haver Analytics.

The negative output gap will not close completely over the medium term.



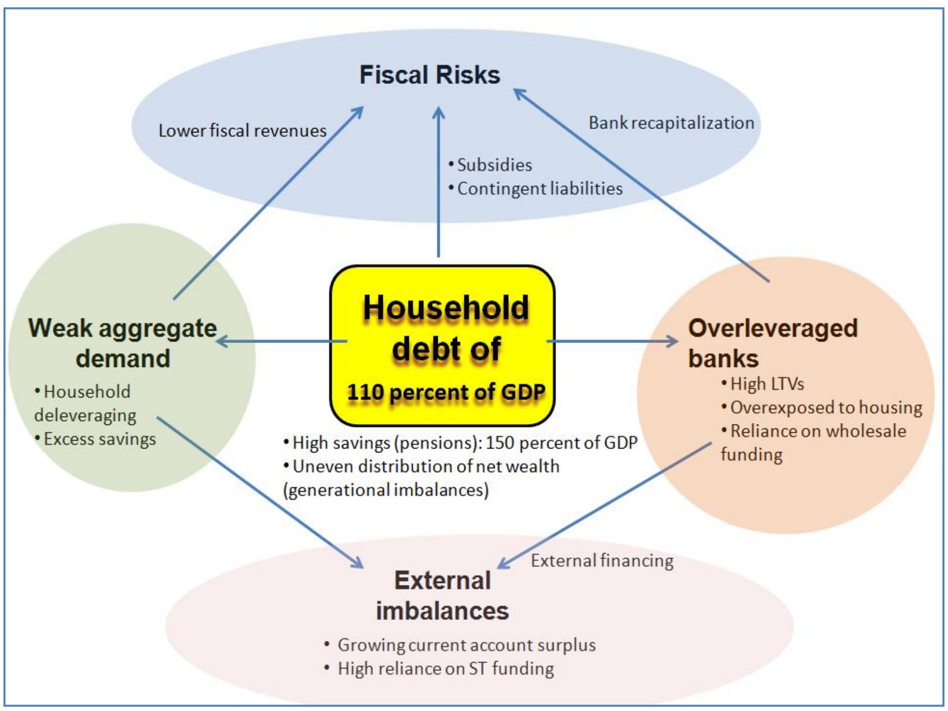
Sources: Fund staff calculations.

POLICIES TO PROMOTE ORDERLY DELEVERAGING

10. Over the past year, the government has taken important steps to address the housing market, support indebted households, and implement pension and labor reforms. In particular, policies regarding mortgages have stabilized expectations and supported a pickup in housing prices and transactions. These and other reforms to strengthen the financial system and assist SMEs have helped boost confidence, increase policy certainty, and support the nascent recovery.

11. To secure a robust recovery, it will be important to build on these reforms to reduce household indebtedness, enhance the resilience of the financial system, and improve the efficiency of the housing market. At the same time, accommodative macro policies and structural reforms to raise productivity, especially for smaller firms, should support the balance sheet adjustment and improve the economy's growth potential. The Article IV consultation focused on a comprehensive strategy for promoting orderly household deleveraging while supporting growth.

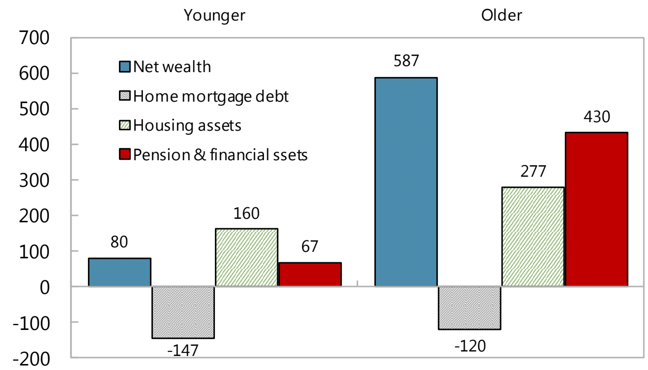
A. Addressing the Household Debt Overhang



Context **High household debt is at the center of the weak economy.** The legacy of the housing crisis has left behind a large household debt overhang, a distorted housing market, and leveraged banks that have all contributed to depressing aggregate demand. Indebted homeowners have reduced consumption to repay debt, which in turn has held back investment demand. With their large mortgage portfolios, banks are overleveraged and vulnerable to a growth shock or a cutoff in wholesale funding. Public recapitalization of the banks and various support of home ownership create risks for the fiscal sector. These in turn have contributed to excess savings and growing external imbalances.

The burden of the large debt overhang is also unevenly distributed across generations. Aggregate household net wealth is high at 400 percent of GDP but is concentrated mainly among the older generations who benefit from high pension savings and low mortgage debt, while younger households who purchased their homes at the peak of the market, remain heavily in debt. Deleveraging pressures on these younger households, with their higher marginal propensity to consume, are a drag on personal consumption and a constraint on the economy's ability to adjust and reallocate resources.[3]

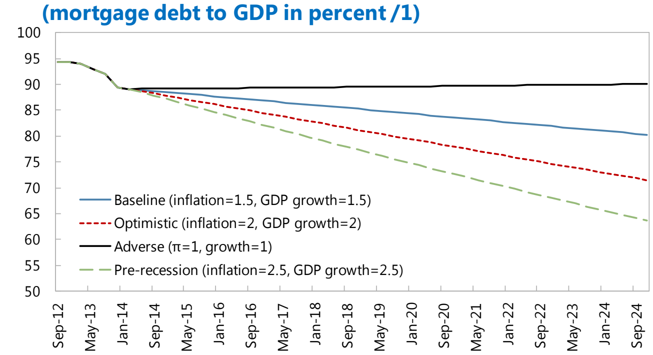
Balance Sheet of Dutch Households by Age, 2011
(Percent of average gross household income by main earner's age)



Source: Dutch Central Bureau of Statistics and DNB

Faster progress in repairing household balance sheets would support a more robust and sustained recovery and reduce intergenerational imbalances. Staff simulations suggest that under current house prices and deleveraging trends, it would take about 10 years before household leverage ratios return to their pre-crisis levels (even longer for a new lower "equilibrium" debt ratio). During this period, growth would remain subdued as reduced spending (higher savings) by low net wealth households more than offsets higher spending by older households (see Box 3). To facilitate an orderly adjustment, a comprehensive strategy to raise household surpluses to pay down debt (flow problem) and to alleviate debt burden among the young (stock problem), including through intergenerational transfers and more efficient workouts is needed.

Duration of Deleveraging (Illustrative Scenarios)
(mortgage debt to GDP in percent /1)



Source: Haver Analytics and Fund Staff calculations
/1 Mortgage debt in MFIs and special purpose vehicles

[3] See for example Bijlsma (2013): Changes in Household Behavior after a Housing Wealth Shock.

Advice

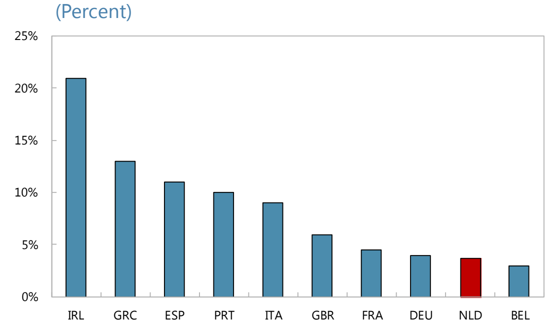
Addressing the household debt problem among the young would lift overall spending. Policies to assist younger cohorts with a higher propensity to consume would lift overall spending and could include:

- ***Increasing transfers between generations***. A temporary tax exemption for monetary gifts of up to €100,000 was introduced last year to reduce mortgage debt and was used by more than 50,000 households. Staff estimates suggest that around 0.4 percent of GDP has been transferred and likely contributed to the nascent housing recovery. Absent any extension of the measure beyond its expiration at end-December, the authorities could consider increasing the €50,000 limit for tax-free transfers, allowing gifts to all family members to be used to repay mortgage debt. To help lower income groups, individuals could be allowed to spread payments over several years up to the limit.

- ***More reprofiling of underwater mortgages***. Banks have taken steps to renegotiate mortgages with distressed borrowers, but progress on reprofiling debt has been slow. Supervisors should encourage banks to remove restrictions and limits on prepayment and sequestered savings accounts to facilitate reprofiling into longer-term, amortizing mortgages. Regulatory measures, such as higher risk weights on interest-only loans, could lead to greater price differentiation in favor of traditional annuity mortgages.

- ***Reducing the stigma of personal bankruptcy***. Mortgages in Dutch law are full-recourse and easily enforceable, even in personal bankruptcies. This has kept mortgage defaults very low, but limited the use of the system for insolvent borrowers. Easing restrictions on certain professions or constraints on financial services resulting from bankruptcy would encourage greater use of the system for the heavily indebted and ultimately reduce the stigma associated with bankruptcy and encourage greater use of the system for the heavily indebted. Targeting a nominal debt repayment amount rather than a percent of income could encourage work and debt repayment under probation. Greater use of out-of-court alternative dispute resolution mechanisms such as arbitration or mediation could also help avoid foreclosure and personal bankruptcy.

Expected Mortgage Default Rate by Country
(Percent)



Source: Fitch Residential Mortgage Briefing, 2013.

Authorities' Views

The authorities saw the temporary tax break on monetary gifts as having contributed to a revival in the housing sector. The program was designed to be temporary to bring forward spending and was allowed to expire as part of a broader effort to scale back exceptional support to the housing market. Nevertheless, the authorities saw merit in expanding the general €50,000 exemption for tax-free transfers in order to give lower income groups more time to build up savings and benefit from the transfers.

Box 2. Deleveraging and Household Debt Overhang

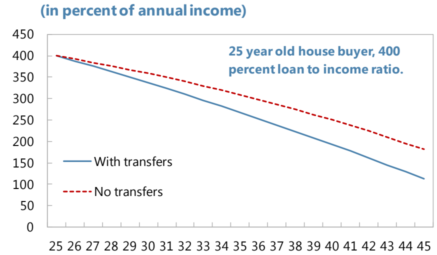
The deflation of the Dutch housing bubble has reduced the aggregate housing wealth by approximately 60 percent of GDP and impeded consumption growth. While house prices generally influence consumption through changes in the net wealth of house owners, the strength of the effect depends on country specific characteristics. International comparison of the relationship between household consumption and house prices shows that the influence of house prices is particularly strong in the Netherlands. Consequently, the recent contractions of private consumption in the Netherlands can be at least in part attributed to the loss in housing wealth and the debt overhang (for details see Mrkaic (2014), *House Prices, Consumption, and Household Debt Overhang in the Netherlands*.)

The losses in home equity have been greater among highly leveraged younger house owners than among the old. Younger households have suffered particularly large losses in home equity. They purchased houses near the peak of the market and had to absorb large price declines. In addition, due to their high leverage, their home equity declined more than that of the older house owners. The loss in house equity is equal to the percentage change in house prices times the leverage multiplier. The leverage multiplier is equal to $(1\text{-LTV})^{-1}$; it grows rapidly with leverage. In 2011, the leverage multiplier for highly levered house owners below 45 years of age was approximately 12 and only 1.8 for older ones. Currently, approximately two thirds of younger households have negative housing equity.

Duration of deleveraging depends on the magnitude of debt overhang and macroeconomic environment. The negative shock to the housing wealth of young house buyers, together with their low levels of financial wealth, incentivizes them to increase savings in order to rebuild their net wealth. The speed of debt overhang reduction depends on the rate of saving, income growth, inflation, and growth of house prices. A flow of funds analysis shows that deleveraging is a slow process; under the assumption of no new policies it would be a drag on consumption over the medium term.

Intergenerational rebalancing could accelerate deleveraging of the young households and reduce the negative effect on their consumption. Reducing pension contributions (as described in the main text of the Staff report) could help accelerate deleveraging by giving younger generations additional resources to reduce their debt. Simulations show that, for younger cohorts, over a ten year horizon the reduction of the outstanding debt to income ratio could be accelerated by approximately fifty percentage points, should such transfers be implemented.

Outstanding Mortgage Debt
(in percent of annual income)



Source: Fund staff calculations

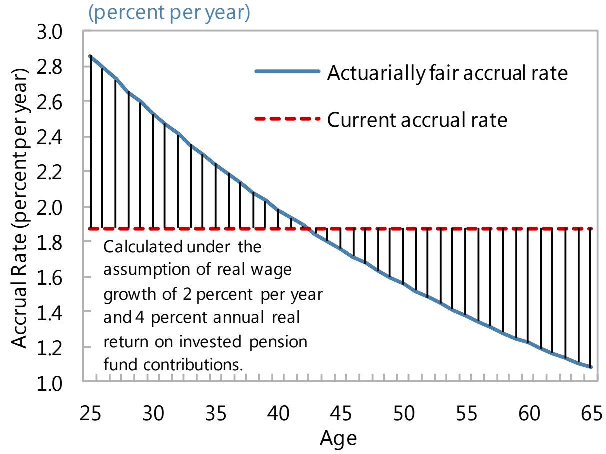
Despite the high share of underwater mortgages, default rates have remained low and are unlikely to rise. For these reasons, the authorities saw little need to reprofile underwater mortgages on a large scale. Banks were already encouraging heavily indebted borrowers to switch from interest-only to longer-maturity amortizing mortgages, but faced challenges given the strong tax incentives for borrowers to retain their current loan. To avoid moral hazard, they stressed that any reprofiling should be agreed with lenders on a voluntary basis. The authorities believed that the price impact of increasing risk weights to discourage interest only mortgages would likely be small and dominated by the favorable fiscal incentives under the MID.

The authorities highlighted that the Dutch personal bankruptcy code now allows for a "fresh start." The new arrangement under the Dutch Bankruptcy Act allows a bankrupt borrower the opportunity for discharge after meeting payment requirements for three years, and education and training programs are in place to support work during probation. Mortgage debt relief is also possible under the discharge. However, the track record of successful repayment is mixed, and the stigma associated with bankruptcy remains severe.

Advice

Reducing pension contributions for the young could also free resources to reduce debt. Under the Dutch system where occupational pension accrual rates are equal for all participants, most younger employees contribute in excess of the present value of their pension benefits, i.e. pension benefits are back loaded. This implicitly transfers savings from the relatively poorer, young to the wealthier older cohorts. Staff simulations suggest that rebalancing pension contributions to an actuarially fair level while keeping the career-average accrual rate unchanged could shorten the duration of deleveraging for younger generations by one to three years by helping to lower debt faster and support demand. Similar to corporate equity financing, providing tax allowances for the buildup of home equity could also encourage using pension savings to pay down mortgages (see fiscal Section).

