INTERNATIONAL MONETARY FUND

IMF Country Report No. 17/77

KINGDOM OF THE NETHERLANDS—NETHERLANDS

2016 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE ALTERNATE EXECUTIVE DIRECTOR FOR THE KINGDOM OF THE NETHERLANDS—NETHERLANDS

April 2017

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 2016 Article IV consultation with the Kingdom of the Netherlands—Netherlands, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its March 29, 2017 consideration of the staff report that concluded the Article IV consultation with the Kingdom of the Netherlands—Netherlands.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on March 29, 2017, following discussions that ended on December 8, 2016, with the officials of the Kingdom of the Netherlands—Netherlands on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on March 15, 2017.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Alternate Executive Director** for the Kingdom of the Netherlands—Netherlands
- The documents listed below have been or will be separately released.

Selected Issues

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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INTERNATIONAL MONETARY FUND

COMMUNICATIONS DEPARTMENT

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FOR IMMEDIATE RELEASE
April 3, 2017

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Washington, D. C. 20431 USA

IMF Executive Board Concludes 2016 Article IV Consultation with Kingdom of the Netherlands - Netherlands

On March 29, 2017, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Netherlands.

The economic recovery is broad based and has been gathering speed. Real growth is forecast to reach 2.1 percent in 2016 owing to strong consumption and investment, reflecting improving confidence and rising house prices, while net exports are expected to slow down due to weak external demand. Unemployment has been rapidly declining against the backdrop of increasing labor supply. Inflation has remained low in the absence of wage pressure. Credit growth bottomed out recently for households, but remains negative for the corporate sector, signaling protracted deleveraging. The banking system has continued to build capital buffers to withstand challenges associated with the low interest rate environment.

The economy is expected to keep its momentum in the coming years. Domestic consumption and investment are forecast to remain the main drivers of growth, prompting a gradual decline of the current account surplus. Inflation would pick up along the closing of the output gap. Risks to the outlook are broadly balanced, as weaker than expected growth in the Euro area or uncertainties surrounding Brexit negotiations could negatively impact the economy, while more favorable labor market developments and a faster house price recovery could further support demand.

Credit continues to decline as banks' balance-sheets shrink, and firms and households continue to deleverage. Large Dutch multinationals generally have substantial cash balances and access to bond markets, and are not a significant source of increased credit growth. In spite of the ECB's accommodative monetary policy stance, credit has declined further in the Netherlands as banks continued to deleverage in 2016, reacting to both market and regulatory pressures. While credit to households appears to have bottomed out, credit to non-financial corporations has continued to sag this year, contracting by 6 percent (year-over-year) in July. Despite increased competition in credit market, banks continue to charge relatively high interest rates to risky borrowers to cover their relatively high funding costs. Looking ahead, prices for houses—SMEs' main source of collateral—should gradually return to pre-crisis levels and credit standards should loosen.

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[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.

The risks to the outlook are tilted slightly to the downside. Foreign demand could end up being weaker than expected in the baseline as many economies in Europe continue to struggle with post-crisis legacies, in particular in the banking sector, and slow growth which weighs on import demand. Also, the uncertainty surrounding the aftermath of the Brexit decision may have larger than expected effects on the Dutch economy given its openness and relatively large share of exports to the U.K. On the other hand, the strength of domestic demand may be underestimated in the baseline, as suggested by fiscal over-performance and a faster than expected improvement in labor market conditions. Housing prices could also recover faster than anticipated spurring a positive feedback loop of higher consumption, higher investment, especially in the construction sector, higher employment and higher demand for housing.

Executive Board Assessment[2]

Executive Directors welcomed the continued recovery of the Dutch economy despite the ongoing deleveraging process in the private sector. Directors noted, however, that risks to the outlook are slightly tilted to the downside and challenges remain, particularly due to uncertainties related to external developments and low productivity growth. Against this backdrop, they concurred that the priority should be to ensure steady and sustainable growth through policies that focus on decreasing leverage, boosting potential output, and safeguarding financial stability.

Many Directors supported staff's recommendation to use existing fiscal space to support the recovery in the short term, particularly through additional growth-enhancing spending in public R&D and education or through further reducing the tax wedge for workers at the margin of the labor force; the need to comply with the requirements of the Stability and Growth Pact when using the fiscal space was noted. A number of Directors, however, expressed concern that further fiscal stimulus could become procyclical in the near term.

More generally, Directors agreed that, in the medium run, aiming for some fiscal consolidation would help rebuild buffers in a still highly-leveraged economy.

Directors underscored the importance of lessening the financial vulnerability of still highly leveraged households. They encouraged the authorities to build on the important steps taken in the last few years and accelerate the implementation of real-estate-specific macroprudential measures. In addition, Directors noted that the efficiency and flexibility of the housing market could be improved by removing existing subsidies in the social and owner-occupied sectors—thereby promoting the development of the private rental market—and by easing existing regulations that prevent construction from meeting housing demand.

Directors commended the authorities for improving the oversight of the financial sector, and recommended continued vigilance. They agreed that the banking sector is well capitalized and resilient to risks, but faces challenges associated with high leverage, low interest rates, and continued reliance on wholesale funding. Against this backdrop, Directors saw scope for banks to further increase their capital buffers. They also encouraged the authorities to closely monitor banks' business models and risk management frameworks.

[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.

Directors considered that insurers' financial conditions should also be closely monitored and Pillar 2 measures should be applied if required.

Directors welcomed the labor tax reduction package introduced in 2016, but stressed that a more fundamental overhaul of the tax system is needed. In particular, they noted that future tax reforms should aim to further improve efficiency, reduce the debt bias, and shift the tax burden from labor toward consumption and property.

Directors noted that the increase of flexible work arrangements calls for addressing potential rigidities in the formal employment sector, while ensuring the sustainability of the safety net. In particular, they underscored the need to better harmonize labor protection as well as social benefits and taxation frameworks across various categories of workers.

Directors also commended the authorities' efforts to integrate refugees into society and the labor market.

Directors welcomed the principles underpinning the government's pension reform proposals, which are focused on enhancing transparency and ensuring portability, while preserving financial security at retirement.

Netherlands: Selected Economic Indicators, 2014–18

	2014	2015	2016 Est.	2017 Proj.	2018 Proj.
National accounts (percent change)					
Gross domestic product	1.4	2.0	2.1	2.1	1.8
Private consumption	0.3	1.8	1.7	1.7	1.5
Public consumption	0.3	0.2	0.8	0.8	0.5
Gross fixed investment	2.3	9.9	4.8	4.1	3.8
Total domestic demand	0.9	2.3	2.1	2.0	1.8
Exports of goods and nonfactor services	4.5	5.0	3.6	3.6	3.3
Imports of goods and nonfactor services	4.2	5.8	3.8	3.7	3.4
Net foreign balance 1/	0.7	0.0	0.3	0.3	0.3
Output gap (percent of potential output)	-2.2	-1.4	-0.9	-0.4	-0.2
Prices, wages, and employment					
Consumer price index (HICP)	0.3	0.2	0.1	0.9	1.4
GDP deflator	0.1	0.1	0.2	1.0	1.0
Hourly compensation (manufacturing)	2.9	1.5	1.2	2.2	2.1
Unit labor costs (manufacturing)	0.8	0.5	0.8	1.3	0.9
Employment (percent)					
Unemployment rate (national definition)	9.0	8.6	7.3		
Unemployment rate (ILO definition)	7.4	6.9	5.9	5.4	5.3
NAIRU	5.5	5.5	5.5	5.3	5.2
External trade					
Merchandise balance (percent of GDP)	11.4	11.3	10.7	10.7	10.5
Current account balance (percent of GDP)	8.9	8.7	8.9	8.5	8.2
General government accounts (percent of GDP)					
Revenue	43.9	43.2	44.1	44.3	44.3
Expenditure	46.2	45.2	44.6	44.3	44.2
Net lending/borrowing	-2.3	-1.9	-0.5	0.0	0.1
Primary balance	-0.8	-0.7	0.6	1.0	1.1
Structural balance 2/	-1.2	-1.3	-0.1	0.2	0.2
Structural primary balance 2/	0.6	0.2	1.3	1.1	1.1
General government gross debt	67.9	65.1	63.0	60.1	58.3

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

INTERNATIONAL MONETARY FUND

KINGDOM OF THE NETHERLANDS—NETHERLANDS

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION

March 15, 2017

KEY ISSUES

Context

The Netherlands is in the third year of a gradual recovery. Following a double-dip recession, the economy has been steadily accelerating in the context of increasing house prices and gradually improving household balance sheets, rising consumption but weak credit growth. Growth is projected to remain solid in the baseline, but it will be held back by the ongoing process of deleveraging on the part of banks, firms, and households and by lackluster medium-term prospects for the country's major trading partners (including in relation to Brexit). In this scenario, the economy is only projected to return to potential in 2019.

Against this background, the consultation focused on the following issues:

- The sustainability of the recovery against a backdrop of deleveraging in multiple sectors of the economy and tepid foreign demand;
- The opportunity to use existing fiscal space to support the recovery;
- The need to continue reforming the pension system towards more transparency, fairer intergenerational transfers, lower administrative costs, better portability, and less pro-cyclicality;
- The need to continue tightening the macro-prudential toolkit in the face of protracted household sector indebtedness and an underdeveloped rental housing market; and
- The need to address lingering constraints on productivity growth—such as labor market inefficiencies, sub-optimal taxation, limited support for R&D, SMEs' insufficient access to financing.

Approved By
Mahmood Pradhan (EUR) and Zuzana Murgasova (SPR)

Discussions took place in The Hague and Amsterdam during November 29–December 8, 2016. The mission team comprised Messrs. T. Dorsey (head), M. Gerard, J.M. Natal (all EUR), and Ms. M. Khamis (MCM). Messrs. R. Doornbosch and W. Evers (both OED) participated in some of the meetings. The team was supported from headquarters by Mmes. M. Burova and M. Maneely (both EUR). The team met with the Treasurer-General Hans Vijlbrief, De Nederlandsche Bank President Klaas Knot; other officials from the Ministries of Finance, Housing, Social Affairs, De Nederlandsche Bank, and other government entities; representatives of labor unions and employers, and representatives of private sector institutions.

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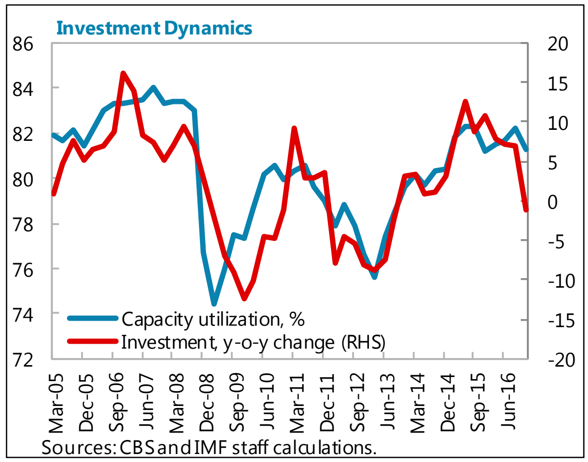
CONTEXT AND OUTLOOK

A. Macroeconomic Developments and Outlook

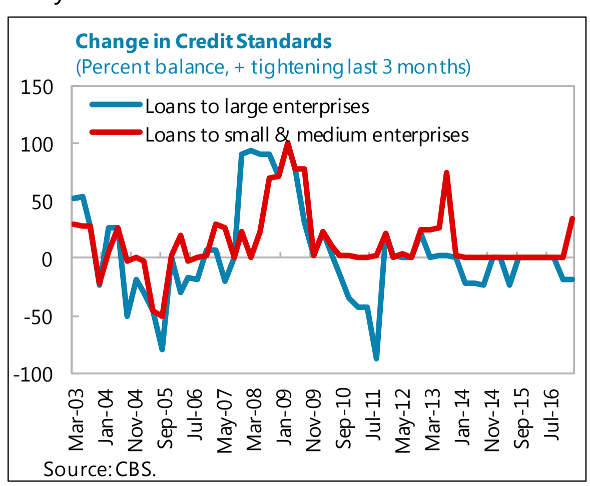
1. The Netherlands is gradually shaking off the legacies of a double-dip recession, in spite of still subdued foreign demand. As house prices continue to recover—improving bank and household balance sheets—a positive feedback loop is emerging with rising consumer confidence, employment, and fueling higher consumption and house purchases. (Figure 1).



2. House prices have been accelerating and close monitoring may be warranted in the country's main cities. After turning a corner in 2014, house prices have been steadily accelerating and transaction volumes have doubled in 2016. At the aggregate level, real house prices are broadly consistent with long-term equilibrium (price-to-income, price-to-rent ratios, Figure 3) but developments have been uneven across regions, with prices for apartments in Amsterdam 15 percent higher than a year ago. After plummeting by 20 percent during the crisis, commercial real estate has only started to recover recently.

3. The labor market is tightening and real wages have started to pick up, supporting consumption. Employment has been increasing for 29 consecutive months, pushing the unemployment rate to 5.3 percent in January 2017, only marginally higher than its long-term average. Recent indicators suggest that the situation on the labor market is progressively becoming firmer (e.g., hours worked, vacancies, wages have all improved, see Figure 2). However, employees' compensation has increased less than labor productivity over the last 8 years, keeping inflation down.

4. Credit continues to decline as banks' balance-sheets shrink, and firms and households continue to delever. Large Dutch multinationals generally have substantial cash balances and access to bond markets, and are not a significant source of increased credit growth. In spite of the ECB's accommodative monetary policy stance, credit has declined further in the Netherlands as banks continued to delever in 2016, reacting to both market and regulatory pressures. While credit to households appears to have bottomed out, credit to non-financial corporations has continued to sag this year, contracting by 6 percent (year-over-year) in July. Survey data (e.g., ECB's Bank Lending Survey (BLS) and the Survey on the Access to Finance of Enterprises in the euro area, (SAFE))



suggest that credit conditions have remained particularly tight for small and medium-sized enterprises (SMEs). Despite increased competition in credit markets, banks continue to charge relatively high interest rates to risky borrowers to cover their relatively high funding costs. Looking ahead, prices for houses—SMEs' main source of collateral—should gradually return to pre-crisis levels and credit standards should loosen.

5. **Growth has been driven by strong domestic demand and resilient net exports.** Private consumption remained robust throughout 2016, but non-residential investment growth appears to have slowed down in Q4. The contribution of foreign demand turned slightly positive, as exports proved more resilient than expected in the face of sluggish external demand while import growth remained contained despite strengthening domestic demand. The inflation rate is expected to gradually pick up in 2017 in line with price developments in the euro area.

6. **Under current policies, potential output will increase only slowly in the next few years, and the output gap will close by 2019.** New staff estimates (Annex VI) suggest that slow TFP growth and subdued capital deepening, demographics, and participation will dampen long-term growth under current policies. This highlights the need for structural reforms that boost labor market participation. GDP should grow faster than potential over the forecast horizon, with investment (residential and business) catching up after the double-dip recession. The output and unemployment gaps are expected to close in 2019 as inflation picks up from current low levels.

B. External Assessment

7. **The current account surplus is expected to narrow but remain positive and large over the medium term.** The current account surplus is estimated to have stabilized around 8.9 percent of GDP in 2016, as a slightly weaker trade balance would be offset by a slight pickup in net primary income. Trade remained sluggish, due to weak global demand and lower energy exports (lower prices and decline in natural gas production) while non-energy imports remained relatively contained even as domestic demand picked up pace. The current account surplus is expected to decline further in the medium term as the Netherlands becomes a net importer of natural gas and baby boomers start to draw down their accumulated pension savings. However, the current account surplus is likely to remain large and positive over the medium term as fiscal restraint, strong profit generation and retained earnings by foreign multinationals, continued deleveraging by firms and households, and the inclination of pension funds to invest abroad should keep the country's saving-investment balance positive. The staff's assessment in the External Sector Report (ESR, Annex II) suggests that the external position is stronger than the level consistent with medium-term fundamentals and desirable policy settings by 2–4 percent of GDP. However, the assessment is particularly uncertain in the Netherlands as the current account surplus may also reflect the high corporate savings and liquidity of Netherlands-based multinationals and favorable tax treatment for corporate income in the Netherlands. The corresponding assessment of the REER equilibrium points to an undervaluation of 2 to 11 percent.

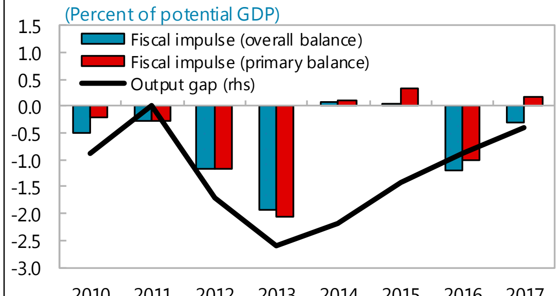
C. Risks and Spillovers

8. The risks to the outlook are tilted slightly to the downside. Foreign demand could end up being weaker than expected in the baseline as many economies continue to struggle with post-crisis legacies, in particular in the banking sector, and fail to implement necessary structural reforms. Moreover, the recent erosion of support for European institutions and increased protectionist sentiment in many economies—exacerbated by the refugee crisis—may also end up hampering international integration and coordination, with detrimental effect on international trade and growth. In particular, the uncertainty surrounding the aftermath of the Brexit decision may have larger than expected effects on the Dutch economy given its openness and relatively large share of exports to the U.K.[1] On the other hand, the strength of domestic demand may be underestimated in the baseline, as suggested by fiscal over-performance and a faster than expected improvement in labor market conditions. Housing prices could also recover faster than anticipated spurring a positive feedback loop of higher consumption, higher investment in the construction sector, higher employment and higher demand for housing. Finally, a post-Brexit move of financial institutions from London to Amsterdam could also boost growth.

