INTERNATIONAL MONETARY FUND

IMF Country Report No. 13/115

KINGDOM OF THE NETHERLANDS—NETHERLANDS

2013 ARTICLE IV CONSULTATION

May 2013

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 2013 Article IV consultation with the Netherlands, the following documents have been released and are included in this package:

- **Staff Report** for the 2013 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on March 19, 2013, with the officials of the Netherlands on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on April 17, 2013. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- **Informational Annex** prepared by the IMF.
- **Statement by the IMF Staff Representative.**
- **Public Information Notice** (PIN) summarizing the views of the Executive Board as expressed during its May 1, 2013 discussion of the staff report that concluded the Article IV consultation.
- **Statement by the Executive Director for the Kingdom of the Netherlands—Netherlands**.

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

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KINGDOM OF THE NETHERLANDS—NETHERLANDS

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION

April 17, 2013

KEY ISSUES

Context: The Netherlands' track record of robust public finances and status as a safe haven are attributes of the euro area (EA) AAA countries. However, the economy faces many of the challenges of the periphery economies, including headwinds from a highly indebted household sector, significant financial sector stresses, declining real estate prices, and weak domestic demand.

Risks: The cycle of household and bank deleveraging, declining house prices and weak domestic demand would be amplified by any adverse external developments, particularly in the rest of the euro area, unanticipated shocks to domestic confidence, or heightened policy uncertainty. A more medium-term risk is that policy measures fail to avoid a decline in the economy's growth potential.

Policy recommendations: The main policy challenge is to restore growth and manage downside risks, while allowing for an orderly adjustment of private sector balance sheets. Fiscal consolidation should focus on structural targets aimed at ensuring sustainable public debt dynamics over the medium term, and avoid excessive procyclicality linked to short-term macroeconomic developments. Ensuring the resilience of the banking system is a top priority, given its exposure to falling real estate prices and heavy reliance on wholesale funding. The measured pace of implementation of housing sector policies, including reductions in mortgage interest deductibility (MID) and loan-to-value (LTV) ratios, is appropriate. Additional policies to improve the functioning of housing and labor markets should be phased in.

Approved By
Ranjit Teja and Tamim Bayoumi

Discussions took place in Amsterdam, Rotterdam, and The Hague during March 5–19, 2013. The staff team comprised Messrs. Lall (head), Mrkaic, Aslam (all EUR), and Santos (MCM), and Mmes. Ivanova and Hassine (both EUR). Mr. Mosch (OED) participated in key policy meetings.

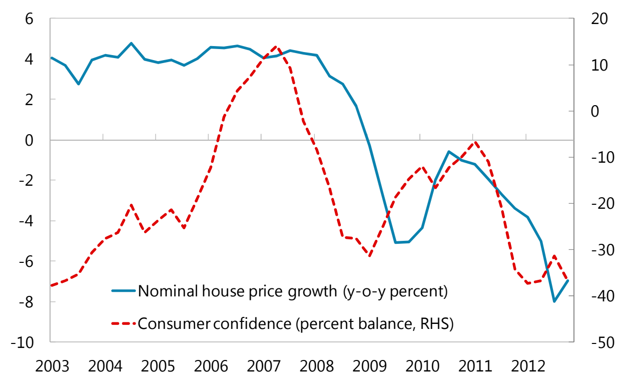
CONTENTS

INTRODUCTION

1. **The Netherlands is an AAA euro area (EA) economy, but with significant private sector imbalances.** It shares an AAA credit rating and relatively robust public finances with Germany, Finland, and Luxembourg. Like Germany, its sovereign bonds enjoy safe haven status, and it has a growing net international asset position since 2008. However, it also has a highly indebted household sector, significant financial sector challenges, declining real estate prices, and weak domestic demand. As a result, the Netherlands' GDP growth, unemployment, and public debt dynamics since the onset of the global financial crisis have diverged from other AAA EA economies (Figure 1).

2. **The main policy challenge over the near term is to restore growth and manage downside risks, while allowing for an orderly adjustment of private sector balance sheets.** Policy actions should be executed in a predictable manner to minimize policy uncertainty and support confidence, with a focus on the unwinding of accumulated distortions and balance sheet imbalances as well as on protecting the economy's growth potential. Fiscal consolidation should focus on structural targets while allowing automatic stabilizers to operate fully in order to reduce excessive procyclicality. The resilience of the banking system is a top priority given its exposure to falling real estate prices and the system's heavy reliance on wholesale funding. Housing sector policies need to be phased in at a measured pace, with the aim of reducing distortions further. Reforms to safeguard the economy's growth potential and boost the economy's resilience are important medium-term priorities.

House Price Growth and Consumer Confidence



Sources: Haver Analytics and Fund staff calculations.

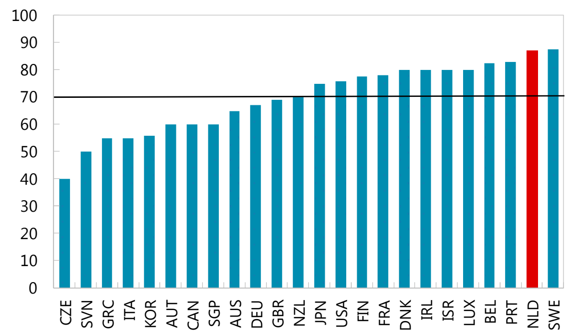
3. **The staff's diagnosis and policy advice is built around an analytical framework that considers the Netherlands to be undergoing a balance sheet recession linked to the adjustment of house prices.** The outlook is clouded by uncertainty mainly surrounding the future path of house prices, as well as the policy environment and developments in the rest of the EA. Reasonable counterarguments to the underlying analytical framework could be made, which would have implications for the appropriateness of staff's main policy recommendations, which are to let house prices adjust naturally and to anchor fiscal policy around medium-term objectives linked to specific structural measures. The section "Point and Counterpoint to the Staff's Views" (p.22) attempts to highlight possible counterarguments to the staff's diagnosis and key policy recommendations that readers may pose, and offers responses.

RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK

A. Recent Economic Developments

4. **The extended weakness in activity in the Netherlands reflects the slow deleveraging of the household and financial sectors.** Prior to 2008, in the context of ample global liquidity, a favorable macroeconomic environment, and supportive tax and regulatory incentives, households had accumulated substantial mortgage debt with generous loan-to-value (LTV) ratios and advantageous mortgage interest deductibility (MID). Household debt as a share of disposable income doubled over the past decade—to the highest in the euro area—and drove up house prices to unsustainable levels. Meanwhile, banks' assets-to-GDP rose to a peak of 4 times GDP by 2011 accompanied by a sharp increase in wholesale funding. Zoning and other restrictions prevented an adequate supply response to cool house prices. The global financial crisis of 2008 was the external trigger that led to a slow deleveraging spiral accompanied by falling confidence, declining house prices, and increasing financial strains. As a result, despite the recovery of global trade, a balance sheet recession has left GDP in the Netherlands below the 2008 level five years on.

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



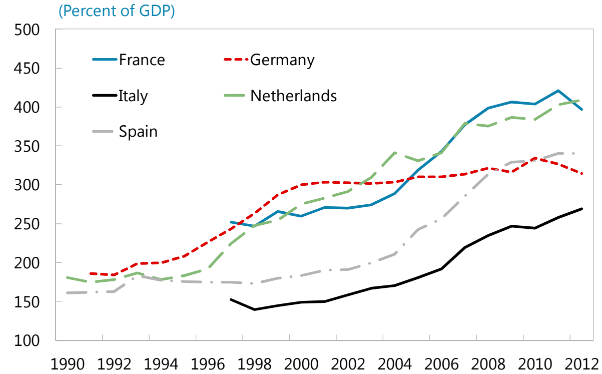
Sources: BIS, ECLAC, EMF, IADB, IHUF, IUT, OECD, UNECE, National Statistics, Central Bank Statistics, Warnock and Warnock (2009) and Fund staff calculations.

B. Outlook and Risks

Staff's Views

5. **Balance sheet adjustments in the context of weakness in the rest of the EA will continue to be a drag on the recovery and delay external adjustment.** Despite the nominal 20 percent correction since the peak, a further decline in house prices is expected to weigh on consumer confidence and consumption. With the banking system highly exposed to the real estate sector and continuing to rely on wholesale funding, the adjustment of its balance sheets is still underway. Exports to the rest of the EA are expected to pick up only gradually against the backdrop of a slow EA recovery. This implies that under the baseline, following an estimated 0.9 percent contraction last year, output is projected to fall by an additional 0.5 percent in 2013 before recovering by 1.1 percent in 2014. Reflecting the need to shore up balance sheets, the current account surplus is

Banking Sector Assets
(Percent of GDP)



Sources: Haver Analytics and Fund staff calculations.

expected to widen marginally through 2014. In line with these projections, the output gap will narrow only gradually over the forecast horizon.

6. The baseline outlook is subject to a number of downside risks. The interaction of household and bank balance sheets linked through changes in house prices makes the outlook subject to unusually large uncertainty. A drop in house prices in excess of what is currently assumed, although a low likelihood event, would further restrain both household consumption and lending by banks, and could in turn lead to a deepening cycle of falling house prices and deleveraging, clearly a high impact event (see paragraph 14 for appropriate policy responses). Solvency requirements in pension funds also weigh on consumer confidence as benefits and contributions need to be adjusted procyclically.[1] Persistent uncertainty about structural policies and the degree of procyclicality of fiscal policies could also act as a restraint on household spending decisions and postpone the recovery. External developments, especially in the rest of the EA, that add to uncertainty, generate financial stress, weaken consumer confidence, and lower exports, would adversely affect activity in the Netherlands (see discussion of related policy challenges in paragraphs 8-11 and 13) (Figure 4).These medium-likelihood risks would have a medium to high impact in the Netherlands. A more medium-term risk is that policy measures fail to avoid a decline in the economy's growth potential, with medium likelihood and medium impact on the Dutch economy (discussed in paragraphs 28-30). On the upside, a rapid reduction in uncertainty and a recovery in consumer confidence could help support the outlook.

The Authorities' Views

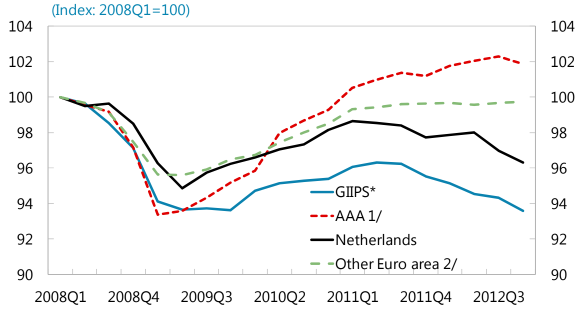
7. The authorities agreed with the staff's analysis of the outlook and risks. They noted that the ongoing balance sheet recession would act as a drag on activity for an extended period, and that uncertainty among households remains elevated. They were of the view that the bottoming out of house prices would mark a turning point for the economy. On pension funds, the authorities shared the view that a stable and predictable discount rate would reduce uncertainty about the level of expected pension benefits and contributions and make it less procyclical. Finally, the authorities agreed that external developments, especially in the rest of the EA, would strongly influence the outlook.

[1] Reforms introduced in 2011 aimed at improving solvency in pension funds. In addition, regulation requires pension funds to implement recovery plans if their coverage ratio is less than 105 percent.

Figure 1. Economic Activity has Disappointed

Real GDP has grown more slowly than in other AAA countries…

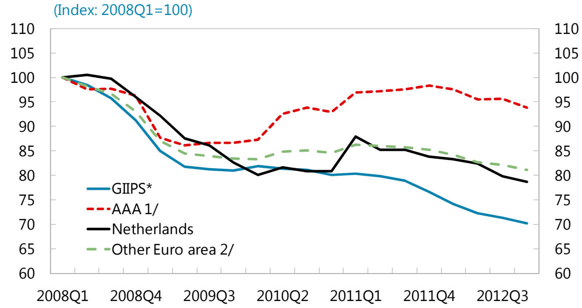
Real GDP
(Index: 2008Q1=100)



Sources: IMF *World Economic Outlook* and Fund staff calculations.
* Greece, Italy, Ireland, Portugal, and Spain.
1/ Includes Germany, Finland and Luxembourg.
2/ Euro area excluding GIIPS, AAA, and Netherlands.

…as has investment…

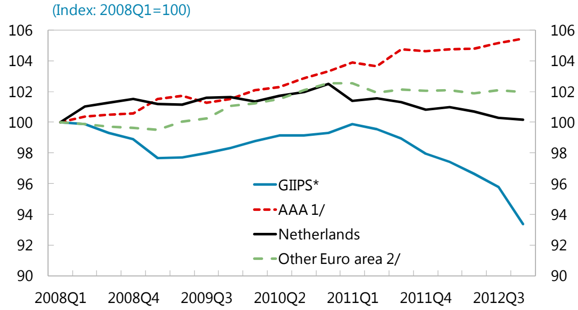
Real Gross Fixed Capital Formation
(Index: 2008Q1=100)



Sources: IMF *World Economic Outlook* and Fund staff calculations.
* Greece, Italy, Ireland, Portugal, and Spain.
1/ Includes Germany, Finland and Luxembourg.
2/ Euro area excluding GIIPS, AAA, and Netherlands.

…and consumption.

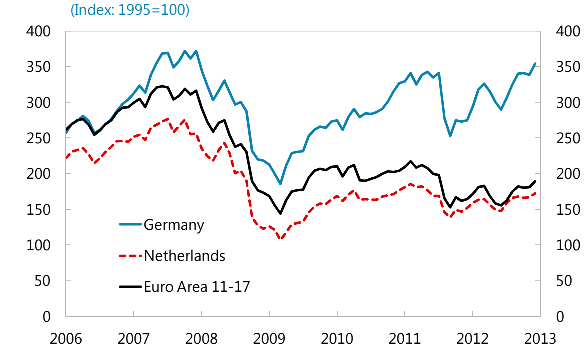
Real Total Consumption
(Index: 2008Q1=100)



Sources: IMF *World Economic Outlook* and Fund staff calculations.
* Greece, Italy, Ireland, Portugal, and Spain.
1/ Includes Germany, Finland and Luxembourg.
2/ Euro area excluding GIIPS, AAA, and Netherlands.

Stock prices signal expectations of tepid earnings growth.

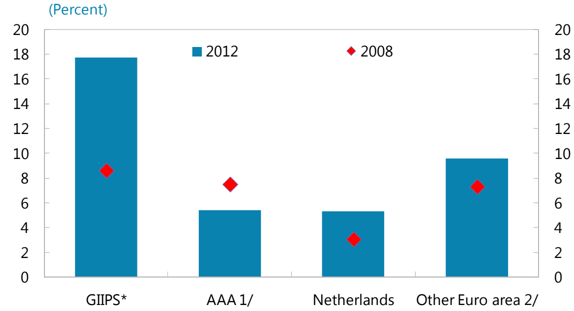
Share Price Index
(Index: 1995=100)



Sources: Haver Analytics and Fund staff calculations.

Unemployment is low but rising.

