INTERNATIONAL MONETARY FUND

IMF Country Report No. 19/44

THE KINGDOM OF THE NETHERLANDS—NETHERLANDS

FEBRUARY 2019

2019 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE KINGDOM OF THE NETHERLANDS—NETHERLANDS

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2019 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 February 8, 2019 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 February 8, 2019, following discussions that ended on December 6, 2018 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 January 23, 2019.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for The Kingdom of the Netherlands—Netherlands.

The document 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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February 12, 2019

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

IMF Executive Board Concludes 2019 Article IV Consultation with Kingdom of the Netherlands—Netherlands

On February 8, 2019, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Netherlands.[1]

The Dutch economy has performed very well in recent years. Growth is estimated at 2.6 percent in the 2018, owing to strong domestic demand and robust net exports. Domestic consumption was supported by favorable labor market developments, expansionary fiscal policy, and a booming housing market. The large trade surplus contributed to the still high current account surplus, estimated at 9.8 percent of GDP in 2018. The unemployment rate reached a decade low although real wages and inflation remain subdued. Households and corporations are still deleveraging, and credit growth remains negative. Banks capitalization improved, and non-performing loans are among the lowest in the euro area.

The economy will continue to expand, but at a lower growth rate. Strong domestic demand will support growth in the near term as global trade slows down. However, in the medium- and longer-term, unfavorable demographic developments and weak productivity growth will weigh on potential growth. Inflation and wages are projected to pick up gradually owing to continued tightening labor market and increased basic VAT. Fiscal policy will remain supportive and public debt is projected to decline further.

Risks to the outlook are titled to the downside. Rising global protectionism and treats to global demand, uncertainties surrounding fiscal policies in other euro area countries, and a possible no-agreement Brexit could negatively affect the Dutch economy through exports and investment. In addition, a sharp tightening of global financial conditions could weigh on the financial positions of still highly leveraged households that have large balance sheets which contributes to increased volatility of the economy and reduced consumption, and could lead to heightened stress in banks due to their heavy reliance on wholesale funding.

[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.

Executive Board Assessment[2]

Executive Directors commended the authorities for the sound macroeconomic management and welcomed the Netherlands' robust economic performance that is increasingly driven by domestic demand. Growth rates have been above the euro area average, the fiscal position is strong, unemployment is low, and the banking sector is healthy overall. However, Directors noted that structural imbalances in the household and corporate sectors and uncertainties in the global environment, including from rising global protectionism and spillovers from a disorderly Brexit, weigh on potential growth in the medium term. Directors recommended that policy priorities should focus on addressing the imbalances, including through boosting household disposable income and reducing household debt, and strengthening the small and medium-sized enterprises (SMEs) sector to help long-term growth and build resilience to shocks. Policies to reduce the imbalances would also help reduce the large current account surplus.

Directors commended the authorities' policy to use the economic upswing to build fiscal buffers. Noting the available fiscal space, many Directors recommended using this opportunity to further reduce labor taxation and increase spending on priorities such as human capital and research and development (R&D). This would help support potential growth and rebalancing without jeopardizing long-term fiscal sustainability. At the same time, many Directors sympathized with the authorities' cautious fiscal framework and saw merit in preserving some fiscal space as a buffer to deal with potential adverse shocks, given that the Dutch economy is relatively exposed to external risks.

Directors encouraged higher wage growth to boost households' disposable income and welcomed the authorities' planned decrease in the labor tax wedge. They emphasized that labor market duality should be reduced, as part-time workers and the self-employed have on average lower wages. Directors agreed that a pension system reform that provides more choice could help reduce the prevalence of self-employment, thereby supporting higher wages.

Directors encouraged efforts to improve housing affordability and reduce household indebtedness. They supported the authorities' plan to lower the mortgage interest deductibility to reduce mortgage debt bias for households. In addition, they recommended further tightening of macroprudential policies, including loan-to value and debt-service-to-income ratios. Directors encouraged the authorities to further liberalize rent controls, improve mean-testing for social housing, and simplify procedures for building permits, to help boost supply of housing and further reduce household mortgage debt. Directors welcomed ongoing efforts to improve coordination among main stakeholders involved in this process.

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[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 recommended policies to support SMEs and boost investment, including expending direct public support to R&D. They welcomed the steps being taken to increase access to finance for SMEs and saw merit in establishing a credit bureau that would help improve availability of information and facilitate access to finance.

Directors observed that banking sector soundness and profitability have improved. However, noting that banks remain highly leveraged, concentrated, and vulnerable to shocks, they encouraged the authorities to continue to build buffers and further strengthen supervision. Given the Netherlands' position as a financial and corporate center, Directors considered that maintaining a strong AML/CFT framework will be essential for effective banking supervision.

Netherlands: Selected Economic Indicators, 2017–2020

	2017	2018 Est.	2019 Proj.	2020 Proj.
National accounts (percent change)				
Gross domestic product	2.9	2.6	2.2	2.1
Private consumption	1.9	2.4	2.4	2.4
Public consumption	1.1	1.4	1.8	2.0
Gross fixed investment	6.1	4.9	4.7	4.5
Total domestic demand	2.2	2.7	2.8	2.8
Exports of goods and nonfactor services	5.4	5.1	4.4	3.9
Imports of goods and nonfactor services	4.9	5.5	5.3	4.9
Net foreign balance[1]	0.9	0.2	-0.3	-0.4
Output gap (percent of potential output)	-0.1	0.7	1.2	1.2
Prices, wages, and employment				
Consumer price index (HICP)	1.3	1.6	2.4	2.0
GDP deflator	1.2	1.9	2.3	1.9
Hourly compensation (manufacturing)	2.3	2.5	2.8	3.0
Unit labor costs (manufacturing)	-1.5	0.0	0.1	0.4
Employment (percent)				
Unemployment rate (national definition)	5.9	...	...	...
Unemployment rate (ILO definition)	4.9	3.9	3.8	3.7
NAIRU	5.3	5.2	5.2	5.2
External trade				
Merchandise balance (percent of GDP)	9.6	9.1	8.6	8.0
Current account balance (percent of GDP)	10.5	9.8	9.5	8.9
General government accounts (percent of GDP)				
Revenue	43.7	43.6	44.0	43.6
Expenditure	42.6	42.5	43.0	42.8
Net lending/borrowing	1.2	1.1	1.0	0.8
Primary balance	2.1	1.8	1.6	1.4
Structural balance[2]	1.2	0.5	-0.1	0.0
Structural primary balance[2]	2.4	1.5	0.7	0.8
General government gross debt	57.0	54.6	51.6	49.1

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 2019 ARTICLE IV CONSULTATION

January 23, 2019

KEY ISSUES

The Dutch economy has grown faster than the euro area average over the past few years reflecting recovering consumption and investment, and strong net exports. The unemployment rate reached a decade low, but slow productivity growth and growing labor market duality have constrained wages and contributed to low inflation. Moreover, progress with tackling long-standing imbalances in the households and corporate sectors, and thus external imbalances, has lagged. Households remain highly leveraged and their consumption constrained by a stagnating disposable income. In the corporate sector, dominated by large multinational corporations (MNCs), investment is low but savings are high, and developments are diverging with domestic small and medium enterprises (SMEs) relatively stagnant. Strong fiscal performance in recent years has boosted buffers that can now be used to reduce distortions and strengthen potential growth.

Key Policy Recommendations:

- Fully use substantial fiscal space to support potential growth and rebalancing.
- Further reduce the labor tax wedge and household debt bias.
- Harmonize tax benefits and social security contributions for different types of employment to reduce labor market duality while increasing overall labor market flexibility.
- Push forward with second-pillar pension reform to improve pension transparency and flexibility, clarifying transition costs, and designing a compensation package for those adversely affected by the transition.
- Continue tightening macro-prudential policies to reduce households’ indebtedness, and expedite reforms to increase housing supply, particularly in the private rental market.
- Revive SMEs dynamism and business investment, including by increasing direct support to Research and Development (R&D) and establishing a credit bureau.

Approved By
E. Detragiache (EUR) and Z. Murgasova (SPR)

Discussions took place in The Hague and Amsterdam during November 27–December 6, 2018. The mission team comprised Messrs. T. Dorsey (head) and A. Fouejieu, Mmes. R. Chen and I. Karpowicz (all EUR). Mr. R. Doornbosch and Mr. J. Hanson. (both OED) participated in some of the meetings. The team was supported from headquarters by Ms. G. Ordonez-Baric and Mr. A. Musayev (both EUR). The team met with De Nederlandsche Bank President Klaas Knot; Finance Minister Wopke Hoekstra, and other officials from the Ministries of Finance, the Interior and Kingdom Relations, Social Affairs and Employment, Economic Affairs and Climate Policy, De Nederlandsche Bank, other government entities, and the Single Supervisory Mechanism; representatives of labor unions and employers, and representatives of private sector institutions.

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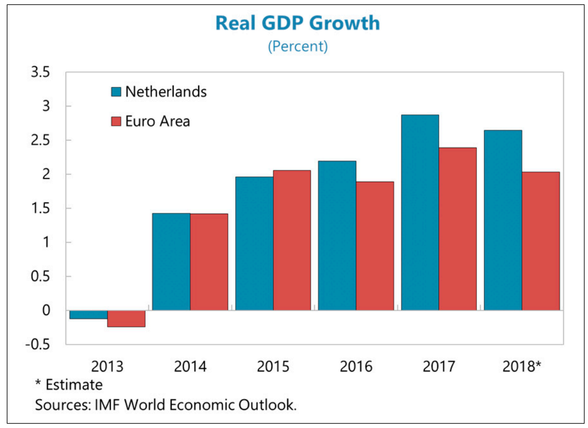
CONTEXT AND RECENT DEVELOPMENTS

1. **Strong economic growth, above the euro area average, continued in 2018 at an estimated 2.6 percent**. Robust domestic demand was supported by favorable labor market developments, expansionary fiscal policy, and a booming housing market (Figure 1). However, growth slowed to 0.2 percent (q-o-q) in the third quarter reflecting weaker investment and net exports in the context of rising global trade disputes. The unemployment rate reached a historical low of 3.8 percent while wages only grew moderately by 0.2 percent in the 2018 Q3. Inflation remained subdued, with headline inflation at 1.8 percent and core inflation at 1.2 percent in November 2018, respectively (Figure 2).



2. **Public debt continued to decline, reaching an estimated 54.6 of GDP in 2018.** The overall fiscal balance is set to register a third consecutive surplus at an estimated 1 percent of GDP in 2018 as favorable cyclical conditions compensated higher spending on public investment. The structural balance is expected to deteriorate by about 0.7 percentage point of potential GDP.

3. **Lending to the private sector contracted further.** After recovering in 2017, bank credit to non-financial corporations contracted by about 1 percent y-o-y in November 2018. Non-banks, mainly insurance companies and pension funds, increased their mortgage lending recently, but from relatively low levels (Figure 4). Banks capitalization improved and non-performing loans (NPLs) are among the lowest in the euro area. On the back of favorable economic developments, average return on equity reached 13 percent in the 2018 Q3.

4. **The current account (CA) surplus remains high at an estimated 9.8 percent of GDP in 2018, reflecting a large trade surplus (Figure 5).** Elevated corporate savings which stood about 6 percent of GDP on average since 2000, mostly attributable to MNCs, are the main contributor to the persistent high CA surplus. Household net savings are small, about ½ percent of GDP on average since 2000, as high second-pillar pension savings are offset by high real estate investment. The real effective exchange rate (REER) appreciated by 1.4 percent in the first eleven months of 2018, relative to the 2017 average.

OUTLOOK AND RISKS

5. **Growth is expected to slow down in the near term, and gradually converge to potential over the medium term.** Under current policies, the economy will continue to expand, with real GDP growth projected at 2.2 percent in 2019. Inflation and wage growth are likely to pick up gradually, on the back of continued labor market tightening. However, in the medium- and longer-term, unfavorable demographic developments and slow productivity growth will weigh on potential growth.

6. **Fiscal policy should remain supportive in 2019.** The authorities' 2019 budget plan aims at upgrading infrastructure and strengthening human capital through higher spending on education and research while measures on the revenue side should be broadly neutral (Box 1). However, there is a risk that the planned spending will not be realized, as the very low unemployment is complicating efforts to hire skilled employees. Over the medium term, the overall tax burden is projected to shrink on account of progressively lower CIT rates and higher PIT deductions, while changes in the composition and structure of taxes will rebalance revenues away from direct towards indirect taxes. Debt should fall below 40 percent of GDP by 2024, as over time, spending reverts to recent lower trends.

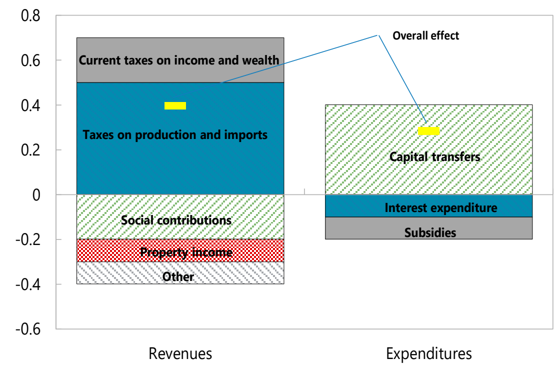
7. **The CA surplus is expected to decline moderately under current policies.** Trade tensions, continued strong domestic demand, and expedited phasing-out of gas production should lead to a modest rebalancing in the short term. However, returns on a rising net IIP position will preserve the large current account surplus over the medium term. Staff projects a modest 2½ percentage points of GDP decline in CA surplus by 2024.

8. **Risks to the outlook are tilted to the downside (Annex I).** As a very open economy, the Netherlands is vulnerable to rising global protectionism and threats to global demand. Disruptions to the global trade system, uncertainties surrounding fiscal policies in other euro area countries, a possible no-agreement Brexit (Box 2), or weaker-than-expected global growth could affect exports and investment and lead to renewed financial stress. A sharp tightening of global financial conditions could weigh on the financial positions of highly leveraged households that have large balance sheets which contributes to increased volatility of the economy and reduced consumption and could lead to heightened stress in banks due to their heavy reliance on wholesale funding.

Box 1. The 2019 Budget

In 2019, tax rebalancing will be revenue neutral (-€0.2 billion). Corporate taxes will be temporarily higher despite a planned reduction in the high and low rates (by 0.7 and 1 percentage points respectively), because the tax base will be broadened through the progressive elimination of corporate interest rate deductibility. Personal income tax revenues will decline as the four income brackets will be replaced by two and tax credits will be raised. Higher environmental excises and the increase in the basic VAT from 6 to 9 percent will broadly offset these effects. A planned elimination of the dividends tax, with full effect starting in 2020, is no longer considered, but a new withholding tax on interest, royalties and dividends will be introduced as planned to address compliance issues.

Revenues and Expenditures, difference from 2018
(Percent of GDP)



Sources: National budget

Expenditures will increase in structural terms. New expenditure mandates slated for 2019 include reestablishment of the Department of Agriculture, Nature, and Food Quality (LNV), additional funds for the Netherlands Food and Consumer Product Safety Authority (NVWA), supplementary allocations for primary education, and higher teachers' wages (an 8.5 percent increase). Additional budget transfers for regional development and investment will be allocated to the Groningen region, on top of those envisaged in the medium-term plan for the restructuring of the gas sector. While on balance investment spending is budgeted higher in 2019 by about ½ percentage point of GDP, implementation obstacles may challenge execution. Lower-than-expected healthcare and social security expenditure, and lower interest charges on public debt will help cover part of the additional expenditures.

Authorities' Views

9. **The authorities agreed with the main sources of international risks identified by staff.** They thought that no-agreement Brexit or trade war would affect the economy strongly given its openness and close ties to the UK. On the risk associated with a sharp tightening of global financial conditions, they stressed that banks are resilient, and most new mortgage loans have fixed rates. They added that the main domestic risks, both upside and downside, are related to the developments in the housing market due to the close relationship between consumption and house prices. Over the medium term, continued increases in household debt, could weigh on consumption and GDP growth.