Actuarially Fair and Current Accrual Rates
(percent per year)

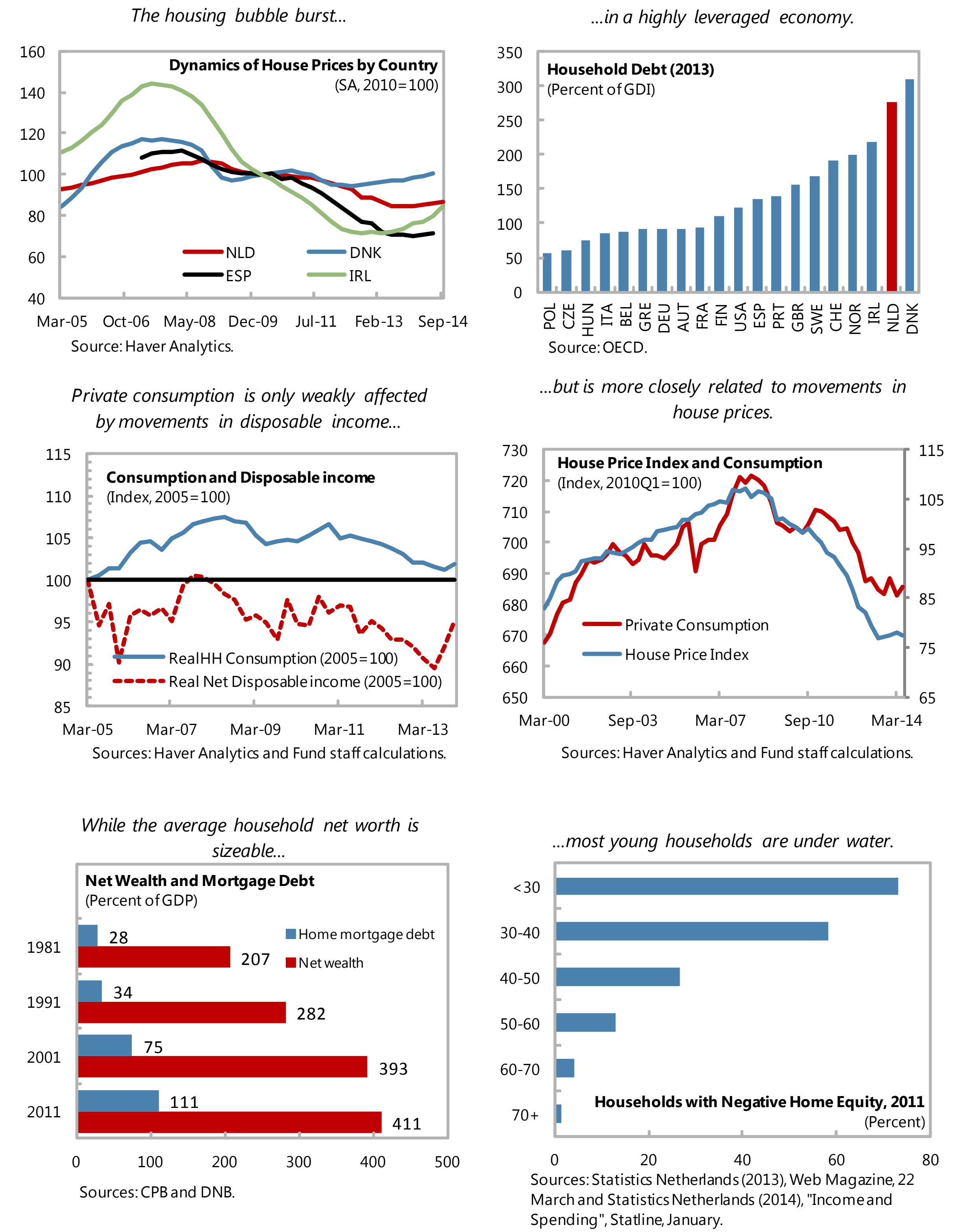


Sources: Fund Staff calculations.

Authorities' Views

The authorities noted that the recent pension reform would further lighten the burden on younger cohorts starting next year. To increase disposable income and link occupational pensions to increased life expectancy, the authorities reduced the

Figure 2. Housing Cycle in the Netherlands

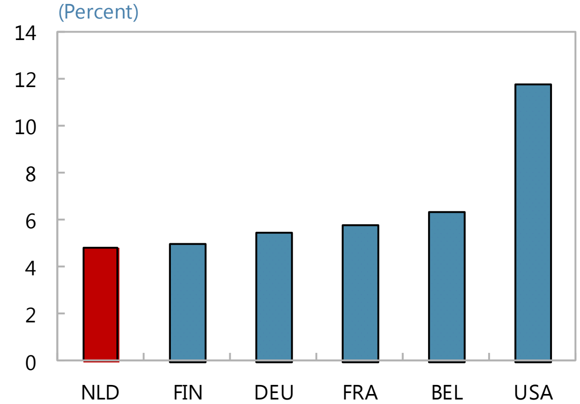


annual pension accrual rate from 2.15 to 1.875 percent, starting in 2015.[4] However, any more drastic measures such as using pension savings to pay down mortgages would need to be considered in the context of broader reforms so as to safeguard the fully funded system which has served pensioners well. Options to reduce intergenerational imbalances include adjusting accrual or contribution rates or possibly moving closer to a defined contribution system with individual accounts. Discussions on broader pension reforms are expected to start next year.

B. Strengthening the Financial Sector to Support the Recovery and Reduce Future Housing Risks

Context **Dutch banks have strengthened their capital base but continue to face pressures from the weak economy and their own need to deleverage.** Since end-2013, Dutch banks have raised €8.5 billion in capital and under ECB's Comprehensive Assessment were found not to have a capital shortfall. Nevertheless, they remain highly leveraged, with a capital-asset ratio (4.8 percent) among the lowest in Europe and with a loan-to-deposit ratio of 133 percent, strongly reliant on wholesale funding. Banks also face risks from their exposure to commercial real estate where prices continue to fall and to rising defaults among SMEs. The authorities estimate that banks need to further raise €20 billion in capital by 2019 to meet Basel requirements, mainly through retained earnings.

Capital to Assets Ratio for Select Developed Economies
(Percent)



Source: IMF.

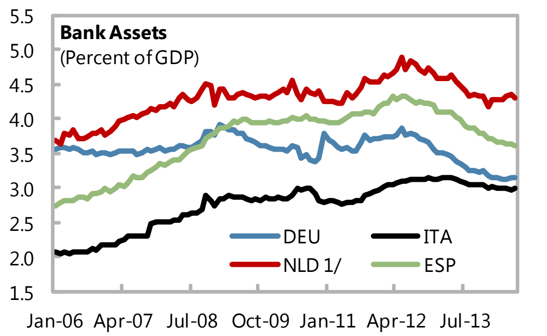
Advice **Stronger capital and liquidity buffers would ensure that banks have the capacity to support the recovery and the adjustment of household's balance sheet.** Supervisors should encourage banks to frontload their capital raising plans before 2019, to ensure that banks are prepared for the transition to Basel III and have adequate capital to support lending in the recovery.[5] Capital raising plans should be based on tapping private sources and suspending dividend payments, rather than cutting credit. Greater use of securitization and covered bonds could help banks to reduce their funding costs and mortgage and SME loan exposure.

[4] The accrual rate was already lowered from 2.25 to 2.15 percent in 2014.

[5] See the DNB Occasional Study "Bank Lending and Capital", Vol. 12/No. 3 (2014), which estimates that shortfall in banking capital would reach €3.2-4.3 billion, depending on the pace of investment recovery. According to staff calculations, under a 5 percent increase in credit to the economy given unchanged capital, the core tier-1 capital ratio would fall by 65 bps, roughly half the improvement in the ratio during 2013-14.

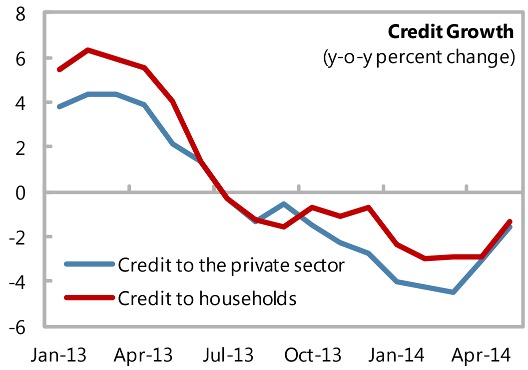
Figure 3. Banking: Strengths and Weaknesses

The Dutch banking system is large but is shrinking…



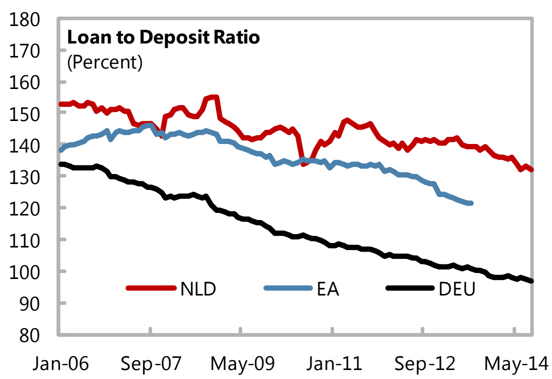
Sources: Country reporting, Haver Analytics, and Fund staff calculations.
1/ GDP reported in ESA 10 methodology.

…which is reflected in the fall in credit growth.



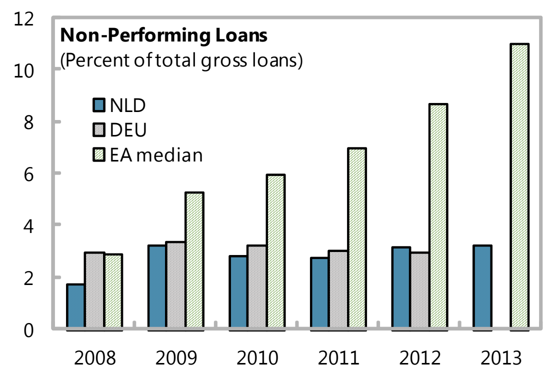
Sources: Country reporting and Fund staff calculations.

While wholesale funding needs are significantly above the EA average…



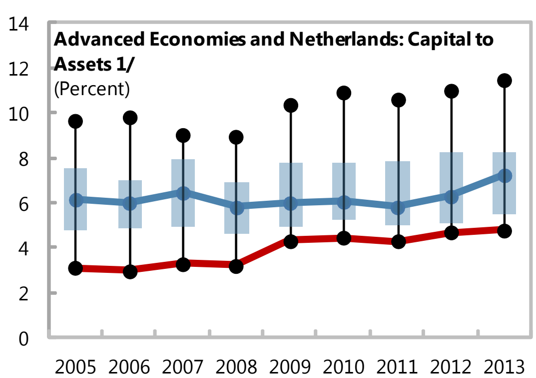
Sources: Country reporting and Fund staff calculations.

…NPL ratios are low.



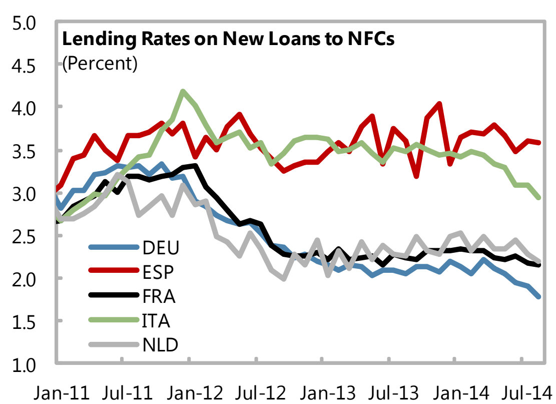
Sources: World Bank.

Dutch have low capital-asset ratios compared to peers.



Source: IMF *Financial Soundness Indicators*.
1/ Shaded box represents the 25th to 75th percentile; whiskers show the 10th and 90th percentiles, blue line represents the median and red line represents Netherlands.

And maintain low lending rates to service the real sector.



Sources: ECB.

Authorities' Views

The authorities saw that banks were on track to complete their adoption of Basel III requirements and raise the needed capital by 2019. However, they recognized that the capital target did not account for the higher national leverage ratio of 4 percent, the SIFI surcharge, and the new requirements for the Deposit Guarantee Scheme and Single Resolution Fund. The authorities viewed banks' capital as sufficient to support lending in an environment of moderate growth, but raised concerns that high required rates of return on capital may push banks to take on excessive risks. Banks were expecting tax deductibility for Tier-1 capital instruments from January 1 and the ECB's comprehensive assessment before issuing new capital.

Securitization of Dutch mortgages faces challenges. The authorities noted that high LTVs, a large share of non-amortizing loans, and public mortgage insurance limited the eligible loans for securitization and pushed up the cost of credit enhancements to a very high 6-15 percent.

Context

The DNB will become the resolution authority for banks in the Netherlands. With the Bank Recovery and Resolution Directive and the Single Resolution Mechanism Regulation in place from 2015, the authorities decided to place the resolution authority with the DNB to improve coordination and synergies between the institutions.

Advice

Further improvement to the framework for risk management and resolution are needed. In particular, national arrangements for resolution and backstopping should be completed to safeguard financial stability.

Authorities' Views

The authorities were positive about the benefits of the banking union. Progress in the banking union will diversify sources of funding and reduce borrowing rates through greater cross-border competition. They noted that the completion of the ECB's Comprehensive Assessment would help reduce uncertainty, increase investments, and support growth. As regards the Single Resolution Mechanism and the national backstop, preparations are underway but the authorities were hesitant to issue ex ante commitments before bail-in of private creditors. In the event that public funds are needed, they can go directly to Parliament, as was done in the case of SNS Reaal.

Macro prudential measures should be tightened to reduce housing vulnerabilities

Advice

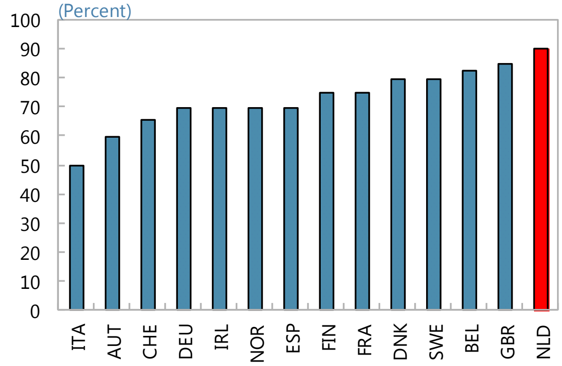
Macro prudential policies face the tradeoff between safeguarding financial stability and supporting the housing recovery. The authorities' policies to gradually reduce loan-to-value ratios (LTVs) on new mortgages to 100 percent by 2018 and allow mortgage interest deductibility (MID) only for new fully amortizing loans are appropriate to mitigate housing risks and were accompanied by a gradual housing recovery. Beyond 2018, the authorities should aim for a faster pace of LTV reduction, eventually reaching 80 percent. Clarifying now the LTV path after 2018 would enhance regulatory certainty and give buyers time to build savings. The average LTV for new mortgages has declined to around 90 percent, suggesting that borrowers and lenders are internalizing declining

LTV loans. Lower LTVs should also be part of comprehensive housing reforms to promote intergenerational transfers, improve debt monitoring, and expand the private rental market.

