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THE NETHERLANDS – REVIEW OF PROGRESS ON POLICY MEASURES RELEVANT FOR THE CORRECTION OF MACROECONOMIC IMBALANCES

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Executive summary

This is the fourth specific monitoring report under the Macroeconomic Imbalance Procedure (MIP) for the Netherlands, reflecting the strengthened monitoring of all Member States with imbalances[1]. The Netherlands has been found to have macroeconomic imbalances in previous years, relating in particular to the level of private debt and the current account surplus. This report reviews the latest developments and policy initiatives to address those imbalances, which were identified in the 2019 Country Report and which were addressed by the 2019 country-specific recommendations. The cut-off date for this report is 11 November 2019.

The growth momentum remained robust overall despite an increasingly challenging external environment, and passive deleveraging continued. After a strong performance of 2.6% in 2018, real GDP growth is forecast to moderate to 1.7% in 2019 and 1.3% per annum in both 2020 and 2021, according to the European Commission 2019 autumn forecast. Over this period, household and public consumption are expected to be the main growth drivers. While wage growth remained subdued for some time, it picked up in 2019 and is expected to strengthen further over the coming years, driven by a continued tight labour market. The combination of a lower tax burden on labour income, continued employment growth and dissipating inflation should support disposable income and private consumption growth. At the same time, households have been passively deleveraging, with private debt growing at a significantly lower pace than nominal GDP, despite dynamic house price developments.

The current account surplus widened from 10.8% of GDP in 2017 to 11.2% in 2018. A large part of the surplus is attributable to the corporate sector: its contribution grew from 7.3% to 8.1% of GDP, with both multinationals and smaller companies making a sizable aggregate savings surplus. Household net lending continued on a declining trend after peaking in 2014, while remaining positive at 1.5% of GDP (versus 2.2% in 2017). The government surplus increased somewhat from 1.3% to 1.5% of GDP. In the coming years, the current account surplus is set to decline gradually as imports are projected to outpace exports, against a backdrop of a weakening external environment combined with still relatively robust domestic demand, as well as declining natural gas exports following the phase-out of gas production in Groningen.

An accelerated reduction in mortgage interest deductibility is underway and initiatives have been launched to boost housing supply but incentives for households to take on mortgage debt remain. Private sector indebtedness in the Netherlands is mainly related to households' high mortgage debt levels, driven by the favourable tax treatment of (debt-financed) home-ownership, combined with an underdeveloped private rental sector. Following the financial crisis, a series of incremental measures were taken to rein-in mortgage debt growth, including by tightening the rules for loan-to-value and loan-to-income ratios, making interest-only mortgages ineligible for mortgage interest tax deductibility (MID), and lowering the maximum applicable rate for MID. From 2020, the latter will proceed at an accelerated pace, with the maximum rate lowered from 49% currently to about 37% in 2023. At the same time, this still represents a high level of subsidies and the decrease will only affect a small number of households. Additionally, the Dutch central bank announced plans to introduce a risk-weight floor for banks' mortgage holdings from the

[1] COM(2016)95 final, 8.3.2016.

autumn of 2020 onwards. While mainly intended to enhance financial sector resilience, this is likely to also have a modest dampening effect on debt growth. In the housing market, in recent years a number of steps to improve the functioning of the private rental market have been implemented. Furthermore, in 2019 the government announced a package of further initiatives aimed at alleviating the housing shortage. However, the private rental market remains underdeveloped, thus forcing households into the owner-occupancy market due to the lack of a viable alternative.

The government is pursuing an expansionary fiscal stance, thus supporting domestic demand growth. Following a boost to public spending in 2019 (albeit largely offset by higher tax revenues), further expenditure increases are planned for 2020, including in the areas of pensions and youth services, as well as investment in housing, education and measures to address climate change. At the same time, the labour tax burden for households will be lowered, boosting disposable income. Overall, the structural budget balance is set to decline by 0.7% of GDP over a period of two years, from 0.9% of GDP in 2018 to 0.2% in 2020 according to the Commission 2019 autumn forecast.