Box 2. Impact of Brexit on The Netherlands

The Netherlands has strong trade and financial links with the United Kingdom. In 2017, the UK was the third largest trading partner of the Netherlands in terms of trade values in both goods and services. Although trade between the two countries stagnated since the Brexit vote, the Netherlands still has about 4 percent of GDP in net exports in goods and services with the UK. The two countries also have strong links through cross-border investment. Bilateral direct investment and portfolio investment positions (both inward and outward) stood at 125 percent of GDP and 32 percent of GDP, respectively, at end-2016. The UK ranked as the third and the fourth partner of Dutch direct investment and portfolio investment, respectively.

Uncertainties on post-Brexit arrangements weigh on the Dutch economy. It is estimated that the long-run reduction on the Netherlands output would be about 0.7 percent or 1 percent in the case of a standard free trade agreement or a default to World Trade Organization (WTO) rules, respectively.[1] The estimated output loss mainly captures direct and indirect trade effects, and domestic consumption and investment decisions could be further held back by the increasing uncertainty.[2]

The government has increased the 2019 budget allocation to prepare for Brexit. About €92 million was reserved for enhancing capacity at the Customs and NVWA. The money will be spent on hiring new staff for increasing workloads for goods inspections and customs formalities at the new border between the Netherlands and the UK after Brexit.

[1] See "Long-Term Impact of Brexit on the EU", Selected Issues paper, IMF country report No. 18/224.

[2] The Central Planning Bureau's analysis shows that an unfavorable Brexit would cost the Netherlands up to 1.2 percent of GDP by 2030 ("Brexit Costs for the Netherlands Arise from Reduced Trade", CPB 2016).

POLICY DISCUSSIONS

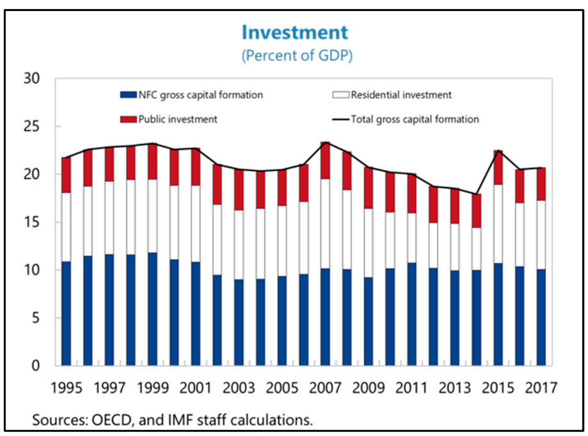
The large external imbalance reflects internal imbalances. Households remain highly leveraged and their consumption constrained by a stagnating disposable income. In the corporate sector, dominated by MNCs, investment is low, but savings are high, and developments are diverging with SMEs relatively stagnant. The strong cyclical condition provides an opportunity for policies to focus on reducing imbalances and raising long-term productivity growth, through boosting household disposable income, repairing private sector balance sheets, and strengthening the SME sector. These policies would support domestic demand and potential growth and help reduce the large CA surplus.

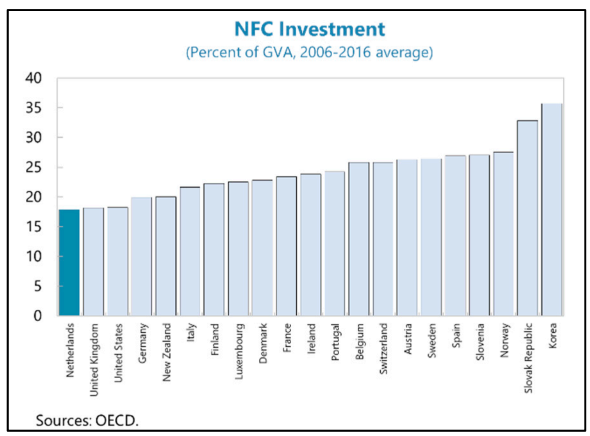
A. An Opportunity to Reduce Imbalances

10. The Netherlands' external position remains substantially stronger than implied by medium-term fundamentals and desirable policy settings. The cyclically adjusted CA surplus is estimated at 10 percent of GDP in 2018, 6.6 percent of GDP above the EBA norm. Only a small part of the resulting CA gap is attributed to identified domestic fiscal policy gaps (0.9 percentage point). The REER is assessed as undervalued by 7–13 percent (Annex II). The unexplained CA gap (5.4 percentage points of GDP) is likely partly related to the very large activities of Netherlands-domiciled MNCs.

11. The high CA surplus partly reflects the dominance of MNCs. High corporate savings are concentrated in large firms, often MNCs, while SMEs are stagnant. The Netherlands is an attractive location for MNCs because of its favorable international corporate taxation regime. MNC global profits registered in the Netherlands are exempted from domestic corporate taxes under the "double participation exemption".[1] As MNCs invest globally, large net savings are recorded in the Netherlands, a large share of which is concentrated in a few MNCs. While these companies are domiciled in the Netherlands, they are owned by shareholders dispersed among many jurisdictions. Due to the complicated corporate structures, liabilities of a Dutch MNC ultimately owned by foreigners may not be fully recorded as Dutch foreign direct investment (FDI) or portfolio investment liabilities. In principle, retained earnings attributed to ultimate investors—mostly foreign shareholders in the case of Dutch MNCs—should be recorded as outflows in the Netherlands' CA, but this is not feasible. In practice, only retained earnings of FDI are recorded in CA, and those of only direct investors—which may include Dutch investors—are recorded instead of ultimate foreign investors. This could result in an overestimate of the CA surplus (see Selected Issues Paper). Correcting this overestimation could significantly reduce the CA gap, but more granular information on MNCs' activities would be needed to quantify it. Initiatives currently underway to improve statistics of special purpose vehicles are in the right direction to address this issue. The Netherlands also appears to be used as a conduit to transfer interest and royalties to low-tax jurisdictions, and the authorities are implementing measures (e.g., a withholding tax on transfers to such jurisdictions) to make this less attractive. However, this is unlikely to affect the current account much as inflows and outflows of such funds are nearly equal. Weak domestic investment also reflects low dynamism in the SME sector, which is constrained by skill shortages and lack of innovation and access to finance. Policies that support SMEs investment and growth (see Section D below) would help reduce the corporate sector imbalance and CA surplus.

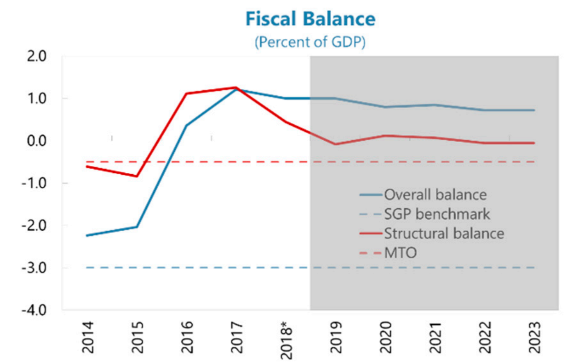
12. The external imbalance also likely reflects imbalances in the household sector. On the household side, low wage growth and high labor tax wedge have compressed disposable income, limiting domestic demand. Consumption by young households is also curtailed by rising housing prices and a shortage of mid-range private rental houses. Policies aimed at boosting household disposable income (including through higher wage growth) and reducing household debt, would help reduce both internal and external imbalances, including rebalancing within the monetary union.





[1] The "double participation exemption" refers the tax exemption of both dividends paid by foreign subsidiaries and capital gains on the disposal of foreign equity, which was designed to avoid double taxation.

13. Using fiscal space to address household and corporate imbalances is desirable and is unlikely to jeopardize long-term fiscal sustainability. Strong economic growth and a declining public debt have boosted fiscal space. Taking into account the contingent fiscal costs associated with the large financial sector, high volatility of the economy, and fiscal pressures from population aging, staff views the Stability and Growth Pact's medium-term objective (MTO) of a structural deficit of 0.5 percent of GDP as appropriate. While the authorities' 2019 budget implies a stimulus, over the medium term the structural balance is projected to stabilize at 0 percent of GDP, leaving substantial space of ½ percent of GDP annually. Given the internal and external imbalances, and the projected decline in the debt ratio over the medium term consistent with the MTO objective, this space should be fully used as detailed in Section B below. While this would be pro-cyclical, given depressed wage growth and low inflation such an expansion would not jeopardize debt consolidation or macro-economic stability (Annex III).



* Estimate
Source: IMF staff projections.

Authorities' Views

14. The authorities stressed that Fund's EBA models do not provide good explanations for corporate saving and believe that further research is needed before making policy recommendations. The central bank's research shows that the high net saving in the corporate sector is dominated by a few MNCs.[2] However, further research to understand corporate behavior and identify policies to reduce saving is needed. The authorities agreed that phasing out of gas production and higher wage growth would reduce the current account surplus moderately, but the structural surplus would remain high over the medium term.

15. The authorities disagreed that there is fiscal space currently available for additional measures, including because of the national budgetary framework.[3] They noted that fiscal costs from population aging imply the need for prudent fiscal policy over the long term which would allow maintaining the current collective provisions. Moreover, in their view, holding buffers is preferable to further fiscal expansion given the volatility of the economy and its high openness. They pointed out that they are already using a substantial share of the fiscal space available as per the IMF methodology and stressed that the planned expenditure and tax policy measures are growth-friendly and that some of the expenditures are structural in nature.

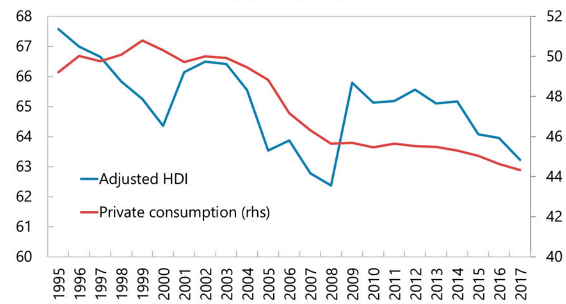
[2] Preliminary results of the central bank's research using unconsolidated firm-level data are consistent with the staff analysis. However, there is inconsistency between macro- and micro-level data. The central bank and statistical office are investigating this issue.

[3] In addition to the European fiscal rules, the Netherlands has its own budgetary framework which is built around 4-year expenditure ceilings set at the beginning of each legislature.

B. Policies to Increase Households' Disposable Income

16. Households' disposable income and consumption have been progressively squeezed. Dutch household's disposable income and consumption as a share of GDP have declined by 2½ and 1½ percentage points, respectively, since 2009. While weak labor productivity growth has contributed to slow wage growth, increased labor market duality has also been a factor.[4] Self-employment and part-time employment are among the highest in the developed world and are on a rising trend. The share of self-employment in total employment has picked up by more than 4 percentage points since 2005, reaching 15.7 percent in 2017. The part-time work is particularly prevalent for women. Wages are lower for part-time and self-employed workers, even after controlling for job and workers' characteristics (Box 3). In addition, labor income carries the largest share of the burden of taxes and social security contributions. Therefore, to increase households' disposable income and consumption, policies should aim at reducing labor market duality and lowering labor taxation.

Adjusted Household Gross Disposable Income and Private Consumption
(Percent of GDP)



Sources: OECD, CBS, and IMF staff calculations.

17. The widening labor market duality potentially jeopardizes pension system sustainability. Most self-employed do not participate in the second-pillar pension system and are therefore at risk of old-age poverty. Greater harmonization of tax and social protection treatments of permanent employees, workers with flexible contracts, and the self-employed, would improve equity and efficiency, particularly harmonization takes place by increasing overall flexibility. Policies should aim at including all categories of workers into social protection and insurance and lowering overall protection in regular employment contracts. Increasing full-time employment for women will require expanding the availability and affordability of childcare, reforming parental leave policies, and reducing tax disincentives for second-earners in full-time jobs.

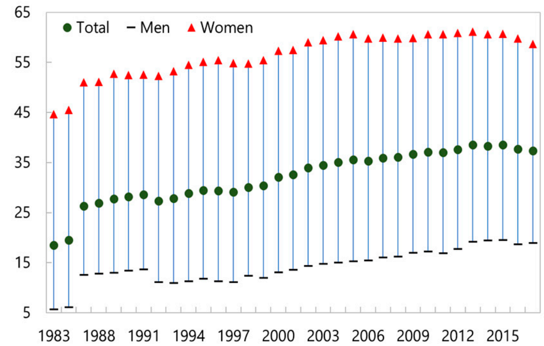
[4] See "Wage Moderation in the Netherlands", *Selected Issues Paper*, IMF country report No. 18/131.

Box 3. Labor Market Flexibility and Wages

Netherlands has the highest share of part-time employment and one of the largest share of self-employment among OECD countries.

Part-time employment reached 37 percent of total employment in 2017, more than twice the average in OECD or EU countries, and mainly driven by a higher prevalence for women (around 60 percent). The share of self-employment at about 15.7 percent in 2017 is also higher than the EU average.

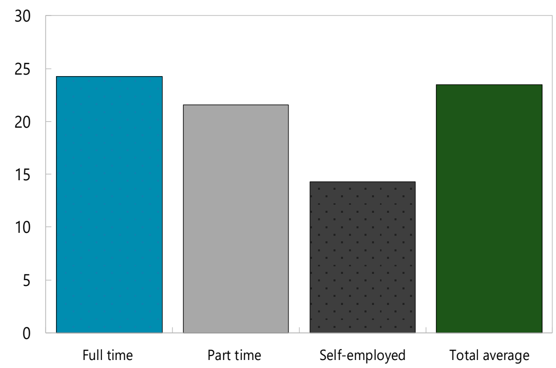
Netherlands: Part-Time Employment
(Percent of total employment)



Sources: OECD

Part-time and self-employment provide flexibility to workers and have contributed to reducing unemployment. Part-time jobs contribute to increase labor force participation, especially for women. Part-timers also tend to benefit from higher health, safety and "no-stress" premiums compared to full-time workers (OECD, 2010). Self-employment offers advantages for workers and employers. Workers often choose self-employment to lower individual tax burden, since they are not required to contribute to sickness and disability insurance, and they benefit from tax deductions (aiming at incentivizing entrepreneurship). For employers, self-employment offers more flexibility and is more cost-competitive than other standard forms of employment. Both part-time and self-employment are attractive for young workers who need to gain work experience, for parents with young children who need to accommodate family constraints, and for old workers who want to remain active.

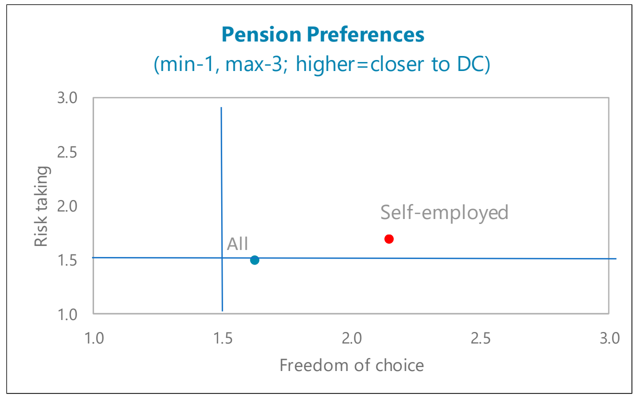
Gross Hourly Wages
(euro)



Sources: DHS and IMF Staff calculations

However, part-time and self-employment are associated with lower wages relative to the average. Such non-standard forms of jobs could carry penalties, including in terms of wages, training participation, and promotions. Overall, part-time jobs and self-employment are likely to be negatively correlated with career progression and wages. Based on the Dutch National Bank household survey (DHS) the gross hourly wage is about 3 euros lower for part-timers compared to full-time workers. Self-employed are found to have an estimated net hourly wage about 6 euros lower compared to regular contracts, on average. These differences are statistically significant even after controlling for workers and jobs characteristics, as well as exposure to common factors (Table 5). Moreover, wage growth is also lower for part-timers and self-employed compared to average wage growth in regular contracts.

18. A pension system reform that provides more choice could help bring the self-employed into regular employment. The pension system has been widely considered as one of the world's strongest, having achieved high participation rates, provided adequate retirement income, and ensured sustainability. However, with an increasing number of workers opting for self-employment participation in the system is declining, with only a fifth of self-employed participating in the second- or third-pillar pension system, compared with nearly 90 percent for employees in regular contracts. The pension reform proposed by the government introduces a new pension contract based on personal pension accounts, complemented by provisions aimed at preserving appropriate risk pooling. While the details of any new proposal remain under negotiation, the reform envisages the abolishment of the system of uniform premium and constant accrual rates. This could help increase disposable income for some households and support domestic demand. Agreement on the reform could be expedited by clarifying the cost of redistribution during transition and using some fiscal space to compensate individuals who are made worse off. Staff analysis suggests that such reform could help lower the share of self-employment in total employment, as preference for more choice regarding pension is a determinant in the choice to go into self-employment (see Selected Issues Paper).