Authorities' Views

Discussions on the LTVs focused on the appropriate level and time needed for adjustment. Government officials viewed the current LTV target of 100 percent as appropriate given low mortgage defaults, efficient loan to income (LTI) ratio, and full loan recourse in the Netherlands. They saw risks that announcing further LTV cuts beyond 2018 could derail the fragile housing recovery by delaying home purchases and adding to policy uncertainty. The DNB agreed that from a financial stability perspective, a lower LTV would help create buffers in household balance sheets and avoid the sharp swings in consumption experienced during the crisis, but saw room for a soft LTV cap given the existing LTI. There was general agreement that lowering LTVs needed to be accompanied by other housing reforms, such as expanding the private rental market. The Financial Stability Committee (FSC) will address housing related macro prudential measures in November.

Loan-to-Value Ratios of New Mortgage Loan Originations
(Percent)



Sources: Calza, Monacelli, and Stracca (2013).

Reducing the procylicality of pension funds can assist in household deleveraging

Advice

Dutch pension funds should look to reduce further the procyclical link between interest rates and payouts. In 2008, the financial crisis shrunk real pension fund assets by 11 percent. This together with low interest rate increased liabilities triggering reductions in benefits and increased contributions in order to restore coverage ratios above the regulatory minimum of 105 percent. The close link between interest rates and payouts has created a procyclical bias, adding to the pressures on households to deleverage. To address this bias, the authorities should encourage pension funds to hedge interest rate risk more aggressively and use more stable discount rates.

Authorities' Views

The authorities saw it as the first priority to ensure that the reduced accrual rates will be translated into lower pension contributions as a part of the pension reform whose second stage will be implemented in January 2015. They stated that more hedging of the interest rate risk would lower the expected returns of their investments, since they would have to match assets to liabilities, thereby increasing investment in treasury securities.

C. Building a More Competitive, Flexible Housing Market

Context **The Dutch housing market suffers from numerous distortions that have contributed to the debt overhang.** Compared to the rest of Europe, the Dutch private rental market is small, squeezed between an oversized social housing sector which owns nearly one in every three dwellings and strong ownership demand fueled by generous mortgage interest deductibility (MID) and other fiscal support. Full MID combined with high LTVs has also led to a buildup of long-term interest only mortgages.

The authorities have undertaken a number of measures to shrink the social housing sector (SHC) and expand the rental market. They have increased rents for higher income individuals and shifted SHC rents closer to market levels. To shrink the SHC sector, improve its efficiency and governance, the authorities have also imposed a levy, and encourage the sale of dwellings into the non-regulated housing sector.

Advice **The size of the SHC sector should be scaled back to focus on its social mandate and allow the development of the private rental market**. Accordingly, the authorities should continue to raise taxes on SHCs, apply more rigorous and frequent means testing to determine tenants' eligibility to social housing, and complete the shift to market-based rents. To reduce fiscal contingent risks, public support of SHCs through guarantees should be scaled back to core social tasks, and replaced with a more targeted system of direct subsidies to lower income groups. Price controls on rents should be lifted to attract private investors and help expand the private rental market.

Zoning regulations should be eased to expand housing supply…. The supply of new housing has been held back by tight zoning regulations and a fragmented jurisdictional system. The authorities should relax gradually constraints on new construction by incentivizing municipalities to open land for new developments through increased shares of property tax revenues and by elevating more zoning decisions to the level of provinces and the central government.

…while scaling back public support would reduce housing risks to the government. The National Mortgage Guarantee (NHG) scheme insures lenders against default and sets flat, below market premiums, independent of borrower risk, with payments almost fully backed by the government. NHG-related contingent liabilities amount to around 27 percent of GDP. Shifting to risk-based pricing and lowering the maximum guarantee threshold would reduce distortions in mortgage financing and contingent liabilities for the government. The government is also considering packaging NHG-backed mortgage bonds through the National Mortgage Institute (NHI) to attract pension funds and other nonbank investors. To avoid further contingent liabilities, the NHI should not expand fiscal risks beyond its packaging of NHG-backed bonds.

Box 3. Reforming Social Housing Corporations in the Netherlands

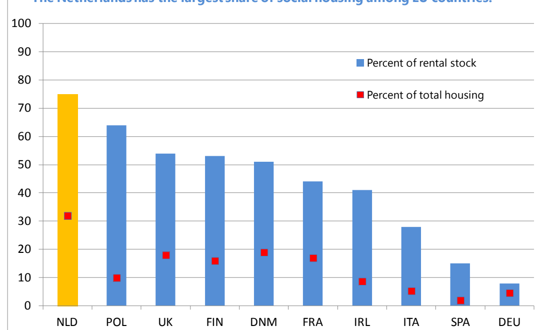
Social housing corporations (SHCs) overlook the housing market, managing 2.4 million dwellings or 34 percent of the total stock and offering cheap housing to low and middle-income households. Social housing also accounts for nearly 80 percent of the rental sector and in big cities, such as Amsterdam and Rotterdam, more than half of all dwellings are social.

About 420 SHCs dominate the rental market. Most housing corporations were established before 1930, with the oldest ones founded in the second half of the 19^{th} century by corporations, charitable institutions, churches, and municipalities. Housing corporations constructed 60 percent of all new dwellings in 2011, and operate their dwellings within government rent-price regulation and tenure protection in various forms. Housing corporations manage tenures through a complex scoring system for dwellings and waiting lists for tenants. On average, the waiting time for social housing in Amsterdam and The Hague is 8 and 6 years, respectively.

SHCs have to be self sustaining and could be given more flexibility to sell their real estate holdings. The 1995 reform ("Brutering" or Balancing-out agreement) ended subsidies and public support to housing corporations and gave full ownership of the social housing stock to the SHCs. Ever since, SHCs fund themselves through rents and other real-estate activities. Selling dwellings also allows SHCs to realize the latent value added on their books. Additionally, SHCs rely on cross-subsidies and financial transfers among housing corporations, mainly from stronger to weaker SHCs.

SHC funding also benefits from public guarantees. SHCs are incorporated as non-profit corporations under a Board of Directors, with a majority established as foundations. They are eligible for government guarantees when raising funding from the Guarantee Fund for Social Housing (WSW), and reduced prices for purchasing land from local governments. At end-2013, housing corporations had borrowed about 14 percent of GDP (€86.2 billion) from the WSW.

The Netherlands has the largest share of social housing among EU countries.



Source: CECODHAS Housing Europe, Housing Europe Review, 2012

Some SHCs were found lacking proper governance and transparency. SHC Board of Directors are self-appointed with limited supervision by public authorities. They often engage in activities beyond their core business, including risky non-real estate related investments. For example, the large losses on derivative deals by the top housing corporation in 2012 prompted the authorities to strengthen oversight and enforce more stringent reporting.

New risk-sharing instruments could be introduced to protect homeowners. Reliance on debt financing concentrates the risk of declining house prices on borrowers. Introducing new financing instruments, such as debt-equity swaps for underwater mortgages, equity loans for home buyers, or futures contracts to insure against idiosyncratic drops in house prices, could diversify housing risks across the economy and facilitate an orderly adjustment of household balance sheets. The authorities could explore the possibility of supporting these new risk-sharing instruments, such as by setting market standards, pricing benchmarks or offering GFI preferential treatment of such contracts.

Authorities' Views

The authorities agreed on the need to gradually ease restrictions on the private rental market. This has been done mainly through increasing rents in social housing sector for higher income dwellers and by making the rent-setting mechanism less administrative and more market based. In addition, the authorities have encouraged the sale of social dwellings, including through a tax on social housing corporations. They, however, noted the difficulties in introducing changes to SHC governance through legislative measures because they are private entities. To encourage further housing developments, the authorities have also increased the share of property taxes received by municipalities from 2016 onwards. They noted that the lack of land for residential construction was not a binding constraint in the housing market given the unused land available for construction and low demand.

The government's exposure to housing risk through the NHG is set to decline. The authorities have already taken steps to reduce the maximum value of insured properties and increase the insurance premium. Since January 2014 the NHG exposure has been reduced to 90 percent of the claims. In addition, from January 2015, 15 bps of the mortgage insurance premium will be set aside to safeguard against the risk of excessive defaults. The authorities, however, cautioned against reducing further the NGH's guarantee limit and raising its premium which could undermine the NHG's social mandate to promote affordable housing.

On new financial risk-sharing instruments, the authorities saw benefits for households to hedge risk to their most important asset but noted that this went against the push for greater simplicity in financial instruments. Over time with a firm housing recovery and stronger balance sheets, banks could consider developing such instruments to help borrowers hedge their risks.

D. Supportive Macro Policies and Structural Reforms

Context **After several years of consolidation, the fiscal stance is set to return to neutral.** Cuts to health and long-term care and social security as well as increased revenues reduced last year's headline deficit to below 3 percent of GDP, allowing for an exit from EDP in June. In 2014-15, the fiscal impulse is expected to be around zero, as the government has shifted to targeting a structural balance in line with their medium-term framework. Looking ahead, the headline deficit is expected to narrow further and the general government debt to decline to 67 percent of GDP by 2019. For 2015, the authorities plan to reduce the tax burden on labor by €1 billion by increasing the employed persons' tax credit and cutting the lowest rate of income tax. They also plan to start discussions in 2016 on more fundamental reforms to the tax system.

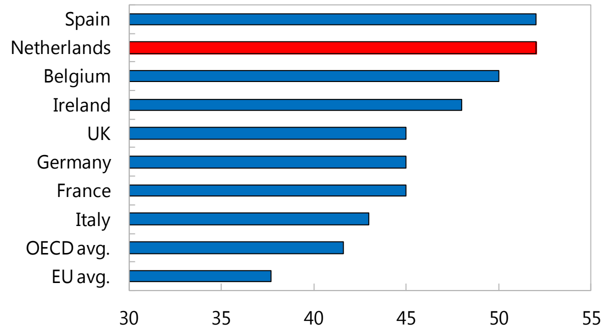
Advice **To support growth during deleveraging, fiscal policy should focus on structural targets.** For 2015, the budget should continue to aim for a neutral stance to avoid harmful tightening in the event that growth slows. Over the medium term, fiscal policy should maintain a structural balance and avoid targeting headline balances in response to adverse shocks. To mitigate the need for active fiscal policies, automatic stabilizers on the revenue side appear to function well, but are constrained on the expenditure side due to the real spending ceilings in the budget. Moving cyclical spending such as unemployment insurance above the ceiling could allow for more automatic responses to economic conditions.

A shift to a medium-term budget framework would also enhance the predictability and responsiveness of fiscal policy. The current budget framework based on tight expenditure ceilings depends crucially on the quality of macro projections over a 4 year period and is linked closely to the political cycle. Moving to a medium-term budget framework that is reviewed annually and allowing automatic stabilizers full play could better incorporate macro developments and minimize the risk of procyclical tightening.

Tax reform should aim to reduce the debt bias, VAT distortions, and the labor tax wedge

Debt bias. The tax system allows interest deductibility to households and corporations with no similar benefit to equity financing. To address this bias, an Allowance for Corporate Equity (ACE) could be introduced to extend tax allowances to corporate equity at a specified "normal return." The ACE could link the "normal return" to corporate bond rates, apply the allowance only on new investments, and allow the netting of benefits for holding companies. Such an approach could also be extended to households to build new home equity.

Highest Marginal Income Tax Rate
(in percent)



Source: KPMG

Labor tax wedge. The Netherlands has one of the highest marginal income tax rate at 52 percent in the OECD. Reducing the labor tax wedge, especially the highest marginal tax rate would help expand the labor supply and provide incentives for new hires.

Unifying VAT. The standard and the reduced VAT rates are 21 percent 6 percent respectively, with the reduced VAT rate applying to items such as foodstuffs, books, and pharmaceuticals. VAT reforms should aim to unify the tax system by reducing exemptions and moving to a single standard rate.

Authorities' Views

Authorities agreed on a neutral fiscal stance as the appropriate medium-term target to anchor fiscal sustainability. Recent measures to reduce health care spending have helped to contain longer-term expenditure pressures. On shifting to a medium-term budget framework, the authorities noted that with the exit from the EDP, they are now returning to a trend-based fiscal framework that has performed well under normal times. They saw the framework as sufficiently flexible to shocks and an effective instrument to coordinate expenditures across ministries. On automatic stabilizers, they saw benefits to keeping more spending within the ceiling to enhance predictability and maintain spending efficiency but noted that when needed, items such as unemployment insurance can be moved outside the ceiling. To better anchor expectations, they highlighted the lesson of relying on more cautious fiscal projections at the beginning of budget periods.

On eliminating the asymmetry of tax treatment of debt and equity, the authorities saw some scope for reform. For example, aligning the tax deductibility of equity and debt would encourage the buildup of capital and strengthen bank and corporate balance sheets. The authorities were in favor of simplifying the VAT system by reducing exemptions and did not rule out unifying the VAT rates. Simplifying the VAT by reducing exceptions would provide an opportunity to lower the tax burden on labor.

Further labor reforms would support employment and SME growth.

Context

The labor market suffers from a high degree of duality. Restrictions against dismissal under regular contracts are extensive as measured by the OECD. High severance payments and lengthy trial periods have raised the cost of dismissals and contributed to the shift towards more flexible temporary and self-employed hires whose share in the labor force has risen to 10 percent in 2012, from 7 percent in 2001.

Advice **Easing protection for regular workers combined with reductions in the tax wedge would support employment.** To enhance the protection of temporary workers, the authorities recently reduced the number of extensions of a temporary work contact from two to one. Reducing the length of trial periods and streamlining notice procedures would ease employment protection and encourage the hiring of regular workers.

Supporting innovative SMEs would boost productivity

Context **Dutch SMEs were hit hard by the slump in domestic demand.** Compared to large firms, SMEs suffer more from high leverage, weak profitability, and tight credit conditions after the housing bust. The loan rejection rate for SME was among the highest in the euro area, reflecting in part their weak financial conditions.

Important insolvency reforms are underway that could support corporate restructuring, including for SMEs. These reforms aim to prevent abuse, rescue viable businesses, and modernize insolvency proceedings. Key features include prepackaged bankruptcies. The bills are expected to enter into force in 2016.

Advice **Improving the quality and sharing of credit information would enhance the availability of credit for SMEs.** This could be achieved by developing a credit bureau system to collect and share loan exposures, collateral, and payment history. Such a system could contribute to greater standardization of SME loans and facilitate securitization and should feature both positive and negative information, as well as cover nonfinancial and public agencies.

Shifting public support from credit guarantees to equity or quasi-equity initiatives could foster SME startups and innovation. Developing alternative sources of market financing, such as securitized loans and mini-bonds, and broadening the range of eligible collateral such as receivables or inventory could help lessen dependence on bank financing. Encouraging Dutch pension funds to invest more in domestic alternative assets, such as venture capital and private equity, could expand the availability of longer-term risk capital.

Authorities' Views **The authorities saw weak domestic demand as the main reason for SME difficulties.** They saw few financing constraints, noting that Dutch banks had sufficient capital buffers but saw little demand for funds. A number of policies have been put in to support SME financing, such as credit guarantees, but demand for these schemes has been low. A smaller portion has been allocated for equity support for innovative SMEs.

