INTERNATIONAL MONETARY FUND

IMF Country Report No. 18/130

KINGDOM OF THE NETHERLANDS—NETHERLANDS

May 2018

2018 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 2018 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 May 23, 2018 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 May 23, 2018, following discussions that ended on February 28, 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 May 8, 2018.
- 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.

Copies of this report are available to the public from
International Monetary Fund • Publication Services
PO Box 92780 • Washington, D.C. 20090
Telephone: (202) 623-7430 • Fax: (202) 623-7201
E-mail: publications@imf.org Web: http://www.imf.org
Price: $18.00 per printed copy

International Monetary Fund
Washington, D.C.

© 2018 International Monetary Fund

Press Release No. 18/197
FOR IMMEDIATE RELEASE
May 28, 2018

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

IMF Executive Board Concludes 2018 Article IV Consultation with Kingdom of the Netherlands - Netherlands

On May 23, 2018, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Netherlands.[1]

The Netherland's economic recovery has taken hold. Real growth is forecast to reach 3.1 percent in 2018 owing to robust domestic demand. Private consumption has been supported by rising disposable income and positive wealth effects from increasing house prices. Net exports have proven resilient to global uncertainties, pushing up the already large current account surplus. Unemployment has continued to decline rapidly, although most of the jobs have been created under temporary contracts or self-employment status. Inflation has been low in the absence of wage growth, which has been lagging productivity gains. Credit growth has been gradually recovering for households, but remains negative for the corporate sector, signaling protracted deleveraging. The banking system has continued to build up capital buffers to withstand challenges associated with the low interest rate environment and new regulatory constraints.

The economy is expected to keep its momentum in the coming years. Domestic consumption and investment are forecast to remain the main drivers of growth, prompting a gradual decline of the current account surplus. Inflation should pick up as the economy reaches its capacity and wages increase. Some important risks loom in the horizon: foreign demand could be dampened by unresolved crisis legacies in EU countries, rising protectionist measures, and uncertain Brexit negotiations. On the upside, improving labor market conditions, positive income developments, and a continued house price recovery would likely continue supporting consumption and investment.

In this favorable environment, the coalition agreement adopted in late 2017 by the new government lays out a broad-based fiscal expansion and an ambitious structural reform agenda. Reforms aim at strengthening the macroprudential toolkit to reduce household indebtedness and reducing duality in the labor market, thereby addressing challenges associated with weak wage

[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.

growth. It also proposes reforming the second pillar of the pension system to promote more transparency and intergenerational fairness, while reducing pro-cyclicality.

Executive Board Assessment[2]

Executive Directors welcomed the broad-based economic recovery, which was supported by domestic demand, on the backdrop of strong housing prices, and resilient net exports. While unemployment has been rapidly decreasing, Directors noted that wage and inflation developments remained weak. The current account surplus remains large and is expected to only gradually decline over time.

Noting that the risks to the growth projections were tilted to the downside, Directors recommended that economic policies should be focused on further decreasing leverage and boosting potential output, including through measures aimed at improving the housing market, strengthening resilience to financial vulnerabilities, addressing challenges related to labor market duality, and reforming the pension system. Directors supported the authorities' use of the fiscal space, aimed at boosting potential growth and welcomed the reform plan for international corporate taxation.

Directors agreed with staff on the need to continue lessening household indebtedness through further tightening of macro-prudential policies in the context of increased house prices and a comprehensive housing market reform. They commended the authorities for accelerating the pace of reduction in mortgage tax relief, and considered that further lowering loan-to-value ratios on mortgages would help address financial vulnerabilities.

Directors commended the authorities for enhanced financial sector oversight. While they noted that the banking sector is well capitalized on a risk-weighted basis, they stressed that a continued buildup of capital buffers remains warranted to cope with challenges associated with high leverage, low interest rates, and significant reliance on wholesale funding. They welcomed the continued close monitoring of financial conditions in the insurance and pension sectors. Directors welcomed the principles laid out in the prospective reform of the second pillar pension system to promote more transparency and intergenerational fairness.

Directors observed that labor market conditions had improved, but noted that employment growth had been mostly in self-employment and temporary contracts. They supported the authorities' reforms aimed at making open-ended contracts more attractive for employers by curtailing excessive rigidity in employment statutes, and discouraging the abuse of flexible work arrangements. Directors supported the authorities' view to foster increased wage growth in cooperation with social partners.

---

[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.

Netherlands: Selected Economic Indicators, 2016-2019

	2016	2017	2018 Proj.	2019 Proj.
National accounts (percent change)				
Gross domestic product	2.2	3.2	3.1	2.4
Private consumption	1.6	1.9	1.9	1.9
Public consumption	1.2	1.2	3.1	3.0
Gross fixed investment	5.3	5.6	5.3	4.0
Total domestic demand	1.8	2.3	3.1	2.7
Exports of goods and nonfactor services	4.3	6.1	6.0	4.6
Imports of goods and nonfactor services	4.1	5.4	6.7	5.3
Net foreign balance 1/	0.6	1.2	0.2	0.0
Output gap (percent of potential output)	-0.9	0.0	1.2	1.7
Prices, wages, and employment				
Consumer price index (HICP)	0.1	1.3	1.7	2.2
GDP deflator	0.6	1.1	1.2	1.6
Hourly compensation (manufacturing)	1.2	2.2	2.1	1.9
Unit labor costs (manufacturing)	0.3	1.1	-0.2	0.1
Employment (percent)				
Unemployment rate (national definition)	7.3			
Unemployment rate (ILO definition)	6.0	4.9	4.7	4.6
NAIRU	5.5	5.3	5.2	5.2
External trade				
Merchandise balance (percent of GDP)	11.9	12.3	12.2	11.9
Current account balance (percent of GDP)	8.4	10.2	9.9	9.2
Revenue	43.8	43.8	43.8	43.8
Expenditure	43.4	43.2	43.2	43.1
Net lending/borrowing	0.4	0.5	0.5	0.7
Primary balance	1.4	1.5	1.3	1.5
Structural balance 2/	0.8	0.5	0.0	0.0
Structural primary balance 2/	2.1	1.3	0.4	0.3
General government gross debt	61.8	56.5	53.3	50.7

1/ Contribution to GDP growth.

2/ In percent of potential GDP.

INTERNATIONAL MONETARY FUND

KINGDOM OF THE NETHERLANDS—NETHERLANDS

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION

May 8, 2018

KEY ISSUES

Context

Four years after exiting a double dip recession, the economic recovery has taken hold, driven by robust domestic demand against the backdrop of increasing house prices. Net exports have also proven resilient to global uncertainties so far, pushing up the already large current account surplus. The pickup in economic activity has resulted in a marked decrease in the unemployment rate. In this context, the coalition agreement, adopted in late 2017 by the new government following general elections earlier on that year, lays out a broad-based fiscal expansion and an ambitious structural reform agenda aimed at strengthening the macroprudential toolkit, reducing duality on the labor market, and overhauling the second pillar of the pension system over the next four years.

Key Policy Recommendations:

- Continue tightening macro-prudential policies in a context of rapidly increasing housing prices.
- Address challenges associated with increasing duality in the labor market and weak wage growth.
- Use fiscal space wisely to boost potential growth.
- Reform the pension system towards more transparency, fairer intergenerational transfers, and reduced pro-cyclicality.

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

Discussions took place in The Hague and Amsterdam during February 19-28, 2018. The mission team comprised Messrs. T. Dorsey (head) and M. Gerard, Mmes. R. Chen, D. Dimova, and Y. Zhang (all EUR). Mr. R. Doornbosch and Ms. De Lint (both OED) participated in some of the meetings. The team was supported from headquarters by Ms. G. Ordoñez-Baric and Mr. A. Musayev (both EUR). Ms. N. Geng participated in a preparatory staff visit and contributed a selected issues paper. The team met with De Nederlandsche Bank President Klaas Knot; Finance Minister Wopke Hoekstra, and other officials from the Ministries of Finance, and officials from the Ministries of the Interior and Kingdom Relations, Social Affairs, Health, De Nederlandsche Bank, other government entities, and the Single Supervisory Mechanism; representatives of labor unions and employers, and representatives of private sector institutions.

CONTENTS

CONTEXT AND OUTLOOK 4

A. Macroeconomic Developments and Outlook 4

B. Risks and Spillovers 5

C. External Assessment 6

POLICY DISCUSSIONS 7

A. Fiscal Policy 7

B. Wages and the Labor Market 9

C. Financial Sector Policies 10

D. The Pension System 16

STAFF APPRAISAL 17

FIGURES

1. Real Growth 20
2. Labor Market and Inflation 21
3. Credit and Housing Market Conditions 22
4. Fiscal Developments 23
5. Current Account Developments 24

TABLES

1. Medium-Term Macroeconomic Framework, 2015–23 25

2a. General Government Statement of Operations, 2015–23 (Percent of GDP) 26

2b. General Government Statement of Operations, 2015–23 (Billions of euros) 27

2c. General Government Integrated Balance Sheet, 2010–16 28

3. External Sector, 2015–23 29

4. Core Financial Soundness Indicators for Banks, 2010-2017 30

ANNEXES

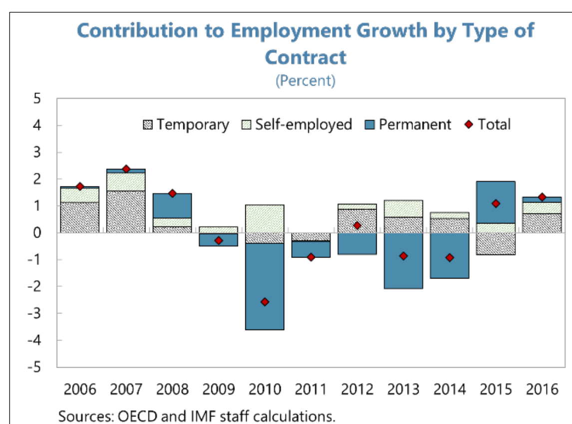
I. Risk Assessment Matrix 31
II. External Sector Assessment 33
III. Progress Against IMF Recommendations 34
IV. FSAP Key Recommendations 35
V. Public Debt Sustainability Analysis 38
VI. Reform Plans of the International Corporate Taxation Regime in the Netherlands 45

CONTEXT AND OUTLOOK

A. Macroeconomic Developments and Outlook

1. The economic recovery has taken hold (Figure 1). After steadily increasing since the trough reached in 2013, real growth was above 3 percent in 2017 owing to strong domestic demand and resilient net exports. Private consumption has been supported by rising disposable income and positive wealth effects from the continued house price recovery. Investment growth has continued with improved confidence, notably in the construction sector, and enabled capacity utilization toward its long-term average. Both imports and exports have increased as a share of GDP with strengthening domestic demand and improved growth in trade partners. Inflation rose to 1.3 percent at end-2017.

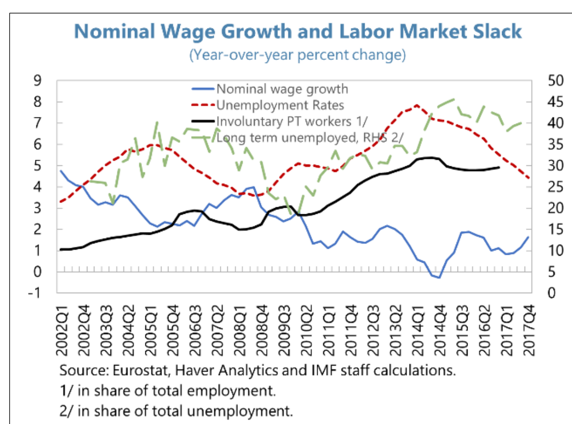
2. The labor market has tightened, albeit in a context of increasing duality (Figure 2). Employment has been on the rise since 2015 with stable participation, and the unemployment rate was down to 4.4 percent in 2017:Q4, slightly below NAIRU estimates. While conditions have become tighter (as evidenced by higher vacancies and increasing hours worked), most of the jobs appear to have been created under temporary contracts or self-employment status, pointing to increasing duality in the labor market.



Contribution to Employment Growth by Type of Contract
(Percent)

Sources: OECD and IMF staff calculations.

3. Wage growth has been subdued despite tighter labor market conditions in recent years. While this "wage puzzle" is shared by many other advanced economies, the Netherlands has had the slowest nominal wage growth among its peers, declining from above 6 percent in early 2000 to about 1 percent in recent years, entailing a real wage growth close to zero. The decline partly reflects the slowdown of trend productivity growth, subdued inflation expectations, and remaining labor market slack not captured by unemployment rates, such as the long-term unemployed.[1] Overall, the ULC-based REER depreciated by about 7.5 percent since the peak reached in mid-2008, while the labor share in national income declined from 51 to 48 percent over the same period.



Nominal Wage Growth and Labor Market Slack
(Year-over-year percent change)

Source: Eurostat, Haver Analytics and IMF staff calculations.
1/ in share of total employment.
2/ in share of total unemployment.

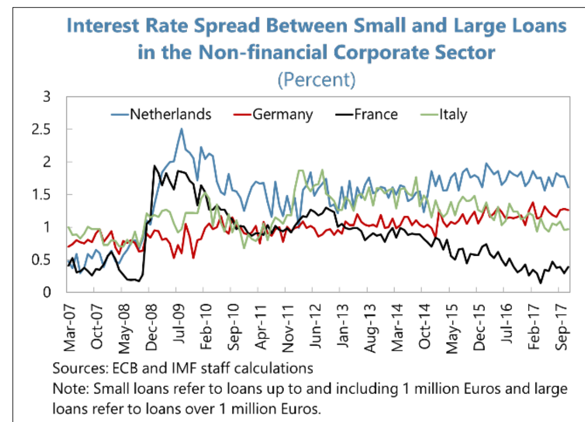
---

[1] See Y. Zhang and D. Dimova (2018), "Wage Moderation in the Netherlands" chapter in the Selected Issues Paper.

4. House prices have been on the rise in the country's main cities (Figure 3). House prices increased by 6.7 percent y-o-y in 2017 H1 and are now 17.4 percent higher than the low point reached in 2013, although still 6.9 percent below the peaked reached in 2008 H2. Transaction volumes almost doubled in 2016. Staff's analysis suggests that real house prices have risen somewhat above the level implied by fundamentals. Overheating particularly affects the main cities of the Randstad area, reflecting supply shortages and low interest rates. Due to overcapacity in retail and office space, the recovery in commercial real estate has been more sluggish after the 20 percent price drop experienced during the crisis.

5. Credit developments have been contained overall, but mortgage lending to households is reviving (Figure 3). Credit to households has been strengthening, reflecting a slight pickup in nominal mortgage lending after two years of deleveraging. However, household debt relative to GDP has remained on a slightly declining path, reaching around 118 percent in 2016. By contrast, credit to the non-financial corporate sector was still contracting by 1.2 percent y-o-y in November 2017, mostly reflecting continued tight lending standards for small and medium enterprises while multinationals typically rely on other sources of financing. The interest rate spread between small and large loans appears high compared to other euro area countries. Banks have continued to deleverage, making room for new entrants (insurers, pension funds) on the mortgage market, while preserving their net interest margins, but remain vulnerable to increasing funding costs given their large reliance on the wholesale funding market.

Interest Rate Spread Between Small and Large Loans in the Non-financial Corporate Sector
(Percent)



Sources: ECB and IMF staff calculations
Note: Small loans refer to loans up to and including 1 million Euros and large loans refer to loans over 1 million Euros.

6. Growth is expected to continue, albeit at a slower pace (Figure 2). The output gap is estimated to have closed. Over the forecast horizon, real GDP will continue to grow faster than potential due to supporting macroeconomic policies and vigorous domestic demand. In the medium term, potential growth is expected to be capped below 2 percent by unfavorable demographic developments, limited capital deepening in line with declining public investment, and sluggish productivity developments.

B. Risks and Spillovers

7. The risks to the outlook continue to be tilted to the downside. Foreign demand may be dampened by unresolved crisis legacies in EU countries and low productivity growth in the U.S., the euro area, and Japan, and a "hard" Brexit. Rising protectionist pressures are also a risk for a highly open economy such as the Netherlands. These factors may particularly affect the Dutch economy given its openness and relatively large share of exports to the U.K. and the rest of the EU. Moreover, tighter global financial conditions and pressure on traditional bank models, including from new

"Basel III.5" requirements (see paragraph 27) may stress the financial position of leveraged firms and households and raise the risk of distress in major banks due to their heavy reliance on wholesale funding. On the upside, the domestic drivers of growth are likely to pick up, leading to improving labor market conditions, house prices and disposable income, supporting consumption and alleviating the burden of deleveraging, while confidence effects would support investment, thus bolstering productivity gains and potential growth.

Authorities' Views

8. The authorities broadly agreed that there were uncertainties associated with the Brexit negotiations and growth outlook in major trading partners. In response to risks to Dutch banks mentioned, mainly related to monetary policy normalization as well as revisions of the IRB-framework, in particular with respect to the application of output floors, authorities stressed that Dutch banks are resilient, and expect that they will be able to accommodate the revision of the internal model approach in the near future. They also mentioned that house price growth in big cities, particularly Amsterdam, deserves attention. They stressed that procyclical fiscal policies increase the risk of overheating and that fiscal consolidation over the medium term remains critical for fiscal sustainability. They also pointed out the upside risk that wage growth might respond to growth with delays and could turn out to be stronger than expected.

C. External Assessment

9. The current account surplus at above 10 percent of GDP is substantially higher than the level implied by fundamentals. It is expected to slightly diminish but remain high over the medium term (Figure 5). The current account surplus strengthened in 2017, supported by positive trade balance developments. The high CA surplus largely reflects the high corporate savings and liquidity of Netherlands-based multinationals, partly due to some favorable tax treatment for corporate income. As of December 2017, the CPI-based REER had appreciated by about 2.7 percent since end-2016. Staff assessed that the external position in 2017 was substantially stronger than the level consistent with medium-term fundamentals and desirable policy settings, with a current account gap of 4.8 to 8.8 percent of GDP (based on a CA norm of 1.5 to 5.5 percent of GDP) and a REER gap of -13 to -7 percent (see Annex II). In the short term, a more expansionary fiscal policy stance, as well as progress in repairing households' balance sheets and strengthening the banking system, should bolster domestic demand and lower the surplus. In the medium-to-long run, the surplus is expected to gradually diminish as the country turns a net importer of natural gas due to the phase-out of natural gas production and as baby boomers start drawing down their accumulated pension savings. However, the savings-investment balance would remain large and positive owing to strong profit generation and retained earnings by foreign and domestic multinationals (absent fundamental changes in the tax treatment of corporate income).

Authorities' Views

10. While acknowledging that the current account surplus is relatively large, the authorities stressed that the scope to reduce it through domestic policies is very limited.

A large part of the current account surplus is contributed by high net savings in the corporate sector, mostly by multinational corporations. The high corporate savings are not unique to the Netherlands, but the reasons behind that are still unclear. De Nederlandsche Bank is conducting research to seek further explanations. The authorities agreed that the continued deleveraging by banks, firms, and households also contributed to the rising current account surplus, which would be unwound gradually as the economic recovery continues. The authorities supported higher wage growth and labor market reforms, but they were not sure if these would reduce the current account surplus significantly.