In conclusion, the government is addressing the debt bias for households and supports demand by fiscal policy, but subsidies for mortgage debt remain and the current account surplus is expected to stay elevated. The tax treatment of mortgage debt is gradually being made less favourable, while remaining generous by international standards. Although the rental market has seen some targeted reforms in recent years and measures to boost housing supply have been launched, the private rental sector remains underdeveloped. External rebalancing is expected to benefit from domestic-demand driven growth, supported by an expansionary fiscal stance. Finally, in June 2019, social partners reached an agreement on overall principles for pension reform. This creates scope for addressing distortions in the second-pillar pension system, with an important impact on the compulsory payment wedge and savings-investments balance. However, crucial details still need to be decided upon and significant implementation uncertainty remains.

Table 1: Key findings on the implementation of policy reforms[2]

On track	Wait-and-see	Action wanted
• Implementation of fiscal measures • Faster reduction in mortgage interest tax deductibility	• Further measures to boost housing supply and improve rental market functioning • Policies to increase household disposable income	• Second pillar pension reform process

[2] The table classifies reforms under review on the basis of their respective adoption and implementation process, uncertainty and their level of detail. “On track” are measures for which the legislative or implementation process has been completed or is progressing well according to the foreseen timeline, and which are expected to be sufficiently effective. “Wait and see” are measures for which the legislative process is on-going, but is still in a relatively early phase, or measures for which there is still uncertainty on the complete implementation and effectiveness. “Action wanted” are measures for which limited or no action has been taken, or measures that have been announced but which are not sufficiently detailed yet to be assessed.

1. Introduction

On 21 November 2018, the European Commission presented, in the context of the Macroeconomic Imbalance Procedure (MIP), its eighth alert mechanism report[3] to underpin the selection of Member States requiring an in-depth investigation into the existence and extent of macroeconomic imbalances. The subsequent in-depth review in the country report – published on 27 February 2019[4] – examined the nature, origin and severity of macroeconomic imbalances and risks in the Netherlands. In the accompanying Communication[5], the Commission concluded that "the Netherlands is experiencing imbalances". Theses imbalances are linked to the high stock of private debt and the large current account surplus.

In April 2019, the Netherlands submitted its Stability Programme[6] and National Reform Programme (NRP)[7], respectively outlining the fiscal targets and the policy measures to improve its economic performance and to unwind imbalances. On the basis of an assessment of these plans, the Commission proposed three country-specific recommendations (CSRs)[8], which were adopted by the Council on 9 July 2019[9]. These recommendations concern (i) household balance sheets, including reducing the debt bias for households and distortions in the housing market, reforming the second pillar of the pension system, increasing household disposable income, and addressing features of the tax system that may facilitate aggressive tax planning; (ii) the labour market, including promoting adequate social protection for self-employed workers while tackling bogus self-employment, and strengthening comprehensive lifelong learning and up-skilling; (iii) supporting an upward trend in investment, with a particular focus on R&D, renewable energy and addressing transport bottlenecks. Recommendations 1 and 3 are considered to be MIP-relevant, as they are related to domestic saving and investment patterns and household indebtedness.

The present report assesses the latest key policy initiatives[10] undertaken by the Dutch authorities also in light of the findings of the monitoring mission, which took place on 14-15 October 2019.

2. Outlook and recent developments on imbalances

2.1 Recent economic developments and outlook

Following GDP growth of 2.6% in 2018, the economic expansion remained relatively solid in the first half of 2019, supported by robust domestic demand and foreign demand. However, against the backdrop of a weak external environment, growth is expected

[3] https://ec.europa.eu/info/sites/info/files/file_import/2019-european-semester-alert-mechanism-report_en_0.pdf
[4] https://ec.europa.eu/info/sites/info/files/file_import/2019-european-semester-country-report-netherlands_en.pdf
[5] https://ec.europa.eu/info/sites/info/files/file_import/2019-european-semester-communication-country-reports_en_0.pdf
[6] https://ec.europa.eu/info/sites/info/files/2019-european-semester-stability-programme-netherlands_en_0.pdf
[7] https://ec.europa.eu/info/sites/info/files/2019-european-semester-national-reform-programme-netherlands_en.pdf
[8] https://ec.europa.eu/info/sites/info/files/2019-european-semester-country-specific-recommendation-commission-recommendation-netherlands_en.pdf
[9] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:C:2019:301:FULL&from=EN
[10] Details on the policy measures taken can be found in the overview table in the Annex.