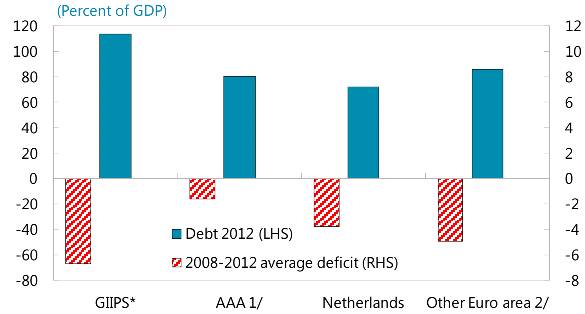
Unemployment Rate
(Percent)



Sources: IMF *World Economic Outlook* and Fund staff calculations.
* Greece, Italy, Ireland, Portugal, and Spain.
1/ Includes Germany, Finland and Luxembourg.
2/ Euro area excluding GIIPS, AAA, and Netherlands.

Public debt is among the lowest in the euro area but the deficit is higher than in other AAAs.

General Government Deficit and Public Debt
(Percent of GDP)

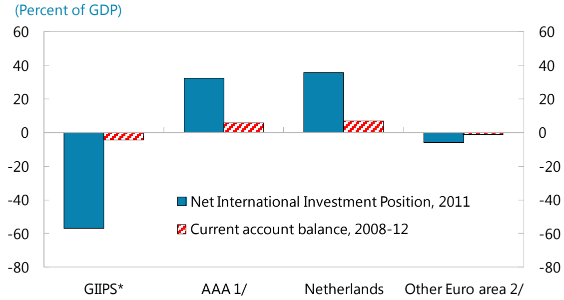


Sources: IMF *World Economic Outlook* and Fund staff calculations.
* Greece, Italy, Ireland, Portugal, and Spain.
1/ Includes Germany, Finland and Luxembourg.
2/ Euro area excluding GIIPS, AAA, and Netherlands.

Figure 2. Nevertheless the Economy has Some Notable Strengths

The current account balance has been consistently positive and higher than in peer countries, but the average net IIP position was only slightly positive.

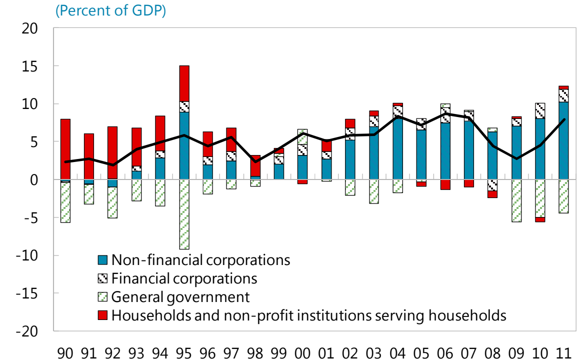
Current Account and Net International Investment Position
(Percent of GDP)



Sources: IMF *World Economic Outlook* and Fund staff calculations.
* Greece, Italy, Ireland, Portugal, and Spain.
1/ Includes Germany, Finland and Luxembourg.
2/ Euro area excluding GIIPS, AAA, and Netherlands.

Since the early 2000s, the current account surplus has been driven almost entirely by the corporate sector.

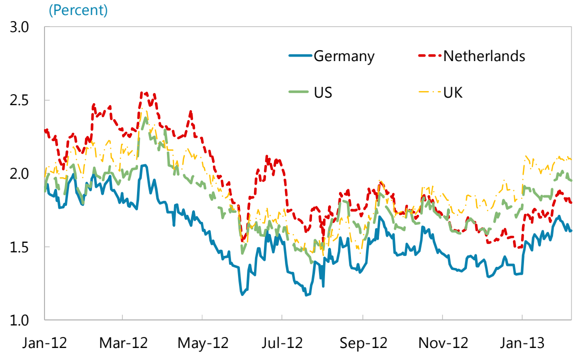
Net Lending/Borrowing by Sector
(Percent of GDP)



Sources: OECD and Fund staff calculations.

Yields on government bonds are low…

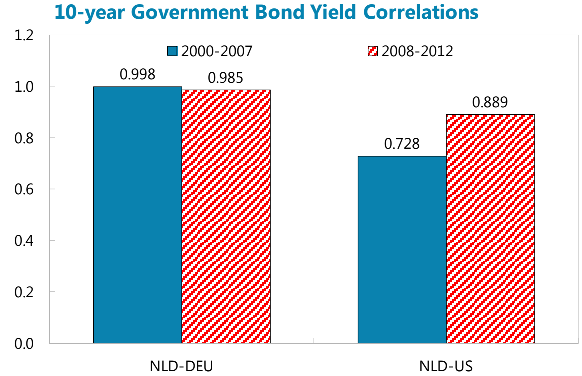
10-year Government Bond Yields
(Percent)



Sources: Bloomberg L.P. and Fund staff calculations.

…and strongly correlated with those in safe havens.

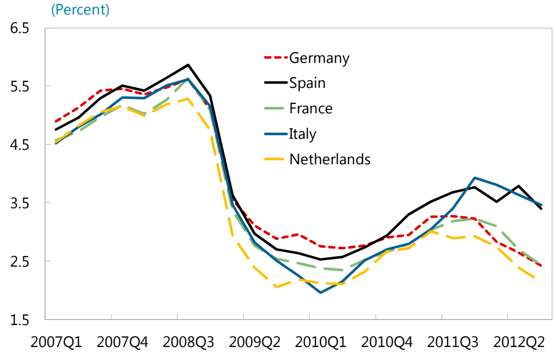
10-year Government Bond Yield Correlations



Sources: Bloomberg L.P. and Fund staff calculations.

Lending rates are among the lowest in the EA…

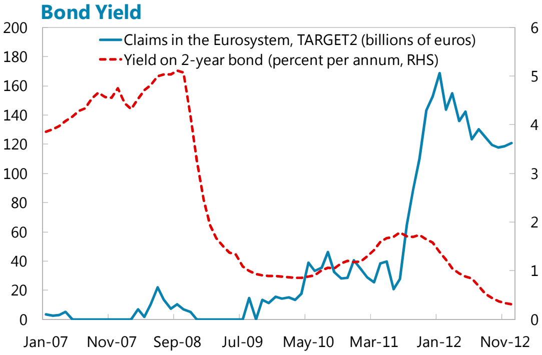
Lending Rates on New Loans to NFCs
(Percent)



Sources: ECB and Fund staff calculations.

…as yields have declined and the DNB's claims on the Eurosystem ballooned until their recent moderation.

Claims on the Eurosystem and 2-year Government Bond Yield

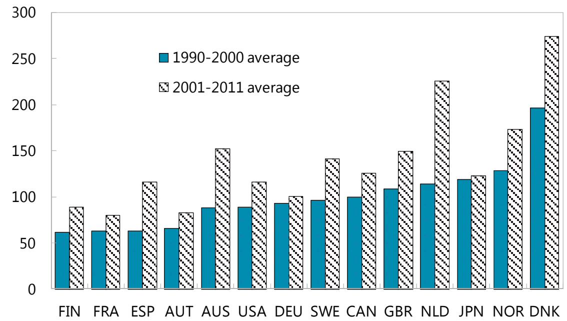


Sources: DNB and Fund staff calculations.

Figure 3. The Netherlands Faces Private Balance Sheet Challenges

Household indebtedness has risen sharply…

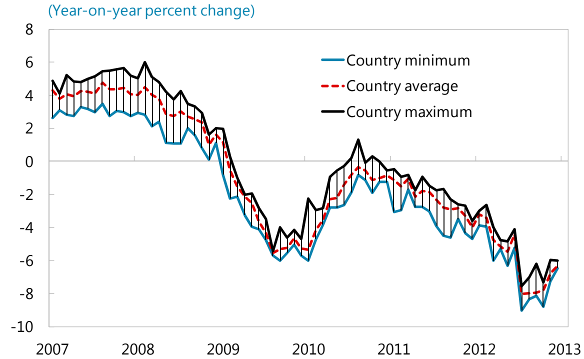
Household Liabilities as a Share of Disposable Income
(Percent)



Sources: OECD and Fund staff calculations.

…while house prices have declined considerably since their peak in 2008.

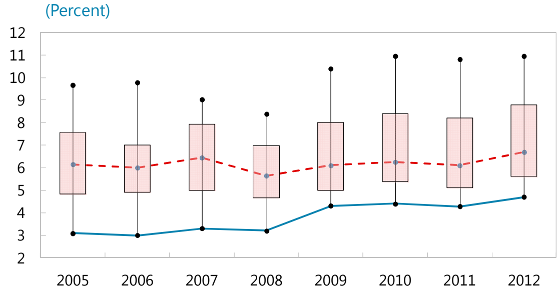
Nominal House Price Dynamics, 2007-12
(Year-on-year percent change)



Sources: Haver Analytics and Fund staff calculations.

Banks in the Netherlands remain highly leveraged…

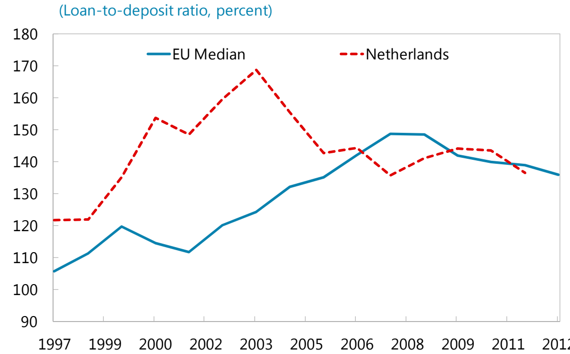
Capital to Assets 1/
(Percent)



Sources: IMF *Global Financial Stability Report* and Fund staff calculations.
1/ Advanced countries and the Netherlands; boxes represent 25th to 75th percentiles; whiskers show the 10th and 90th percentiles: dashed line represents the median; solid line represents the Netherlands.

…and continue to rely on wholesale funding.

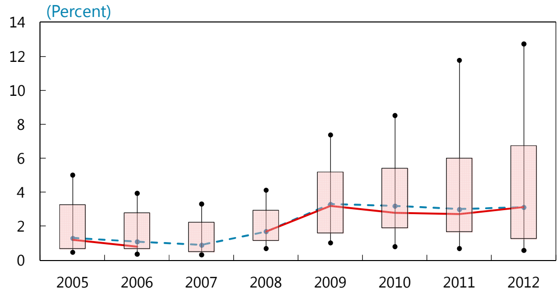
Reliance of Banks on Wholesale Funding
(Loan-to-deposit ratio, percent)



Sources: Bloomberg L.P. and Fund staff calculations

The share of NPLs has risen after the 2008-09 financial crises in line with the median for advanced economies.

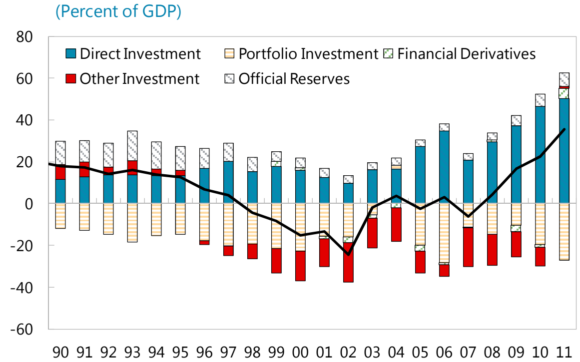
Non-Performing Loans to Total Loans 1/
(Percent)



Sources: IMF *Global Financial Stability Report* and Fund staff calculations.
1/ Advanced countries and the Netherlands; boxes represent 25th to 75th percentiles; whiskers show the 10th and 90th percentiles: dashed line represents the median; solid line represents the Netherlands.

While the net IIP position is currently strongly positive, its previous track record suggests a high degree of variability over time.

Net International Investment Position, 1990-2011
(Percent of GDP)

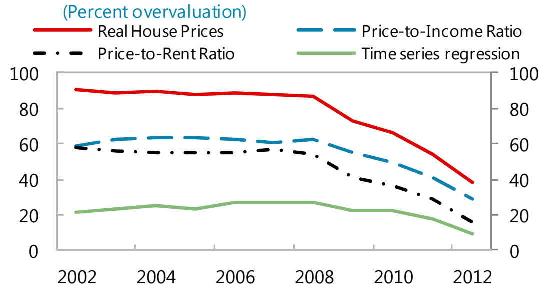


Sources: Haver Analytics and Fund staff calculations.

Figure 4. Risks to the Outlook are from Spillovers, Vulnerabilities, and Policy Uncertainty

Overvalued house prices point to downside risks to valuations.

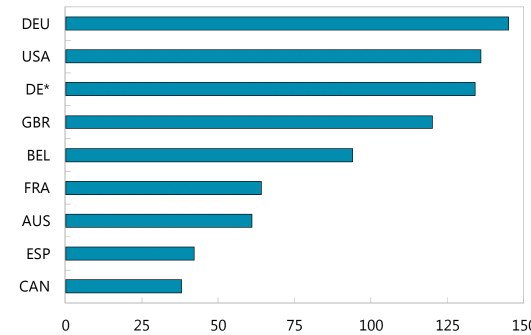
Range of House Price Valuation*
(Percent overvaluation)



Sources: OECD and Fund staff calculations.
* The range represents estimates obtained from an IMF RES-MFU time series regression and percentage deviations of the price-to-income ratio, price-to-rent ratio and real house prices from their long-run historical averages (calculated from 1970Q1).

Dutch banks have significant cross-border assets.

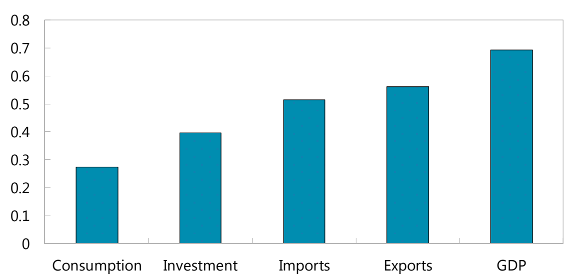
Consolidated Foreign Claims
(Immediate Borrower Basis, in billions of euro)



Sources: BIS and Fund staff calculations. *Developing Economies.

The Netherlands is very susceptible to financial stress shocks, largely through trade channels and investment.

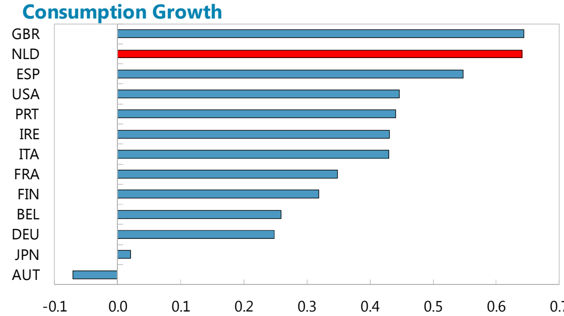
Correlation of Growth in Demand Components with the Financial Stress Index



Source: Fund staff calculations.
Note: Financial stress is measured using an index FSI (see Cardarelli, Elekdag, Lall, 2011). Correlations show FSI correlation with the q-o-q changes in the components of real GDP taken with the reversed sign (1998Q1-2012Q3).

House prices and consumption are strongly related.