POLICY DISCUSSIONS

Policies should take advantage of improved macroeconomic conditions to focus on measures aimed at lessening financial vulnerabilities in the private sector and unlocking potential growth. With expansionary fiscal policy, a stronger focus on growth-enhancing measures would help bolster potential growth. Tax and pension reforms, together with other structural reforms in the housing and labor markets, would help reduce financial vulnerabilities, improve market efficiency, and enhance productivity and potential growth.

A. Fiscal Policy

11. Past policies created substantial fiscal space, part of which is now being used (Figure 4). The spending increases and revenue cuts announced by the new government provide for a fiscal expansion of almost 2 percent of GDP over the next four years. Over this period, total government revenue is forecast to diminish by about 0.8 percent of GDP due to corporate and income tax cuts, partially offset by an increase in the reduced VAT rate. Total public spending would increase by 1 percent of GDP, notably in the areas of health care, security, defense, education, and climate change mitigation.[2] While these measures will result in a reduction of the structural balance by about 0.8 percent of GDP, they will not entirely exhaust the space relative to the medium-term budgetary objectives (MTOs) of a structural deficit of 0.5 percent of GDP for the general government based on staff estimates. However, the authorities' calculations using the European Commission methodology imply that they have little or no fiscal space once the fiscal expansion is implemented. Should fiscal space consistent with the Stability and Growth Pact (SGP) rules re-emerge, it should be used for further growth-enhancing expenditures or tax cuts aimed at increasing labor force participation. The authorities' plans imply a pro-cyclical fiscal stance in 2018 and, to a lesser extent, in 2019. However, since inflation and wage growth are still very subdued and many of the measures are expected to raise potential growth and help reduce external imbalances, pro-cyclicality is not a strong concern. In this respect, higher expenditure on education and public R&D would have a larger impact on potential output. Over the longer term, continued compliance with the SGP will provide buffers to face demographic pressures and support the financial sector as needed.

[2] See I. Parry and R. Chen (2018), "Options for carbon mitigation and transportation policy in the Netherlands" chapter in the Selected Issues Paper.

12. The ambitious tax reform agenda included in the coalition agreement is appropriately aimed at lowering the labor tax wedge, and reducing the debt bias. Personal income tax revenue is expected to fall by slightly less than 1 percent of GDP over 2018–21 through the introduction of two brackets (instead of four) with reduced marginal rates. In addition, the statutory normal and reduced rates of corporate income tax will be incrementally reduced from 25 to 21 percent and 20 to 16 percent, respectively, by 2021, as compensation for an expansion in the tax base achieved by reducing interest payment deductibility. The revenue impact of both sets of measures is partially offset by an increase in the reduced VAT rate from 6 to 9 percent. Such rebalancing from direct to indirect taxation should increase work incentives and raise potential output. Further progress in reducing the current debt bias in the tax system will be achieved through partially phasing out mortgage interest deductibility for households. The planned abolition of the dividend tax, however, will increase regressivity in capital income taxation.

13. The authorities have announced a reform plan for international corporate taxation (Annex VI). The reform aims at reducing the scope of the Netherlands being used as a 'conduit' for tax optimization schemes involving low-tax jurisdictions, while at the same time reinforcing the country's attractiveness for foreign direct investment from multinationals. Because of the complicated nature of these measures and their very recent announcement, it is too early to assess their effectiveness or their economic impact. We encourage the authorities to monitor the effects of the reforms and continue to participate in efforts to increase tax transparency and combat tax avoidance at the global and European levels.

14. The main fiscal risks over the medium and long term arise from public expenditure on health care. The Netherlands faces significant cost containment challenges due to a rapidly aging population, with public spending on health and long-term care standing at about 6 percent and 4 percent of GDP, respectively, representing the highest shares in the budget among OECD countries. The 2006–07 health care reform launched the transition from a heavy regulated system covering about two-third of the population to one of "regulated competition", whereby all residents are mandated to be covered by private insurers. Insurers are financed through a combination of flat rate premiums and income-related contributions, and are responsible for negotiating tariffs with health care providers. The new system appears to have fostered some greater price differentiation of health care packages offered by insurers. It has had mixed effects on overall costs so far, however, as it may have encouraged an increase in the

Characteristics of the population, health insurers and financial flows before and after the 2006–07 health care reform

	2005	2010	2015
Population covered (million)	10.1	16.5	16.8
Number of health insurers	21	28	25
Number of health policy choices	21	57	71
Average annual premium (euro)	378	1118	1168
Annual premiums/total costs (percent)	22	50	50
Number of switchers across insurers (percent)	4.2	4.3	7.3

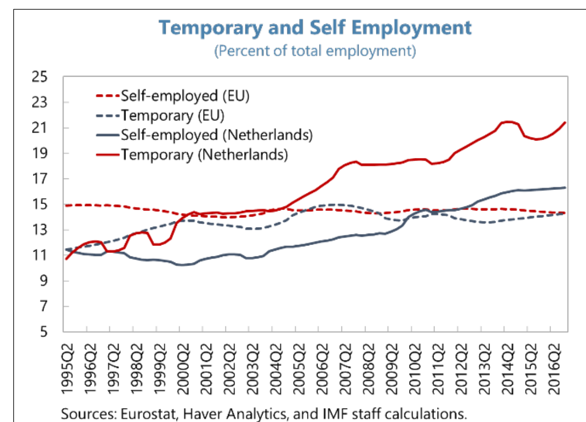
Sources: CPB (2017)

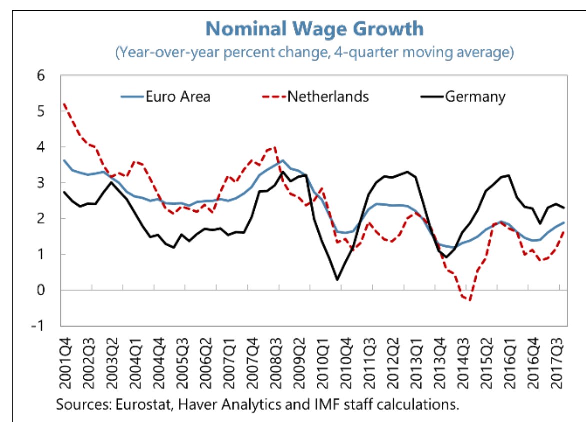
supplier-induced volume of hospital care as a compensation for nominal price reductions, further to curtailing excess demand through higher premiums and deductibles.[3]

Authorities' Views

15. The authorities disagreed with the assessment that there was any fiscal space after implementation of the fiscal policies laid out in the coalition agreement, insisting instead on the procyclicality of a fiscal expansion. They stressed that the current fiscal stance implied a 0.4 percentage point deficit gap based on their long-term sustainability analysis. They also pointed out that a structural fiscal surplus over the medium term would be more appropriate for the Netherlands given the high volatility of the economy and large contingent liabilities associated with a large financial system. The authorities agreed that fiscal policies should be employment friendly, but noted that this could be achieved through compositional changes. The authorities welcomed the analysis on health care reforms and stressed that the contemplated stakeholders' agreements will continue helping contain health care expenditure growth.

B. Wages and the Labor Market





16. Changes in the employment structure have contributed to wage moderation. Domestic macro-fundamentals can explain only part of the "wage puzzle" as real product wages have been under-shooting productivity gains for over a decade. Econometric analysis suggests that wage moderation in the Netherlands is associated with a rising share of temporary workers, who are willing to accept lower wages while continuing to look for more job security from open-ended contracts.[4] There is also an increasing trend of employees becoming self-employed, partly motivated by the prospect of avoiding high social security contributions.

17. Wage moderation may also reflect a wage bargaining process led by the exporting sectors, which puts emphasis on external competitiveness. Following the wage moderation observed in Germany in the early 2000s, nominal wage growth in the Netherlands declined rapidly to a level comparable to its competitors. Wage

[3] See M. Gerard (2018), "Health care reforms in the Netherlands: how effective is "regulated competition"?" chapter in the Selected Issues Paper.

[4] See Y. Zhang and D. Dimova (2018), "Wage Moderation in the Netherlands" chapter in the Selected Issues Paper.

growth continued to decline after the crisis, however, and is now lower than in partner countries, despite productivity growth comparable to Germany. Too much emphasis on external competitiveness may make wages in the Netherlands less responsive to domestic fundamentals, hindering efficient factor allocation and external rebalancing.

18. Policy proposals in the coalition agreement to reduce dualism and increase flexibility in the labor market are welcome provided that they reduce rather than increase the rigidity of labor market arrangements on net. However, more emphasis should be laid on increasing wages to better reflect domestic fundamentals. Higher wage growth, consistent with tighter labor market conditions, would also help rebalancing within the monetary union. Staff support proposals in the coalition agreement for measures to more closely align employment protection regulations in temporary and permanent contracts, facilitate employees' transition from temporary to open-ended positions, and curtail "false" self-employment (i.e., de facto employees reclassified as self-employed) while harmonizing arrangements for the genuinely self-employed with other employment arrangements in the direction of a more flexible arrangement on balance. These measures should allow the wage formation process to better reflect productivity and inflation expectations to the extent that they can be made more flexible on net and allow those in more flexible employment arrangements to organize and bargain effectively. However, moving forward on these proposals would require some agreement with the unions and employers. Staff supports the authorities' ongoing communication efforts, including by the central bank, to highlight the desirability of stronger wage growth at the present juncture.

Authorities' Views

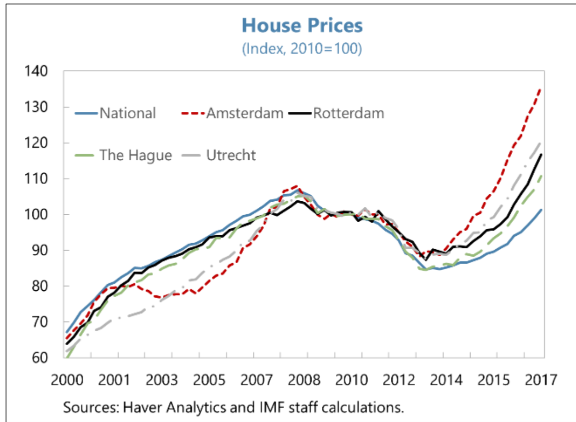
19. The authorities agreed that slow wage growth in recent years has been largely driven by remaining slack in the labor market, lower productivity growth and subdued inflation expectations. In the longer-term horizon, rising labor market flexibility (more temporary and self-employed workers) may have also contributed to slower wage growth; but they emphasized that such relationship is not necessarily causal. They also suggested that the proposed measures in the coalition agreement, which aim at reducing labor market duality, should make hiring workers on open-ended contracts more attractive. Furthermore, the authorities have encouraged social partners to support higher wage growth where appropriate.

C. Financial Sector Policies

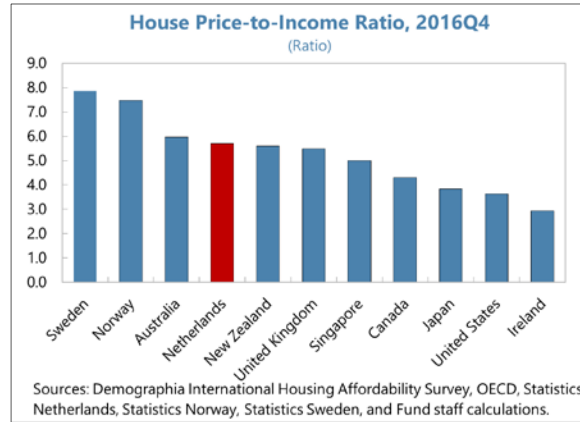
Housing Market and Macroprudential Issues

20. House prices growth increased in most parts of the country over the past years, with price levels surpassing pre-crisis highs in the main cities. House prices rose nation-wide at an average pace of about 7.5 percent y-o-y in the first ten months of 2017—up from 5 percent in 2016—and are particularly high in major cities (about 10 percent y-o-y in Amsterdam and Rotterdam in 2017:Q3). House price levels are now over 20 percent higher than their post-crisis lows in 2013, and transaction volumes have exceeded the pre-crisis highs. Staff's cross-country econometric, analysis suggests that the uptrend in real housing prices in the Netherlands is driven

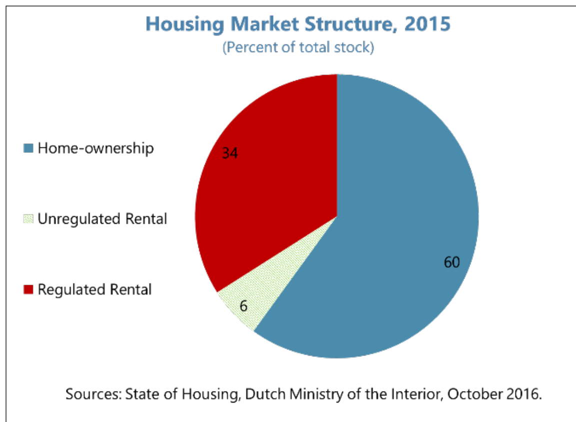
by growing incomes low interest rates, generous tax treatment for mortgages, stringent rent control, and low-price elasticity of housing supply. Overall, staff estimate that there is a modest overvaluation of about 5 percent as of end-2016.[5] The average cost of a home relative to the median household income is relatively high compared to peer countries, hindering affordability, especially in the major cities.



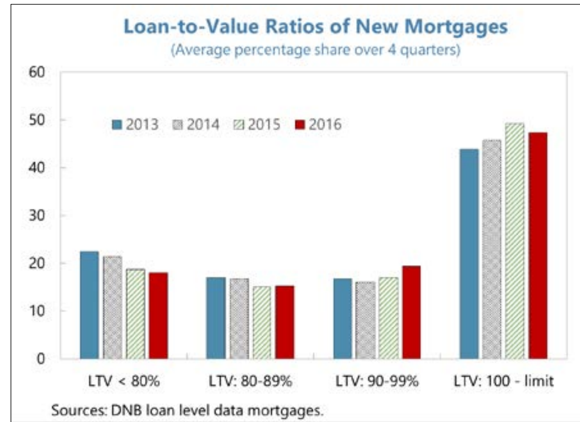
Sources: Haver Analytics and IMF staff calculations.



Sources: Demographia International Housing Affordability Survey, OECD, Statistics Netherlands, Statistics Norway, Statistics Sweden, and Fund staff calculations.



Sources: State of Housing, Dutch Ministry of the Interior, October 2016.



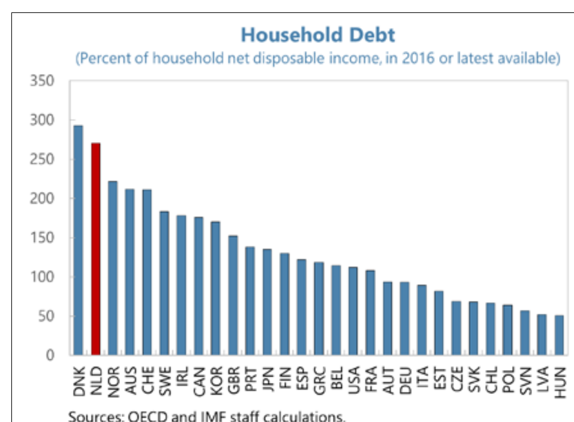
Sources: DNB loan level data mortgages.

21. The debt overhang in the household sector remains elevated, with a significant share of mortgages still underwater. Households have deleveraged gradually from record debt levels over the past years, partly owing to the reduced tax exemption for gifts used for down payments or mortgage repayments.[6] But they remain highly indebted in comparison to other countries, with their debt as a share of net disposable income standing at 270 percent at end-2016. Households have substantial net wealth in the aggregate, but their asset holdings are mostly illiquid in the form of pension entitlements and housing. Against the backdrop of rising house prices, the share of mortgages in negative equity, particularly prevalent among young borrowers, has gradually declined

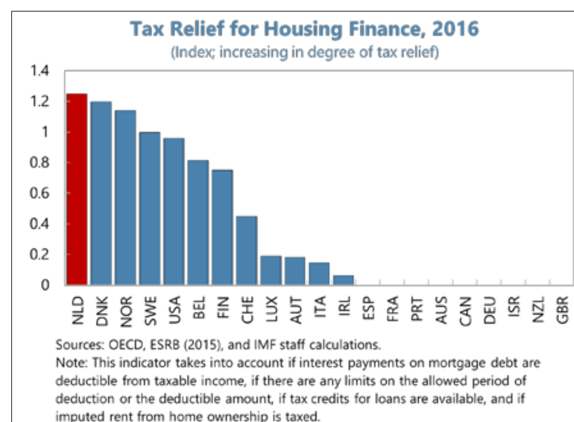
[5] See N. Geng (2018), "The Fundamental Drivers of House Prices in the Netherlands — A Cross-Country Analysis" chapter in the Selected Issues Paper.

[6] A gift tax exemption of up to EUR 100,000 was in effect until the end of 2014 and has been reintroduced effective from January 1, 2017.

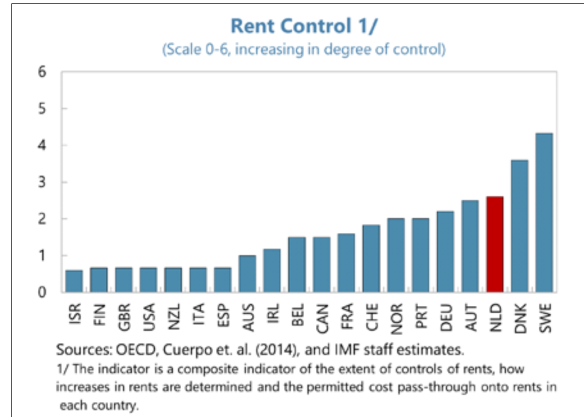
to 9 percent in 2017Q4. New mortgages with loan-to-value (LTV) ratios over 90 percent have decreased since mid-2016. While arrears have remained low on average, notably due to the full recourse on borrowers, a large correction in house prices—driven by weak growth, a reversal in sentiment, or interest rate hikes—could weaken household balance sheets and depress private demand in a procyclical way by forcing financially-constrained agents to reduce expenditure on items other than mortgage debt service, potentially weakening the overall economy. In the medium run, the large share of interest-only mortgages, which stood at 55 percent of total mortgages at end-2015, implies significant rollover risks by the time most of them mature in the early 2030s, underlining the importance of building up compensatory savings.[7]



22. Excessive debt largely reflects structural weaknesses in the Dutch housing market, which also undermines labor mobility and growth. Tax relief for housing financing in the Netherlands is the most generous in the OECD, and tends to favor higher-income earners and encourage excessive leverage, leading to higher house and land prices. It also provides municipalities and contractors with strong incentives to develop owner-occupied housing instead of private rental housing. Meanwhile, the second-to-most stringent rent control scheme in the OECD allows low-income earners to rent in the social housing market below the market-clearing level, creating "locked-in" effects and resulting in long waiting lists for social housing. Such large subsidies for renting in the regulated market and for homeownership have crowded out investment in the unregulated rental dwellings sector, which has been steadily contracting since the 1970s to less than 10 percent of all housing stock. The supply shortage of the unregulated rental housing, especially in large cities, limits the functioning of the housing market, hindering mobility to areas with greatest job availability. This particularly affects the part of the population that is not willing or able to enter the owner-occupied market and that has no access to the social housing market.