to moderate over the coming years. At the same time, domestic demand is projected to remain resilient, with comparatively high real wage growth as the labour market remains tight. Expansionary fiscal policy provides a further boost to disposable income and public consumption, predominantly in 2020. However, business investments are projected to abate as a result of heightened (trade related) uncertainty, and residential investment growth is expected to moderate, in part due to capacity constraints in the construction sector. Overall, real GDP is expected to increase by 1.7% this year, followed by 1.3% in 2020 and 2021 according to the Commission 2019 autumn forecast. Increases in indirect taxes have pushed up inflation to 2.6% in 2019. For 2020 and 2021 respectively, inflation is set to moderate to 1.4% and 1.5% as these tax increases are no longer reflected in the figures while underlying trend inflation remains flat. The headline budget surplus is forecast at 1.5% of GDP in 2019 and 0.5% and 0.4% of GDP in 2020 and 2021 respectively. In 2019, higher government spending is offset by higher tax revenues, driven by robust wage and employment growth, dynamic corporate profitability developments and a substantial policy-driven increase in indirect taxes. In 2020, government expenditure is expected to continue increasing following recent expansionary budget decisions. Government debt is forecast to fall below 50% of GDP in 2019 and to decline further to 45.6% by 2021.

2.2. Developments as regards imbalances

The Commission concluded in February 2019 that the Netherlands was experiencing macroeconomic imbalances related to a high stock of private debt and a large current account surplus. The following section provides an update of the situation with regard to economic developments related to the imbalances.

Private sector debt

Although household debt remains high, driven by tax incentives and policy distortions in the housing market, it has been steadily declining as a share of GDP. From a peak of 118% of GDP in 2010 it declined to 102% of GDP in 2018. This is mainly the result of passive deleveraging, as nominal mortgage debt growth has been outpaced by nominal GDP growth. Over the last four quarters (2018Q3-2019Q2), mortgage debt increased by 1.2%, which was substantially below nominal GDP growth (4.7%) over the same period. Survey-based data by the Dutch central bank show that average loan-to-value and loan-to-income ratios for buyers under 35 (a proxy for first-time buyers) remain high, at around 90% and 400% respectively. House price growth has slowed somewhat amidst falling transaction volumes, to about 6% y-o-y in nominal terms as of September 2019 (from a peak of over 9% y-o-y in autumn 2018). Prices are now above the pre-crisis peak, although there are considerable regional disparities. At the same time, the share of underwater mortgages has declined further and is now essentially negligible.

Current account surplus

The current account surplus widened somewhat in 2018, reaching a record high of 11.2% of GDP, but is set to moderate gradually going forward. From a net lending perspective, all institutional sectors remained in surplus, with the corporate sector making the largest contribution to domestic net lending in 2018, at 8.1% of GDP. This is in part linked to the presence of several large multinational enterprises in the Netherlands (which include retained earnings of foreign holdings and subsidiaries). Recent research by the Dutch central bank shows that small and medium-sized enterprises (SME) have also been consistently

responsible for a sizable share of the non-financial corporate surplus (about 42% on average over the period of 2000-2017). The latter appears linked in part to tax incentives favouring accumulation of retained earnings within SMEs. Household net lending has declined somewhat in recent years, to 1.5% of GDP in 2018 versus a peak of 4.4% in 2014, driven by continued residential investment growth. However, the household sector remains in surplus, linked to high compulsory savings (notably via second-pillar pension contributions) and continued pressure to reduce mortgage debt. The government budget balance increased slightly to 1.5% in 2018 (from 1.3% in 2017) due to buoyant revenue developments. For the coming years, the current account surplus is expected to decline as imports are projected to outpace exports. This reflects a weakening external environment combined with comparatively robust domestic demand (in turn linked to a pick-up in wage growth and an expansionary fiscal stance), as well as declining natural gas exports following the phase-out of gas production in Groningen.