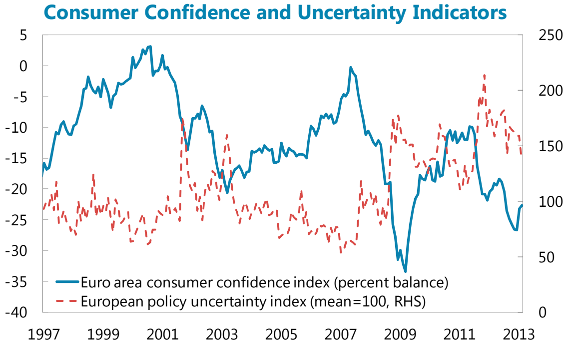
Correlation of Real House Price Growth with Real Private Consumption Growth



Source: Fund staff calculations.
Note: Correlations are between q-o-q real house price growth with q-o-q growth in real private consumption (1998Q1-2012Q3).

Wider euro area policy uncertainty has a strong effect on consumer confidence…

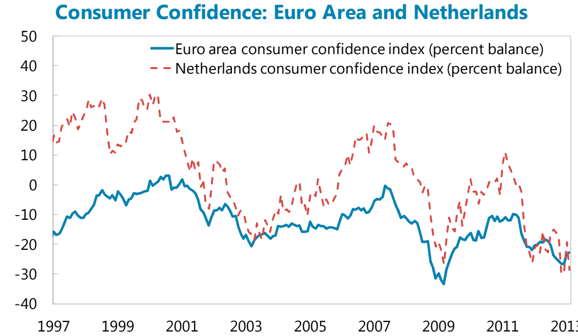
Consumer Confidence and Uncertainty Indicators



Sources: Haver Analytics, European Commission consumer confidence indicators, Policy Uncertainty Index developed by Baker, Bloom and Steven (2013) and Fund staff calculations.

…which remains low in both the euro area and in the Netherlands.

Consumer Confidence: Euro Area and Netherlands



Sources: Haver Analytics, European Commission consumer confidence indicators, Policy Uncertainty Index developed by Baker, Bloom and Steven (2013) and Fund staff calculations.

SUPPORTING RECOVERY WHILE MANAGING THE ADJUSTMENT OF BALANCE SHEETS

The main policy challenge over the near term is to restore growth and manage downside risks, while allowing for an orderly adjustment of private sector balance sheets.

A. Fiscal Policy

Background

8. Following structural fiscal consolidation of around 1 percent of GDP last year, an additional 1.6 percent structural tightening is envisaged this year with some additional tightening planned over 2014–17. Despite the 1.6 percent of fiscal tightening in structural terms envisaged in 2013, the considerably weaker macroeconomic outlook this year points to a headline deficit of 3.4 percent in 2013 under the staff's baseline (0.7 ppt higher than under the December 2012 Update of the Stability Program), broadly in line with the authorities' projections. The authorities now aim to attain the target of a headline deficit below 3 percent by end-2014, with proposed additional structural measures of around €4.3 billion (0.7 percent of GDP). The measures consist mostly of freezing income tax indexation and public sector wages in the health sector and general government. The current baseline does not include these additional discretionary policy measures, because they are pending approval in parliament.

Staff's Views

9. Fiscal policies should reduce the risk of a self-reinforcing downward spiral of deleveraging and economic contraction. While the Netherlands' strong public finances are central to its role as an anchor for the EA, excessive procyclical tightening could be self-defeating as only modest improvements in public sector balance sheets would come at the cost of worsening household balance sheets and financial sector fragility. There is also little evidence to suggest that the safe haven status of the Netherlands and its low borrowing costs are linked to meeting short-term headline deficit targets. Making fiscal policy conditional on frequent revisions to the near-term macroeconomic outlook would introduce unnecessary uncertainty into households' and firms' decisions to consume and invest, and possibly lead to greater output losses than necessary. Were the cycle of low growth and deleveraging to become entrenched, this could pose longer-term risks to the sustainability of public debt and damage the economy's growth potential (Figure 5).

10. Fiscal consolidation should therefore focus on structural targets and allow automatic stabilizers to operate fully. In the staff's view, the fiscal policy commitments made under the December 2012 Update of the Stability Program remain appropriate and budgeted expenditures should be fully executed. The envisaged structural consolidation (including measures to contain the growth of public healthcare expenditures) would ensure that public debt is firmly on a downward trajectory over the medium term, while automatic stabilizers would act as a shock absorber for shorter term macroeconomic volatility. Moreover, since the medium-term path has been communicated and internalized, it could serve as an anchor for expectations by making the fiscal policy stance more predictable and less dependent on short-term macroeconomic developments. Frequent discretionary changes in the fiscal policy stance would be avoided.

11. The authorities' decision not to undertake any additional measures in 2013 is appropriate and additional discretionary measures for next year are not necessary. Under the staff's baseline, this would imply that the headline deficit would remain slightly above 3 percent in 2014, and would decline to below 3 percent by 2016 as the recovery becomes firmly established. This would ensure that debt is on a declining trajectory over the medium term and that unemployment does not rise beyond what is currently projected. Most importantly, the Netherlands' fiscal credibility would remain secure.

The Authorities' Views

12. The authorities stated that the goal to meet the 3 percent deficit target in 2014 is appropriate. In their view, the headline deficit target is a measure of fiscal policy credibility and enjoys the broad support of the public. As a result, the authorities see meeting the target as soon as possible as supportive of stability and a means to anchor policy expectations. They see the benefits of enhanced credibility and adherence to EU rules as outweighing the uncertain benefits of a slightly less procyclical stance.

B. Financial Sector Policies

Background

13. The Dutch financial system is large relative to the size of the economy and remains heavily reliant on wholesale funding. Dutch banks have significant exposure to the real estate sector domestically— residential real estate loans represent about 30 percent of total loans—in addition to large cross-border exposures. Ensuring adequate buffers to falling real estate prices and allowing orderly deleveraging thus assumes systemic importance given the potential for outward spillovers. As regards outward bank spillovers, the three most exposed countries (defined in terms of consolidated claims of Dutch banks as a percentage of borrower country GDP) are Luxembourg (38.7), Belgium (25.4), and Ireland (8.7). In absolute terms, the most exposed countries are Germany (€145 billion), United States (€136 billion), and the United Kingdom (€120 billion).[2]

Staff's Views

14. Given banks' exposure to the real estate sector, and the significant exposure of the public sector to the banking system through capital and guarantees, proactive measures to shore up capital from private sources need to be stepped up. Three of the top four banks are

[2] BIS data as of September 2012.

reliant on significant public sector support which will need to be scaled back.[3] As underscored by the nationalization of fourth largest bank SNS REAAL on February 1, banks should be strongly encouraged by the regulator to build additional capital buffers to guard against any systemic threats from the real estate sector. This could take the form of issuing additional equity and higher retained earnings. Higher capital would also allow banks to lengthen the maturity profile of wholesale funding liabilities and reduce vulnerability to funding shocks. Thus far an abrupt pullback in lending has been avoided as rising deposits have helped reduce the loan-to-deposit ratio. Nevertheless, a reduction in assets will also be necessary. It will be important to ensure that the pull back in assets is done in an orderly manner both domestically and for cross-border lending to avoid adverse external spillovers.[4]

15. Overseas exposures of banks would need to be rationalized carefully by focusing on core business lines to avoid adverse outward spillovers. Dutch banks have sizable overseas exposures (Figure 4). While the largest nominal exposures are to large economies including Germany and the United States, Dutch banks are notable in their exposures as a share of host country GDP in several other countries. Some Dutch banks are also significant players in global trade financing, particularly of commodity trade including for a number of low-income countries, and the process of deleveraging should ensure that global trade is not adversely affected.

16. The treatment of senior creditors of banks needs the introduction of rules at the EU level, carefully weighing the trade-off between financial stability and protection of taxpayers. In the case of SNS REAAL, the authorities fully expropriated equity and subordinated debt holders, while deciding not to bail-in senior creditors. The government nationalized the bank and provided €2.2 billion in new capital, €1.1 billion in new loans and €5 billion in guarantees. In addition, €0.8 billion was written off from an earlier aid package and €0.7 billion was used to put the real estate portfolio at arm's length. This operation added 0.6 percent to the deficit in 2013 and 1.6 percent to national debt. In the absence of rules at the EU level on the treatment of senior creditors and loss-sharing, a unilateral bailing-in of senior creditors in the case of SNS REAAL could have induced funding stress on other banks and led to systemic repercussions. Looking ahead, staff support a clear European framework for applying the hierarchy of creditor claims under resolution while ensuring the protection of insured depositors.

[3] With the notable exception of SNS REAAL, banks have made progress in the repayment of public support. In November 2012, ING agreed with the European Community to amend its restructuring plan and committed to repay the remaining capital plus the 50 percent exit premium to the Dutch state in 4 equal tranches. The government has also announced that it expects to sell its stake in ABN Amro, preferably through an initial public offering, but not before 2014. However, the Dutch state still has a large stake in the banking system as of end-2012, with guarantees on bank liabilities totaling €17.5 billion, capital injections in the amount of €30.7 billion, an asset relief facility of €7.8 billion, and a liquidity support equivalent to €3.7 billion. In addition, the rescue of SNS-REAAL has further increased the exposure of taxpayers to the banking sector, with €3.7 billion to stabilize SNS REAAL and its newly-created bad bank and about €6 billion in loans and guarantees for SNS REAAL and its bad bank.

[4] The banking system's Basel II Tier 1 capital ratio was at about 12.3 percent in 2012Q3. On the basis of a pro forma Basel III core Tier 1 capital ratio, both ABN Amro and ING raised their ratios to 10 percent at end-2012 while Rabobank has reported that it has already complied with Basel III at end-2011.

17. Most FSAP recommendations have been implemented and supervision in the DNB has been strengthened. The authorities have established a Financial Stability Committee and adopted a macro-prudential mandate. Measures on LTV and MID have been adopted as planned. Adequate legal protection has been granted to the DNB and the AFM officials for their actions in official capacity. The DNB has adopted a new supervisory approach, which consists of three elements: cultural change ("Learning to say No"), stronger risk-based supervision with five categories (T1 to T5), and macro, sectoral, and thematic assessments of risk. The DNB on-site inspection staff has been increased by 10 percent. Crisis management and bank resolution have been strengthened with the Intervention Act. However, in monitoring of unfolding risks in banks, the DNB still lacks adequate legal basis to request information from institutions for macro-prudential reasons. There are no direct implications of the Banking Union on previous FSAP recommendations. The ultimate steady state single supervisory mechanism is likely to depend on local expertise and therefore strengthening domestic supervision, reporting, and other recommendations along the lines of FSAP recommendations remain relevant.

The Authorities' Views

18. The authorities agreed that the real estate sector and wholesale financing continue to pose vulnerabilities for the banking system. They were of the view that the size of wholesale financing relative to real estate lending among banks was large (the so-called "funding gap") and that this needed to be reduced over time. The authorities also were of the view that the move towards a pan-European Banking Union was proceeding at a rapid pace, and this would help improve the resilience of financial systems across the region, including in the Netherlands. They were also of the view that European directives for resolution would provide the foundations of a framework that would clarify the landscape for different classes of creditors of banks.

C. Housing and Macro-Prudential Policies

Background

19. Based on a range of metrics, house prices are still overvalued and could be expected to continue to fall. The authorities have initiated steps to reduce the Netherlands' generous LTV ratios and full MID, given their role in increasing household indebtedness and fueling a housing bubble. The housing market is also subject to a number of distortions, including the high proportion of subsidized public housing (some 80 percent of the stock of rental housing) and constraints to increasing the supply of owner-occupied dwellings.

Staff's Views

20. The reduction of LTV ratios and limiting the scope of MID is a necessary first step to reform the housing market. The authorities' plan to reduce maximum LTVs (from 106 percent by 1 percentage point each year until it reaches 100 percent) is appropriately paced given the prevailing house price dynamics. After the market has stabilized, consideration should be given to reduce maximum LTVs further. The elimination of MID for new mortgages except for 30 year amortizing mortgages is also a welcome step that over time should also help generate sustainable housing market dynamics and improve financial stability. There is scope to gradually phase in caps to the size of MID in nominal terms and target MID to lower-income citizens. After prices have stabilized, announcing a time path and gradually phasing in further housing reform measures would help anchor expectations and avoid destabilizing markets.

21. Sensitivity analyses showed banks to be resilient to moderate macro shocks and potentially large losses if tail risks materialize. The analyses used a model that estimated the sensitivity of expected losses to changes in unemployment, mortgage rates, and house prices. A 20 percent drop in house prices in 2013, a transient increase in mortgage rates, and rise of unemployment rate above 7 percent in 2014, would lead to insignificant reductions in the capital ratios due to generous unemployment and social benefits, the lack of strategic defaults and fact that most at-risk employees live in rental housing. However, if economic conditions deteriorate further and households with underwater mortgages change behavior, the possibility of a large number of simultaneous defaults cannot be ruled out. This reinforces the need for banks to shore up capital from private sources.

22. There are several structural measures that could improve the functioning of the housing market. The supply response of housing to price changes is limited by regulations (including on zoning) that prevent new construction to meet increased demand. While zoning regulations to some extent reflect social choices, solutions need to be explored that allow improvement in the functioning of the housing market through increased supply when demand rises. The planned review of the scope of public housing with a view to better targeting them to lower-income segments is also welcome as it would free up more dwellings for the rental market. Similarly, constraints to repurposing vacant commercial real estate for residential use need to be addressed.

The Authorities' Views

23. The authorities believe that uncertainty about the future path of house prices impedes recovery. They emphasize that their goal is to pursue predictable policies to remove the distortions from the housing market gradually, without adding to policy uncertainty. The reforms to LTVs and MID are therefore important first steps in their aim to reform the housing sector. However, many distortions have been built up over a considerable period of time, and additional reforms will need broad support across the population and will take a number of years to be implemented.

Box 1. Sensitivity Analysis of a Decline in House Prices

As requested by Staff, DNB conducted a sensitivity analysis to assess the resilience of the banking system to further declines in house prices. The sensitivity analysis estimated expected loan losses arising from a 10-20 percent decline in house prices in 2013.[1/]

The Netherlands: Sensitivity Analysis

	2013	2014
Scenario 1		
House price change (percent)	-10.0	0.0
Additional assumptions		
Unemployment rate (percent of labor force)	6.5	6.8
Long-term mortgage rate (percent)	5.4	4.7
Scenario 2		
House price change (percent)	-20.0	0.0
Additional assumptions		
Unemployment rate (percent of labor force)	6.8	7.1
Long-term mortgage rate (percent)	6.0	4.7

The sensitivity analysis combined a micro-level satellite model containing household specific information and a firm-level model that simulates bank balance sheets. The satellite model contains information on a representative sample of 100,000 households including data on their mortgage loans, payments, and income sources and reflects important behavioral and institutional features of the Dutch mortgage and labor markets. Staff further provided assumptions related to unemployment and refinancing mortgage rates during 2013-14 that were required by the micro-level satellite model. The effects of changes in house prices on expected losses and capital ratios are mitigated by generous unemployment and social benefits embedded in the micro-level satellite model that lessen the likelihood of households defaulting on their mortgages as well as by the inability to declare strategic default under the Dutch law. Therefore, the decline in house prices only affects the Loss-Given-Default (LGD) and not the Probabilities of Default (PDs) of the residential loan portfolio implicit in the DNB micro-level satellite model.