[7] Interest-only mortgages have no amortization until a bullet repayment upon maturity. New interest-only mortgages have been effectively phased out through the removal of interest deductibility, but there is a large remaining stock still outstanding.



23. Comprehensive housing market reforms are needed to reduce household indebtedness, rebalance housing demand and supply, and promote labor mobility. These could include:

- *implementing the phasing down of mortgage interest deductibility (MID)* by 3 percentage point per year as of 2020 as per the coalition agreement, to ultimately bring it to a neutral level relative to the taxation of other assets;

- *improving housing supply responsiveness in large cities,* by streamlining and relaxing stringent building aesthetics criteria, restrictive zoning plans, and cumbersome permitting processes. Addressing impediments to urban redevelopment and improving public transportation would help relieve demand pressures in major centers;

- *phasing out rent control.* Rents on regulated rental housing should be gradually raised to be aligned with market rates while vulnerable households could be protected through targeted housing allowances, which would promote mobility across housing types and locations;

- *temporarily allowing for a partial use of pension savings for housing purchases to ease liquidity constraints for first-time home buyers*, e.g. by meeting part of the down payment. This would reduce debt burdens while easing total savings needs of home purchasers; and

- *better means*-testing of social housing rents, and sale of some units into the private market with the proceeds used to build additional affordable social housing to increase the supply of both private rental and affordable housing.

24. Taking advantage of benign financial conditions and the favorable outlook, the authorities should accelerate the implementation of macro-prudential measures aimed at lessening household financial vulnerabilities. Building on recent initiatives, the authorities should consider gradually lowering the maximum limit on LTV ratios by at least 1 percentage point per year to no more than 90 percent by 2028 and to 80 percent thereafter. Since 2013, LTV limits have been incorporated into law and set to decline to 100 percent by 2018. In 2015, the Dutch Financial Stability Committee (FSC) recommended to further lower maximum LTV ratios to 90 percent between 2018 and 2028. Further to taking up this recommendation, the authorities should consider taking advantage of strong house price developments to accelerate the pace of reduction and adopt an ultimate target of 80 percent.

Authorities' Views

25. The authorities noted that the reduction of mortgage interest deductibility set out in the coalition agreement will go a long way toward reducing the bias for home ownership, thus containing household debt. The authorities noted that the coalition agreement does not address previous IMF recommendations and the FSC advice on further lowering loan-to-value limits beyond the 100 percent ratio achieved in 2018. The national authorities emphasized that further lowering the LTV-limit calls for better private rental opportunities to offer young households an affordable alternative for buying a house. They also underscored that debt-service-to-income ratios modulated by income categories operationalized since 2013 have helped in containing leverage. However, due to low interest rates the maximum obtainable mortgage loan for a typical fixed-rate mortgage of 10 years or longer is now often higher than in the pre-crisis period. Furthermore, the authorities note that the amortization requirement introduced in 2013 will reduce the debt bias and mortgage debt levels in the long run. The authorities concurred with staff that priority should be given to developing the non-regulated rental market. The authorities pointed out that the government started a platform in 2017 to identify and resolve bottlenecks in the further development of the non-regulated sector and that zoning regulations now enable municipalities to create a specific category for non-regulated rental houses. Moreover, the coalition has agreed on removing unnecessary barriers for social housing corporations to invest in middle range residential activities where commercial parties are unable or unwilling to do so.

Financial Sector Stability

26. While exhibiting relatively strong financial resilience, Dutch banks remain exposed to refinancing risk due to their heavy reliance on wholesale funding (Table 4). The Dutch banking sector appears adequately capitalized on a risk weighted basis, but leverage remains high. Furthermore, given their heavy reliance on wholesale funding, with an aggregate loan-to-deposit ratio of 136 percent at end-2017, banks remain vulnerable to an increase in their funding costs that could be prompted by tighter financial conditions. While net interest margins have proven resilient so far, bank profitability may come under pressure in the context of persistently low interest rates and intensified competition triggered by new non-bank entrants into the mortgage market, where about 30 percent of new mortgages were already issued by pension funds and insurers in 2016.

27. Dutch banks should continue building up capital buffers to prepare for new regulatory requirements on internal risk models. Given the significant share of highly leveraged mortgages in bank portfolios, own fund ratios in the banking sector will be impacted by the introduction of new risk-weight floors on mortgages combined with the revisions to the standardized approach under the Basel III.5 framework. Dutch banks had already started this process in anticipation of new regulations, and the process should continue. A continued buildup of capital buffers through cost reduction and earnings retention would generally be welcome, especially as this may turn challenging in the future if profitability declines. In parallel, a stronger focus of bank supervision should be directed toward banks' evolving business models and risk management frameworks, as the low interest rate environment and increased competition from shadow banking activities may encourage excessive risk taking in the financial sector.

28. The insurance sector merits continued close supervision as it has come under financial stress under the effects of low interest rates and heightened competition from new entrants. The insurance sector remains vulnerable to possible losses that rising interest rates could inflict on their investment portfolios. Moreover, the financial position of life insurers has been undermined by very low interest rates and an increasing duration mismatch in a context where average guaranteed rates remain high. A swift elaboration of preparatory crisis plans by insurers under the Recovery and Resolution of Insurers Act to come into force in 2018 would be welcome.

Authorities' Views

29. Both European and national authorities consider that the Basel III.5 agreement makes an important contribution to harmonizing the calculation of capital buffers, making capital ratios more comparable across banks. They indicated that banks have the capacity to comply, before the foreseen implementation date of 2022-27, with the required capital increase, owing to solid net interest margins. They shared staff's analysis that profitability might come under pressure along with interest rate normalization, however, calling for strengthening the banks' business models to improve their cost-to-income ratios. On the other hand, national authorities noted that higher interest rates would ease the financial position of insurers, the monitoring of which still requires continued vigilance.

Credit Developments

30. Credit to the corporate sector remains weak, reflecting both demand and supply factors. Total outstanding bank loans to non-financial corporates have dropped from about 59 percent of GDP in 2013 to less about 43 percent of GDP in 2017:Q3. While some moderate expansion of credit to service activities and manufacturing seems to have taken place, most economic sectors are still deleveraging. Accommodative monetary policies have substantially reduced lending rates, but interest rate margins on small loans remain much higher than euro area averages. Higher financing costs for small loans reflect both tightened lending standards (underlined in the latest ECB's Bank Lending Survey) and weaker financial conditions of firms, especially SMEs. Despite strong growth, households and corporates are still in the process of repairing their balance sheets, constraining credit demand.

31. Fostering credit growth would require policy support, particularly to strengthen the SME sector. Dutch SMEs are highly dependent on bank financing. Enhancing credit information would help reduce information asymmetries and credit scoring costs, thus improving supply. In addition, it could stimulate competition in the financial sector and help broaden the range of financing instruments available to SMEs over the medium term. Additional SME financing would also help shift towards more investment and boost potential growth.

Authorities' Views

32. While the financing conditions for the SMEs are improving, the authorities agreed that challenges remain. The authorities stressed that the interest rate differences between small and large loans raised concerns about the efficiency of the allocation of credit to small and large companies. While the reasons behind the rising spread are not fully understood, the authorities argued that the latter might partially reflect relatively weak competition between banks in the market for SME loans as compared with the market for loans to large companies. The authorities consider developing a credit bureau to enhance credit information and improve credit supply. The authorities agreed that additional SME financing would support domestic investment.

D. The Pension System

33. The financial situation of defined benefit second pillar pension funds remains fragile. By the end of 2016, about 90 percent of the pension funds had been forced to adopt recovery plans intended to bring back their solvency ratios above minimum regulatory coverage requirements. Yet these plans have recently been found to rely on excessively optimistic return assumptions which, combined with the possibility for premium contributions to not fully cover corresponding accrued benefits under the new supervisory framework, might end up triggering benefit curtailments that could affect up to 10 million members by 2020–21 (DNB, 2017). Furthermore, stress tests performed in 2017 by the EIOPA reveal that Dutch pension funds are more vulnerable to financial market shocks than European peers. More generally, in the absence of a sponsor to provide a financial backstop, the funds have been increasingly combining the disadvantages of defined benefit schemes (i.e., opaque and actuarially unfair redistribution mechanisms), with those of defined contribution schemes, as most of the investment risk is actually borne by participants.

34. 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 authorities are contemplating a new system whereby mandatory personal DC contracts would be complemented with provisions for pooling the micro longevity risk and some financial risks. Further to addressing solvency concerns, such a reform would allow for greater transparency and portability across types of employment contracts and better tailoring of investment strategies to individual needs. Crucially, it would also eliminate the pro-cyclical bias and ex ante redistribution mechanisms embedded in current schemes. The main challenges pertain to the design of payout options and the control of costs. This may argue for organizing some form of collective asset management by the social partners, which would enlarge the possibilities of risk sharing and potentially allow for substantial economies of scale. However, the government needs the agreement of unions and employers to move forward on most aspects of pension reform.

Authorities' Views

35. The authorities highlighted the merits of jointly abolishing the system of uniform contributions and accruals rates in existing plans and adopting a new pension contract. While

the design of a new pension contract is left to social partners based on guidelines laid out in the coalition agreement, the government has indicated its willingness to relax temporarily the tax deductibility framework on contributions to alleviate the effects on participants. In the authorities' views, crucial features of the future personal defined contribution schemes should include mandatory participation and could include the buildup of limited financial buffers (to allow for sharing macro longevity risks and some of the financial risks) that should, however, never be allowed to become negative (to prevent the risk of passing the bill to future generations).

STAFF APPRAISAL

36. The Dutch economy is in a positive phase. Growth is estimated at just above 3 percent in 2017 and is forecast to continue at about the same rate in 2018, supported by strong domestic demand and resilient exports. However, wage growth has been modest at around 1 percent in recent years although trending upwards, reflecting slow productivity growth, subdued inflation expectations, and remaining slack in the labor market. Inflation only picked up moderately, to 1.3 percent in 2017. Credit developments have remained contained due to continued deleveraging by banks, firms, and households. The output gap is estimated to have closed in 2017 and remain positive over the medium term as macroeconomic policies remain supportive and adverse demographics limit potential growth.

37. The external position is assessed substantially stronger than the level consistent with fundamentals and desirable policy settings. The high current account surplus reflects high domestic net savings, especially in the corporate sector, and the pick-up in global trade. The expansionary fiscal policy planned by the new government, progress in repairing household balance sheets, and the strengthening of the banking system could support domestic demand and contribute to reducing excess external imbalances. Higher wage growth, consistent with tighter labor market conditions, would help rebalancing within the monetary union. In addition, structural reforms aimed at raising the productivity of small domestic firms and encouraging domestic productive investment, as well as pension reforms to reduce precautionary savings, would also reduce the CA surplus.

38. The risks to the outlook are tilted to the downside. Foreign demand could be dampened by growth uncertainties in major trading partners and intensification of the risks of fragmentation/security dislocation. Rising protectionist pressures also pose a risk for a highly open economy such as the Netherlands. Monetary policy normalization may add pressures to already leveraged firms and households and increase the risk of distress in major banks. On the upside, improvements in labor and housing markets might support consumption and investment, and growth could turn out to be stronger than expected.

39. Policies adopted by the new Dutch government are appropriately aimed at reducing financial vulnerabilities in the private sector and unlocking potential growth. Under the envisaged expansionary fiscal policy, a strong focus on growth- enhancing measures would help bolster potential growth. Accelerating the phasing out of regulatory and tax distortions would help

repair household and firm balance sheets. Tax and pension reforms, together with other structural reforms in housing and labor markets, would help reduce financial vulnerabilities, improve market efficiency, enhance productivity and potential growth, and help external rebalancing.

40. Using the fiscal space for growth-enhancing measures is appropriate and helpful for external rebalancing. Past policies created substantial fiscal space, part of which is now being used for both tax cuts and expenditure increases. On the revenue side, lower corporate and personal income taxes will partly be compensated by raising the low VAT rate. Shifting further from direct to indirect taxation would increase work incentives and raise potential output. On the expenditure side, higher spending is allocated to security, defense, and education. To have a stronger impact on potential growth, devoting a larger share of any additional spending to education and public R&D would be desirable. Current fiscal plans would result in a pro-cyclical fiscal stance in 2018 and, to a less extent, in 2019. However, the inflation and wage growth are still subdued and most of the measures are expected to raise potential growth and help reduce external imbalances.

41. The authorities are encouraged to contribute to international efforts to improve the taxation of international activities of multinational corporations. The recently announced reform of corporate taxation appropriately aims at reducing the scope of the Netherlands being used as a conduit for tax optimization schemes involving low-tax jurisdictions. The authorities should monitor the effects of the reform, while continuing to actively participate in global and European initiatives to increase tax transparency and combat tax avoidance.

42. Policy actions should aim at reducing dualism in the labor market and supporting wage growth. The government's plan to relax stringent employment protection regulation on permanent contracts, facilitate transitions from temporary to more permanent contracts, and better regulate the registration of self-employed workers to reduce labor market dualism is welcome. Reducing the tax exemptions for self-employed people and requiring acquisition of some appropriate social insurance (e.g., disability insurance) should also help reduce labor market dualism. Stronger wage growth would be warranted given the cyclical position and would help rebalancing within the monetary union. To support higher wages, the social partners should work together to build consensus on making wages more responsive to domestic macroeconomic conditions, allowing the current wage formation process to better reflect productivity and inflation expectations. In this context, the authorities' open public communications to encourage higher wages, including in the coalition agreement, are welcome.

43. Rapid increases in house prices and highly indebted households reflect structural weakness in the Dutch housing market. Large subsidies for social housing and owner-occupied homes have crowded out investment in the unregulated rental sector. The supply shortage of private rental houses, especially in large cities, limits the functioning of the housing market, leading to higher housing prices and lower labor mobility. Comprehensive housing market reforms need to rebalance housing supply and demand, reduce household indebtedness, and promote labor mobility. The authorities' plan to accelerate the phasing down of mortgage interest deductibility (MID) by 3 percentage points instead of the 0.5 percentage point reduction per year thus far to ultimately limit deductibility to the lowest income tax rate is welcome. However, distortions to home

ownership due to tax incentives will remain large even after this is fully phased down. To further reduce household financial vulnerabilities, gradually lowering the maximum limit on loan-to-value (LTV) ratios from 100 percent remains critical. Staff acknowledges that actions to develop affordable houses in the private rental sector need to be taken in parallel.

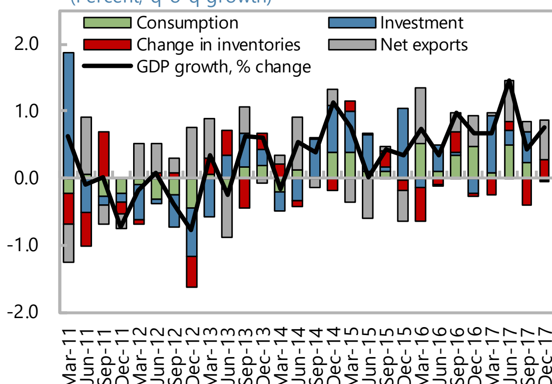
44. Dutch banks remain highly leveraged and exposed to refinancing risk due to their reliance on wholesale funding. Banks should continue to improve leverage ratios and build up capital buffers to adjust to new regulations on internal risk models, which result in higher capital requirements. In parallel, a stronger focus of bank supervision, both at the national level and by the Single Supervisory Mechanism (SSM), should be directed toward banks' evolving business models and risk management frameworks, as the low interest rate environment and increased competition from shadow banking activities may encourage excessive risk taking. The insurance sector has come under financial stress under the effects of low interest rates and heightened competition. In this respect, staff supports the swift elaboration of preparatory crisis plans by insurers, which will become mandatory this year, as well as and continuous efforts to streamline the insurers' business models.

45. Transition to a transparent, individualized, sustainable pension system is welcome and should be expedited. With protracted low interest rates and continued population aging, the defined benefit second pillar pension funds remain under financial stress and lead to intergeneration tensions. Staff supports the pension reform outlined in the government coalition agreement, whereby collective defined benefits schemes would be replaced by personal defined contributions contracts, complemented by provisions aimed at preserving appropriate risk pooling among participants and financial security at retirement.

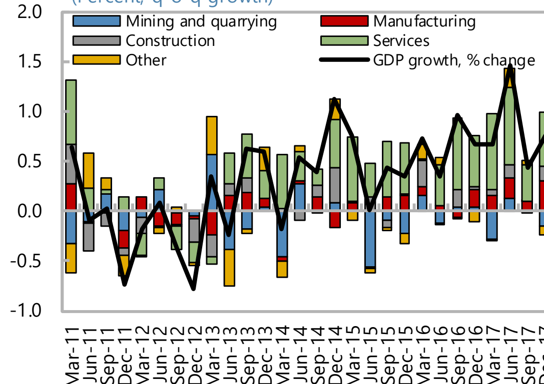
46. It is proposed that the next Article IV consultation take place on the standard 12-month cycle.

Figure 1. Netherlands: Real Growth

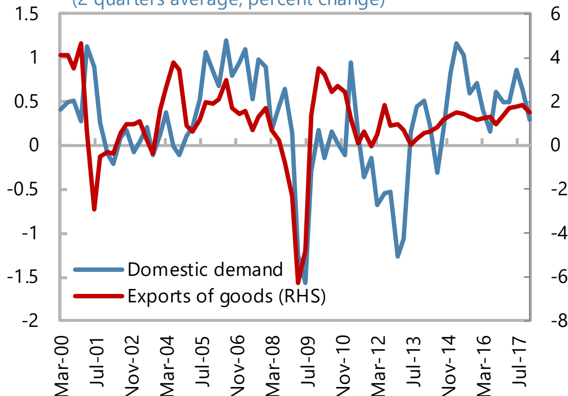
Growth has been strengthening, driven by consumption, investment, and net exports...



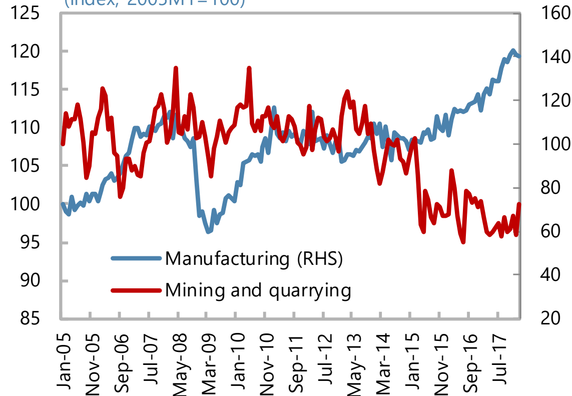
...also reflecting increasing activity in the services sector.