3. Progress with policy implementation

This section describes policy measures taken to address the high level of household debt and the large current account surplus, against the background of the 2019 country-specific recommendations (CSRs). These recommendations call for measures addressing the debt bias for households and distortions in the housing market, including by supporting the development of the private rental sector. The 2019 CSRs also called for policy steps to support external rebalancing, in particular reforming the second pillar of the pension system, implementing measures to increase household disposable income, and using fiscal and structural policies to support an upward trend in investment.

3.1 Reduce private debt

Mortgage interest deductibility (MID) is being reduced, but remains generous. High household indebtedness in the Netherlands can largely be linked to mortgage debt, which is fuelled by favourable tax treatment (as well as policy distortions in the housing market, as discussed below). Since 2012, all CSR vintages have called for measures to address housing market distortions and the debt bias for households, in particular by decreasing MID. Dutch authorities have reduced the tax deductibility of mortgage interest payments, via both the obligation to take out annuity mortgages with a maximum maturity of 30 years in order to qualify for MID (in force since 2013) and a reduction of the maximum applicable rate. Initially this reduction was very gradual (by 0.5 p.p. per year from 2014), but from 2020 it will proceed at an accelerated pace, with the maximum rate lowered in three steps from 49% currently to 37% in 2023. While this represents a considerable reduction in MID, a rate of 37% still implies a strong subsidy on mortgage borrowing, and contrasts with policies in most other EU member states, where MID has either been phased out or capped at a fixed amount. It also only affects a small number of households, as only 10% of the employees is in the highest tax bracket and the reduction would essentially only impact annual income above EUR 68,507.

Dutch authorities have also taken some limited macroprudential policy steps to address the risks associated with high mortgage debt levels. Since 2012, a binding loan-to-value (LTV) ceiling of 106% was put in place for new mortgages (accompanied by mandatory annuity repayment), which was subsequently lowered by 1 percentage point per year to 100% in 2018. Rules determining maximum loan levels as a function of income (combined with some other parameters as well as interest rates) also became more stringent. In October

2019, the Dutch central bank announced that it intends to introduce a risk-weight floor for banks' mortgage holdings from the autumn of 2020 onwards, with the level of the floor dependent on the LTV ratio of the underlying loans, thus forcing banks to hold more capital against riskier mortgages. While primarily intended to boost financial sector resilience, at the margin this measure will also have a dampening effect on mortgage debt growth.

Lack of a viable alternative on the rental market pushes households into (mortgage-financed) owner-occupancy. The Dutch housing market is characterised by large owner-occupied and social housing sectors, each of which are subsidised through different channels. The private rental market is the only sector not receiving any subsidy, and with a share of 13% in 2018 it remains underdeveloped. The underlying policy distortions have been acknowledged by the government, and boosting housing supply, with a particular focus on the mid-priced rental sector, is considered a policy priority.[11] In recent years, a number of steps aimed at improving rental market functioning have been implemented. These include measures to allow higher rent increases for '*scheefhuurders*' (middle and high income earners in social housing), a regulatory change allowing for more short-term rental contracts since 2016, and the possibility for municipalities to designate a portion of dwellings as intended for the private rental sector in their zoning plans since 2017. In May 2019, legislation was adopted[12] to simplify the market criterion ('*markttoets*') for social housing corporations, which should allow them to engage in construction of mid-priced (non-regulated) rental housing more easily. However, given the current backdrop of strong private-sector development activity, high land valuations and capacity constraints in the construction sector, this appears unlikely to create significant incremental rental housing supply in the near-term.