19. Tax policy measures should aim at lowering the labor wedge further. The planned decrease in the labor tax wedge and the harmonization of VAT rates are welcome steps. However, after the reform, labor income taxes will remain comparatively high. Acknowledging that introducing any changes to the medium-term budget agreed upon by the Coalition would be difficult, fiscal space should be used to further lower the labor tax wedge by focusing on supporting low-income and second earners. These measures could be partly financed by equalizing the tax rate on retirement income to the one at which deductions were made. This would also improve progressivity as currently higher income earners are able to deduct a larger share of contributions and receive pensions taxed at a lower rate. Revenue measures would also not jeopardize the expenditure ceilings which are fixed under the national fiscal rules for the four-years-ahead period.

Authorities' Views

20. The authorities agreed with the assessment of pressures on households' disposable income. They noted, however, that income tax cuts will alleviate the burden substantially, including on lower-income families. They also pointed that wage growth is already picking up, reflecting labor market tightness, and that further growth in private sector wages will stem from contractual wage increases above inflation agreed in the second half of the year. An increase of the lower VAT rate and higher bonuses are projected to push the nominal wage bill up by 3 percent or more in 2019. Moreover, the authorities agreed that slow productivity growth is constraining wage and income growth. Beyond 2019, supply side reforms and investment in R&D should reinvigorate productivity and create pre-conditions for solid wage growth, but collective bargaining may be influenced by the progress on pension reform front.

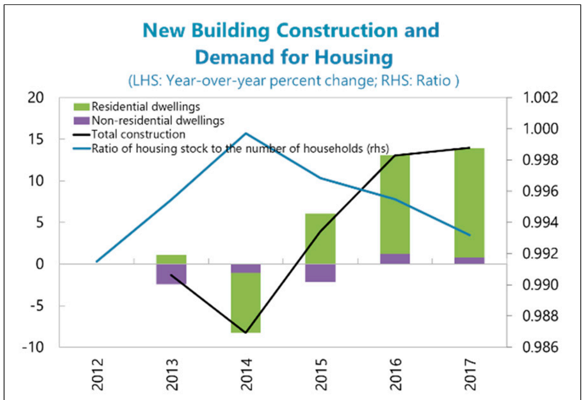
21. The authorities saw a need to address labor market duality. While noting that self-employment was often voluntary and linked to entrepreneurial activity and a preference for flexibility, the authorities acknowledged the possible adverse implications of the rise in self-employment for the adequacy of old-age income and the insurance for disability. The authorities stated that measures are being taken to reduce the institutional differences between standard and non-standard work. They noted that, beginning in 2020, tax incentives for self-employed will be reduced to the basic rate, which will lower incentives for self-employment at higher income levels. At the same time, measures are being taken to improve the balance between open-ended and flexible contracts, including making dismissal under regular contracts more flexible, harmonizing the severance payment schemes across contracts, and introducing differentiation in unemployment insurance contributions to make permanent contracts more attractive.

22. The authorities were disappointed with the outcome of the latest discussions on the pension reform with the social partners. A pension reform is still necessary to make the pension system compatible with today's dynamic labor market, reduce tensions between generations, and restore trust in the system. Lowering the labor tax wedge further is not on the authorities' agenda.

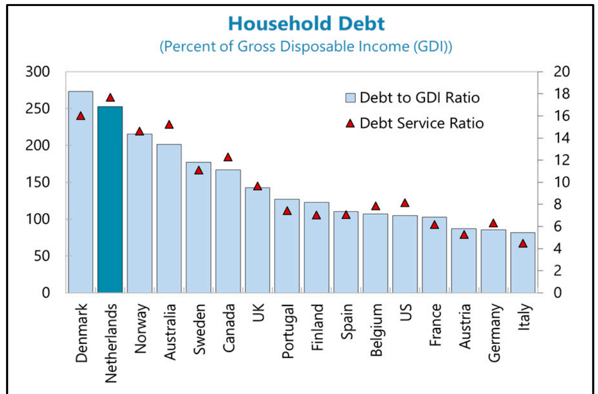
C. Policies to Reduce Households' Debt

23. High debt limits households' capacity to smooth consumption in the face of shocks. The housing market is dominated by social housing (with a wait time exceeding a decade in some cases) and owner-occupied houses with significant shortages. The absence of a robust private rental market leaves young households, in particular, with little alternative to purchasing owner-occupied housing with high leverage and thin financial buffers. Rent controls, regulations, and inadequate means-testing result in long waiting lists for social housing. Elevated demand for owner-occupied houses was encouraged by generous mortgage interest deductibility (MID) in the past, which also boosted house prices. As macro-prudential policies were tightened recently, households' debt has stabilized at about 250 percent of net disposable income, but it remains the second highest among OECD countries. Overborrowing on mortgages has contributed to the accumulation of household debt. When housing prices declined sharply after the global financial crisis (GFC), many mortgages were underwater and private consumption contracted sharply as households attempted to rebuild their net worth. Nevertheless, household overborrowing on mortgages is not a significant source of systemic risk in the financial sector even though it is a threat to the macro-economy.[5]

[5] NPLs did not rise during the GFC despite a very large fall in house prices, largely due to the full legal recourse on mortgage borrowers.



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



Sources: OECD.

24. To reduce household debt and improve housing affordability, it is necessary to increase housing supply, tighten macro-prudential policies, and further reduce the debt bias in the tax system. Liberalizing rent controls for higher-income households and improving means-testing for social housing would help optimize allocation and improve housing supply. In addition, private investment should be encouraged by relaxing restrictions on zoning plans and simplifying administrative procedures for building permits. Lowering the maximum loan-to-value (LTV) ratio to no more than 90 percent (from 100 percent currently) and capping the debt service to income (DSTI) ratio to limit its procyclicality should be considered. The authorities plan to accelerate the phasing down of MID by 3 percentage points per year starting from 2020 until the basic rate of 37.05 percent is reached is a welcome step. Further phasing down of MID, to bring it at a neutral level compared with taxation of investment in other type of assets, would not only generate additional revenues but also help address the current debt bias of households.

Authorities' Views

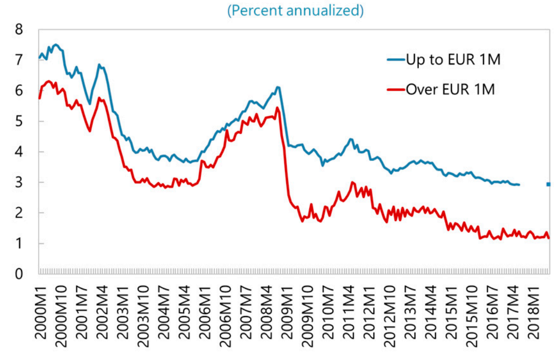
25. The authorities emphasized that the focus is currently on increasing housing supply, while giving due consideration to possible tighter macro-prudential policies. To increase supply, the authorities are taking actions to improve coordination among the main stakeholders, including the relevant ministries, subnational governments, and private investors to reduce building preparation time, stimulate the transformation of suitable areas like outdated industrial areas for housing, and increase the amount of new construction plans. The authorities noted that the coalition agreement does address previous IMF recommendations to lower the MID but does not follow the previous IMF and Financial Stability Committee (FSC) recommendation to further lower LTV limits beyond the 100 percent ratio. The authorities noted that a lower LTV limit would make it more difficult, especially for younger households, to buy a house, while the middle-range rental market is already tight. The Dutch Central Bank and the Financial Market Authority noted that the current DSTI framework has procyclical elements. Increasing risk weights on mortgages in banks' balance sheets and activating the countercyclical buffer could be considered if household debt continues to rise due to further tightening of the housing market.

D. Policies to Support SMEs and Boost Business Investment

26. The SME sector is an important part of the economy that faces barriers to growth. SMEs employ the majority of workers and contribute the largest share of value added. However, they face barriers to growth after the start-up phase. Tight and complex labor market regulation and skill shortages are reportedly a drag on employment expansion while lack of innovation and access to finance may also contribute to low dynamism. Interest rate margins on small loans are high, though the loan rejection rate, at 2.7 percent in the first half of 2018, is comparable to peer countries. The government has provided various forms of guarantees, export credit insurance, venture capital funding, and tax credits to support SMEs. Yet, SMEs' activity remains constrained while participation in public procurement continues to decline.

Interest Rates of Loans to Corporation, New Business

(Percent annualized)



Sources: ECB.

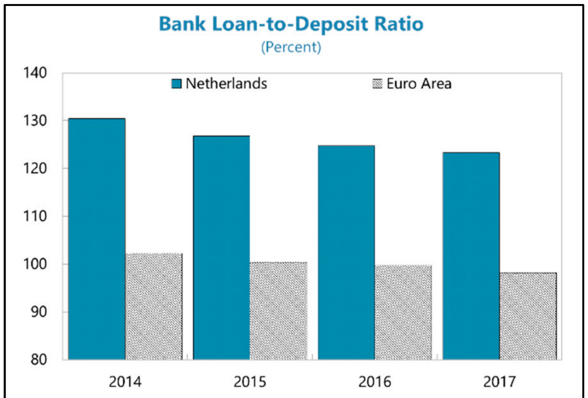
27. Policies to support SMEs should focus on expanding direct support to R&D, investing in digitalization and lifelong learning, and establishing a business credit bureau. Total public spending on R&D in percent of GDP is below the OECD average and, absent policy action, it is set to decline over the medium term. Moreover, R&D support relies heavily on tax incentives, a large part of which favor incumbents over new and potential entrants. Expanding direct public spending on R&D to support riskier and longer-term innovations, targeting start-ups and young SMEs with growth potentials would be useful. Scaling up investment in the digital economy and programs to support lifelong learning would improve SMEs' adaptation to new market conditions and reduce their business costs. A credit bureau for businesses would improve information and facilitate SMEs' access to finance, while development of financial technologies could offer alternative sources of financing.

Authorities' Views

28. The authorities agreed that sustaining and increasing public R&D over the medium-term is a priority. They noted that their R&D strategy relies also on government policies that ensure a favorable business environment, provide high-skilled labor, adequate IT and digitalization, creating opportunities for public-private partnerships and attracting more R&D investments from foreign companies. The authorities agreed that improved availability of data on, for example, credit, invoices, and securities would be beneficial, especially for SMEs.

E. Policies to Reduce Financial Sector Vulnerability

29. Banking system soundness and profitability have improved in recent years, but the sector remains highly leveraged, concentrated, and vulnerable to shocks. Banks are increasingly focusing their lending activity on the domestic market, with mortgage loans representing about 90 percent of long-term lending. In addition, banks are still highly dependent on wholesale funding, with an aggregate loan-to-deposit ratio above 120 percent, compared to below 100 for the euro area. Short-term market funding represents about 28 percent of total. This makes banks vulnerable to changes in global financial conditions. Continued building of capital and liquidity buffers to comply with tightening requirements and reinforce resilience to shocks is warranted. The 2018 EBA stress test indicates that large banks are well capitalized but one bank falls below the 3 percent leverage ratio (capital-to-assets) limit in the adverse scenario. In addition, the leverage ratio is below the euro area average for significant institutions and should be strengthened.



Sources: ECB.

30. Insurance sector solvency has improved but insurers remain vulnerable in the current low interest rate environment. Low interest rates are associated with higher liabilities for insurers, especially for life insurance where 67 percent of liabilities consist of guaranteed return policies. The new national recovery and resolution framework for insurance companies is a welcome development. Such a framework, aiming at protecting policy holders and safeguarding financial stability, will facilitate orderly resolution of insurance companies in the event of a disruptive shock.

31. Anti-money laundering and combating the financing of terrorism (AML/CFT) is a key financial stability and integrity issue. The Netherlands is a financial and corporate center through which significant international financial transactions are conducted. The recent large fine levied by Dutch financial prosecutors on a major Dutch bank for money laundering (following previous such fines) underscores the importance of ensuring comprehensive compliance with AML/CFT requirements for financial institutions. Development of financial technology and cryptocurrencies poses new challenges as it creates new opportunities for criminals to launder their proceeds and terrorists to finance their activities. Stronger coordination between national authorities, investigators and other stakeholders, including at the global level, is needed. Removing legal and operational barriers to information sharing with the European authorities is also critical for assessing AML/CFT risks at the European level.

Authorities' Views

32. The authorities agreed that bank buffers should be strengthened further to help cope with future shocks. The authorities emphasized that a low leverage ratio compared with peers is the most urgent concern and further efforts by banks to increase it are warranted. Although the loan-to-deposit ratio remains high, it has declined substantially over the past few years, and the low level of bank deposits is due to the structural high pension contributions.

33. The authorities indicated that AML/CFT is a priority, including to safeguard financial stability. The authorities emphasized the critical role of international coordination, especially at the European level. To better tackle AML/CFT, such a coordination should focus on improving data collection and information sharing, conducting reviews of national AML/CFT regulations, enforcing European law, and ensuring coordination with the microprudential authorities.

STAFF APPRAISAL

34. Economic growth remains strong but there are imbalances. The Dutch economy has grown above the euro area average over the past few years reflecting recovering consumption and investment and strong net exports. The labor market has tightened, and the unemployment rate has fallen to its lowest level in a decade. But slow productivity growth is constraining wage and income growth. Households remain highly leveraged and their consumption constrained by a stagnating disposable income. In the corporate sector, dominated by MNCs, investment is low and corporate savings are high, while domestic SMEs' activity is stagnant. These factors also contribute to the large current account surplus. Staff assesses that the external position remains substantially stronger than the level consistent with the medium-term fundamentals and desirable policy settings. Staff recommends policies aimed at reducing imbalances in the household and corporate sectors, which would also help reduce the large CA surplus.

35. Risks to the outlook are tilted to the downside. Disruptions to the global trade system, uncertainties surrounding fiscal policies in other euro area countries, a possible no-agreement Brexit, or weaker-than-expected global growth could affect exports and investment negatively. Furthermore, a sharp tightening of global financial conditions could weigh on the financial positions of highly leveraged households both directly and indirectly through reduced consumption and lead to heightened stress in banks due to their heavy reliance on wholesale funding.

36. Using available fiscal space to reduce imbalances is desirable and would not jeopardize long-term fiscal sustainability. Strong economic growth and prudent fiscal policy have boosted fiscal space in recent years. The authorities' 2019 budget plan implies a stimulus, while substantial space would become available over the medium term. Staff recommends fully using this space to address imbalances by reducing labor taxation and further investing in public R&D and lifelong learning. Such expansionary fiscal policy would support growth potential without undermining fiscal sustainability.

37. Policies to reduce labor market duality would support household disposable income. Weak labor productivity growth and a high labor tax wedge have contributed to moderating wage growth and are putting pressure on household's disposable income. Labor market duality dampens the wage growth. Greater harmonization of the tax and social protection treatment of permanent employees, temporary workers, and the self-employed while increasing overall flexibility should be pursued and would improve equity and efficiency.

38. Pension reform along the lines advocated by the government would be beneficial. While returns on pension fund assets have improved in recent years, persistent growth in self-employment and population aging will continue to challenge the defined-benefit second-pillar pension system. The proposed pension reform whereby collective defined-benefits schemes are replaced by personal accounts, complemented by provisions aimed at preserving appropriate risk pooling would provide greater predictability and transparency to the system, and might help bring more self-employed into the system.

39. Further measures are needed to improve housing affordability and reduce household debt. A lack of affordable rental housing has contributed to excessive household debt. This should be addressed by liberalizing rent controls and improving means-testing for social housing. In addition, restrictions on zoning plans should be reduced, administrative procedures for building permits simplified, and coordination at the subnational government level improved. Moreover, the maximum LTV ratio should be set at no more than 90 percent and the DSTI ratio should be capped to avoid pro-cyclicality in borrowing. The accelerated phasing down of the mortgage interest deductibility by 3 percent starting from 2020 is a welcome step and it should be pursued beyond its planned end-point in 2023.