The authorities agreed on the need for broader sharing of credit information and were considering to what extent this should be undertaken by the public sector. Efforts to improve the quality and coverage of credit information were underway under the ECB directive to introduce granular credit registries. While there were no legal impediments to creating a public credit registry, concerns over data privacy remains. Creating a public centralized registry also risks crowding out private firms already in this field. Companies also raised concerns that a credit registry could be used as a "blacklist" to deny credit, rather than as an instrument for credit scoring.

The authorities broadly agreed with the need to develop alternative sources of financing for SMEs but saw it as a medium-term objective. SMEs need more equity but this should come without explicit public support. Securitization of SME credits was difficult due to heterogeneity of loans and currently unfavorable capital treatment. Expanding the range of collateral for secured lending faced challenges in the proper valuation. In the near term, the authorities highlighted the recently created National Investment Institute—a private initiative aimed at matching investors with viable projects—as providing support to innovative startups.

STAFF APPRAISAL

12. The recovery continues but remains sluggish. After contracting for two consecutive years, the economy has entered a tepid, export-led recovery with consumption still declining as indebted households continue to save. Deleveraging pressures are expected to keep growth low at 0.8 percent this year before rising gradually to 1.2 percent in 2015. Investment growth is projected to remain sluggish due to weak domestic demand and reduced euro area growth.

13. Progress in household deleveraging has been slow. Household leverage remains high, with debt to income ratios still around 300 percent, almost double the levels in the early 2000s. The loss of housing wealth has been significant at about 60 percent of GDP, concentrated mainly among younger cohorts with nearly two-thirds of mortgages underwater.

14. After several years of consolidation, the fiscal stance is set to turn neutral in 2014. Expenditure cuts and increased revenues allowed for an exit from EDP in June. In 2014-15, the fiscal impulse is expected to be around zero, as the government has shifted to targeting a structural balance in line with their medium-term framework. Over the medium term, the headline deficit is expected to narrow further and the general government debt to decline.

15. The risks to the outlook are on the downside. The Netherlands is exposed to weakness in the euro area which accounts for 60 percent of Dutch exports. An escalation of the Russia-Ukraine crisis that leads to more sanctions or higher fuel prices would also negatively affect growth, mostly through trade and financial linkages with Germany. Combined with a decline in house prices, this would further weaken household balance sheets and spending. Over the medium term, low inflation would exacerbate real household debt burdens and increase the risk of disorderly deleveraging.

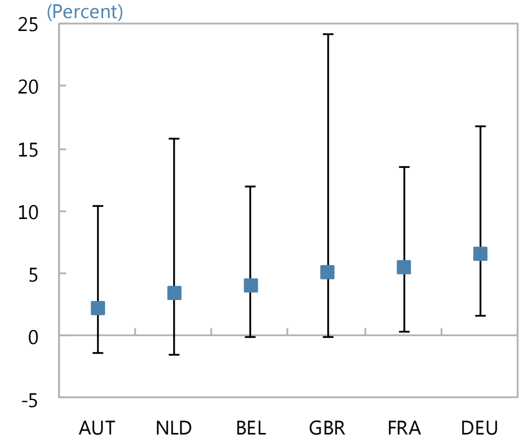
Box 4. Financing Small and Medium Enterprises in the Netherlands

Dutch SMEs were hit hard by the housing price collapse which reduced the value of their collateral. Developing a credit bureau system with sharing of positive and negative credit information could reduce banks' reliance on secured lending as well as expand the availability and lower the cost of credit.

Dutch SMEs are concentrated in the services and trade sectors. Almost half of SME employment and value added in 2013 was from the services, and another quarter from trade. More than 90 percent of firms employ less than 10 employees. Only eight percent of Dutch SMEs are exporters.

Weak domestic demand has worsened financial position of Dutch SMEs, especially at the tail end of the distribution. Around half of the firms had falling revenues with the smallest firms affected the most. Profitability has been falling since 2007. Firm-level data from the ORBIS database suggests that profitability of Dutch firms is more variable compared to similar countries. Median return on assets for Dutch SMEs is in line with peers, however more than 25 percent of firms had negative profitability in 2013. In addition, Dutch SMEs were hit hard by the collapse in housing prices which reduced significantly the value of their collateral and the availability of credit.

SME Return on Assets, Median and Interquartile Range
(Percent)



Liquidity constrained households reduce their consumption more than those that are not constrained.

Underwriting SME loans is costly for Dutch banks. Dutch banks typically rely on real estate collateral for SME lending given the high fixed costs relative to the size of loans and lack of equity and credit information, including through a centralized registry. This has led to a rationing of credit for those firms with high quality collateral and away from riskier startups, even at higher interest rates. Addressing the information asymmetry in SME lending by facilitating the sharing of credit information should lower borrowing costs and expand the availability of credit, including to riskier borrowers.

A comprehensive credit bureau system that collects and shares both positive and negative information could address this lending risk gap. Positive information on payment history, incomes, loan exposures, and assets can complement negative information on defaults in developing credit scoring models that relate the probability of default to firm characteristics. Cross-country evidence suggests that after the introduction of a credit bureau, firm access to finance increases, interest rates drop, maturity lengthens, and the share of working capital financed by banks increases.[6]

16. The government has taken important steps to address the housing problem, support indebted households, implement pension and labor reforms, and consolidate the fiscal

[6] Peria and Singh (2014), "The Impact of Credit Information Sharing Reforms on Firm Financing", World Bank.

position. In particular, the policy measures regarding mortgages have stabilized expectations and supported a gradual pickup in housing prices and transactions. These and other reforms to strengthen the financial system and assist SMEs have helped boost confidence, increase policy certainty, and support the nascent recovery.

17. Addressing the private debt overhang is key to securing a robust recovery. Faster progress in repairing household balance sheets would support a more robust and sustained recovery and reduce intergenerational imbalances. Encouraging more reprofiling of underwater mortgages and reducing the stigma of personal bankruptcy could help address the problem of heavily indebted borrowers. Facilitating transfers between generations could also support deleveraging while stimulating spending.

18. Dutch banks continue to face pressures from the weak economy and their own need to deleverage. Stronger capital and liquidity buffers would ensure that banks have the capacity to support the recovery and the adjustment of household's balance sheet. Further strengthening of the framework for risk management and resolution are also needed. More ambitious medium-term targets for reducing LTV ratios and mortgage deductibility would reduce housing risks.

19. The Dutch housing market suffers from numerous distortions that have contributed to the debt overhang. Deregulating the private rental market would ease pressures on home ownership. The supply of land for residential construction should be made more elastic. Reforms to the government-owned financial institutions (GFIs) are needed to reduce contingent liabilities.

20. Supportive macro-fiscal and structural policies are needed to safeguard the recovery. To support growth during deleveraging, fiscal policy should focus on structural targets. A shift to a medium-term budget framework would strengthen predictability and responsiveness of fiscal policy to shocks. The upcoming tax reform should reduce the debt bias and distortions in the VAT exemptions. Structural reforms to boost potential growth would support activity during the adjustment period.

21. Improving the quality and sharing of credit information would enhance the availability of credit for SMEs. This could be achieved by developing a credit bureau system to collect and share loan exposures, collateral, and payment history. Such a system could contribute to greater standardization of SME loans and facilitate securitization and should feature both positive and negative information, as well as cover nonfinancial and public agencies.

22. It is recommended that the next Article IV consultation be held in the usual 12-month cycle.

Table 1. The Netherlands: Selected Economic Indicators, 2012–15

Total area (2012)	41.5 thousand sq. km.	
Population (Jan. 2013)	16.8 million	
Population characteristics and health		
Life expectancy at birth (2010)	78.1 (male), 82.2 (female)	
Fertility rate (2010)	1.8 children/woman	
Infant mortality rate (2011)	3 per 1,000 live births	
Population per sq. km. of land area (Jan. 2013)	497 persons	
National accounts 2013	(In billions of euros)	(In percent of GDP)
Private consumption	289.6	45.0
Public consumption	169.3	26.3
Gross fixed investment	117.6	18.3
Stockbuilding	0.3	0.0
Exports of goods and nonfactor services	533.2	82.9
Imports of goods and nonfactor services	466.8	72.6
Nominal GDP (at market prices)	642.9	100.0

	2012	2013	2014 Proj.	2015 Proj.
National accounts (constant prices)				
Gross domestic product	-1.6	-0.7	0.8	1.2
Private consumption	-1.4	-1.6	-0.2	0.3
Public consumption	-1.6	-0.3	-0.6	0.0
Gross fixed investment	-6.0	-4.0	1.6	2.6
Total domestic demand	-2.4	-2.0	-0.1	0.7
Exports of goods and nonfactor services	3.3	2.0	3.5	3.5
Imports of goods and nonfactor services	2.8	0.8	2.9	3.1
Net foreign balance 1/	0.6	1.0	0.8	0.7
Output gap (in percent of potential output)	-3.0	-4.4	-4.4	-3.9
Prices, wages, and employment				
Consumer price index (HICP)	2.8	2.6	0.5	0.7
GDP deflator	1.3	1.1	0.5	0.5
Hourly compensation (manufacturing)	1.8	1.6	1.5	1.5
Unit labor costs (manufacturing)	4.1	1.6	-0.2	0.7
Employment				
Unemployment rate (in percent)	5.3	6.7	7.2	6.9
NAIRU	4.8	4.9	5.0	5.0
External trade				
Merchandise balance (percent of GDP)	6.9	7.8	8.2	8.5
Current account balance (percent of GDP)	8.9	10.2	9.8	9.4
General government accounts (percent of GDP)				
Revenue	43.4	44.4	43.8	43.2
Expenditure	47.2	46.7	46.2	45.3
Net lending/borrowing	-3.7	-2.3	-2.4	-2.2
Primary balance	-2.0	-0.7	-0.8	-0.6
Structural balance 2/	-1.8	0.5	0.4	0.4
Structural primary balance 2/	-0.1	2.1	1.9	1.9
General government gross debt	66.5	68.6	69.3	69.8

Sources: Dutch official publications, IMF, IFS, and Fund staff calculations.
1/ Contribution to GDP growth.
2/ In percent of potential GDP.

Table 2a. The Netherlands: General Government Statement of Operations, 2012–19

(In percent of GDP)

	2012	2013	2014 Proj.	2015 Proj.	2016 Proj.	2017 Proj.	2018 Proj.	2019 Proj.
Revenue	43.4	44.4	43.8	43.2	43.2	43.1	43.0	42.9
Taxes	21.1	21.5	22.9	23.6	23.6	23.6	23.6	23.5
Taxes on production and imports	10.7	11.0	11.5	11.3	11.3	11.3	11.2	11.2
Current taxes on income, wealth, etc.	10.2	10.2	11.2	12.1	12.1	12.1	12.1	12.0
Capital taxes	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Social contributions	15.5	15.9	15.2	14.1	14.1	14.1	14.1	14.1
Grants	0.4	0.4	0.4	0.3	0.3	0.3	0.3	0.3
Other revenue	6.3	6.6	5.3	5.1	5.1	5.0	5.0	5.0
Expenditure	47.2	46.7	46.2	45.3	45.1	44.8	44.4	44.0
Expense	46.1	46.3	45.7	45.2	45.0	44.7	44.3	43.8
Compensation of employees	9.2	8.9	8.8	8.6	8.6	8.5	8.4	8.3
Use of goods and services	7.1	7.2	6.8	6.6	6.5	6.5	6.4	6.3
Consumption of fixed capital	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7
Interest	1.7	1.6	1.6	1.5	1.5	1.5	1.5	1.5
Subsidies	1.2	1.2	1.1	1.1	1.1	1.1	1.1	1.1
Grants	1.6	1.6	1.7	1.7	1.7	1.7	1.7	1.7
Social benefits	22.4	22.9	22.9	22.8	22.7	22.5	22.3	22.1
Other expense	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Net acquisition of nonfinancial assets	1.0	0.3	0.5	0.1	0.1	0.1	0.1	0.1
Net operating balance	-2.7	-2.0	-2.0	-2.0	-1.8	-1.5	-1.2	-0.9
Net lending/borrowing	-3.7	-2.3	-2.4	-2.2	-1.9	-1.7	-1.4	-1.0
Net acquisition of financial assets	1.4	0.0	…	…	…	…	…	…
Currency and deposits	-0.1	-0.4	…	…	…	…	…	…
Securities other than shares	-0.4	-1.0	…	…	…	…	…	…
Loans	1.3	0.8	…	…	…	…	…	…
Shares and other equity	0.2	0.5	…	…	…	…	…	…
Insurance technical reserves	0.0	0.0	…	…	…	…	…	…
Financial derivatives	0.1	0.1	…	…	…	…	…	…
Other accounts receivable	0.3	0.1	…	…	…	…	…	…
Net incurrence of liabilities	5.2	2.3	…	…	…	…	…	…
Special Drawing Rights (SDRs)	0.0	0.0	…	…	…	…	…	…
Currency and deposits	0.0	0.0	…	…	…	…	…	…
Securities other than shares	3.8	2.6	…	…	…	…	…	…
Loans	1.7	-0.8	…	…	…	…	…	…
Shares and other equity	0.0	0.0	…	…	…	…	…	…
Insurance technical reserves	0.0	0.0	…	…	…	…	…	…
Financial derivatives	0.0	0.0	…	…	…	…	…	…
Other accounts payable	-0.3	0.6	…	…	…	…	…	…
Memorandum items								
Primary balance	-2.0	-0.7	-0.8	-0.6	-0.4	-0.2	0.1	0.4
Structural balance (percent of potential GDP)	-1.8	0.5	0.4	0.4	0.3	0.3	0.3	0.3
Structural primary balance (percent of potential GDP)	-0.1	2.1	1.9	1.9	1.8	1.8	1.7	1.7
Gross Debt	66.5	68.6	69.3	69.8	69.2	68.1	67.6	66.6
Output gap	-3.0	-4.4	-4.4	-3.9	-3.2	-2.6	-2.0	-1.4
Nominal GDP (billions of euros)	640.6	642.9	650.8	662.0	677.3	695.2	715.4	737.6
Nominal GDP growth (percent)	-0.4	0.3	1.2	1.7	2.3	2.6	2.9	3.1
Real GDP growth (percent)	-1.6	-0.7	0.8	1.2	1.5	1.6	1.8	1.9
GDP deflator growth (percent)	1.3	1.1	0.5	0.5	0.8	1.1	1.1	1.2

Sources: The Netherlands' Bureau for Economic Policy Analysis (CPB), Ministry of Finance, and Fund staff calculations.