In September 2019, a package of further housing market measures was announced. These include steps to boost new housing supply, via subsidies for municipalities where shortages are most acute combined with targeted tax reductions for social housing corporations developing new homes. While these measures could, over time, contribute to increasing new housing construction, significant implementation uncertainty remains. In particular, it may be challenging to ensure that any new homes built under the schemes genuinely represent a net addition to the housing stock (rather than projects which would have occurred anyway, or which simply shift resources away from other potential developments). Moreover, other key proposals included in the new housing market package risk having a negative impact on the supply of private rental housing: certain adjustments to the rent-setting system for social housing[13] will mean more homes remain in the regulated sector rather than transitioning to the private rental market, and measures to discourage 'buy-to-let' purchases may favour expansion of the owner-occupier market at the expense of rental housing availability. Effective implementation of measures to support new housing development is especially important at the current juncture, in light of a recent court judgment restricting construction activity which creates incremental nitrate deposition in certain areas. While its ultimate impact on residential construction remains highly uncertain, it is clear that this creates downside risks to new housing supply.

[11] Paragraph 3.1.2, National Reform Programme 2019

[12] Law '*Maatregelen middenhuur*'

[13] In particular, lowering the weight of the assessed value ('*WOZ-waarde*') in setting the maximum rent for a property, which in turn determines whether it falls within the social (regulated) or private rental sector.

3.2 External rebalancing

Fiscal policy will contribute positively to domestic demand from 2020 onwards, as the government plans to pursue an expansionary fiscal stance, including by increasing investment. The 2019 CSRs contained recommendations to implement policies to increase household disposable income (CSR 1), as well as to use fiscal and structural policies to support an upward trend in investment (CSR 3). In 2019, increased government spending was largely offset by higher tax revenues. From 2020 on, further public expenditure increases are planned linked to pensions and youth services, as well as increased investment, including in housing, infrastructure, education and measures to address climate change. At the same time, revenue growth is expected to decline by about 0.5% of GDP due to lower direct taxes on labour income, thus contributing to lifting household disposable income. As a result, the structural surplus is set to fall from 0.9% of GDP in 2018 to 0.2% in 2020, according to the Commission 2019 autumn forecast. To enhance investment over the longer run, the government is also preparing the launch of Invest-NL, a national promotional bank with a mandate to support private-sector investment aimed at tackling key societal challenges as well as access to finance for SMEs. Separately, the possibility will be investigated to launch an investment fund to boost the long-term growth potential of the economy, although details on its financial firepower and target sectors are still to be decided upon.

Robust wage growth is projected to continue supporting domestic demand as the labour market remains tight. The unemployment rate has declined to 3.5% in September 2019, while the labour participation rate reached an all-time high. Labour market tightness has started putting upwards pressure on wage growth, with nominal compensation per employee rising by about 2.5% in 2019. With wage developments lagging employment growth and both the government and trade unions calling for higher private-sector wage growth, this trend is set to continue in the near-term: according to the Commission 2019 autumn forecast, wage growth is expected to climb to 3.2% in 2020. Together with lower taxes on labour income (see above), this would boost household disposable income and private consumption.

A large part of the surplus relates to the activity of non-financial corporations, which may be influenced by tax policy. As explained above, both multinational enterprises and SMEs are an important contributor to the Dutch corporate savings surplus, which in turn is the largest component of the overall surplus. For multinationals, the implementation of measures in the area of income taxation of corporate groups, e.g. the Anti Tax Avoidance Directive (ATAD) which came into force in January 2019, might affect their behaviour in terms of cross-border income flows. For SMEs, large controlling director shareholders (‘*directeur-grootaandeelhouders*’) can have tax incentives favouring accumulation of retained earnings within their company. Some tax reforms that have recently been introduced or announced could help address this to some extent, e.g. the phasing out of tax-advantaged internally-managed pension plans (‘*Pensioen in eigen beheer’*) introduced in 2017, and new legislation which will make large debts owed by controlling shareholders to their companies partially subject to tax from 2022[14]. However, the effect of such tax measures on the current account will remain to be seen.