40. Government action could help the SME sector regain dynamism. SMEs growth has stagnated as companies are facing difficulties in hiring due to rigid regulation, tight labor market, and skill shortages. Financing is limited to bank loans and borrowing costs for small firms remain higher than in peer countries. The creation of a credit bureau would help improve information and facilitate SMEs' access to finance. Further investment in the digital economy and programs to support lifelong learning would also help SMEs adapt to new market conditions and reduce their costs. Moreover, expanding direct public spending on R&D could have positive spillovers to start-ups and young SMEs with growth potential.

41. Despite significant improvements in soundness, banks and insurers remain vulnerable. Banks are profitable but still highly dependent on wholesale funding. Continued building of capital and liquidity buffers should therefore remain a priority. The leverage ratio is below the euro area average for significant institutions and should be strengthened. Insurance sector solvency has improved; however, life insurers remain vulnerable in the low-interest environment given the still large share of guaranteed-return policies that need to be further reduced. Continued supervisory attention in this area is warranted.

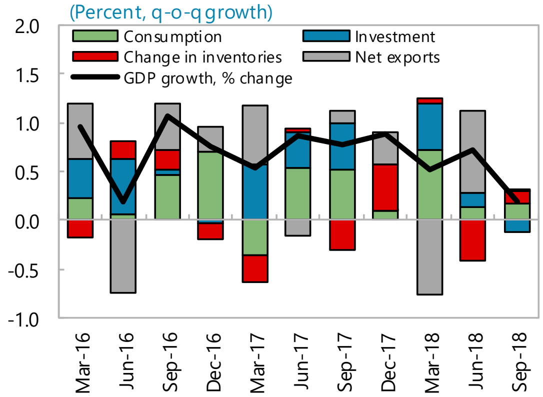
42. AML/CFT supervision is challenging, given the Netherlands' position as a financial and corporate center. Cooperation between supervisors, law enforcement, and other stakeholders, including at the regional and global level, is needed to effectively tackle money laundering and terrorist financing risks. Removing legal and operational barriers to information sharing among prudential and national AML/CFT supervisors, and establishing a European-level institution responsible for AML/CFT supervision is also critical for effective banking supervision.

43. It is recommended that the next Article IV consultation take place on the regular 12-month cycle.

Figure 1. Netherlands: Real Growth

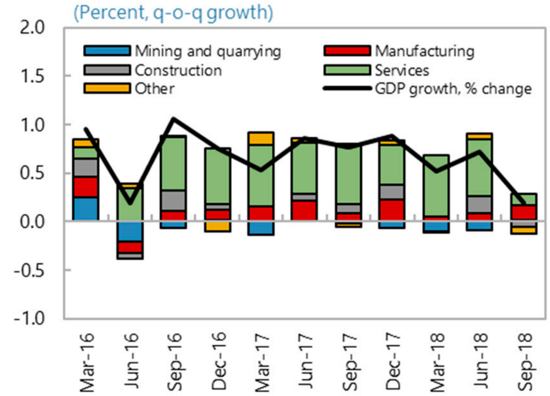
Growth has been strong, driven by consumption, investment, and net exports…

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



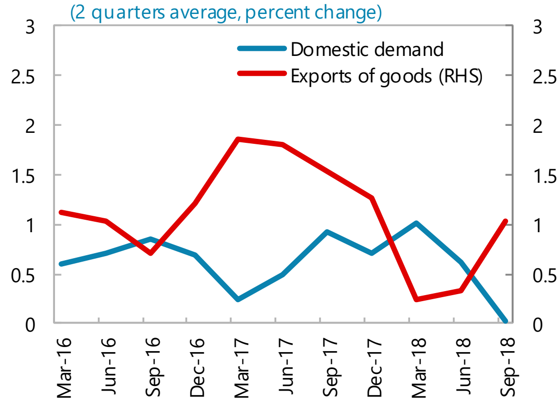
…also reflecting increasing activity in the business services sector.

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



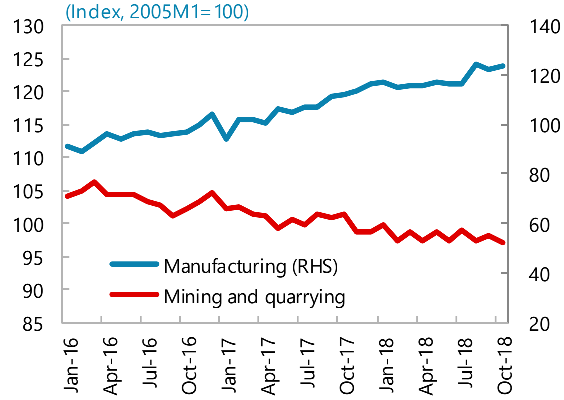
Foreign demand has been robust …

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



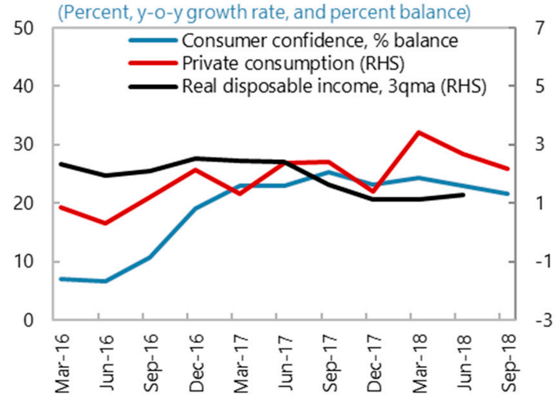
… bolstering production in the manufacturing sector.

Industrial Production
(Index, 2005M1=100)



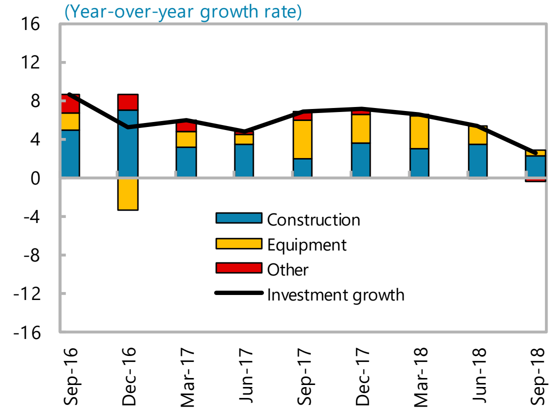
Consumption has been supported by improved confidence effects although disposable income has stagnated.

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



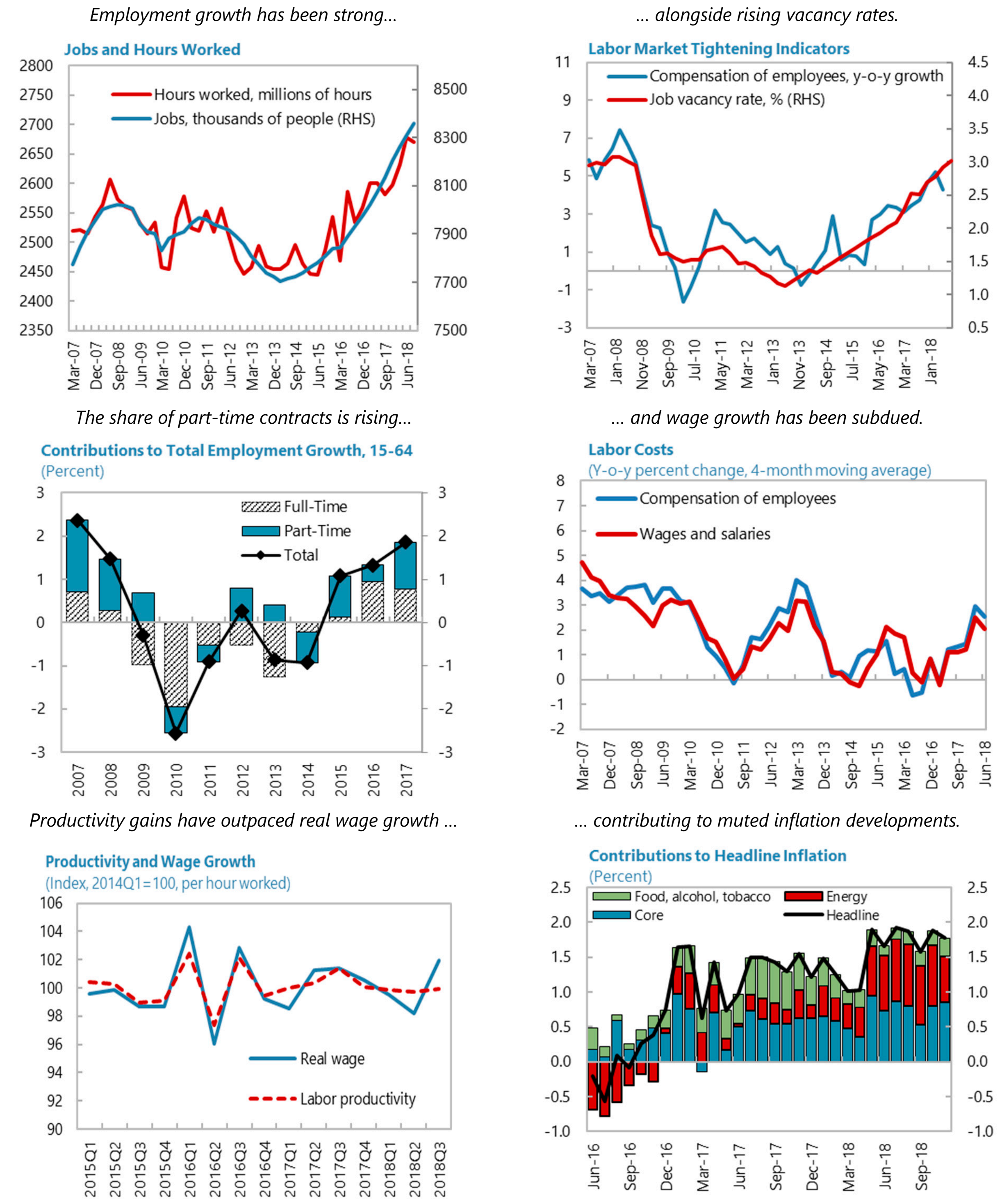
Investment growth is trending down in the equipment sector.

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



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

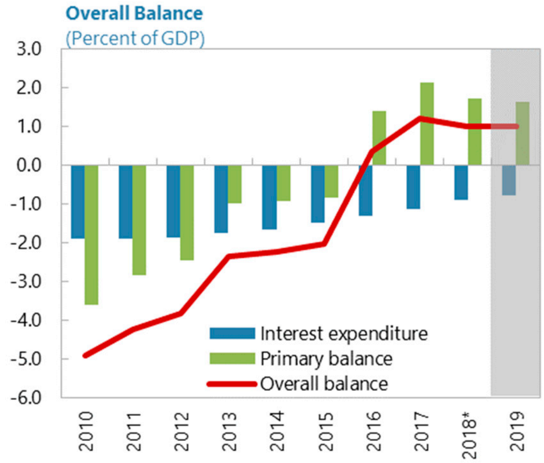
Figure 2. Netherlands: Labor Market and Inflation



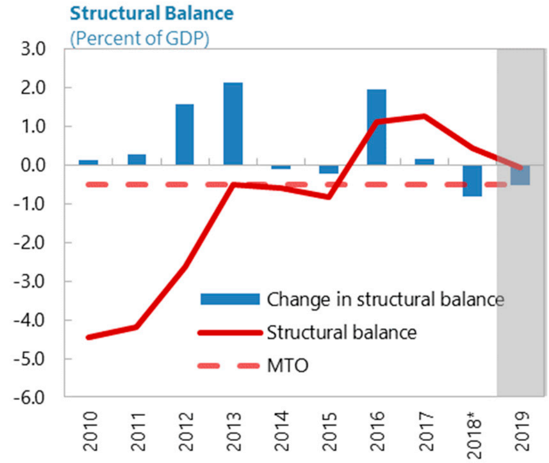
Sources: CBS, DNB, EC, Eurostat, Haver Analytics, OECD, and IMF staff calculations.

Figure 3. Netherlands: Fiscal Developments

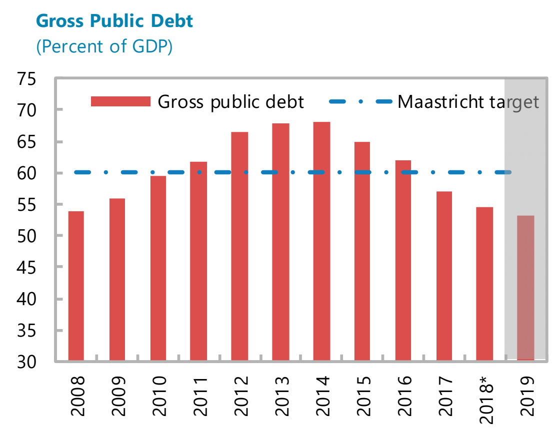
Primary surpluses and declining interest payments are driving the overall fiscal surplus up…



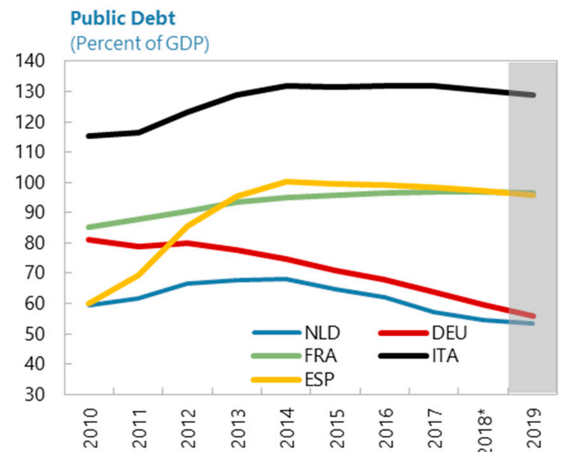
… while the structural balance will deteriorate somewhat…



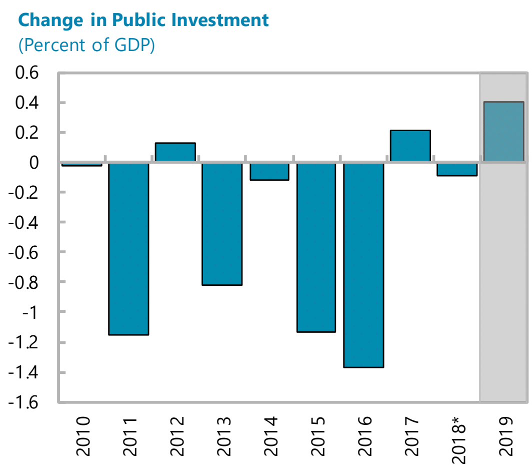
Public debt has decreased rapidly…



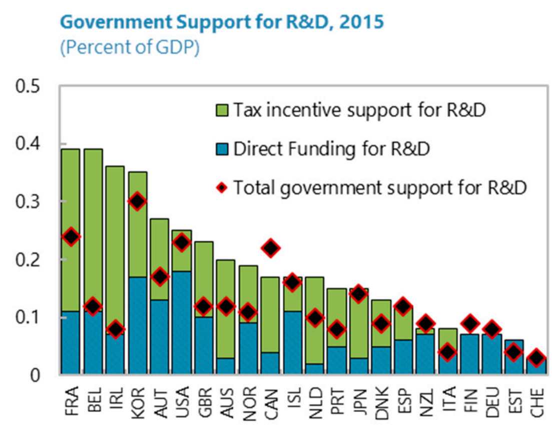
… and is the lowest among peer countries.



Public investment is recovering…



…but direct spending on R&D is comparatively low.



