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December 1, 2014

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

We thank staff for an interesting set of papers and Mr. Snel and Ms. De Lint for their useful Buff statement. We broadly concur with the staff appraisal. The economy of the Netherlands is gradually recovering from a protracted balance sheet recession; however, growth rates are projected to be moderate in the medium term, leaving a sizable negative output gap. Macroeconomic policies and structural reforms have thus to be carefully calibrated to promote the necessary household deleveraging, while at the same time securing the economic recovery, ensuring sound public finances and bringing the current account close to its long-term position. Further improving the functioning of the housing market and encouraging banks to further strengthen their buffers by raising private capital remain important to enhance financial stability.

Macroeconomic outlook

We broadly share staff's macroeconomic projections pointing to a moderate recovery over the forecast horizon, with risks mainly tilted on the downside. However, we have a slightly different assessment of the main drivers of growth, as we expect a somewhat stronger contribution from domestic demand amidst a stabilization of the labor market, and early signals of a recovery in the housing sector. Nonetheless, we agree that inflation will remain well below target over the forecast horizon, reflecting the decline in energy and commodity prices and the still large scale of excess capacity, despite a slightly better outlook for the labor market.

Fiscal policy

The fiscal outlook has improved. The authorities have achieved a correction in both the nominal deficit – thereby exiting the European Excessive Deficit Procedure – and the structural deficit, which has met the country's medium-term objective. The debt ratio is significantly below the euro area average and is stabilizing. Nevertheless, at around 70 percent of GDP, it is still relatively high and subject to the upward pressures stemming from an ageing population. Altogether, we support the staff's recommendation to maintain a broadly neutral fiscal stance close to the MTO. Going forward, we are pleased to read in Mr. Snel and Ms De Lint's Buff that the government remains fully committed to the European budgetary rules as laid down in the Stability and Growth Pact.

We agree with staff that the tax system could be further reformed to make it more supportive to potential growth. In this respect we are pleased that discussions on a comprehensive tax reform are scheduled for next year. We also appreciate the measures adopted to increase the retirement age and the government's effort to facilitate a dialogue on the sustainability of the pension system. We invite the authorities to ensure that the ongoing reform of the second pillar also takes into account an appropriate intra- and intergenerational distribution of costs and risks.

Structural policies

The significant measures adopted to improve the functioning of the housing market should ultimately lead to lower housing-related debt and leverage ratios. Nevertheless, further initiatives would be important to avoid an excessively prolonged adjustment period. Like staff, we would thus support intergenerational transfers and reprofiling of mortgages into longer term amortizing loans. We welcome the various steps taken by the authorities, and in particular the measure that allows new loans to qualify for interest deductibility only if they are fully amortizing.

We welcome the ongoing efforts to promote the emergence of a well functioning private rental market of an appropriate size, such as those aimed at refocusing social housing corporations on their core mandate. Further progress towards freeing up the private rental market would also create a more favorable context for gradually reducing the maximum loan to value ratios of mortgages to somewhat below 100 percent after 2018, which would also help providing a sizeable buffer against adverse price shocks.

We concur with staff that further labor market reforms are important to enhance participation and that alternative source of financing for SMEs should be developed. In fact, while we understand the reasons behind staff's attention to the housing sector, we would have appreciated a broader discussion of structural reforms.

Financial sector

The results of the ECB's Comprehensive Assessment confirmed the improvements undergone by the Dutch banking system in recent years. Banks benefitted from the strengthening of their capital base and they are on the way to raise the additional buffers needed to meet Basel III capital requirements by 2019. Nonetheless, significant vulnerabilities remain, including the high leverage, the dependency on wholesale funding, the large exposure to the housing sector, and the sizeable household debt.

A comprehensive macro-prudential agenda is thus instrumental to containing key risks. The authorities are taking steps in this direction. Going forward, it will be important to clarify possible further regulatory developments for the housing and financial sectors, thus reducing uncertainties and allowing economic agents a gradual adjustment.