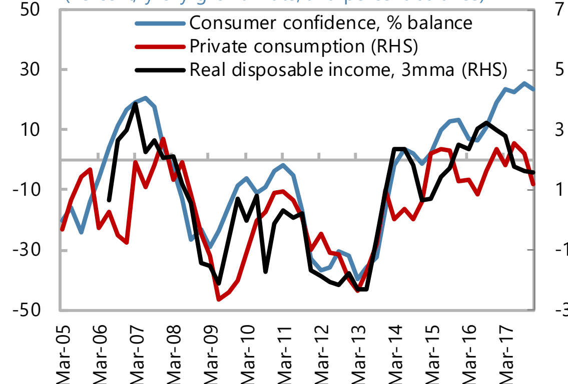
Foreign demand has gradually picked up ...



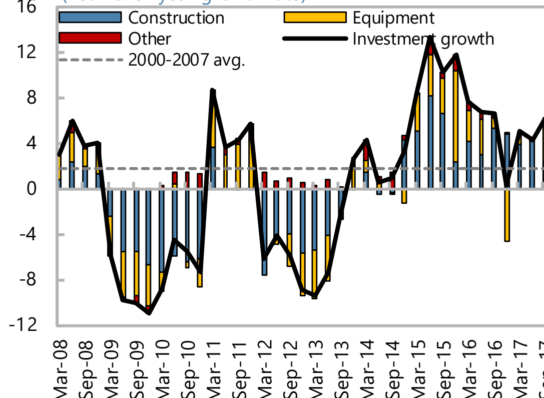
... bolstering production in the manufacturing sector.



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



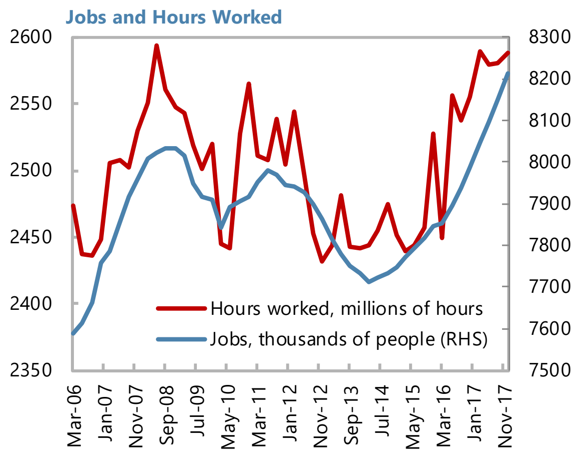
Investment growth has resumed in the equipment and construction sectors.



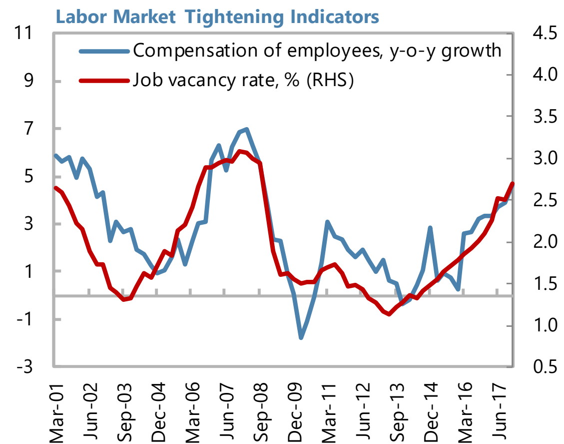
Sources: CBS, DNB, Haver Analytics, and IMF staff calculations.

Figure 2. Netherlands: Labor Market and Inflation

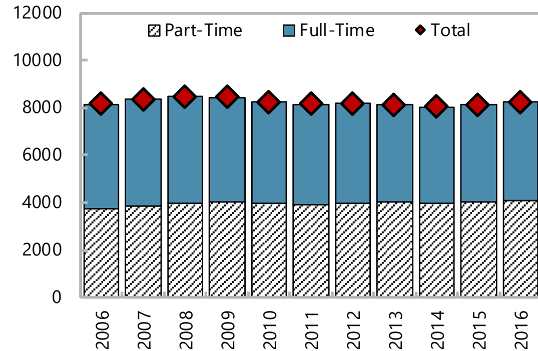
Employment growth has been strong...



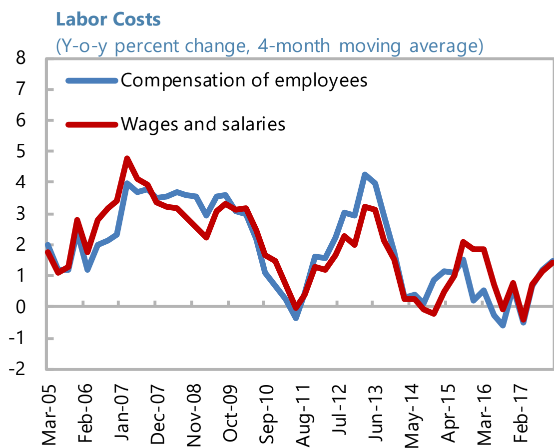
... alongside rising vacancy rates.



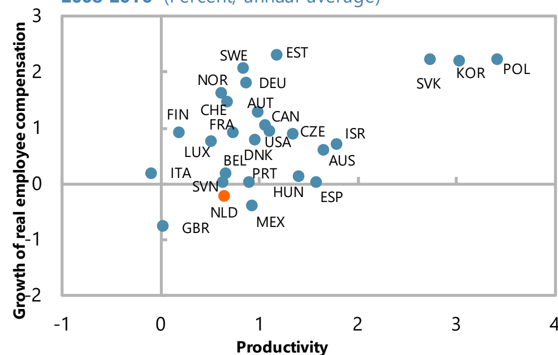
The increasing share of flexible contracts ...



... has long kept nominal labor costs in check.

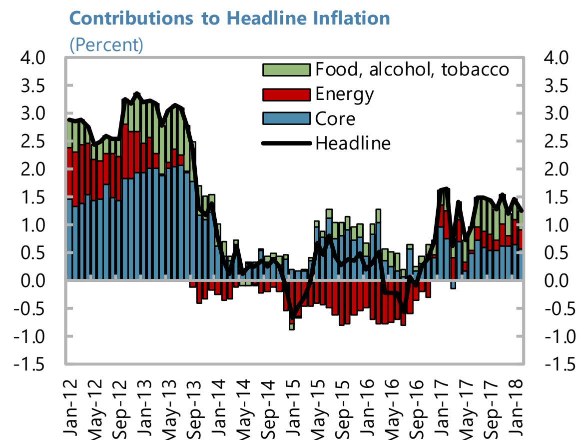


Productivity gains have outpaced real wage growth ...



Note: Productivity and employee compensation are measured per hour worked.

... contributing to muted inflation developments.

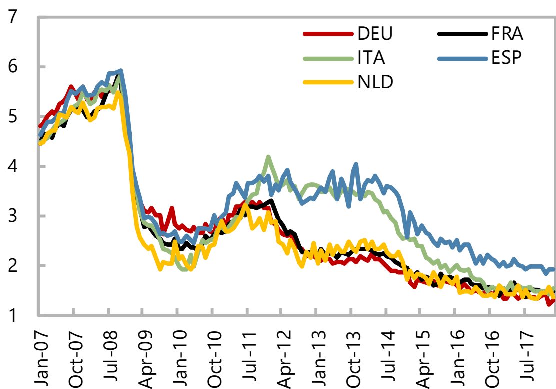


Sources: CBS, DNB, EC, Eurostat, Haver Analytics, OECD, and IMF staff calculations.

Figure 3. Netherlands: Credit and Housing Market Conditions

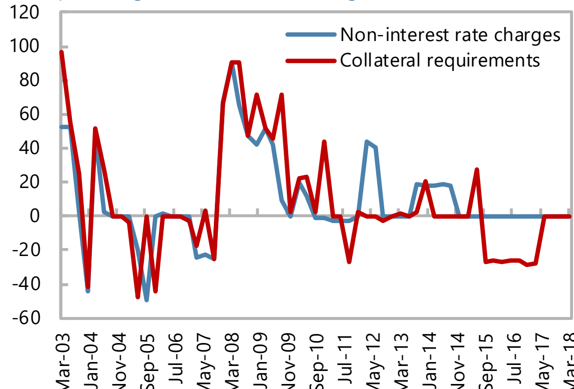
Average lending rates to firms have been trending downwards...

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



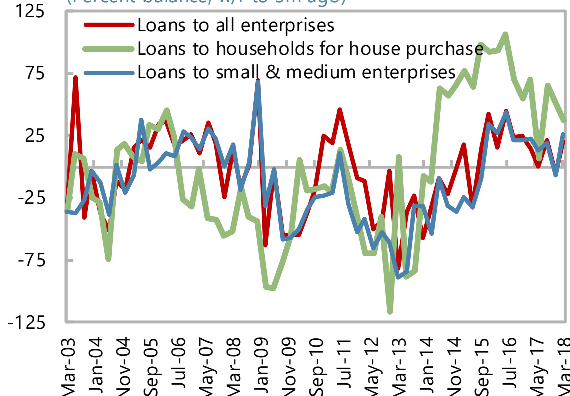
... accompanied by a gradual relaxation of collateral requirements.

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



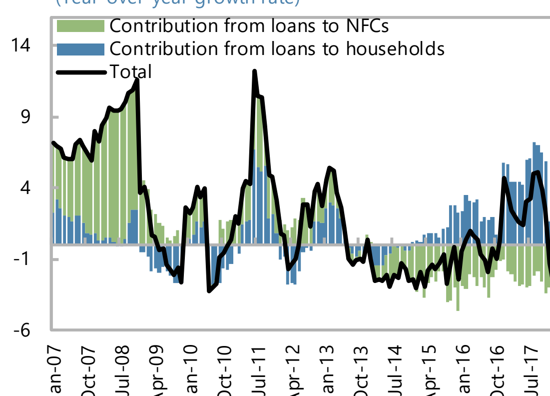
Yet credit recovery has mostly concerned households ...

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



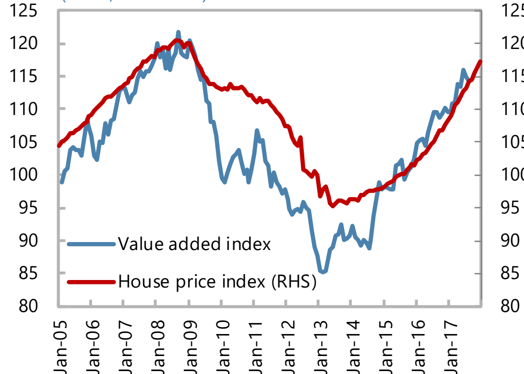
... while lending to the non-financial corporate sector is still contracting.

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



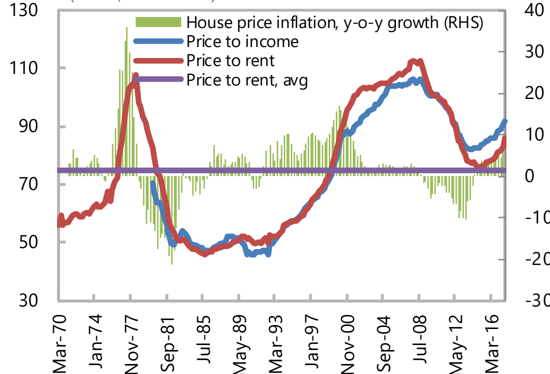
The housing market has recovered from the trough reached in 2013 ...

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



... and rising prices have started to depart from levels consistent with fundamentals.

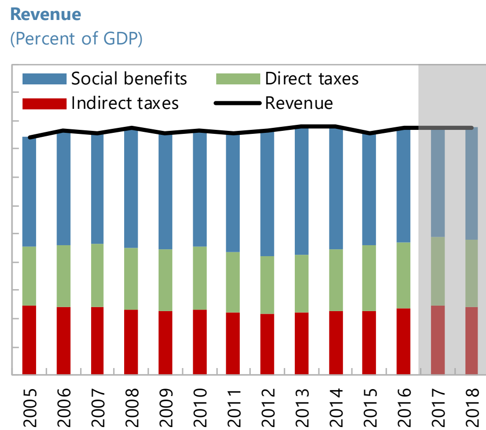
House Price Indices
(Index, 2010=100)



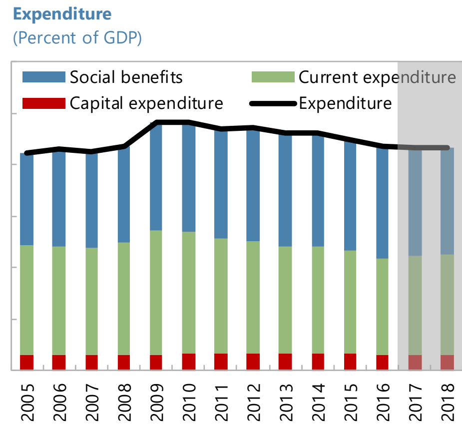
Sources: CBS, DNB, ECB, and IMF staff calculations.

Figure 4. Netherlands: Fiscal Developments

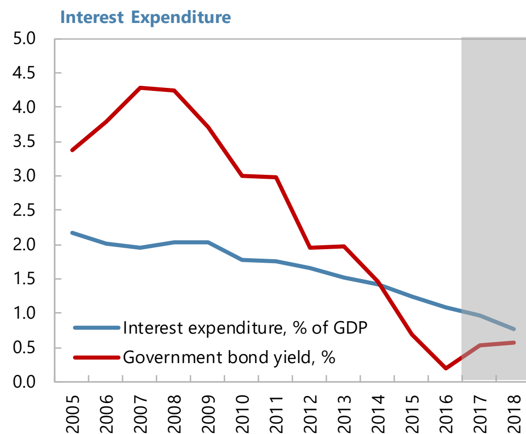
Revenue has been broadly flat as a proportion of GDP...



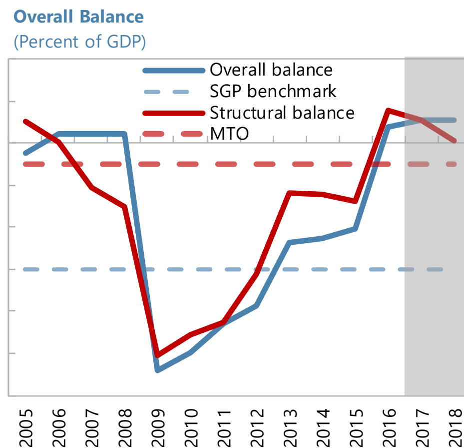
... with consolidation mostly falling on current expenditure.



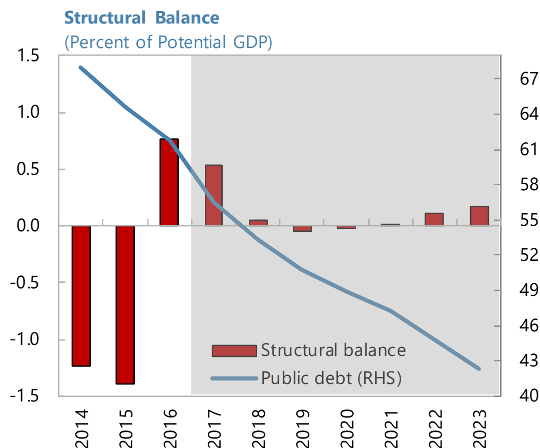
Interest expenditure has reached record low levels.



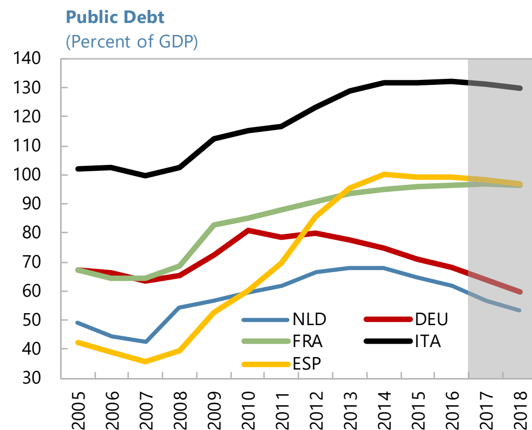
The structural balance has improved beyond levels prescribed by the MTO ...



...allowing for a rapid decrease in public debt ...



... which remains the lowest among peer countries.

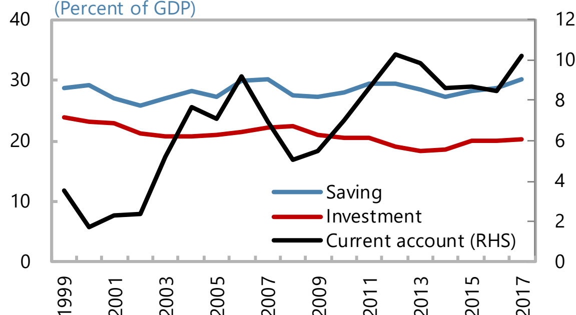


Sources: CBS, CPB, Eurostat, and IMF staff calculations.

Figure 5. Netherlands: Current Account Developments

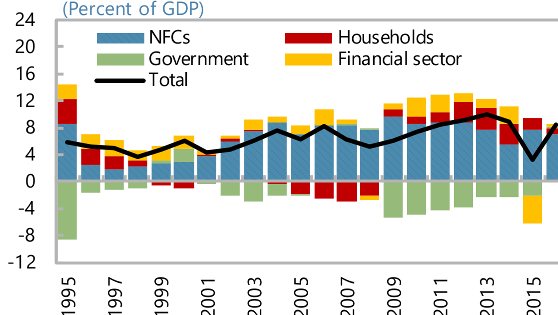
The current account surplus has been hovering at elevated levels for decades ...

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



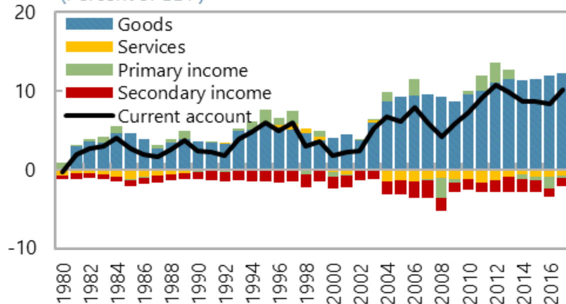
... with the savings-investment imbalance mostly accounted for by the non-financial corporate sector.

Net Lending and Borrowing by Sector
(Percent of GDP)



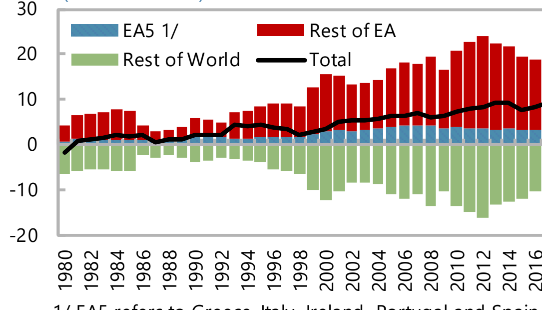
As a counterpart, the trade balance has been steadily strengthening...

Current Account
(Percent of GDP)



... owing to increasing commercial integration within the euro area.