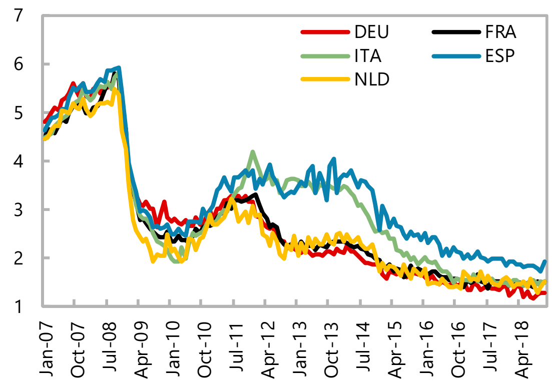
* Estimate

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

Figure 4. Netherlands: Credit and Housing Market Conditions

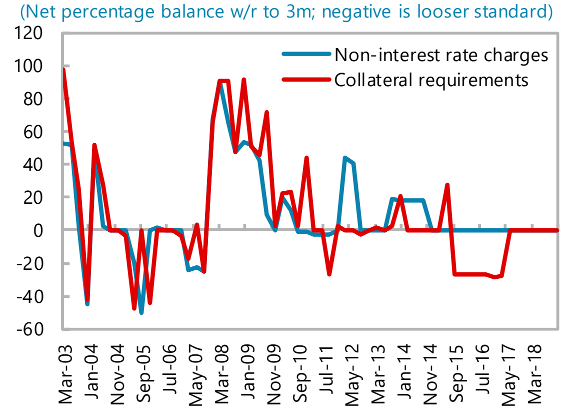
Average lending rates to firms have been trending downwards…

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



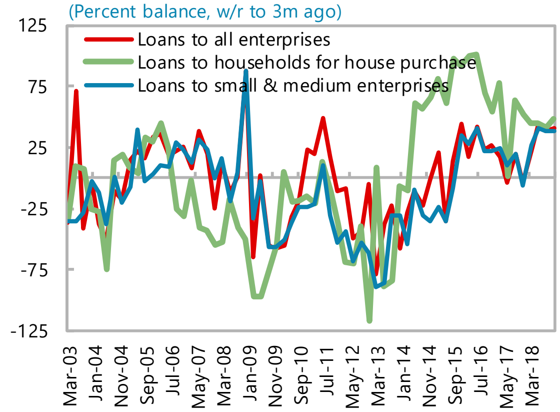
… but not accompanied by a significant loosing of collateral requirements.

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



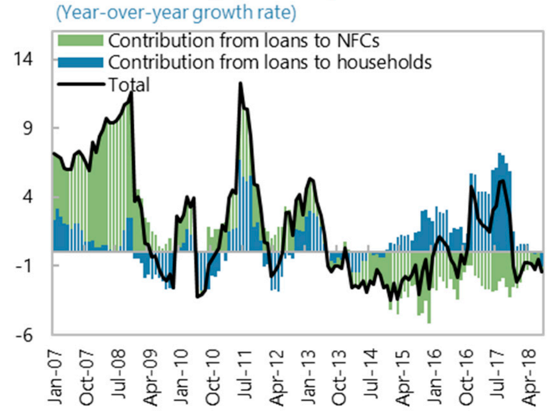
Overall, credit to the private sector is subdued …

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



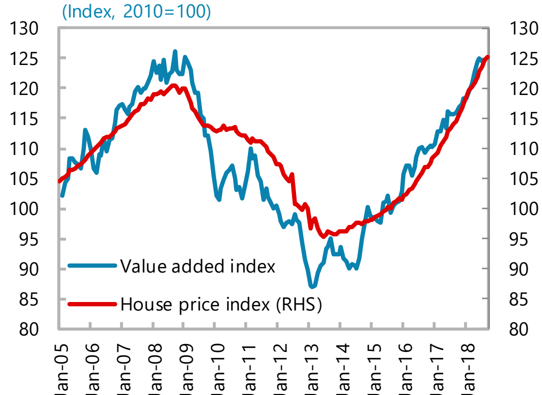
… while lending to the non-financial corporate sector is still contracting.

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



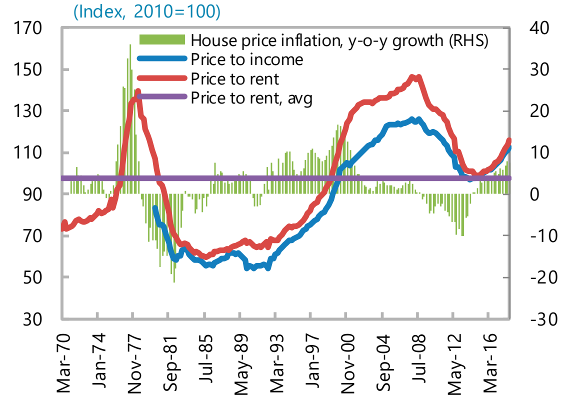
The housing market continues to tighten …

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



… and rising prices have departed from levels consistent with fundamentals.

House Price Indices
(Index, 2010=100)

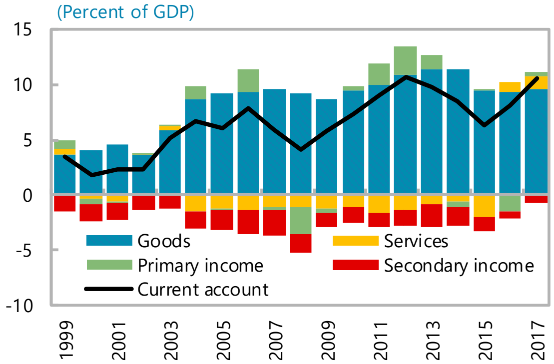


Sources: CBS, DNB, ECB, and IMF staff calculations.

Figure 5. Netherlands: Current Account Developments

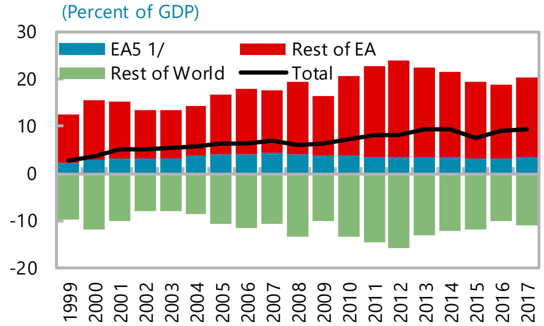
The current account surplus has been hovering at elevated levels for decades …

Current Account
(Percent of GDP)



… reflecting increasing commercial integration within the euro area.

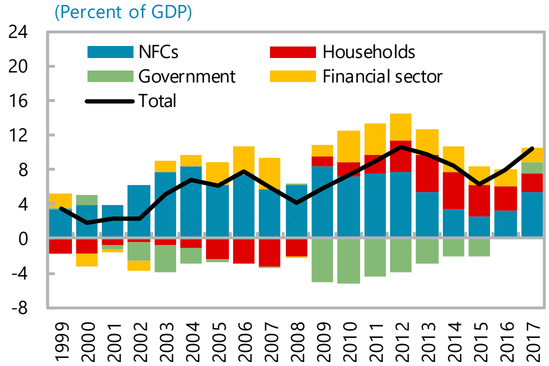
Trade Balance by Region
(Percent of GDP)



1/ EA5 refers to Greece, Italy, Ireland, Portugal and Spain.

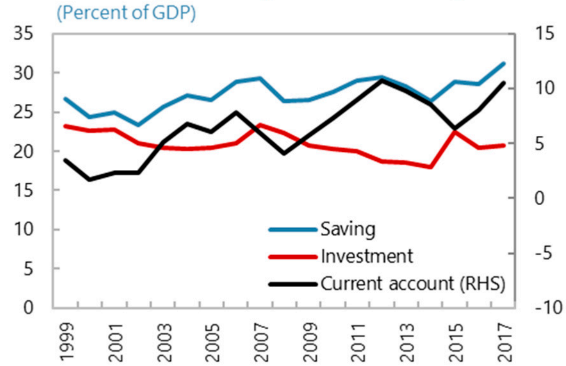
The saving-investment imbalance mostly accounted for by the non-financial corporate sector.

Net Lending and Borrowing by Sector
(Percent of GDP)



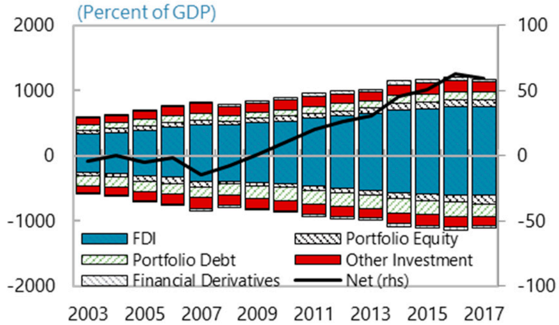
Total investment has been weak.

Net Lending/Borrowing of the Total Economy
(Percent of GDP)



External assets and liabilities are extremely large…

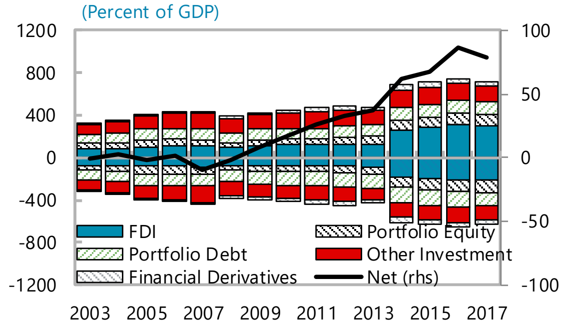
External Assets and Liabilities
(Percent of GDP)



Note: Positive numbers are assets; negative are liabilities.

… even after excluding stocks holding by Special Financial Institutions (SFIs).

External Assets and Liabilities, excluding SFIs
(Percent of GDP)



Note: Positive numbers are assets; negative are liabilities.

Sources: CBS, EC, Eurostat, IMF BoP database, IMF DOTS, and IMF staff calculations.

Table 1. Netherlands: Medium-Term Macroeconomic Framework, 2016–24
(Growth rates, in percent, unless otherwise indicated)

	2016	2017	2018 Est.	2019 Proj.	2020 Proj.	2021 Proj.	2022 Proj.	2023 Proj.	2024 Proj.
National accounts									
Real GDP	2.2	2.9	2.6	2.2	2.1	2.1	2.0	1.8	1.8
Domestic demand	-0.7	2.2	2.7	2.8	2.8	2.4	2.3	2.2	2.2
Private consumption	1.1	1.9	2.4	2.4	2.4	2.3	2.0	2.0	2.0
Public Consumption	1.3	1.1	1.4	1.8	2.0	2.0	2.0	2.0	2.0
Gross fixed investment (total)	-7.3	6.1	4.9	4.7	4.5	3.1	3.1	3.0	3.0
Public	0.7	1.1	3.0	3.0	4.0	0.0	0.0	0.0	0.0
Private	-8.8	7.1	5.2	5.1	4.6	3.6	3.6	3.5	3.5
Residential	21.7	12.0	5.8	5.3	5.0	4.0	4.0	3.5	3.5
Business	-15.9	5.4	5.0	5.0	4.5	3.5	3.5	3.5	3.5
Stocks (contribution to GDP growth)	0.1	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Exports goods and services	1.7	5.4	5.1	4.4	3.9	3.8	3.4	3.0	3.0
Imports goods and services	-2.0	4.9	5.5	5.3	4.9	4.4	3.9	3.5	3.5
Domestic demand (contribution to GDP growth	-0.7	2.0	2.4	2.5	2.5	2.2	2.1	2.0	2.0
External demand (contribution to GDP growth)	2.9	0.9	0.2	-0.3	-0.4	-0.1	-0.1	-0.2	-0.2
Output gap	-1.2	-0.1	0.7	1.2	1.2	1.2	1.2	1.2	1.2
Potential output growth	1.5	1.7	1.9	1.7	2.1	2.1	2.0	1.8	1.8
Gross investment (percent of GDP)	20.5	20.7	21.1	21.6	22.1	22.3	22.6	22.9	23.2
Gross national saving (percent of GDP) 1/	28.5	31.2	30.9	31.0	31.0	30.9	30.8	30.6	30.5
Prices and employment									
Consumer price index (year average)	0.1	1.3	1.6	2.4	2.0	2.1	2.2	2.3	2.4
GDP deflator	0.5	1.2	1.9	2.3	1.9	1.9	2.0	2.1	2.2
Employment	1.3	2.1	1.6	0.6	0.6	0.6	0.6	0.6	0.6
Unemployment rate (percent) 2/	7.3	5.9	…	…	…	…	…	…	…
Unemployment rate (percent) 3/	6.0	4.9	3.9	3.8	3.7	3.6	3.5	3.4	3.3
External									
Current account balance (percent of GDP)	8.0	10.5	9.8	9.5	8.9	8.6	8.2	7.7	7.3
Public sector accounts (percent of GDP)									
Revenue	42.8	43.7	43.6	44.0	43.6	43.4	43.1	43.1	43.1
Expenditure	42.8	42.6	42.5	43.0	42.8	42.6	42.3	42.3	42.3
General government balance	0.0	1.2	1.1	1.0	0.8	0.8	0.8	0.8	0.8
Structural balance (percent of potential GDP)	0.8	1.2	0.5	-0.1	0.0	0.0	0.0	0.0	0.0
General government debt	61.9	57.0	54.6	51.6	49.1	46.4	43.6	41.0	38.3

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. Netherlands: General Government Statement of Operations, 2016–24
(Percent of GDP)

	2016	2017	2018 Est.	2019 Proj.	2020 Proj.	2021 Proj.	2022 Proj.	2023 Proj.	2024 Proj.
Revenue	42.8	43.7	43.6	44.0	43.6	43.4	43.1	43.1	43.1
Taxes	23.3	24.4	24.4	25.1	24.4	24.3	24.1	24.1	24.1
Taxes on production and imports	11.5	11.5	11.7	12.1	12.1	12.1	12.0	12.0	12.0
Current taxes on income, wealth, etc.	11.5	12.7	12.5	12.7	12.1	11.9	11.8	11.8	11.8
Capital taxes	0.3	0.2	0.2	0.2	0.3	0.3	0.3	0.3	0.3
Social contributions	15.2	14.3	14.5	14.3	14.6	14.6	14.5	14.5	14.5
Grants	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other revenue	4.2	4.8	4.5	4.5	4.5	4.4	4.4	4.4	4.4
Expenditure	42.8	42.6	42.5	43.0	42.8	42.6	42.3	42.3	42.3
Expense	42.7	42.5	42.1	41.8	41.8	41.6	41.5	41.5	41.5
Compensation of employees	8.1	8.0	7.9	8.0	8.1	8.0	8.0	8.0	8.0
Use of goods and services	5.6	5.4	5.3	5.3	5.1	5.1	5.0	5.0	5.0
Consumption of fixed capital	3.2	3.1	3.1	3.0	2.9	2.9	2.8	2.8	2.8
Interest	1.4	1.2	0.9	0.8	0.8	0.8	0.8	0.8	0.8
Subsidies	1.1	1.2	1.3	1.2	1.2	1.2	1.1	1.1	1.1
Grants	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Social benefits	21.5	21.1	20.8	20.8	20.9	20.9	21.1	21.1	21.1
Other expense	1.0	1.6	1.9	1.8	1.8	1.9	1.7	1.7	1.7
Net acquisition of nonfinancial assets	0.0	0.1	0.5	1.1	1.0	1.0	0.8	0.8	0.8
Net operating balance	0.1	1.2	1.5	2.1	1.8	1.8	1.6	1.6	1.6
Net lending/borrowing	0.0	1.2	1.1	1.0	0.8	0.8	0.8	0.8	0.8
Net acquisition of financial assets	-0.7	-1.2	...	...	...	...	...	...	...
Currency and deposits	0.2	0.3	...	...	...	...	...	...	...
Securities other than shares	-0.1	-0.1	...	...	...	...	...	...	...
Loans	-0.2	0.2	...	...	...	...	...	...	...
Shares and other equity	-0.4	-0.8	...	...	...	...	...	...	...
Insurance technical reserves	0.0	0.0	...	...	...	...	...	...	...
Financial derivatives	-0.9	-0.4	...	...	...	...	...	...	...
Other accounts receivable	0.7	-0.4	...	...	...	...	...	...	...
Net incurrence of liabilities	-0.8	-2.4	...	...	...	...	...	...	...
Special Drawing Rights (SDRs)	0.0	0.0	...	...	...	...	...	...	...
Currency and deposits	0.3	-0.2	...	...	...	...	...	...	...
Securities other than shares	-0.5	-1.2	...	...	...	...	...	...	...
Loans	-0.4	-1.1	...	...	...	...	...	...	...
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	0.1	...	...	...	...	...	...	...
Memorandum items									
Primary balance	1.1	2.1	1.8	1.6	1.4	1.4	1.4	1.4	1.4
Structural balance (percent of potential GDP)	0.8	1.2	0.5	-0.1	0.0	0.0	0.0	0.0	0.0
Structural primary balance (percent of potential GDP)	2.1	2.4	1.5	0.7	0.8	0.8	0.8	0.8	0.8
Gross Debt	61.9	57.0	54.6	51.6	49.1	46.4	43.6	41.0	38.3
Output gap	-1.2	-0.1	0.7	1.2	1.2	1.2	1.2	1.2	1.2
Nominal GDP (billions of euros)	708.3	737.0	770.9	806.5	839.0	873.2	907.9	944.4	983.2
Nominal GDP growth (percent)	2.7	4.1	4.6	4.6	4.0	4.1	4.0	4.0	4.1
Real GDP growth (percent)	2.2	2.9	2.6	2.2	2.1	2.1	2.0	1.8	1.8
GDP deflator growth (percent)	0.5	1.2	1.9	2.3	1.9	1.9	2.0	2.1	2.2