POLICY DISCUSSIONS

Three years into the recovery, policies should focus on improving the country's resilience to shocks and boosting its long-term growth potential. Over the years, an interrelated set of policies has given rise to an over-leveraged and under-performing Dutch economy. An excessively regulated rental market combined with fiscal incentives towards mortgage indebtedness have led to premature home ownership due to the unavailability of rental housing, while high pension contributions and labor taxation have left households, in particular younger workers, cash-constrained and vulnerable to shocks. Moreover, the relatively high reliance on labor taxation discourages labor supply and hampers growth, while excessive mortgage leverage may stifle labor mobility as underwater mortgages complicate home sales. Excessive regulation in the traditional labor market has encouraged the emergence of "self-employment", which is exempt from some taxes and social contribution requirements and may eventually threaten the sustainability of the social safety net. The government has made some progress to address inefficiencies in the housing and labor markets, trim the labor tax wedge, and reform pensions. However, more should be done and faster. Given the intertwined nature of the required reforms, there is merit in pursuing them together.

General Government Fiscal Stance
(Percent of potential GDP)



Note: the fiscal impulse corresponds to the year-on-year difference in structural overall and primary balances, with a negative sign denoting a fiscal contraction.
Sources: Eurostat; and IMF staff calculations.

A. Fiscal Policy

9. The Netherlands has substantial fiscal space. The country faces very limited financing risks, and the level and trajectory of debt and gross financing needs as well as medium-term fiscal adjustment needs do not raise sizable risks. Over the longer term, the Netherlands

[1] See Risk Assessment Matrix, Annex I.

faces some additional adjustment needs related to demographics. Only in a very severe stress scenario involving a large banking sector shock that would be in the tail of the distribution would debt burden indicators turn unfavorable. Use of fiscal room should, however, be compliant with the SGP.

The Netherlands: Output Gap and Cyclically-adjusted Balance Forecasts

(in percent of potential GDP)

	2015		2016		2017		2018	
	Staff	EC	Staff	EC	Staff	EC	Staff	EC
Output gap	-1.4	-1.2	-0.9	-0.8	-0.4	-0.5	-0.2	-
Cyclically-adjusted balance	-1.3	-0.9	-0.1	0.4	0.2	0.3	0.2	0.2

Sources: European Commission Winter 2017 Forecasts (February 2017); Commission Staff Working Document, Analysis of the 2017 draft budgetary plan of the Netherlands (November 2016); and Staff estimates.

10. Under current policies, the fiscal stance is projected to tighten. Staff's baseline projections of a zero structural fiscal balance over the medium term are based on the authorities' spending plans. In this scenario, the negative output gap would only close gradually by 2019 while the current account surplus would remain sizable, signaling that the fiscal stance may be excessively tight. Moreover, following the over-performance achieved in 2016, the 2017 budget would imply a further structural consolidation.

11. There is a case for some additional, near-term growth enhancing spending or tax reductions, of the order of magnitude of 0.5–1.0 percent of GDP as the output gap closes over the next few years. These could take the form of education or public R&D expenditures, where the country has been performing below European peers and which would also help boost potential growth over the medium run. Further tax reductions could also be considered, focused on cuts to the labor tax wedge that would promote greater employment of workers at the margin of the labor force. Some near-term fiscal easing would also help bringing down the current account in line with fundamentals. Over the longer term, aiming for some consolidation would provide margin for unforeseen weakness in the economy, demographic pressures, or future fiscal support for the financial sector.

12. Utilization of the fiscal space along the lines suggested by staff can be accommodated within the SGP rules. This implies the commitment to steadily proceed to meeting quantitative targets without requesting possible deviations for investment and structural reforms. However, the European Commission's November 2016 estimates of the structural balance project it to meet the country's MTO of -0.5 percent of GDP in 2016 and improve to -0.2 and 0.0 percent of GDP in 2017 and 2018, respectively. Avoiding the over-performance relative to the MTO in these years leaves some scope for temporary tax and expenditure measures that would be broadly in line with what would be appropriate to accelerate the closure of the output gap and implement further growth-enhancing tax and expenditure changes. General government debt remains above

60 percent of GDP although it is projected to fall below this limit in 2019, well in line with the pace of debt reduction expected under the SGP.

Authorities' Views

13. The authorities pointed out that in the context of a rapidly closing output gap and given implementation lags, fiscal stimulus measures could end up being pro-cyclical inasmuch as they would only start to materialize in 2018. Moreover, they underlined the uncertainties associated with the measurement of the structural balance by both staff and the European Commission. Nevertheless, they agreed that any fiscal space, should it materialize, could be used for further reduction in labor taxation or spending on R&D and human capital. In the medium and long-term, they agreed that reducing public debt should be a priority given the highly leveraged status of private balance sheets and the potential need for government intervention.

B. Financial Sector Policies

Housing Market and Macroprudential Policies

14. Households remain highly leveraged, with a sizeable share of mortgages in negative equity. Albeit on a downward trend, households' debt-to-disposable income ratios were still very high by comparison with European peers at 220 percent of GDP in 2015, whereas households' asset holdings are mostly illiquid in the form of pension entitlements and housing. House prices have rebounded from their 2013 low, but one fifth of mortgages are still underwater, particularly among young borrowers. Arrears have remained low, in part due to the full recourse on borrowers, but they tend to sharply increase for mortgages with higher originating loan-to-value (LTV) and loan-to-income (LTI) ratios. Moreover, empirical work suggests that financially-constrained agents tend to cut back on other forms of spending when faced with excessive mortgage repayments, thus exacerbating the pro-cyclicality of house price shocks (IMF, 2014). In the medium run, the large remaining stock of interest-only mortgages, which represented 55 percent of total mortgages at end 2015, imply significant rollover risks (the bulk of these loans mature in the early 2030s).

Mortgage Arrears by Originating LTV and LTI Ratios
(Share of total in percent as of 2015:Q4, loan level data)

		Originating LTV ratios							
		< 60	60-70	70-80	80-90	90-100	100-110	110-120	> 120
Originating LTI ratios	0-2	0.4	0.4	0.4	0.5	0.6	0.7	1.1	0.6
	2-3	0.4	0.5	0.6	0.8	0.9	1.2	1.6	1.5
	3-4	0.6	0.7	0.8	1.1	1.1	1.6	2.3	2.7
	4-5	0.8	1.0	1.3	1.5	1.8	2.1	3.1	4.4
	5-6	1.0	1.3	1.6	2.0	2.3	3.0	4.2	5.9
	> 6	1.4	1.4	1.6	2.0	2.4	2.9	3.7	4.9

Source: DNB.

15. Staff recommends accelerating the implementation of macro-prudential and other measures aimed at lessening household financial vulnerabilities. The authorities should build on recent initiatives, including the following.

- They should accelerate the phasing down of mortgage interest deductibility (MID), by at least 1 percentage point per year ultimately bringing it to a neutral level relative to the taxation of other assets. Alongside low imputed returns on property, MID has been one of several policies that led to excessive mortgage indebtedness. Since 2014, eligibility for MID has been restricted to 30-year amortizing mortgages and the MID rate is being reduced by 0.5 percentage point per year to 38 percent by 2042.

- **The authorities should continue to gradually lower the maximum limit on LTV ratios by at least 1 percentage point per year to no more than 90 percent by 2028 and to 80 percent thereafter.** In 2013, LTV limits were incorporated into law and set to decline to 100 percent by 2018. In 2015, the Financial Stability Committee (FSC) recommended to further lower maximum LTV ratios to 90 percent between 2018 and 2028. The authorities should implement this recommendation and consider taking advantage of the recovery in housing prices to implement a more rapid pace of reduction and adopt an ultimate target of 80 percent LTV taking into account market developments at the time.

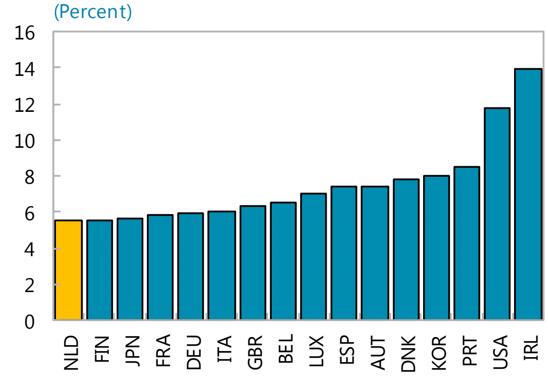
- The authorities should introduce prudential ceilings on debt service-to-income caps by income category that could not be relaxed during periods of strong growth. While guidelines to implement DSTI ratios have been tightened in recent years, the authorities should take advantage of the current period of low interest rates to introduce caps that would avoid pro-cyclical developments in good times.

16. The private rental market needs to be deregulated and placed on a more even footing with owner-occupied homes and social housing. The private rental market has been stifled by the fiscal subsidization of both social housing and owner-occupied homes. Furthermore, regulations on permissible rents based on social housing regulations and zoning prevent the supply of private rental units from meeting an increasing demand. This pushes younger households, for whom the non-market allocation mechanisms for social housing do not provide rental units in a timely manner, into purchasing homes before they have adequate financial buffers. To address this, housing tax reforms (e.g., MID, taxation on imputed returns) should be implemented to level the fiscal playing field with respect to private rental market housing. As subsidies on home ownership are withdrawn, complementary measures to boost the supply of rental alternatives have to be taken. In particular, as the shift to market-based rents is completed, tenants’ eligibility to social housing should be means-tested more rigorously and support to social housing should be scaled back to the core social tasks and possibly replaced with a more targeted system of subsidies to lower income groups.

Financial Sector Stability and Microprudential Oversight

17. Dutch banks appear resilient to risks, but they still face some challenges. FSAP stress tests indicate that banks, which built buffers through retained earnings and lower leverage since the crisis, are well capitalized on a risk-weighted basis. A severe stress test scenario would have a significant negative impact on Basel III fully loaded (risk-weighted) capital ratios, but all banks would maintain capital ratios above these minimum regulatory requirements. However, banks have high leverage and a relatively low risk-weighted assets (RWAs)-to-total assets ratio, particularly those using internal ratings-based (IRB) models. A significant bank could fall just below the minimum 3 percent leverage ratio hurdle used in the stress tests (not the legal minimum) in the adverse scenario. Banks also face challenges associated with low profitability and continued reliance on wholesale funding. While net interest margins have proven resilient to the low interest rate environment so far, the recent decline in mortgage rates and tepid credit growth are expected to further weigh on banks' profitability, which only bottomed out recently from historically low levels. As wholesale funding represents above 40 percent of total liabilities, funding costs are also vulnerable to tighter and more volatile global financial conditions. Nevertheless, liquidity stress tests conducted by the FSAP team showed that banks would be able to withstand significant withdrawals of funding under severe shocks, thanks to the relatively long term structure of wholesale funding.

Capital to Assets Ratio, 2015
(Percent)



Source: IFS.

18. Supervisors—including the SSM—are encouraged to build upon the substantial progress to date. Supervisors should minimize residual risks by closely monitoring banks' business models and risk management frameworks as the low yield environment may encourage excessive risk taking, and take a more active role in assessing loan classification to strengthen prudent provisioning practices. The FSAP recommended that the banks should continue to build capital buffers to support credit growth and help mitigate the need for significant deleveraging in the case of adverse shocks (thus lessening the potential macrofinancial implications). It also recommends that the independence of supervisors be buttressed, including their ability to set supervisory budgets and remuneration and to issue technical regulations.

19. The insurance sector faces important challenges. Challenges arise from low interest rates, increasing longevity, and growing competition. The life insurance sector faces severe stress. Supervisors should monitor closely the financial conditions of insurers and apply Pillar 2 measures, if required. The proposed introduction in 2017 of a new national law on the recovery and resolution of insurers is welcome**.**

Authorities' Views

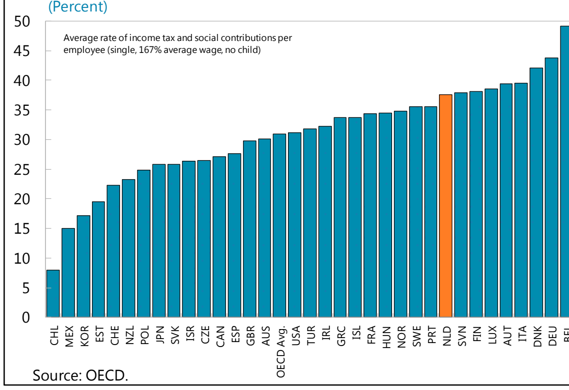
20. The authorities welcomed the assessment of the financial sector from the FSAP, sharing staff views on the main risks, factors of resilience and scope for improvement in the banking, insurance, and pension sectors. They emphasized that the government has taken far reaching measures in the housing sector, but agreed that further deleveraging in the household sector would be welcome. They took note of the view that a more rapid phasing out of mortgage interest deductibility should be a higher priority. Furthermore, they noted that the FSC advice on further reducing the LTV limit was addressed to future governments, which should decide on this and any further measures. Policy options for the housing market, as outlined in the report by the workgroup on sustainable growth (SDG) will also be considered by future governments. The authorities noted that introducing ceilings above existing income-modulated DSTI ratios would add complexity to policies that had already been appropriately tightened in recent years and could make the LTI framework too rigid from a consumer perspective.

C. Structural Reforms

Further Tax Reform to Promote Growth and Improve the Resilience of the Economy

21. Future tax reforms should enhance fairness, improve efficiency, and boost potential output. The Dutch tax and benefit system has labor income taxation doing most of the heavy lifting in spite of the 2016 labor tax reforms. Future tax reforms should explore ways to diversify the sources of tax revenues while encouraging greater labor force participation. Labor taxes should be reduced while shifting the tax burden towards consumption and property. Staff simulations suggest that significant efficiency gains could be achieved by making such changes in the composition of taxes.[2] Some progress was achieved through the tax reduction package implemented in 2016, which featured an increase in earnings-related tax credit at the lower end of the income distribution, but a more fundamental overhaul would be welcome. Thought should also be given to reforming capital income taxation (including the MID) which is fragmented, inefficient, and has many regressive features, and eliminating distortions associated with multiple VAT rates.[3] This makes some sense on distributional grounds as well; Dutch households have high net wealth on average, but—excluding pension entitlements—it is unevenly distributed and most of the assets are in illiquid real estate and pension accounts.

Labor Income Taxation, 2015
(Percent)



Source: OECD.

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[2] See "Quantifying Tax Reforms in the Netherlands: Shifting the Burden" in the Selected Issues paper accompanying this staff report.

[3] See "Tax reforms in the Netherlands: Moving Closer to Best Practices.", in the Selected Issues paper for the 2015 Article IV Consultation for the Netherlands (IMF Country Report No. 16/46)

22. Future tax reforms should also minimize the debt bias. The current tax system, (e.g., allowing interest rate deductibility), favors debt over equity and has contributed to overly-leveraged households and firms. This makes the Dutch economy particularly vulnerable to shocks and presents important risks for financial stability and fiscal sustainability. The debt bias is particularly large in the subsidized housing sector and should be eliminated by either introducing a similar deduction for equity finance or by abrogating the MID, as MID is larger than the taxation of imputed rental income. Similar measures could also be applied to the corporate and banking sectors. To encourage equity building, an allowance for corporate equity (ACE) could be introduced and calibrated so that equity and debt finance become fiscally neutral. Alternatively, interest deductibility could be removed or limited.

Authorities' Views

23. The authorities agreed with staff about the desirability of tax reforms that would reduce the debt bias and enhance efficiency. Future tax reforms should shift the burden of taxation away from labor and towards less distortionary alternatives. They stressed that the 2016 labor income tax cut package was a step in the right direction. Unifying VAT to the standard rate would be welcome with an eye on reducing distortions in consumer behavior, but the decision is up to a future government. The government sees the removal of incentives for debt formation at both household and corporate levels as a priority for future tax reforms. In particular, the measures taken with regards to the MID are deemed to enhance the efficiency of the housing market. This is expected to stimulate the development of the private rental market by reducing an important incentive for debt-financed home ownership.

Pension Reform to Maintain Sustainability and Improve Transparency

24. The defined benefit second pillar pension funds have come under increasing stress. Protracted low interest rates and adverse market conditions have pushed solvency ratios below the minimum regulatory coverage requirement of 105 percent, prompting about 90 percent of the funds to adopt recovery plans by mid-2016. Yet the viability of the plans has been questioned in view of highly optimistic return assumptions and the possibility for premium contributions to not fully cover corresponding accrued benefits under the new Financial Assessment Framework (nFTK), foreshadowing benefit cuts for large segments of the population in the coming years.

25. More generally, the second pillar pension plans are increasingly combining the disadvantages of both defined contribution (DC) and defined benefit (DB) schemes. As private, formal DB schemes without a sponsor to cover shortfalls, contribution rates, indexation mechanisms and sometimes even nominal benefits had to be adjusted in response to solvency pressures, undermining predictability for both participants and retirees and hurting disposal income in a pro-cyclical way during the economic downturn. As a result, the participants in the current system bear the investment risk, much as they would in a defined contribution scheme, but in a less transparent manner. Also, the current collective pension schemes feature opaque and actuarially unfair transfer redistribution mechanisms, notably from the young to the old or from the poor to the rich, that have been eroding public support and confidence.

