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

The slow recovery of the Dutch economy is driven mostly by exports. Domestic demand remains subdued. The recovery is fragile. Risks to the outlook remain on the downside, stemming mainly from the weakness of the euro area and geopolitical tensions. In this context, we encourage the authorities to intensify their efforts to tackle the household debt overhang of households. A reduced debt burden would help strengthen private consumption and thus make the recovery more robust and sustainable.

Intergenerational transfers can contribute to the repair of household balance sheets. We note that the debt overhang problem affects mostly younger households, while older generations have considerable net wealth. Given the success of the temporary tax exemption for monetary gifts which was introduced last year, we see merit in staff's call on the authorities to consider an increase in the general EUR 50'000 exemption for tax-free transfers, an expansion of the universe of possible beneficiaries beyond direct family members, and a longer time period for lower income groups to build up savings. *Could staff elaborate on the potential magnitude of the benefits to be expected from this three-pronged set of measures?*

Reducing pension contributions for the young or using pension savings to repay mortgage debt should be considered with caution. Both measures may ease intergenerational imbalances in the short run, but could also lead to new, possibly worse, intergenerational problems in the long run. In any case, as the authorities rightly point out, such measures would need to be considered in the context of broader reforms to safeguard the fully funded system that has served pensioners well so far.

Capital and liquidity buffers of Dutch banks should be strengthened further. While intergenerational transfers offer some relief also for financial institutions in the Netherlands, the pressure from underwater mortgages is expected to remain significant. Additional pressures stem from commercial real estate, which are confronted with falling prices, and from SMEs, which are experiencing rising defaults. Those unfavorable developments call for a further recapitalization of banks. An early recapitalization, mainly through retained earnings, would not only support the recovery but facilitate the transition to Basel III and secure the compliance with a leverage ratio of 4 percent.

A proper assessment of the current account gap is made difficult by specific peculiarities, including the Netherlands' important role as a trade hub for the EU, statistical issues related to the income measurement of FDI flows, and specific tax provisions aimed at supporting trade and FDI. It remains unclear from the report to what extent these peculiarities bear on the identification of the current account gap. It is also unclear how the possible distortions linked to the treatment of profits of multinationals can be overcome. In the end, the text of the report concludes that the external position is stronger than the level consistent with medium-term fundamentals and desirable policy settings, but fails to mention—as the ESR page included in the report does—that this external assessment is subject to relatively large uncertainty. We urge staff to maintain a perfect mapping between their assessment of the external position in the text and the ESR page included in the report.

Finally, we concur with the authorities that bilateral surveillance should preferably be conducted in the more traditional, holistic, manner, covering all the key macroeconomic and financial issues. One lesson of the global financial crisis is that the seeds of the next crisis are sometimes sown in unexpected areas of the global economy. A holistic approach is more likely to identify today's rising vulnerabilities that may morph into full-blown crises tomorrow.