Even under the most adverse scenario of a 20 percent decline in house prices, the increase in expected losses and the reduction in the banking system capital ratios would be small in during 2013-14.[1/] In particular, the increase in expected losses would reduce the banking system's Basel II Capital Adequacy and Tier 1 Capital ratios by about 13 bps and 26 bps in 2013 and 2014, respectively.[2/] Despite a small average increase in default rates, it is important to note that the distribution of simulated loss rates across different age cohorts is different, with the 35-44 year cohort shouldering a large share of the losses. Should economic conditions deteriorate further, with higher unemployment rates and lower house prices and should underwater households change their behavior, the possibility of a large number of simultaneous defaults by households cannot be disregarded.

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1/ Due to confidentiality understandings, the numerical estimates of loan losses are not presented.

2/ The banking system's Basel II Capital Adequacy and Tier 1 ratios amounted to 14.3 percent and 12.3 percent, respectively, in 2012Q3.

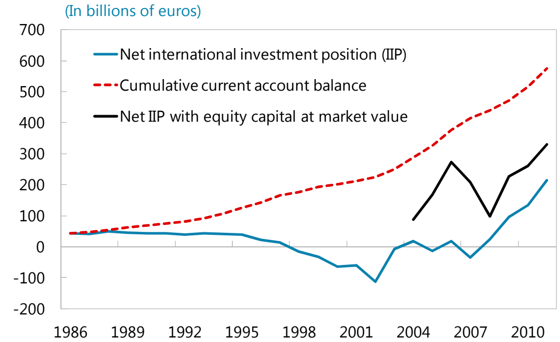
D. External Sector Issues

Background

24. **While the Netherlands has run large current account surpluses for decades, its net international investment position turned positive again only in 2008.** The sustained current account surpluses are explained in large part by savings of the corporate sector and to a lesser extent by institutional pension savings of the households. A favorable tax regime, good infrastructure, a helpful geographical location, and stable business environment make the Netherlands an attractive business location for trade-oriented companies while relatively slow growth and the nature of some large businesses make domestic investment less attractive than the alternatives abroad or even infeasible. Large domestic corporate sector savings arise as globally-oriented firms in the Netherlands finance a substantial outflow of FDI (the stock of outward FDI stood at 85 percent of GDP at end-2011). In the past decade, about half of the current account surplus can be accounted for by demographic changes, the presence of an exhaustible resource such as natural gas, fiscal policy, increased financial integration, and relatively slow GDP growth.

25. **The large current account surpluses have not generated a correspondingly large net international investment position**. Appreciation of the exchange rate, write-offs on paid goodwill, the fact that Dutch foreign assets comprise largely debt and FDI while foreign liabilities are tilted towards portfolio equities with higher returns, and statistical issues related to the accounting of the holdings of equity in subsidiaries are all believed to be important pieces in explaining this phenomenon, known as the "Dutch Black Hole". Hence, due to statistical issues with recording equity transactions in the BOP both the data on the current account and IIP have to be treated with caution.

The Dutch 'Black Hole': Net External Assets And Cumulative Current Account Balance
(In billions of euros)

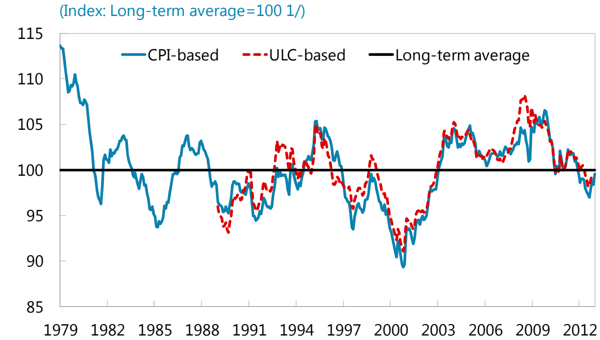


Sources: DNB and Fund staff calculations.

Staff's Views

26. **The external position is stronger than is consistent with medium-term fundamentals,** While the accumulation of external surpluses is not indicative of any competitiveness gains by the Netherlands at the expense of its trading partners, a slower pace of fiscal consolidation and greater expenditures, including on public sector wages, would help efforts to rebalance the economy although more structural measures will also be needed. The staff's assessment remains that the external sector is stronger than justified by

Real Effective Exchange Rate
(Index: Long-term average=100 1/)



Sources: IFS, INS and Fund staff calculations.
1/ For CPI-based average, Jan 1979 to Dec 2012=100; for ULC-based average, Jan 1989 to Nov 2012=100.

fundamentals, and is consistent with the ESR assessment. Persistently large surpluses, even after allowing for biases created by being a financial center and an energy exporter (with a cyclically-adjusted surplus estimated at 8 percent of GDP), point to a cyclically-adjusted current account balance 1–3 percent stronger than the value implied by fundamentals and desirable policy settings. The REER has fallen somewhat in recent years, following appreciation between 2006–09, as a result of euro depreciation and decelerating wage and price pressures. It remains slightly higher than historical averages. Policy settings are broadly appropriate and few policy measures are needed.

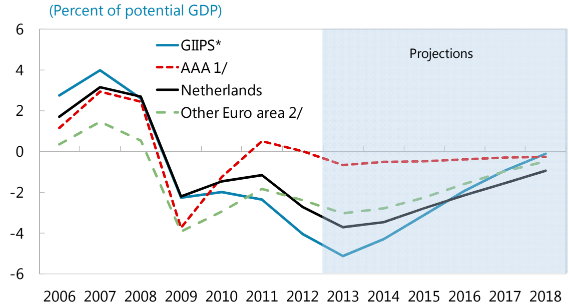
The Authorities' Views

27. The Authorities view persistent current accounts surpluses as a result of the Netherlands' openness, geographic location and the fact that the country is a domicile to many export-oriented corporations.

Figure 5. Raising the Economy's Growth Potential is Important

A negative output gap will persist in the medium term.

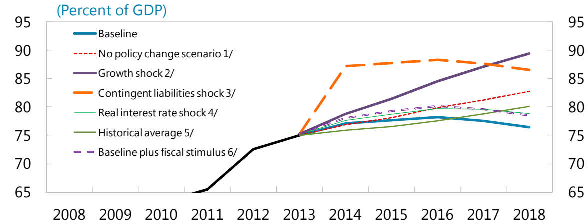
Output Gap
(Percent of potential GDP)



Sources: IMF *World Economic Outlook* and Fund staff calculations.
* Greece, Italy, Ireland, Portugal, and Spain
1/ Includes Germany, Finland and Luxembourg
2/ Euro area excluding GIIPS, AAA, and Netherlands

Public debt is vulnerable to permanent growth shocks.

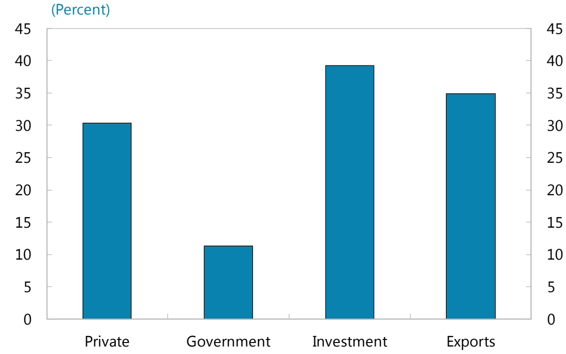
Government Debt Path Under Alternative Scenarios
(Percent of GDP)



Sources: CPB and Fund staff estimates.
1/ "No policy change" scenario assumes that the primary balance remains unchanged from 2013 onwards, while all other macroeconomic variables are the same as under the baseline.
2/ "Growth shock" scenario: permanently lower real GDP growth at baseline minus one-half standard deviation.
3/ "Contingent liability shock" scenario assumes a 10 percent of GDP increase in other debt-creating flows in 2013.
4/ "Real interest rate shock" scenario assumes baseline interest rate plus one standard deviation.
5/ "Historical average" scenario assumes that all variables, including the primary balance, growth and interest rates, are at historical averages.
6/ Based on the simulations using an augmented version of EUROMOD, a module of the new Flexible System of Global Models (FSGM) developed by the IMF's research department. Fiscal stimulus is assumed to be 1 percent of GDP in 2013 and 2014 and 0.5 percent of GDP in 2015.

Private and government consumption have low external leakages.

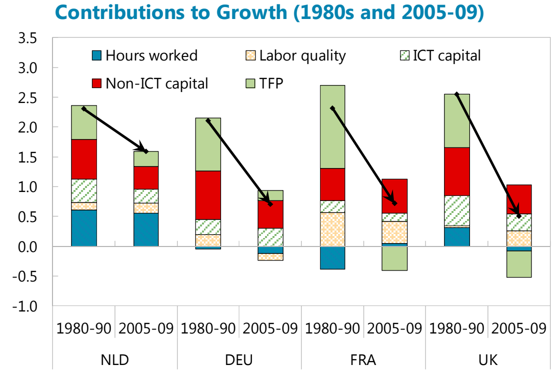
Import Content of Main Macro Aggregates
(Percent)



Sources: NBER and Fund staff calculations.

Slower growth of TFP and investments has reduced long-run growth.

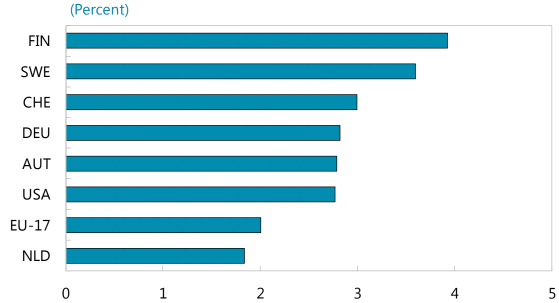
Contributions to Growth (1980s and 2005-09)



Sources: EU KLEMS (2012) and Fund staff estimates

Low Research and Development intensity hampers growth.

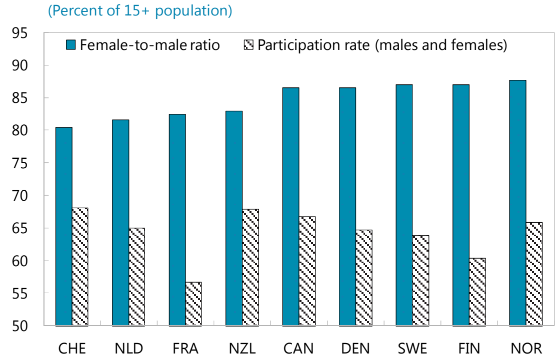
R & D Intensity 1/
(Percent)



Sources: European Commission Innovation Competitiveness Report (2011) and Fund staff calculations. 1/ R&D intensity is the ratio of a company's investment in R&D to its sales.

Labor market participation is comparably low.

Labor Market Participation, 2010
(Percent of 15+ population)



Sources: ILO and Fund staff calculations.

RAISING LONG-TERM GROWTH POTENTIAL

Implementing measures to raise the economy's growth potential will help anchor expectations constructively and safeguard the credibility of long term fiscal sustainability.

Background

28. The Netherlands' trend decline in potential growth over the past three decades, due mainly to a slowing of both productivity growth and capital deepening, will face added pressures as an aging population shrinks the labor force. The larger and globally competitive multinationals domiciled in the Netherlands are highly productive, but smaller domestically-oriented firms are much less so.

Staff's Views

29. Efforts to raise the productivity of smaller and domestically-oriented firms can raise potential growth while contributing to the reduction of external imbalances. Increasing the intensity of research and development activities (R&D) is an area where the Netherlands lags many regional peers and could boost productivity. Policies that improve the incentives for private research activities and that bring the results of research in academic institutions closer to industry have promise. There is also room for improvement in streamlining procedures for starting businesses, enhancing the protection of investors in these businesses and improving the efficiency of contract enforcement, where Netherlands lags some of its regional peers. To the extent that these measures boost investment and growth in domestically oriented firms, they could help reduce imbalances on a structural basis by reducing the savings-investment imbalances of the corporate sector and boosting domestic demand (Figure 2). Containing long term healthcare costs will also be important to maintaining competitiveness and safeguard fiscal soundness.

30. Further measures to improve the functioning of labor markets and raise human capital will be needed. Measures to further reduce the duality in labor markets by increasing the protection for temporary workers while reducing rigidities for permanent workers will help improve equity and preserve flexibility. In addition, the reduction of the period of unemployment benefits to two years and additional measures to increase incentives to re-enter employment within a year of unemployment are welcome. Improving the quality of education will be an essential building block of raising the productivity of the labor force.

The Authorities' Views

31. To increase potential GDP growth, the authorities plan to implement measures to improve the functioning of the labor market and to enhance human capital. The duration of unemployment benefits is proposed to decrease from 38 to 24 months, and their level will be reduced after the first year of unemployment from 70 percent of the salary to 70 percent of the minimum wage. The authorities view this measure as necessary to reduce the duration of unemployment spells. Student grants will be replaced with loans from 2014-15 academic year onwards and the revenue from student loans will be invested in education and research. An additional 150 million euro will be available for strengthening fundamental research and 250 million for intensifying secondary vocational education.

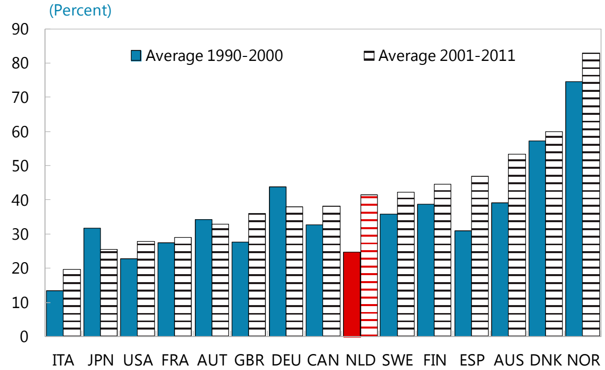
POINT AND COUNTERPOINT TO THE STAFF'S VIEWS

While the staff's conclusions have been articulated in the previous sections, they are debatable. Four elements of the staff's views are scrutinized below, with the view to providing the reader a better sense of the arguments and counterarguments.

32. *Is the staff's characterization of a balance sheet recession right?*

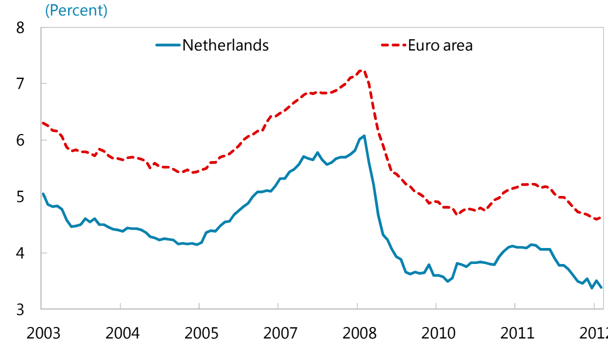
Argument: Can weak consumer confidence really be blamed on weak balance sheets? This seems unlikely because, while household's gross debt is high, this is balanced by very large financial assets. Moreover, the Netherlands enjoys low borrowing costs as a safe haven with an AAA sovereign rating, and households could work off their high gross debt gradually as debt servicing costs are not rising sharply. So the characterization of household balance sheet strains by staff may be exaggerated and the only thing needed to revive consumption and growth would be to a return of positive "animal spirits."