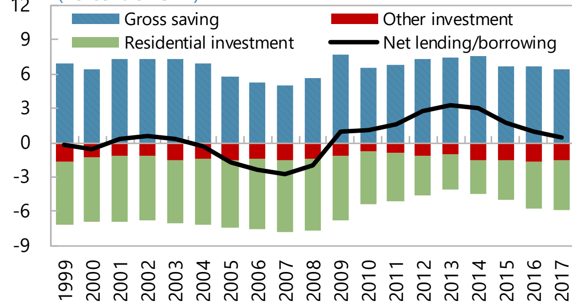
Trade Balance by Region
(Percent of GDP)



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

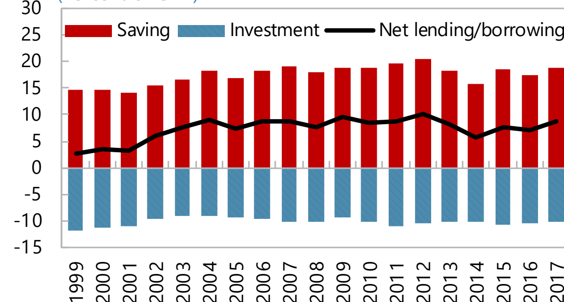
Households tend to be net savers, with large pension assets accumulated abroad.

Household: Saving and Investment
(Percent of GDP)



The non-financial corporate surplus essentially results from important excess savings.

NFC: Saving and Investment
(Percent of GDP)



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

Table 1. Netherlands: Medium-Term Macroeconomic Framework, 2015–23

(Growth rates, in percent, unless otherwise indicated)

	2015	2016	2017	2018 Proj.	2019 Proj.	2020 Proj.	2021 Proj.	2022 Proj.	2023 Proj.
National accounts									
Real GDP	2.3	2.2	3.2	3.1	2.4	2.1	2.0	1.9	1.9
Domestic demand	3.4	1.8	2.3	3.1	2.7	2.3	2.0	1.9	1.9
Private consumption	2.0	1.6	1.9	1.9	1.9	1.8	1.7	1.7	1.7
Public Consumption	-0.2	1.2	1.2	3.1	3.0	2.0	1.8	1.8	1.8
Gross fixed investment (total)	11.0	5.3	5.6	5.3	4.0	3.5	2.9	2.5	2.5
Public	5.5	-0.3	4.0	7.2	1.0	0.0	0.0	0.0	0.0
Private	12.3	6.5	5.9	4.7	4.6	4.1	3.4	3.0	2.9
Residential	20.8	19.1	12.7	4.0	4.0	3.3	3.3	3.0	2.8
Business	9.6	2.2	3.3	5.3	4.9	4.5	3.5	3.0	3.0
Stocks (contribution to GDP growth)	0.1	-0.4	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
Exports goods and services	6.5	4.3	6.1	6.0	4.6	4.0	3.2	3.0	3.0
Imports goods and services	8.4	4.1	5.4	6.7	5.3	4.5	3.4	3.2	3.2
Domestic demand (contribution to GDP growth	3.0	1.6	2.1	2.7	2.4	2.0	1.8	1.7	1.7
External demand (contribution to GDP growth)	-0.6	0.6	1.2	0.2	0.0	0.1	0.2	0.2	0.2
Output gap	-1.4	-0.9	0.0	1.2	1.7	1.9	2.0	2.0	2.0
Potential output growth	1.5	1.7	2.2	1.9	1.9	1.9	1.9	1.9	1.9
Gross investment (percent of GDP)	19.9	20.1	20.2	20.9	21.3	21.7	22.1	22.3	22.6
Gross national saving (percent of GDP) 1/	28.6	28.5	30.2	30.6	30.4	30.5	30.5	30.5	30.5
Prices and employment									
Consumer price index (year average)	0.2	0.1	1.3	1.7	2.2	2.3	2.4	2.4	2.4
GDP deflator	0.8	0.6	1.1	1.2	1.6	1.2	1.4	1.4	1.4
Employment	1.0	1.3	2.1	0.8	0.6	0.6	0.6	0.6	0.6
Unemployment rate (percent) 2/	8.6	7.3	...	...	...	...	...	...	...
Unemployment rate (percent) 3/	6.9	6.0	4.9	4.7	4.6	4.5	4.4	4.3	4.2
External									
Current account balance (percent of GDP)	8.7	8.4	10.2	9.9	9.2	9.0	8.6	8.3	8.0
Public sector accounts (percent of GDP)									
Revenue	42.8	43.8	43.8	43.8	43.8	43.8	43.8	43.8	43.8
Expenditure	44.9	43.4	43.2	43.2	43.1	43.0	42.9	42.8	42.7
General government balance	-2.0	0.4	0.5	0.5	0.7	0.8	0.9	1.0	1.0
Structural balance (percent of potential GDP)	-1.4	0.8	0.5	0.0	0.0	0.0	0.0	0.1	0.2
General government debt	64.6	61.8	56.5	53.3	50.7	48.9	47.3	44.8	42.3

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, 2015–23

(Percent of GDP)

	2015	2016	2017	2018 Proj.	2019 Proj.	2020 Proj.	2021 Proj.	2022 Proj.	2023 Proj.
Revenue	42.8	43.8	43.8	43.8	43.8	43.8	43.8	43.8	43.8
Taxes	22.9	23.6	24.4	23.9	23.9	23.9	23.9	23.9	23.9
Taxes on production and imports	11.2	11.6	11.7	11.8	11.8	11.8	11.8	11.8	11.8
Current taxes on income, wealth, etc.	11.5	11.7	12.5	11.9	11.9	11.9	11.9	11.9	11.9
Capital taxes	0.2	0.3	0.2	0.3	0.3	0.3	0.3	0.3	0.3
Social contributions	14.1	14.8	14.2	14.8	14.8	14.8	14.8	14.8	14.8
Grants	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other revenue	5.8	5.3	5.1	5.0	5.0	5.0	5.0	5.0	5.0
Expenditure	44.9	43.4	43.2	43.2	43.1	43.0	42.9	42.8	42.7
Expense	44.8	43.5	42.7	42.4	42.4	42.4	42.4	42.4	42.4
Compensation of employees	8.7	8.7	8.6	8.6	8.6	8.6	8.6	8.6	8.6
Use of goods and services	6.1	5.8	5.8	5.9	5.9	5.9	5.9	5.9	5.9
Consumption of fixed capital	3.3	3.2	3.1	3.0	3.0	3.0	3.0	3.0	3.0
Interest	1.2	1.1	1.0	0.8	0.8	0.8	0.8	0.8	0.8
Subsidies	1.1	1.2	1.2	1.3	1.3	1.3	1.3	1.3	1.3
Grants	1.5	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Social benefits	21.7	21.6	21.0	20.7	20.7	20.7	20.7	20.7	20.7
Other expense	1.2	1.0	1.1	1.2	1.2	1.2	1.2	1.2	1.2
Net acquisition of nonfinancial assets	0.0	0.0	0.5	0.8	0.6	0.5	0.4	0.3	0.3
Net operating balance	-2.0	0.3	1.0	1.3	1.3	1.3	1.3	1.3	1.3
Net lending/borrowing	-2.0	0.4	0.5	0.5	0.7	0.8	0.9	1.0	1.0
Net acquisition of financial assets	-2.6	...	...	...	...	...	...	...	...
Currency and deposits	-0.1	...	...	...	...	...	...	...	...
Securities other than shares	-0.1	...	...	...	...	...	...	...	...
Loans	-0.6	...	...	...	...	...	...	...	...
Shares and other equity	-0.7	...	...	...	...	...	...	...	...
Insurance technical reserves	0.0	...	...	...	...	...	...	...	...
Financial derivatives	-0.8	...	...	...	...	...	...	...	...
Other accounts receivable	-0.3	...	...	...	...	...	...	...	...
Net incurrence of liabilities	-0.6	...	...	...	...	...	...	...	...
Special Drawing Rights (SDRs)	0.0	...	...	...	...	...	...	...	...
Currency and deposits	0.1	...	...	...	...	...	...	...	...
Securities other than shares	-1.3	...	...	...	...	...	...	...	...
Loans	-0.1	...	...	...	...	...	...	...	...
Shares and other equity	0.0	...	...	...	...	...	...	...	...
Insurance technical reserves	0.0	...	...	...	...	...	...	...	...
Financial derivatives	0.0	...	...	...	...	...	...	...	...
Other accounts payable	0.6	...	...	...	...	...	...	...	...
Memorandum items									
Primary balance	-0.8	1.4	1.5	1.3	1.5	1.6	1.7	1.8	1.8
Structural balance (percent of potential GDP)	-1.4	0.8	0.5	0.0	0.0	0.0	0.0	0.1	0.2
Structural primary balance (percent of potential GDP)	0.1	2.1	1.3	0.4	0.3	0.2	0.2	0.3	0.3
Gross Debt	64.6	61.8	56.5	53.3	50.7	48.9	47.3	44.8	42.3
Output gap	-1.4	-0.9	0.0	1.2	1.7	1.9	2.0	2.0	2.0
Nominal GDP (billions of euros)	683.5	702.6	733.2	765.4	796.1	822.1	850.0	878.0	907.1
Nominal GDP growth (percent)	3.1	2.8	4.3	4.4	4.0	3.3	3.4	3.3	3.3
Real GDP growth (percent)	2.3	2.2	3.2	3.1	2.4	2.1	2.0	1.9	1.9
GDP deflator growth (percent)	0.8	0.6	1.1	1.2	1.6	1.2	1.4	1.4	1.4

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

Table 2b. Netherlands: General Government Statement of Operations, 2015–23
(Billions of euros)

	2015	2016	2017	2018 Proj.	2019 Proj.	2020 Proj.	2021 Proj.	2022 Proj.	2023 Proj.
Revenue	292.7	307.8	320.9	334.9	348.4	359.8	372.0	384.2	397.0
Taxes	156.3	165.6	178.6	183.0	190.3	196.5	203.2	209.9	216.8
Taxes on production and imports	76.4	81.8	85.7	90.0	93.7	96.7	100.0	103.3	106.7
Current taxes on income, wealth, etc.	78.3	82.0	91.3	90.8	94.5	97.6	100.9	104.2	107.6
Capital taxes	1.6	1.8	1.7	2.1	2.2	2.2	2.3	2.4	2.5
Social contributions	96.4	104.3	104.1	113.1	117.7	121.5	125.6	129.8	134.1
Grants	0.7	0.6	0.7	0.7	0.7	0.7	0.8	0.8	0.8
Other revenue	39.3	37.3	37.5	38.2	39.7	41.0	42.4	43.8	45.2
Expenditure	306.7	305.2	316.9	330.8	343.0	353.3	364.4	375.6	387.6
Expense	306.5	305.4	313.2	324.8	337.9	348.9	360.7	372.6	385.0
Compensation of employees	59.7	61.0	62.9	66.1	68.8	71.0	73.4	75.8	78.3
Use of goods and services	42.0	40.9	42.4	44.9	46.7	48.3	49.9	51.6	53.3
Consumption of fixed capital	22.2	22.5	22.8	23.3	24.2	25.0	25.9	26.7	27.6
Interest	8.5	7.6	7.0	6.0	6.2	6.4	6.6	6.8	7.1
Subsidies	7.8	8.4	9.1	9.6	10.0	10.3	10.7	11.0	11.4
Grants	10.1	6.4	6.6	6.9	7.2	7.4	7.7	7.9	8.2
Social benefits	148.1	151.4	154.1	158.8	165.2	170.6	176.4	182.2	188.2
Other expense	8.1	7.3	8.3	9.2	9.6	9.9	10.2	10.6	10.9
Net acquisition of nonfinancial assets	0.3	-0.2	3.7	5.9	5.1	4.4	3.7	2.9	2.7
Net operating balance	-13.7	2.4	7.6	10.1	10.5	10.9	11.2	11.6	12.0
Net lending/borrowing	-14.0	2.6	4.0	4.2	5.4	6.4	7.6	8.7	9.3
Net acquisition of financial assets	-18.0	...	...	...	...	...	...	...	...
Currency and deposits	-0.6	...	...	...	...	...	...	...	...
Securities other than shares	-1.0	...	...	...	...	...	...	...	...
Loans	-3.9	...	...	...	...	...	...	...	...
Shares and other equity	-4.5	...	...	...	...	...	...	...	...
Insurance technical reserves	0.0	...	...	...	...	...	...	...	...
Financial derivatives	-5.8	...	...	...	...	...	...	...	...
Other accounts receivable	-2.2	...	...	...	...	...	...	...	...
Net incurrence of liabilities	-4.4	...	...	...	...	...	...	...	...
Special Drawing Rights (SDRs)	0.0	...	...	...	...	...	...	...	...
Currency and deposits	0.9	...	...	...	...	...	...	...	...
Securities other than shares	-9.2	...	...	...	...	...	...	...	...
Loans	-0.4	...	...	...	...	...	...	...	...
Shares and other equity	0.0	...	...	...	...	...	...	...	...
Insurance technical reserves	0.0	...	...	...	...	...	...	...	...
Financial derivatives	0.0	...	...	...	...	...	...	...	...
Other accounts payable	4.4	...	...	...	...	...	...	...	...
Memorandum items									
Primary balance	-5.5	10.2	11.0	10.2	11.6	12.9	14.2	15.5	16.4
Gross Debt	441.4	434.2	414.3	408.0	403.8	401.8	402.0	393.3	384.0
Nominal GDP (Euro bill.)	683.5	702.6	733.2	765.4	796.1	822.1	850.0	878.0	907.1

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

Table 2c. Netherlands: General Government Integrated Balance Sheet, 2010–16

(Percent of GDP)

	2010	2011	2012	2013	2014	2015	2016
Net Worth	27.9	23.6	22.1	22.0	17.6	16.7	
Nonfinancial assets	60.2	60.7	61.8	62.0	61.4	59.1	
Net Financial Worth	-32.3	-37.2	-39.7	-40.1	-43.8	-42.4	-40.6
Financial assets	35.6	34.8	38.0	36.5	37.4	35.1	34.7
Currency and deposits	2.3	2.2	2.3	1.8	1.6	1.4	1.5
Securities other than shares	3.7	3.5	3.1	2.2	1.5	1.3	1.1
Loans	7.7	7.7	9.0	10.4	10.2	9.2	8.3
Shares and other equity	13.7	12.7	14.5	13.8	13.4	13.9	14.2
Insurance technical reserves	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial derivatives	0.3	1.4	2.0	1.5	3.6	2.6	2.2
Other accounts receivable	7.9	7.3	7.1	6.9	7.1	6.5	7.4
Liabilities	68.0	71.9	77.7	76.6	81.2	77.5	75.3
Special Drawing Rights (SDRs)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits	0.2	0.3	0.2	0.2	0.2	0.3	0.6
Securities other than shares	50.4	54.1	58.5	57.9	62.8	59.0	57.5
Loans	12.5	13.2	14.7	14.3	13.9	13.4	12.7
Shares and other equity	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Insurance technical reserves	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial derivatives	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other accounts payable	4.9	4.4	4.2	4.2	4.3	4.8	4.6

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

Table 3. Netherlands: External Sector, 2015–23

(Percent of GDP, unless otherwise indicated)

	2015	2016	2017	2018 Proj.	2019 Proj.	2020 Proj.	2021 Proj.	2022 Proj.	2023 Proj.
Balance on Current Account	8.7	8.4	10.2	9.9	9.2	9.0	8.6	8.3	8.0
Trade Balance	11.5	11.9	12.3	12.2	11.9	11.6	11.4	11.2	10.9
Exports of goods	64.4	63.7	67.1	69.0	70.2	71.5	72.1	72.6	73.2
Imports of goods	52.9	51.8	54.8	56.8	58.3	59.8	60.7	61.5	62.3
Service Balance	-0.9	-0.9	-0.7	-0.9	-1.1	-1.2	-1.3	-1.4	-1.5
Exports of services	19.0	18.7	19.2	19.8	20.2	20.6	20.9	21.1	21.4
Imports of services	19.9	19.6	19.9	20.7	21.3	21.9	22.2	22.5	22.9
Factor Income	-0.4	-1.5	-0.3	-0.4	-0.5	-0.3	-0.4	-0.4	-0.4
Current transfers, net	-1.5	-1.1	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0
Balance on capital account	-5.0	-0.2	0.5	0.0	0.0	0.0	0.0	0.0	0.0
Balance on financial account	4.9	8.2	7.1	9.9	9.2	9.0	8.6	8.3	8.0
Direct investment, net	11.8	12.8	-2.6	6.2	5.3	6.1	5.0	3.7	4.7
Direct investment abroad	31.2	36.7	35.5	31.6	27.6	29.7	29.0	27.6	26.3
FDI in Netherlands	19.4	23.9	38.0	25.4	22.3	23.6	24.0	23.9	21.6
Portfolio investment, net	-7.8	-3.7	8.2	0.8	1.5	1.6	0.9	0.9	0.4
Financial derivatives	2.5	-2.5	-2.2	-0.4	-0.5	-0.7	-0.6	-0.5	-0.5
Other investment	-1.6	2.0	3.8	3.1	2.9	1.9	3.2	4.1	3.4
Reserve assets	-0.1	-0.4	-0.2	0.1	0.1	0.1	0.1	0.1	0.1
Errors and omissions, net	1.2	0.0	-3.7	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, 2010-2017

(Percent)

	2010	2011	2012	2013	2014	2015	2016	2017
Regulatory Capital to Risk-Weighted Assets	13.9	13.5	14.2	14.9	17.9	20.1	22.4	22
Regulatory Tier 1 Capital to Risk-Weighted Assets	11.8	11.8	12.2	12.5	15.0	16.2	17.7	18.4
Non-performing Loans Net of Provisions to Capital	47.3	44.2	46.7	50.4	40.0	35.3	32.6	28.8
Non-performing Loans to Total Gross Loans	2.8	2.7	3.1	3.2	3.0	2.7	2.5	2.3
Sectoral Distribution of Total Loans: Residents	67.5	70.7	72.4	70.2	66.1	64.4	64.2	65.7
Sectoral Distribution of Total Loans: Deposit-takers	1.4	1.2	0.9	1.2	0.8	0.8	0.7	0.6
Sectoral Distribution of Total Loans: Central bank	3.0	8.5	8.7	4.1	2.4	5.8	9.0	8.7
Sectoral Distribution of Total Loans: Other financial corporations	12.2	12.3	13.1	13.0	13.0	12.4	8.1	7.4
Sectoral Distribution of Total Loans: General government	3.3	3.1	3.4	3.6	3.3	3.2	3.0	2.9
Sectoral Distribution of Total Loans: Nonfinancial corporations	20.6	19.9	20.1	20.6	20.2	16.9	16.8	16.8
Sectoral Distribution of Total Loans: Other domestic sectors	27.1	25.7	26.1	27.7	26.3	25.3	26.6	29.2
Sectoral Distribution of Total Loans: Nonresidents	32.5	29.3	27.6	29.8	33.9	35.6	35.7	34.3
Return on Assets	0.4	0.4	0.3	0.3	0.3	0.6	0.6	0.7
Return on Equity	8.9	9.6	7.4	6.2	6.6	10.8	10.1	12.8
Interest Margin to Gross Income	71.1	73.0	75.1	82.8	77.7	73.5	64.8	73.5
Non-interest Expenses to Gross Income	80.7	86.6	101.6	108.5	84.4	77.9	78.8	71.7
Liquid Assets to Total Assets (Liquid Asset Ratio)	24.5	24.8	24.3	23.6	21.1	22.8	21.8	
Liquid Assets to Short Term Liabilities	176.2	175.8	179.5	180.3	162.5	169.7	167.0	
Net Open Position in Foreign Exchange to Capital								

Source: DNB.