26. The reform of the pension system should focus on enhancing transparency and portability, while preserving financial security at retirement. Following a proposal sent to Parliament in July 2015 the government recently laid out a range of reform options articulated around the principle of "personal pensions with risk sharing", namely mandatory individual DC contracts complemented with provisions for pooling the longevity and some financial risks. Further to allowing portability across types of employment contracts and for investment strategies best suited to life-cycle considerations, such a scheme would crucially enhance transparency as to how benefits and contributions would respond to economic circumstances, while also getting rid of ex ante transfer mechanisms. Challenges to be addressed including the cushioning of individual risk taking, the design of payout options, and the control of costs might create a role for some form of collective asset management by the social partners.

Sources: OECD (2016), OECD Economic Outlook: Statistics and Projections (database), February.
1/ Labour productivity is defined as real GDP divided by total hours worked. Pre-crisis labour productivity trend growth is calculated between 1982 Q1 and 2007 Q4, and is projected from 2008 onwards.

Authorities' Views

27. The authorities broadly agreed that the second pillar pension system needed some fundamental overhaul in the direction of more personalization of the basic pension contract. They noted that the government had called for a system with greater transparency so as to give greater predictability to participants but retaining some collective risk sharing.

Addressing Labor Market Rigidities and Segmentation of the Labor Force

28. The rapid rise of self- and temporary employment may jeopardize the sustainability of the Dutch safety net and pension schemes. The rapid rise of the self-employed and workers in temporary contracts has helped increase the flexibility of the Dutch labor market and contain the rise in unemployment during the last recession. However, it is likely to be a be a symptom of an overly rigid regulatory regime for workers in standard open-ended contracts (Figure 2). Dismissals are arduous and expensive in the Netherlands, and costs tend to increase with workers' age and years of service.[4] Because the self-employed receive large tax exemptions and pay lower social and pension contributions, their continuous increase may eventually threaten the viability of the current social security arrangements.

29. But many self-employed are not in this status voluntarily. The rapid increase in the number of self-employed over the last 15 years does not exclusively reflect social preferences: many self-employed find themselves in labor relationships that are in all aspects similar to regular employment but without many elements of the social safety net. In turn, low participation rates in

[4] The OECD Employment Protection Indicator ranks the Netherlands second in the protection of regular workers against individual and collective dismissals.

disability insurance and pension schemes may expose many of the self-employed to old-age hardships. To avoid an unequitable treatment of citizens in standard and non-standard work arrangements, the authorities should consider liberalizing the regulatory regime for standard employment contract and harmonize its application across different employment statuses.[5]

30. Structural reforms should also aim to boost labor productivity in the Netherlands. While labor productivity has slowed down sharply in all major advanced economies in recent years, it has virtually ground to a halt in the Netherlands over the last decade. Boosting labor productivity through higher TFP and increased investment should be high on the reform agenda as the Dutch economy will soon be confronted with the pressure of a shrinking labor force. Recent consultations have highlighted a number of reform areas, but progress has been slow so far. In particular, efforts to raise productivity levels of small and medium-sized enterprises could be stepped up. Measures that increase public R&D, incentivize private R&D, streamline procedures for starting businesses, promote lifelong training of the labor force should be encouraged.[6]

Authorities' Views

31. The authorities agreed that flexible work arrangements have contributed to labor market flexibility, but they have raised new policy issues. They agreed that low levels of participation in disability insurance programs could expose a significant part of the self-employed to economic vulnerability, and that to a lesser extent the same would hold for pension schemes.

Asylum Seekers and the Integration of Refugees

32. Innovative and dynamic approaches are being implemented to foster the integration of refugees into the Dutch society and labor market. Confronted with an influx of about 58,000 asylum seekers in 2015, the authorities should be commended for launching a broad program aimed at fast-tracking the integration of refugees into Dutch society and labor market through housing, education and training, and assistance in matching refugees to employment opportunities.

STAFF APPRAISAL

33. The economic recovery is broad-based and has been gathering speed. We forecast growth slightly above 2 percent in both 2016 and 2017. Sustained growth should allow for a further decline in the unemployment rate, albeit at a slower pace due to increasing labor supply. After bottoming out for households recently, credit growth is expected to slowly turn positive for SMEs as prices for houses, their main source of collateral, continue to recover. Inflation should remain low as wage pressures remain subdued. In the medium term, domestic demand is forecast to remain

[5] See "Dual Labor Markets in the Netherlands—Environment and Policy Implications" in the Selected Issues paper accompanying this staff report.

[6] The rise of flexible forms of employment arrangement could also have hampered productivity growth for firms' incentives to provide training.

strong notwithstanding continuous deleveraging, prompting a gradual reduction in the current account surplus. The output gap should close by 2019.

34. The risks to the macroeconomic outlook are tilted slightly toward the downside. Weaker than expected growth in the Euro area or emerging markets, as well as uncertainties surrounding Brexit negotiations, could still negatively impact the economy. On the other hand, current projections may underestimate the strength of domestic demand and the improvement in labor market conditions. Fiscal revenues have over-performed recently and the decline in the unemployment rate has accelerated.

35. The existing fiscal space could be used to support the recovery. A small negative output gap is expected in 2017–18, and there is a case for an amount of additional growth enhancing spending (e.g., ½ to 1 percent of GDP), such as on public R&D or education, or further tax reductions, notably to reduce the tax wedge for workers at the margin of the labor force and preferably in the context of a broader tax reform. Using the existing fiscal space would be consistent with meeting the Stability and Growth Pact (SGP) requirements, since the headline deficit, structural balance, and pace of debt reduction are expected to remain comfortably within prescribed limits in the European Commission's November 2016 forecasts. In the medium run, aiming for some consolidation would help build additional buffers in a still highly-leveraged economy. While general government debt remains above 60 percent of GDP, it is projected to fall below this limit by 2019.

36. The implementation of macro-prudential measures should be accelerated to lessen financial vulnerabilities in the household sector. Households remain highly leveraged, with high debt-to-income ratios in a context where their assets remain mostly illiquid in the form of pension entitlements and housing. Building on important steps taken in the last few years, the mission team recommends: (i) accelerating the phasing-out of mortgage interest deductibility to at least 1 percentage point per year, ultimately bringing it to a tax neutral level relative to the taxation of other assets; (ii) continuing to gradually lower the maximum limit on loan-to-value (LTV) ratios by at least 1 percentage point per year to no more than 90 percent by 2028 and consider reducing it to 80 percent afterwards; and (iii) introducing ceilings on debt-service-to-income (DSTI) caps by income category that would not be relaxed in periods of strong growth.

37. Financial sector oversight has been strengthened in recent years, but continued vigilance is needed. The banking sector is well capitalized on a risk-weighted basis and resilient to risks, but faces challenges associated with high leverage, low interest rates, and continued reliance on wholesale funding. Banks should continue to build capital buffers to support credit growth and help mitigate the need for simultaneous deleveraging in the case of adverse shocks. Supervisors should closely monitor banks' business models and risk management frameworks and take a more active role in assessing loan classification. Supervisors should monitor closely the financial conditions of insurers and apply Pillar 2 measures, if required.

38. The provision of housing should be made more flexible to improve market efficiency. On the demand side, entrenched subsidies in the social housing and owner-occupied sectors stifle the development of the private rental market. In this context, social housing and associated support should be better targeted to low-income households through more thorough means-testing, and an acceleration of the ongoing process of rent differentiation across income categories. Increasing the share of local government spending financed by local taxes, which are generally on real estate, could be a move in the same direction. On the supply side, consideration should be given to relax existing regulations such as zoning that prevent construction from meeting housing demand.

39. Tax reforms should aim at improving efficiency and reducing the debt bias. In addition to the reduction of the MID**,** the economic efficiency of the Dutch tax system could be improved by shifting the tax burden away from labor and towards consumption and property, eliminating regressive features in asset taxation, and eliminating distortions associated with multiple VAT rates. Some progress was achieved through the tax reduction package embedded in the 2016 budget, which featured an increase in earnings-related tax credit at the lower end of the income distribution, but a more fundamental overhaul would be welcome. The tax system also features a strong debt bias, posing risks to macroeconomic and financial stability. The introduction of an allowance for corporate equity or limiting the deductibility of interest from corporate taxes—as for the MID—would encourage stronger equity building.

40. The reform of the pension system should focus on enhancing transparency and ensuring portability. The defined benefit second pillar of the pension system has come under increasing financial stress as protracted low interest rates have pushed solvency ratios below the regulatory coverage requirements for about 90 percent of the occupational funds. More generally, *ad hoc* adjustments in contribution premiums and benefit indexation mechanisms in recent years have undermined predictability for both participants and retirees, who end up bearing most of the investment risk in a non-transparent manner. In this context, the reform of the pension system should focus on enhancing transparency as to how benefits and contributions would respond to economic circumstances and on ensuring greater portability when changing jobs, while preserving financial security at retirement. Some of these priorities could be addressed by personal pension accounts. These contracts could combine individual accounts with collective risk sharing so as to cushion individual risk taking and ensure viable payout options.

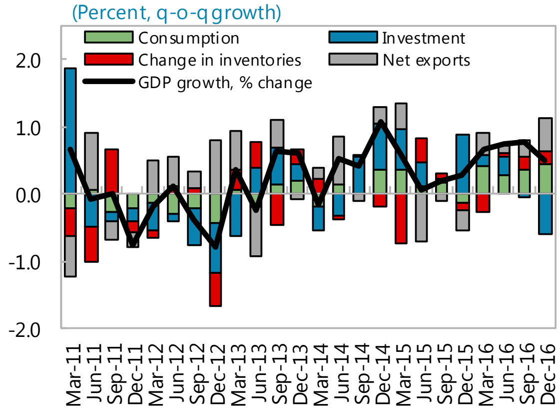
41. The increasing importance of flexible work arrangements calls for policy responses. The last two decades have witnessed a rapid increase in the proportion of the labor force in self-employment, employment under temporary contracts, or other flexible employment arrangements. These developments point to overly rigid social benefit requirements and employment protection legislation (EPL) frameworks covering permanent contracts and the too-extensive exemption of the self-employed from significant taxes and social benefits. Some greater harmonization would be welcome across the three main categories of workers in the context of a general move in the direction of more rather than less flexibility. Further efforts should also be made to differentiate spurious from genuine self-employed workers, while recognizing that the choice of self-employment may be a legitimate one for certain professions.

42. It is proposed that the next Article IV consultation take place on the standard 12-month cycle.

Figure 1. The Netherlands: Outlook

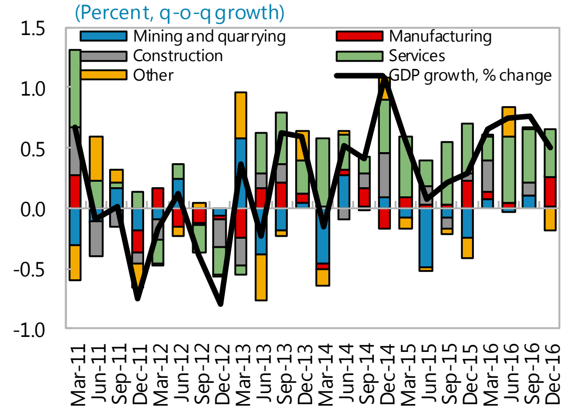
Growth has been strengthening, mostly driven by investment…

Contributions to GDP Growth
(Percent, q-o-q growth)



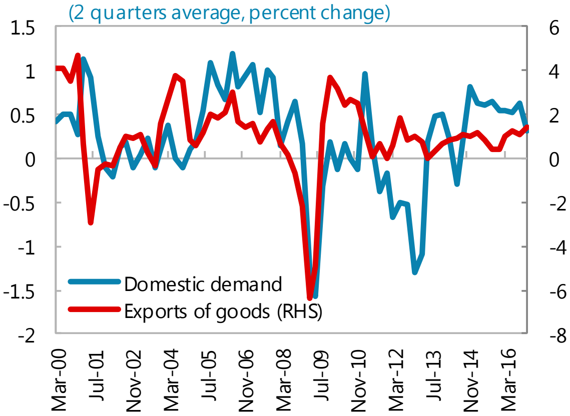
…and the construction and services sectors.

Contributions to GDP Growth
(Percent, q-o-q growth)



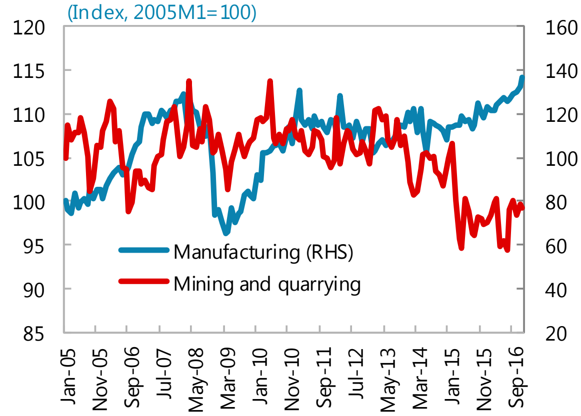
Although foreign demand remains muted …

Domestic and Foreign Demand
(2 quarters average, percent change)



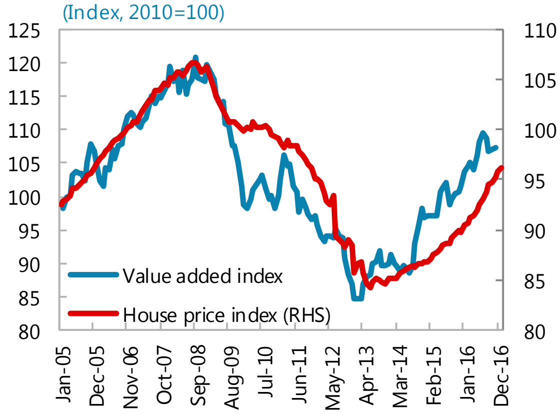
… production in the manufacturing sector has been trending upwards since 2013.

Industrial Production
(Index, 2005M1=100)



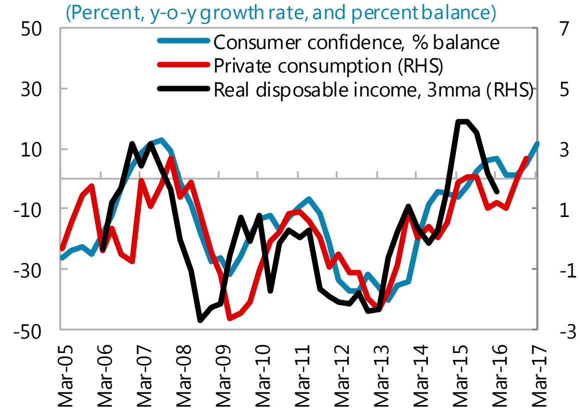
The housing market has largely recovered from the trough reached in 2013, supporting activity in construction

House Prices and Value Added in Construction
(Index, 2010=100)



Consumption has been supported by rising disposable income and confidence effects.

Consumption Indicators
(Percent, y-o-y growth rate, and percent balance)

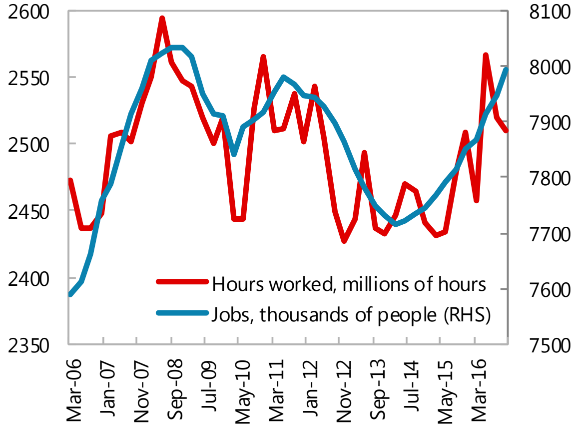


Sources: CBS, DNB, Haver Analytics, and IMF staff calculations.

Figure 2. The Netherlands: Labor Market and Inflation

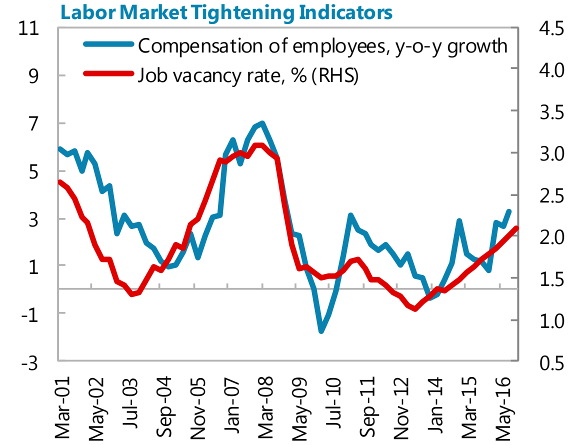
Labor market recovery has been strong...

Jobs and Hours Worked



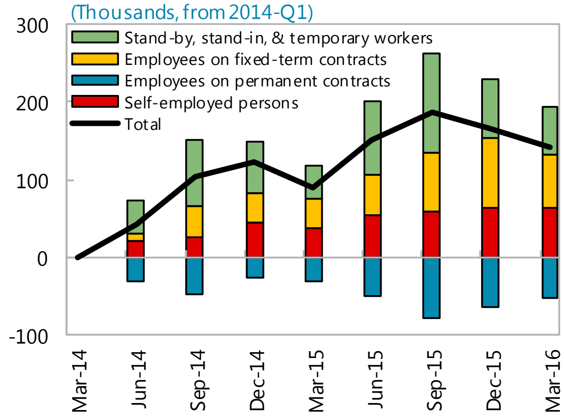
... vacancies are on the rise ...