Table 2b. The Netherlands: General Government Statement of Operations, 2012–19

(In billions of euros)

	2012	2013	2014 Proj.	2015 Proj.	2016 Proj.	2017 Proj.	2018 Proj.	2019 Proj.
Revenue	278.2	285.3	284.9	285.9	292.5	299.9	307.9	316.7
Taxes	135.3	138.4	149.0	156.4	160.0	164.2	168.6	173.4
Taxes on production and imports	68.4	70.8	74.6	74.6	76.3	78.3	80.4	82.7
Current taxes on income, wealth, etc.	65.6	65.9	72.6	80.0	81.9	84.1	86.3	88.8
Capital taxes	1.4	1.7	1.8	1.8	1.8	1.9	1.9	2.0
Social contributions	99.6	102.0	99.1	93.5	95.7	98.2	100.8	103.7
Grants	2.6	2.8	2.4	2.3	2.4	2.4	2.5	2.5
Other revenue	40.6	42.1	34.5	33.7	34.5	35.1	36.0	37.0
Expenditure	302.1	300.0	300.6	300.2	305.7	311.5	317.6	324.3
Expense	295.5	297.9	297.7	299.2	304.7	310.5	316.6	323.2
Compensation of employees	58.6	57.5	57.0	57.1	58.2	59.3	60.3	61.4
Use of goods and services	45.5	46.2	44.1	43.5	44.3	45.1	45.7	46.4
Consumption of fixed capital	17.6	17.6	17.8	18.2	18.5	18.8	19.4	20.0
Interest	11.0	10.4	10.3	10.0	10.2	10.4	10.6	10.8
Subsidies	7.9	7.8	7.4	7.5	7.6	7.8	8.0	8.2
Grants	10.3	10.6	11.1	11.5	11.7	11.9	12.2	12.6
Social benefits	143.8	147.1	149.2	150.7	153.5	156.5	159.6	163.0
Other expense	0.7	0.7	0.7	0.7	0.7	0.7	0.8	0.8
Net acquisition of nonfinancial assets	6.6	2.1	2.9	1.0	1.0	1.0	1.0	1.1
Net operating balance	-17.3	-12.7	-12.7	-13.3	-12.1	-10.5	-8.7	-6.4
Net lending/borrowing	-23.9	-14.8	-15.7	-14.3	-13.1	-11.5	-9.7	-7.5
Net acquisition of financial assets	9.1	0.3	…	…	…	…	…	…
Currency and deposits	-0.8	-2.6	…	…	…	…	…	…
Securities other than shares	-2.4	-6.3	…	…	…	…	…	…
Loans	8.6	5.0	…	…	…	…	…	…
Shares and other equity	1.1	3.4	…	…	…	…	…	…
Insurance technical reserves	0.0	0.0	…	…	…	…	…	…
Financial derivatives	0.4	0.4	…	…	…	…	…	…
Other accounts receivable	2.2	0.4	…	…	…	…	…	…
Net incurrence of liabilities	33.1	15.0	…	…	…	…	…	…
Special Drawing Rights (SDRs)	0.0	0.0	…	…	…	…	…	…
Currency and deposits	0.0	0.0	…	…	…	…	…	…
Securities other than shares	24.1	16.7	…	…	…	…	…	…
Loans	11.1	-5.3	…	…	…	…	…	…
Shares and other equity	0.0	0.0	…	…	…	…	…	…
Insurance technical reserves	0.0	0.0	…	…	…	…	…	…
Financial derivatives	0.0	0.0	…	…	…	…	…	…
Other accounts payable	-2.2	3.6	…	…	…	…	…	…
Memorandum items								
Primary balance	-13.0	-4.3	-5.4	-4.2	-2.9	-1.2	0.9	3.3
Gross Debt	426.1	441.0	450.8	462.3	468.9	473.7	483.4	490.9
Nominal GDP (Euro bill.)	640.6	642.9	650.8	662.0	677.3	695.2	715.4	737.6

Sources: The Netherlands' Bureau for Economic Policy Analysis (CPB), Ministry of Finance, and Fund staff calculations.

Table 3. The Netherlands: Medium-Term Macroeconomic Framework, 2012–19

(Growth rates, in percent, except where otherwise mentioned)

	2012	2013	2014	2015	2016	2017	2018	2019
National accounts (constant prices)								
Real GDP	**-1.6**	**-0.7**	**0.8**	**1.2**	**1.5**	**1.6**	**1.8**	**1.9**
Domestic demand	-2.4	-2.0	-0.1	0.7	1.0	1.2	1.4	1.6
Private consumption	-1.4	-1.6	-0.2	0.3	0.6	0.8	0.9	0.9
Public Consumption	-1.6	-0.3	-0.6	0.0	0.8	1.0	1.1	1.2
Gross fixed investment (total)	-6.0	-4.0	1.6	2.6	2.2	2.5	3.0	3.4
Public	-7.2	-3.4	0.1	0.4	0.5	0.6	0.7	0.8
Private	-5.7	-4.1	2.0	3.1	2.6	2.9	3.5	4.0
Residential	-8.1	-9.1	-3.1	0.1	0.2	1.0	1.5	2.0
Business	-4.9	-2.3	3.6	4.0	3.3	3.5	4.0	4.5
Stocks 1/	0.1	-0.3	-0.1	0.0	0.0	0.0	0.0	0.0
Exports goods and services	3.3	2.0	3.5	3.5	3.6	3.8	4.0	4.0
Imports goods and services	2.8	0.8	2.9	3.1	3.4	3.8	3.9	4.0
Domestic demand (contribution to growth)	-2.2	-1.8	-0.1	0.6	0.9	1.1	1.2	1.4
External demand (contribution to growth)	0.6	1.0	0.8	0.7	0.6	0.5	0.6	0.5
Output gap	-3.0	-4.4	-4.4	-3.9	-3.2	-2.6	-2.0	-1.4
Potential output growth	0.7	0.7	0.7	0.7	0.7	1.0	1.1	1.3
Gross investment (percent of GDP)	19.4	18.3	18.4	18.6	18.9	19.2	19.6	20.0
Gross national saving (percent of GDP) 2/	28.3	28.5	28.2	28.0	27.9	28.1	28.3	28.5
Prices and employment								
Consumer price index (year average)	2.8	2.6	0.5	0.7	1.0	1.1	1.3	1.4
GDP deflator	1.3	1.1	0.5	0.5	0.8	1.1	1.1	1.2
Employment	0.6	-0.7	-0.9	0.5	1.1	0.7	0.6	0.5
Unemployment rate (Eurostat definition)	5.3	6.7	7.2	6.9	6.6	6.3	6.0	5.8
External								
Current account balance (percent of GDP)	8.9	10.2	9.8	9.4	9.0	8.9	8.7	8.5
Public sector accounts (percent of GDP)								
Revenue	43.4	44.4	43.8	43.2	43.2	43.1	43.0	42.9
Expenditure	47.2	46.7	46.2	45.3	45.1	44.8	44.4	44.0
General government balance	-3.7	-2.3	-2.4	-2.2	-1.9	-1.7	-1.4	-1.0
Structural balance (percent of potential GDP)	-1.8	0.5	0.4	0.4	0.3	0.3	0.3	0.3
General government debt	66.5	68.6	69.3	69.8	69.2	68.1	67.6	66.6

Sources: Dutch official publications, International Monetary Fund, International Financial Statistics, and Fund staff estimates.

1/ Contribution to GDP growth.

2/ Value implied by investment and current account data.

Table 4. The Netherlands: External Sector, 2010–15

	2010	2011	2012	2013	2014 Proj.	2015 Proj.
(in percent of GDP except where otherwise stated)						
Balance on Current Account	6.9	8.5	8.9	10.2	9.8	9.4
Trade Balance	6.3	6.7	6.9	7.8	8.2	8.5
Exports of goods	57.0	61.5	65.3	65.1	66.5	68.5
Imports of goods	50.7	54.7	58.5	57.3	58.4	60.0
Service Balance	1.3	1.4	1.2	2.1	2.5	2.5
Exports of services	11.4	12.0	12.7	13.6	14.5	14.9
Imports of services	10.2	10.6	11.5	11.5	12.0	12.4
Factor Income	1.0	2.2	2.8	2.4	1.5	1.5
Receipts	12.7	13.8	13.4	12.8	12.5	11.6
Expenditures	11.7	11.6	10.6	10.3	11.0	10.0
Current transfers, net	-1.7	-1.8	-2.0	-2.2	-2.3	-3.1
Balance on capital account	-0.5	-0.2	-1.5	-0.1	-0.2	-0.3
Balance on financial account	-5.0	-7.8	-7.4	-8.9	-9.6	-9.1
Direct investment, net	-9.0	-2.1	1.1	-1.1	-2.1	-2.5
Direct investment abroad	-8.2	-4.4	0.0	-5.5	-4.3	-4.3
FDI in Netherlands	-0.9	2.4	1.2	4.3	2.2	1.8
Portfolio investment, net	4.0	1.8	-7.2	-4.2	-3.4	-3.6
Other investment	0.1	-7.3	-1.1	-3.5	-4.1	-2.9
Other investment, official	-8.6	-4.8	-22.6	1.2	0.0	0.0
Reserve assets	-0.1	-0.3	-0.3	0.0	-0.1	-0.1
Errors and omissions, net	-1.3	-0.5	0.0	-1.3	0.0	0.0

Sources: DNB and Fund staff calculations.

<table>
<tr><th></th><th>The Netherlands—External Sector Assessment</th><th>Overall Assessment</th></tr>
<tr><td>Foreign asset and liability position and trajectory</td><td>Background. The growth in foreign assets has been driven by large FDI outflows, while liabilities have increased owing to portfolio investments, mainly equities. The net international investment position (NIIP) turned positive in 2008 and is estimated to have reached 53 percent of GDP in 2013, indicating a strong position. Direct investment net assets are considerable at 48 percent of GDP, while portfolio investments are in net liability of approximately 4 percent of GDP.

Assessment. The Netherland's sizeable foreign assets, amounting to 495 percent of GDP, and safe haven status limit the risks from foreign liabilities that are 442 percent of GDP. In light of projected continued sizable current account surpluses, the ratio of NIIP to GDP is likely to continue rising.</td><td rowspan="3">Overall Assessment:

The external position is stronger than the level consistent with medium-term fundamentals and desirable policy settings. However, the external assessment is subject to relatively large uncertainty, including because of the Netherlands' role as a trade and financial center.

Potential policy responses

Structural reforms to raise the productivity of smaller, domestic firms and progress in repairing household balance sheets and strengthening the banking system will support domestic demand and contribute to reducing external imbalances. A slower pace of fiscal consolidation and shift towards more productive investment will also help in the</td></tr>
<tr><td>Current account</td><td>Background. The current account has been in surplus since 1981, reaching 10.2 percent of GDP in 2013. The current account surpluses are explained in large part by savings of the corporate sector and institutional pensions held by households and reflect Netherland's status as a trade and financial center and natural gas exporter. The large corporate savings have been used to finance substantial FDI outflows by global firms in the Netherlands. The rise in household savings since 2008 also reflects deleveraging in response to the sharp declines in housing prices.

Assessment. After accounting for the Netherlands' status as a financial center and energy exporter, the EBA model results suggest that the cyclically-adjusted current account surplus (estimated at 9.3 percent of GDP) is stronger than the value implied by medium-term fundamentals (a current account norm estimated at 5.0 percent of GDP). The current account gap is likely to be smaller due to the following country-specific factors: (i) unlike many other advanced economies, the Netherlands has a fully funded pension system which has increased household saving rates; (ii) following a real estate collapse, household deleveraging has also kept saving rates high, and (iii) statistical issues related to the income measurement of large FDI flows. Taking account these factors, the staff assessment of the current account gap is in the range of 0-4 percent of GDP. 1/</td></tr>
<tr><td>Real exchange rate</td><td>Background. After depreciating during the period 2008–12, both the ULC and CPI based REERs appreciated somewhat in 2013 and are now slightly above their historical averages.

Assessment. The EBA REER model estimates a gap of -1 percent, while the translation of the EBA CA regression estimate to REER terms yields a gap of -7 percent. Considering in addition the staff's CA assessment, and taking into account that trade elasticities tend be larger for members of monetary unions and for economies with high trade shares, the staff's assessment is that the real exchange rate is below the level consistent with fundamentals and desirable policy settings by 0–10 percent.</td></tr>
</table>

Capital and financial accounts: flows and policy measures	**Background**. Net FDI and portfolio outflows dominate the financial account. FDI outflows are driven by the investment of corporate profits abroad. On average, gross FDI outflows largely match corporate profits. **Assessment.** The strong external position limits vulnerabilities from capital flows. The financial account is likely to remain in deficit as long as the corporate sector continues to investment substantially abroad.	rebalancing.
FX intervention and reserves level	**Background**. The euro has the status of a global reserve currency. **Assessment.** Reserves held by the Euro area are typically low relative to standard metrics, but the currency is free floating.	
Technical Background Notes	1/ The larger external balance sheet, presence of large international corporations, and issues related to the measurement of the current account add uncertainty to this assessment.	

Annex I. Progress Against IMF Recommendations

The authorities have taken on board several policy recommendation made by the Fund in previous Article IV consultations. They have implemented tighter macro prudential measures, differentiated rents in the social housing sector by income, and passed structural reforms to improve the functioning of the labor market.

Housing and macro prudential policies

The Fund recommended that after the stabilization of the housing market, consideration be given to reduce maximum LTVs below the current target of 100 percent. While there is sufficient time to implement further reductions after 2018, the authorities have not committed to a course of action after 2018. In line with the Fund advice, the authorities have implemented measures to increase the supply of land for new housing developments by enhancing property tax revenue sharing with the municipalities. Increases in social housing rents for higher income dwellers are also in line with past Fund advice to better target social housing support to lower income individuals. However, measures to gradually phase in caps to the size of MID in nominal terms and target MID to lower-income citizens have not been announced.

Financial sector issues

In line with the Fund advice, banks have increased their capital base, although the leverage ratio remains comparatively high and more capital is needed to reach their Basel III targets. After a sharp reduction after the global financial crisis, foreign claims of Dutch banks have been broadly unchanged since mid-2012.

Fiscal issues

The 2013 Article IV report recommended a more relaxed fiscal stance than the one adopted by the authorities. More broadly, the Fund recommended that fiscal consolidation focus on structural targets and allow automatic stabilizers to operate fully. The authorities instead attached greater importance to lowering the headline deficit below the SGP limit of 3 percent of GDP.

Structural reforms

The authorities have proposed several structural reforms to increase potential growth that are in line with past Fund advice. These include the labor market where the authorities are working to bring the employment conditions of the self employed closer to those of regular employees. On research and development, the Netherlands is set to reach its target of R&D spending of 2.5 percent by 2020.

Annex II. Public Debt Sustainability Analysis

Public debt is expected to remain sustainable supported by recent fiscal consolidation and favorable growth. Under the baseline, the public debt-to-GDP ratio is forecast to peak at 70 percent of GDP in 2015 and decline steadily onwards to close to 66 percent by 2019. A negative growth shock represents the largest risk to the debt outlook, and could increase the debt by about 8 percent of GDP in 2016. In all stress test scenarios, the debt remains on the downward trajectory over the medium term.

Macroeconomic assumptions. Growth is projected to reach [0.8] percent in 2014, driven mostly by expanding exports. Inflation is expected to be low in 2014-15 at between 0.5 and 0.7 percent and is projected to remain below 2 percent over the forecast horizon, reflecting weak domestic demand. Growth will average [1.3] percent over the medium term. The output gap will narrow but not close completely by 2019. The Netherlands' level of government debt, which exceeds 60 percent of GDP, calls for using the higher scrutiny framework. Gross financing needs are projected to be between 10-13 percent of GDP in the medium term.