Annex I. Risk Assessment Matrix[1]

Source of Risks	Relative Likelihood	Impact	Policy response
Weaker-than-expected global growth			
Structurally weak growth in key advanced economies: Low productivity growth (U.S., the Euro Area, and Japan), a failure to fully address crisis legacies and undertake structural reforms, and persistently low inflation undermine medium-term growth in the Euro Area. As a small highly open economy, the Netherlands is sensitive to sluggish growth in the region	H	M	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.
Significant U.S. slowdown and its spillovers: As the current recovery ages and vulnerabilities build up, the risks of a sharper-than-expected slowdown increase. The proximate causes could be a fiscal contraction associated with the eventual planned withdrawal of the tax stimulus or market fears of overheating. A sharp adjustment necessitated by relatively limited fiscal policy space would create global spillovers.	M	M	
Policy and geopolitical uncertainties			
Policy uncertainty. Two-sided risks to U.S. growth with uncertainties about the positive short-term impact of the tax bill on growth and the extent of potential medium-term adjustment to offset its fiscal costs; uncertainty associated with negotiating post-Brexit arrangements and NAFTA and associated market fragmentation risks; and evolving political processes, including elections in several large economies, weigh overall on global growth. As a small highly open economy, the Netherlands is sensitive to sluggish growth in the region.	M	M	Maintain broad political dialogue and focus on social and demographic policies that diminish socioeconomic fragmentation, improve employment opportunities to reduce labor market duality and encourage migrant integration. Consider a discretionary fiscal expansion to the

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline. The RAM reflects staff views on the source of the risks and overall level of concern as of the time of the discussion with the authorities.

Source of Risks	Relative Likelihood	Impact	Policy response
Intensification of the risks of fragmentation/ security dislocation. Intensification of conflicts in the Middle East and Africa could lead to sharp rises in migrant flows into Europe. The lack of a common cooperative policy to deal with asylum seekers and other migrants to the EU could deepen political divisions. Limited integration of asylum seekers into the labor force could raise unemployment rates, put pressure on national budgets, and put social cohesion at risk.	H	M	extent allowed by the fiscal rules if Eu growth is impacted by a potential Brexit fallout.
Risks to the financial sector			
Tighter global financial conditions. Against the backdrop of continued monetary policy normalization and increasingly stretched valuations across asset classes, an abrupt change in global risk appetite (e.g., due to higher-than-expected inflation in the U.S) could lead to sudden, sharp increases in interest rates and associated tightening of financial conditions. Higher debt service and refinancing risks could stress leveraged firms, households, and vulnerable sovereigns, including through capital account pressures in some cases.	H	M	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.
Further pressure on traditional bank business models: Legacy problems, and potential competition from non-banks curtail banks' profitability globally. Loss of confidence if such profitability challenges are not addressed could increase the risk of distress at one or more major banks with possible knock-on effects on the broader financial sector and for sovereign yields in vulnerable economies. Migration of activities outside of the traditional banking sector, including provision of financial services by fintech intermediaries, raises competitive pressures on traditional banks, making risk monitoring and mitigation more difficult.	M	M	Strengthening the macroprudential framework as well as bank and insurance supervision could provide considerable precautionary dividends. Special attention should be paid to major financial institutions where maintaining O-SII buffers could prevent an eventual distress from contaminating the rest of the financial system and ensure ample liquidity provision.

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) increased to 74 percent of GDP at the end of 2017 (with gross assets and liabilities totaling 1251 and 1177 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 reached 956 billion euro (130 percent of GDP) at the end of 2017. Over the medium term, the NIIP is expected to continue growing to about 100 percent of GDP, in line with projected sizeable 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 2017 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 expansionary fiscal policy planned by the new government, progress in repairing household balance sheets, and the strengthening of the banking system could support domestic demand and contribute to reducing excess external imbalances. Higher wage growth, consistent with tighter labor market conditions, would help rebalancing within the monetary union. In addition, structural reforms aimed at raising the productivity of small domestic firms and encouraging domestic productive investment, as well as pension reforms to reduce precautionary savings, would also reduce the CA surplus.</td></tr>
<tr><td>Current account</td><td>Background. The CA surplus increased to 10.2 percent of GDP in 2017 (10.3 percent cyclically adjusted), contributed by continued strong net exports. The CA has been in surplus since 1981—a reflection of a positive goods and services balance—and until 2000 was mainly driven by household savings. Since 2001 however, non-financial corporate net savings have progressively taken over as the main driver of the surpluses, with large and global corporate savings financing substantial FDI outflows. Households savings have nonetheless also risen since mid-2008 as a result of deleveraging following the sharp declines in housing prices and increases in mandatory contributions to the second-pillar pension funds. Netherland's status as a trade and financial center and natural gas exporter likely plays a role to account for the strong structural position.
Assessment. The EBA CA model estimates a CA norm of 3.5 percent of GDP and a CA gap of 6.8 percent of GDP in 2017. [1/] As the CA surplus essentially reflects the high corporate savings and liquidity of Netherlands-based multinationals, partly due to some favorable tax treatment for corporate income, as well as more recent but possibly long-lasting increases in household saving rates, the assessment of the EBA estimated current account gap is particularly uncertain. Taking these factors into account, staff assesses the norm in a range of 1.5–5.5 percent of GDP and a corresponding CA gap of 4.8–8.8 percent of GDP. In the short term, a more expansionary fiscal stance will put some downward pressure on the surplus, while over the medium to long term further declines in the surplus will be supported by progress in private sector deleveraging, declining gas exports, and demographic trends, including divestment by pension funds.</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 2 percent through March 2018, relative to the 2017 average.
Assessment. The EBA REER models indicate a range of overvaluation of 9.8 percent (index model) to slight undervaluation of 2.2 percent (level model) in 2017, largely attributable to unexplained residuals. 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 2017 (unexplained residual plus the contribution of identified policy gaps) widened by 3.2 percent of GDP, reflecting increasing unidentified residuals. The larger gap reflects a higher cyclically adjusted CA surplus (from 8.9 to 10.3 percent of GDP) and a lower CA norm (from 5.3 to 3.5 percent of GDP).
2/The larger external balance sheet, presence of large international corporations, and issues related to the measurement of the current account add uncertainty to this assessment. According to the DNB, half of the positions in assets and liabilities are attributable to subsidiaries of foreign multinationals.</td></tr>
</table>

Annex III. Progress Against IMF Recommendations

IMF 2016 Article IV Recommendations	Authorities' Response
Fiscal Policy	
Compliant with the SGP rules, the authorities could use existing fiscal space to boost potential growth. These could include temporary increases in education or public R&D expenditures and reductions to the labor tax wedge.	The fiscal policy planned by the new government will use most of the fiscal space created in the past. Public spending would increase in the areas of health care, security, defense and education.
Tax reforms should aim to enhance fairness, improve efficiency, and boost potential growth. These include shifting the tax burden from labor towards consumption and property and minimizing the debt bias.	The coalition agreement embraces a tax reform agenda aiming at lowering the labor tax wedge, supporting the business environment, and reducing the debt bias. A reduction of personal income tax will be implemented through the introduction of two brackets instead of four with reduced marginal rates. The statutory normal and reduced rates of corporate income tax will be incrementally reduced from 25 to 21 percent and 20 to 16 percent, respectively, by 2021, as a compensation of an expansion of the tax base notably achieved through increased limits placed on interest rate deductibility. The financial impact of both sets of measures is to be partially offset by an increase in the reduced VAT rate from 6 to 9 percent.
Financial Sector Policy	
The implementation of macro-prudential and other measures to reduce household financial vulnerabilities should be accelerated. The authorities should continue to gradually lower the maximum limit on loan-to-value ratios by at least 1 percentage point per year to no more than 90 percent by 2028 and to 80 percent thereafter. The private rental market needs to be deregulated and placed on a more even footing with owner-occupied homes and social housing.	The authorities plan to markedly accelerate the phasing down of mortgage interest deductibility (MID), by 3 percentage point instead of 1 percent per year in our past recommendations. However, the authorities do not plan to further reduce the maximum limit on LTV ratios and would keep the maximum ratio of 100 percent as of 2018. The authorities plan to improve housing supply responsiveness in large cities and gradually phase out rent controls.
Structural Reform	
Pensions: The reform of the second pillar pension system should focus on enhancing transparency and portability, while preserving financial security at retirement.	The authorities plan to reform the pension system, aiming at replacing the collective defined-benefits schemes with individualized defined-contributions contracts, complemented by provisions aimed at preserving some risk pooling among participants and financial security at retirement.
Labor market: To address labor market rigidities and segmentation of the labor force, the authorities should liberalize the regulatory regime for standard employment contract and harmonize its application across different employment statuses. The authorities should also implement reforms to boost labor productivity.	The new government plans to relax stringent employment protection regulation on permanent contracts, facilitate employees' transition from temporary to more permanent contracts, and better regulate the registration of self-employed workers.

Annex IV. FSAP Key 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 set up a working group together that has set action plans to ensure an industry-wide approach to informing IO mortgagors about their estimated repayment shortfalls.
Continue to build capital buffers to ensure all banks remain above minimum leverage ratio thresholds in the case of severe adverse events.	NT	The coalition agreement of the new government mentions 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 FSC-members acknowledge that vesting the FSC in primary law could enhance its position. The Minister of Finance is supportive to the request of DNB to create a legal basis for the FSC in primary law and is currently consulting with the FSC members, also taking into account possible legal obstacles. It is also being examined whether and to what extent a "comply-or-explain" mechanism will improve the functioning of the FSC. A decision on this topic is anticipated in the FSC's May meeting.
Accelerate the phase-out of MID and reduce the final tax rate to a neutral level.	NT	The coalition agreement states that mortgage interest deductibility is phased out with an annual percentage of 3 percentage points until the base tax level of 36.93% has been reached.
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 coalition agreement states the maximum limit on LTV ratio will not be reduced further after reaches 100 percent in 2018. Moreover, 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		
Enhance the DNB and AFM powers to introduce technical regulations (consistent with the SSM) and to conduct examinations using outside expertise.	NT	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.

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 underwriting standards are being relaxed. As such a cross-sectoral review of underwriting standards is currently not deemed necessary.
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. 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. In the intermediate, DNB is stimulating the usage of article 104 CRD to the extent possible. Regarding internal model validation: No actions are currently foreseen 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).
Harmonize the relevant laws on the quality of advice and suitability of products and provide authority for group supervision in the pension law.	NT	In its coalition agreement the new government puts forward the context within which the Social-Economic Council will develop the details of a new structure for the pension system.

Recommendations	Time[1]	Status
Securities Supervision and Regulation		
Broaden the supervisory authority of the AFM with regard to loan-based crowd-funding platforms.	NT	AFM requested the Ministry of Finance to introduce general provisions regarding loan-based crowd-funding be added to the Act on Financial Services. 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	AFM acknowledges the intended purpose of the recommendations. However, the prompt public disclose of auditor changes or resignations is already sufficiently covered by existing rules and regulations.
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. In addition, a broader involvement of management is achieved through the department head of the FMI Oversight Department attending the quarterly supervisory meetings with EuroCCP.
EuroCCP to strengthen its review of its stress testing and margin models methodology and develop a comprehensive recovery plan.	I	Regarding the stress testing methodology: EuroCCP is currently enhancing 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. Regarding the margin model methodology: EuroCCP has provided documentation on the changes that has been made to address this recommendation. Regarding the recovery plan: Ahead of the EU legislation on CCP recovery and resolution, EuroCCP has already developed a recovery plan based on the CPMI-IOSCO guidelines. In Q1 2018 EuroCCP will provide its action plan to set up a comprehensive recovery plan in anticipation of the enactment of European legislation.
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: On a domestic level, DNB has focused on updating its own internal crisis management manual and bringing it in line with the SRB crisis management manual. Regarding legacy legal frameworks: - Complementarity of the national- and SRM framework: The premise of the recommendation that there is legal uncertainty is not valid. - Transparency of the legal framework: The ministry of Finance is considering a legislative recast of the Act on Financial Supervision. More clarity on the process of this project is expected early 2018.
Allow the deposit guarantee scheme to finance deposit transfers in resolution and insolvency.	NT	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.

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

Annex V. Public Debt Sustainability Analysis

The Netherlands have moderate public debt and low financing needs. Public debt is expected to remain sustainable, decreasing at a faster rate than previously anticipated from 57 percent of GDP in 2017 to 42 percent of GDP by 2023, owing to favorable growth developments. The largest risks to the baseline scenario are represented by a negative growth shock and a contingent liability shock, which could push up the debt-to-GDP ratio to 55 percent and 72 percent by 2020, respectively.

The baseline scenario assumes a steady fiscal adjustment, albeit not in structural terms. It is underpinned by the following assumptions:

- *Real GDP growth* is forecast to stabilize around 2 percent over the projection period, driven by dynamic non-residential investment and strengthening private consumption supported by improving housing prices, while external demand would remain subdued. This is slightly higher than the medium-term growth potential.

- *Inflation* is projected to nominally increase to around 1.6 in 2019 and then stabilize at 1.4 percent over the medium run reflecting stronger domestic demand

- *Public debt* would decline toward 42 percent of GDP by the end of the projection period owing to strong revenue collection and contained expenditure, but remain above 50 percent until end-2019.

Realism of Baseline Assumptions

1. The baseline projections are underpinned by realistic assumptions. Over 2007–15, staff projections of the main macroeconomic and fiscal variables in the Netherlands have constantly remained close to the median within the 25–75 interquartile range vis-à-vis other surveillance countries, except for inflation in 2008. On average, real growth and primary balance forecasts appear to have been relatively conservative, while inflation forecasts have been slightly optimistic.

2. Under the baseline scenario, public debt would rapidly decrease from 57 percent of GDP in 2017 to about 43 percent by the end of the projection period, under the joint effects of steady nominal growth and the pursuit of expenditure-based fiscal consolidation. Public debt would increase up to 59 percent of GDP in the historical scenario, due to conservative growth and primary balance assumptions. It would steadily decrease over the medium term in all other scenarios.

3. Under the baseline scenario, the primary balance would continue to decrease, reducing debt over time. The contribution of the interest rate-growth differential will become more favorable, reflecting steady growth and very low effective interest rates, especially from 2018 onwards. The gross financing needs-to-GDP ratio is forecast to decline to less than zero percent of GDP by the end of the projection period.

Baseline Scenario and Stress Tests:

4. The debt and financing needs projections are particularly sensitive to combined macro-fiscal, growth, and contingent liabilities shocks:

- **Growth shock.** Assuming a negative one standard deviation shock on the real growth rates in 2017–18, lowering them by about 2 ¼ percentage points compared to the baseline scenario, associated with inflation rates lower by 0.4 percentage points, public debt would increase to 55 percent of GDP in 2020 before gradually decreasing to 48 percent by 2023. Gross financing needs would peak at 3.1 percent of GDP in 2020 and remain at that level until the end of the projection period.

- **Primary balance shock.** A deterioration of the primary balance by 1 percentage point in 2017 and 0.8 percentage point in 2018 would lead to decreasing debt-to-GDP ratios to around 44 percent until the end of the projection period, with gross financing needs decreasing to 1.7 percent of GDP by 2023 after peaking at 1.9 in 2020.

- **Contingent liability shock.** A non-interest expenditure shock arising from the need to bail out 10 percent of the banking sector, accompanied with lower growth rates by one standard deviation, lower inflation, and higher interest rates, would push up gross financing needs to 20 percent of GDP in 2020 and public debt to 72 percent of GDP in 2020. Public debt would decrease somewhat to 65 percent of GDP by 2023 but gross financial needs would remain high through the end of the projection period.

5. **The fan charts show low uncertainty around the baseline.** The width of the symmetric fan chart, estimated at around 25 percent of GDP, illustrates the degree of uncertainty for equal probability upside and downside shocks. But given strong demand, upside shocks to growth and primary balance are unconstrained in the asymmetric fan chart, resulting in a downward sloping debt path.

6. **On average, the balance of risks is skewed to the upside with low debt weaknesses.** While external financing needs are well below warning benchmarks, there is a sizeable share of foreign liabilities that is above the upper warning threshold and constitutes a potential risk. However, overall debt levels are below the lower-risk assessment early warning benchmarks.

7. **The Netherlands's debt profile reveals some weaknesses.** While external financing needs are well below the lower risk-assessment early warning benchmark, the public debt held by nonresidents is above the upper benchmark. Spreads and the change in short-term debt are below the lower-risk assessment early warning benchmarks.