Household Liabilities as a Share of Financial Assets
(Percent)



Sources: OECD and Fund staff calculations.

MFI Lending Rates to Households and Non-Financial Corporations
(Percent)



Sources: Haver Analytics and Fund staff calculations.

Counterargument: While it is true in principle low interest rates mean that households in the Netherlands could carry a larger load of debt, this must be weighed against the fact that house prices on average have fallen by 19 percent in nominal terms since 2008. As a result, some 25 percent of mortgages are underwater but need to be serviced as the lenders have full recourse (i.e., can pursue the borrower's other assets in court). The motivation for households to increase their savings and restrain consumption is therefore not due to rising debt service costs but to offset the substantial fall in net worth since 2008 in the face of higher uncertainty about employment and income. Moreover, an overwhelming proportion of household financial assets are in pension funds which cannot be accessed for liquidity purposes, and the present value of these assets is also dependent on economic and financial factors. As a result, the balance sheet strains on households reflect the decline in the value of assets rather than an increase in the value of their liabilities, and households could be expected to continue to restrain consumption and build savings until the imbalance has been narrowed substantially. Finally, underwater mortgages are most common among young households, who also have higher net debt and lower assets. Hence, aggregate balance sheets mask substantial distributional differences which are important for consumption behavior.

33. ***Since household savings are primarily channeled to pension funds, should not more of these funds be intermediated domestically to offset the structurally lower amount of household deposits in banks relative to bank assets? Wouldn't that help support the housing market while also reducing banks' reliance on wholesale funding?***

Argument: The assets of pension funds amount to about 160 percent of GDP. Some 88 percent of these are invested abroad and act as a conduit for channeling household savings overseas. As a result, household deposits at domestic banks are low at €374 billion while mortgage loans (primarily by domestic banks) are €651 billion. This "funding gap" for mortgages is filled through wholesale financing by banks. Channeling pension fund assets domestically could alleviate the funding gap for banks and make them less reliant on wholesale funding, while making mortgages less sensitive to bank funding conditions.[5] Therefore, the staff's assertion that mortgage debt is too high may be misleading as there is an ample pool of domestic savings which could be tapped to support mortgages.

Counterargument: Pension funds already have a home bias since the Netherlands' own securities account for some 5 percent of the universe of investible assets of Dutch pension funds. The so-called "funding gap" instead, in the staff's view, reflects the fact that banks expanded on the basis of wholesale financing to provide mortgages that benefited from favorable MID and generous LTV ratios. This in turn fueled the sharp rise in household debt (and mortgage debt in particular) and house prices. Pension funds manage their assets independently and in the view of staff need not be provided with any additional incentives to alter their asset allocation process. In the staff's view, the main principles that should be observed with regard to reducing distortions in the housing sector are that the natural adjustment of prices should proceed unimpeded, that banks continue to reduce their reliance on wholesale funding, that risk from exposure to the real estate sector is priced transparently and appropriately, and that the government does not take on additional contingent liabilities.

[5] The "funding gap" is described in the Van Dijkhuizen proposal of March 11, 2013 to establish a new Dutch Mortgage Institution (NHI)) to tap funds from pension funds, insurance companies and other national and international investors to finance Dutch mortgages.

34. ***How is staff sure that home prices have not overshot? Wouldn't this justify intervention?***

Argument: With house prices having already fallen by 20 percent, and no evidence of an abnormal rise in vacancies, could prices be overshooting? Given the impact of house prices dynamics on overall sentiment and activity, is there not a case for intervention to support house prices?

Counterargument: It is true that house prices have fallen substantially. But while no one can be sure about house prices, various models to estimate their level relative to fundamentals (summarized in Figure 4, top panel) suggest that they remain overvalued. There is little evidence to support the view that house prices have overshot. Moreover, in the staff's view, the housing market is subject to numerous distortions, such as the small market for rentals outside of social housing, the constraints to a supply response in housing due to regulations, and still generous LTV ratios. Additional interventions in a highly distorted market could produce unwelcome side effects, and the priority should be instead to allow for the natural adjustment of prices and wind down the distortions to enable a better functioning housing market to emerge.

35. ***If policy uncertainty is such a concern, why does staff oppose the specification of a target for the headline deficit of 3 percent to alleviate uncertainty? Why is focusing on medium-term hard-to-assess structural targets better?***

Argument: While removing uncertainty probably would support activity, it is less clear that the focus of fiscal policy should be on medium-term targets based on specified structural measures. This makes it difficult to form expectations of the headline deficit path, which would add to uncertainty and possibly restrain households' and firms spending decisions. If the headline deficit target is known, then that could be the anchor for the private sector that reduces uncertainty.

Counterargument: The staff's argument to focus on medium term structural targets and reduce policy uncertainty rests on minimizing the deviation of discretionary fiscal policy measures from the specified medium-term path. With the Coalition Agreement having already spelled out the medium-term structural measures that would be undertaken, this can help anchor the private sector's expectations. Given that headline deficits are highly dependent on near-term macroeconomic prospects which are subject to high uncertainty from both domestic and external sources, focusing on a headline deficit target adds rather than subtracts from the general macroeconomic uncertainty as the discretionary component of fiscal policy becomes a moving target. The staff is of the view that the already articulated medium-term structural measures are a better anchor of expectations.

STAFF APPRAISAL

36. The Netherlands is in a balance sheet recession as households and banks continue to deleverage against the backdrop of still declining house prices. The necessary reduction of household debt is expected to weigh on sentiment and consumption over the medium term. Banks remain heavily exposed to the real estate sector and overly reliant on wholesale funding, requiring adjustments in their balance sheets over the foreseeable future. With exports to the rest of the EA expected to strengthen only gradually, output growth will remain below its potential for some time.

37. Downside risks dominate. The interaction of household and bank balance sheets through house prices magnifies the uncertainty surrounding the outlook. Larger-than-expected house price adjustments would restrain household consumption and bank lending, and could result in an amplified cycle of falling house prices and deleveraging. Persistent uncertainty about fiscal and structural policies could also restrain household spending and postpone the recovery. External developments that aggravate uncertainty, especially in the rest of the EA, could weaken consumer confidence, lower exports, and further diminish activity. On the upside, a rapid recovery in consumer confidence and resolution of uncertainty could improve the outlook.

38. The overarching policy priority is to support activity and manage downside risks, while allowing for an orderly adjustment of private sector balance sheets. Given weak consumer confidence and considerable uncertainty, policies should help minimize downside risks to growth and avoid exacerbating the pace of deleveraging, while anchoring medium-term expectations to enable a sustained recovery to take hold.

39. Adhering to the structural fiscal measures outlined in the December 2012 Update of the Stability Program remains the appropriate fiscal policy anchor over the medium term. Given the unexpected weakness in activity, the plan for no additional measures in 2013 is appropriate. Fiscal policy beyond 2013 should focus on structural adjustment as outlined in the December 2012 Stability Program Update, while allowing automatic stabilizers full play. A clear focus on medium-term objectives will cement the Netherlands' policy credibility and mitigate policy uncertainty. Excessively procyclical fiscal policies could damage potential growth should they deepen and prolong the downturn.

40. The financial system needs to reduce its dependence on wholesale financing and banks reliant on public sector support need to wind down this support. Given banks' exposures to the real estate sector, capital should be increased from private sources by issuing common equity and through higher retained earnings. Higher capital buffers would extend the duration and terms of the wholesale financing, reduce vulnerability to abrupt shifts in funding conditions, and prepare banks for Basel III capital requirements. Banks should also increase allowances for loan losses in the real estate portfolio. While idiosyncratic shocks to the real estate portfolio appear manageable, a large systemic shock could expose banks to more significant losses.

41. The numerous distortions in the housing market should be removed gradually. The key principles that should guide the reduction of housing sector distortions are the unimpeded natural adjustment of house prices, continued reduction of banks' reliance on wholesale funding, transparent pricing of risk from exposure to the real estate sector, and avoiding the assumption of additional contingent liabilities by the government. The incremental reduction of maximum loan-to-value ratios from 106 to 100 percent and elimination of mortgage interest deductibility for non-amortizing mortgages are important initial steps in reducing the excesses emanating from the housing sector.

42. Reforms in the labor markets and to raise human capital will be important in safeguarding the economy's growth potential. More protection for temporary workers with more flexibility for permanent workers will help improve equity while incentives to re-enter employment as quickly as possible will help reduce longer term unemployment. Channeling resources into fundamental research and improved quality of education will help raise productivity. Measures must also be taken to contain long-term healthcare costs which could in the long-term threaten public finances and competitiveness.

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

Box 2. Authorities' Response to Past IMF Policy Recommendations

The authorities have taken on board several policy recommendation made by the Fund in the previous Article IV consultations. They have implemented tighter macroprudential measures in the housing markets, proposed structural reforms to improve the functioning of the labor market, and passed a pension reform to counteract declines in the supply of labor due to ageing.

Financial sector issues

The plan to reduce maximum LTVs (from 106 percent by 1 percentage point each year until it reaches 100 percent) and the elimination of MID for new mortgages except for 30-year amortizing mortgages are in line past Fund policy recommendations to improve financial stability. In addition, most FSAP recommendations have been implemented and supervision in the DNB has been strengthened.

Fiscal issues

The authorities implemented a frontloaded fiscal tightening in 2012-13 during a period of contracting GDP while Fund's recommendation was to tighten fiscal policy once growth firms. The Fund recommended improvements to trend budgeting to further reduce its procyclicality and augment its flexibility to deal with severe recessions. However, the authorities attach great importance to adhering to the SGP rule that limits headline deficits to 3 percent of GDP.

Structural reforms

In line with Fund's advice, the authorities have proposed measures to increase potential growth. They have proposed measures to reduce the period of unemployment benefits to two years with additional measures to increase incentives to re-enter employment within a year of unemployment. The new government has also proposed increases in the funding of R & D and improvements in the quality of education. Finally, measures to contain the growth of healthcare costs are being implemented.

Table 1. Netherlands: Selected Economic Indicators, 2010-14

Total area (2012)	41.5 thousand sq. km.	
Population (Jan. 2013)	16.8 million	
Population characteristics and health		
Life expectancy at birth (2010)	78.1 (male), 82.2 (female)	
Fertility rate (2010)	1.8 children/woman	
Infant mortality rate (2011)	3 per 1,000 live births	
Population per sq. km. of land area (Jan. 2013)	497 persons	
National accounts 2012	(In billions of euros)	(In percent of GDP)
Private consumption	273.3	45.5
Public consumption	170.6	28.4
Gross fixed investment	101.1	16.8
Stockbuilding	2.5	0.4
Exports of goods and nonfactor services	524.7	87.4
Imports of goods and nonfactor services	471.6	78.5
Nominal GDP (at market prices)	600.6	100.0

	2010	2011	2012 Est.	2013 Proj.	2014 Proj.
National accounts (constant prices)					
Private consumption	0.3	-1.0	-1.4	-1.3	0.4
Public consumption	0.7	0.1	0.0	0.0	0.7
Gross fixed investment	-7.2	5.7	-4.6	-1.9	1.5
Total domestic demand	0.2	0.5	-1.5	-1.4	0.6
Exports of goods and nonfactor services	11.2	3.9	3.3	2.2	2.1
Imports of goods and nonfactor services	10.2	3.6	3.1	1.6	1.6
Net foreign balance 1/	1.5	0.5	0.4	0.6	0.6
Gross domestic product	1.6	1.0	-1.0	-0.5	1.1
Output gap (in percent of potential output)	-1.5	-1.2	-2.8	-3.7	-3.4
Prices, wages, and employment					
Consumer price index (HICP)	0.9	2.5	2.8	2.8	1.7
GDP deflator	1.1	1.2	0.7	1.7	1.4
Hourly compensation (manufacturing)	1.3	1.1	2.1	2.1	2.2
Unit labor costs (manufacturing)	-1.4	0.1	3.4	2.3	0.6
Employment					
Unemployment rate (in percent)	4.5	4.4	5.3	6.3	6.5
NAIRU	4.5	4.7	4.8	4.9	5.0
External trade					
Merchandise balance (percent of GDP)	7.2	7.8	8.0	8.4	8.7
Current account balance (percent of GDP)	7.7	9.7	9.1	9.2	9.6
General government accounts (percent of GDP)					
Revenue	45.6	45.1	45.9	46.8	46.4
Expenditure	50.7	49.6	50.1	50.3	50.1
Net lending/borrowing	-5.1	-4.5	-4.1	-3.4	-3.7
Primary balance	-3.3	-2.6	-2.4	-1.7	-1.9
Structural balance 2/	-4.4	-4.0	-2.6	-1.3	-1.6
Structural primary balance 2/	-2.6	-2.1	-0.9	0.5	0.1
Robust balance 2/ 3/	-5.0	-4.5	-3.8	-2.2	-2.0
General government gross debt	63.1	65.5	71.7	74.5	75.8

Sources: Dutch official publications, IMF, IFS, and Fund staff calculations.
1/ Contribution to GDP growth.
2/ In percent of potential GDP.
3/ Robust balance is the structural primary balance excluding property income (mainly gas revenue).

