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**Statement by Mr. Palei and Mr. Tolstikov on Kingdom of the Netherlands - Netherlands
(Preliminary)
Executive Board Meeting
December 3, 2014**

We thank staff for a set of informative papers and Mr. Snel and Ms. De Lint for their helpful Buff statement. While growth has resumed in the Netherlands, it is driven mostly by exports. The recovery remains fragile as it is not yet supported by domestic demand, and risks to the outlook are tilted to the downside. Large household debt and highly leveraged banking system are the main obstacles to reviving domestic demand and growth. Therefore, the report rightly focuses on the strategy for promoting household deleveraging and strengthening the banking system. It seems to us that a more traditional format of the report would have been preferable.

We note differences in the staff's and the authorities' views on the Netherlands' economic situation, as the authorities' assessment is somewhat more benign. From the report we learn about contracting consumption and rising unemployment, while in their Buff statement Mr. Snel and Ms. De Lint inform us that consumption is increasing and unemployment rate is declining faster than expected. We would welcome staff comments on the reasons for this discrepancy, whether it was known at the time of discussions with the authorities, and whether recent information may alter staff's policy advice.

Notwithstanding the fluctuations of short-term economic developments, heavy household indebtedness and stretched banks' balance sheets will remain key medium-term challenges for the Netherlands. We, therefore, welcome the authorities' comprehensive reform agenda aimed at addressing distortions in the housing market as well as intertwined issues of intergenerational rebalancing and strengthening of the financial system.

The reduction of the household debt burden in the environment of slow growth and very low inflation is not an easy task. Alleviation of debt burden of the younger generations, with their higher propensity to consume may give a boost to the economy and relieve an overall debt overhang. Therefore, the authorities should continue to facilitate intergenerational transfers through tax exemption. We welcome the discussion of the pension reform, including reducing contribution rates for the young. Restructuring of underwater

mortgages and reducing the stigma of personal bankruptcy may also contribute to reduction of the debt overhang and improve economic activity.

We note the progress achieved in strengthening the Dutch banks' capital base and their commitments to meet Basel III requirements by 2019. However, the banks' capacity to support growth remains constrained by their high leverage and large exposure to the troubled housing sector. Additional structural measures are needed to improve efficiency of the financial system and resilience of their mortgage portfolios. In particular, the authorities should be more ambitious in reducing the loan-to-value ratios and increasing the share of fully amortizing loans, including through phasing out mortgage interest deductibility for interest-only mortgages.

On the fiscal side, we welcome the achievement of the 3 percent of GDP headline deficit target, which allowed the Netherlands to exit from the EDP in 2014. We agree with staff recommendations that going forward fiscal policy should focus on structural targets, and allow automatic stabilizers to operate fully. The tax system reforms should be advanced to remove distortions and reduce labor tax wedge.