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

(in percent of GDP unless otherwise indicated)

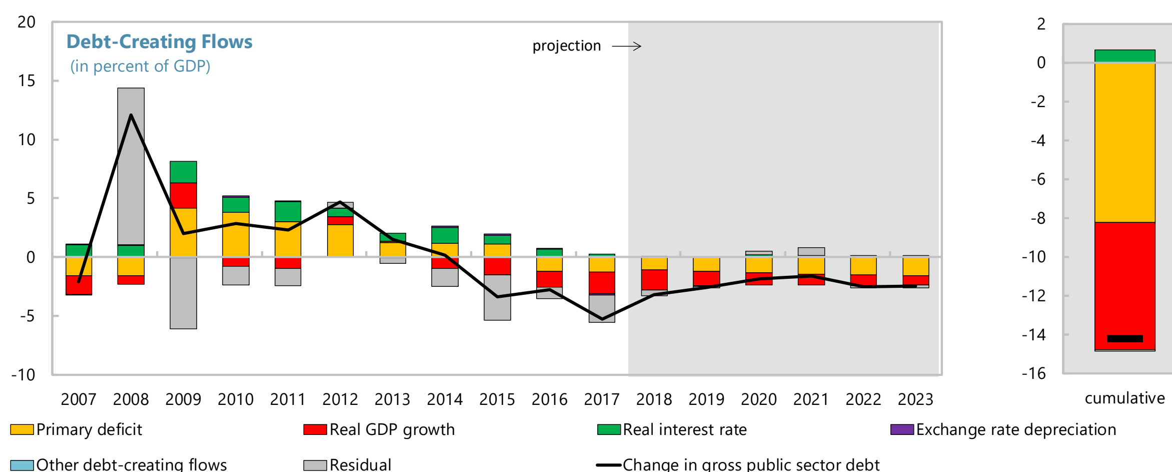
Debt, Economic and Market Indicators [1]

	Actual			Projections					
	2007-2015 [2]	2016	2017	2018	2019	2020	2021	2022	2023
Nominal gross public debt	60.1	61.8	56.5	53.3	50.7	48.9	47.3	44.8	42.3
Public gross financing needs	2.8	-0.4	-0.5	-0.5	-0.7	-0.8	-0.9	-1.0	-1.0
Public debt (in percent of potential GDP)	59.7	61.2	56.5	53.9	51.6	49.8	48.3	45.7	43.2
Real GDP growth (in percent)	0.8	2.2	3.2	3.1	2.4	2.1	2.0	1.9	1.9
Inflation (GDP deflator, in percent)	1.1	0.6	1.1	1.2	1.6	1.2	1.4	1.4	1.4
Nominal GDP growth (in percent)	1.9	2.8	4.3	4.4	4.0	3.3	3.4	3.3	3.3
Effective interest rate (in percent) [4]	3.2	1.7	1.6	1.4	1.5	1.6	1.6	1.7	1.8

As of May 03, 2018		
Sovereign Spreads		
EMBIG (bp) 3/		7
5Y CDS (bp)		26
Ratings	Foreign	Local
Moody's	Aaa	Aaa
S&Ps	AA+	AA+
Fitch	AAA	AAA

Contribution to Changes in Public Debt

	Actual			Projections							
	2007-2015	2016	2017	2018	2019	2020	2021	2022	2023	cumulative	debt-stabilizing primary balance [9]
Change in gross public sector debt	2.2	-2.8	-5.3	-3.2	-2.6	-1.9	-1.6	-2.5	-2.5	-14.2	
Identified debt-creating flows	2.4	-1.8	-3.0	-2.7	-2.5	-2.2	-2.3	-2.3	-2.2	-14.1	
Primary deficit	1.6	-1.2	-1.3	-1.1	-1.2	-1.3	-1.4	-1.5	-1.6	-8.2	-0.7
Primary (noninterest) revenue and grants	42.7	43.6	43.5	43.5	43.5	43.5	43.5	43.5	43.5	261.2	
Primary (noninterest) expenditure	44.3	42.4	42.3	42.4	42.3	42.2	42.1	42.0	42.0	253.0	
Automatic debt dynamics [5]	0.8	-0.7	-1.7	-1.6	-1.3	-0.8	-0.8	-0.7	-0.7	-5.9	
Interest rate/growth differential [6]	0.8	-0.7	-1.6	-1.6	-1.3	-0.8	-0.8	-0.7	-0.7	-5.9	
Of which: real interest rate	1.1	0.7	0.3	0.1	-0.1	0.2	0.1	0.1	0.2	0.6	
Of which: real GDP growth	-0.4	-1.4	-1.9	-1.7	-1.2	-1.0	-0.9	-0.9	-0.8	-6.6	
Exchange rate depreciation [7]	0.0	0.0	-0.1	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (1) (e.g., drawdown of deposits)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (2) (e.g., ESM and Euroarea loans)	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	-0.9	-2.3	-0.5	-0.1	0.3	0.7	-0.2	-0.2	-0.1	



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.

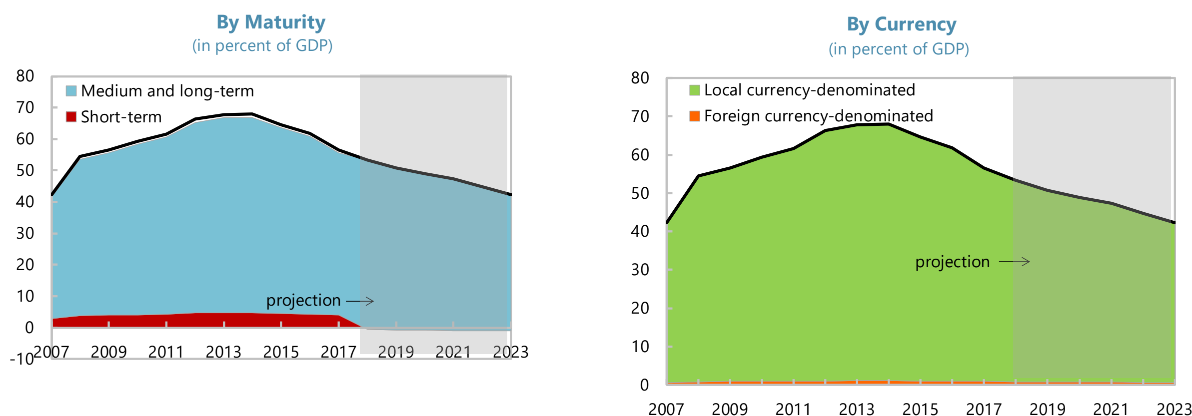
7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

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

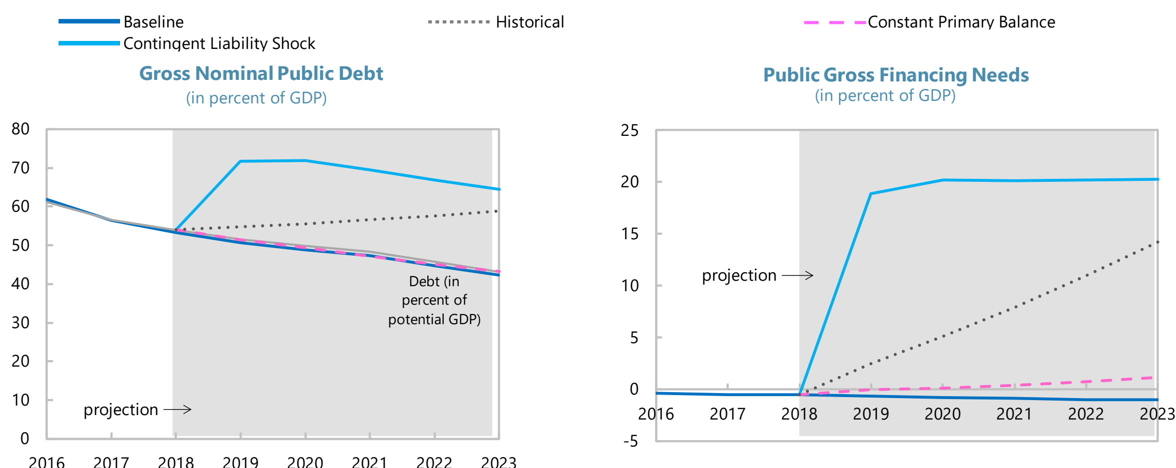
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

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

Composition of Public Debt



Alternative Scenarios



Underlying Assumptions

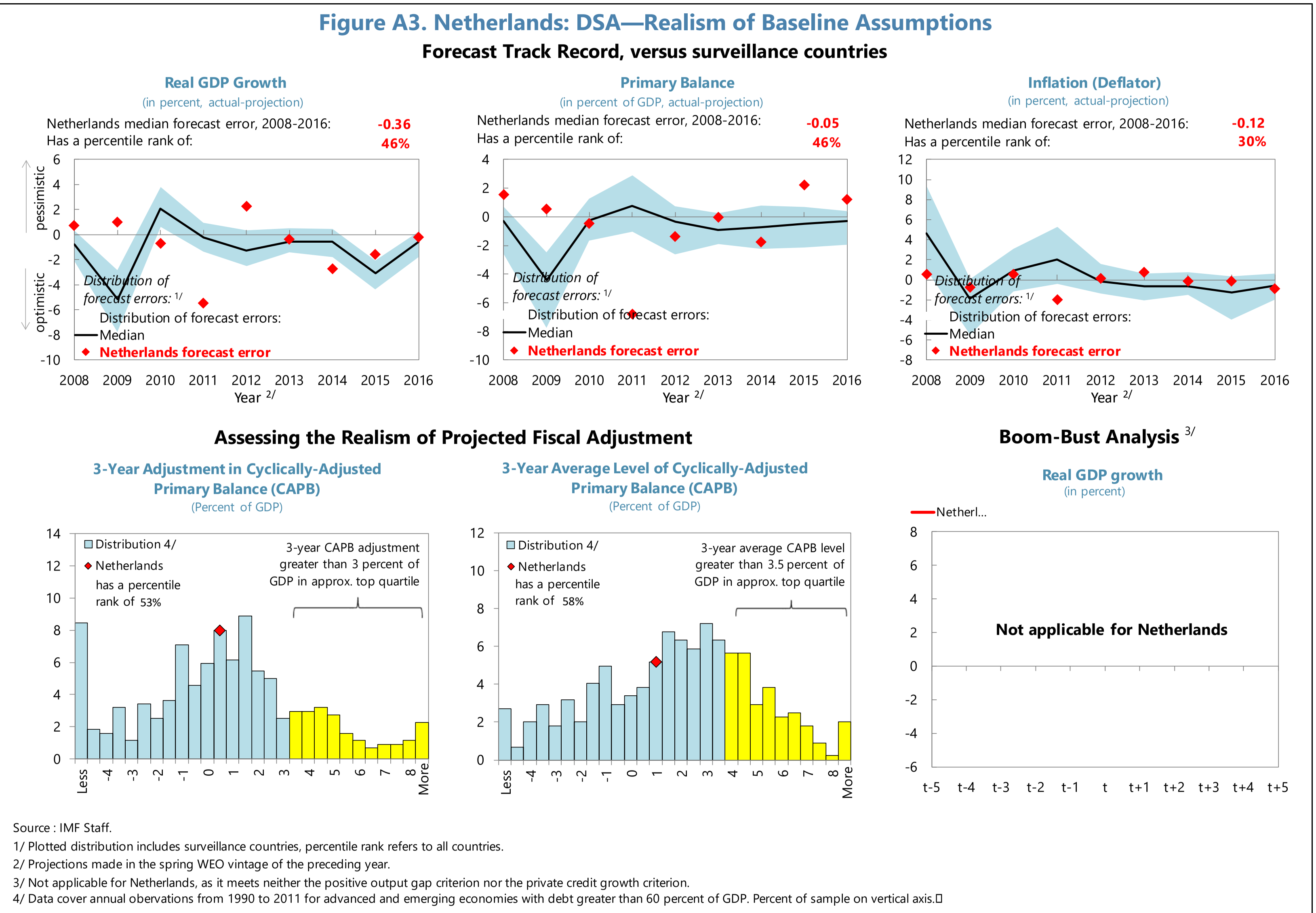
(in percent)

Baseline Scenario	2018	2019	2020	2021	2022	2023
Real GDP growth	3.1	2.4	2.1	2.0	1.9	1.9
Inflation	1.2	1.6	1.2	1.4	1.4	1.4
Primary Balance	1.1	1.2	1.3	1.4	1.5	1.6
Effective interest rate	1.4	1.5	1.6	1.6	1.7	1.8
Constant Primary Balance Scenario						
Real GDP growth	3.1	2.4	2.1	2.0	1.9	1.9
Inflation	1.2	1.6	1.2	1.4	1.4	1.4
Primary Balance	1.1	1.1	1.1	1.1	1.1	1.1
Effective interest rate	1.4	1.5	1.6	1.7	1.8	1.9

Historical Scenario	2018	2019	2020	2021	2022	2023
Real GDP growth	3.1	0.9	0.9	0.9	0.9	0.9
Inflation	1.2	1.6	1.2	1.4	1.4	1.4
Primary Balance	1.1	-1.3	-1.3	-1.3	-1.3	-1.3
Effective interest rate	1.4	1.5	1.8	2.0	2.2	2.5
Contingent Liability Shock						
Real GDP growth	3.1	0.4	0.0	2.0	1.9	1.9
Inflation	1.2	1.1	0.7	1.4	1.4	1.4
Primary Balance	1.1	-17.7	1.3	1.4	1.5	1.6
Effective interest rate	1.4	1.7	3.3	2.1	2.3	2.4

Source: IMF staff.

Figure A3. Netherlands: DSA—Realism of Baseline Assumptions



Source : IMF Staff.

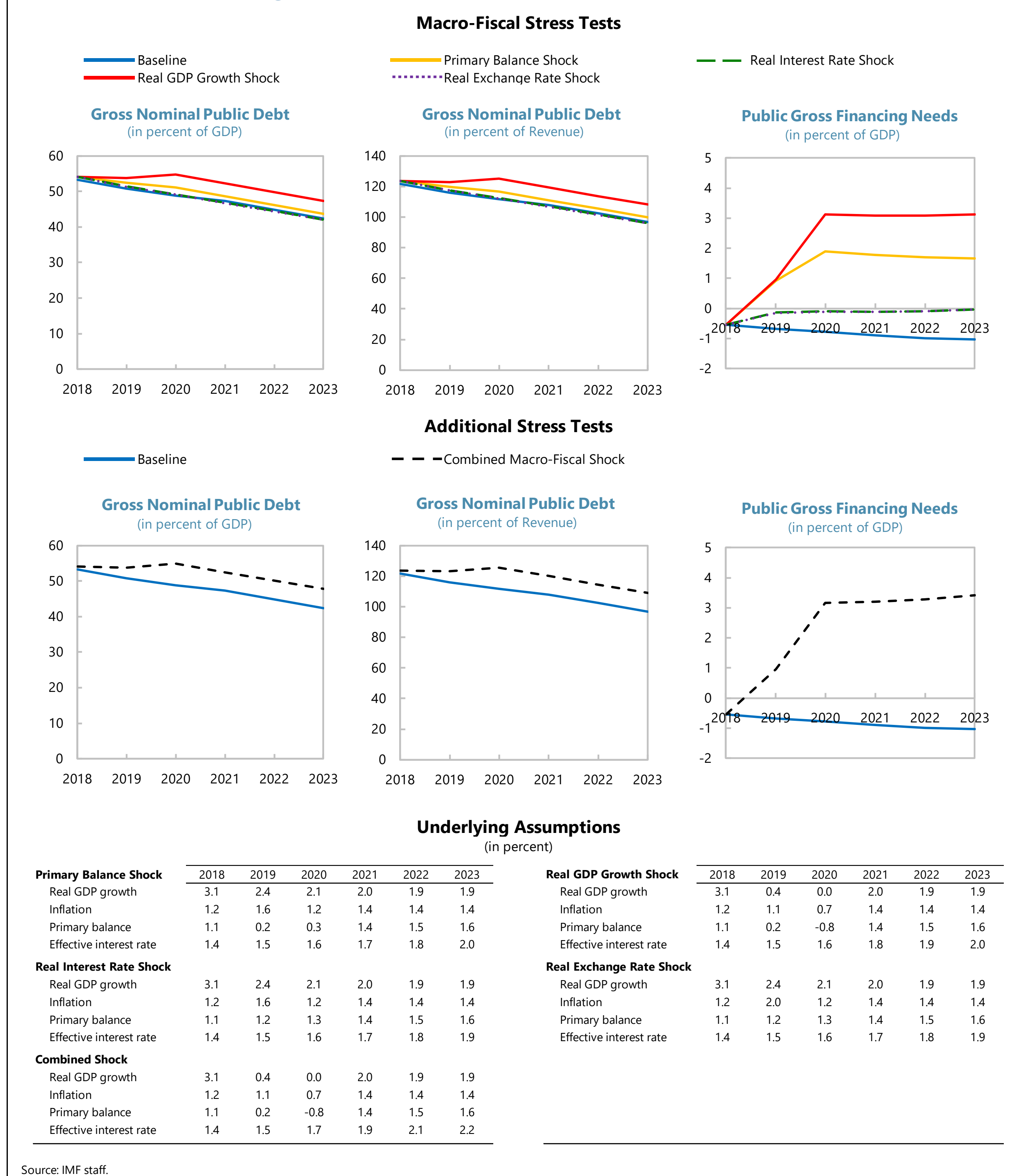
1/ Plotted distribution includes surveillance countries, percentile rank refers to all countries.

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

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

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

Figure A4. Netherlands: Public DSA—Stress Tests



Underlying Assumptions
(in percent)

	2018	2019	2020	2021	2022	2023
Primary Balance Shock						
Real GDP growth	3.1	2.4	2.1	2.0	1.9	1.9
Inflation	1.2	1.6	1.2	1.4	1.4	1.4
Primary balance	1.1	0.2	0.3	1.4	1.5	1.6
Effective interest rate	1.4	1.5	1.6	1.7	1.8	2.0
Real Interest Rate Shock						
Real GDP growth	3.1	2.4	2.1	2.0	1.9	1.9
Inflation	1.2	1.6	1.2	1.4	1.4	1.4
Primary balance	1.1	1.2	1.3	1.4	1.5	1.6
Effective interest rate	1.4	1.5	1.6	1.7	1.8	1.9
Combined Shock						
Real GDP growth	3.1	0.4	0.0	2.0	1.9	1.9
Inflation	1.2	1.1	0.7	1.4	1.4	1.4
Primary balance	1.1	0.2	-0.8	1.4	1.5	1.6
Effective interest rate	1.4	1.5	1.7	1.9	2.1	2.2

	2018	2019	2020	2021	2022	2023
Real GDP Growth Shock						
Real GDP growth	3.1	0.4	0.0	2.0	1.9	1.9
Inflation	1.2	1.1	0.7	1.4	1.4	1.4
Primary balance	1.1	0.2	-0.8	1.4	1.5	1.6
Effective interest rate	1.4	1.5	1.6	1.8	1.9	2.0
Real Exchange Rate Shock						
Real GDP growth	3.1	2.4	2.1	2.0	1.9	1.9
Inflation	1.2	2.0	1.2	1.4	1.4	1.4
Primary balance	1.1	1.2	1.3	1.4	1.5	1.6
Effective interest rate	1.4	1.5	1.6	1.7	1.8	1.9

Source: IMF staff.

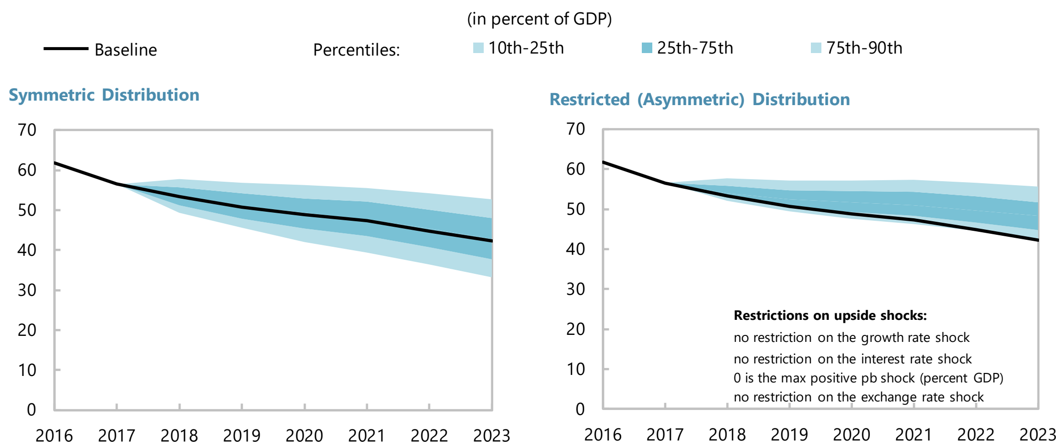
Figure A5. Netherlands: Public DSA—Risk Assessment

Heat Map

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

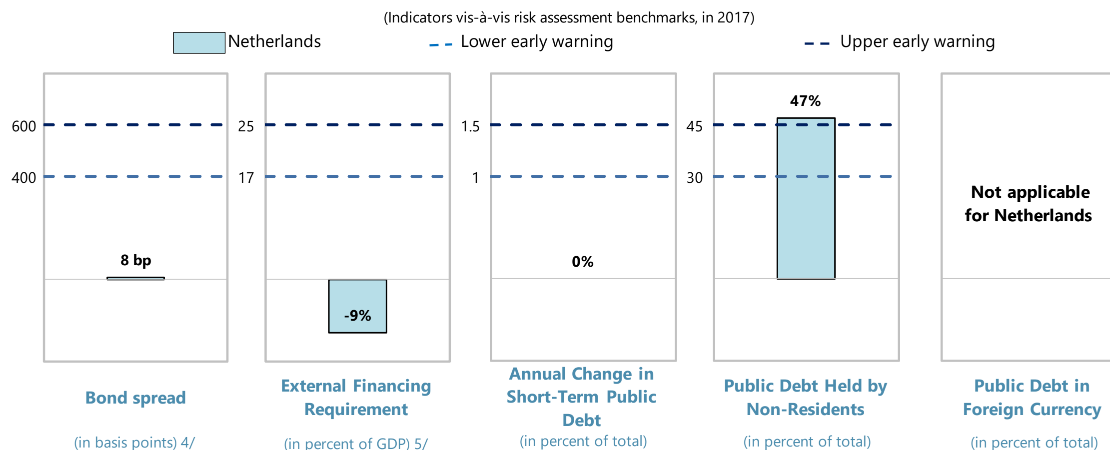
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2017)



Source: IMF staff.