Table 2a. Netherlands: General Government Statement of Operations, 2010–18

(In percent of GDP)

	2010	2011	2012 Est.	2013 Proj.	2014 Proj.	2015 Proj.	2016 Proj.	2017 Proj.	2018 Proj.
Revenue	45.6	45.1	45.9	46.8	46.4	46.3	46.2	46.1	46.1
Taxes	24.1	23.1	22.4	23.2	23.2	24.5	24.8	24.9	24.9
Taxes on production and imports	11.9	11.4	11.2	11.9	12.2	11.8	11.7	11.6	11.6
Current taxes on income, wealth, etc.	11.9	11.3	10.8	11.0	10.7	12.5	12.7	13.0	13.0
Capital taxes	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Social contributions	14.9	15.5	16.6	16.8	17.1	15.9	15.8	15.7	15.7
Grants	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.3	0.3
Other revenue	6.2	6.1	6.6	6.3	5.8	5.5	5.2	5.1	5.1
Expenditure	50.7	49.6	50.1	50.3	50.1	49.6	49.1	48.4	47.7
Expense	48.3	47.5	48.0	47.8	47.5	47.1	47.0	46.6	46.0
Compensation of employees	10.0	9.7	9.9	9.6	9.5	9.1	9.0	8.8	8.6
Use of goods and services	7.9	7.6	7.8	7.6	7.4	7.2	7.0	6.8	6.7
Consumption of fixed capital	2.7	2.7	2.7	2.7	2.7	2.8	2.7	2.7	2.7
Interest	1.9	1.9	1.8	1.8	1.8	2.0	2.1	2.1	2.1
Subsidies	1.5	1.4	1.3	1.2	1.1	1.1	1.0	1.1	1.1
Grants	1.3	1.2	1.0	0.6	0.6	0.5	0.7	0.9	0.9
Social benefits	22.8	22.9	23.3	24.1	24.4	24.3	24.2	24.0	23.8
Other expense	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Net acquisition of nonfinancial assets	2.4	2.1	2.1	2.5	2.6	2.5	2.2	1.8	1.8
Net operating balance	-2.7	-2.4	-2.0	-0.9	-1.1	-0.8	-0.8	-0.5	0.1
Net lending/borrowing	-5.1	-4.5	-4.1	-3.4	-3.7	-3.3	-2.9	-2.3	-1.7
Net acquisition of financial assets	-0.3	-0.7	…	…	…	…	…	…	…
Currency and deposits	-0.6	0.0	…	…	…	…	…	…	…
Securities other than shares	-0.3	-0.5	…	…	…	…	…	…	…
Loans	-0.2	-0.5	…	…	…	…	…	…	…
Shares and other equity	-0.1	-0.2	…	…	…	…	…	…	…
Insurance technical reserves	0.0	0.0	…	…	…	…	…	…	…
Financial derivatives	0.1	0.1	…	…	…	…	…	…	…
Other accounts receivable	0.9	0.4	…	…	…	…	…	…	…
Net incurrence of liabilities	4.9	3.8	…	…	…	…	…	…	…
Special Drawing Rights (SDRs)	0.0	0.0	…	…	…	…	…	…	…
Currency and deposits	0.0	0.0	…	…	…	…	…	…	…
Securities other than shares	4.5	3.4	…	…	…	…	…	…	…
Loans	-0.4	0.3	…	…	…	…	…	…	…
Shares and other equity	0.0	0.0	…	…	…	…	…	…	…
Insurance technical reserves	0.0	0.0	…	…	…	…	…	…	…
Financial derivatives	0.0	0.0	…	…	…	…	…	…	…
Other accounts payable	0.7	0.1	…	…	…	…	…	…	…
Memorandum items									
Primary balance	-3.3	-2.6	-2.4	-1.7	-1.9	-1.2	-0.8	-0.2	0.5
Structural balance (percent of potential GDP)	-4.4	-4.0	-2.6	-1.3	-1.6	-1.6	-1.7	-1.4	-1.1
Structural primary balance (percent of potential GDP)	-2.6	-2.1	-0.9	0.5	0.1	0.4	0.4	0.7	1.0
Robust balance (percent of potential GDP) 1/	-5.0	-4.5	-3.8	-2.2	-2.0	-1.5	-1.3	-0.9	-0.6
Gross Debt	63.1	65.5	71.7	74.5	75.8	75.0	75.4	75.1	74.2
Output gap	-1.5	-1.2	-2.8	-3.7	-3.4	-2.6	-1.8	-1.3	-0.7
Nominal GDP (billions of euros)	588.7	602.0	600.6	607.8	623.4	642.7	663.2	684.8	708.0
Nominal GDP growth (percent)	2.7	2.2	-0.2	1.2	2.6	3.1	3.2	3.3	3.4
Real GDP growth (percent)	1.6	1.0	-1.0	-0.5	1.1	1.7	1.8	1.9	2.1
GDP deflator growth (percent)	1.1	1.2	0.7	1.7	1.4	1.3	1.3	1.3	1.3

Sources: The Netherlands' Bureau for Economic Policy Analysis (CPB), Ministry of Finance, and Fund staff calculations.
1/ Robust balance is the structural primary balance excluding property income (mainly gas revenue).

Table 2b. Netherlands: General Government Statement of Operations, 2010–18

(In billions of euros)

	2010	2011	2012 Est.	2013 Proj.	2014 Proj.	2015 Proj.	2016 Proj.	2017 Proj.	2018 Proj.
Revenue	268.6	271.5	275.9	284.5	289.4	297.8	306.2	315.4	326.2
Taxes	142.1	138.8	134.4	141.2	144.5	157.8	164.2	170.8	176.6
Taxes on production and imports	70.3	68.7	67.5	72.4	75.9	75.6	77.6	79.7	82.4
Current taxes on income, wealth, etc.	69.9	68.2	65.0	66.9	66.6	80.1	84.5	88.9	92.0
Capital taxes	1.9	1.9	1.9	1.9	2.0	2.0	2.1	2.2	2.2
Social contributions	87.4	93.2	99.5	102.4	106.3	102.4	105.0	107.5	111.2
Grants	2.4	2.5	2.6	2.6	2.4	2.4	2.4	2.4	2.5
Other revenue	36.6	37.0	39.4	38.4	36.2	35.3	34.6	34.8	35.9
Expenditure	298.8	298.6	300.8	305.5	312.6	318.8	325.7	331.2	338.0
Expense	284.4	285.7	288.1	290.2	296.4	303.0	311.4	319.1	325.5
Compensation of employees	59.0	58.7	59.2	58.6	59.3	58.7	59.5	60.1	61.0
Use of goods and services	46.8	45.6	47.0	46.3	46.2	46.1	46.5	46.6	47.1
Consumption of fixed capital	15.9	16.3	16.3	16.5	16.9	17.8	18.2	18.7	19.2
Interest	11.0	11.4	10.6	10.8	11.1	13.0	14.1	14.5	15.0
Subsidies	9.1	8.5	8.1	7.4	6.9	6.9	6.9	7.3	7.5
Grants	7.8	7.0	6.1	3.6	3.4	3.5	4.7	6.5	6.6
Social benefits	134.1	137.7	140.2	146.4	151.9	156.3	160.8	164.6	168.3
Other expense	0.6	0.6	0.6	0.7	0.7	0.7	0.7	0.7	0.8
Net acquisition of nonfinancial assets	14.4	12.8	12.6	15.3	16.2	15.8	14.3	12.1	12.4
Net operating balance	-15.8	-14.3	-12.2	-5.7	-7.0	-5.2	-5.2	-3.6	0.6
Net lending/borrowing	-30.2	-27.1	-24.8	-21.0	-23.2	-21.0	-19.5	-15.8	-11.8
Net acquisition of financial assets	-1.5	-4.0	…	…	…	…	…	…	…
Currency and deposits	-3.5	0.3	…	…	…	…	…	…	…
Securities other than shares	-1.5	-3.0	…	…	…	…	…	…	…
Loans	-1.3	-3.0	…	…	…	…	…	…	…
Shares and other equity	-0.8	-1.2	…	…	…	…	…	…	…
Insurance technical reserves	0.0	0.0	…	…	…	…	…	…	…
Financial derivatives	0.6	0.6	…	…	…	…	…	…	…
Other accounts receivable	5.1	2.3	…	…	…	…	…	…	…
Net incurrence of liabilities	28.7	23.0	…	…	…	…	…	…	…
Special Drawing Rights (SDRs)	0.0	0.0	…	…	…	…	…	…	…
Currency and deposits	-0.1	0.0	…	…	…	…	…	…	…
Securities other than shares	26.7	20.2	…	…	…	…	…	…	…
Loans	-2.2	2.0	…	…	…	…	…	…	…
Shares and other equity	0.0	0.0	…	…	…	…	…	…	…
Insurance technical reserves	0.0	0.0	…	…	…	…	…	…	…
Financial derivatives	0.0	0.0	…	…	…	…	…	…	…
Other accounts payable	4.3	0.9	…	…	…	…	…	…	…
Memorandum items									
Primary balance	-19.2	-15.7	-14.2	-10.1	-12.1	-8.0	-5.4	-1.3	3.2
Robust balance 1/	-29.7	-27.3	-22.6	-13.1	-12.4	-9.7	-8.5	-6.2	-4.2
Gross Debt	371.8	394.2	430.7	452.7	472.8	481.8	499.7	513.9	525.7
Nominal GDP (Euro bill.)	588.7	602.0	600.6	607.8	623.4	642.7	663.2	684.8	708.0

Sources: The Netherlands' Bureau for Economic Policy Analysis (CPB), Ministry of Finance, and Fund staff calculations.
1/ Robust balance is the structural primary balance excluding property income (mainly gas revenue).

Table 2c. Netherlands: General Government Integrated Balance Sheet, 2008–12

(In percent of GDP)

	2008	2009	2010	2011	2012
Net Worth	…	…	…	…	…
Nonfinancial assets	…	…	…	…	…
Net Financial Worth	-27.0	-29.7	-34.4	-38.8	-42.1
Financial assets	37.8	38.0	37.2	37.2	40.6
Currency and deposits	3.2	3.0	2.3	2.3	2.2
Securities other than shares	0.1	3.8	3.7	3.4	3.0
Loans	12.8	8.5	8.0	8.1	9.5
Shares and other equity	15.0	15.4	14.8	13.9	15.3
Insurance technical reserves	0.0	0.0	0.0	0.0	0.0
Financial derivatives	0.3	0.0	0.3	1.5	2.2
Other accounts receivable	6.4	7.3	8.0	7.9	8.4
Liabilities	64.8	67.6	71.6	75.9	82.6
Special Drawing Rights (SDRs)	0.0	0.0	0.0	0.0	0.0
Currency and deposits	0.1	0.1	0.1	0.1	0.1
Securities other than shares	49.3	49.0	52.9	56.6	61.7
Loans	10.8	13.7	13.2	14.1	16.0
Shares and other equity	0.0	0.0	0.0	0.0	0.0
Insurance technical reserves	0.0	0.0	0.0	0.0	0.0
Financial derivatives	0.0	0.0	0.0	0.0	0.0
Other accounts payable	4.6	4.9	5.5	5.2	4.9

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

Table 3. Netherlands: Medium-Term Macroeconomic Framework, 2010-18

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

	2010	2011	2012	2013	2014	2015	2016	2017	2018
National accounts (constant prices)									
Real GDP	1.6	1.0	-1.0	-0.5	1.1	1.7	1.8	1.9	2.1
Domestic demand	0.2	0.5	-1.5	-1.4	0.6	1.2	1.5	1.8	2.0
Private consumption	0.3	-1.0	-1.4	-1.3	0.4	0.7	1.0	1.4	1.6
Public Consumption	0.7	0.1	0.0	0.0	0.7	0.9	1.3	1.4	1.5
Gross fixed investment (total)	-7.2	5.7	-4.6	-1.9	1.5	3.0	3.1	3.6	3.6
Public	-2.9	-6.0	-1.5	-0.2	0.2	0.7	0.7	1.0	1.0
Private	-8.2	8.9	-5.3	-2.3	1.8	3.6	3.6	4.2	4.2
Residential	-13.2	6.5	-9.6	-4.5	-1.9	1.7	1.8	2.6	2.7
Business	-5.4	10.1	-3.2	-1.3	3.5	4.4	4.4	4.8	4.8
Stocks 1/	1.2	-0.1	0.1	-0.4	-0.1	0.0	0.0	0.0	0.0
Exports goods and services	11.2	3.9	3.3	2.2	2.1	2.7	2.9	3.3	3.3
Imports goods and services	10.2	3.6	3.1	1.6	1.6	2.1	2.6	3.4	3.4
Output gap	-1.5	-1.2	-2.8	-3.7	-3.4	-2.6	-1.8	-1.3	-0.7
Potential output growth	0.8	0.7	0.7	0.5	0.8	0.9	1.1	1.3	1.5
Gross investment (percent of GDP)	18.0	18.1	17.3	16.5	16.4	16.5	16.8	17.1	17.4
Gross national saving (percent of GDP) 2/	25.6	27.8	26.4	25.7	25.9	26.3	26.6	26.5	26.5
Prices and employment									
Consumer price index (year average)	0.9	2.5	2.8	2.8	1.7	1.4	1.4	1.5	1.5
GDP deflator	1.1	1.2	0.7	1.7	1.4	1.3	1.3	1.3	1.3
Employment	-1.1	0.0	0.4	-0.3	-0.4	0.6	0.7	0.7	0.5
Unemployment rate (Eurostat definition)	4.5	4.4	5.3	6.3	6.5	6.2	5.9	5.6	5.4
External									
Current account balance (percent of GDP)	7.7	9.7	9.1	9.2	9.6	9.8	9.8	9.5	9.1
Public sector accounts (percent of GDP)									
Revenue	45.6	45.1	45.9	46.8	46.4	46.3	46.2	46.1	46.1
Expenditure	50.7	49.6	50.1	50.3	50.1	49.6	49.1	48.4	47.7
General government balance	-5.1	-4.5	-4.1	-3.4	-3.7	-3.3	-2.9	-2.3	-1.7
Robust balance (percent of potential GDP) 3/	-5.0	-4.5	-3.8	-2.2	-2.0	-1.5	-1.3	-0.9	-0.6
General government debt	63.1	65.5	71.7	74.5	75.8	75.0	75.4	75.1	74.2

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

1/ Contribution to GDP growth.

2/ Value implied by investment and current account data.

3/ Robust balance is the structural primary balance excluding property income (mainly gas revenue).

Table 4. Netherlands: External Sector, 2010-14

	2010	2011	2012 Est.	2013 Proj.	2014 Proj.
(in percent of GDP except where otherwise stated)					
Balance on Current Account	7.7	9.7	9.1	9.2	9.6
Trade Balance	7.2	7.8	8.0	8.4	8.7
Exports of goods	61.4	65.6	69.7	71.7	72.8
Imports of goods	54.2	57.8	61.7	63.3	64.1
Service Balance	1.4	1.5	1.2	1.1	1.1
Exports of services	12.3	12.8	13.0	13.5	13.7
Imports of services	10.9	11.3	11.8	12.4	12.6
Factor Income	1.0	2.3	1.7	1.5	1.5
Receipts	12.8	14.0	13.4	13.0	12.8
Expenditures	11.9	11.7	11.7	11.5	11.3
Current transfers, net	-1.9	-1.8	-1.8	-1.8	-1.8
Balance on capital account	-0.2	0.0	-0.2	-0.2	-0.2
Balance on financial account	-3.6	-8.7	-9.0	-9.0	-9.4
Direct investment, net	-8.3	-2.5	-1.9	-3.8	-3.1
Direct investment abroad	-7.0	-4.2	-5.9	-5.7	-5.2
FDI in Netherlands	-1.3	1.6	4.0	1.9	2.1
Portfolio investment, net	5.3	1.9	1.8	2.4	1.6
Other investment	-0.5	-7.8	-8.8	-7.5	-7.7
Other investment, official	-9.2	-5.1	0.0	0.0	0.0
Reserve assets	-0.1	-0.3	0.0	-0.1	-0.1
Errors and omissions, net	-3.9	-1.0	0.0	0.0	0.0

Sources: DNB and Fund staff calculations.