Labor Market Tightening Indicators



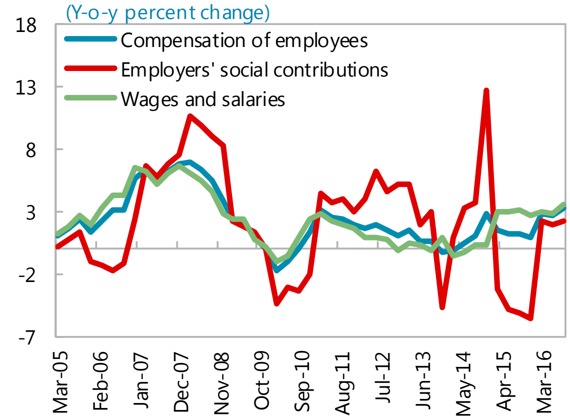
... and increasingly filled through flexible employment arrangements ...

Cumulative Increase in Active Working Population
(Thousands, from 2014-Q1)



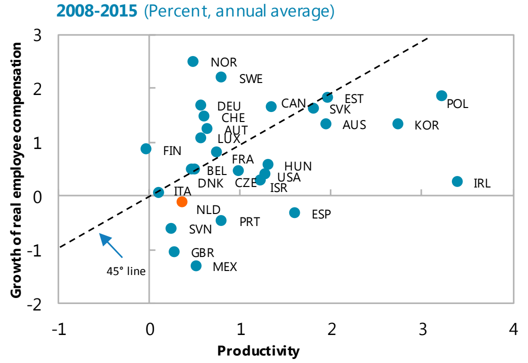
... keeping labor costs in check.

Labor Costs
(Y-o-y percent change)



Real wages have progressed less than productivity ...

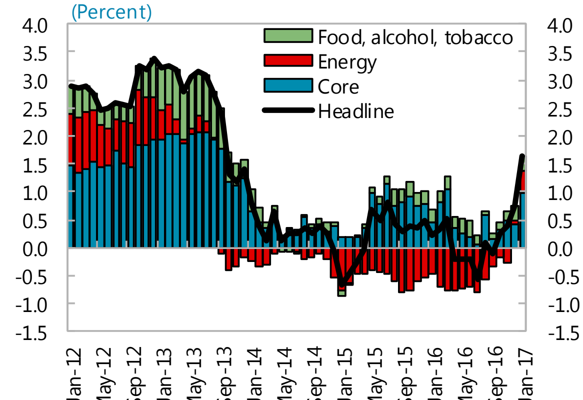
Growth of Productivity and Employee Compensation 1/, 2008-2015 (Percent, annual average)



1/ Productivity and employee compensation are measured per hour worked.

... which explains still subdued inflationary pressures.

Contributions to Headline Inflation
(Percent)

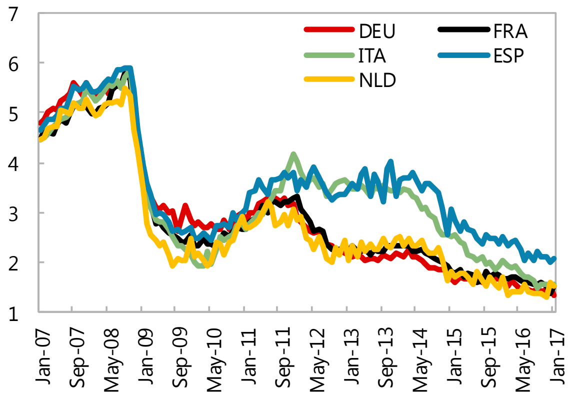


Sources: CBS, DNB, EC, Eurostat, Haver Analytics, OECD, and IMF staff calculations.

Figure 3. The Netherlands: Credit Conditions

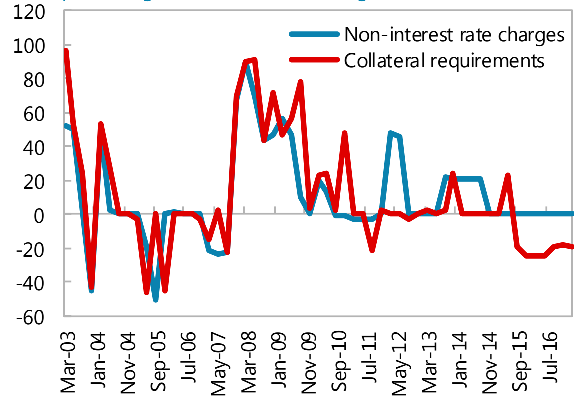
Both lending rates …

Lending Rates on New Loans to Non-Financial Corporations
(Percent)



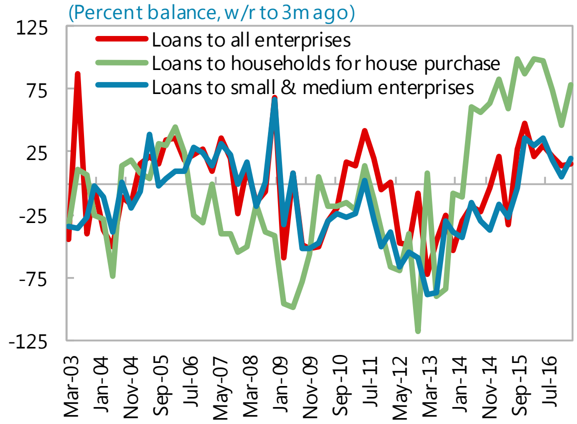
… and collateral requirements for new loans to NFC have been gradually relaxed.

Change in Bank Standards for Lending to Enterprises
(Net percentage balance w/r to 3m; negative is looser standard)



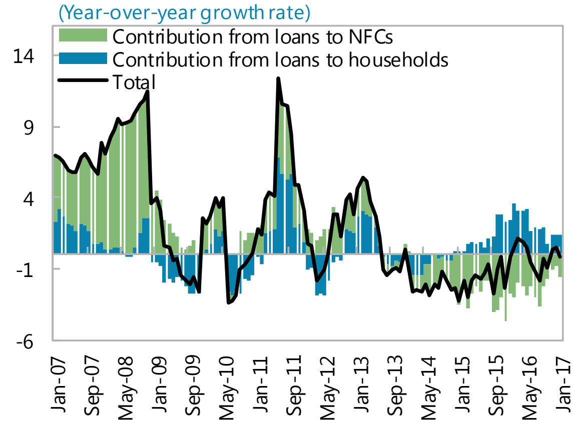
… and despite a recent increase in loan demand …

Change in Loan Demand
(Percent balance, w/r to 3m ago)



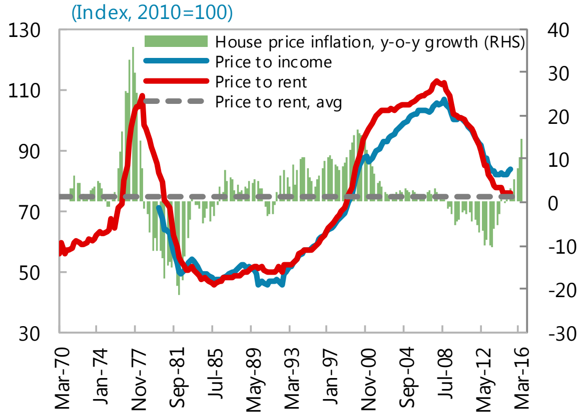
… the contribution to total credit from loans to NFCs remains negative.

Lending by Monetary Financial Institutions
(Year-over-year growth rate)



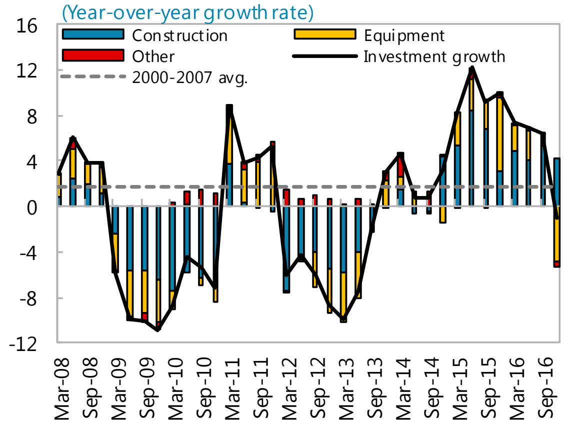
After reaching a level consistent with long-term fundamentals, house prices have started to accelerate …

House Price Indices
(Index, 2010=100)



… propping up investment in construction

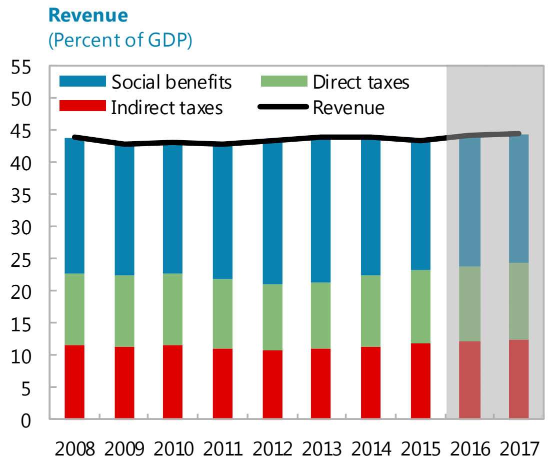
Contributions to Investment Growth
(Year-over-year growth rate)



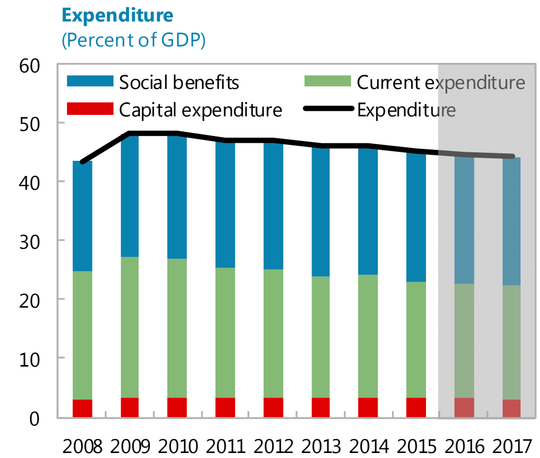
Sources: CBS, DNB, ECB, and IMF staff calculations.

Figure 4. The Netherlands: Fiscal Developments and Outlook

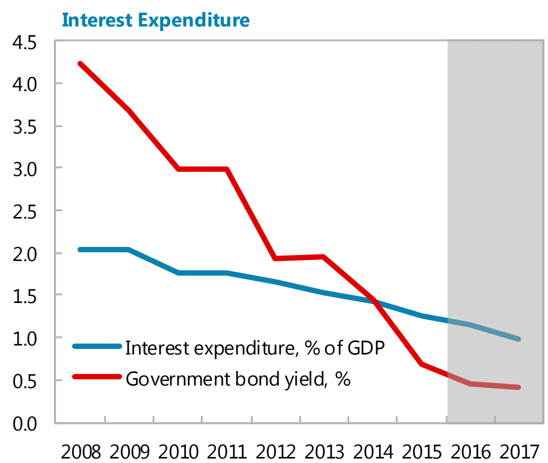
Revenue has been broadly flat as a proportion of GDP…



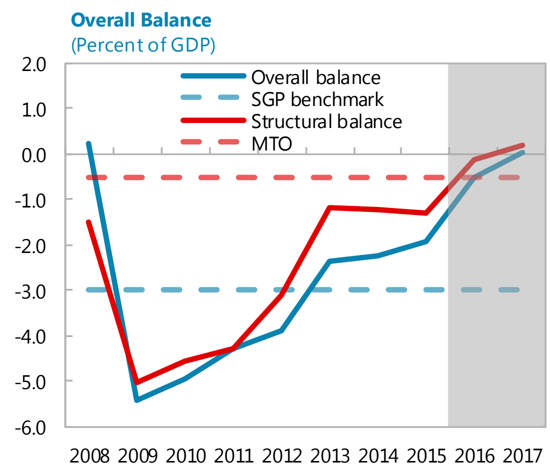
…with consolidation falling on current expenditure.



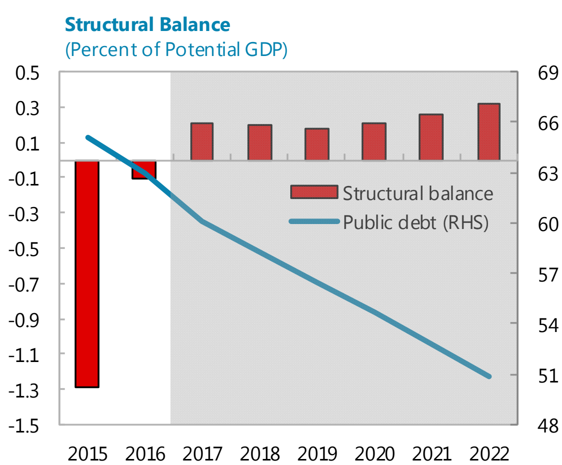
Interest expenditure has reached record low levels.



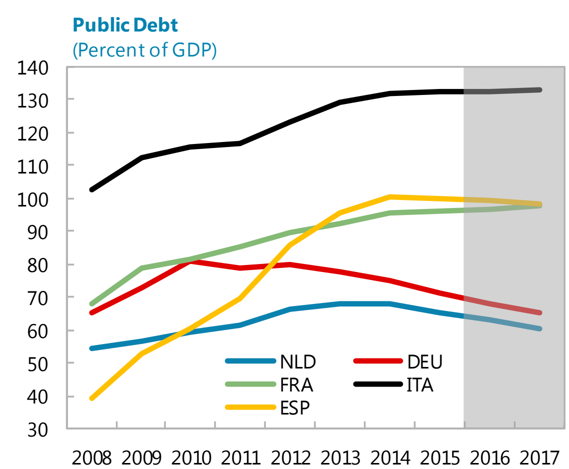
The structural balance has strengthened rapidly in the last few years…



…allowing for a rapid decrease in public debt …



… which remains the lowest among peer countries.



Sources: CBS, CPB, Eurostat, and IMF staff calculations.

Table 1. The Netherlands: Medium-Term Macroeconomic Framework, 2014–22

(Growth rates, in percent, unless otherwise indicated)

	2014	2015	2016	2017 Proj.	2018 Proj.	2019 Proj.	2020 Proj.	2021 Proj.	2022 Proj.
National accounts									
Real GDP	1.4	2.0	2.1	2.1	1.8	1.8	1.7	1.7	1.6
Domestic demand	0.9	2.3	2.1	2.0	1.8	1.8	1.7	1.7	1.6
Private consumption	0.3	1.8	1.7	1.7	1.5	1.5	1.5	1.5	1.5
Public Consumption	0.3	0.2	0.8	0.8	0.5	0.5	0.5	0.5	0.5
Gross fixed investment (total)	2.3	9.9	4.8	4.1	3.8	3.7	3.3	3.2	3.1
Public	-2.1	2.7	-0.7	1.0	1.0	1.0	1.0	1.0	1.0
Private	3.4	11.6	5.8	4.7	4.3	4.2	3.7	3.5	3.4
Residential	6.2	27.3	7.2	3.0	3.0	3.0	3.0	2.8	2.6
Business	2.5	6.7	5.5	5.3	4.7	4.6	3.9	3.8	3.7
Stocks (contribution to GDP growth)	0.2	-0.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Exports goods and services	4.5	5.0	3.6	3.6	3.3	3.1	3.1	3.0	3.0
Imports goods and services	4.2	5.8	3.8	3.7	3.4	3.4	3.3	3.2	3.2
Domestic demand (contribution to GDP growth)	0.8	2.1	1.9	1.8	1.6	1.6	1.5	1.5	1.4
External demand (contribution to GDP growth)	0.7	0.0	0.3	0.3	0.3	0.2	0.2	0.2	0.2
Output gap	-2.2	-1.4	-0.9	-0.4	-0.2	0.0	0.2	0.2	0.2
Potential output growth	1.0	1.1	1.5	1.6	1.6	1.6	1.6	1.6	1.6
Gross investment (percent of GDP)	18.5	19.3	20.2	20.8	21.4	22.0	22.6	23.1	23.6
Gross national saving (percent of GDP) 1/	27.3	27.9	29.1	29.3	29.6	30.0	30.1	30.4	30.7
Prices and employment									
Consumer price index (year average)	0.3	0.2	0.1	0.9	1.4	1.5	1.6	1.6	1.6
GDP deflator	0.1	0.1	0.2	1.0	1.0	1.0	1.1	1.3	1.3
Employment	-0.7	1.0	1.7	1.2	0.7	0.6	0.6	0.6	0.6
Unemployment rate (percent) 2/	9.0	8.6	…	…	…	…	…	…	…
Unemployment rate (percent) 3/	7.4	6.9	5.9	5.4	5.3	5.2	5.1	5.0	4.9
External									
Current account balance (percent of GDP)	8.9	8.7	8.9	8.5	8.2	8.0	7.6	7.3	7.1
Public sector accounts (percent of GDP)									
Revenue	43.9	43.2	44.1	44.3	44.3	44.3	44.3	44.3	44.3
Expenditure	46.2	45.2	44.6	44.3	44.2	44.1	44.0	43.9	43.9
General government balance	-2.3	-1.9	-0.5	0.0	0.1	0.2	0.3	0.3	0.4
Structural balance (percent of potential GDP)	-1.2	-1.3	-0.1	0.2	0.2	0.2	0.2	0.3	0.3
General government debt	67.9	65.1	63.0	60.1	58.3	56.5	54.7	52.8	50.9

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

1/ Value implied by investment and current account data.