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

Table 2b. Netherlands: General Government Statement of Operations, 2016–24
(Billions of euros)

	2016	2017	2018 Est.	2019 Proj.	2020 Proj.	2021 Proj.	2022 Proj.	2023 Proj.	2024 Proj.
Revenue	303.2	322.2	336.2	354.6	365.8	378.9	391.5	407.2	424.0
Taxes	165.0	180.2	188.3	202.3	204.4	211.8	218.7	227.5	236.9
Taxes on production and imports	81.6	85.1	90.1	97.7	101.7	105.7	108.9	113.3	117.9
Current taxes on income, wealth, etc.	81.6	93.6	96.4	102.7	101.4	103.9	107.5	111.8	116.4
Capital taxes	1.8	1.4	1.7	1.8	2.2	2.3	2.4	2.5	2.6
Social contributions	107.5	105.5	111.9	115.2	122.5	127.5	131.6	136.9	142.6
Grants	0.9	0.9	1.0	1.0	1.1	1.1	1.2	1.2	1.3
Other revenue	29.8	35.5	35.0	36.1	37.8	38.4	39.9	41.6	43.3
Expenditure	303.1	313.7	328.0	346.5	359.1	371.9	384.2	399.6	416.1
Expense	302.8	313.2	324.3	337.3	350.4	363.4	376.8	391.9	408.0
Compensation of employees	57.6	58.7	61.2	64.5	68.2	70.0	72.5	75.4	78.5
Use of goods and services	39.4	39.7	40.8	42.8	43.2	44.5	45.8	47.6	49.6
Consumption of fixed capital	22.3	22.9	23.6	24.4	24.6	25.1	25.8	26.8	27.9
Interest	9.7	8.8	7.3	6.6	6.6	6.6	7.2	7.5	7.8
Subsidies	7.9	8.9	9.7	9.9	10.0	10.1	10.2	10.6	11.0
Grants	6.5	6.7	7.0	7.3	7.6	8.0	8.3	8.6	9.0
Social benefits	152.5	155.5	160.4	167.5	175.0	182.7	191.6	199.3	207.5
Other expense	7.0	12.1	14.3	14.5	15.2	16.3	15.5	16.1	16.8
Net acquisition of nonfinancial assets	0.3	0.4	3.7	9.2	8.7	8.5	7.4	7.7	8.0
Net operating balance	0.4	8.9	11.9	17.3	15.4	15.5	14.7	15.3	15.9
Net lending/borrowing	0.1	8.5	8.2	8.1	6.7	7.0	7.3	7.6	7.9
Net acquisition of financial assets	-4.7	-9.1	...	...	...	...	...	...	...
Currency and deposits	1.8	2.3	...	...	...	...	...	...	...
Securities other than shares	-0.6	-0.9	...	...	...	...	...	...	...
Loans	-1.5	1.2	...	...	...	...	...	...	...
Shares and other equity	-3.1	-5.7	...	...	...	...	...	...	...
Insurance technical reserves	0.0	0.0	...	...	...	...	...	...	...
Financial derivatives	-6.5	-3.1	...	...	...	...	...	...	...
Other accounts receivable	5.2	-2.9	...	...	...	...	...	...	...
Net incurrence of liabilities	-5.6	-17.6	...	...	...	...	...	...	...
Special Drawing Rights (SDRs)	0.0	0.0	...	...	...	...	...	...	...
Currency and deposits	2.0	-1.8	...	...	...	...	...	...	...
Securities other than shares	-3.8	-8.5	...	...	...	...	...	...	...
Loans	-2.7	-7.8	...	...	...	...	...	...	...
Shares and other equity	0.0	0.0	...	...	...	...	...	...	...
Insurance technical reserves	0.0	0.0	...	...	...	...	...	...	...
Financial derivatives	0.0	0.0	...	...	...	...	...	...	...
Other accounts payable	-1.0	0.5	...	...	...	...	...	...	...
Memorandum items									
Primary balance	8.1	15.6	14.0	13.1	11.7	12.0	12.8	13.3	13.8
Gross Debt	438.4	419.8	420.6	416.0	412.0	404.9	396.1	387.0	376.9
Nominal GDP (Euro bill.)	708.3	737.0	770.9	806.5	839.0	873.2	907.9	944.4	983.2

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

Table 2c. Netherlands: General Government Integrated Balance Sheet, 2011–17
(Percent of GDP)

	2011	2012	2013	2014	2015	2016	2017
Net Worth	21.8	20.4	19.7	15.4	15.0	15.1	…
Nonfinancial assets	60.1	61.0	61.3	60.6	58.8	57.5	…
Net Financial Worth	-38.3	-40.6	-41.6	-45.3	-43.8	-42.4	-37.7
Financial assets	34.6	37.9	36.4	37.2	34.8	34.2	32.2
Currency and deposits	2.4	2.6	2.0	1.8	1.6	1.7	1.9
Securities other than shares	3.5	3.1	2.2	1.5	1.3	1.2	1.0
Loans	7.4	8.6	10.0	9.9	8.9	7.9	7.8
Shares and other equity	12.6	14.3	13.7	13.3	14.0	14.1	13.5
Insurance technical reserves	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial derivatives	1.4	1.9	1.5	3.5	2.6	2.2	1.6
Other accounts receivable	7.4	7.3	7.1	7.2	6.4	7.0	6.3
Liabilities	72.9	78.5	78.0	82.4	78.6	76.6	69.8
Special Drawing Rights (SDRs)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits	0.3	0.2	0.2	0.1	0.3	0.5	0.3
Securities other than shares	53.9	58.2	57.5	62.3	58.6	57.2	52.4
Loans	13.5	14.9	14.5	14.2	13.7	13.0	11.4
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	5.3	5.2	5.8	5.8	6.1	5.9	5.8

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

Table 3. Netherlands: External Sector, 2016–24
(Percent of GDP, unless otherwise indicated)

	2016	2017	2018 Est.	2019 Proj.	2020 Proj.	2021 Proj.	2022 Proj.	2023 Proj.	2024 Proj.
Balance on Current Account	8.0	10.5	9.8	9.5	8.9	8.6	8.2	7.7	7.3
Trade Balance	9.3	9.6	9.1	8.6	8.0	7.8	7.4	7.1	6.7
Exports of goods	59.4	62.7	66.5	66.1	66.4	66.4	65.9	65.2	64.3
Imports of goods	50.1	53.1	57.4	57.5	58.3	58.7	58.5	58.1	57.7
Service Balance	0.9	1.1	1.1	1.1	1.0	0.8	0.7	0.5	0.3
Exports of services	20.1	20.4	20.6	20.8	21.0	21.1	21.2	21.3	21.3
Imports of services	19.2	19.3	19.5	19.7	20.0	20.3	20.6	20.8	21.0
Factor Income	-1.5	0.4	0.2	0.4	0.5	0.6	0.6	0.7	0.8
Current transfers, net	-0.7	-0.7	-0.6	-0.6	-0.6	-0.6	-0.5	-0.5	-0.5
Balance on capital account	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Balance on financial account	8.1	10.2	9.8	9.5	8.9	8.6	8.2	7.7	7.3
Direct investment, net	14.5	1.9	7.2	6.6	7.9	7.6	6.2	7.1	7.1
Direct investment abroad	35.1	39.9	33.7	31.0	34.5	34.9	34.8	33.8	33.8
FDI in Netherlands	20.6	38.0	26.6	24.4	26.7	27.3	28.6	26.7	26.7
Portfolio investment, net	-3.2	8.6	1.3	2.0	2.1	1.5	1.5	1.1	1.5
Financial derivatives	-2.7	-2.6	-0.5	-0.6	-0.8	-0.7	-0.7	-0.7	-0.9
Other investment	0.0	2.5	1.7	1.4	-0.5	0.1	0.9	0.1	-0.6
Reserve assets	-0.4	-0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Errors and omissions, net	0.2	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Sources: DNB and IMF staff calculations.

Table 4. Netherlands: Core Financial Soundness Indicators for Banks, 2011–18

(Percent)

	2011	2012	2013	2014	2015	2016	2017	2018Q3
Regulatory Capital to Risk-Weighted Assets	13.5	14.2	14.9	17.9	20.1	22.4	22.0	22.2
Regulatory Tier 1 Capital to Risk-Weighted Assets	11.8	12.2	12.5	15.0	16.2	17.7	18.4	18.5
Non-performing Loans Net of Provisions to Capital	44.2	46.7	50.4	40.0	35.3	32.6	28.8	28.0
Non-performing Loans to Total Gross Loans	2.7	3.1	3.2	3.0	2.7	2.5	2.3	1.9
Sectoral Distribution of Total Loans: Residents	70.7	72.4	70.2	66.1	64.4	64.2	65.7	65.7
Sectoral Distribution of Total Loans: Deposit-takers	1.2	0.9	1.2	0.8	0.8	0.7	0.6	0.5
Sectoral Distribution of Total Loans: Central bank	8.5	8.7	4.1	2.4	5.8	9.0	8.7	11.2
Sectoral Distribution of Total Loans: Other financial corporations	12.3	13.1	13.0	13.0	12.4	8.1	7.4	6.0
Sectoral Distribution of Total Loans: General government	3.1	3.4	3.6	3.3	3.2	3.0	2.9	2.8
Sectoral Distribution of Total Loans: Nonfinancial corporations	19.9	20.1	20.6	20.2	16.9	16.8	16.8	16.9
Sectoral Distribution of Total Loans: Other domestic sectors	25.7	26.1	27.7	26.3	25.3	26.6	29.2	28.4
Sectoral Distribution of Total Loans: Nonresidents	29.3	27.6	29.8	33.9	35.6	35.7	34.3	34.3
Return on Assets	0.4	0.3	0.3	0.3	0.6	0.6	0.7	0.8
Return on Equity	9.6	7.4	6.2	6.6	10.8	10.1	12.8	12.7
Interest Margin to Gross Income	73.0	75.1	82.8	77.7	73.5	64.8	73.5	55.2
Non-interest Expenses to Gross Income	86.6	101.6	108.5	84.4	77.9	78.8	71.7	70.2
Liquid Assets to Total Assets (Liquid Asset Ratio)	24.8	24.3	23.6	21.1	22.8	21.8	…	…
Liquid Assets to Short Term Liabilities	175.8	179.5	180.3	162.5	169.7	167.0	…	…
Net Open Position in Foreign Exchange to Capital								

Source: DNB.

Table 5. Labor Market Flexibility and Wages: Econometric Results

	Neighbour matching			Radius matching			Kernel matching
	Nearest neighbour	3 nearest neighbours	5 nearest neighbours	r=0.1	r=0.05	r=0.02	
ATT *(Part-time vs Full time)*	-3.537** (-2.247)	-2.942** (-2.123)	-3.192** (-2.337)	-2.616** (-2.215)	-2.948** (-2.456)	-2.861** (-2.241)	-2.873** (-2.569)
Observations	1,406	1,406	1,406	1,406	1,406	1,406	1,406
ATT *(Self-employment vs Others)*	-8.950** (-2.546)	-7.138** (-2.115)	-6.532** (-2.080)	-5.674** (-2.149)	-5.666** (-2.098)	-5.736** (-1.998)	-5.792** (-2.078)
Observations	1,458	1,458	1,458	1,458	1,458	1,458	1,458

ATT is the average treatment effect on the treated (impact of part-time or self- employment on hourly wage). Estimates based on nearest neighbor, radius, and Kernel matching methods. T-statistics based on bootstrapped standard errors are reported in parentheses. ** indicate statistical significance at 5 percent levels.
Source: IMF staff estimates.

Note: Results based on propensity score matching (PSM) estimates using DHS data over 2013–17. The PSM mimics a natural experiment where wage in the group of treated units (part-timers or self-employed) is compared to wage in the control group (full-timers or others), based a set of observable characteristics. Observables included in the estimation of propensity score: education, age, number of children, marital status, work experience (years since first paid job), "student" dummy, "self-employed" or "part-time" dummy, and year dummies.

Annex I. Risk Assessment Matrix

Source of Risks	Relative Likelihood	Impact and Policy response
Risks to the economic outlook		
I. Rising protectionism and retreat from multilateralism. Global imbalances and fraying consensus about the benefits of globalization lead to escalating and sustained trade actions and spreading isolationism.	High	High: As a small highly open economy, the Netherlands is sensitive to global demand. ***Policy response*** Automatic stabilizers and discretionary fiscal expansion to the extent allowed by the fiscal rules could soften the constraints. 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. Uncertainties surrounding fiscal policies in other euro area countries. Expansionary fiscal plan in other euro area countries poses risks to debt sustainability and could trigger adverse market reactions. The risk of a confidence crisis is high, with the potential for adverse global and regional spillovers.	Medium	
III. Weaker-than-expected global growth. - Weak growth in key advanced economies including euro area and U.S. - Slowdown in China	Low/ Medium	
Risks to the financial sector		
IV. Sharp tightening of global financial conditions causes higher debt service and refinancing risks; stress on households, and vulnerable sovereigns; and a broad-based downturn. Tighter financial conditions could be triggered by a sharper-than-expected increase in U.S. interest rates (prompted by higher-than-expected inflation) or the materialization of other risks.	High	Medium: The Netherlands is still in the process of deleveraging and prone to boom-bust cycles. ***Policy response*** Financial supervisors should continue pressure on large banks to reduce their high leverage and make full use of the more stringent supervisory guidelines under Solvency II and Basel III. Accelerate the implementation of macroprudential measures aimed at lessening household financial vulnerabilities.