Table 5. Netherlands: Financial Soundness Indicators (Deposit Takers)

	2008	2009	2010	2011	2012 1/
End-of-period, % (unless otherwise indicated)					
Regulatory Capital to risk weighted assets	11.9	14.9	13.9	13.5	14.2
Regulatory Tier 1 Capital to risk weighted asssets	9.6	12.4	11.8	11.8	12.2
Nonperforming loans net of provisions to capital	35.0	51.8	47.1	44.2	46.7
Nonperforming loans to total gross loans	1.7	3.2	2.8	2.7	3.1
Return on assets	-0.4	0.0	0.3	0.2	0.0
Return on equity	-12.5	-0.4	7.1	5.4	-0.1
Interest Margin to Gross Income	182.6	69.8	61.7	73.0	75.1
Noninterest expenses to Gross income	223.1	78.1	77.1	86.6	101.6
Liquid asssets to total assets	21.7	25.8	21.4	24.8	24.3
Liquid assets to short-term liabilities	202.1	187.4	176.2	175.8	179.5
Capital to assets	3.2	4.3	4.4	4.3	4.7
Large exposures to Capital (number)	82.0	54.0	51.0	…	…
Geographical distribution of loans to total loans					
Domestic economy	42.7	46.6	55.4	52.2	56.5
Advanced economies, excluding China	49.9	46.9	39.2	41.5	36.9
China	7.4	6.5	5.4	6.2	6.6
Africa	1.6	1.8	1.8	1.7	0.1
of which: Sub-Sahara	1.5	1.7	1.7	1.6	0.1
Central and Eastern Europe	36.4	38.3	45.5	41.0	3.0
Commonwealth of independent states and Mongolia	11.6	9.5	9.7	10.4	0.7
Developing China, including China	20.3	22.5	20.3	19.0	1.2
Middle-East	5.2	5.4	4.7	4.6	0.2
Western Hemisphere	24.9	22.5	17.9	23.4	1.4
Total	100.0	100.0	100.0	100.0	100.0
Gross asset position in financial derivatives to capital	382.3	148.7	120.6	162.8	159.1
Gross liability position in financial derivatives to capital	414.9	175.2	135.0	179.7	185.5
Trading income to total income	-67.1	11.9	3.9	4.0	-8.4
Personel expenses to noninterest expenses	50.1	48.3	56.1	49.3	47.0
Foreign currency denominated loans to total loans	20.0	17.0	19.7	18.0	17.5
Foreign currency denominated liabilities to total liablilities	22.5	19.7	21.8	22.4	19.7
Net open position in equities to Capital	31.1	34.1	24.4	20.6	14.4

Sources: DNB and Fund staff calculations.
1/ Data for 2012Q4.

Table 6. The Netherlands: Implementation of the Main FSAP Update Recommendations

Recommendations	Implementation
Macroprudential Management Priority	
Assign priority to developing macro-prudential instruments.	Macroprudential instruments to be introduced through the implementation of CRD IV will include anticyclical buffers, RRP's, leverage constraints, stress tests, and higher risk weights for real estate. The introduction of a domestic SIB-buffer has been announced.
Announce maximum loan-to-value (LTV) ratios for new lending, and consider linking higher LTVs to higher capital ratios.	Since 2013 the maximum LTV ratio will be gradually reduced from 106 percent to 100 percent.
Provide supervisors with powers to vary the level of designated macroprudential instruments in response to developments.	A Financial Stability Committee has been set up with representatives of DNB (chair), the Ministry of Finance (MoF), and the AFM to discuss macroprudential developments, issue warnings and recommendations, and monitor the implementation of ESRB-recommendations. Legislation to be in force in 2014 will expand DNB's mandate to include macroprudential supervision.
Announce plans to reduce mortgage interest deductibility (MID) over the medium–term.	The new tax regime limits MID only to amortizing loans. In addition the maximum tax rate for deductibility will be capped and gradually reduced.
Twin Peaks	
Provide the DNB and AFM greater discretion to put in place enforceable rules. The lack of sufficient rule making authority leads to ad hoc approaches that risk becoming arbitrary and subject to legal challenge.	The DNB and the AFM have operational independence to set rules within their legal mandate, and are equipped with enforcement powers. Rules not under the DNB and AFM powers can be requested in regular top-level discussions and formally to the MoF in an annual open legislation letter. The Minister responds to these requests in a letter to Parliament.
Afford legal protection to DNB and the AFM as institutions, for their official actions, except in cases of gross negligence or willful misconduct, in line with practice in many neighboring countries.	Since July 2012 legislation limits the legal liability of the DNB and the AFM. In February 2012, a clear division of responsibility between the President of DNB (central bank tasks) and a newly appointed Head of Supervision (prudential supervision) was introduced by a change in the DNB governance.
Continue integration of DNB staff across banking, insurance, and pensions functions, to draw the synergies of having a single regulator.	In renewing the Mission Statement of the DNB, its new Board of Directors has identified the need to strengthen synergies within DNB. Proposals have been made to assign cross-sectoral responsibilities to a Division Director and several initiatives have encouraged job-shifting between Divisions.
Microprudential Bank and Insurance Supervision	
Establish routine reporting requirements to strengthen monitoring and risk modeling.	Improving data quality and availability has been identified as a main priority in DNB's thematic approach. Legislation granting power to DNB to request information for monitoring and risk modeling purposes needs to be passed.
Intensify supervision of large international financial institutions, with greater emphasis on group supervision and soundness of business models. Greater international cooperation, beyond participation in colleges of supervisors, is warranted.	The new supervisory approach introduced in February 2012, internalizes the broader scope of supervision and includes elements of supervision, with two new risk drivers added: i) business models and strategy; and ii) behavior, culture, and governance. Legislation granting powers to the DNB to request information on foreign subsidiaries of Dutch financial groups needs to be passed.
Adopt more proactive and decisive approach, including timely off-site inspection and corrective actions that rely less on moral suasion.	The new supervisory approach aims at making supervision more comprehensive and intrusive, including with risk-based, multidisciplinary, and sector-wide assessments, strengthened macro-orientation, and thematic reviews. To support it, a new separate Division has been set-up with a stronger role for experts, a separate department for internal risk management, and a separate department responsible for intervention policy to safeguard timely intervention.

Table 6. The Netherlands: Implementation of the Main FSAP Update Recommendations (continued)

Recommendations	Implementation
Securities market	
Strengthen the AFM's ability to enforce issuers' compliance with financial reporting standards.	The AFM's legal ability to enforce issuers' compliance with financial reporting standards has been strengthened by amendments to the Act on Financial Reporting.
Strengthen the regulatory and supervisory framework for management companies of collective investment schemes.	In July 2011 the European Alternative Investment Fund Managers Directive (AIFMD) was published that covers all of these aspects. The Netherlands will implement the Directive by end-July 2013.
Pensions	
Develop a communication plan on recent and prospective changes in payouts to stakeholders.	The DNB, the Federation of the Dutch Pension Funds and the Ministry of Social Affairs and Employment, have developed a communication plan for approximately 70 funds to lower their entitlements in 2013. The DNB will encourage and monitor pension funds' transition process to the new type of pension contract.
Require incorporation of professional Board members for pension funds beyond a minimum size, and provide legal authority that allows direct supervision of core pension activities independently of the entity performing them.	From July 2013 new legislation on the governance of pension funds will be in force. Key elements include reinforcing countervailing powers in the governance structure and improving quality by creating seats for professional board members. DNB already has, through the board of pension funds, powers to supervise all core pension activities even if outsourced.
Crisis management and bank resolution	
Reform the Deposit Guarantee Scheme so that it is: (i) ex ante funded, (ii) authorized to fund bank resolution operations, and (iii) enjoys depositor preference. (¶49)	The introduction of the DGS with an ex-ante funded scheme has been postponed from 2013 to 2015 as a result of the "resolution tax" to be imposed on banks in 2014 after the SNS Reaal nationalization. The Dutch Intervention Act in force since June 2012 has introduced the option to transfer deposits with DGS resources. The introduction of depositor preference in the Netherlands will be discussed at the European level.
Strengthen the institutional framework for crisis management by: (i) shifting decision-making power from the Judiciary to DNB in the context of bank resolution, and (ii) specifying more clearly the respective roles of the MoF and DNB in bank resolution.	The Intervention Act has strengthened the role the both DNB and the MoF in crisis management and clarified their responsibilities and roles. The Intervention Act provides for powers for DNB to resolve banks and insurance companies in a timely and orderly manner, powers for the MoF to ensure the stability of the financial system, and limitation of the rights of contracting parties of a financial institution after a measure ("trigger event") taken by DNB or the MoF.
Improve the framework for official financial support by establishing a standing budgetary authorization for the Government to fund solvency support in a manner that avoids risk of moral hazard.	The Netherlands has not amended the Public Accounts Law or other relevant legislation to establish a standing budgetary authorization for the Government to fund solvency support. If a financial institution needs solvency support, the State can decide to recapitalize it under strict conditions and only as a last resort. The Intervention Act provides for the possibility for the Dutch Minister of Finance to expropriate common equity and (subordinated) debt.
Improve the framework for bank resolution by establishing a single regime for resolving banks under official control; such regime should set appropriate objectives (including financial stability), as well as tasks and powers for the official administrators.	Since June 2012 the Intervention Act has strengthened the role of both DNB and the Ministry of Finance in crisis management and clarified the different responsibilities and roles in the process.

INTERNATIONAL MONETARY FUND

KINGDOM OF THE NETHERLANDS—NETHERLANDS

April 17, 2013

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By | The Netherlands Team

CONTENTS

FUND RELATIONS

(As of March 31, 2013)

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

General Resources Account

	SDR Million	Percent of Quota
Quota	5,162.40	100.00
Fund holdings of currency	3,610.57	69.94
Reserve Tranche Position	1,551.89	30.06
Lending to the Fund	1,135.05	

SDR Department

	SDR Million	Percent of Allocation
Net cumulative Allocation	4,836.63	100.00
Holdings	4,616.94	95.46

Outstanding Purchases and Loans

None

Latest Financial Arrangements

None

Projected Obligations to Fund[6]

(SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2013	2014	2015	2016	2017
Principal					
Charges/interest	0.19	0.23	0.23	0.23	0.23
Total	0.19	0.23	0.23	0.23	0.23

Implementation of HIPC Initiative

Not Applicable

Implementation of Multilateral Debt Relief Initiative (MDRI)

Not Applicable

Implementation of Post-Catastrophe Debt Relief (PCDR)

Not Applicable

Exchange Rate Arrangements

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

Last Article IV Consultation

Discussions for the 2013 Article IV consultation were held in Amsterdam and The Hague from March 5 to 19, 2013. The staff report for the 2011 Article IV Consultation (IMF Country Report No. 11/142, June 21, 2011) was considered by the Executive Board on June 10, 2011. The Article IV discussions with the Netherlands are on the standard 12-month consultation cycle.

[6] 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 Integrated Economic Accounts 1995 (ESA95) in 1999. As a one-off matter, a number of institutional reforms had a significant impact on national account and other data in 2006. Most importantly, the reform of healthcare insurance caused a significant reclassification of private consumption into public consumption. This shift had a big impact on the growth rates of the components concerned, but overall GDP was not affected. **Government Accounts** Until 2004, general government data compiled in the context of the national accounts have been used as the basis, together with additional fiscal data, for compiling and reporting GFS according to the GFSM 2001 for publication in the IMF's Government Finance Statistics Yearbook (GFSY). This practice was ceased in 2005, when the authorities agreed that the IMF uses the fiscal data reported to EUROSTAT for publication in the GFSY (bridged from 1995 ESA formats to the GFSM 2001 framework). **Balance of Payments Accounts** The DNB compiles the balance of payments in close cooperation with the CBS. An agreement between the CBS and the DNB was formally ratified in 2006 to further strengthen the decades-long cooperation between the two institutions. Balance of payments is compiled according to the Balance of Payments Manual, fifth edition (BPM5) and the legal requirements of the ECB and Eurostat. **Financial Soundness Indicators** The Netherlands participates in the financial soundness indicators (FSIs) project. Quarterly data for most of the 40 FSIs are posted on the FSI website for the period 2008:Q1 to 2012:Q4.	
II. Data Standards and Quality	
Subscriber to the Fund's Special Data Dissemination Standard since June 11, 1996.	Data ROSC is available.

Netherlands—Table of Common Indicators Required for Surveillance

(As of April 16, 2013)

	Date of Latest Observation	Date Received	Frequency of Data /8	Frequency of Reporting /8	Frequency of Publication /8	Memo Items: Data Quality—Methodological Soundness /9	Memo Items: Data Quality—Accuracy and Reliability /10
Exchange Rates	Current	Current	D and M	D and M	D and M		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities /1	3/13	4/13	M	M	M		
Reserve/Base Money 2/	3/13	4/13	M	M	M		
Broad Money 2/	3/13	4/13	M	M	W and M		
Central Bank Balance Sheet	3/13	4/13	M	M	M		
Consolidated Balance Sheet of the Banking System	2/13	3/13	M	M	M		
Interest Rates /3	Current	Current	D and M	D and M	D and M		
Consumer Price Index	3/13	4/13	M	M	M	O, O, LO, O	O, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing /4—General Government /5	Q4/12	Q1/13	Q	Q	Q	LO, LO, LO, O	LO, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing /4—Central Government	Q4/12	Q1/13	Q	Q	Q		
Stocks of Central Government and Central Government-Guaranteed Debt /6	Q4/12	Q1/13	Q	Q	Q		
External Current Account Balance	Q4/12	Q1/13	Q	Q	Q	O, O, O, O	O, O, O, O, O
Exports and Imports of Goods and Services	Q4/12	Q1/13	Q	Q	Q		
GDP/GNP	Q4/12	Q1/13	Q	Q	Q	O, O, O, O	LO, O, O, O, O
Gross External Debt	Q4/12	Q1/13	Q	Q	Q		
International Investment Position 7/	Q4/12	Q1/13	Q	Q	Q		

1/ Includes reserve assets pledged of otherwise encumbered.

2/ Pertains to contribution to EMU aggregate.

3/ Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

4/ Foreign, domestic bank, and domestic nonbank financing.

5/ The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

6/ Including currency and maturity composition.

7/ Includes external gross financial asset and liability positions vis-à-vis nonresidents.

8/ Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).

9/ Reflects the assessment provided in the data ROSC (published on January 10, 2008, and based on the findings of the mission that took place October 3-17, 2007) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O); largely observed (LO); largely not observed (LNO); not observed (NO); and not available (NA).

10/ Same as footnote 9, except referring to international standards concerning (respectively) source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.

INTERNATIONAL MONETARY FUND
Public Information Notice

EXTERNAL
RELATIONS
DEPARTMENT

Public Information Notice (PIN) No. 13/48
FOR IMMEDIATE RELEASE
May 10, 2013

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

IMF Executive Board Concludes 2013 Article IV Consultation with the Kingdom of the Netherlands—Netherlands

On May 1, 2013, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Kingdom of the Netherlands.[1]

Background

The Netherlands is an AAA euro area (EA) economy, but with significant private sector imbalances. It shares an AAA credit rating and relatively robust public finances with Germany, Finland, and Luxembourg. Its sovereign bonds enjoy safe haven status, and it has a growing net international asset position since 2008. However, it also has a highly indebted household sector, significant financial sector challenges, declining real estate prices, and weak domestic demand. As a result, the Netherlands' GDP growth, unemployment, and public debt dynamics since the onset of the global financial crisis have diverged from other AAA EA economies.