Realism of baseline assumptions. The Staff's forecasts of the relevant macroeconomic variables are broadly within the 27-75 interquartile range, indicating that there are few forecast outliers that could bias the analysis. The median forecast for real GDP growth during 2005−2013 has been somewhat optimistic, with the median forecast error of -0.45 percent. The primary balance forecast has been very precise, with the median error of 0.05. Inflation (GDP deflator) forecasts have been slightly on the downside, with the median forecast error of 0.16.

Baseline scenario and stress tests. Under the baseline scenario, the debt-to-GDP ratio is projected to decrease to 66 percent by 2019, after peaking at 70 percent of GDP in 2015. Under all macro-fiscal stress tests, the debt-to-GDP ratio first increases in response to the shocks and afterwards declines over the medium term. The strongest shocks to the baseline are to real GDP growth, after which debt-to-GDP ratio initially increases to 78 percent in 2016 and declines thereafter, and the primary balance shock, which elevates the debt to GDP ratio to 73 percent in 2016. Gross financing needs remain at or below 20 percent of GDP, with the exception of the contingent liability shock, which temporarily increases the financing needs above 30 percent of GDP.

The Main Shocks to the Baseline

Growth shock. Under this scenario, real output growth rates are lower by one standard deviation over 2015-16, that is, 2.4 percentage points below the baseline scenario. The assumed decline in growth also lowers inflation by 0.6 percentage points over the same period.

Primary balance shock. This scenario examines the implications of a dual shock of lower revenues and rise in interest rate, leading to a 1.7 percent deterioration in primary balance over 2015-16. This shock increases the debt to GDP ratio to 73 percent in 2016.

Contingent liability shock. This scenario assumes a shock stemming from an increase in the need to support the banking system due to a large shock that wipes out 10 percent of the loans to the private sector. The shock reduces the primary balance in 2015 by approximately 20 percentage points, leading to a large but temporary increase in gross financing needs and a large increase in the gross public debt to GDP ratio. The magnitude of this shock is large due to the large size of the Dutch banking system; however, this shock represents a tail risk event.

Netherlands Public Sector Debt Sustainability Analysis (DSA) - Baseline Scenario

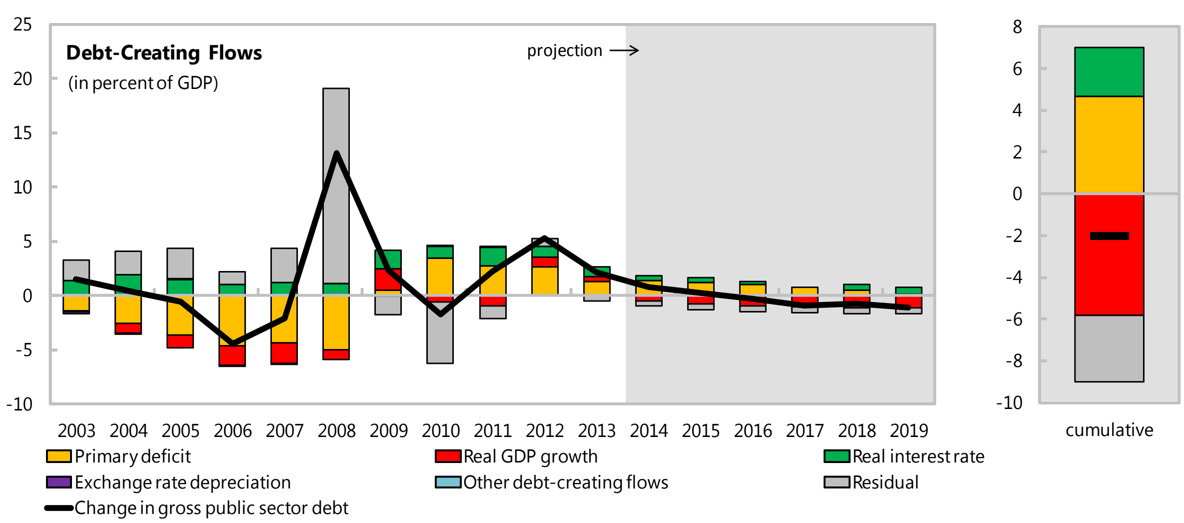
(in percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators [1/]

	Actual			Projections						As of November 03, 2014		
	2003-2011 [2/]	2012	2013	2014	2015	2016	2017	2018	2019	Sovereign Spreads		
Nominal gross public debt	54.3	66.5	68.6	69	70	69	68	68	67	Bond Spread (bp) 3/		15
Public gross financing needs	-0.1	3.7	2.3	6.7	11.6	10.3	12.9	11.2	11.1	5Y CDS (bp)		48
Public debt (in percent of potential GDP)	54.1	64.5	65.6	66.3	66.9	67.0	66.5	66.2	65.5			
Real GDP growth (in percent)	1.5	-1.6	-0.7	0.8	1.2	1.5	1.6	1.8	1.9	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	1.4	1.3	1.1	0.5	0.5	0.8	1.1	1.1	1.2	Moody's	Aaa	Aaa
Nominal GDP growth (in percent)	3.0	-0.4	0.3	1.2	1.7	2.3	2.6	2.9	3.1	S&Ps	AA+	AA+
Effective interest rate (in percent) [4/]	4.2	2.8	2.4	1.2	1.2	1.2	1.0	2.0	2.1	Fitch	AAA	AAA

Contribution to Changes in Public Debt

	Actual			Projections							
	2003-2011	2012	2013	2014	2015	2016	2017	2018	2019	cumulative	debt-stabilizing
Change in gross public sector debt	1.2	5.3	2.1	0.8	0.3	-0.3	-0.9	-0.7	-1.1	-2.0	primary
Identified debt-creating flows	-1.1	4.5	2.6	1.3	0.8	0.2	-0.4	-0.2	-0.6	1.2	balance [9/]
Primary deficit	-1.7	2.6	1.2	1.4	1.2	1.0	0.7	0.4	0.1	4.7	-0.6
Primary (noninterest) revenue and gra	44.2	42.9	43.8	43.2	42.7	42.7	42.6	42.5	42.4	256.1	
Primary (noninterest) expenditure	42.4	45.4	45.1	44.6	43.8	43.6	43.3	42.9	42.5	260.8	
Automatic debt dynamics [5/]	0.6	1.9	1.3	0.0	-0.4	-0.7	-1.1	-0.6	-0.6	-3.5	
Interest rate/growth differential [6/]	0.7	1.9	1.4	0.0	-0.4	-0.7	-1.1	-0.6	-0.6	-3.5	
Of which: real interest rate	1.4	1.0	0.9	0.5	0.5	0.3	-0.1	0.6	0.6	2.3	
Of which: real GDP growth	-0.7	1.0	0.5	-0.5	-0.8	-1.0	-1.1	-1.2	-1.2	-5.8	
Exchange rate depreciation [7/]	0.0	0.0	0.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (1) (e.g., privatization r	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (2) (e.g., other debt flo	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8/]	2.3	0.8	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-3.2	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds (bp).

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as [r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ) times previous period debt ratio, with r = effective nominal interest rate; π = growth rate of GDP deflator; g = real GDP growth ra a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

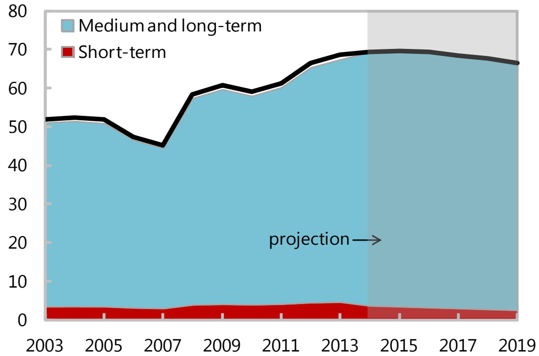
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Netherlands Public DSA - Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

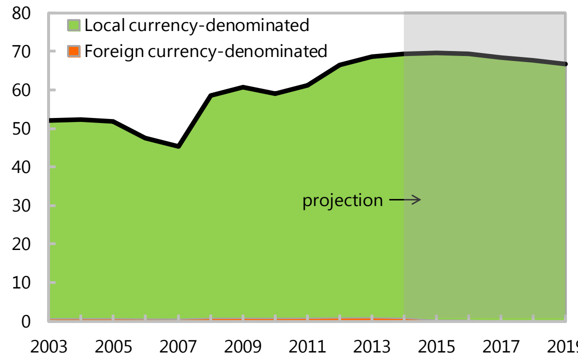
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

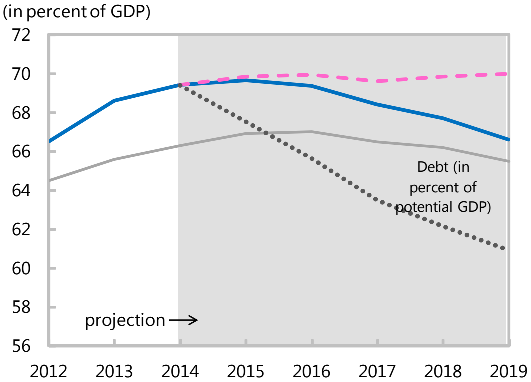


Alternative Scenarios

Baseline Historical Constant Primary Balance

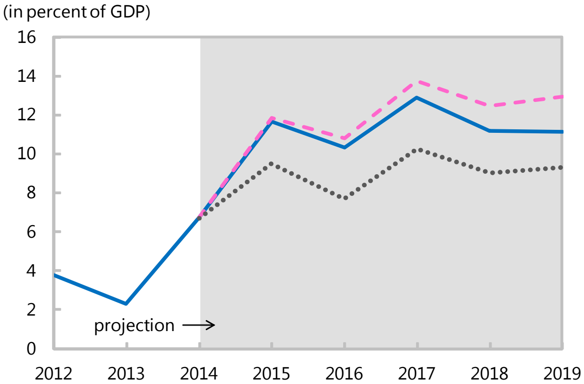
Gross Nominal Public Debt [1/]

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

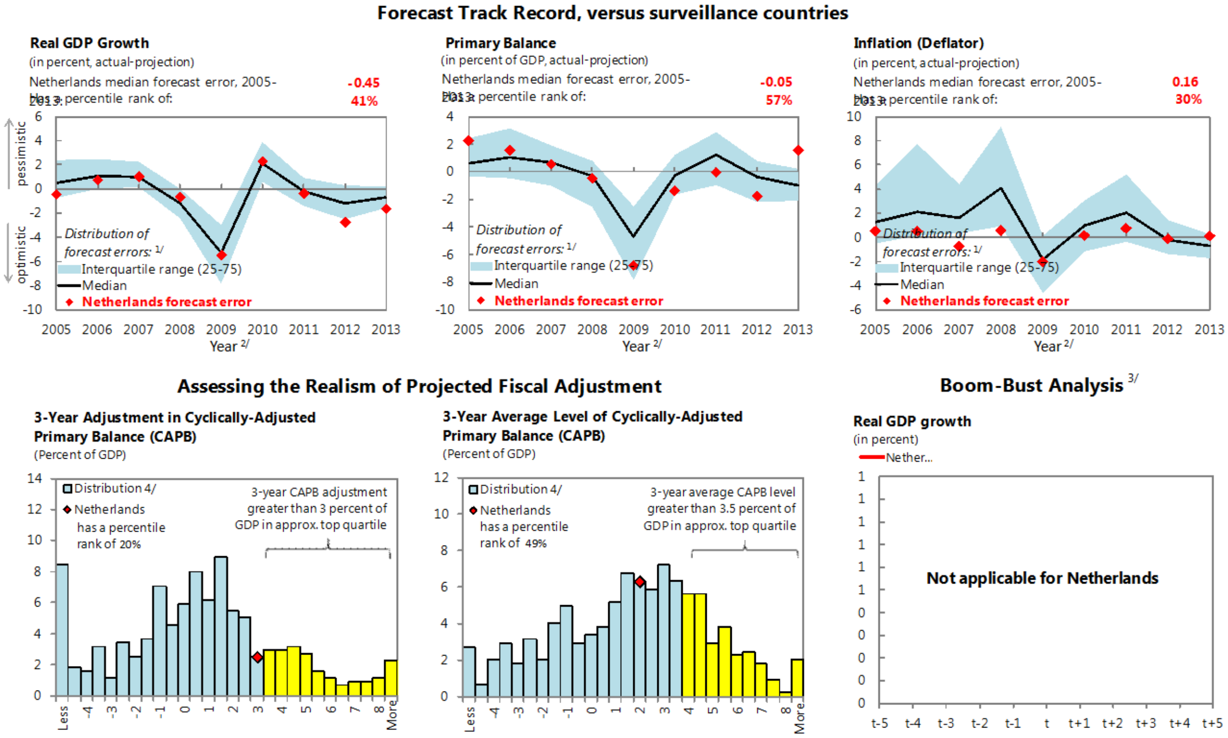
(in percent)

Baseline Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	0.8	1.2	1.5	1.6	1.8	1.9
Inflation	0.5	0.5	0.8	1.1	1.1	1.2
Primary Balance	-1.4	-1.2	-1.0	-0.7	-0.4	-0.1
Effective interest rate	1.2	1.2	1.2	1.0	2.0	2.1
Constant Primary Balance Scenario						
Real GDP growth	0.8	1.2	1.5	1.6	1.8	1.9
Inflation	0.5	0.5	0.8	1.1	1.1	1.2
Primary Balance	-1.4	-1.4	-1.4	-1.4	-1.4	-1.4
Effective interest rate	1.2	1.2	1.2	1.0	2.0	2.1

Historical Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	0.8	1.1	1.1	1.1	1.1	1.1
Inflation	0.5	0.5	0.8	1.1	1.1	1.2
Primary Balance	-1.4	1.0	1.0	1.0	1.0	1.0
Effective interest rate	1.2	1.2	1.5	1.3	2.6	2.9

Source: IMF staff.

Netherlands Public DSA - Realism of Baseline Assumptions



Source : IMF Staff.

1/ Plotted distribution includes surveillance countries, percentile rank refers to all countries.

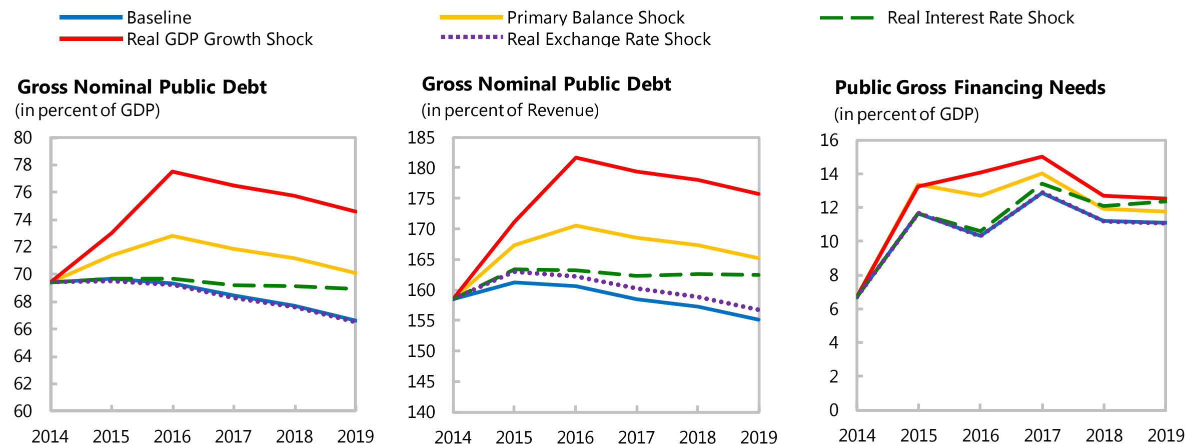
2/ Projections made in the spring WEO vintage of the preceding year.