Annex II. External Sector Assessment

<table>
<tr><td>Foreign asset and liability position and trajectory</td><td>Background. The Netherlands’ net international investment position (NIIP) is estimated at 63 percent of GDP at the end of 2018 (with gross assets and liabilities totaling 1234 and 1162 percent of GDP, respectively), rising from almost balanced NIIP at end-2009. The largest component of the NIIP comes from the net FDI stock, which is estimated at 1,091 billion euro (141 percent of GDP) at the end of 2018. TARGET2 assets on the euro system is estimated at around 100 billion euro. Over the medium term, the NIIP is expected to continue growing to above 100 percent of GDP, in line with projected sizable current account (CA) surpluses.
Assessment. The Netherland’s safe haven status and its sizeable foreign assets limit risks from its large foreign liabilities.</td><td rowspan="6">Overall Assessment
The external position in 2018 was substantially 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 envisaged expansionary fiscal policy, progress in household and corporate rebalancing, and the strengthening of the banking system could support domestic demand and adequately contribute to reducing excess external imbalances. Higher wage growth, consistent with tighter labor market conditions, would however be needed to help rebalancing within the monetary union. In addition, policies and structural reforms aimed at supporting SMEs, including expanding direct support to R&D, investing in digitalization and lifelong learning, and establishing a business credit bureau, as well as pension reforms to reduce precautionary saving, would also reduce the CA surplus.</td></tr>
<tr><td>Current account</td><td>Background. The CA surplus is estimated at 9.8 percent of GDP in 2018 (10 percent cyclically adjusted), driven by continued strong net exports. The CA has been in surplus since 1981—a reflection of a positive goods and services balance. Non-financial corporate net saving has been the main driver of the surpluses since 2000, with large corporate saving financing substantial FDI outflows. Households net saving is low reflecting high mandatory contributions to the second-pillar pension funds and high mortgage borrowing. The Netherlands’ status as a trade and financial center and natural gas exporter likely contributes to the strong structural position.
Assessment. The EBA CA model estimates a preliminary CA norm of 3.4 percent of GDP and a CA gap of 6.6 percent of GDP in 2018, with an unexplained residual of 5.4 percent of GDP 1/. The large unexplained residual primarily reflects the high net saving of Netherlands-based multinationals, partly due to some favorable tax treatment for corporate income. Taking these factors into account, staff assesses the norm in a range of 1.4-5.4 percent of GDP, and a corresponding CA gap of 4.6-8.6 percent of GDP. The CA gap is expected to narrow moderately over the medium term, supported by continued strong domestic demand and expedited phasing-out of gas production.
Actual CA | 9.8 | Cycl. Adj. CA | 10 | EBA CA Norm | 3.4 | EBA CA Gap | 6.6 | Staff Adj. | 0.0 | Staff CA Gap | 6.6</td></tr>
<tr><td>Real exchange rate</td><td>Background. The real effective exchange rate (REER) has been on an appreciation path since April 2015. The annual average CPI-based and ULC-based REER appreciated 1 percent and 1.7 percent, respectively, in 2017. The REER appreciated by an additional 1.4 percent through November 2018, relative to the 2017 average.
Assessment. The EBA REER models indicate a preliminary overvaluation between 1.3 percent (level model) and 13.8 percent (index model) in 2018, largely attributable to unexplained residuals. The staff-assessed CA gap implies a REER undervaluation of 9.2 percent (elasticity of 0.73). Taking into account all estimates and the uncertainty surrounding the EBA REER results, staff assesses that the REER remained undervalued by around 10 percent within a range of 7–13 percent.</td></tr>
<tr><td>Capital and financial accounts: flows and policy measures</td><td>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.</td></tr>
<tr><td>FX intervention and reserves level</td><td>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.</td></tr>
<tr><td>Technical Background Notes</td><td>1/ In comparison with last year, the EBA-estimated CA gap in 2018 (unexplained residual plus the contribution of identified policy gaps) narrowed by 0.1 percent of GDP, reflecting slightly lower CA.
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.</td></tr>
</table>

Annex III. Public Debt Sustainability Analysis

Figure A1. Netherlands: Public Sector Debt Sustainability Analysis (DSA)—Baseline Scenario

(in percent of GDP unless otherwise indicated)

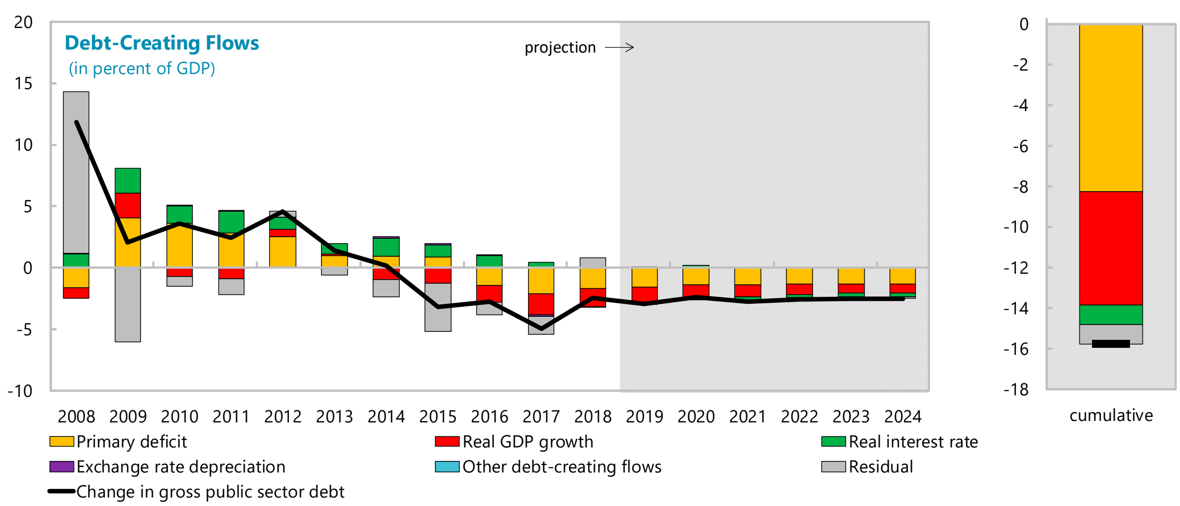
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2008-2016 [2/]	2017	2018	2019	2020	2021	2022	2023	2024
Nominal gross public debt	62.2	57.1	54.6	51.7	49.3	46.5	43.9	41.4	38.9
Public gross financing needs	2.7	-1.2	-1.0	3.2	5.6	3.4	5.0	4.9	4.5
Real GDP growth (in percent)	0.6	2.9	2.6	2.2	2.1	2.1	2.0	1.8	1.8
Inflation (GDP deflator, in percent)	0.9	1.2	1.8	2.2	1.8	1.8	1.9	2.0	2.1
Nominal GDP growth (in percent)	1.5	4.1	4.5	4.5	3.9	4.0	3.9	3.9	4.0
Effective interest rate (in percent) [4/]	3.1	1.9	1.7	2.3	2.2	1.4	1.3	1.4	1.3

As of October 24, 2018		
Sovereign Spreads		
EMBIG (bp) 3/		8
5Y CDS (bp)		13
Ratings	Foreign	Local
Moody's	Aaa	Aaa
S&Ps	AA+	AA+
Fitch	AAA	AAA

Contribution to Changes in Public Debt

	Actual			Projections							
	2008-2016	2017	2018	2019	2020	2021	2022	2023	2024	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	2.2	-5.0	-2.4	-2.9	-2.4	-2.8	-2.6	-2.5	-2.5	-15.8	
Identified debt-creating flows	2.4	-3.5	-3.2	-2.8	-2.2	-2.6	-2.4	-2.4	-2.4	-14.8	
Primary deficit	1.4	-2.1	-1.7	-1.6	-1.4	-1.4	-1.3	-1.3	-1.3	-8.3	-1.1
Primary (noninterest) revenue and grants	41.5	43.5	43.2	43.6	43.6	43.3	43.0	43.0	43.0	259.5	
Primary (noninterest) expenditure	43.0	41.3	41.5	42.0	42.2	41.9	41.7	41.7	41.7	251.3	
Automatic debt dynamics [5/]	1.0	-1.4	-1.5	-1.2	-0.9	-1.2	-1.1	-1.1	-1.1	-6.5	
Interest rate/growth differential [6/]	0.9	-1.3	-1.5	-1.2	-0.9	-1.2	-1.1	-1.1	-1.1	-6.5	
Of which: real interest rate	1.3	0.4	-0.1	0.0	0.2	-0.2	-0.3	-0.3	-0.3	-0.9	
Of which: real GDP growth	-0.4	-1.7	-1.4	-1.2	-1.0	-1.0	-0.9	-0.8	-0.7	-5.6	
Exchange rate depreciation [7/]	0.0	-0.1	0.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8/]	-0.1	-1.5	0.8	-0.2	-0.2	-0.2	-0.2	-0.1	-0.1	-1.0	
o/w interest income	-0.5	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-1.2	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

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

5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = 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 - π (1+g) and the real growth contribution as -g.

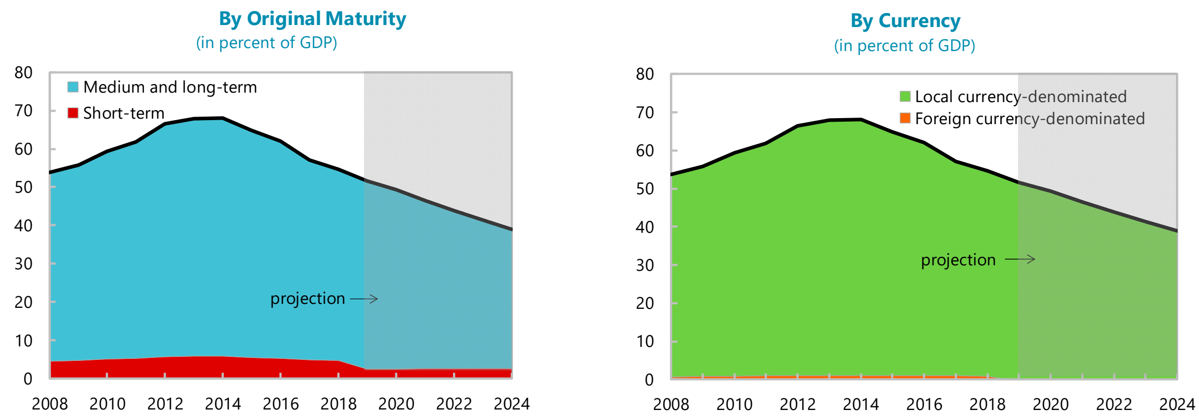
7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

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

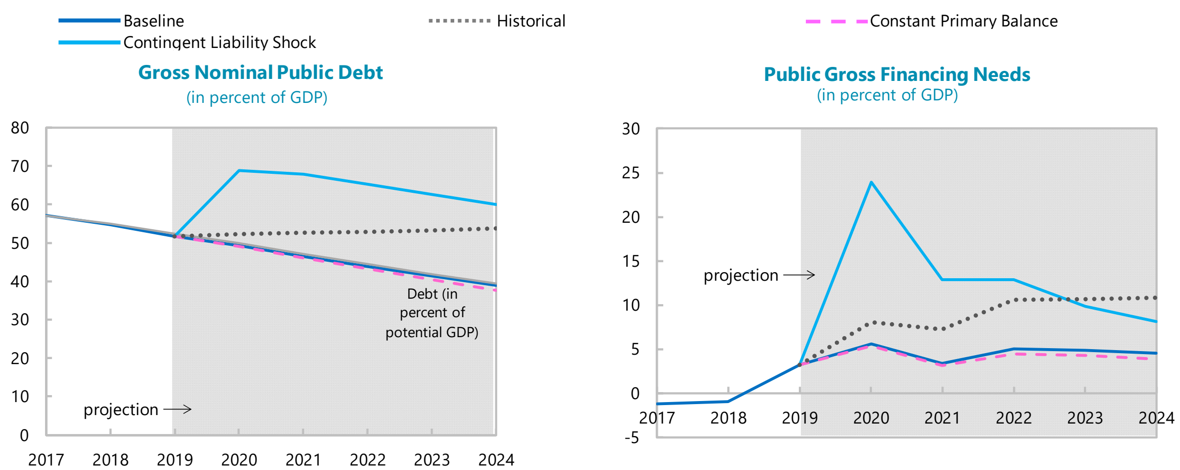
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Figure A2. Netherlands: Public DSA—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt



Alternative Scenarios



Underlying Assumptions
(in percent)

Baseline Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	2.2	2.1	2.1	2.0	1.8	1.8
Inflation	2.2	1.8	1.8	1.9	2.0	2.1
Primary Balance	1.6	1.4	1.4	1.3	1.3	1.3
Effective interest rate	2.3	2.2	1.4	1.3	1.4	1.3
Constant Primary Balance Scenario						
Real GDP growth	2.2	2.1	2.1	2.0	1.8	1.8
Inflation	2.2	1.8	1.8	1.9	2.0	2.1
Primary Balance	1.6	1.6	1.6	1.6	1.6	1.6
Effective interest rate	2.3	2.2	1.4	1.3	1.4	1.3

Historical Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	2.2	0.9	0.9	0.9	0.9	0.9
Inflation	2.2	1.8	1.8	1.9	2.0	2.1
Primary Balance	1.6	-1.1	-1.1	-1.1	-1.1	-1.1
Effective interest rate	2.3	2.2	1.6	1.6	1.9	2.1
Contingent Liability Shock						
Real GDP growth	2.2	0.1	0.1	2.0	1.8	1.8
Inflation	2.2	1.3	1.3	1.9	2.0	2.1
Primary Balance	1.6	-16.7	1.4	1.3	1.3	1.3
Effective interest rate	2.3	2.4	2.4	2.1	2.2	2.2

Source: IMF staff.

Annex IV. Past IMF Policy Recommendations

IMF 2018 Article IV Recommendations	Authorities' Responses
Fiscal Policy	
Use available fiscal space under the Stability and Growth Pact (SGP) rules for further growth-enhancing expenditures or tax cuts aimed at increasing labor force participation.	The fiscal stance was expansionary in 2018, with the structural fiscal balance declining by about 1 percentage point of potential GDP compared to 2017. The 2019 budget plan includes further spending on the infrastructure, and education and research.
Phase out mortgage interest deductibility for households to reduce the current debt bias in the tax system.	The mortgage interest deductibility is planned to be phased down by 3 percentage points per year, starting in 2020, until the basic rate of 36 percent is reached.
Structural Reforms	
Wages and labor market: Place more emphasis on increasing wages to better reflect domestic fundamentals.	Wages growth remains subdued, mainly due to lower productivity growth.
Pension system: The second pillar of the pension system should be overhauled to ensure more clarity for participants through setting up notional personal accounts while preserving some risk sharing and financial security at retirement.	The planned reform of the pension system failed in November 2018, as different parties could not reach an agreement. However, the discussions will continue, and an agreement could be reached in the near future.
Financial Sector Policies	
Reform the housing market to rebalance housing supply and demand, and reduce household indebtedness.	Measures to boost housing supply are contemplated, including by improving coordination among main stakeholders involved in various projects.
Tighten macroprudential measures to reduce households financial vulnerabilities	Tightening macroprudential policies (loan-to-value and debt-service-to-income limits) should go hand-in-hand with measures to boost housing supply, to avoid undermining housing affordability for younger households.
Continued building capital buffers in the banking sector to prepare for likely new regulatory requirements.	Banks capitalization has improved, and most of the largest Dutch banks will meet the new Basel III.5 requirements, if implemented.

Annex V. FSAP Recommendations

Recommendations	Time[1]	Status
	Financial Risks and Stability Analysis	
Enforce an industry-wide approach to informing IO mortgagors of estimated repayment shortfalls.	I	AFM and SSM (DNB/ECB) have together set up a working group that has set actions into motion to ensure an industry-wide approach to informing IO mortgagors about their estimated repayment shortfalls. Steps towards this goal will continue in 2019.
Continue to build capital buffers to ensure all banks remain above minimum leverage ratio thresholds in the case of severe adverse events.	NT	The government has mentioned in its coalition agreement that national requirements on the leverage ratio will be aligned with European requirements when the Basel III.5 leverage ratio requirements come into force. Basel III.5 will contribute to increased leverage ratios of all Dutch systemically important credit institutions, due to the increase in risk-weighted capital requirements.
	Macroprudential Policy Framework	
Strengthen the FSC by establishing it under primary law and vest it with "comply-or-explain" powers.	NT	The Ministry of Finance has drafted, in close cooperation with the other members of the FSC, a legislative proposal to explicitly vest the FSC into the Banking Act. This provides the FSC with a clear legal basis to give advice and provide recommendations on issues related to financial stability. The legislative proposal is planned to be submitted to Parliament in the course of 2019.
Accelerate the phase-out of MID and reduce the final tax rate to a neutral level.	NT	The government states that phasing down the mortgage interest deductibility will be accelerated from 0.5 to 3 percentage points annually starting in 2020 until the base tax rate level of 37.05% is reached in 2023. An evaluation of the tax treatment of owner occupied housing is scheduled for 2019.
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	The maximum LTV-ratio was reduced to 100% in 2018. No actions are currently foreseen to set prudential ceilings on DSTI limits that would prevent them from being relaxed through the cycle.
	Cross-cutting Supervisory Issues	
Further enhance supervisory oversight of loan classification and strengthen internal model validation by providing Joint Supervisory Teams more support from risk specialist divisions.	I	The powers of DNB and AFM to introduce technical regulations have not been enhanced. No actions to do so are currently foreseen. DNB and AFM already have the ability to involve outside expertise in conducting their supervisory examinations.
Exclude the DNB and AFM from the proposed salary cap, and provide them with greater autonomy in setting their supervisory budgets.	I	The Ministry of Finance has not provided DNB and AFM with greater autonomy in setting their supervisory budgets. No actions to do so are foreseen.

[1] Immediately (I) is within one year, near term (NT) is 1–3 years.

