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

We broadly share staff's appraisal and associate ourselves with the statement of Mr. Cottarelli. Economic research shows that regions/countries with inelastic housing supply are more prone to housing bubbles, hence, staff's thematic focus on the Netherlands' housing sector is welcome. We would like to provide the following remarks related to the housing market.

We believe that household indebtedness, stretched real estate valuations, and banks' balance sheet risks are a direct result of supportive and sometimes distorting housing-related policies. In particular, the size of the mortgage debt and the associated problems for the banks' balance sheets (including their high leverage) are derived from years of skewed housing market policies that incentivized households to take on more debt in an environment of an artificially suppressed housing supply.

Therefore, going forward, the discussions between staff and authorities should be geared less toward how to support growth in the short term and more toward building a more resilient system in the long term by enabling households to deleverage, which takes time. The Staff Report is not very clear on whether the aim of the proposed measures (e.g. in the pension system and the housing market) is to boost current household consumption or to help households pay off their debt more quickly. If it is the former, we are not convinced that over-leveraged households would use these extra savings for consumption purposes instead of paying off their debts.

As we have emphasized in previous years, from the perspective of banks, the housing equity of borrowers is secondary as long as borrowers have sufficient disposable income and continue to service their debt. Therefore, employment (and disposable income) is the key determinant of the effect of a housing correction on banks' balance sheets. The existence of the banks' full recourse and the absence of the possibility of strategic default create sufficiently strong incentives for households to service their debt, even if their disposable income is temporarily lowered or despite negative equity in their mortgages, hence tapping their savings.

In particular, we encourage the authorities to take more ambitious steps in the following areas:

- Reducing loan-to-value (LTV*)* ratios for new mortgages beyond 100 percent after 2018. We do not regard LTV ratios at around 100 percent as providing sufficient risk buffers. Such a high LTV ratio also does not set the right incentives for neither borrowers nor lenders. Aiming at 80 percent LTV, as suggested by staff, is a prudent approach. Addititonally, we side with the latest FSB Peer Review of the Netherlands, which recommends shifting the responsibility for setting LTV and loan-to-income limits from the government to a prudential authority in order to shield such important macroprudential decisions from the political cycle.

- Reducing the debt bias in the tax system by phasing out the mortgage interest deductibility (MID) for all new mortgages. In our view, this point should have more prominence in staff's future work, as it is one of the key incentives that contributes to households' leveraging. We do not support balancing the MID with allowances for equity capital (for corporations or even for households), as this only adds to the complexity of the tax system without addressing the underlying problem.

- Constraining the ability of households to extract equity out of their houses, as it introduces a speculative element in real estate investing and increases the sensitivity of households' consumption to developments on the housing market. *Staff views and comparisons with other EU countries are welcome.*

- Greater effort to ease zoning restrictions in order to expand the housing supply, and a comprehensive rental market reform, including by substantially reducing rental market subsidies to support only the most vulnerable. The focus of the social housing corporations should be narrowed. The housing supply should be more delinked from various fiscal and social policies. *Could staff reconcile their advice on easing zoning restrictions with the authorities' view that the lack of land for residential construction was not a binding constraint in the housing market, given the unused land available for construction and low demand?*

- Greater use of out-of-court resolution of households' debt, as well as reprofiling of underwater mortgages (going hand-in-hand with addressing the aforementioned tax incentives that lead to keeping the current mortgages without reprofiling).

- We do not support staff's proposal to introduce new risk-sharing instruments for households, such as swaps or futures. We are concerned that such instruments very often benefit only sellers (i.e. banks) and can induce new speculative elements in the housing market.

- Even though reducing pension contributions for the young has some merits in making the pension system fairer, such a step should not be taken with the aim to support the current aggregate demand. Potential reforms would also need to be well calibrated, as simply relying on averages in terms of wealth may conceal uneven wealth distributions in a respective group. *We would appreciate staff's calculations of the extent to which the reduction in the contributions for the young will influence their own pensions in the future. We would also appreciate information about the reactions within Dutch society to this proposal.*