2/ National definition.

3/ ILO definition.

Table 2a. The Netherlands: General Government Statement of Operations, 2014–22

(Percent of GDP)

	2014	2015	2016	2017 Proj.	2018 Proj.	2019 Proj.	2020 Proj.	2021 Proj.	2022 Proj.
Revenue	43.9	43.2	44.1	44.3	44.3	44.3	44.3	44.3	44.3
Taxes	22.3	23.1	23.8	24.4	24.4	24.4	24.4	24.4	24.4
Taxes on production and imports	11.3	11.3	11.6	11.7	11.7	11.7	11.7	11.7	11.7
Current taxes on income, wealth, etc.	10.7	11.6	11.9	12.4	12.4	12.4	12.4	12.4	12.4
Capital taxes	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Social contributions	14.9	14.2	14.8	14.5	14.5	14.5	14.5	14.5	14.5
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other revenue	6.7	5.9	5.5	5.4	5.4	5.4	5.4	5.4	5.4
Expenditure	46.2	45.2	44.6	44.3	44.2	44.1	44.0	43.9	43.9
Expense	46.2	45.3	44.4	44.0	44.0	44.0	44.0	43.9	43.9
Compensation of employees	9.1	8.8	8.9	8.7	8.7	8.7	8.7	8.7	8.7
Use of goods and services	6.5	6.0	6.0	5.9	5.9	5.9	5.9	5.9	5.9
Consumption of fixed capital	3.3	3.3	3.2	3.1	3.1	3.1	3.1	3.1	3.1
Interest	1.4	1.3	1.1	1.0	1.0	1.0	1.0	1.0	1.0
Subsidies	1.2	1.2	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Grants	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Social benefits	22.1	22.1	21.9	21.7	21.7	21.7	21.7	21.7	21.7
Other expense	1.2	1.3	0.7	0.8	0.8	0.8	0.8	0.8	0.8
Net acquisition of nonfinancial assets	0.0	-0.1	0.1	0.2	0.2	0.1	0.1	0.0	-0.1
Net operating balance	-2.2	-2.0	-0.4	0.3	0.3	0.3	0.3	0.4	0.4
Net lending/borrowing	-2.3	-1.9	-0.5	0.0	0.1	0.2	0.3	0.3	0.4
Net acquisition of financial assets	-0.8	-3.0	...	...	...	...	...	...	...
Currency and deposits	0.1	-0.3	...	...	...	...	...	...	...
Securities other than shares	-0.7	-0.1	...	...	...	...	...	...	...
Loans	0.0	-0.7	...	...	...	...	...	...	...
Shares and other equity	-0.2	-0.6	...	...	...	...	...	...	...
Insurance technical reserves	0.0	0.0	...	...	...	...	...	...	...
Financial derivatives	-0.2	-0.9	...	...	...	...	...	...	...
Other accounts receivable	0.2	-0.3	...	...	...	...	...	...	...
Net incurrence of liabilities	1.6	-1.3	...	...	...	...	...	...	...
Special Drawing Rights (SDRs)	0.0	0.0	...	...	...	...	...	...	...
Currency and deposits	0.0	0.0	...	...	...	...	...	...	...
Securities other than shares	1.5	-1.4	...	...	...	...	...	...	...
Loans	0.0	-0.3	...	...	...	...	...	...	...
Shares and other equity	0.0	0.0	...	...	...	...	...	...	...
Insurance technical reserves	0.0	0.0	...	...	...	...	...	...	...
Financial derivatives	0.0	0.0	...	...	...	...	...	...	...
Other accounts payable	0.1	0.4	...	...	...	...	...	...	...
Memorandum items									
Primary balance	-0.8	-0.7	0.6	1.0	1.1	1.2	1.3	1.3	1.4
Structural balance (percent of potential GDP)	-1.2	-1.3	-0.1	0.2	0.2	0.2	0.2	0.3	0.3
Structural primary balance (percent of potential GDP)	0.6	0.2	1.3	1.1	1.1	1.0	1.0	1.1	1.1
Gross Debt	67.9	65.1	63.0	60.1	58.3	56.5	54.7	52.8	50.9
Output gap	-2.2	-1.4	-0.9	-0.4	-0.2	0.0	0.2	0.2	0.2
Nominal GDP (billions of euros)	663.0	676.5	692.0	713.2	733.8	754.4	775.8	798.6	822.1
Nominal GDP growth (percent)	1.6	2.0	2.3	3.1	2.9	2.8	2.8	2.9	2.9
Real GDP growth (percent)	1.4	2.0	2.1	2.1	1.8	1.8	1.7	1.7	1.6
GDP deflator growth (percent)	0.1	0.1	0.2	1.0	1.0	1.0	1.1	1.3	1.3

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

Table 2b. The Netherlands: General Government Statement of Operations, 2014–22

(Billions of euros)

	2014	2015	2016	2017 Proj.	2018 Proj.	2019 Proj.	2020 Proj.	2021 Proj.	2022 Proj.
Revenue	291.2	292.6	305.0	315.9	325.0	334.2	343.6	353.8	364.2
Taxes	147.8	156.2	164.5	173.9	178.9	184.0	189.2	194.7	200.5
Taxes on production and imports	75.2	76.3	80.5	83.6	86.0	88.4	90.9	93.6	96.4
Current taxes on income, wealth, etc.	71.1	78.3	82.1	88.3	90.9	93.4	96.1	98.9	101.8
Capital taxes	1.5	1.6	1.9	2.0	2.0	2.1	2.1	2.2	2.3
Social contributions	98.6	96.4	102.3	103.5	106.4	109.4	112.5	115.8	119.3
Grants	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other revenue	44.7	39.9	38.1	38.5	39.6	40.7	41.9	43.1	44.4
Expenditure	306.2	305.8	308.5	315.7	324.2	332.8	341.6	351.0	360.8
Expense	306.1	306.2	307.5	314.0	322.9	331.8	341.0	350.9	361.2
Compensation of employees	60.4	59.8	61.6	62.4	64.1	65.9	67.7	69.7	71.7
Use of goods and services	42.9	40.7	41.4	42.4	43.6	44.8	46.0	47.4	48.8
Consumption of fixed capital	22.1	22.2	22.3	22.5	23.1	23.7	24.4	25.1	25.8
Interest	9.5	8.5	7.9	7.1	7.3	7.5	7.7	7.9	8.1
Subsidies	8.0	8.0	8.7	9.3	9.6	9.8	10.1	10.4	10.7
Grants	8.8	9.0	9.2	9.5	9.8	10.0	10.3	10.6	10.9
Social benefits	146.2	149.3	151.7	154.9	159.3	163.7	168.3	173.2	178.3
Other expense	8.1	8.6	4.6	6.0	6.1	6.3	6.5	6.7	6.9
Net acquisition of nonfinancial assets	0.1	-0.4	1.0	1.7	1.3	0.9	0.5	0.1	-0.4
Net operating balance	-14.9	-13.6	-2.5	1.9	2.1	2.4	2.6	2.9	2.9
Net lending/borrowing	-15.0	-13.2	-3.5	0.2	0.8	1.4	2.1	2.8	3.4
Net acquisition of financial assets	-5.0	-20.1	...	...	...	...	...	...	...
Currency and deposits	0.4	-2.1	...	...	...	...	...	...	...
Securities other than shares	-4.6	-0.9	...	...	...	...	...	...	...
Loans	0.2	-4.5	...	...	...	...	...	...	...
Shares and other equity	-1.5	-4.3	...	...	...	...	...	...	...
Insurance technical reserves	0.0	0.0	...	...	...	...	...	...	...
Financial derivatives	-1.0	-6.0	...	...	...	...	...	...	...
Other accounts receivable	1.4	-2.3	...	...	...	...	...	...	...
Net incurrence of liabilities	10.9	-8.5	...	...	...	...	...	...	...
Special Drawing Rights (SDRs)	0.0	0.0	...	...	...	...	...	...	...
Currency and deposits	0.1	0.2	...	...	...	...	...	...	...
Securities other than shares	9.7	-9.7	...	...	...	...	...	...	...
Loans	0.2	-2.0	...	...	...	...	...	...	...
Shares and other equity	0.0	0.0	...	...	...	...	...	...	...
Insurance technical reserves	0.0	0.0	...	...	...	...	...	...	...
Financial derivatives	0.0	0.0	...	...	...	...	...	...	...
Other accounts payable	0.9	3.0	...	...	...	...	...	...	...
Memorandum items									
Primary balance	-5.5	-4.7	4.5	7.3	8.1	8.9	9.8	10.7	11.5
Gross Debt	450.5	440.6	436.0	428.6	427.8	426.4	424.3	421.5	418.2
Nominal GDP (Euro bill.)	663.0	676.5	692.0	713.2	733.8	754.4	775.8	798.6	822.1

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

Table 2c. The Netherlands: General Government Integrated Balance Sheet, 2009–15
(Percent of GDP)

	2009	2010	2011	2012	2013	2014	2015
Net Worth	32.0	28.3	24.0	22.5	22.3	17.6	…
Nonfinancial assets	59.4	60.2	60.7	61.8	61.8	60.9	…
Net Financial Worth	-27.4	-31.9	-36.7	-39.2	-39.5	-43.3	-42.2
Financial assets	36.3	35.7	34.9	38.1	36.7	37.7	35.4
Currency and deposits	2.9	2.3	2.2	2.3	1.7	1.7	1.4
Securities other than shares	3.9	3.7	3.5	3.1	2.0	1.4	1.2
Loans	8.0	7.7	7.7	9.0	10.4	10.3	9.4
Shares and other equity	14.1	13.9	12.8	14.6	14.1	13.7	14.2
Insurance technical reserves	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial derivatives	0.0	0.3	1.4	2.0	1.5	3.6	2.7
Other accounts receivable	7.4	7.8	7.2	7.1	6.9	7.0	6.5
Liabilities	63.7	67.6	71.6	77.4	76.1	81.0	77.6
Special Drawing Rights (SDRs)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Securities other than shares	46.5	50.4	54.1	58.5	57.8	62.7	59.4
Loans	12.6	12.2	13.0	14.5	14.1	13.9	13.4
Shares and other equity	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Insurance technical reserves	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial derivatives	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other accounts payable	4.4	4.9	4.4	4.1	4.1	4.2	4.6

Sources: The Netherlands' Ministry of Finance, and IMF staff calculations.

Table 3. The Netherlands: External Sector, 2014–22
(Percent of GDP, unless otherwise indicated)

	2014	2015	2016	2017 Proj.	2018 Proj.	2019 Proj.	2020 Proj.	2021 Proj.	2022 Proj.
Balance on Current Account	8.9	8.7	8.9	8.5	8.2	8.0	7.6	7.3	7.1
Trade Balance	11.4	11.3	10.7	10.7	10.5	10.2	9.9	9.7	9.4
Exports of goods	64.8	63.2	64.1	65.2	66.1	66.8	67.6	68.3	68.9
Imports of goods	53.3	51.9	53.4	54.5	55.6	56.7	57.7	58.6	59.5
Service Balance	-0.6	-0.5	-0.5	-0.6	-0.6	-0.7	-0.7	-0.7	-0.7
Exports of services	17.7	19.3	19.8	20.2	20.6	20.9	21.3	21.7	22.0
Imports of services	18.4	19.8	20.3	20.7	21.2	21.6	22.1	22.4	22.7
Factor Income	0.1	-0.3	0.5	0.2	0.2	0.3	0.3	0.3	0.3
Current transfers, net	-2.0	-1.8	-1.8	-1.9	-1.9	-1.9	-1.9	-1.9	-1.9
Balance on capital account	-0.1	-5.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Balance on financial account	9.3	6.2	8.9	8.5	8.2	8.0	7.6	7.3	7.1
Direct investment, net	-5.0	1.3	1.1	1.2	1.1	1.1	1.1	1.0	0.9
Direct investment abroad	6.5	14.8	16.1	17.6	19.1	20.8	22.7	24.7	26.9
FDI in Netherlands	11.5	13.6	14.9	16.4	17.9	19.7	21.6	23.7	26.0
Portfolio investment, net	10.4	2.4	0.9	2.1	2.2	3.0	3.3	2.7	2.9
Financial derivatives	0.5	1.1	-0.2	-0.3	0.1	0.0	-0.1	0.0	0.1
Other investment	3.5	1.5	7.0	5.4	4.7	3.7	3.2	3.5	3.1
Other investment, official	-0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Reserve assets	-0.2	-0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Errors and omissions, net	0.4	2.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Sources: DNB and IMF staff calculations.

Annex I. Risk Assessment Matrix

Source of Risks	Relative Likelihood	Impact	Policy response
Weaker than expected global growth			
I. Euro area's failure to fully address crisis legacies and undertake structural reforms may lead to a decline in medium-term growth and inflation and the accumulation of financial imbalances, especially at banks. With close to 70 percent of exports to the euro area, the Netherlands is especially sensitive to output fluctuations in the region.	H	M	Let automatic stabilizers work. Consider a discretionary fiscal expansion to the extent allowed by the fiscal rules. If the output gap widens significantly, depending on the size and nature of the shock to the economy, invoking the escape clause under the SGP could be appropriate to support growth.
II. Significant slowdown in large Ems/frontier economies. Turning of the credit cycle and fallout from excess household and corporate (FX) leverage as investors withdraw from EM corporate debt, generating disorderly deleveraging, with potential spillbacks to advanced economies.	M	M	
Economic fallout from political fragmentation			
III. Erosion of confidence in the European project across parts of Europe. Some European countries—especially those with upcoming elections—may renegotiate the terms of their membership to the European Union, or exit the Union altogether (e.g., Brexit), leading to periods of financial volatility, higher trade barriers, and lack of policy coordination. Increased uncertainty regarding the future of Europe may affect confidence and investment in the Netherlands, a small open economy highly dependent on unimpeded access to the European market.	H	H	Let automatic stabilizers work. Consider a discretionary fiscal expansion to the extent allowed by the fiscal rules. If the output gap widens significantly, depending on the size and nature of the shock to the economy, invoking the escape clause under the SGP could be appropriate to support growth.
Risks to the financial sector			
IV. Sharp rise in risk premia with flight to safety. Investors withdraw from specific risk asset classes as they reassess underlying economic and financial risks in large economies, or respond to unanticipated Fed tightening, and increases in U.S. term premia, with poor market liquidity amplifying volatility. Safe haven currencies—especially the US dollar—surge creates balance sheet strains for FX debtors. **V. Structurally weak growth in key advanced and emerging economies.** Weak demand, low productivity growth, and persistently low inflation from a failure to fully address crisis legacies and undertake structural reforms, leading to lower medium-term path of potential growth (the Euro area, Japan, and the United States) and exacerbating legacy financial imbalances especially among banks (the Euro area) (high likelihood). Tighter financial conditions and insufficient reforms undermine medium-term growth in emerging markets (medium likelihood).	M	M	The authorities should make sure that the resolution of a major financial institution does not contaminate the rest of the financial system and ensure ample liquidity provision. In the meanwhile, supervisors should keep pushing large banks to reduce their high leverage, and make full use of the more stringent supervisory guidelines under Solvency II to improve solvency of the life insurance sector.

Source of Risks	Relative Likelihood	Impact	Policy response
Risks to the financial sector (continued)			
VI. Excessive risk-taking associated to the low interest rate environment. Faced with falling net interest margins, banks and other non-banks financial institutions may be tempted to adopt (risky) search-for-yield strategies by e.g., continuing to invest in overheated housing and lend to over-leveraged households and firms. This runs the risk of exacerbating the next recession as financial institutions pro-cyclically tighten credit conditions in a downturn. The Netherlands is a highly leveraged economy and prone to boom-bust cycles.	H	H	Take precautionary measures now by strengthening the macroprudential framework as well as bank and insurance supervision. The authorities should also make sure that the resolution of a major financial institution does not contaminate the rest of the financial system and ensure ample liquidity provision.