3/ Not applicable for Netherlands, as it meets neither the positive output gap criterion nor the private credit growth criterion.

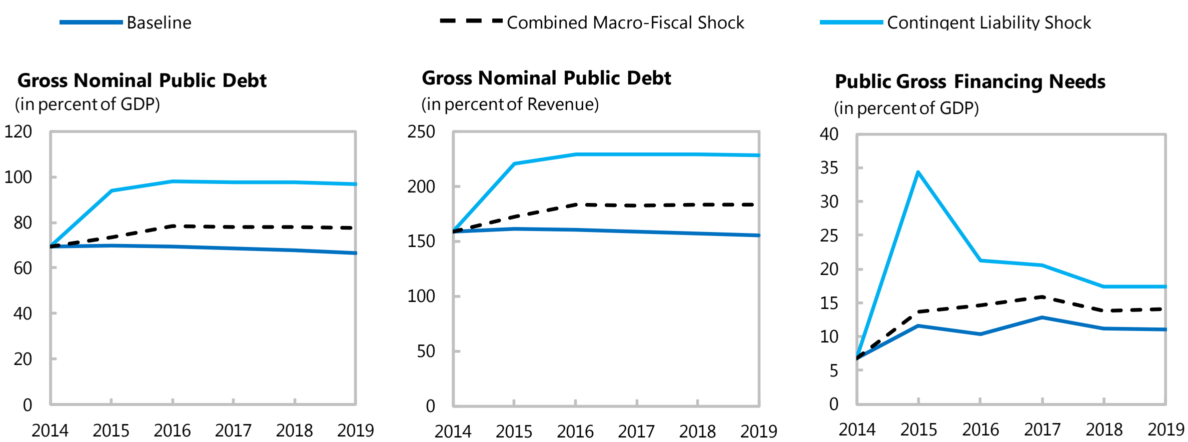
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Netherlands Public DSA - Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

Primary Balance Shock	2014	2015	2016	2017	2018	2019
Real GDP growth	0.8	1.2	1.5	1.6	1.8	1.9
Inflation	0.5	0.5	0.8	1.1	1.1	1.2
Primary balance	-1.4	-2.9	-2.7	-0.7	-0.4	-0.1
Effective interest rate	1.2	1.2	1.3	1.1	2.1	2.2
Real Interest Rate Shock						
Real GDP growth	0.8	1.2	1.5	1.6	1.8	1.9
Inflation	0.5	0.5	0.8	1.1	1.1	1.2
Primary balance	-1.4	-1.2	-1.0	-0.7	-0.4	-0.1
Effective interest rate	1.2	1.2	1.7	1.7	3.1	3.4
Combined Shock						
Real GDP growth	0.8	-1.1	-0.9	1.6	1.8	1.9
Inflation	0.5	-0.1	0.2	1.1	1.1	1.2
Primary balance	-1.4	-2.9	-3.6	-0.7	-0.4	-0.1
Effective interest rate	1.2	1.2	1.7	1.8	3.1	3.5

Real GDP Growth Shock	2014	2015	2016	2017	2018	2019
Real GDP growth	0.8	-1.1	-0.9	1.6	1.8	1.9
Inflation	0.5	-0.1	0.2	1.1	1.1	1.2
Primary balance	-1.4	-2.5	-3.6	-0.7	-0.4	-0.1
Effective interest rate	1.2	1.2	1.3	1.1	2.1	2.2
Real Exchange Rate Shock						
Real GDP growth	0.8	1.2	1.5	1.6	1.8	1.9
Inflation	0.5	0.9	0.8	1.1	1.1	1.2
Primary balance	-1.4	-1.2	-1.0	-0.7	-0.4	-0.1
Effective interest rate	1.2	1.2	1.2	1.0	2.0	2.1
Contingent Liability Shock						
Real GDP growth	0.8	-1.1	-0.9	1.6	1.8	1.9
Inflation	0.5	-0.1	0.2	1.1	1.1	1.2
Primary balance	-1.4	-23.5	-1.0	-0.7	-0.4	-0.1
Effective interest rate	1.2	1.2	2.9	2.3	2.9	2.8

Source: IMF staff.

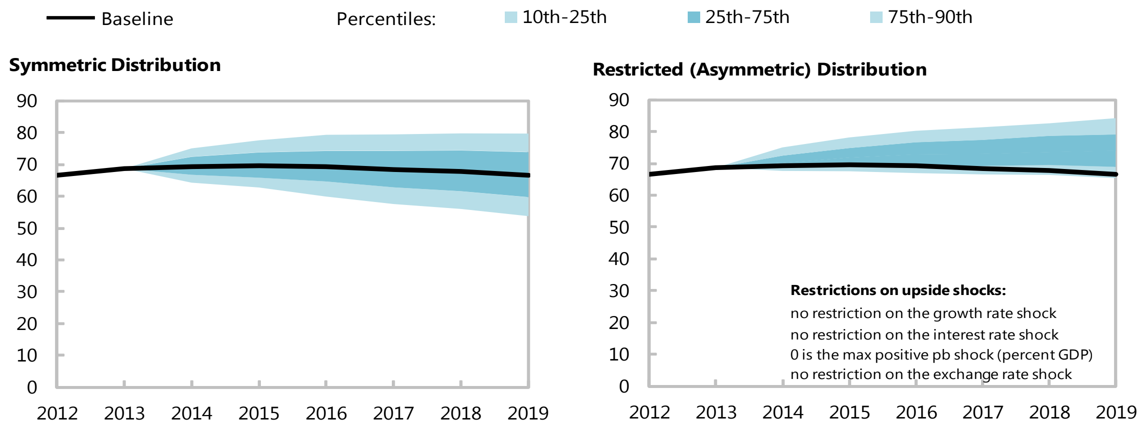
Netherlands Public DSA Risk Assessment

Heat Map

Debt level [1/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs [2/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile [3/]	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

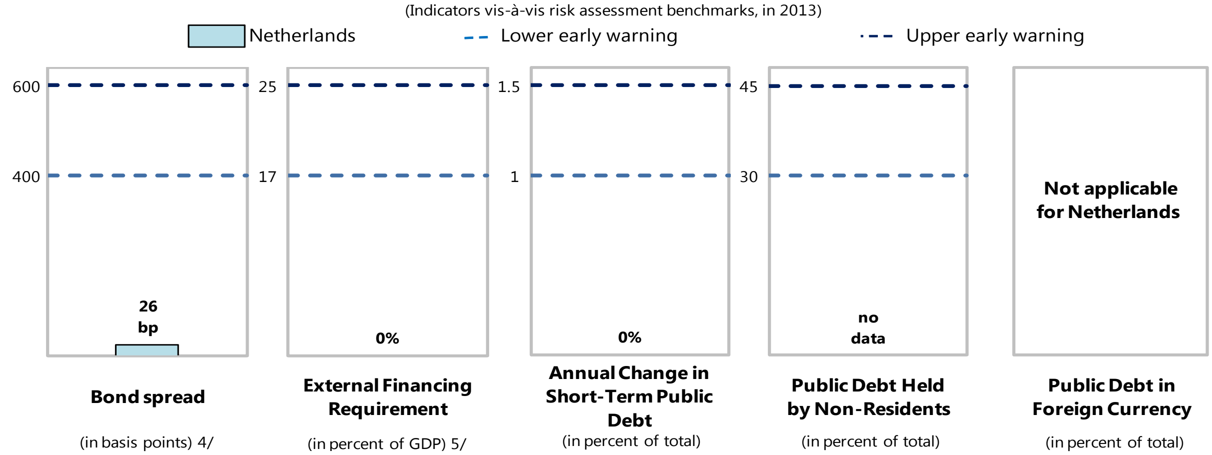
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2013)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 85% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 20% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are:

400 and 600 basis points for bond spreads; 17 and 25 percent of GDP for external financing requirement; 1 and 1.5 percent for change in the share of short-term debt; 30 and 45 percent for the public debt held by non-residents.

4/ Long-term bond spread over German bonds (bp), an average over the last 3 months, 05-Aug-14 through 03-Nov-14.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Text Table 1. Recent Policies Targeting the Owner-Occupied Housing Sector

Changes to the tax system

■ Since January 2013, only interest on fully amortizing mortgages is tax deductibile. Mortgages outstanding as of January 1, 2013 are unaffected.

■ Transfer tax on purchase of existing homes was reduced from 6 to 2 percent.

■ Interest paid on outstanding debt remaining after a house sale can be deducted for up to 10 years.

■ As a temporary measure until end-2014, mortgage debt can be reduced through a one-time tax-free donation for a maximum €100,000.

Mortgage Code of conduct

■ LTV was capped to 106 percent (104 + 2 percent transaction tax) in January 2013. It will fall further by 1 percent per year until it reaches 100 percent, with possible further reduction after 2018. Interest-only mortgages are capped at 50 percent LTV.

■ Prepayment on mortgages with 10 years or less of remaining maturity is possible without penalty.

NHG mortgage guarantee

■ The maximum purchase threshold for NHG guarantee was gradually reduced back to its pre-crisis €265,000 level in July 2014. It will further decline to €225,000 in 2016, then will adjust to the average house price.

■ In parallel, the NHG premium has increased from 0.7 percent to 1.0 percent. The fee remains tax-deductible, and lowers mortgage rates by 40-50 bps.

Loan portfolio market

■ Creation of a National Mortgage Institution (NHI) in 2014 to assist banks in securitizing mortgage loans through a state-supported credit guarantee.

KINGDOM OF THE NETHERLANDS—NETHERLANDS

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

November 18, 2014

Prepared By | European Department

CONTENTS

FUND RELATIONS

(As of September 30, 2014, unless specified otherwise)

Mission: September 25–October 7, 2014 in Amsterdam and The Hague. The concluding statement of the mission is available at http://www.imf.org/external/np/ms/2014/100614.htm

Staff team: Messrs. Kang (head), Mrkaic and Saksonovs and Ms. Hassine (all EUR).

Country interlocutors: The mission met with Finance Minister Dijsselbloem, Dutch National Bank President Knot, other senior officials, finance industry, academic, and trade union representatives. Ms. De Lint and Mr. Snell (OED) joined the end of the visit. On September 30, the team participated in a seminar at the DNB as a part of the EUR housing cluster project.

Fund relations: Discussions for the 2014 Article IV consultation were held in Amsterdam and The Hague from September 25 to October 7, 2014. The staff report for the 2013 Article IV Consultation (IMF Country Report No. 13/115, April 17, 2013) was considered by the Executive Board on May 1, 2013. The Article IV discussions with the Netherlands are on the standard 12-month consultation cycle. The Executive Board's assessment and staff report are available at http://www.imf.org/external/pubs/cat/longres.aspx?sk=40522.0

Membership Status: Joined December 27, 1945; Article VIII.

General Resources Account:	**SDR Million**	**Percent of Quota**
Quota	5,162.40	100.00
Fund holdings of currency	4,032.59	78.11
Reserve Tranche Position	1,129.89	21.89
Lending to the Fund	1,201.08	

SDR Department:	**SDR Million**	**Percent of Allocation**
Net cumulative allocation	4,836.63	100.00
Holdings	4,569.63	94.48

Outstanding Purchases and Loans: None

Latest Financial Arrangements: None

Projected Obligations to Fund[1] (SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2014	2015	2016	2017	2018
Principal					
Charges/interest	0.04	0.14	0.14	0.14	0.14
Total	0.04	0.14	0.14	0.14	0.14

Implementation of HIPC Initiative
Not Applicable

Implementation of Multilateral Debt Relief Initiative (MDRI)
Not Applicable

Implementation of Post-Catastrophe Debt Relief (PCDR)
Not Applicable

Exchange Rate Arrangements
The Netherlands' currency is the euro, which floats freely and independently against other currencies.

[1] When a member has overdue financial obligations outstanding for more than three months, the amount of arrears will be shown in this section.

STATISTICAL ISSUES

I. Assessment of Data Adequacy for Surveillance
National accounts The Netherlands adopted the *European System of Accounts 2010 (ESA 2010)* in March 2014. The transition from the *ESA 1995 (ESA 95)* entailed a revision of national accounts data. New data sources have been incorporated in the new estimates. As a result of these changes, the GDP level in 2010 has been revised 7.6 percent upward (only 3 percent because of the *ESA 2010)*. Historical data series are available from 2001. **Government Finance Statistics** Government finance statistics reported to Eurostat and the Fund are compiled using the *ESA 95* methodology and are converted to the *Government Finance Statistics Manual 2001* format. Starting from September 2014, government finance statistics data will be based on *ESA 2010* methodology which is likely to include revisions of the general government deficit and debt levels from 1995 onwards. Revised ESA based data series will be published in October 2014. **External Sector Statistics** The DNB compiles the balance of payments in close cooperation with the CBS. An agreement between the CBS and the DNB was formally ratified in 2006 to further strengthen the decades-long cooperation between the two institutions. Balance of payments and international investment position (IIP) statistics are compiled according to the *Balance of Payments Manual, fifth edition (BPM5)* and the legal requirements of the ECB and Eurostat. The Data Template on International Reserves and Foreign Currency Liquidity is disseminated monthly and quarterly external debt data are reported to the World Bank for redissemination in the Quarterly External Debt Statistics (QEDS) database. **Monetary and Financial Statistics:** Monetary data reported for International Financial Statistics are based on the European Central Bank's (ECB) framework for collecting, compiling, and reporting monetary data. **Financial Soundness Indicators** The Netherlands participates in the financial soundness indicators (FSIs) project. Quarterly data for most of the 40 FSIs are posted on the FSI website for the period 2008:Q1 to 2012:Q4.

II. Data Standards and Quality	
Subscriber to the Fund's Special Data Dissemination Standard since June 11, 1996.	Data ROSC is available.