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

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

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

Lower and upper risk-assessment benchmarks are:

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

4/ Long-term bond spread over German bonds, an average over the last 3 months, 02-Feb-18 through 03-May-18.

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

Annex VI. Reform Plans of the International Corporate Taxation Regime in the Netherlands[1]

The government recently announced its intention to reform the Dutch international corporate taxation regime, which has come under increased scrutiny in recent years for being used by multinational enterprises (MNEs) for tax avoidance schemes. Efforts are directed towards preventing the country to be used as a 'conduit' for tax optimization schemes involving tax havens, while at the same time reinforcing its attractiveness for foreign direct investment from multinationals.

1. The international corporate taxation regime of the Netherlands is geared toward making it an attractive location for headquarters of MNEs. Its main features include:

Under Domestic Law:

- *A 'double participation exemption', namely the non-taxation of both dividends paid by foreign subsidiaries and capital gains on the disposal of foreign equity*. Whereas similar rules are typically applicable in most countries and are in line with the EU Parent-Subsidiary Directive to ward off the risk of 'double taxation' of profits, their Dutch version is characterized by a 100 percent exclusion on foreign earnings, a very low ownership share for the exemption to apply, and the absence of controlled foreign corporations (CFC) rules to nullify it. These provisions are meant to encourage MNEs to establish their headquarters in the Netherlands and retain their consolidated profits there, especially in case their ultimate beneficial owners reside in countries operating a system of 'worldwide' taxation with deferral—typically, the U.S. until the recent tax reform;
- *A favorable innovation box regime,* whereby companies typically benefit from an effective tax rate of 5 percent (to be raised to 7 percent as per the recent coalition agreement) for income from intangible assets for which R&D tax credit is received;
- *Advanced tax rulings and pricing agreements*. These are entered into by the Dutch Tax Authority and offer tax certainty for investors, often for several years. Individual cases are typically confidential, including vis-à-vis the Parliament.

As Part of International Tax Agreements:

- *No withholding tax rates on outward payments of interests, royalties and fees to foreign subsidiaries, including those located in non-EU countries.* While such provisions apply within the EU in application of the Interest and Royalty Directive, the Netherlands considers them part of its internationally-oriented tax system more generally, providing an attractive climate for foreign investors;
- *A comprehensive network of double taxation treaties, allowing for reduced withholding taxes on inbound payments.* Such bilateral agreements have been negotiated with about 90 countries.

[1] Prepared by Marc Gérard (EUR). I wish to thank my colleagues, Ruud De Mooij and Geerten Michielse (both FAD) for their insightful comments.

They typically reduce the maximum applicable withholding tax rates on interest, royalties and dividends to very low levels in both signatory states. The comparatively low rate often agreed in Dutch tax treaties imply that foreign companies find it attractive to channel their outbound payments through the Netherlands.

2. When used in combination, some features of the Dutch international corporate taxation regime have proven prone to abuse. To the extent that interest payments are (as is commonly the case) tax deductible, the combination of zero withholding tax rates on outbound payments and low tax burden on inbound payments as per bilateral treaties typically allows for substantial profit shifting by multinationals from source countries, where the corporate income tax rate may be relatively high, to residence countries of the ultimate investor where the corporate income tax rate may be much lower, or even nil (so called 'earnings stripping' practices), using the Netherlands as a conduit. Furthermore, such schemes may be embedded for years in advanced tax rulings that safeguard the rate differences on incoming and outgoing interest payments, in effect locking in the tax base at very low levels. Likewise, advanced pricing agreements have been used to safeguard the transfer prices of incoming and outcoming royalty flows, giving rise to abuse of the Dutch treaty network without leading to a significant expansion of the Dutch tax base.

3. The Dutch authorities have recently announced measures to protect the domestic corporate income tax base as well as prevent the Netherlands to be used as conduit through special purpose vehicles as part of tax avoidance schemes. These include:

- *The adoption and strict implementation by 2019 of the first EU Anti-Tax Avoidance Directive (ATAD1) mainly aimed at limiting interest deductibility.* The latter covers two sets of measures:
    - The directive provides for an 'earnings stripping rule' limiting interest deductibility to 30 percent of the gross operating result, for which the Dutch authorities will not be seeking a 'group escape' clause. In the case of conduits, the effectiveness of the measure will, however, depend on the extent to which the initial tax base has been previously reduced (in a typical ruling, the tax base is commonly found to represent less than 1 percent of the amount flown through the SPV);
    - The directive also requires implementation of controlled foreign corporation (CFC) rules to determine the conditions under which foreign subsidiaries are to be considered controlled entities, typically if they operate in countries listed as non-cooperative by the EU or that feature very low statutory rates, and to ensure that the income they generate is appropriately accounted for as part of the parent's profits. In this respect, while the EU list has been widely criticized as being too limited, specific requirements for a foreign entity to be recognized as carrying on a "substantive economic activity", thus being considered as having a 'permanent establishment' abroad, will be enforced by Dutch authorities, in line with those allowing for the planned abolition of the dividend withholding tax. These requirements may, however, arguably be considered insufficiently restrictive (see below). Furthermore, in as much as CFC rules are aimed at protecting the Dutch tax base, they are by nature ineffective to address the reverse situation of subsidiaries in high tax jurisdictions shifting profits to the Netherlands at the detriment of other source countries;

- *The implementation by 2020 of the second EU Anti-Tax Avoidance Directive (ATAD2) aimed at curtailing the use of hybrid instruments for profit shifting*. This will entail amendments to Dutch tax laws to neutralize the tax impact of hybrid mismatched arrangements allowed by some bilateral treaties, whereby some costs are considered deductible in some countries whereas they are not included as income in the tax base of other countries;
- *The introduction of a withholding tax on dividends (by 2020), as well as on interest and royalty outflows (by 2021) to entities operating in low tax jurisdictions*. Importantly, these measures would go a long way to lessening the benefit for foreign MNEs of using the Netherlands as a conduit for tax avoidance purposes. Their implementation remains however conditional on the renegotiation of existing bilateral treaties – which may not be particularly constraining as the Netherlands does not have tax treaties with traditional tax haven countries;
- *The recent signature by the government of the Multilateral Instrument (MLI) adopted by Parliament*. The instrument provides for a 'principle purpose test' that aims to curtail treaty abuse in cases where the Netherlands is used as conduit country. It heavily relies on substance requirements, i.e. some judicial interpretation of specific facts and circumstances.

4. The authorities also announced measures aimed at increasing transparency, exchange of information, and anti-abuse provisions in keeping with the Base Erosion and Profit Shifting (BEPS) project spearheaded by the OECD and the G20. Further to taking up recommendations to neutralize the tax impact of hybrid instruments (action 2 of the Action Plan of the BEPS adopted in October 2015), to strengthen CFC rules (action 3) or to prevent corporate tax base erosion through the use of interest expenses (action 4), the Dutch authorities have expressed support to the Commission's proposal for a directive on mandatory disclosure of aggressive tax planning schemes (as per action 12), as well as to the EU initiative to prompt MNEs to publish information on their operations and profits broken down by countries (covered, with regards to transfer pricing documentation, by action 13 of the BEPS). Furthermore, based on findings by a parliamentary committee, the statutory rights of non-disclosure enjoyed by lawyers and civil law notaries in tax matters would be amended to impose fines for participation in illegal tax schemes. The government also intends to establish a register for ultimate beneficial owners and to tighten legislation on trusts, as well as to keep the Parliament better informed of developments pertaining to advance tax rulings.

5. At the same time, the government intends to remain an attractive location for MNEs, notably through the abolition of the dividend withholding tax. While exemptions were formerly applicable within the EU in application of the Parent-Subsidiary Directive as well as with treaty partners with whom zero withholding tax rates had been agreed, the dividend withholding tax, hitherto perceived at a rate of 15 percent, will now be abolished for all corporations, except those, among others, considered CFC after failing the test of "substantive economic activity" now required to consider them autonomous entities. The latter test may arguably be considered relatively easy to pass for most MNEs, however, as it mostly comprises that a payroll of €100,000 be disbursed and some office space be held for at least 24 months—fixed costs that may turn out particularly low with regards to the financial gains to be expected from dividend exemption for big MNEs.

INTERNATIONAL MONETARY FUND

KINGDOM OF THE NETHERLANDS—NETHERLANDS

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

May 8, 2018

Prepared By: European Department

CONTENTS

FUND RELATIONS 2

STATISTICAL ISSUES 4

FUND RELATIONS

(As of Apr 25, 2018, unless specified otherwise)

Mission: February 19-28, 2018 in The Hague and Amsterdam. The concluding statement of the mission is available at http://www.imf.org/en/News/Articles/2018/02/28/ms022818-kingdom-of-the-netherlands-concluding-statement-of-the-2018-article-iv-consultation

Staff team: Messrs. T. Dorsey (head) and M. Gerard, Mmes. R. Chen, D. Dimova, and Y. Zhang (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; officials from the Ministries of Housing, Social Affairs, Health, 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 Ms. De Lint (both OED) participated in some of the meetings.

Fund relations: Discussions for the 2018 Article IV consultation were held in The Hague and Amsterdam from February 19 to February 28, 2018. The staff report for the 2016 Article IV Consultation (IMF Country Report No. 17/77, April 3, 2017) was considered by the Executive Board on March 29, 2017. The Article IV consultations with the Netherlands are on the standard 12-month consultation cycle. The Executive Board's assessment and staff report are available at http://www.imf.org/en/Publications/CR/Issues/2017/04/03/kingdom-of-the-netherlands-netherlands-2016-article-iv-consultation-staff-report-44788.

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

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

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

Outstanding Purchases and Loans: None

Latest Financial Arrangements: None

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

	2018	2019	2020	2021	2022
Principal					
Charges/Interest	2.38	3.16	3.16	3.16	3.16
Total	2.38	3.16	3.16	3.16	3.16

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	
General: Data provision is adequate 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 2014* 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. For goods, services, primary and secondary income, and capital account, the DNB partly uses source data from CBS. Balance of payments and international investment position (IIP) statistics are compiled according to the sixth edition of the *Balance of Payments and International Investment Position Manual (BPM6)* and the legal requirements of the ECB and Eurostat. The DNB monthly disseminates the Data Template on International Reserves and Foreign Currency Liquidity. The Netherlands also participates in the Coordinated Direct Investment Survey (CDIS) and the Coordinated Portfolio Investment Survey (CPIS), and reports quarterly external debt data to the World Bank's 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 2017:Q4.	
II. Data Standards and Quality	
Subscriber to the Fund's Special Data Dissemination Standard since January 2015.	The 2007 Data ROSC was published in early 2008.

Netherlands: Table of Common Indicators Required for Surveillance

(As of April 25, 2018)

	Date of Latest Observation	Date Received	Frequency of Data 8/	Frequency of Reporting 8/	Frequency of Publication 8/
Exchange Rates	Current	Current	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities 1/	03/18	04/18	M	M	M
Reserve/Base Money 2/	02/18	04/18	M	M	M
Broad Money 2/	02/18	04/18	M	M	W and M
Central Bank Balance Sheet	02/18	04/18	M	M	M
Consolidated Balance Sheet of the Banking System	02/18	04/18	M	M	M
Interest Rates 3/	Current	Current	D	D	D
Consumer Price Index	03/18	04/18	M	M	M
Revenue, Expenditure, Balance and Composition of Financing 4/—General Government 5/	Q4/17	02/18	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing 4/—Central Government	Q4/17	02/18	Q	Q	Q
Stocks of Central Government and Central Government-Guaranteed Debt 6/	Q4/17	02/18	Q	Q	Q
External Current Account Balance	Q4/17	03/18	Q	Q	Q
Exports and Imports of Goods and Services	01/18	04/18	Q	Q	Q
GDP/GNP	Q4/17	03/18	Q	Q	Q
Gross External Debt	Q4/17	03/18	Q	Q	Q
International Investment Position 7/	Q4/17	03/18	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).

Statement by Mr. Doornbosch, Alternate Executive Director for Kingdom of the Netherlands - Netherlands and Ms. De Lint, Advisor to the Executive Director
May 23, 2018

The Dutch authorities would like to thank staff for the constructive dialogue and their insightful report and selected issues paper. A new government took office in October 2017. **The coalition agreement outlines an ambitious reform agenda** with as key elements: i) investments in education and healthcare; ii) striking a new balance between flexible working and permanent contracts; iii) pursuing a more customized approach to pensions; iv) modernizing the tax system and lowering taxes on labor; and v) transitioning to a low carbon economy. An important recent development is that the government decided to phase out gas production in the north of the Netherlands completely by 2030.

The Dutch economy is gathering steam with growth figures of 3.2% in 2018 and 2.7% in 2019. Unemployment is rapidly decreasing to its lowest level since 2001. The authorities forecast unemployment at 3.9% in 2018 and 3.5% in 2019, which is more than a percentage point lower than the Fund's estimations. The Dutch economy is benefiting from the global economic upswing, lower interest rates, an expansive budgetary policy and a persistently strong housing market. The authorities share the risk assessment of the IMF and particularly stress that negative consequences of Brexit may increase substantially under a hard Brexit.

Staff's assessment of fiscal space is narrow and the recommendations are of limited use in the context of the Dutch fiscal policy framework. In the Netherlands, a long-term sustainability assessment of fiscal space guides the medium term fiscal policy framework of every new government. In this assessment, current collective provisions are assumed to remain the same in the future. Mainly because of the gradual increase of the retirement age, the assessment for the first time indicated fiscal space. This formed the base on which the coalition decided to use this space for an expansionary fiscal policy over the coalition period until 2021. Within the medium-term framework, Dutch fiscal policy is non-discretionary with real expenditure ceilings and automatic stabilization on the revenue side. These rules are in addition to and consistent with the rules of the EU Stability and Growth Pact. In staff's assessment and recommendations on the fiscal policy stance, staff only considers the medium-term objective (MTOs) of the European rules. While the authorities appreciate a frank discussion, and do not mind disagreement with staff on some aspects of their policies, a more comprehensive analysis and policy advice, taking into consideration the Dutch fiscal policy framework, would have improved the dialogue and traction with the authorities.

The new EBA methodology increased the current account gap overnight with almost 2 percentage points. The current account surplus has been consistently high for more than 45 years and can largely be explained by the structure of the Dutch economy. It is hard to explain the excess surplus by policy failures. Key country specific factors would be the high savings rates with an increasing share of foreign investment, the presence of large multinationals with both positive net exports and outgoing FDI, large pension funds that invest heavily abroad, a sizable trade surplus due to the openness of the economy, and the presence of the port of Rotterdam with a high volume of gross trade through re-exports (around 40% of total Dutch trade) and value-added in services embedded in the port

activities. Natural gas exports are decreasing but still adding in recent years around 1 %-point to the trade surplus. Moreover, demographic factors increase the CA surplus in the Netherlands relative to other OECD countries, as the share of the Dutch working-age population is currently still relatively large and the share of retirees is small. While we appreciate that staff takes some of these factors into account and therefore uses a range for the CA norm, we believe that a CA gap of 4.8-8.8 percent of GDP is hard to justify. More emphasis should be put on country specific judgment in the assessment and it should be mentioned that a large part of the widening of the gap is a direct consequence of the change in the EBA methodology. Further research on the causes of savings in the non-financial corporate sector is warranted before they can be qualified as excessive.

The authorities appreciate staff's support for the reform agenda of the government. Staff's work on pension reform, wage moderation, drivers of house prices, health care reforms, options for carbon mitigation, and transportation policy and reform plans of the international corporate taxation regime is timely and very useful for the ongoing domestic policy debates and implementation of measures. Regarding these issues we have the following remarks for emphasis:

- We agree with the key drivers of slow **wage growth identified by** staff. The authorities are encouraging social partners to support higher wage growth where appropriate. Staff suggests that the rise in self-employed workers also contributed to the slow wage growth. In this context, it is important to acknowledge that the group of self-employed is diverse. A large part of the self-employed are entrepreneurs, who appreciate flexible contracts. The authorities aim for a new balance by making open-ended contracts more attractive for employers and flexible work more secure. The problem of false self-employment should be addressed.

- We appreciate the cross-country analysis of the drivers of **house prices**. We agree that the developments in the housing market require close monitoring and continuous efforts to ensure affordable housing for everyone and contain financial stability risks. The authorities agree with staff that a comprehensive approach is required and give high priority to developing the non-regulated rental market.

- We thank staff for their assessment of the plans for **mitigating CO2 emissions and broader environmental costs of transportation** and their useful suggestions on how to strengthen incentives, improve cost effectiveness, raise more revenue and improve policy credibility, which will be taken into due consideration by the authorities when 2 implementing measures. Staff's analysis of the costs of envisioned policies (0.6% of GDP) and the possible new revenues that could be raised with additional or alternative reforms (close to 2% of GDP) is very helpful and shows the macro-criticality of these policies as it has a significant impact on the macroeconomy and fiscal balance. An additional perspective where the Fund could be helpful is in assessing the implications for when countries implement such a policy package unilaterally versus as part of multilateral effort, by looking at the consequences for competitiveness.

- The positive assessment of the reform plans of the **international corporate taxation** regime in the Netherlands is appreciated. The international corporate taxation regime is geared towards avoiding double taxation of corporate profits, which ensures that Dutch businesses can compete on an equal footing abroad. As a result, the Netherlands is an attractive location for headquarters of MNEs. The downside of a tax system that takes account of multinationals is that it may also be susceptible to arrangements that erode the tax base. With the recently announced reforms, it will be prevented that the Netherlands is used as a 'conduit' for tax optimization schemes involving tax havens. The authorities currently investigate the possibilities to monitor the effects on FDI for instance.

Regarding the financial sector, the finalization of the Basel III framework will contribute to a global level playing field and an improved resilience of banks. The focus for the Dutch banking sector will now shift towards implementation. The major Dutch banks currently have strong capital positions and profitability, and are therefore able to meet these requirements well within the available time-period through profit retention.