Annex II. External Sector Report

Foreign asset and liability position and trajectory	**Background**. The Netherlands' positive net international investment position (NIIP) has continued to strengthen and reached 77 percent of GDP at the end of 2016:Q2. As in previous years, the increase chiefly reflects l the net FDI position which rose from 566 billion in 2010:Q1 to 712 billion at the end of 2016:Q2. Over the medium term, the NIIP is expected to continue growing in line with the projected sizeable current account surpluses. **Assessment.** The Netherland's safe haven status and its sizeable foreign assets limit risks from its large foreign liabilities.
Current account	**Background**. The current account is estimated to have stabilized at 8.8 percent of GDP in 2016 (8.9 percent cyclically adjusted) as a rebound in net primary income (investment income) offset a decline in the trade balance by 0.7 pp to 10.6 percent of GDP. Beyond 2016, the CA surplus is projected to decline in line with the trade balance, as a lackluster foreign environment and lower gas production due to earthquakes in extraction areas dampen exports, and robust domestic demand tends to boost imports. The current account has been in surplus since 1981—a reflection of a positive goods and services balance—and until 2000 was mainly driven by household savings. Since 2001, non-financial corporate net savings have progressively taken over as the main driver of current account surpluses, with large and global corporate savings financing substantial FDI outflows. Households savings have nonetheless also increased as a result of deleveraging following the sharp declines in housing prices starting in mid-2008 as well as an increase in mandatory contributions to the second-pillar pension funds. Netherland's status as a trade and financial center and natural gas exporter also likely plays a role to account for the strong structural position. **Assessment**. As the current account surplus essentially reflects the high corporate savings and liquidity of Netherlands-based multinationals, partly due to some favorable tax treatment for corporate income, as well as more recent but possibly long lasting increases in household saving rates following the sharp decline in real estate prices and financial difficulties of the pension funds, the assessment of the EBA estimated current account gap is particularly uncertain. Taking these factors into account, staff assesses the norm in a range of 5–7 percent of GDP and a corresponding CA gap of 2–4 percent of GDP. 1/ In the medium to long term, the CA surplus is likely to decline, supported by a recovery in domestic demand, progress in household deleveraging, declining gas exports, and demographic trends, including divestment by pension funds.
Real exchange rate	**Background.** Following a year and a half long depreciation trend (that primarily followed the euro depreciation) the CPI-based REER started to appreciate again from May 2015 on. In January 2017 the REER was 1.9 percent above its April 2015 trough. **Assessment**. The EBA REER gaps span a large range in 2016, from an overvaluation of 6.1 percent (index) to an undervaluation of 5.2 percent (level), exclusively attributable to unexplained residuals. The REER elasticity approach to the current account would imply an undervaluation of 6 to 12 percent (assuming an elasticity of 0.33 and a current account gap of 2 to 4 percent). Taking into account all estimates and the uncertainty surrounding the EBA REER results, staff assesses that the REER remained undervalued by around 6.5 percent within a range of 2–11 percent.
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. 2/ **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 invest substantially abroad.
FX intervention and reserves level	**Background**. The euro is 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/ In comparison with last year, the EBA-estimated CA gap in 2016 (unexplained residual plus the contribution of identified policy gaps) widened by 0.8 percentage point to 3 percent of GDP, mostly reflecting unidentified residuals. The larger gap reflects a higher cyclically adjusted CA surplus (up from 8.3 to 8.9 percent of GDP) and an unchanged CA norm of 5.9 percent of GDP. 2/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. According to the DNB, half of the positions in assets and liabilities are attributable to subsidiaries of foreign multinationals.

Overall Assessment

The external position in 2016 was stronger than the level consistent with medium-term fundamentals and desirable policy settings. The Netherlands' status as a trade and financial center and natural gas exporter make an external assessment more uncertain than usual.

Potential policy responses

The use of any available fiscal space as long as the economy operates below potential, structural reforms to raise the productivity of small domestic firms, progress in repairing household balance sheets, and strengthening the banking system could support domestic demand and contribute to reducing external imbalances. A shift towards more domestic productive investment as the Dutch and global economies recover would also help in the rebalancing.

Annex III. Progress Against IMF Recommendations

IMF 2015 Article IV Recommendations	Authorities' Response
Promote orderly deleveraging	
Addressing young households' indebtedness would lift overall spending by increasing transfers between generations. Underwater mortgages should be re-profiled and the stigma associated with personal bankruptcy should be reduced. Mortgage interest rate deductibility (MID) should be phased out faster and complemented by accelerated social housing reforms (see below housing reforms) to offer private rental alternatives to premature home ownership.	The recovery in the housing sector since mid-2014 reduced the share of underwater households. The tax break on monetary gifts up to €100,000 will be restored from January 2017. In the meantime, households can use a standard €50,000 exemption on tax-free transfers. The authorities leave further action on reducing MID beyond the current arrangement to future governments.
Fiscal Policy	
Dutch fiscal policy should support the recovery to the extent possible. The authorities could use any available fiscal space to catch up on deferred spending priorities.	Despite the implementation of a 0.7 percent of GDP tax reduction package, fiscal space has increased in the Netherlands in 2016 owing to strong revenue collection.
Tax reform should aim to reduce the debt bias, VAT distortions, and the labor tax wedge. It should also shift the burden away from labor towards consumption and property taxation.	The 2016 5 billion tax cut, especially on second-income earners, helped reduce the labor tax wedge and elicit burden shifting, but no progress has been made in terms of owner occupied housing and indirect taxation. The debt bias is being addressed but LTV and MID are reduced only gradually.
Financial Sector Policy and Housing Finance	
Stronger capital and liquidity buffers would ensure that banks have the capacity to support the recovery and the adjustment of household's balance sheet. The recommendation of the Financial stability committee (FSC) to reduce maximum loan-to-value ratio for mortgages loans to 90 percent by 2028 should be adopted, and the path after 2018 should be clarified.	The authorities are confident that the capital and liquidity targets are within reach, and that Dutch banks will be able to find adequate resources to meet their buffers through 2019. The authorities leave the decision on further reducing the maximum LTVs below 100 percent after 2018 to future governments.
Faster LTV (and MID) reduction should be complemented by accelerated social housing reforms to offer private rental alternatives to premature home ownership.	The reformed Housing Valuation Schemes helps reduce the rents gap between social and private rental markets and promotes increased supply of private rental alternatives.

IMF 2015 Article IV Recommendations	Authorities' Response
Structural Reform	
Labor market: Rapid growth in self- employment points to the need to address rigidities in the formal employment sector and to ensure equitable treatment between the self-employed and regular employees; tax and other incentives for self-employment should be reviewed.	New legislation was introduced to increase flexibility in the regular labor market and to limit abuse and tighten eligibility to the self-employed category. Although authorities also agreed that tax, social and pension contribution and benefit regimes should be examined, they have not committed to a course of action yet.
Housing market: The size of the social housing corporation (SHC) sector should be scaled back to focus on its social mandate and allow the development of the private sector rental market. Zoning regulations should be eased to expand housing supply.	The new Housing Act entered into effect in July 2015, and stipulates that SHC should concentrate on their core social mandate. The reformed housing valuation scheme introduced in October 2015 and the approval of the Rental Market Mobility Act by the House of Representatives in February 2016 allow for tenants' income and market prices to play a role in rent increases.
Pensions: The strains in the second pillar pension system need to be addressed by shifting to a new model with more transparency and individual choices.	The authorities agree with the assessment but have not committed to a course of action yet. Building on preparatory work by the Socio-economic Council (SER), the government has laid out various reform options in a letter to Parliament in July 2016.

Annex IV. The Netherlands: FSAP Key Recommendations

Recommendations	Time[1]
Financial Risks and Stability analysis	
Enforce an industry-wide approach to informing IO mortgagors of estimated repayment shortfalls.	I
Continue to build capital buffers to ensure all banks remain above minimum leverage ratio thresholds in the case of severe adverse events.	NT
Macroprudential policy framework	
Strengthen the FSC by establishing it under primary law and vest it with "comply-or-explain" powers.	NT
Accelerate the phase-out of MID and reduce the final tax rate to a neutral level.	NT
Continue gradually reducing maximum limits on LTV ratio to no more than 90 percent after 2018, and place prudential ceilings above which DSTI limits (by income group) cannot be relaxed.	NT
Cross-cutting supervisory issues	
Enhance the DNB and AFM powers to introduce technical regulations (consistent with the SSM) and to conduct examinations using outside expertise.	NT
Exclude the DNB and AFM from the proposed salary cap, and provide them with greater autonomy in setting their supervisory budgets.	I
The DNB and AFM to undertake a cross-sectoral review of credit underwriting standards of mortgages.	I
Ensure that reliable and complete data is available on a timely basis to support off-site supervision.	NT
Banking supervision and regulation	
Further enhance supervisory oversight of loan classification and strengthen internal model validation by providing Joint Supervisory Teams more support from risk specialist divisions.	NT
Encourage a more active role of the Supervisory Board of Dutch banks via ongoing engagement.	NT
Insurance and pension supervision and regulation	
Monitor closely and take a series of well-defined actions, under Pillar 2, at different levels of VA and UFR impact on insurers' solvency position.	I
Harmonize the relevant laws on the quality of advice and suitability of products and provide authority for group supervision in the pension law.	NT
Securities supervision and regulation	
Broaden the supervisory authority of the AFM with regard to loan-based crowd-funding platforms.	NT
Require prompt public disclose of auditor changes or resignations.	NT
Financial market infrastructure	
Augment the supervisory resources devoted to the oversight of European Central Counterparty (EuroCCP).	I
EuroCCP to strengthen its review of its stress testing and margin models methodology and develop a comprehensive recovery plan.	I
Crisis management and bank resolution	
Develop adequate arrangements for systemic crisis management, and make legacy frameworks for managing failing banks complementary to the new SRM framework and more transparent.	NT
Allow the deposit guarantee scheme to finance deposit transfers in resolution and insolvency.	NT

[1] Immediately is within one year, near term is 1–3 years.

Annex V. Public Debt Sustainability Analysis

Public debt is expected to remain sustainable, decreasing at a faster rate than previously anticipated from 63 percent of GDP in 2016 to 50.9 percent of GDP by 2021, owing to favorable growth developments and continued fiscal tightening. The largest risks to the baseline scenario are represented by a negative growth shock and a contingent liability shock, which could push up the debt-to-GDP ratio to 68.4 percent and 88.8 percent by 2018, respectively.

Macroeconomic assumptions: Real growth is forecast to stabilize around 1.7–1.8 percent over the projection period, driven by dynamic non-residential investment and strengthening private consumption supported by improving housing prices, while external demand would remain subdued. Reflecting stronger domestic demand, inflation would gradually increase to around 1.5 percent over the medium run. Owing to strong revenue collection and contained expenditure, public debt would decline toward 51 percent of GDP by the end of the projection period, but remain above 60 percent until end-2017, calling for the use of the higher scrutiny framework in the context of the Fund framework for debt sustainability analysis.

Realism of baseline assumptions: Over 2007–15, staff projections of the main macroeconomic and fiscal variables in the Netherlands have constantly remained close to the median within the 25–75 interquartile range vis-à-vis other surveillance countries, expect for inflation in 2015. On average, real growth and primary balance forecasts appear to have been relatively conservative, while inflation forecasts have been slightly optimistic.

Baseline scenario and stress tests: Under the baseline scenario, public debt would rapidly decrease from 63 percent of GDP in 2016 to about 51 percent by the end of the projection period, under the joint effects of steady nominal growth and the pursuit of expenditure-based fiscal consolidation. Public debt would increase up to 68.2 percent of GDP in the historical scenario, due to conservative growth assumptions. It would first peak, and then steadily decrease over the medium term, in all other scenarios.

Main shocks to the baseline scenario

- **Growth shock.** Assuming a negative one standard deviation shock on the real growth rates in 2017–18, lowering them by about 2 ¼ percentage points compared to the baseline scenario, associated with inflation rates lower by 0.4 percentage points, public debt would increase to 68.4 percent of GDP in 2018 before gradually returning to current levels by 2022. Gross financing needs would peak at 12.2 percent of GDP in 2018.

- **Primary balance shock.** A deterioration of the primary balance by 1 percentage points in 2017 and 0.8 percent in 2018 would stabilize the debt-to-GDP ratios around 64 percent for these years, with gross financing needs reaching 10.3 in 2018 percent of GDP, thus postponing fiscal consolidation until 2018.

- **Contingent liability shock.** A non-interest expenditure shock arising from the need to bail out 10 percent of the banking sector, accompanied with lower growth rates by one standard deviation, lower inflation, and higher interest rates, would push up gross financing needs to 31 percent of GDP in 2017 and public debt to 88.8 percent of GDP in 2018. Public debt would subsequently decrease, but remain above 85 percent of GDP by the end of the projection period.

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

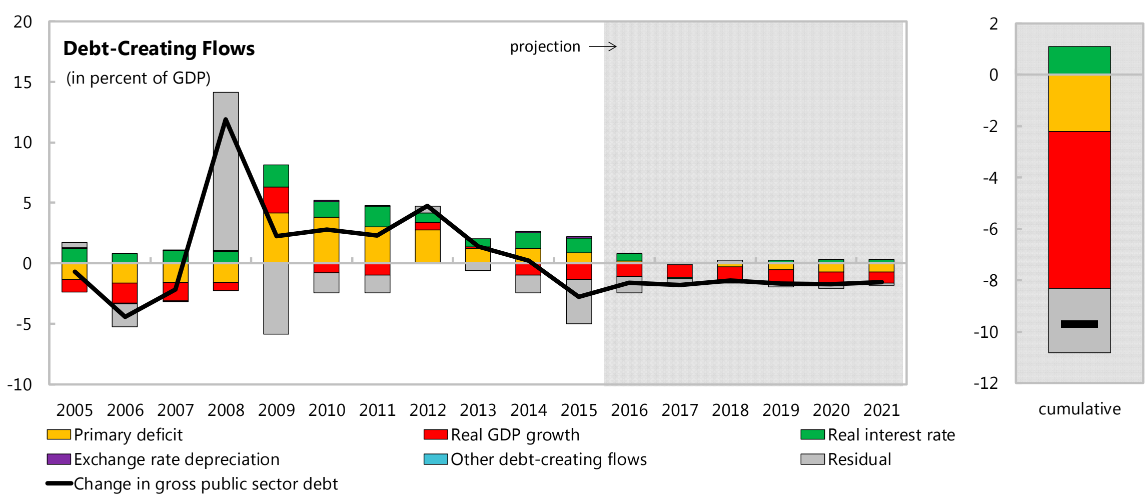
(in percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators [1/]

	Actual			Projections						As of November 09, 2016		
	2005-2013 [2/]	2014	2015	2016	2017	2018	2019	2020	2021	Sovereign Spreads		
Nominal gross public debt	55.7	67.9	65.1	63.5	61.7	60.3	58.7	57.0	55.4	EMBIG (bp) 3/		7
Public gross financing needs	2.3	2.3	1.9	4.8	8.1	8.8	6.0	5.1	2.8	5Y CDS (bp)		26
Public debt (in percent of potential GDP)	55.5	66.4	64.2	62.9	61.2	60.1	58.6	57.0	55.4			
Real GDP growth (in percent)	1.0	1.4	2.0	1.7	1.7	1.8	1.8	1.7	1.6	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	1.5	0.1	0.1	0.2	1.3	1.2	1.3	1.3	1.4	Moody's	Aaa	Aaa
Nominal GDP growth (in percent)	2.5	1.6	2.0	1.9	3.0	3.1	3.2	3.1	3.0	S&Ps	AA+	AA+
Effective interest rate (in percent) [4/]	3.7	2.1	1.9	1.1	1.1	0.9	1.8	1.9	2.0	Fitch	AAA	AAA

Contribution to Changes in Public Debt

	Actual			Projections							
	2005-2013	2014	2015	2016	2017	2018	2019	2020	2021	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	2.0	0.2	-2.8	-1.6	-1.8	-1.4	-1.6	-1.7	-1.5	-9.7	
Identified debt-creating flows	1.7	1.7	0.9	-0.3	-1.3	-1.6	-1.3	-1.4	-1.3	-7.2	
Primary deficit	1.0	1.2	0.9	0.2	-0.1	-0.3	-0.5	-0.7	-0.7	-2.2	-0.5
Primary (noninterest) revenue and grant	42.5	43.5	43.0	43.4	43.5	43.5	43.5	43.5	43.5	260.8	
Primary (noninterest) expenditure	43.4	44.8	43.9	43.6	43.4	43.2	43.0	42.7	42.7	258.6	
Automatic debt dynamics [5/]	0.7	0.5	0.0	-0.5	-1.2	-1.3	-0.8	-0.7	-0.5	-5.0	
Interest rate/growth differential [6/]	0.7	0.4	-0.1	-0.5	-1.2	-1.3	-0.8	-0.7	-0.5	-5.0	
Of which: real interest rate	1.1	1.3	1.2	0.6	-0.1	-0.2	0.3	0.3	0.3	1.1	
Of which: real GDP growth	-0.4	-0.9	-1.3	-1.1	-1.0	-1.1	-1.1	-1.0	-0.9	-6.1	
Exchange rate depreciation [7/]	0.0	0.1	0.1	...	...	...	...	...	...	...	
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., drawdown of d	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., ESM and Euroa	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/]	0.3	-1.5	-3.7	-1.3	-0.5	0.2	-0.3	-0.3	-0.2	-2.5	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

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

5/ Derived as $[(r - \pi(1+g) - g + ae(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; 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 $r - \pi(1+g)$ 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.