Netherlands—Table of Common Indicators Required for Surveillance

(As of November 18, 2014)

	Date of Latest Observation	Date Received	Frequency of Data /8	Frequency of Reporting /8	Frequency of Publication /8	Memo Items:	
						Data Quality—Methodological Soundness /9	Data Quality—Accuracy and Reliability /10
Exchange Rates	Current	Current	D and M	D and M	D and M		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities /1	10/14	11/14	M	M	M		
Reserve/Base Money 2/	10/14	11/14	M	M	M		
Broad Money 2/	10/14	11/14	M	M	W and M		
Central Bank Balance Sheet	10/14	11/14	M	M	M		
Consolidated Balance Sheet of the Banking System	10/14	11/14	M	M	M		
Interest Rates /3	Current	Current	D and M	D and M	D and M		
Consumer Price Index	9/14	10/13	M	M	M	O, O, LO, O	O, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing /4—General Government /5	Q2/14	Q3/14	Q	Q	Q	LO, LO, LO, O	LO, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing /4—Central Government	Q2/14	Q3/14	Q	Q	Q		
Stocks of Central Government and Central Government-Guaranteed Debt /6	Q2/14	Q3/14	Q	Q	Q		

Netherlands—Table of Common Indicators Required for Surveillance (concluded)
(As of November 18, 2014)

External Current Account Balance	Q2/14	Q3/14	Q	Q	Q	O, O, O, O	O, O, O, O, O
Exports and Imports of Goods and Services	Q2/14	Q3/14	Q	Q	Q		
GDP/GNP	Q2/14	Q3/14	Q	Q	Q	O, O, O, O	LO, O, O, O, O
Gross External Debt	Q2/14	Q3/14	Q	Q	Q		
International Investment Position 7/	Q2/14	Q3/14	Q	Q	Q		

1/ Includes reserve assets pledged of otherwise encumbered.
2/ Pertains to contribution to EMU aggregate.
3/ Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
4/ Foreign, domestic bank, and domestic nonbank financing.
5/ The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
6/ Including currency and maturity composition.
7/ Includes external gross financial asset and liability positions vis-à-vis nonresidents.
8/ Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).
9/ Reflects the assessment provided in the data ROSC (published on January 10, 2008, and based on the findings of the mission that took place October 3-17, 2007) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O); largely observed (LO); largely not observed (LNO); not observed (NO); and not available (NA).
10/ Same as footnote 9, except referring to international standards concerning (respectively) source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.

INTERNATIONAL MONETARY FUND
COMMUNICATIONS DEPARTMENT

Press Release No. 14/552
FOR IMMEDIATE RELEASE
December 5, 2014

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2014 Article IV Consultation with the Netherlands

On December 3, 2014, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Netherlands.

The Dutch economy continues to improve, supported by exports, rising house prices, and improving sentiment. Exports are rising on expanding global trade, but consumption remains sluggish as indebted households continue to save. The external current account surplus now exceeds 10 percent of GDP, led by an improving trade balance. Labor slack and the large output gap have pushed down core inflation, raising real interest rates. Following a decline of 27 percent in real terms, housing prices have gradually increased this year, halting the decline in household wealth. Household leverage, however, remains high, concentrated mainly among younger cohorts.

On this basis, growth is expected to reach 0.8 percent this year before rising gradually to 1.2 percent in 2015, supported by rising exports and a modest recovery in housing prices. Investment is projected to remain subdued due to weak domestic demand. The risks to the outlook are on the downside. Near term risks stem from the euro area weakness and geopolitical spillovers, while medium-term growth prospects are overshadowed by the large household debt. Lower energy prices or a faster pickup in housing prices could lift growth.

Executive Board Assessment[2]

Executive Directors welcomed the continued economic recovery and the pickup in exports and house prices. Directors noted nevertheless that consumption is still sluggish, held down

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

by high household indebtedness and weak incomes, while inflation is still low. In light of these developments and the elevated current account surplus, accommodative macroeconomic policies would be important to boost domestic demand and growth, while also facilitating external rebalancing. Directors called on the authorities to build on recent progress to ensure orderly deleveraging of households, reform the tax and pension systems, and advance broader structural reforms to improve the housing and labor markets, productivity, and potential growth.

Directors emphasized that further repair of household balance sheets is needed to sustain a more robust recovery. They recommended steps to assist the heavily indebted young borrowers, including by facilitating a reprofiling of underwater mortgages, out-of-court debt workouts, and intergenerational transfers to pay down mortgage debt. Directors noted that reducing pension contributions for younger generations could also be considered as part of a broader reform, while safeguarding the soundness of the pension system.

Directors considered it important that banks have strong capital and liquidity buffers to underpin the recovery. They looked forward to the completion of national arrangements for resolution and backstopping in support of euro area institutional reforms for the banking sector. Directors also saw merit in setting ambitious medium-term targets for further reducing the maximum loan-to-value ratios and mortgage interest deductibility, while carefully taking into account the stability and broader developments in the economy.

Directors welcomed the government’s comprehensive reform of the housing market to remove remaining distortions and restore confidence. They supported steps to deregulate the private rental market and scale back public support for the social housing sector. Continued reforms to the social housing corporations are needed to further reduce distortions in the rental market.

Directors broadly supported a neutral fiscal position and a focus on structural targets. They agreed that maintaining a structural balance should remain the medium-term goal, although a few saw scope for a more expansionary stance to prop up growth in the near term. Directors noted that more frequently updated trend forecasts in the context of the Netherlands’ medium-term budget framework would help strengthen predictability and responsiveness of fiscal policy to shocks. A number of Directors also supported the authorities’ commitment to maintain the fiscal rules under the Stability and Growth Pact. Directors welcomed the planned reform of the tax system, noting that consideration could be given to options to promote equity financing, reduce the labor tax wedge, and simplify the value-added tax.

Directors highlighted the role of small- and medium-size enterprises (SMEs) in promoting employment and growth. They called for continued efforts to enhance the availability of credit for SMEs, including by improving the quality and sharing of credit information and developing alternative financing sources.

The Netherlands: Selected Economic Indicators, 2012-15

Total area (2012)	41.5 thousand sq. km.	
Population (Jan. 2013)	16.8 million	
Population characteristics and health		
Life expectancy at birth (2010)	78.1 (male), 82.2 (female)	
Fertility rate (2010)	1.8 children/woman	
Infant mortality rate (2011)	3 per 1,000 live births	
Population per sq. km. of land area (Jan. 2013)	497 persons	
National accounts 2013	(In billions of euros)	(In percent of GDP)
Private consumption	289.6	45.0
Public consumption	169.3	26.3
Gross fixed investment	117.6	18.3
Stockbuilding	0.3	0.0
Exports of goods and nonfactor services	533.2	82.9
Imports of goods and nonfactor services	466.8	72.6
Nominal GDP (at market prices)	642.9	100.0

	2012	2013	2014 Proj.	2015 Proj.
National accounts (constant prices)				
Gross domestic product	-1.6	-0.7	0.8	1.2
Private consumption	-1.4	-1.6	-0.2	0.3
Public consumption	-1.6	-0.3	-0.6	0.0
Gross fixed investment	-6.0	-4.0	1.6	2.6
Total domestic demand	-2.4	-2.0	-0.1	0.7
Exports of goods and nonfactor services	3.3	2.0	3.5	3.5
Imports of goods and nonfactor services	2.8	0.8	2.9	3.1
Net foreign balance 1/	0.6	1.0	0.8	0.7
Output gap (in percent of potential output)	-3.0	-4.4	-4.4	-3.9
Prices, wages, and employment				
Consumer price index (HICP)	2.8	2.6	0.5	0.7
GDP deflator	1.3	1.1	0.5	0.5
Hourly compensation (manufacturing)	1.8	1.6	1.5	1.5
Unit labor costs (manufacturing)	4.1	1.6	-0.2	0.7
Employment				
Unemployment rate (in percent)	5.3	6.7	7.2	6.9
NAIRU	4.8	4.9	5.0	5.0
External trade				
Merchandise balance (percent of GDP)	6.9	7.8	8.2	8.5
Current account balance (percent of GDP)	8.9	10.2	9.8	9.4

The Netherlands: Selected Economic Indicators, 2012-15 (continued)

General government accounts (percent of GDP)				
Revenue	43.4	44.4	43.8	43.2
Expenditure	47.2	46.7	46.2	45.3
Net lending/borrowing	-3.7	-2.3	-2.4	-2.2
Primary balance	-2.0	-0.7	-0.8	-0.6
Structural balance 2/	-1.8	0.5	0.4	0.4
Structural primary balance 2/	-0.1	2.1	1.9	1.9
General government gross debt	66.5	68.6	69.3	69.8

Sources: Dutch official publications, IMF, IFS, and Fund staff calculations.

1/ Contribution to GDP growth.

2/ In percent of potential GDP.

Statement by Menno Snel, Executive Director and Jeske De Lint, Advisor to the Executive Director for Kingdom of the Netherlands - Netherlands
December 3, 2014

We thank staff for the report which provides useful insights into important issues of the Dutch economy, with a special focus on household debt. While we recognise that there are significant risks stemming from the international environment, we are more positive than staff regarding the fundamentals of the Dutch economy. The medium-term outlook for the economy is supported by the reform agenda the government is currently implementing.

Although fragile, the Dutch economy is recovering slowly. Currently growth is mostly driven by exports, but investments and consumption are on the increase and in 2015 domestic demand will contribute substantially to GDP growth. The unemployment rate is declining faster than expected, while employment is on the rise. Public finances have improved significantly. The housing market is showing clear signs of recovery, both in prices and in transactions. The positive outcome for the Dutch banks in the ECB's comprehensive assessment confirms the stronger capital base of banks.

The government is implementing an ambitious and comprehensive reform agenda. Important and politically very contentious issues were tackled in the housing market, the labour market and the health care sector. The state pension age will be increased more rapidly which results in a retirement age of 66 in 2018 and 67 in 2021. Thereafter, the state pension age will be linked to life expectancy. The reform package includes both short-term measures, with an aim to compensate for the negative impacts of the crisis, and reforms designed to make institutions and frameworks fit for the future. Meanwhile, the government is planning further reforms. Discussions on a comprehensive tax reform are scheduled for next year. Currently the government and social partners are heavily engaged in an open dialogue on the future of the pension system. In designing the measures, budget implications, the impact on long-term growth and redistribution effects are taken into account to make sure the overall package is well-balanced and sustainable.

On staff's assessment

We recognise that Dutch households face relatively large mortgage debts resulting in negative net equity for a large number of households, but the term 'debt overhang' might be a bit too strong. Dutch households have substantial assets (e.g. pensions and saving accounts linked to mortgages) which creates an overall positive net wealth at the macro level. Moreover, the effect of underwater mortgages on consumption and economic growth remains uncertain. Staff suggests that growth will fall to 1.5% annually compared to 2.3% annually in the period 2000-2007 because of household debt overhang, an assumption which does not seem well underpinned. There is uncertainty to what extent households with underwater mortgages are increasing their savings in order to pay down mortgages or increase buffers. There are several factors at play that may mitigate the effect on consumption, such as saving accounts linked to mortgages (which are sizeable but do not appear in headline figures), backing of more than half of the underwater mortgages by the National Mortgage Guarantee Scheme (NHG) and relatively high incomes and future earning potential of the households affected. The delinquency is low (suggesting that immediate liquidity problems are small) and by postponing to move to a larger house, households deleverage without reducing non-housing consumption. More in general, an increase in disposable income is the key driver for consumption growth. Disposable income is expected to rise by 2% in 2014 and 1% in 2015. This trend will likely compensate for the potentially negative impact on overall consumption of deleveraging by households.

The government has undertaken several measures to support households that face negative net equity due to lower housing prices. For instance, mortgage interest deductibility (MID) remains possible for residual debt. Also, residual debt can be financed under the NHG insurance scheme, to reduce the risks for indebted borrowers. Furthermore, the temporary exemption from the gift tax facilitates intergenerational transfers. The extent to which underwater mortgages remain problematic, will strongly depend on the development of the housing market. If, for instance, nominal house prices were to rise by 2 percent annually as from 2014, prices would return to the pre-crisis level in ten years time. Three quarters of the underwater mortgages would be ’above water’. Recent developments are encouraging in this regard.

The government has enacted a comprehensive reform of the housing market, encompassing the owner-occupied and rental sectors. These measures have restored the necessary confidence in and stability of the housing market and prevent households from taking up excessive debt in the future. The government strikes a balance between the implementation of reforms on the one hand and safeguarding the stability of the housing market and income position of households on the other hand.

We agree with staff that gradually reducing LTV ratios is important, but further reduction of the LTV ratio below 100 percent, as suggested by staff, will depend on developments on the housing market and requires a careful cost and benefit analysis. Financial stability would benefit from conservative LTV ratios. New proposals in this direction are, however, conditional on a robust recovery of the housing market and should carefully taking into account the broader development of the housing sector, including the situation on the private rental market. Timing is critical, since further reduction of the LTV ratios may hamper recovery of the housing market and will also require substantial additional savings, mainly from younger households, putting a drag on consumption. The phasing in of the new mortgage interest deductibility (MID) regime for new mortgages will contribute to lowering LTV ratios after 2018. Discussions on housing related macro prudential measures will continue in the Financial Stability Committee (FSC) in the coming months.

A scale back of public support of social housing corporations (SHCs) through guarantees to core social tasks, as advised by staff, is already being implemented. Legislation is being prepared that requires SHCs to separate their services of general economic interest (SGEI) from their non-SGEI activities. Whilst reforms are implemented, lower income groups are supported by targeted rent subsidies. Moreover, social housing corporations' tasks extend under a broader social mandate touching on general living conditions in neighbourhoods. Furthermore, the government focuses on the development of the private rental sector, as expansion of this sector will contribute to a more balanced housing market.

Any reform in the pension system should not be done in isolation but be part of a broader overhaul of the framework by taking into account short and long-term implications, including transition costs. Two things are important to consider in relation to the staff's advice to make accrual rates actuarially fair. First, a reduction in the contributions for the younger generation risks increasing the relative cost of older employees, which can have severe and unintended implications when at the same time the retirement age is lifted. Second, a transition to actuarially fair accrual rates has to take into account the complex issue of intergenerational fairness. For this reason, the government is facilitating a comprehensive and open dialogue on the sustainability of the pension system. This dialogue focuses on aspects related to solidarity, freedom of choice, collectivism and responsibilities in the fully funded part of the pension system. The government will present its vision on the future of the pension system before summer 2015. Regarding staff's advice to reduce procylicality in the pension system, it should be noted that the new financial assessment framework (FTK), which enters into force next year, will result in more stable premiums as well as pay-outs.

As regards the budget, the government remains fully committed to the European budgetary rules as laid down in the Stability and Growth Pact. Now that the development of Dutch public finances looks favourable for 2015 and the EMU balance gradually moves away from the -3 percent benchmark, there is more room for trend-based fiscal policy, the fiscal policy framework successfully used in the Netherlands since 1994. With regard to staff's remarks in Annex I on progress on fiscal issues against IMF recommendations, the sentence on the SGP limit of 3 percent could be misread. Any suggestion that staff is advising against meeting the European budgetary objectives should be avoided.

The loan rejection rate for SMEs is relatively high in the Netherlands because the few enterprises that request financing are mainly the weaker micro firms facing high risks. The main reason for lack of SME financing is because of weak demand and not so much because of supply constraints. We agree that improvements in sharing of positive credit information could be beneficial to the process of SME lending, while still respecting privacy.

Finally, we note that a new and somewhat different format was used for this article IV consultation. The report has a narrow focus on some specific issues and presents the authorities’ views issue by issue. Although, as said, we welcome the report as it provides the authorities with useful input on complex and relevant matters and we had valuable discussions during the mission, for the next article IV we would appreciate a return to the more traditional, holistic approach covering all the key macroeconomic and financial issues.