DOCUMENT OF INTERNATIONAL MONETARY FUND AND FOR OFFICIAL USE ONLY

The contents of this document are preliminary and subject to change.

GRAY/14/3574

December 1, 2014

Statement by Ms. Kapwepwe and Mr. Uwatt on Kingdom of the Netherlands - Netherlands (Preliminary) Executive Board Meeting December 3, 2014

We note that the Dutch economy is recovering after two consecutive years of decline albeit slowly. The positive impact on growth of rising exports is being subdued by contracting domestic demand, particularly consumption, due to deleveraging pressures. This means that growth is likely to remain low in the near to medium-term amidst sizeable downside risks including geopolitical tensions, weak euro area growth, and huge household debt. It is, therefore, important for the Dutch authorities to urgently address the household debt problem, strengthen the financial sector, and reform the rental market in order to enhance growth while also continuing with accommodative macro policies and structural reforms to raise productivity in the economy.

The huge household leverage, significant loss of household wealth especially among the young households where nearly two-thirds of mortgage are underwater, and the rising but unbalanced household debt burden due to rising real interest rates constitute huge drag on the economy. Unfortunately, the progress on household deleveraging has been slow despite government policies in recent years regarding mortgages that have helped stabilize expectations and housing prices. This trend needs to be reversed. Accordingly, we support measures that would ease the household debt burden especially for the young households and raise their propensity to consume including raising the limit for tax-free transfer, reprofiling of underwater mortgages, reduced pension contribution for the young, and reducing the stigma of personal bankruptcy. We take note of the authorities’ view on mortgage profiling and the recent pension reforms that have reduced the annual pension accrual rate and which the young households are expected to benefit.

An important legacy of the housing crisis is highly leveraged banks. With the economy remaining weak coupled with the banks' own desire to deleverage, the banking system would not be in a good position to support economic recovery in the absence of stronger capital and liquidity buffers. The recently raised capital by banks appear sufficient to support moderate growth but additional capital expected to be raised by 2019 to meet the Basel requirements may require frontloading in order to shield banks from shocks. Besides, there is the concern that banks may be pushed to take excessive risks as they search for high rates of return on capital. In this sense, we support further efforts to improve the risk management and resolution frameworks just as we welcome the authorities' decision to place the resolution authority with the DNB. We also consider appropriate the authorities' decision to gradually reduce loan-to-value (LTV) ratios to 100 percent by 2018. We, however, do not see the urgent need to fast track LTV reduction after 2018. Rather we share the authorities' view that further lowering of the LTVs should be accompanied by other housing reforms and should be dependent on actual developments in the housing market at that time.

Correcting distortions in the housing market is also important for economic recovery. While we take note of measures already taken to shrink the social housing sector and expand the rental market, more still needs to be done. We see urgent need to significantly scale back government involvement in the social housing sector and allow the private sector to take the lead. The zoning regulations should be relaxed in order to increase housing supply. Furthermore, we believe that a shift to risk-based pricing and the lowering of the maximum guarantee threshold under the National Mortgage Guarantee Scheme would reduce distortions in mortgage financing and contingent liabilities to the government.

Repairing the household and banks' balance sheets is critical to the economy, but supportive macro-fiscal policies and structural reforms can speed up the recovery process. To this end, we agree with staff on the need to slow down the pace of fiscal consolidation and maintain neutral fiscal policy stance in the medium-term with focus on structural balance rather than headline deficits. This would be further enhanced with a shift to a medium term budget framework to allow for greater predictability and responsiveness of fiscal policy to shocks. *We, however, note the authorities' preference for a trend-based fiscal framework rather than medium-term framework. Staff comment on this is welcomed*. In addition, we support tax reforms that would eliminate asymmetrical treatment of debt and equity, VAT distortions, and labor tax wedge.

On structural reforms, we see scope for additional measures that would ease protection for regular workers, reduce the cost of dismissals, and support employment. The economy would also benefit greatly from increased financing for SMEs in which case improving the quality and sharing of credit information would be critical. We, however, take note of the low demand by SMEs for some of the programs put in place to support them including Guarantee Schemes, and urge the authorities to find ways of improving these arrangements while also developing alternative sources of financing for SMEs.