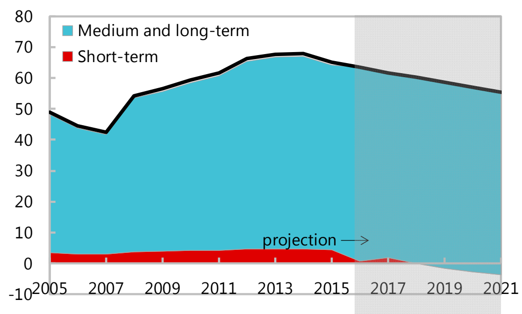
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Netherlands Public DSA—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

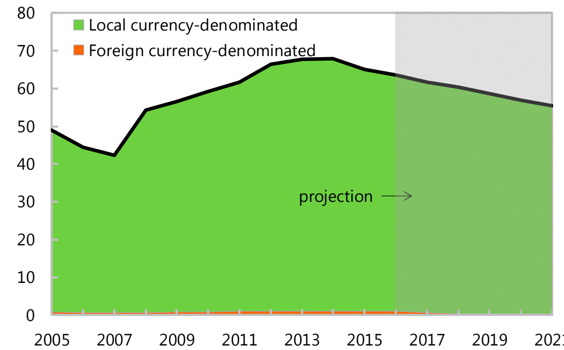
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

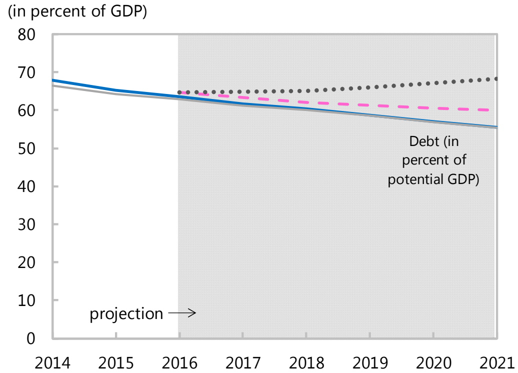


Alternative Scenarios

Baseline — Historical — Constant Primary Balance

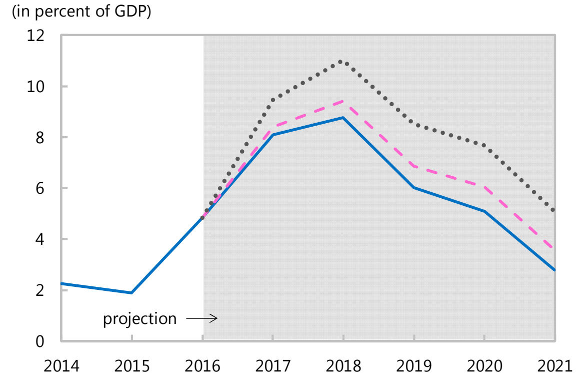
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

Baseline Scenario	2016	2017	2018	2019	2020	2021
Real GDP growth	1.7	1.7	1.8	1.8	1.7	1.6
Inflation	0.2	1.3	1.2	1.3	1.3	1.4
Primary Balance	-0.2	0.1	0.3	0.5	0.7	0.7
Effective interest rate	1.1	1.1	0.9	1.8	1.9	2.0
Constant Primary Balance Scenario						
Real GDP growth	1.7	1.7	1.8	1.8	1.7	1.6
Inflation	0.2	1.3	1.2	1.3	1.3	1.4
Primary Balance	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Effective interest rate	1.1	1.0	0.8	1.8	1.8	1.9

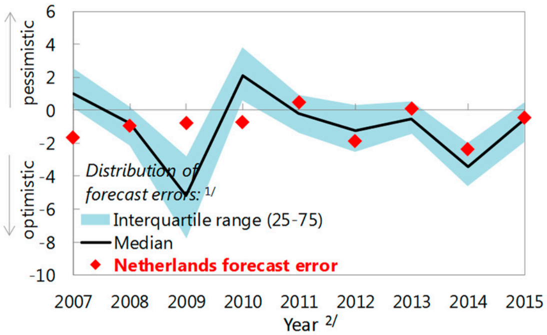
Historical Scenario	2016	2017	2018	2019	2020	2021
Real GDP growth	1.7	1.0	1.0	1.0	1.0	1.0
Inflation	0.2	1.3	1.2	1.3	1.3	1.4
Primary Balance	-0.2	-1.2	-1.2	-1.2	-1.2	-1.2
Effective interest rate	1.1	1.0	1.1	2.2	2.4	2.6

Source: IMF staff.

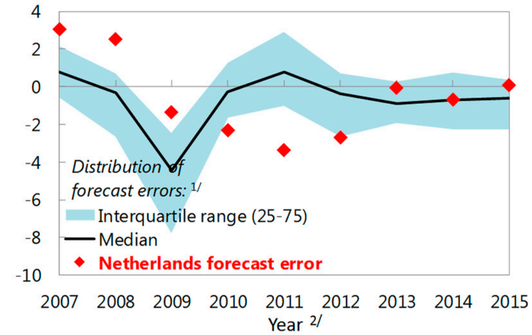
Netherlands Public DSA—Realism of Baseline Assumptions

Forecast Track Record, versus surveillance countries

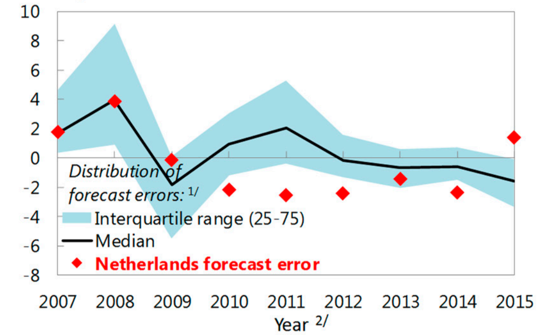
Real GDP Growth
(in percent, actual-projection)
Netherlands median forecast error, 2007-2015: **-0.77**
Has a percentile rank of: **33%**



Primary Balance
(in percent of GDP, actual-projection)
Netherlands median forecast error, 2007-2015: **-0.67**
Has a percentile rank of: **49%**

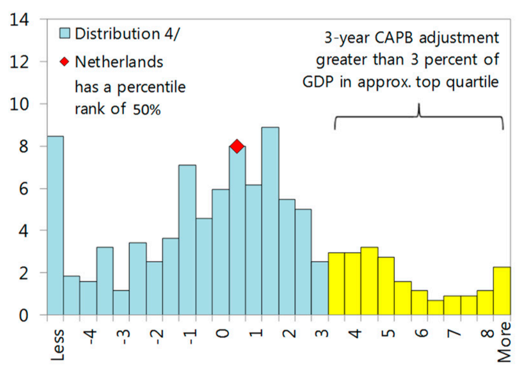


Inflation (Deflator)
(in percent, actual-projection)
Netherlands median forecast error, 2007-2015: **-1.45**
Has a percentile rank of: **7%**

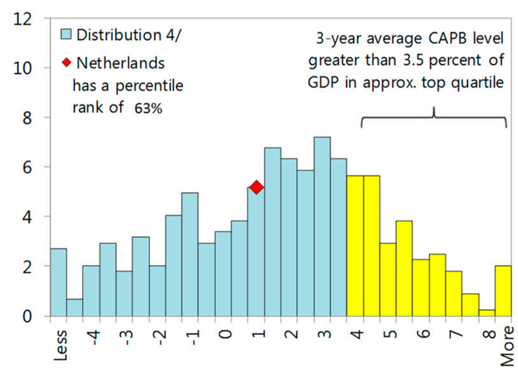


Assessing the Realism of Projected Fiscal Adjustment

3-Year Adjustment in Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)

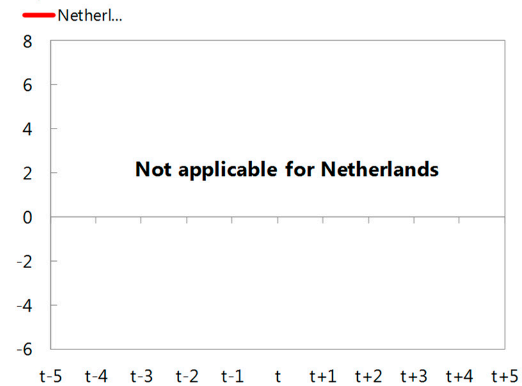


3-Year Average Level of Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)



Boom-Bust Analysis 3/

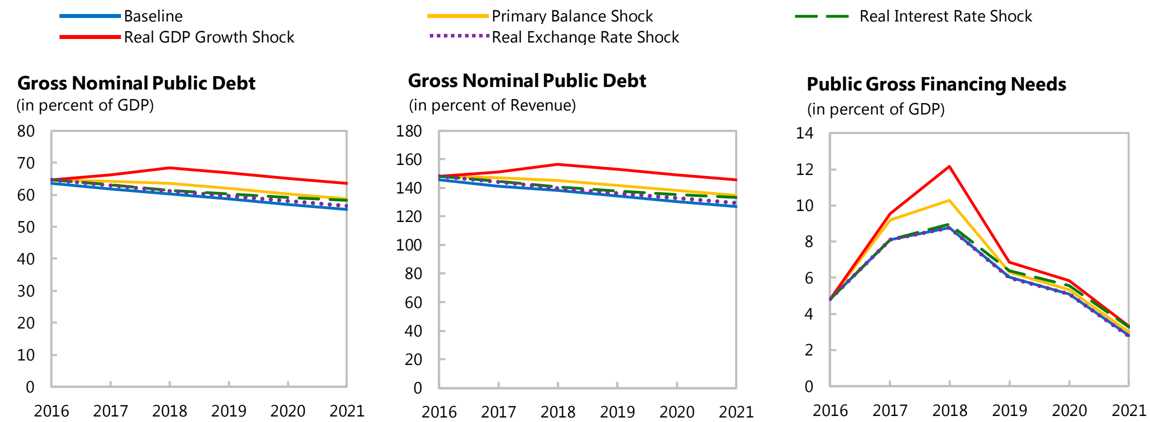
Real GDP growth
(in percent)



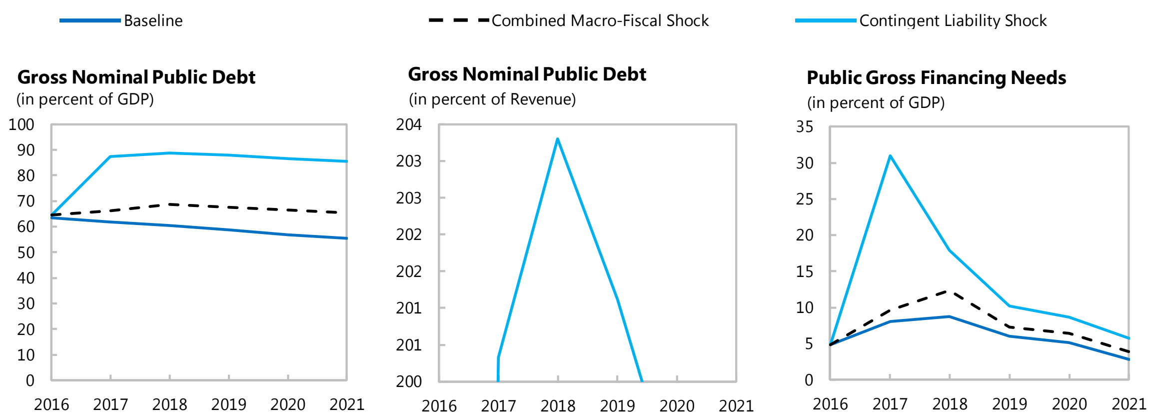
Source : IMF Staff.
1/ Plotted distribution includes surveillance countries, percentile rank refers to all countries.
2/ Projections made in the spring WEO vintage of the preceding year.
3/ Not applicable for Netherlands, as it meets neither the positive output gap criterion nor the private credit growth 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)

	2016	2017	2018	2019	2020	2021
Primary Balance Shock						
Real GDP growth	1.7	1.7	1.8	1.8	1.7	1.6
Inflation	0.2	1.3	1.2	1.3	1.3	1.4
Primary balance	-0.2	-1.0	-0.8	0.5	0.7	0.7
Effective interest rate	1.1	1.0	0.9	1.8	1.9	2.0
Real Interest Rate Shock						
Real GDP growth	1.7	1.7	1.8	1.8	1.7	1.6
Inflation	0.2	1.3	1.2	1.3	1.3	1.4
Primary balance	-0.2	0.1	0.3	0.5	0.7	0.7
Effective interest rate	1.1	1.0	1.1	2.4	2.7	3.0
Combined Shock						
Real GDP growth	1.7	-0.5	-0.4	1.8	1.7	1.6
Inflation	0.2	0.7	0.7	1.3	1.3	1.4
Primary balance	-0.2	-1.1	-2.1	0.5	0.7	0.7
Effective interest rate	1.1	1.0	1.2	2.4	2.8	3.0

	2016	2017	2018	2019	2020	2021
Real GDP Growth Shock						
Real GDP growth	1.7	-0.5	-0.4	1.8	1.7	1.6
Inflation	0.2	0.7	0.7	1.3	1.3	1.4
Primary balance	-0.2	-1.1	-2.1	0.5	0.7	0.7
Effective interest rate	1.1	1.0	0.9	1.9	2.0	2.0
Real Exchange Rate Shock						
Real GDP growth	1.7	1.7	1.8	1.8	1.7	1.6
Inflation	0.2	1.7	1.2	1.3	1.3	1.4
Primary balance	-0.2	0.1	0.3	0.5	0.7	0.7
Effective interest rate	1.1	1.0	0.9	1.8	1.9	2.0
Contingent Liability Shock						
Real GDP growth	1.7	-0.5	-0.4	1.8	1.7	1.6
Inflation	0.2	0.7	0.7	1.3	1.3	1.4
Primary balance	-0.2	-22.5	0.3	0.5	0.7	0.7
Effective interest rate	1.1	1.1	2.4	2.9	2.8	2.7

Source: IMF staff.

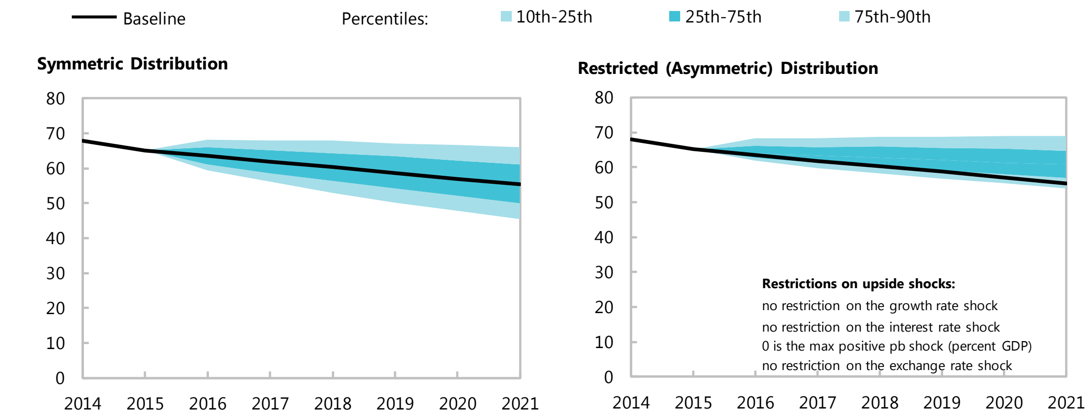
Netherlands Public DSA—Risk Assessment

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

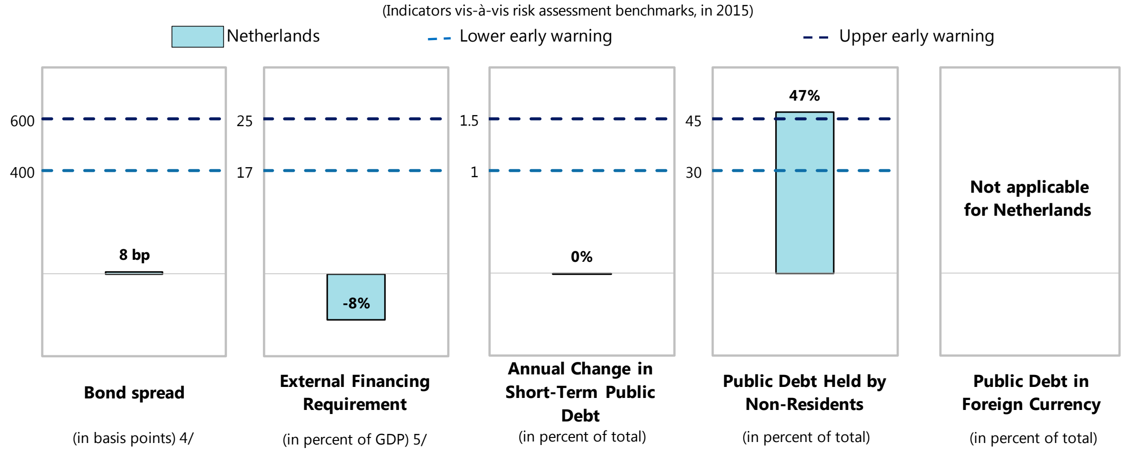
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2015)



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:

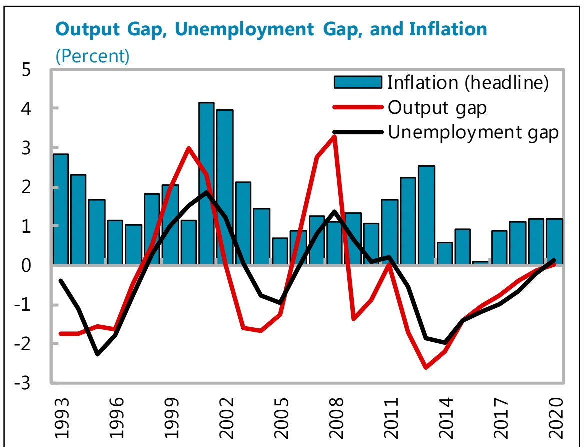
400 and 600 basis points for bond spreads; 17 and 25 percent of GDP for external financing requirement; 1 and 1.5 percent for change in the share of short-term debt; 30 and 45 percent for the public debt held by non-residents.

4/ Long-term bond spread over German bonds, an average over the last 3 months, 11-Aug-16 through 09-Nov-16.