The extended weakness in activity in the Netherlands reflects the slow deleveraging of the household and financial sectors. Prior to 2008, in the context of ample global liquidity, a favorable macroeconomic environment and supportive tax and regulatory incentives, households had accumulated substantial mortgage debt with generous loan-to-value

[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. 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.

ratios and advantageous mortgage interest deductibility. Household debt as a share of disposable income doubled over the past decade—to the highest in the euro area—and drove up house prices to unsustainable levels. Meanwhile, banks' assets-to-GDP rose to a peak of 4 times GDP by 2011 accompanied by a sharp increase in wholesale funding. Zoning and other restrictions prevented an adequate supply response to cool house prices. The global financial crisis of 2008 was the external trigger that led to a slow deleveraging spiral accompanied by falling confidence, declining house prices, and increasing financial strains. As a result, despite the recovery of global trade, a balance sheet recession has left GDP in the Netherlands below the 2008 level five years on.

Balance sheet adjustments in the context of weakness in the rest of the EA will continue to be a drag on the recovery and delay external adjustment. Despite the nominal 18-percent correction since the peak, a further decline in house prices is expected to weigh on consumer confidence and consumption. With the banking system highly exposed to the real estate sector and continuing to rely on wholesale funding, the adjustment of its balance sheets is still underway. Exports to the rest of the EA are expected to pick up only gradually against the backdrop of a slow EA recovery. This implies that under the baseline, following an estimated 0.9 percent contraction last year, output is projected to fall by an additional 0.5 percent in 2013 before recovering by 1.1 percent in 2014. Reflecting the need to shore up balance sheets, the current account surplus is expected to widen marginally through 2014. In line with these projections, the output gap will narrow only gradually over the forecast horizon.

The baseline outlook is subject to a number of downside risks. The interaction of household and bank balance sheets linked through changes in house prices makes the outlook subject to unusually large uncertainty. A drop in house prices in excess of what is currently assumed would further restrain both household consumption and lending by banks, and could in turn lead to a deepening cycle of falling house prices and deleveraging. Solvency requirements in pension funds also weigh on consumer confidence as benefits and contributions need to be adjusted procyclically. Persistent uncertainty about structural policies and the degree of procyclicality of fiscal policies could also act as a restraint on household spending decisions and postpone the recovery. External developments, especially in the rest of the euro area, that add to uncertainty, generate financial stress, weaken consumer confidence, and lower exports would affect activity adversely in the Netherlands (Figure 4). A more medium-term risk is that policy measures fail to avoid a decline in the economy's growth potential. On the upside, a rapid reduction in uncertainty and a recovery in consumer confidence could help support the outlook.

Executive Board Assessment

Executive Directors commended the Netherlands's track record of robust public finances and status as a safe haven. Directors noted that notwithstanding these strong fundamentals, the economy faces challenges from a highly indebted household sector, significant financial system stresses, still declining real estate prices, and weak domestic demand. Adverse external developments, especially in the euro area, could also pose risks. Directors agreed that policy priorities ahead should focus on restoring growth and managing downside risks while allowing for an orderly adjustment of private sector balance sheets.

Directors commended the authorities' commitment to maintaining fiscal sustainability and welcomed the decision not to undertake any additional fiscal measures in 2013. In light of the ongoing economic uncertainty, most Directors recommended that fiscal policy should be more flexible, focus on structural targets, and allow automatic stabilizers to operate fully. The envisaged consolidation under the 2012 Update of the Stability Program remains appropriate and would ensure sustainable public debt dynamics over the medium term. Some Directors were of the view that the authorities' emphasis on achieving the headline deficit target provided policy credibility and anchored expectations.

Noting the vulnerabilities facing the financial system, Directors emphasized the need to reduce its dependence on wholesale financing and increase bank capital from private sources. Building additional capital buffers will be important to guard against any systemic threats from the real sector as well reduce vulnerability to shocks. Directors commended the implementation of most Financial Sector Assessment Program (FSAP) recommendations and encouraged further action to strengthen domestic supervision and reporting. A clear framework for creditor hierarchy, at the EU level, which carefully establishes burden sharing between financial stability and protection of taxpayers, will also be important.

Directors underscored the need to remove housing market distortions. In this context, they saw need for unimpeded adjustment of house prices, transparent pricing of real estate sector risk, and avoidance of additional contingent liabilities by the government. Directors commended the steps taken to reduce maximum loan-to-value ratios and eliminate mortgage interest deductibility and called for further efforts in these areas after the market has stabilized.

Directors emphasized that labor market reforms as well as measures to increase productivity and raise human capital will be important to boost the economy's growth potential. Reform efforts should focus on reducing the duality in labor markets and period of unemployment benefits. Channeling resources into research and development and improving the quality of education will also be essential.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The staff report (use the free Adobe Acrobat Reader to view this pdf file) for the 2013 Article IV Consultation with the Kingdom of the Netherlands is also available.

Netherlands: Selected Economic and Social Indicators

	2010	2011	2012	2013 1/	2014 1/
Real economy (change in percent)					
Real GDP	1.6	1.0	-1.0	-0.5	1.1
Domestic demand	0.2	0.5	-1.5	-1.4	0.6
CPI (harmonized)	0.9	2.5	2.8	2.8	1.7
Unemployment rate (in percent)	4.5	4.4	5.3	6.3	6.5
Gross national saving (percent of GDP)	25.6	27.8	26.4	25.7	25.9
Gross investment (percent of GDP)	18.0	18.1	17.3	16.5	16.4
Public finance (percent of GDP)					
General government balance	-5.1	-4.5	-4.1	-3.4	-3.7
Structural balance	-5.0	-4.5	-3.8	-2.2	-2.0
General government debt	63.1	65.5	71.7	74.5	75.8
Interest rates (percent)					
Government bond yield	3.0	3.0	1.9	...	...
Money market rate	0.8	1.4	0.6	...	...
Balance of payments (in percent of GDP, unless otherwise indicated) 2/					
Trade balance	7.2	7.8	8.0	8.4	8.7
Current account	7.7	9.7	9.1	9.2	9.6
Exports of goods and services	73.7	78.4	82.7	85.2	86.6
Volume, growth (in percent)	11.2	3.9	3.3	2.2	2.1
Imports of goods and services	65.1	69.2	73.5	75.7	76.7
Volume, growth (in percent)	10.2	3.6	3.1	1.6	1.6
Net oil exports (billions of US$)					
Net foreign direct investment	-8.3	-2.5	-1.9	-3.8	-3.1
Official reserves, excl. gold (US$ billion)					
Exchange rate					
Exchange rate regime					
U.S. dollar per euro	1.3	1.4	1.3	1.3	1.3
Nominal effective rate (2005=100)	102.9	102.8	100.4	101.9	101.3
Real effective rate (2005=100) 3/	99.2	99.1	97.3	99.0	99.1

Sources: International Financial Statistics, OECD, Eurostat, Dutch authorities, and IMF Staff estimates.

1/ Staff projections.

2/ Transactions basis.

3/ Based on relative normalized unit labor costs.

Statement by the Staff Representative on the Kingdom of the Netherlands—Netherlands
May 1, 2013

This statement summarizes developments in the Netherlands since the issuance of the staff report. This new information is in line with staff recommendation and does not change the thrust of the staff appraisal.

In April 2013, the Dutch government and social partners have reached agreement ("Social Accord") on fiscal policies and labor market reforms. The agreement postpones the decision on additional spending cuts for 2014 until autumn. The cuts of €4.3 billion (0.7 percent of GDP) will be reassessed in light of new information on the state of the economy. The postponement of a decision on additional spending cuts is welcome and in line with staff recommendations not to implement additional tightening measures. The agreement also postpones the gradual reduction in the duration of unemployment benefits until 2016; it unifies redundancy procedures, provides for a transitional allowance for those employees whose contracts have been terminated, and allows temporary employees to qualify for a permanent contract more quickly. Finally, the maximum pension tax incentive will be reduced by 0.4 percent and no tax incentive will be given for pensionable annual earnings above €100,000.

Statement by Menno Snel, Executive Director for the Kingdom of the Netherlands—Netherlands and Robert Mosch, Advisor to Executive Director
May 1, 2013

We thank staff for their thorough analysis of the Dutch economy. The Dutch authorities appreciated the constructive discussions during the mission, and share the main gist of the staff report.

On the policy agenda

Since the start of its term at the end of 2012, the Dutch government has pursued an ambitious agenda of structural reform and budgetary consolidation. Currently, reforms of the pension system, health care, labor market and housing market are being implemented.

To increase the sustainability of the pension system, the retirement age will be gradually increased from 65 to 67 years and indexed to life expectancy. The pace of retirement age increases has been stepped up to three months a year until 2018, and four months a year thereafter. The subsidy for pension savings will be better targeted by eliminating the favorable fiscal treatment for annual income above EUR 100,000.

Wide-ranging measures have been introduced to stem the rise in health care costs. Over the government's term, growth of health care expenditures will be cut back by EUR 5 billion (0.8% of GDP). Health care insurers and providers will bear more risk, entitlements will be cut back and co-payments will increase.

On the labor market, several measures are being taken to counter unemployment. For instance, the government will support initiatives for retraining and measures to increase job-to-job mobility. Specific measures will be introduced to reduce youth employment and promote re-integration of older unemployed workers. The pace of reforms will be gradual to take account of the current low growth environment and consumer confidence, and in order to lessen any potential negative impact in the short term. The government will also take measures that aim to achieve a better balance between flexible and permanent employment by increasing the protection for temporary workers while reducing rigidities for permanent workers.

As part of a wide-ranging reform, the implicit subsidy to the housing market is being cut back by half. Mortgage Interest Deductibility (MID) has been limited to 30-year amortizing mortgages, and the rate at which the mortgage is deductible will be gradually lowered starting January 1, 2014. Also, the Loan-to-Value (LTV) ratio is being lowered from 106% to 100% in six years – gradually, so as to not be procyclical in a downward housing market. Although assets of households are significantly larger than their liabilities, these measures will be instrumental to address risks that may arise from high household debt. An important element of reforms in the rental market is to bring current subsidized rents more in line with market values, thereby improving allocational efficiency and realizing a better targeting of public resources.

Given the impact of reforms, the government has actively pursued broad support. The current political situation, with the government lacking a majority in the Senate, and low consumer confidence require an inclusive decision making process. A gradual and inclusive approach is a general feature of successful reforms. In recent months, the government managed to reach agreement with opposition parties on the reform of the housing market, and with labor unions and employers' federations on the reform of the labor market and health care system.

On staff's assessment

While we share the main thrust of staff's appraisal, we would like to offer the following comments.

Staff seems to ignore the sound fundamentals of the Dutch economy when it compares the Netherlands to countries which are under market pressures. Among other things, the current account surplus, the funded pension system with assets over 100% of GDP, the government debt ratio below OECD average, the strong competitiveness position, and the high labor participation rate do not warrant such a comparison. Indeed, international rankings such as the OECD's Programme for International Student Assessment (PISA), the competiveness indicators of the World Economic Forum, and the ranking in the Doing Business report would call for a more balanced description.

We see little argument to consider the budgetary policy being excessively procyclical, as staff suggests. Automatic stabilization is an important element of the Dutch budgetary system. By letting the budget balance deteriorate from a surplus at the onset of the crisis to current sizable deficits, the budget has provided support to the real economy. Moreover, interventions in the financial sector, which resulted in a rapid increase in government debt and government guarantees, have supported the functioning of the financial system. Although the original aim was to bring the deficit within the 3% limit in 2013, the government decided not to take additional measures for 2013 as economic conditions have deteriorated. The deficit is likely to surpass the 3% limit for the fifth consecutive year in 2013.

For 2014, the government remains committed to a deficit within the European limit of 3% of GDP. Whereas in 2013 cyclical conditions will warrant an extension of the EDP deadline (the nominal budget deficit will likely stay above 3% of GDP even as the structural budget balance will improve), this is not the case in 2014. Without additional measures, the structural budget balance is set to deteriorate. Surpassing the 3% limit while also not improving the underlying budgetary position could jeopardize the credibility of the medium-term consolidation plan as well as the recently reformed EU governance framework.

Regarding the characterizations of the authorities' views, we feel that the short descriptions do not always do justice to the information and views shared with staff during the mission. In our view, staff could have elaborated in more detail on the extensive discussions and on the information provided. This would portray a more nuanced view than currently follows from these paragraphs. More specifically, a recurrent theme over the past year has been the IMF's emphasis on the cyclical nature of the current economic situation, whereas the authorities take the view that economic growth will be lower for an extended period of time, which argues against back loading the necessary budgetary adjustment and structural reforms.

Staff mentions that structural measures will be needed to reduce the current account surplus. However, it is not clear why and how the current account surplus should be reduced by policy measures in the short term, since there are no indications that the Dutch current account surplus is the result of underlying distortions. Therefore, before action is taken in an effort to reduce the surplus, a much better understanding would be needed of the underlying mechanisms that are responsible for the structural surplus. For example, as staff mentions, data on the current account should be treated with great caution due to statistical issues. In this respect, we also note that some of staff's other recommendations, such as limiting household debt related to the housing market, could actually result in an increase of the surplus.

On the financial sector

We generally agree with staff's assessment of macroprudential policy and supervision in the Netherlands, including the recent reforms to the macroprudential framework and supervision. Table 6, on implementation of the main recommendations of the 2011 FSAP, shows that the results of the FSAP continue to be relevant for financial stability policy in the Netherlands. The new Financial Stability Committee, which met for the first time in December 2012, should prove to be a strong forum to discuss macroprudential issues at the national level. The three elements of a new supervisory approach – cultural change, stronger risk-based supervision, and macro, sectoral, and thematic assessments of risk – are based in large part on international best practices compiled by the Fund. We add to this list the extensive top-down and bottom-up stress testing of the financial sector by DNB (the Dutch Central Bank), which is a critical tool in assessing the resilience of the financial sector. DNB is currently undertaking an ongoing asset quality review (AQR) of commercial real estate, also meant to identify pockets of distress and ensure adequate valuations by banks.

We concur with staff's identification of the financial stability risks. As staff points out, a renewed escalation of the European debt crisis remains the major risk, and unanticipated shocks to domestic confidence or persistently low growth could also have a clear impact on the outlook. In its most recent Overview of Financial Stability, DNB has also emphasized the risks for banks and pension funds of the low interest rate environment, banks' retail funding gap and the use by banks of secured funding, which can shift risks between investors. Finally, current policies are in line with staff's recommendation for proactive measures to shore up capital from private sources. The Netherlands plans to use the national discretion available in CRD4 to introduce additional SIFI buffers and Systemic Risk Buffers to address risks within the banking system.

In line with staff's recommendation, the authorities took steps to reduce procyclical elements of the pension system. Measures have already been implemented to reduce the volatility in the market-based discount rate due to illiquidity of interest swap markets for long horizons. Furthermore, by lengthening the recovery period and smoothing benefit reductions, the procyclical impact of decisions has been limited. In addition, the Dutch authorities are working towards a new regulatory system as part of reforms to safeguard the sustainability of pension contracts. Even though this financial supervision framework is based on marked valuation, the reforms are expected to help reduce the procyclicality of contributions and benefits. Day-to-day volatility will be smoothened through several adjustment mechanisms.