Recommendations	Time[1]	Status
The DNB and AFM to undertake a cross-sectoral review of credit underwriting standards of mortgages	I	Several on-site examinations in financial institutions' mortgage portfolios have been carried out in recent years. Moreover, DNB collects loan level data on the mortgage exposures of banks, insurers, and pension funds. Based on the latest data available, DNB has no signals that mortgage lenders are significantly loosening their underwriting standards.
Ensure that reliable and complete data is available on a timely basis to support off-site supervision.	NT	Regarding insurers and pension funds: DNB will continue to conduct rigorous checks on the consistency and plausibility of the data it receives from insurers and pension funds. Regarding banks: This is done through rigorous checks on the consistency and plausibility of data, on-site examinations that target data quality as well as extended on-site inspections, in which data quality is addressed. The first new initiatives on Data Driven Supervision that DNB has taken have been implemented, aiming at supporting quality of data. Regarding collective investment schemes: Several actions have been taken by DNB and AFM to ensure reliable and complete data is available on a timely basis.
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	Regarding supervisory oversight of loan classification: DNB has requested the Ministry of Finance to allow imposing binding requirements on the size of banks' impairment charges. DNB is also stimulating the usage of article 104 CRD to allows competent authorities to intervene an entity's provisioning policy is not adequate. Regarding internal model validation: actions are currently in place to provide Joint Supervisory Teams with more support than they already receive from specialist divisions.
Encourage a more active role of the Supervisory Board of Dutch banks via ongoing engagement.	NT	Engaging the SB is part of ongoing supervision through e.g. periodic interviews and the annual SB self-assessment. Furthermore, DNB discusses the outcomes of the annual Supervisory Review and Evaluation Process (SREP) with the SB's of all LSI's it supervises. In addition, the SSM wide Targeted Review of Internal Models (TRIM) will put the supervisory findings on banks' internal models on the SB agenda.
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	Several actions have been taken by DNB regarding the impact of the VA and UFR on insurers' solvency position. In order to monitor the effects of elements that limit the economic valuation of liabilities, DNB requested life insurers to report additional data on their solvency position. In 2016, DNB asked insurers to explicitly take into account the effects of an economic valuation of liabilities in their capital policy. In order to address the solvency position of 'economically insolvent' insurers, DNB is using a so called internal signaling value as a point of reference. For insurers whose solvency position falls below this internal signaling value, DNB will actively engage to discuss their solvency position (moral suasion).
Recommendations	**Time[1]**	**Status**
Harmonize the relevant laws on the quality of advice and suitability of products and	NT	No mechanisms have been introduced to ensure pension participants receive financial advice. The required supervisory

provide authority for group supervision in the pension law.		powers to allow for effective supervision of risks stemming from service providers of pension funds are being investigated.
Securities Supervision and Regulation		
Broaden the supervisory authority of the AFM with regard to loan-based crowd-funding platforms.	NT	The Ministry of Finance has published a consultation on how a concrete legislative proposal should take shape in the very near term. A feedback statement is planned to be published in the near future.
Require prompt public disclose of auditor changes or resignations.	NT	The prompt public disclose of auditor changes or resignations is already sufficiently covered by existing rules and regulations. no actions currently foreseen to require additional public disclosure of auditor changes or resignations
Financial Market Infrastructure		
Augment the supervisory resources devoted to the oversight of European Central Counterparty (EuroCCP).	I	The staff resources devoted to EuroCCP supervision have been expanded from 2 FTE to 3 FTE. More generally, the staff resources devoted to ICE Clear Netherlands supervision have been expanded from 1 FTE to 3 FTE, bringing the total for CCP supervision to 6 FTE.
EuroCCP to strengthen its review of its stress testing and margin models methodology and develop a comprehensive recovery plan.	I	EuroCCP has enhanced its reverse stress testing approach to consider a wider set of market price scenarios and combinations of participant defaults that would exhaust its financial resources. Its margin model methodology has also been improved. Sensitivity analyses have been developed to examine how the parameters and assumptions affect the outcome of its stress tests. EuroCCP has developed a comprehensive recovery plan ahead of the EU legislation on CCP recovery and resolution, EuroCCP.
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	Regarding adequate arrangements for systemic crisis management: measures at the domestic level have focused on updating DNB own internal crisis management manual to align with the SRB crisis management manual. At the European level, the role and responsibilities of SRB, ECB and Dutch Authorities a managing systemic crisis are formalized in the SRB and DNB crisis management manuals, the Cooperation Framework (CoFra) and horizontal policy guidance. Regarding legacy legal frameworks: a proposal has been put forward in the context of the legislative proposal for a resolution regime for insurance companies to rescind the 'Emergency proceedings' and transfer some of the powers of DNB to the administrator. This legislative proposal has been accepted by the parliament and is expected to be in force as of 1 January 2019, after ratification by the Senate.
Allow the deposit guarantee scheme to finance deposit transfers in resolution and insolvency.	NT	Since 2017 it is possible to finance the gross amount of deposits that are transferred in resolution. The legislative process to allow funding by the DGS of a transfer of covered deposits in insolvency is ongoing. DNB and the Ministry of Finance are currently looking into the technical feasibility of such techniques.

INTERNATIONAL MONETARY FUND

KINGDOM OF THE NETHERLANDS—NETHERLANDS

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

January 23, 2019

Prepared By	European Department

CONTENTS

FUND RELATIONS

(As of Dec 17, 2018, unless specified otherwise)

Mission: November 27–December 6, 2018 in The Hague and Amsterdam. The concluding statement of the mission is available at https://www.imf.org/en/News/Articles/2018/12/05/ms120618-kingdom-of-the-netherlands-staff-concluding-statement-of-the-2019-article-iv-consultation.

Staff team: Messrs. T. Dorsey (head) and A. Fouejieu, Mmes. R. Chen and I. Karpowicz (all EUR).

Country interlocutors: The mission met with De Nederlandsche Bank President Klaas Knot; Finance Minister Wopke Hoekstra and other officials from the Ministries of Finance, the Interior and Kingdom Relations, Social Affairs and Employment, Economic Affairs and Climate Policy, De Nederlandsche Bank, other government entities, and the Single Supervisory Mechanism; representatives of labor unions and employers, and representatives of private sector institutions. Mr. R. Doornbosch and Mr. J. Hanson (both OED) participated in some of the meetings.

Fund relations: Discussions for the 2019 Article IV consultation were held in The Hague and Amsterdam from November 27 to December 6, 2018. The staff report for the 2018 Article IV Consultation (IMF Country Report No. 18/130, May 28, 2018) was considered by the Executive Board on May 23, 2018. 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 https://www.imf.org/en/Publications/CR/Issues/2018/05/28/Kingdom-of-the-Netherlands-Netherlands-2018-Article-IV-Consultation-Press-Release-Staff-45900.

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	7873.47	90.12
Reserve Tranche Position	863.04	9.88
Lending to the Fund	463.70	

SDR Department:	**SDR Million**	**Percent of Allocation**
Net cumulative allocation	4,836.63	100.00
Holdings	4,628.94	95.71

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):

	2018	2019	2020	2021	2022
Principal					
Charges/Interest		2.36	2.32	2.32	2.32
Total		2.36	2.32	2.32	2.32

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.

[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 2008:Q1 to 2018: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 December 17, 2018)

	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/	Memo Items: Data Quality—Accuracy and Reliability 10/
Exchange Rates	Current	Current	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities 1/	10/18	11/18	M	M	M		
Reserve/Base Money 2/	10/18	11/18	M	M	M		
Broad Money 2/	10/18	11/18	M	M	W and M		
Central Bank Balance Sheet	10/18	11/18	M	M	M		
Consolidated Balance Sheet of the Banking System	10/18	11/18	M	M	M		
Interest Rates 3/	Current	Current	D	D	D		
Consumer Price Index	11/18	12/18	M	M	M	O, O, LO, O	O, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing 4/—General Government 5/	Q3/18	11/18	Q	Q	Q	LO, LO, LO, O	LO, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing 4/—Central Government	Q3/18	11/18	Q	Q	Q		
Stocks of Central Government and Central Government-Guaranteed Debt 6/	Q3/18	11/18	Q	Q	Q		

Netherlands: Table of Common Indicators Required for Surveillance (concluded)
(As of December 17, 2018)

External Current Account Balance	Q3/18	11/18	Q	Q	Q	O, O, O, O	O, O, O, O, O
Exports and Imports of Goods and Services	Q3/18	11/18	Q	Q	Q		
GDP/GNP	Q3/18	11/18	Q	Q	Q	O, O, O, O	LO, O, O, O, O
Gross External Debt	Q2/18	09/18	Q	Q	Q		
International Investment Position 7/	Q2/18	09/18	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 Mr. Doornbosch and Mr. Hanson on Kingdom of the Netherlands - Netherlands February 8, 2019

The Dutch authorities would like to thank staff for the constructive policy dialogue, their insightful report and their timely and interesting set of Selected Issues Papers.

The Dutch economy experiences an expansion which is increasingly driven by domestic demand. Private consumption was the main driver of economic growth in 2018, benefitting from real disposable income growth at its highest level since 2001. Fiscal policy also supported growth, as the 2017 coalition agreement results in an expansionary fiscal policy over the coalition period until 2021. Unemployment is expected to decrease to 3.6% in 2019. The authorities agree with staff that growth will moderate to its potential over the forecast horizon and share their assessment of international risks to the outlook, in particular those related to an unorderly Brexit and escalating trade conflicts.

Labor market tightness and income tax cuts translate into an increase in real disposable income. Real disposable income stagnated between 2002 and 2013, growing by 0.2% per year on average, but recovered between 2014 and 2017 to an average rate of 1.7%. Income inequality remained stable at a relatively low level over the past 15 years. The authorities expect wage growth to accelerate from 2.1% in 2018 to 3.0% in 2020. In addition, a simplification of the income tax schedule from four to two brackets, a reduction in tax rates and an increase in tax credits will substantially alleviate the tax burden for households. This will further support real disposable income, which the authorities forecast to grow by 2.0% on average per year between 2018 and 2020, resulting in a cumulative increase of 13% from 2013 to 2020.

The authorities welcome staff's analysis of reforms, which can feed into their reform agenda. Staff's analysis of pension reforms, labor market reform and the housing market is broadly in line with the priorities of the government and forms a useful input for ongoing policy debates. We would like to make the following additional remarks about the reform priorities of the government:

- **Working towards a more balanced labor market:** Self-employment is more prevalent in the Netherlands than in other EU Member States. The group of self-employed is diverse: it includes high-skilled entrepreneurs, but also more vulnerable workers. The government aims to address bogus self-employment and will reduce tax incentives for self-employed. The government also intends to improve the balance between fixed and flexible employment by making open-ended contracts more attractive for employers and flexible work more secure.

- **Mitigating CO2 emissions:** The authorities committed to reduce CO_2 emissions by 49% by 2030 relative to 1990. They increased environmental taxes and a draft proposal for a Climate Agreement with further measures prepared by stakeholder organizations was presented last December. Its effects on emissions and the economy are currently analyzed. Climate risks in the financial sector are high on the agenda of the Dutch central bank.

- **Combating tax avoidance and tax evasion:** The Dutch tax system reflects the international orientation of the economy. The system includes arrangements to prevent that the same income is taxed twice in two different countries, such as the double participation exemption mentioned by staff. This is one of various reasons that makes the Netherlands an attractive location for multinationals, alongside proximity to large markets, an educated labor force and an enabling business environment. An unintended consequence of the system is that companies abuse it to avoid paying taxes in other countries. The government is committed to address this problem. The authorities will introduce a withholding tax on interest rates and royalties to low tax jurisdictions. The authorities will also increase transparency about international tax ruling.

- **Improving the functioning of the housing market:** The housing market tightens while mortgage debt remains elevated. Therefore, the housing market requires close monitoring and continuous efforts to maintain financial stability. To further reduce household debt, the government will significantly accelerate the phasing down of mortgage interest deductibility from 0.5 percentage point per year to 3 percentage points per year. To support housing supply in the private rental market, the government is introducing legislation to make it easier for housing corporations to build in the middle segment of the rental market alongside private parties and is exploring options on how to tackle excessively high rental prices locally.

- **Reforming the pension system:** As staff mentions, the Dutch pension system is considered as one of the world's strongest systems based on its high participation rates, retirement income adequacy and sustainability. The government is committed to reform the Dutch pension system to make it compatible with today's dynamic labor market, reduce tensions between generations, enhance macroeconomic stability and restore trust in the system. Therefore, the government recently announced it will start preparing legislation and guidelines for transition plans to a system that reduces intergenerational transfers.

The high current account surplus cannot be easily explained by policy distortions or the EBA model. The unexplained residual of 5.4% in the EBA model fully "explains" the gap of the surplus with the EBA norm range. The savings surplus is largely driven by corporate savings. Positive household net savings correspond with staff's recommendation to reduce household debt, while the positive fiscal stance aligns with the objective of cyclical stabilization. The Selected Issues Paper shows that the high corporate savings are dominated by a few multinationals. Many of these multinationals are rooted in the Netherlands but have a high share of foreign ownership, reflecting the open nature of the Dutch economy.[1] Their retained earnings are fully assigned to the Dutch savings surplus, even if they are used for investments by foreign subsidiaries, and also if their shareholders are foreign. This counterintuitive statistical treatment of multinationals complicates the economic interpretation of their savings.[2] We agree with staff that separating multinationals from the external sector assessment would benefit the analysis of underlying policy distortions and we encourage further work in this area.

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[1] See e.g. chart 13 in Eggelte, J., R. Hillebrand, T. Kooiman and G. Schotten (2014). "Getting to the bottom of the Dutch savings surplus". DNB Occasional Studies Vol. 12-6.

Government policy supports SMEs, while their access to finance is improving. The government will reduce the tax burden for SMEs through a reduction in the corporate income tax rate, financed by broadening the tax base in a way that mainly affects large corporations. Access to finance for SMEs is improving. Credit provision to SMEs increases since end-2017 and the loan rejection rate of 12.4% in 2017 reported in the staff report dropped to 2.7% in 2018. The coalition agreement foresees a structural increase in investment in education, research and innovation, amounting to 1.9 billion euros in 2019. Sustaining and increasing public R&D over the medium-term remains a priority of the authorities.

The financial sector is resilient, but institutions should continue to build capital buffers. The 2018 EBA stress test results show resilience of the banking sector, in line with the conclusions of the 2016 IMF FSAP. The average stress test impact of Dutch banks is similar to the EBA average and in line with peer countries. Nevertheless, low start levels lead to low absolute leverage ratios in adverse scenarios. Given the financial uncertainty and in the context of preparations for new regulation on internal risk models, we therefore support staff's recommendations to banks to further strengthen leverage ratios and to continue building buffers.

Like last year, it was difficult to have a meaningful discussion about fiscal policy, as staff's advice on the use of fiscal space disregards the Dutch fiscal framework. The Dutch fiscal framework is based on multiannual real expenditure ceilings and a multiannual revenue framework. These are determined for the full government term and allow for predictability and transparency. Automatic stabilization takes place on the revenue side of the budget. The framework complements the EU Stability and Growth Pact and has been acclaimed by international institutions including the IMF.[3] [4] The national fiscal framework limits the ability of the government to use discretionary fiscal policy during its term. Staff's focus on its narrow definition of fiscal space in discussions with the authorities made it difficult to have a substantive dialogue about fiscal priorities. In any case, available fiscal space is negligible: the authorities forecast a structural balance of -0.4% in 2019, against an objective of -0.5% under the European rules. In addition, the economic upswing warrants the build-up of buffers because the open Dutch economy is relatively exposed to external risks, as highlighted by staff, translating into a highly cyclical budget balance.

[2] Avdjiev, S., M. Everett, P.R. Lane and H.S. Shin (2018). "Tracking the international footprints of global firms" BIS Quarterly Review, March 2018.

[3] Eyraud, L., X. Debrun, A. Hodge, V. Lledó, and C. Patillo (2018). "Second-Generation Fiscal Rules: Balancing Simplicity, Flexibility and Enforceability" SDN/18/04.

[4] IMF (2006). "Kingdom of the Netherlands—Netherlands: Report on the Observance of Standards and Codes—Fiscal Transparency Module, and the Aide-Mémoire Regarding the Fiscal Framework", *IMF Country Report*, Issue 06/124.