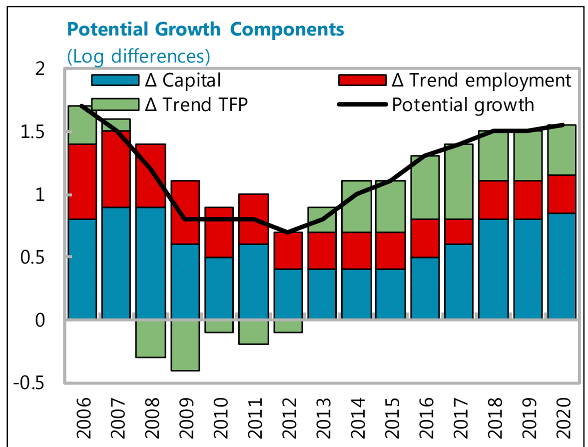
5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Annex VI. Potential Output for The Netherlands: A Structural Approach

As the Netherlands appears to have turned the corner after a double dip recession (global financial crisis in 2008–09, domestic demand-driven slump in 2011–12), some reexamination of the level and trajectory of potential output is warranted to take stock of structural changes that may have affected the economy, properly assess the fiscal stance, and help prioritize structural reforms. To this effect, a 2-pronged approach developed by the Research department was applied to the Netherlands.[1] The potential output and the NAIRU were jointly estimated using a *multivariate filter*, which relies on the modeling of the relationships between the output gap and inflation developments (Phillips curve) and between the output gap and cyclical unemployment (Okun's law). The analysis was then complemented by, and cross-checked with, a decomposition of potential growth between trend employment, capital accumulation and trend total factor productivity (TFP) using a *production function* approach.



Sources: CBS; and Staff computations.



Sources: CBS; and Staff computations.

In the Netherlands, the potential growth rate is estimated to have picked up following anemic developments over the years 2009–13, but is expected to settle around 1.5 percent per year over the projection horizon, below pre-crisis levels. This reflects the impact of very low investment in recent years, including in human capital, as well as a secular decline in both potential employment, due to population aging, and in TFP a development common to other advanced European countries.[2] After a trough at about 2.6 percent in 2013, the output gap is expected to close gradually by 2019, along with the unemployment gap, in a context of low but rising inflation. In terms of policy developments, these trends argue for proactively using any fiscal space to push the technological frontier through public R&D, seeking complementarities with the private sector, and to support human capital developments, e.g. via lifelong training, as well as to implement structural reforms aimed at incentivizing equity build up in innovative firms.

[1] Blagrave, P., R. Garcia-Saltos, D. Laxton, and F.Zhang (2015), "A simple multivariate filter for estimating potential output", IMF Working Paper 2015/79, April

[2] IMF (2015), "Where are we headed? Perspectives on potential output", World Economic Outlook, Chapter 3, April, 2015.

INTERNATIONAL MONETARY FUND

KINGDOM OF THE NETHERLANDS—NETHERLANDS

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

March 15, 2016

Prepared By European Department

CONTENTS

FUND RELATIONS

(As of March 9, 2017, unless specified otherwise)

Mission: November 29–December 8, 2016 in The Hague and Amsterdam. The concluding statement of the mission is available at http://www.imf.org/en/News/Articles/2016/12/07/MS120816-Kingdom-of-the-Netherlands-Concluding-Statement-of-the-2016-Article-IV-Consultation

Staff team: Messrs. Dorsey (head), Gerard, and Natal (all EUR). Ms. Khamis (MCM, FSAP mission chief) joined for part of the mission to follow up on the FSAP.

Country interlocutors: The mission met with De Nederlandsche Bank President Knot, Treasurer General Vijbrief, other senior officials, finance industry, academic, and trade union representatives. Messrs. Doornbosch and Evers (OED) joined for parts of the mission.

Fund relations: Discussions for the 2016 Article IV consultation were held in The Hague and Amsterdam from November 29 to December 8, 2016. The staff report for the 2015 Article IV Consultation (IMF Country Report No. 16/45, February 11, 2016) was considered by the Executive Board on February 8, 2016. The Article IV consultations 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=43694.0

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

General Resources Account:	**SDR Million**	**Percent of Quota**
Quota	8,736.50	100.00
Fund holdings of currency	8,260.50	94.55
Reserve Tranche Position	476.04	5.45
Lending to the Fund	574.10	

SDR Department:	**SDR Million**	**Percent of Allocation**
Net cumulative allocation	4,836.63	100.00
Holdings	4,486.43	92.76

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):

	2017	2018	2019	2020	2021
Principal					
Charges/Interest	0.94	1.18	1.18	1.19	1.18
Total	0.94	1.18	1.18	1.19	1.18

Implementation of HIPC Initiative
Not Applicable

Implementation of Multilateral Debt Relief Initiative (MDRI)
Not Applicable

Implementation of Catastrophe Containment and Relief (CCR)
Not Applicable

Exchange Rate Arrangements
The Netherlands' currency is the euro, which floats freely and independently against other currencies. The Netherlands maintain the exchange system free from restrictions on payment and transfers for current international transactions.

[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 have been based on *ESA 2010* methodology which triggered revisions of the general government deficit and debt levels from 1995 onwards. Revised ESA based data series have been 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 2013:Q1 to 2016:Q3.

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 March 9, 2017)

	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	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities 1/	02/17	03/17	M	M	M		
Reserve/Base Money 2/	01/17	02/17	M	M	M		
Broad Money 2/	01/17	02/17	M	M	W and M		
Central Bank Balance Sheet	01/17	02/17	M	M	M		
Consolidated Balance Sheet of the Banking System	01/17	02/17	M	M	M		
Interest Rates 3/	Current	Current	D	D	D		
Consumer Price Index	01/17	02/17	M	M	M	O, O, LO, O	O, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing 4/—General Government 5/	Q3/16	10/16	Q	Q	Q	LO, LO, LO, O	LO, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing 4/—Central Government	Q3/16	10/16	Q	Q	Q		
Stocks of Central Government and Central Government-Guaranteed Debt 6/	Q3/16	10/16	Q	Q	Q		

Netherlands: Table of Common Indicators Required for Surveillance (concluded)
(As of March 9, 2017)

External Current Account Balance	Q4/16	03/17	Q	Q	Q	O, O, O, O	O, O, O, O, O
Exports and Imports of Goods and Services	Q4/16	03/17	Q	Q	Q		
GDP/GNP	Q4/16	03/17	Q	Q	Q	O, O, O, O	LO, O, O, O, O
Gross External Debt	Q3/16	12/16	Q	Q	Q		
International Investment Position 7/	Q3/16	12/16	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.

Statement by Richard Doornbosch, Alternate Executive Director for Kingdom of the Netherlands—Netherlands and Willem Evers, Advisor to the Executive Director March 29, 2017

The Dutch authorities thank staff of both the Article IV and FSAP mission teams for the constructive meetings, for staff's appraisals and for the well-written reports and SIPs. This board discussion takes place two weeks after the general elections, and a caretaker government is in place. In line with Dutch political etiquette, the caretaker government will leave politically sensitive issues for the incoming coalition government.

Outlook

The post-crisis recovery of the economy is picking up speed and is projected to hold on to its upward trend. GDP growth was 2.1% in 2016, according to Statistics Netherlands (CBS), and is projected to be 2.1% in 2017 as well according to the latest projection by the Netherlands Bureau of Policy Analysis (CPB). Domestic spending serves as the main growth engine, supported by increased consumer confidence due to real wage increases and an increase in employment, a continuing upturn in the housing market and private investment, which is back at long-run average level. With (projected) economic growth well above potential in the four-year period 2015-2018, the authorities consider staff's projection of the output gap closing by 2019 plausible. Growth in employment outpaced growth in labor supply in 2015 and 2016, which resulted in a substantial drop in unemployment. It is expected that in 2017 and 2018 the unemployment rate will further decrease. Core inflation is expected to rise to 1.1% in 2017, after the low level of 0.6% in 2016.

Risks to the outlook stem mainly from external (policy) uncertainties. The Dutch economy is to a relatively large extent affected by global and European economic policies and developments. Therefore, weaker than expected growth in the Euro area (for example as a result of economies continuing to struggle with post-crisis legacies), declining support for international economic cooperation and an increased protectionist sentiment in important trading partners may have negative repercussions for Dutch economic growth. However, the authorities agree with staff that these downward risks may very well be balanced by upward risks stemming from an underestimation of domestic demand, related to even faster than expected improvement in labor market conditions and greater than anticipated housing price developments.

External assessment

The current account surplus can be attributed to fundamental factors. Although expected to narrow, it is likely to remain positive and large. The authorities agree with staff that the current account surplus is expected to decline further in the medium term, as a result of demographic developments (as baby boomers increasingly draw down their pension savings) and domestic energy policy which is expected to turn The Netherlands into a net importer of natural gas. In the near term, the expected stabilization of savings by households will contribute to a further narrowing of the surplus. As stated in the staff report, relatively high savings and foreign investments by multinationals and pension funds will continue to contribute to a large current account surplus in the longer term. The authorities don't see in staff's analyses any indication that the surplus is not in line with market fundamentals.

Fiscal policy and public investment

The authorities disagree with staff's assessment that there is a case for additional, near-term growth enhancing spending or tax reductions. Over the past few years, Dutch budgetary policy was geared towards balancing sustainability and economic stabilization while complying with the rules of the SGP. The Dutch authorities emphasize that, with GDP growth outpacing potential growth, the output gap is closing faster than expected. Given that implementing policy measures tend to take time before returning results, implementing new fiscal measures would have a pro-cyclical effect. Furthermore, the authorities stress that the structural balance is a volatile indicator, and caution against assigning this indicator too much weight in short-term budgetary recommendations. More importantly, the authorities note that the level of public debt, while rapidly declining towards the threshold value of 60% of GDP, remains well above the level prior to the crisis. They agree with staff that, given the still highly leveraged status of private balance sheets and the need to strengthen fiscal buffers in the wake of downside risks to the economic outlook, a further reduction of public debt should be a priority. For these reasons, the authorities disagree with staff on the need and the room for additional spending.

Structural reforms

The Dutch authorities agree with staff that reforms in the tax system aimed at reducing the debt bias and improve efficiency would be welcome. In spite of important labor tax reforms that were already implemented in 2016, the authorities agree that a further diversification of sources of tax revenues is desirable, which could also be aimed at encouraging greater labor force participation. The authorities agree with staff that minimizing the debt bias in the current tax system, which in terms of tax-treatment favors debt over equity, should be part of further future reforms. Indeed, reducing incentives for debt formation at household and corporate levels would significantly strengthen these sectors, and make them more resilient against future shocks. Staff rightly addresses some structural issues related to the housing market. In this regard, the authorities also point to measures taken with regards to the Mortgage Interest Deductibility (MID), which already reduces the debt bias on, and enhances the efficiency of, the housing market.

The Dutch second pillar pension system will need a fundamental overhaul in the direction of personalized contracts combined with collectively shared risks. The authorities agree with the staff assessment that the current pension system, which has come under increasing stress mainly caused by protracted low interest rates, needs a fundamental overhaul to maintain future sustainability, public support and confidence. Greater transparency, to provide more predictability to participants whilst retaining elements of collective risk sharing, should be important elements of this new system. It is up to the next government to decide on these future reforms.

The authorities agree with staff that the rise of flexible work arrangements and temporary contracts raise important policy issues regarding the sustainability of the Dutch safety net. The authorities do not necessarily share staff's assumption that the rise of self-employed and workers in temporary contracts is likely to be a symptom of an overly rigid regulatory regime for workers. They do share staff's concern that this increase may jeopardize the popular support for the Dutch safety net and its sustainability. The big increase in flexible work arrangements has contributed to labor market flexibility in the past years, but the low participation rates in disability insurance and pension schemes may indeed expose the increasingly large group of self-employed to economic vulnerability. Although the majority of the self-employed are self-employed by choice, the authorities share the concern of involuntary self-employment. The authorities are determined to ensure that workers' stated employment status accurately reflects actual employment situation. They share the view that the large differences in institutional treatment across different employment statuses should be reduced.

Financial sector stability

The large Dutch financial sector has recovered from a double-dip recession and important reforms strengthening financial sector oversight have been implemented. Since the last FSAP, the Dutch financial system has steadily built up resilience to shocks, and banks' capitalization improved significantly. However, the authorities agree with staff that risks to its stability are still on the horizon, in particular stemming from the low interest rate environment, indebtedness of Dutch households and NFC-sector and banks' reliance on wholesale funding. The authorities are encouraged by staff's assessment recognizing the reforms that have been implemented over the past years in the face of these risks, which significantly strengthened the financial sector oversight. Also, the authorities share staff's assessment that despite the high indebtedness of Dutch households and high LTV-ratio's, nonperforming mortgage loans remained very low, proving the financial system's resilience against severe external shocks like a housing-price decline of 20-25%.

The Dutch banking sector is resilient to risks and able to withstand severe stress. The FSAP subjected a substantial part of the Dutch banking system to an extreme adverse scenario in which all identified possible risks were included. As was the case with similar exercises executed by domestic and European supervisory authorities, the Dutch banking system showed resilience with all banks staying above the regulatory minima for risk-weighted capital ratios. Also, the exercise showed Dutch banks are able to withstand significant funding withdrawals without having to resort to liquidity assistance. The authorities welcome staff's recommendation to encourage banks to continue to build capital buffers to ensure all banks remain above minimum leverage ratio thresholds in the case of severe adverse events, which is in line with the authorities' aim to bring the leverage ratio of four systemically important banks to at least 4% in 2018.

The authorities share staff's analysis that the low-yield environment poses significant challenges for the insurance sector. Staff's analysis rightly points out that tools provided by Solvency II to generate long-term interest rate curves have become of significant relevance for insurers aiming to meet minimum supervisory thresholds in the current low-yield environment. Therefore, the supervisory authorities are closely monitoring the sector and using all supervisory instruments at their disposal to mitigate risks stemming from this situation. Moreover, the authorities agree with staff on the importance of improved recovery and resolution legislation that could be used for an orderly winding down of life insurance companies.

Macroprudential policies

Institutional arrangements for macroprudential policy setting have been strengthened and new macroprudential instruments have been implemented. The authorities concur with staff's assessment that important improvements to the domestic and European institutional setting for macroprudential policy setting have been made, i.e. by the establishment of the Financial Stability Committee (FSC) and the provision of macroprudential instruments by the CRD IV. They welcome staff's recommendation to strengthen the legal status of the FSC as this would strengthen its effectiveness and accountability. As for staff's recommendation to further tighten macroprudential policies to contain potential risks, the authorities point to the major (tightening) policies that have already been implemented since the last FSAP. DNB imposed systemic capital buffer requirements on five systemically important Dutch banks. Moreover, MID is gradually reduced by 0.5% a year and the maximum LTV-ratio allowed for mortgages will be reduced to

100% in 2018. Staff's recommendation to further lower the LTV-ratio to 90% after 2018 is in line with the FSC-recommendation addressed to the new government.

Microprudential oversight

The institutional framework for banking supervision was significantly strengthened and supervisory strategy is aimed at mitigating risks stemming from the current low interest-rate environment. The authorities welcome the recognition in the staff reports of the significant and far reaching institutional response to the GFC, including a revised strategic vision, more resources, stronger regulations and a more thorough style of supervision. Faced with remaining risks to banks' profitability in a low-rate environment and possible future regulatory changes, the authorities are encouraged by staff's recommendation to adequately assess and supervise banks' business models and risk management, which is well in line with mid-term supervisory strategies. As for staff's recommendation to encourage a more active role of the Supervisory Board of Dutch banks, the authorities note that in the 2-tier governance framework of Dutch companies, the Supervisory Board needs to be at sufficient distance from day-to-day decision making in order to fulfill its oversight function by focusing on the major issues it should be involved in.

The authorities share staff's assessment that supervision of the insurance sector has strengthened and risks stemming from the Solvency II regime should be closely monitored. As pointed out in the staff report, the Solvency II-position of insurers presents an overly-optimistic picture of the financial position, in particular for life insurers. The authorities therefore welcome staff's recommendation to remain vigilant and closely monitor the risks, using all instruments at their disposal to mitigate them.

The authorities welcome staff's recommendations for the Dutch regime for supervision of CIS, auditors and market-based finance. In particular, the authorities welcome staff's recommendation to broaden the supervisory authority of the AFM with regard to loan-based crowd-funding platforms, as they agree that the fast-moving developments in this small but growing area may pose risks to consumer protection that the supervisor should be able to mitigate.

The supervision of financial market infrastructures has been significantly strengthened and the authorities welcome the recommendations for further improvements. As the Netherlands is home to a central counterparty which is systemic for European markets, the authorities support the recommendation to augment the devoted supervisory resources to its oversight. Moreover, the authorities support the recommendation that recovery planning for FMIs within a set resolution regime would further strengthen the FMI supervisory framework.

Financial Safety nets

The authorities welcome staff's appraisal that significant progress in recovery and resolution is being made, though also share staff's view that arrangements for managing failing banks remain work in progress. The authorities note that most recommendations on crisis management will have to be addressed at the European level, within the Single Resolution Mechanism. The authorities in particular support staff's recommendations regarding the improvement of the domestic crisis management framework, the operationalization of resolution tools and optimization of the use of DGS funds to the transfer of deposits in both resolution and bankruptcy. The authorities take note of the staff recommendation to make legacy frameworks for managing failing banks complementary to the new SRM framework. They note that the European Bank Recovery and Resolution Directive was already incorporated in Dutch law and that the repeal of provisions in the old framework that may provide legal uncertainty is foreseen in the near future. The way the national framework relates to the SRM has been elaborately described in explanatory memoranda accompanying these new laws in order to maximize transparency.

The Dutch authorities once again thank staff of both the Article IV and FSAP mission teams for the fruitful exchange of views during the meetings and the candid policy recommendations provided in the well written reports. The authorities look forward to continuing this policy dialogue in the context of the next Article IV cycle.