In June 2019, the social partners and government reached a framework agreement on pension reforms, providing a potential for addressing distortions in the second-pillar

[14] Draft law ‘*Excessief lenen bij de eigen vennootschap*’

pension system. The Dutch three-pillar pension system faces challenges linked to generational fairness, the increase in non-standard forms of work not covered by the system, and sensitivity to low interest rates. Moreover, mandatory second-pillar pension contributions are a key component of the relatively high non-tax compulsory payment wedge on labour, thus weighing on disposable household income and domestic demand. There has long been a broadly shared consensus that the system requires a comprehensive overhaul, which ultimately culminated in the framework agreement mentioned above. Key elements are a more resilient second pillar with more risk taking, lower buffers and less intergenerational redistribution (combined with a slower increase in the first pillar retirement age). However, at the current juncture, this remains an agreement on overall principles only, which will need to be further developed under the guidance of a steering committee of social partner and government representatives. Crucial details are still to be decided upon, and the legislative process is expected to take until early 2021, with the new framework entering into force from 2022. Accordingly, significant implementation uncertainty remains.

Annex 1: Overview table of MIP-relevant reforms

MIP objective: Reduce private debt			
Mortgage and housing market regulation (owner occupied market)			
Announced measures	*Adopted measures*	*Implemented measures*	*Sources of commitment*
• **October 2019**: Risk weight floor for banks' mortgage holdings, to enter into force in autumn 2020.	• **January 2019**: Reduction of the maximum MID rate by 3 pps per year, from 49% in 2019 to 37% in 2023.	• Since **2013** a series of reforms: e.g. only annuity or linear mortgages are eligible for MID. • Maximum loan-to-value ratios are being reduced gradually to 100% **by 2018** and rules relating to loan-to-income ratios are made stricter.	CSR 1, 2019: Reduce the debt bias for households and the distortions in the housing market, …
Housing market regulation (rental market)			
Announced measures	*Adopted measures*	*Implemented measures*	*Sources of commitment*
• **September 2019**: Subsidies for municipalities to stimulate more construction (EUR 1 bn); tax reductions for social housing corporations developing more new homes (up to EUR 100mm per year over a period of 10 years).		• **May 2019:** law '*Maatregelen middenhuur*' to simplify 'market criterion' ('*markttoets*') for social housing corporations engaging in development of rental housing in the non-regulated sector • **In July 2017:** An amendment to the	CSR 1, 2019: …including by supporting the development of the private rental sector. […]

		Law on Spatial Planning entered into force, allowing municipalities to set aside zones specifically for middle segment rental dwellings, • **In July 2016**: The *Wet Doorstroming Huurmarkt* entered into force. This law allows for more short-term contracts and more mobility on the rental market. • **In July 2015:** The Woningwet entered into force which aims at a better allocation in the social housing sector, reducing the number of Scheefhuurders in social housing. The law also forces social housing corporations to focus on their core task, by imposing a legal or administrative split between social housing and commercial activities. • **In July 2013** the *Uitvoeringswet huurprijzen woonruimte* was amended to allow for means tested rent-increases, to create mobility in the rental market and reduce the number of 'scheefhuurders'**.**	
MIP objective: External rebalancing			
Rebalancing via domestic demand			
Public finances and taxation			
Announced measures	*Adopted measures*	*Implemented measures*	*Sources of commitment*
• **Sep 2019:** Expansionary fiscal package was announced, leading to			CSR 3, 2019: While respecting the medium-term budgetary objective, use fiscal and

an expected reduction in the structural balance from 0.9% of GDP in 2018 to 0.2% of GDP in 2020. The package includes measures to boost investment in several areas, including in housing, infrastructure and measures to tackle climate change. • **Sep 2019:** The package also contains public expenditure linked to pensions and youth services, and a reduction in revenue growth (by about 0.5% of GDP) from lower direct taxes on labour income, thus contributing to lifting disposable income. • **Nov 2019:** Additional expenditure package for 2020-2021 focused on education was announced.			structural policies to support an upward trend in investment. […] CSR 1, 2019: Implement policies to increase household disposable income […]
Pensions			
Announced measures	*Adopted measures*	*Implemented measures*	*Sources of commitment*
• **June 2019:** Social partners and government reached a framework agreement on pension reform, but details pertaining to second-pillar reforms are still to be further developed, with the new system set to enter into force from 2022.			CSR 1, 2019: […] Ensure that the second pillar of the pension system is more transparent, inter-generationally fairer and more resilient to shocks.